

Appendix 3

Asset Protection Scheme

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Appendix 3 Asset Protection Scheme

1. Explanatory note

The terms of RBS's participation in the Asset Protection Scheme ("APS") were agreed in principle with HM Treasury in February. Issues still outstanding include the final sign off of assets to be covered, the completion of due diligence, some detailed aspects of the structure of the scheme and EU State Aid approval.

2. Highlights of the Scheme

Objectives

- Credit protection provided by the UK government, which alongside liability management and other measures, would allow RBS to pass the Financial Services Authority stress tests
- Enhance RBS's financial strength and provide stability for customers, depositors and investors as RBS's restructuring programme is executed
- Enhance the Group's capacity to extend new lending in the UK

Current proposed Scheme operation and terms

- Protection for £316 billion covered assets from 1 January 2009, subject to final agreement with HM Treasury on the covered asset pool
- APS assets are a static pool, with no substitution allowed for assets that mature
- Scheme expected to cover both banking assets and trading assets
- APS assets include the Group's global exposures across multiple jurisdictions and multiple legal entities. HM Treasury currently proposes to extend APS protection to RBS plc; RBS plc will then enter into back-to-back arrangements with other legal entities across the Group to extend APS protection to all APS assets
- First loss of £19.5 billion in addition to impairments and write-downs on the APS pool recognised at 31 December 2008
- RBS will bear all losses (net of recoveries) up to the first loss point. Losses (net of recoveries) in excess of the first loss will be 90% borne by HM Treasury
- Management and administration of APS assets will be performed by RBS
- Scheme proposes rigorous governance and specific approval processes for APS assets
- HMT will have representation on the Group's senior oversight committee for the APS and will have wide-ranging rights to audit the management and administration of the Scheme
- Significant RWA relief is expected on the APS assets. On the basis of the proposed pool at 30 June 2009 this relief is estimated at approximately £150 billion.

Asset selection

- Assets were selected for both credit and capital reasons. Key criteria included:
 - Risk and degree of impairment in base case and stressed scenario
 - Liquidity of the exposure
- Both core and non-core assets analysed. Inclusion of core assets reflects their risk profile and provides capacity to meet UK lending commitments.
- Inclusion of equity type exposure and real assets (e.g. hotels, ships, aircraft) and Citizens retail assets was not permitted.

3. Capital effect

The Asset Protection Scheme announced in February, when concluded, is expected to further strengthen the Group's capital ratios, as the assets covered by the Scheme will carry lower risk weightings as a result of UK Government asset insurance. This augments the impact of RBS's own extensive restructuring measures. The Scheme is currently expected to provide approximately £150 billion of risk-weighted asset relief. In addition, HM Treasury will subscribe to a total of £19.5 billion of new B Shares qualifying as capital on implementation of the APS, with a further £6 billion as a contingent reserve. The APS should strengthen Core Tier 1 by more than 5% pro forma. This figure is RBS's current estimate and subject to finalisation of the detailed terms and conditions, confirmation of asset eligibility and pricing (all of which require state aid approval) and without taking account of the £6 billion contingent tranche of B share issuance outlined in February.

4. Credit impairments and write downs

Of the Group's credit impairments and write downs recorded in the first half of 2009, approximately 70% relates to assets proposed for APS. Set out below are the estimated proportions of each division's credit impairments and write downs relating to these assets:

	%
UK Retail	65
UK Corporate	50
Global Banking & Markets	50
Ulster	85
Non-Core	75

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5. Balance sheet and risk weighted assets

The tables below show approximate balances relating to assets proposed for APS, by balance sheet caption and underlying product category, at 31 December 2008.

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	Carrying value (1) £bn	Undrawn commitments and other aspects (2) £bn	Provisions and other related adjustments (3) £bn	Covered amount £bn
Loans and advances (4)				
Residential mortgages	15.3	-	0.1	15.4
Consumer finance	11.4	1.6	1.8	14.8
Commercial property lending	52.3	10.0	0.8	63.1
Leveraged finance	18.3	4.7	2.5	25.5
Project finance	1.9	1.0	-	2.9
Other structured finance	16.4	4.5	0.4	21.3
Other corporate loans	73.3	25.7	2.3	101.3
	188.9	47.5	7.9	244.3
Securities				
RMBS (5)	0.7	0.2	0.2	1.1
CMBS (6)	1.6	0.2	0.2	2.0
CDOs (7) and CLOs (8)	2.3	0.4	5.7	8.4
Other asset-backed securities	3.7	-	0.3	4.0
Other debt securities	2.5	0.6	0.1	3.2
	10.8	1.4	6.5	18.7
Derivatives				
Monoline insurers	5.6	10.9	6.0	22.5
CDPCs (8)	3.5	2.3	1.3	7.1
Other counterparties	16.8	5.7	0.7	23.2
	25.9	18.9	8.0	52.8
Total	225.6	67.8	22.3	315.8

Notes:

- (1) Carrying value represents the amounts recorded on the balance sheet at 31 December 2008 and includes assets classified as loans and receivables, fair valued through profit or loss and available-for-sale ('AFS')
- (2) Undrawn commitments and other aspects comprises:
 - undrawn commitments
 - add-back of AFS reserves
 - master netting arrangements relating to derivatives
 - potential future exposures on certain derivatives
- (3) Provisions and other related adjustments comprises:
 - credit impairment provisions and write downs
 - life-to-date mark-to-market changes on assets measured at fair value through profit or loss
 - credit valuation adjustment on derivative contracts
- (4) The asset categories are as defined by the HM Treasury draft terms and conditions and may vary from the Group's categorisations of such assets
- (5) Residential mortgage-backed securities
- (6) Commercial mortgage-backed securities
- (7) Collateralised debt obligations
- (8) Collateralised loan obligations
- (9) Credit derivative product companies

Risk weighted assets relating to the assets proposed for the scheme were approximately £165 billion at 31 December 2008.