

## Risk and capital management

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Risk and capital management across the Group is based on the risk appetite set by the Board, which sets strategic direction, contributes to, and ultimately approves annual plans for each division, and regularly reviews and monitors the Group's performance in relation to risk through monthly Board reports.

### Commentary and outlook

Whilst the future for many aspects of the global economy remains uncertain, it is clear that the first half of 2009 saw a decisive shift. The extreme volatility and risk aversion that characterised the end of 2008 moderated and equity and fixed income markets largely recovered value lost at the start of the year in a sustained rally that ran for most of the second quarter. Intervention by governments and central banks has prevented further failure in the world's financial system. At this point in what has already been a sharp economic slowdown, the key focus is on whether a broader economic recovery can be established, limiting the recession's duration.

For RBS, as for many of its peers, it appears that the full impact of the slowdown already witnessed has yet to be fully realised in terms of loan impairments. This is true for both retail portfolios, where unemployment is likely to rise further even if the broader economy stabilises, and corporate portfolios, where default rates have yet to peak. The Group's investment in remedial and collection processes is therefore of major importance. The Group is committed to working with its customers to restructure debt and aid recovery wherever possible; doing so both maximises current value and supports the Group's franchises in the longer term.

As importantly, this approach drives a focus on early identification and intervention in portfolios most exposed to economic weakness. Responsibility for this rests with the Group's businesses and functions across the Group; the Group's risk management teams continue to work closely with customer and product groups to identify vulnerable customers or portfolio segments and to implement mitigation strategies.

Recovery from a slowdown as sharp as that recently experienced, especially as it will involve the correction of material imbalances in the global economy, is likely to be accompanied by periods of volatility. Whilst not anticipating a return to the extreme uncertainty and market dislocation witnessed during the past two years, a return to the extended period of extreme stability that preceded them is also not expected. The Group's profile – in both its core and non-core activities – remains such that events in many of the world's geographies and markets have the potential to impact the Group's performance.

Effective risk management is therefore of strategic importance for RBS and refinements to the Group's risk management framework continue to be implemented. Updated limit frameworks for both credit and market risk support strategic priorities by targeting resources on areas that are core to the Group's future success. The Group will continue to invest in people, both through recruitment and development, at all levels in the risk management organisation. Through these and other changes, the risk management framework and function are being developed to support the Group's execution against its strategic plan.

## **Risk and capital management (continued)**

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### **Risk governance**

Risk and capital management strategy is owned and set by the Group's Board of Directors, and implemented by executive management led by the Group Chief Executive. There are a number of committees and executives that support the execution of the business plan and strategy.

Refer to the Annual Report and Accounts 2008 for further information on the risk and capital management strategy, noting the following changes:

- The Group Executive Management Committee has been replaced by the Executive Committee;
- As a result of the Group adopting a new credit approval framework based on delegated individual authority, a new forum – the Executive Credit Group – was formed to consider, on behalf of the Board of Directors, credit applications that exceed the highest level of individual authority provided by the framework; and
- The Group Chief Executive's Advisory Group (GCEAG) has been disbanded and its responsibilities assigned to other fora. Executive Committee and Management Committee members now meet twice weekly. The risk management scope of the GCEAG has been incorporated into the agenda of the Executive Risk Forum.

### **Presentation of information**

The information in this section has been prepared on a pro forma basis (Group before RFS minority interests) unless otherwise indicated as prepared on a statutory basis.

## Risk and capital management (continued)

### Capital

The Group aims to maintain appropriate levels of capital. For details on capital adequacy, refer to the Annual Report and Accounts 2008.

### Capital resources and ratios

The Group's regulatory capital resources on a proportional consolidation basis excluding RFS minority interest at 30 June 2009, in accordance with Financial Services Authority (FSA) definitions, were as follows:

	30 June 2009 £m	31 December 2008 £m	30 June 2008 £m
<b>Capital base</b>			
Core Tier 1 capital: ordinary shareholders' funds and minority interests			
less intangibles	35,177	34,041	26,097
Preference shares and tax deductible securities	13,949	23,091	16,200
Tax on the excess of expected losses over provisions	599	308	437
Less deductions from Tier 1 capital	(329)	(316)	(218)
Tier 1 capital	49,396	57,124	42,516
Tier 2 capital	18,879	28,967	25,966
Tier 3 capital	232	260	215
	68,507	86,351	68,697
Less: Supervisory deductions	(4,536)	(4,155)	(4,157)
Total regulatory capital	63,971	82,196	64,540
<b>Risk-weighted (or equivalent risk-weighted) assets</b>			
Credit risk	404,100	433,400	385,000
Counterparty risk	53,000	61,100	37,100
Market risk	56,300	46,500	32,500
Operational risk	33,900	36,800	37,100
	547,300	577,800	491,700
<b>Risk asset ratio</b>			
Core Tier 1	6.4%	5.9%	5.3%
Tier 1	9.0%	9.9%	8.6%
Total	11.7%	14.2%	13.1%
<b>Risk asset ratio (statutory basis)</b>			
Core Tier 1	7.0%	6.6%	6.5%
Tier 1	9.3%	10.0%	9.1%
Total	11.9%	14.1%	13.2%

## Risk and capital management (continued)

### Capital resources and ratios (continued)

The components of the Group's regulatory capital resources at 30 June 2009 in accordance with FSA definitions were as follows:

	30 June 2009 £m	31 December 2008 £m	30 June 2008 £m
<b>Composition of regulatory capital</b>			
<b>Tier 1</b>			
Ordinary shareholders' equity	47,820	45,525	53,283
Minority interests	2,123	5,436	5,808
Adjustments for:			
Goodwill and other intangible assets - continuing	(15,117)	(16,386)	(27,534)
Goodwill and other intangibles assets - discontinued	-	-	(47)
Unrealised losses on available-for-sale debt securities	4,194	3,687	919
Reserves arising on revaluation of property and unrealised gains on available-for-sale equities	(25)	(984)	(2,623)
Reallocation of preference shares and innovative securities	(656)	(1,813)	(1,813)
Other regulatory adjustments	(263)	9	(37)
Less expected losses over provisions net of tax	(1,502)	(770)	(1,095)
Less securitisation positions	(1,397)	(663)	(764)
Core Tier 1 capital	35,177	34,041	26,097
Preference shares	11,207	16,655	10,608
Innovative Tier 1 securities	2,742	6,436	5,592
Tax on the excess of expected losses over provisions	599	308	437
Less deductions from Tier 1 capital	(329)	(316)	(218)
Total Tier 1 capital	49,396	57,124	42,516
<b>Tier 2</b>			
Reserves arising on revaluation of property and unrealised gains on available-for-sale equities	25	984	2,623
Collective impairment allowances	744	666	326
Perpetual subordinated debt	4,094	9,079	8,419
Term subordinated debt	17,832	20,282	17,012
Minority and other interests in Tier 2 capital	11	11	100
Less deductions from Tier 2 capital	(3,827)	(2,055)	(2,514)
Total Tier 2 capital	18,879	28,967	25,966
<b>Tier 3</b>	232	260	215
<b>Supervisory deductions</b>			
Unconsolidated investments	4,461	4,044	4,119
Other deductions	75	111	38
Total deductions other than from Tier 1 capital	4,536	4,155	4,157
<b>Total regulatory capital</b>	<b>63,971</b>	<b>82,196</b>	<b>64,540</b>

## Risk and capital management (continued)

### Credit risk

Key elements of the Group's credit risk management framework are laid out in the Annual Report & Accounts 2008. Key developments in the first half of 2009 were:

- The introduction of a new credit approval framework for wholesale credit, replacing credit committees with individual delegated authorities and requiring at least two individuals to approve each credit decision, one from the business and one from risk management. Both parties must hold sufficient delegated authority. The level of authority granted to an individual is dependent on their experience and expertise with only a small number of senior executives holding the highest authority provided under the framework.
- Further refinement and embedding of the frameworks to manage the various dimensions of concentration risk: country, sector and single name.

### Credit risk assets

Credit risk assets consist of loans and advances (including overdraft facilities), instalment credit, finance lease receivables and other traded instruments across all customer types. Reverse repurchase agreements and issuer risk are excluded.

	30 June 2009 £bn
UK Retail	98
UK Corporate	100
Wealth	14
Global Banking & Markets	264
Global Transaction Services	7
Ulster Bank	40
US Retail and Commercial	56
RBS Insurance	3
Other	-
Core	582
Non-core	156
	738

Total credit risk assets fell 14% to £738 billion at 30 June 2009, largely owing to a reduction in loans and advances to customers and banks and to the impact of sterling strengthening during the first half of the year. In the UK, credit risk assets fell only 1% while outside the UK the reduction was 22%.

## Risk and capital management (continued)

### Credit risk (continued)

#### Credit concentration risk (including country risk)

The country risk table below shows credit risk assets exceeding £1 billion by borrower domicile for countries designated internally as risk countries. Exposure is stated gross of mitigating action which may have been taken to reduce or eliminate exposure to country risk events.

	30 June 2009				31 December 2008			
	Banks, financial institutions and				Banks, financial institutions and			
	Consumer £m	sovereign £m	Corporate £m	Total £m	Consumer £m	sovereign £m	Corporate £m	Total £m
UAE	596	1,647	2,733	4,976	757	1,813	2,989	5,559
India	970	906	3,047	4,923	1,020	743	3,801	5,564
Russia	91	290	3,305	3,686	51	362	5,361	5,774
Turkey	12	926	2,192	3,130	25	966	3,036	4,027
China	22	1,477	1,473	2,972	25	1,207	2,027	3,259
South Korea	1	1,339	1,004	2,344	2	1,743	1,104	2,849
Taiwan	995	589	558	2,142	1,019	1,394	825	3,238
Romania	512	478	836	1,826	584	305	917	1,806
Mexico	1	234	1,589	1,824	4	268	2,000	2,272
Czech Republic	2	697	818	1,517	2	769	1,058	1,829
Kazakhstan	48	495	661	1,204	70	917	859	1,846
Brazil	3	713	457	1,173	4	1,012	642	1,658
Poland	6	178	983	1,167	7	347	1,309	1,663
Hungary	4	79	1,078	1,161	5	176	831	1,012
South Africa	33	543	452	1,028	27	361	507	895
Saudi Arabia	23	392	597	1,012	23	536	679	1,238

Note:

- (1) Risk countries are defined as those with an internal rating of A+ and below. In addition, United Arab Emirates is included which has a rating of AA.

The outlook for developing markets has improved but remains challenging in line with global trends. Sovereigns are more resilient than during previous downturns, but the collapse in world trade resulted in a severe growth shock across all regions in the first half of 2009. Although most economies have now stabilised and are showing tentative signs of recovery, prospects vary and significant risks remain. Asia is still growing and best placed to rebound as sovereigns continue to provide strong fiscal stimulus, however, growth will remain below trend as export dependency is reduced only slowly. Middle East governments remain strong, but corporates have been hit by the real estate correction. Latin America is reasonably resilient, but still closely linked to the US and to commodities markets. Risks are highest in some Eastern European countries owing to onerous private sector debt levels and weaker sovereign liquidity.

## Risk and capital management (continued)

### Credit risk (continued)

#### Credit risk assets by industry and geography (Core and Non-Core)

Industry analysis plays an important part in assessing potential concentration risk in the loan portfolio. Heightened monitoring applies to industry sectors where the Group believes there is a high degree of risk or potential for volatility in the future.

	30 June 2009 £bn	31 December 2008 (1) £bn
<b>Credit risk assets by industry sector</b>		
Personal	184	198
Property (2)	152	180
Banks and building societies	104	113
Financial intermediaries	54	68
Transport and storage	50	59
Public sectors and quasi-government	35	42
Technology, media, telecommunications	32	35
Wholesale and retail trade	26	29
Building	25	40
Power, water and waste	20	27
Natural resources and nuclear	20	25
Tourism and leisure	18	20
Business services	14	15
Agricultural and fisheries	4	4
	<b>738</b>	<b>855</b>

Notes:

(1) Prior period amounts have been restated to reflect internal reclassifications of certain business lines.

(2) Property includes direct property financing plus related exposures.

	30 June 2009 £bn	31 December 2008 £bn
<b>Credit risk assets by geography</b>		
United Kingdom	324	327
Western Europe (excluding UK)	182	226
North America	136	178
Asia & Pacific	41	56
Latin America	24	31
CEE & Central Asia	17	22
Middle East & Africa	14	15
	<b>738</b>	<b>855</b>

#### Single name concentrations

Some progress was made against exceptions arising from the Group's refined single name concentration framework during the first half of the year, although illiquid markets have reduced the scope for exposure management. In a number of cases, exposure has reduced, however negative rating migration has also created additional cases that exceed the framework's parameters. Overall there were fewer exceptions at the end of the period than at the beginning the number of corporate exceptions reduced from 552 to 501 while financial institution exceptions reduced from 150 to 122. Refining the framework and embedding it in core business processes remains a key focus going forward.

## Risk and capital management (continued)

### Credit risk (continued)

#### Credit risk asset quality

Refer to the Annual Report and Accounts 2008 and 2008 Pillar 3 Disclosure for details of the Group's credit grading framework and processes.

Credit risk assets by asset quality band	PD range	30 June 2009	31 December 2008
		£bn	£bn
AQ1	0% - 0.034%	162	208
AQ2	0.034% – 0.048%	24	30
AQ3	0.048% – 0.095%	33	45
AQ4	0.095% - 0.381%	119	159
AQ5	0.381% - 1.076%	126	157
AQ6	1.076% - 2.153%	102	107
AQ7	2.153% - 6.089%	52	48
AQ8	6.089% - 17.222%	26	26
AQ9	17.222% - 100%	17	12
AQ10	100%	34	19
Other (1)		43	44
		738	855

Notes:

- (1) "Other" largely comprises assets covered by the standardised approach for which a probability of default (PD) equivalent to those assigned to assets covered by the internal ratings based approach is not available.



## Risk and capital management (continued)

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### Credit risk (continued)

**Key credit portfolios** (Analysis refers to combined Core/Non-Core portfolios unless otherwise stated)

The discussions below relate to credit risk assets in specific portfolios within the Group.

#### Commercial property

The commercial property portfolio credit risk assets total £90.8 billion, an 8% decrease from the beginning of the year, split between: UK (£58.0 billion); Western Europe (£22.1 billion); North America (£6.8 billion); and other regions (£3.9 billion). As part of the strategic review, 40% of the Group's commercial property portfolio was designated Non-Core.

Lending is spread across: investment (70%); development (28%); and other (2%). Speculative lending represents less than 2% of the portfolio. The Group's appetite for originating speculative commercial property lending is limited and any such business requires exceptional approval under the credit approval framework.

The decrease in asset valuations continues to place strain on the portfolio with more clients seeking covenant renegotiations while discussing structural enhancements and/or potential equity injections. The average loan-to-value (LTV) is 89%. The average interest coverage ratios for GBM and UK Corporate portfolios are 168% and 162% respectively.

The Group's lending approach has always been predominantly cashflow driven and that has mitigated the impact of asset devaluation, however, the outlook remains challenging with further pressure on asset values expected, limited liquidity to support refinancing and increasing concerns about tenant failures. The Group is working closely with clients to restructure loans and achieve outcomes that benefit both parties. Portfolios are subject to specific monitoring within originating divisions and a separate unit has been established and staffed in the first half of 2009 to ensure that specialised expertise is deployed to actively manage this portfolio on a global and coordinated basis. 13% of the portfolio was non-performing at 30 June 2009, compared to 6% at 31 December 2008.

#### UK residential mortgages

The UK mortgage portfolio totalled £79 billion at 30 June 2009, an increase of 6% during the first half of the year and 9% higher than June 2008, due to strong sales growth and lower redemption rates. Brands are the Royal Bank of Scotland, NatWest, the One Account, and First Active. The assets comprise prime mortgage lending and include 7% (£5.4 billion) of exposure to residential buy-to-let. There is a very small legacy self certification book (0.4% of total assets) which was withdrawn from sale in 2004.

The average LTV for new business was 65% in the first half of 2009 versus 67% for 2008. The maximum LTV available to new customers remains 90% and there has been strong volumes of low LTV applications in the first half of the year coupled with continued subdued demand for higher LTV business.

The arrears rate (three or more payments missed) on the combined Royal Bank of Scotland and NatWest brands was 1.8% at 30 June 2009, up from 1.5% as at 31 December 2008 and 1.16% as at June 2008. The arrears rate on the buy-to-let portfolio was 1.6% at 30 June 2009 (1.5% at 31 December 2008; 0.9% at 30 June 2008).

The mortgage impairment charge was £65 million in the first half of 2009 versus £33 million for the full year 2008. The increase is mainly attributable to declining house prices driving lower recoveries. Provision cover at 30 June 2009 was 0.20% versus 0.18% at 31 December 2008.

## Risk and capital management (continued)

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### Credit risk (continued)

The number of repossessions in the first half of 2009 totalled 567, versus 551 in the second half of 2008. Forbearance policies support customers in financial difficulty and include not initiating repossession proceedings for 6 months after a customer falls in to arrears. The Group also participates in the Government's Mortgage Rescue and Homeowner Mortgage Support Schemes.

### The Republic of Ireland and Northern Ireland residential mortgages

The residential mortgage portfolio in Ireland across the Ulster Bank and First Active brands totalled £21.8 billion at 30 June 2009; 91.7% is in the Republic of Ireland and 8.3% in Northern Ireland. This represents a decline of 2% in the Republic of Ireland and an increase of 2% in Northern Ireland from balances at 31 December 2008.

During the first half of 2009 loan to value and affordability criteria were further tightened, particularly in higher risk segments, e.g. buy to let. The bank also introduced new products - Momentum and SecureStep - in both Northern Ireland and the Republic of Ireland. These products aim to support market activity while continuing to meet the bank's risk criteria.

The arrears rate (three or more payments missed) increased to 2.7% at 30 June 2009 from 1.5% at 31 December 2008. As a result the loan loss impairment charge for the first half of the year was £42 million versus £23 million for the full year 2008.

Repossessions remained low and totalled 21 for first half of the year, similar to levels experienced in 2008.

### US residential mortgages

Citizens Financial Group's (CFG) residential real estate portfolio totalled \$45.9 billion at 30 June 2009 (versus \$50.1 billion at 31 December 2008) comprising \$13.3 billion in first mortgages and \$32.6 billion of home equity loans and lines. Included in this \$4.2 billion decline, is the sale of \$2.4 billion in real estate assets from December through May 2009 to the Federal National Mortgage Association (Fannie Mae) with the remaining fall attributed to pre-payment and declining originations.

CFG has historically adopted conservative risk policies in comparison to the general market. Loan acceptance criteria were tightened further during 2009 to reflect deteriorating economic conditions. Limited exposures to sub-prime underwriting (FICO  $\leq$  620, approximately 0.6%), and Alt-A /other non-conforming balances combined with reduced lending to volatile geographic regions have protected the Bank.

Excluding the Serviced By Others portfolio (SBO) of \$6 billion at 30 June 2009, the portfolio average indexed LTV increased to 68% for June 2009, up from 63% in December 2008. \*

Due to general US economic conditions, delinquencies in the both home equity and mortgage books are steadily rising. At 30 June 2009, 2.7% of home equity loans and 3.7% of mortgages were one payment or more past due (compared to 1.5% and 1.7% respectively at 31 December 2008). Significant investment has been made in problem debt management capability. Loan modification options are being used where appropriate to support troubled customers, including government-sponsored programmes.

Due to its loan to value and geographic profile, the SBO home equity portfolio continues to be particularly affected by the current economic climate, with net credit losses of \$291 million, equivalent to an annualised 9.4% of balances, in the first half of the year (versus 5.3% in 2008). The LTV trend is obscured by the portfolio's contraction with higher LTV a key driver of losses taken to date: average LTV stood at 101% at 30 June 2009 versus 100% at 31 December 2008. Management action to contain losses through optimising problem debt management performance continues to be a specific focus.

*\* Prior period figure has been restated to incorporate updated methodology and additional data.*

## Risk and capital management (continued)

### Credit risk (continued)

#### Automotive sector

Exposure to the automotive sector decreased from £13.3 billion at 31 December 2008(1) to £10.8 billion at 30 June 2009.

Credit risk assets by sector	£bn	%
Original equipment manufacturer / Commercial vehicles	1.9	18
Captive finance companies	0.6	5
Component suppliers	1.5	14
Retail / Services	5.0	46
Rental	1.8	17
Total	10.8	100

Credit risk assets by geography	£bn	%
Americas	2.4	22
Central Eastern Europe	0.7	6
UK	4.1	38
Western Europe	2.9	27
Asia	0.7	7
Total	10.8	100

The sector faces numerous challenges: its exposure to discretionary consumer spending; historically high leverage; volatile input prices; and ongoing political and societal pressure to reduce fuel emissions forcing fundamental changes to business and franchise models. The Group therefore maintains a cautious stance against the sector and remains focused on larger, more diversified customers. Notwithstanding this approach, the scale of downturn has impacted the performance of the portfolio with negative rating migration and higher default rates occurring.

Over the past six months, the Group's exposure to the large US automobile manufacturers has been subject to close scrutiny and material reductions in direct lending have been achieved. The resulting size and structure of the facilities were such that minimal provisions were required on exposure to these names.

Note:

(1) Prior period figure has been restated to incorporate updated methodology and additional data.

#### Shipping

The Group's shipping portfolio largely comprises financing exposure, distributed as shown in the table below.

Credit risk assets by sector	£bn	%
Dry bulk	2.5	25
Tankers	4.2	41
Container	1.1	11
Gas/offshore	1.8	17
Other	0.6	6
Total	10.2	100

88% of exposure (against delivered tonnage) is secured on vessels built in the last 8 years.

Despite the significant fall in asset values and the challenging outlook across all sectors, all shipping loans are performing. The Group's focus on modern assets, with stronger cash flow and liquidity, is reflected in the fact that only £1.5 billion of the portfolio was subject to enhanced monitoring as at 30 June 2009.

## Risk and capital management (continued)

### Credit risk (continued)

#### Oil and gas

Credit risk assets by sector	£bn	%
Vertically integrated	5.9	32
Exploration and production	2.7	14
Oilfield services	2.2	12
Midstream	3.2	17
Refining and marketing	3.1	17
Other	1.5	8
Total	18.6	100

RBS and ABN AMRO had a number of exposures that overlapped, primarily in relation to well rated, vertically integrated companies and several of the larger global exploration and production companies. The Group's strategy is to continue to focus primarily on the more stable midstream and integrated oil sectors, together with well secured exposures to larger exploration and production companies based on a conservative outlook for oil prices that is regularly reassessed. Unsecured exposures are primarily to oil majors and state owned entities.

## Risk and capital management (continued)

### Credit risk (continued)

#### Asset quality

#### Loans and advances to customers by geography and industry

The following table analyses the balance sheet carrying value of loans and advances to customers (excluding reverse repurchase agreements and stock borrowing) by industry and geography.

	30 June 2009			31 December 2008	30 June 2008
	Core £m	Non-core £m	Total £m	£m	£m
<b>UK Domestic</b>					
Central and local government	3,302	138	3,440	3,091	3,381
Finance	17,480	7,462	24,942	28,013	17,940
Individuals – home	85,462	2,048	87,510	80,967	79,114
Individuals – other	23,028	1,096	24,124	26,979	27,264
Other commercial and industrial comprising:					
- Manufacturing	10,762	1,996	12,758	15,067	14,078
- Construction	5,261	3,513	8,774	10,171	10,565
- Service industries and business activities	42,149	12,532	54,681	58,552	58,938
- Agriculture, forestry and fishing	2,839	86	2,925	2,972	2,969
- Property	17,203	33,623	50,826	52,087	50,301
Finance leases and instalment credit	5,026	11,494	16,520	17,363	15,964
Interest accruals	605	188	793	1,687	1,749
	213,117	74,176	287,293	296,949	282,263
<b>UK International</b>					
Central and local government	1,213	61	1,274	3,015	1,255
Finance	19,453	3,810	23,263	35,009	23,541
Individuals – other	375	73	448	490	476
Other commercial and industrial comprising:					
- Manufacturing	7,436	607	8,043	10,932	7,757
- Construction	2,173	820	2,993	3,255	2,645
- Service industries and business activities	23,161	3,137	26,298	29,782	23,562
- Agriculture, forestry and fishing	133	25	158	146	124
- Property	12,670	9,365	22,035	21,923	18,231
Interest accruals	3	445	448	37	31
	66,617	18,343	84,960	104,589	77,622
<b>Overseas</b>					
<b>Europe</b>					
Central and local government	960	534	1,494	1,830	2,709
Finance	2,619	6,134	8,753	9,731	13,501
Individuals – home	14,461	6,582	21,043	23,394	17,893
Individuals – other	2,387	660	3,047	4,641	4,642
Other commercial and industrial comprising:					
- Manufacturing	10,417	6,571	16,988	25,842	15,158
- Construction	2,163	1,670	3,833	5,183	4,674
- Service industries and business activities	25,341	8,195	33,536	40,444	43,463
- Agriculture, forestry and fishing	1,023	64	1,087	1,327	1,297
- Property	9,846	9,627	19,473	19,769	16,108
Finance leases and instalment credit	322	1,187	1,509	1,815	1,705
Interest accruals	220	234	454	798	799
	69,759	41,458	111,217	134,774	121,949

## Risk and capital management (continued)

### Credit risk (continued)

#### Asset quality (continued)

#### Loans and advances to customers (continued)

	30 June 2009			31 December 2008	30 June 2008
	Core £m	Non-core £m	Total £m	£m	£m
<b>US</b>					
Central and local government	224	62	286	482	346
Finance	12,924	816	13,740	16,088	12,016
Individuals – home	23,142	4,830	27,972	34,235	26,544
Individuals – other	8,209	3,920	12,129	14,368	10,691
Other commercial and industrial comprising:					
- Manufacturing	6,955	1,997	8,952	13,127	8,529
- Construction	407	282	689	885	673
- Service industries and business activities	17,644	4,620	22,264	27,913	18,973
- Agriculture, forestry and fishing	219	2	221	30	24
- Property	1,944	3,906	5,850	6,579	4,731
Finance leases and instalment credit	2,563	35	2,598	3,066	2,308
Interest accruals	236	119	355	471	383
	74,467	20,589	95,056	117,244	85,218
<b>Rest of World</b>					
Central and local government	375	3	378	7,079	4,942
Finance	8,491	1,378	9,869	11,722	13,968
Individuals – home	397	343	740	795	723
Individuals – other	1,320	560	1,880	4,592	2,853
Other commercial and industrial comprising:					
- Manufacturing	3,558	2,380	5,938	6,196	5,001
- Construction	232	423	655	756	231
- Service industries and business activities	7,589	2,264	9,853	13,152	10,674
- Agriculture, forestry and fishing	32	187	219	153	104
- Property	693	1,455	2,148	2,918	2,800
Finance leases and instalment credit	34	6	40	111	34
Interest accruals	87	62	149	270	226
	22,808	9,061	31,869	47,744	41,556
<b>Total</b>					
Central and local government	6,074	798	6,872	15,497	12,633
Finance	60,967	19,600	80,567	100,563	80,966
Individuals – home	123,462	13,803	137,265	139,391	124,274
Individuals – other	35,319	6,309	41,628	51,070	45,926
Other commercial and industrial comprising:					
- Manufacturing	39,128	13,551	52,679	71,164	50,523
- Construction	10,236	6,708	16,944	20,250	18,788
- Service industries and business activities	115,884	30,748	146,632	169,843	155,610
- Agriculture, forestry and fishing	4,246	364	4,610	4,628	4,518
- Property	42,356	57,976	100,332	103,276	92,171
Finance leases and instalment credit	7,945	12,722	20,667	22,355	20,011
Interest accruals	1,151	1,048	2,199	3,263	3,188
<b>Loans and advances to customers – gross</b>	446,768	163,627	610,395	701,300	608,608
Loan impairment provisions	(5,449)	(8,198)	(13,647)	(9,324)	(5,031)
<b>Total loans and advances to customers</b>	441,319	155,429	596,748	691,976	603,577

## Risk and capital management (continued)

### Credit risk (continued)

#### Asset quality (continued)

##### Risk elements in lending

The following table shows the estimated amount of loans classified as non-accrual, accruing past due and potential problem loans. The figures are stated before deducting the value of security held or related provisions.

	30 June 2009			31 December	30 June
	Core	Non-core	Total	2008	2008
	£m	£m	£m	£m	£m
Loans accounted for on a non-accrual basis (2):					
- Domestic	5,295	6,676	11,971	8,579	5,940
- Foreign	3,242	12,016	15,258	8,503	2,148
	8,537	18,692	27,229	17,082	8,088
Accruing loans which are contractually overdue 90 days or more as to principal or interest (3):					
- Domestic	1,460	984	2,444	1,201	642
- Foreign	244	812	1,056	508	102
	1,704	1,796	3,500	1,709	744
Total risk elements in lending	10,241	20,488	30,729	18,791	8,832
Potential problem loans:(4)					
- Domestic	110	163	273	218	139
- Foreign	13	10	23	8	2
	123	173	296	226	141
Closing provisions for impairment as a % of total risk elements in lending and potential problem loans	54%	40%	44%	50%	56%
Risk elements in lending as a % of gross lending to customers excluding reverse repos	2.26%	12.52%	5.04%	2.66%	1.45%
Risk elements in lending and potential problem loans as a % of gross lending to customers excluding reverse repos	2.29%	12.63%	5.08%	2.69%	1.47%

##### Notes:

- (1) For the analysis above, 'Domestic' consists of the United Kingdom domestic transactions of the Group. 'Foreign' comprises the Group's transactions conducted through offices outside the UK and through those offices in the UK specifically organised to service international banking transactions.
- (2) All loans against which an impairment provision is held are reported in the non-accrual category.
- (3) Loans where an impairment event has taken place but no impairment recognised. This category is used for fully collateralised non-revolving credit facilities.
- (4) Loans for which an impairment event has occurred but no impairment provision is necessary. This category is used for fully collateralised advances and revolving credit facilities where identification as 90 days overdue is not feasible.

## Risk and capital management (continued)

### Credit risk (continued)

#### Impairments

##### Impairment loss provision methodology

Refer to the Annual Report and Accounts 2008 for information regarding the impairment loss provision methodology.

##### Impairment charge

The following table shows total impairment losses charged to the income statement.

	First half 2009			First half 2008	Full year 2008
	Core £m	Non-core £m	Total £m	£m	£m
New impairment losses	2,257	5,404	7,661	1,617	7,693
Less: recoveries of amounts previously written off	80	60	140	138	261
Charge to income statement	2,177	5,344	7,521	1,479	7,432
Comprising:					
Loan impairment losses	2,170	4,626	6,796	1,406	6,478
Impairment losses on available-for-sale securities	7	718	725	73	954
Charge to income statement	2,177	5,344	7,521	1,479	7,432

	First half 2009 £m	First half 2008 £m	Full year 2008 £m
Impairment losses by division:			
UK Retail	824	440	1,019
UK Corporate	551	96	321
Wealth	22	5	16
Global Banking & Markets	237	17	541
Global Transaction Services	13	4	48
Ulster Bank	157	18	106
US Retail & Commercial	369	126	437
RBS Insurance	6	-	42
Other	(2)	(36)	(18)
Core	2,177	670	2,512
Non-core	5,344	809	4,920
	7,521	1,479	7,432

##### Analysis of loan impairment charge

	First half 2009			First half 2008	Full year 2008
	Core £m	Non-core £m	Total £m	£m	£m
Latent loss impairment charge	454	270	724	328	769
Collectively assessed impairment charge	1,274	729	2,003	940	2,391
Individually assessed impairment charge (1)	434	3,627	4,061	138	3,200
Charge to income statement	2,162	4,626	6,788	1,406	6,360
Charge as a % of customer loans and advances – gross (2)	0.97%	5.65%	2.22%	0.46%	0.91%

Notes:

(1) Excludes loan impairment charge against loans and advances to banks of £8 million (first half 2008 - nil; full year 2008 - £118 million).

(2) Gross of provisions and excluding reverse repurchase agreements.



## Risk and capital management (continued)

### Credit risk (continued)

#### Impairments (continued)

##### Loan impairment provisions

Operating loss is stated after charging loan impairment losses of £6,796 million (first half 2008 - £1,406 million; full year 2008 - £6,478 million). The balance sheet loan impairment provisions increased in the half year ended 30 June 2009 from £9,451 million to £13,773 million, and the movements thereon were:

	First half 2009			First half 2008 £m	Full year 2008 £m
	Core £m	Non-core £m	Total £m		
At 1 January	4,905	4,546	9,451	4,956	4,956
Transfers to disposal groups	-	-	-	(147)	-
Currency translation and other adjustments	(529)	24	(505)	72	1,023
Disposals	-	-	-	(40)	(178)
Amounts written-off	(952)	(980)	(1,932)	(1,261)	(2,897)
Recoveries of amounts previously written-off	80	60	140	138	261
Charge to the income statement	2,170	4,626	6,796	1,406	6,478
Unwind of discount	(99)	(78)	(177)	(90)	(192)
<b>Total</b>	<b>5,575</b>	<b>8,198</b>	<b>13,773</b>	<b>5,034</b>	<b>9,451</b>

Provisions at 30 June 2009 include £126 million (31 December 2008 - £127 million; 30 June 2008 - £3 million) in respect of loans and advances to banks.

##### Analysis of loan impairment provisions

	30 June 2009			31 December 2008 £m	30 June 2008 £m
	Core £m	Non-core £m	Total £m		
Latent loss provisions	1,477	822	2,299	1,719	859
Collectively assessed provisions	3,219	1,334	4,553	3,692	3,134
Individually assessed provisions	753	6,042	6,795	3,913	1,038
<b>Total provisions (1)</b>	<b>5,449</b>	<b>8,198</b>	<b>13,647</b>	<b>9,324</b>	<b>5,031</b>
Total provision as a % of customer loans and advances – gross (2)	1.2%	5.0%	2.2%	1.3%	0.8%

Notes:

- (1) Excludes provisions against loans and advances to banks of £126 million (31 December 2008 - £127 million; 30 June 2008 - £3 million).  
(2) Gross of provisions and excluding reverse repurchase agreements.

##### Provisions coverage

The Group's provision coverage ratios are shown in the table below.

	30 June 2009			31 December 2008	30 June 2008
	Core	Non-core	Total		
Total provision expressed as a:					
% of REIL	54%	40%	45%	50%	57%
% of REIL and PPL	54%	40%	44%	50%	56%

## **Risk and capital management**

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### **Liquidity risk**

The policy of the Group is to ensure that it is able to meet its obligations as they fall due.

The Group has an approved risk appetite supported by explicit targets and metrics to control the size and extent of both short term liquidity and long term funding risk. The Group Asset and Liability Committee (GALCO) chaired by the Group Finance Director has the responsibility to set Group policy and ensure that this is cascaded and communicated to the business divisions.

Group Treasury is the functional area with responsibility for the monitoring and control of the Group's funding and liquidity positions. Group Treasury is supported by a governance process that includes a weekly Liquidity Risk forum comprising functional areas across the organisation responsible for liquidity management, and divisional and regional asset and liability committees.

### **Structural balance sheet management**

The maturity mismatch between deposits and lending is limited and controlled by policies aimed at ensuring assets can be funded over the term of their economic life. The mismatch analysis takes into account the impact of behaviour under normal and stress conditions to evaluate the appropriate balance of funding resources.

### **Stress testing**

The Group uses stress tests as a tool to evaluate the impact of both disrupted market conditions and specific events to measure the impact both on, and off, balance sheet. The stress tests show the degree of resilience in times of stress and the ability for contingency actions to mitigate stressed conditions. The assumptions and nature of the risks driving the stress tests are refined and updated in the light of changing conditions.

### **Contingency planning**

Contingency plans are developed to anticipate the potential for deterioration in market conditions and ensure that the Group has considered how it can respond to adverse developments. The contingency plan considers actions including the use of liquid assets, reduction in lending commitments, increased deposit balances and the use of collateral and management of derivative exposures.

### **Global developments in 2009**

Liquidity conditions in money and debt markets have improved significantly since the beginning of Q2 2009. Following a difficult first quarter, most indicators of stresses in financial markets are close to or better than before the collapse of Lehman Brothers in September 2008. Contributing to the improvement has been a combination of ongoing central bank and other official liquidity support schemes, guarantee schemes and rate cuts. Signs of improvement in underlying macroeconomic trends also helped to sustain a recovery in markets for risky assets, including in debt markets.

Policy rates have reached low levels for the economic cycle in the major currency areas. Unsecured interbank rates, as benchmarked by Libor/Euribor have fallen to all-time lows – 3 month rates are now well below 1% for prime banks in the G3 currency areas. Trading activity at longer term maturities has also picked up and interbank repo of non-government collateral appears to have recovered strongly following the severe stress experienced in 2008. The US Federal Deposit Insurance Corporation's ('FDIC') Temporary Liquidity Guarantee Program ('TLGP') allowed around \$300 billion of debt to be issued by US financial firms in the first half of the year. A similar amount has been issued by European banks, mostly in EUR and USD, covered by institutions' respective home-country guarantee initiatives. However in recent months unguaranteed financial debt issuance, including bank capital has become possible and guaranteed issuance has slowed markedly since May.

## Risk and capital management

### Liquidity risk (continued)

Important developments in central bank liquidity programmes since February include:

- In the UK, the Bank of England reduced interest rates to 0.5% in March, and later the same month the Bank of England initiated 'quantitative easing' through its Asset Purchase Facility. Gilt purchases dominate activity to date, while direct purchases of commercial paper and corporate bonds have been relatively small.
- In the US, the Federal Reserve has maintained its target for the funds rate at 0-0.25% while supplementing its credit-easing programmes with a new Term Asset-Backed Securities Loan Facility ('TALF') although initial take up of the TALF has been slow.
- In the Euro Area, the European Central Bank ('ECB') decided in early May to hold three 1-year repo operations against its general collateral list. The first of these was received enthusiastically in June, resulting in significant supply of ECB liquidity to the banking system and bringing downward pressure on short term rates.

### Liquidity management

The reduction in the size of the overall funded balance sheet of the Group has reduced reliance on wholesale funding markets. The funding markets have been recovering throughout the course of 2009 and this has eased pressure on the funding position of the Group. The improvements in the markets have enabled the Group to issue £4.9 billion of unguaranteed term debt with maturity beyond 12 months and there has been a reduction of funding in short term debt markets. The structure of the balance sheet has improved and the gap between customer loans and customer deposits (excluding repos) fell by £49,325 million from £240,982 million as at 31 December 2008 to £191,657 million as at 30 June 2009. As a result, the loan to deposit ratio reduced from 152.4% to 144.5%.

The Group continues to develop diversified sources of funding across its retail, corporate and wholesale franchises in line with the strategy to rely more on retail and other customer funds to support its lending business.

The Group will seek to build on this improvement in its funding position in the expectation that trading in term markets improve providing the opportunity to increase the maturity profile of wholesale liabilities.

	First half 2009 £m	%	Full year 2008 £m	%
Deposits by Banks	135,601	16.3	178,943	18.8
Debt securities in issue:				
Commercial paper	49,270	5.9	69,891	7.3
Certificates of deposits	76,095	9.2	73,925	7.8
MTNs	104,190	12.5	94,298	9.9
Other (bonds)	4,394	0.5	14,231	1.5
Securitisations	14,761	1.8	17,113	1.8
	248,710	29.9	269,458	28.3
Subordinated debt	32,106	3.9	43,678	4.6
Total wholesale funding	416,417	50.1	492,079	51.7
Customer deposits	415,267	49.9	460,318	48.3
Total	831,684	100.0	952,397	100.0

### Customer accounts

Customer accounts are the largest source of funding for the Group and are highly diversified across both retail and corporate franchises, representing a stable source of core funding. The level of customer deposits decreased over the period from £460,318 million at 31 December 2008 to £415,267 million at 30 June 2009.

## Risk and capital management

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### Liquidity risk (continued)

#### Repo agreements

The repo market represents borrowings that are secured against a range of debt assets and other securities. Repo activity represents an ongoing source of financing activity and the market has not stabilised.

#### Debt securities in issue and subordinated liabilities

The proportion of outstanding debt instruments issued, with a remaining maturity of greater than 12 months has increased from 45% in 31 December 2008 to 47% in June 2009 reflecting a lengthening of the maturity profile of debt issuance over the period.

	First half 2009 £m	%	Full year 2008 £m	%
Less than one year	149,265	53.2	172,234	55.0
1-5 years	67,390	24.0	61,842	19.8
More than 5 years	64,161	22.8	79,060	25.2
Total	280,816	100.0	313,136	100.0

The reduction in the amount of debt instruments with maturities of less than one year reflects the Group's strategy to reduce its reliance on short-term markets and instruments coupled with favourable exchange rate movements. The net movement in maturities of greater than one year is mainly as a result of the exchange and tender offers completed in April 2009 partially offset by new debt issuance.

#### Short term debt and bank deposits

The short term debt markets have improved markedly over the course of 2009 and the Group has been able to readily access this source of funding with increased maturities and reduced costs of spread. This easing of market conditions has enabled the Group to reduce reliance on central bank facilities and move toward its strategic objective of self reliance in the markets.

#### Undrawn commitments

The Group has seen a decrease in undrawn commitments from £352 billion at 31 December 2008 to £299 billion at 30 June 2009 both as a result of the strengthening of sterling against the US dollar and the euro as well as decreased volumes. The decrease in volumes is consistent with the strategic objective to reduce liquidity risk in off-balance sheet activity.

#### Conduits

The Group has a multi seller conduit business that funds assets through the issuance of short term asset backed commercial paper. The total of assets held in Group sponsored conduits fell from £49.9 billion at December 2008 to £35.0 billion at 30 June 2009 as the Group reduced its exposure to this business in line with strategy.

## Risk and capital management

### Market risk

Market risk arises from changes in interest rates, foreign currency, credit spread, equity prices and risk related factors such as market volatilities. The Group manages market risk centrally within its trading and treasury portfolios through a comprehensive market risk management framework. This framework contains limits based on, but not limited to: value-at-risk (VaR), scenario analysis, position and sensitivity analyses.

The Group discloses market risk in VaR terms. VaR is a measure that produces estimates of the potential change in the market value of a portfolio over a specified time horizon at given confidence levels. The Group uses a historical simulation methodology with a two year time horizon and a 99% confidence level.

At the Group level the risk appetite is expressed in the form of a combination of VaR, sensitivity and scenario limits. The Group recently changed its VaR confidence level from 95% to 99% as it believes this provides greater clarity in respect of potential economic outcomes. The table below sets out VaR for the Group's portfolios with prior periods restated to reflect the 99% confidence level for consistency and comparability.

The Group continued to update and enhance its market risk management framework during the first half of 2009. In addition to the move to VaR based on a 99% confidence level, the Group has improved and strengthened its market risk limit framework, increasing the transparency of market price risk taken across the Group's businesses in both the trading and non-trading portfolios.

The Group's market risk appetite is defined within this limit framework which is cascaded down through legal entity, division, business and ultimately trader level market risk limits.

The VaR disclosure is broken down into trading and non-trading (referred to in previous disclosures as Treasury VaR), where trading VaR relates to the main trading activities of the Group and non-trading reflects the VaR associated with reclassified assets, money market business and the management of internet funds flow within the Group's businesses.

As part of the Strategic Review announced on 26 February 2009, the designation of assets between Core and Non-Core divisions was completed during the period. The period end Core/Non-Core VaR as of 30 June 2009 shown below reflects the conclusion of this process. Average, Maximum and Minimum VaR for Core/Non-Core are measures that require daily data. The Non-Core division was not defined at the start of the period and average, maximum and minimum VaR are measures that require daily data. These three measures have been prepared on a best efforts basis and reflect the process of designating Non-Core assets.

	Average £m	Period end £m	Maximum £m	Minimum £m
<b>Trading VaR (pro forma and statutory basis)</b>				
Interest rate	65.6	81.4	112.8	42.5
Credit spread	125.3	199.6	231.2	66.9
Currency	17.7	15.6	35.8	9.2
Equity	13.0	11.7	21.6	8.3
Commodity	12.7	11.5	21.4	6.5
Diversification effects		(129.2)		
<b>30 June 2009</b>	<b>143.3</b>	<b>190.6</b>	<b>229.0</b>	<b>76.8</b>
Core (30 June 2009)	99.6	94.3	135.6	54.2
Non-Core (30 June 2009)	77.3	130.4	166.5	28.6

## Risk and capital management

### Market risk (continued)

	Average £m	Period end £m	Maximum £m	Minimum £m
Interest rate	38.7	54.4	94.0	18.2
Credit spread	71.5	61.5	130.8	51.7
Currency	7.6	17.0	18.0	3.5
Equity	22.4	18.3	42.6	11.0
Commodity	9.9	10.0	25.8	0.2
Diversification effects		(52.4)		
31 December 2008	82.3	108.8	155.7	49.3
Interest rate	29.1	33.7	56.1	18.2
Credit spread	72.7	75.5	96.3	51.7
Currency	6.0	7.1	8.6	3.5
Equity	23.1	19.9	42.6	11.0
Commodity	9.5	23.0	25.3	0.2
Diversification effects		(67.7)		
30 June 2008	70.4	91.5	106.0	49.3

	Average £m	Period end £m	Maximum £m	Minimum £m
<b>Non-trading VaR (pro forma and statutory basis)</b>				
Interest rate	17.6	16.6	26.1	12.9
Credit spread	198.9	205.4	270.3	65.4
Currency	1.2	1.1	3.8	0.2
Equity	4.0	3.7	7.2	2.2
Diversification effects		(27.0)		
<b>30 June 2009</b>	<b>199.6</b>	<b>199.8</b>	<b>274.9</b>	<b>76.1</b>
Core (30 June 2009)	82.6	81.6	133.5	55.0
Non-Core (30 June 2009)	123.1	132.6	145.3	20.2
Interest rate	10.6	24.4	32.9	5.2
Credit spread	10.5	65.2	65.2	5.5
Currency	0.6	2.2	5.7	0.1
Equity	3.4	7.0	8.0	0.8
Diversification effects		(22.7)		
31 December 2008	14.8	76.1	76.1	7.7

	Average £m	Period end £m	Maximum £m	Minimum £m
Interest rate	7.4	9.1	10.2	5.2
Credit spread	7.7	7.0	10.6	5.6
Currency	0.4	0.3	1.0	0.2
Equity	1.7	1.7	2.6	0.8
Diversification effects		(8.7)		
30 June 2008	10.0	9.4	13.4	7.7

### Market risk (continued)

The data in the tables above exclude exposures to super senior tranches of asset-backed CDOs, as VaR does not provide an appropriate measure of risk for these exposures due to the continued illiquidity and opaqueness of pricing of these instruments. For these exposures, the maximum potential loss is equal to the aggregate net exposure of £548 million at 30 June 2009. For more information, please refer to market turmoil exposure - Super senior CDOs on page 130 and Note 11, Financial instruments - collateralised debt obligations.

The Group uses the most recent two years of market data in its VaR model. Accordingly the VaR at June 2009 incorporates all of the market volatility experienced since the credit crisis began in August 2007. On average this means that a given underlying risk position expressed in VaR terms will be considerably larger than previously reported. If one assumes future volatility declines in comparison to the average over the last two years then the half year may well represent a peak VaR number for a given position. The Group has reduced its underlying trading positions in the first half of 2009, but the increase in market volatility factored into the VaR calculation has more than offset this; consequently the Trading VaR has increased when compared with previous periods.

Non-Core credit spread trading VaR increased materially during the period, not only for the reason described above, but also owing to additional hedges against the risk of counterparty failure. As this counterparty risk is itself not in VaR, these hedges increase reported VaR.

The non-trading VaR increased not only because of more volatile market data in the VaR models, but also as a result of reclassification of certain trading portfolio assets.

The Group's VaR should be interpreted in light of the limitations of the methodologies used, detailed as follows:

- Historical Simulation VaR may not provide the best estimate of future market movements. It can only provide a prediction of the future based on events that occurred in the two year time series. Therefore, events that are more severe than those in the historical data series cannot be predicted.
- VaR that uses a 99% confidence level does not reflect the extent of potential losses beyond that percentile.
- VaR uses a one-day time horizon which will not fully capture the profit and loss implications of positions that cannot be liquidated or hedged within one day.
- The Group computes the VaR of trading portfolios at the close of business. Positions may change substantially during the course of the trading day and intraday profit and losses will be incurred.

These limitations mean that the Group cannot guarantee that losses will not exceed the VaR.

## Risk and capital management

### Market risk (continued)

The following table details the combined other than trading (non-trading businesses and retail and commercial banking activities) VaR at a 99% confidence level, which relates mainly to interest rate risk and credit spreads.

Statutory basis	Average £m	Period end £m	Maximum £m	Minimum £m
30 June 2009	<b>187.2</b>	<b>190.6</b>	<b>203.2</b>	<b>177.3</b>
31 December 2008	133.1	134.9	197.0	86.4

### Structural interest rate and currency VaR (statutory basis)

Structural interest rate risks mainly arise in retail and commercial banking assets and liabilities.

Statutory basis	Average £m	Period end £m	Maximum £m	Minimum £m
30 June 2009	<b>91.3</b>	<b>100.4</b>	<b>112.5</b>	<b>69.3</b>
31 December 2008	128.1	60.1	194.6	60.3

Statutory basis	30 June 2009 £m
EUR	<b>39.3</b>
GBP	<b>25.2</b>
USD	<b>83.8</b>
Other	<b>5.1</b>



## Risk and capital management

### Currency risk (statutory basis)

The Group does not maintain material non-trading open currency positions other than the structural foreign currency translation exposures arising from its investments in foreign subsidiaries and associated undertakings and their related currency funding. The Group's policy in relation to structural positions is to match fund the structural foreign currency exposure arising from net asset value, including goodwill, in foreign subsidiaries, equity accounted investments and branches, except where doing so would materially increase the sensitivity of either the Group's or the subsidiary's regulatory capital ratios to currency movements. The policy requires structural foreign exchange positions to be reviewed regularly by GALCO. GALCO approves open structural exposures, primarily in USD and EUR and expressed in currency notional amounts, which are sufficient to reduce the sensitivity of regulatory capital ratios to exchange rate movements within defined tolerance limits.

Foreign exchange differences arising on the translation of foreign operations are recognised directly in equity together with the effective portion of foreign exchange differences arising on hedging instruments.

Equity classification of foreign currency denominated preference share issuances requires that these shares be held on the balance sheet at historic cost. Consequently, these share issuances have the effect of increasing the Group's structural foreign currency position.

See the Annual Report and Accounts 2008 for background on the Group's structural currency risk exposures.

The tables below set out the Group's structural foreign currency exposures.

	Net assets of overseas operations £m	Minority Interests £m	Net investments in foreign operations £m	Net investment hedges £m	Structural foreign currency exposures £m
<b>30 June 2009</b>					
US dollar	15,551	(3)	15,554	(3,330)	12,224
Euro	18,282	13,619	4,663	(1,300)	3,363
Other non sterling	5,639	536	5,103	(3,585)	1,518
<b>Total</b>	<b>39,472</b>	<b>14,152</b>	<b>25,320</b>	<b>(8,215)</b>	<b>17,105</b>
<b>31 December 2008</b>					
US dollar	17,480	(19)	17,499	(3,659)	13,840
Euro	26,943	15,431	11,512	(7,461)	4,051
Chinese RMB	3,928	1,898	2,030	(1,082)	948
Other non sterling	5,088	621	4,467	(3,096)	1,371
<b>Total</b>	<b>53,439</b>	<b>17,931</b>	<b>35,508</b>	<b>(15,298)</b>	<b>20,210</b>

Retranslation gains and losses on the Group's net investments in operations, together with those on instruments hedging these investments, are recognised directly in equity. Changes in foreign currency exchange rates will affect equity in proportion to the structural foreign currency exposure. A five percent strengthening of foreign currencies would result in a gain of £900 million (31 December 2008 – £1,010 million) recognised in equity. A five percent weakening of foreign currencies would result in a loss of £810 million (31 December 2008 – £960 million) recognised in equity. There are no Chinese RMB exposures at 30 June 2009 following the sale of the Group's interest in Bank of China. These movements in equity would offset retranslation effects on the Group's foreign currency denominated risk weighted assets, reducing the sensitivity of the Group's tier 1 capital ratio to movements in foreign currency exchange rates.

## Risk and capital management

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### Market turmoil exposures

#### Explanatory note

These disclosures are focused around certain of the Group's exposures which have been particularly affected by the widespread market disruptions. They reflect the recommendations in the report of the Financial Stability Forum on Enhancing Market and Institutional Resilience and Committee of European Banking Supervisors report on banks' transparency on activities and products affected by the recent market turmoil.

#### Acronyms used in Market turmoil exposures section

The following acronyms are used in this section

ABCP	Asset-backed commercial paper
ABS	Asset-backed security
CDO	Collateralised debt obligation
CDPC	Credit derivative product company
CDS	Credit default swap
CLO	Collateralised loan obligation
CP	Commercial paper
CMBS	Commercial mortgage-backed security
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Corporation
Ginnie Mae	Government National Mortgage Association
GSE	Government Sponsored Entity
IASB	International Accounting Standards Board
RoW	Rest of the world, excluding Europe and US
RMBS	Residential mortgage-backed security
SIV	Structured investment vehicle
SPE	Special purpose entity
US agencies	Ginnie Mae, Fannie Mae, Freddie Mac and similar entities

## Risk and capital management

### Market turmoil exposures (continued)

#### Asset-backed exposures

The carrying value of the Group's debt securities at 30 June 2009 was £229.1 billion compared to £253.2 billion at 31 December 2008 ('2008'). This comprised securities issued by central and local governments of £104.7 billion (2008 - £95.0 billion), asset-backed securities of £90.5 billion (2008 - £111.1 billion), £13.4 billion (2008 - £15.0 billion) of securities issued by banks and building societies and £20.5 billion (2008 - £32.0 billion) issued by corporates, US federal agencies and other entities. This section focuses on asset-backed securities, an area of interest following the market dislocations in 2008.

The Group's credit market activities give rise to risk concentrations that have been particularly affected by the market turmoil experienced since the second half of 2007. The Group structures, originates, distributes and trades debt in the form of loan, bond and derivative instruments in all major currencies and debt capital markets in North America, Western Europe, Asia and major emerging markets.

The tables below summarise the net exposures and balance sheet carrying values of these securities by measurement classification, product and geography of underlying assets at 30 June 2009 ('2009') and 31 December 2008.

	Held-for-trading		Available-for-sale		Loans and receivables		Designated at fair value		Total	
	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Net exposure (1)										
RMBS: G10 governments (2)	16,228	18,631	29,649	32,926	-	-	-	-	45,877	51,557
RMBS: other	4,003	5,831	7,559	11,524	2,602	2,578	133	182	14,297	20,115
CMBS	1,326	1,178	1,531	918	1,413	1,437	193	13	4,463	3,546
CDOs & CLOs	961	2,463	1,751	2,538	890	1,282	1	-	3,603	6,283
Other ABS	461	195	4,466	6,572	3,841	3,621	16	40	8,784	10,428
Total	22,979	28,298	44,956	54,478	8,746	8,918	343	235	77,024	91,929
Carrying value:										
RMBS: G10 governments (2)	16,228	18,631	29,649	32,926	-	-	-	-	45,877	51,557
RMBS: other	5,962	9,218	7,839	11,865	2,602	2,618	133	182	16,536	23,883
CMBS	2,241	2,751	1,704	1,126	1,413	1,437	204	13	5,562	5,327
CDOs & CLOs	6,629	7,774	5,159	9,579	890	1,284	1	-	12,679	18,637
Other ABS	1,479	1,505	4,466	6,572	3,841	3,621	16	41	9,802	11,739
Total	32,539	39,879	48,817	62,068	8,746	8,960	354	236	90,456	111,143

#### Notes:

- (1) Net exposures represent the carrying value after taking account of hedge protection purchased from monolines and other counterparties but exclude the effect of counterparty credit valuation adjustments. The hedges provide credit protection of principal and interest cash flows in the event of default by the counterparty. The value of this protection is based on the underlying instrument being protected.
- (2) RMBS: G10 government securities comprises securities that are:
  - (a) guaranteed or effectively guaranteed by the US government, via its support for US federal agencies and GSEs.
  - (b) guaranteed by the Dutch government.
  - (c) covered bonds, referencing primarily Dutch and Spanish government-backed loans.

## Risk and capital management

### Market turmoil exposures (continued)

#### Asset-backed exposures (continued)

	US		UK		Europe		RoW		Total	
	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Net exposure:										
RMBS: G10 governments	30,798	33,508	271	321	14,771	17,682	37	46	45,877	51,557
RMBS: other	4,589	7,012	5,521	6,981	3,728	5,592	459	530	14,297	20,115
CMBS	2,691	1,147	1,115	1,225	618	1,095	39	79	4,463	3,546
CDOs & CLOs	1,886	3,276	124	386	1,578	2,450	15	171	3,603	6,283
Other ABS	2,392	3,508	1,154	1,368	4,644	4,299	594	1,253	8,784	10,428
Total	42,356	48,451	8,185	10,281	25,339	31,118	1,144	2,079	77,024	91,929
Carrying value:										
RMBS: G10 governments	30,798	33,508	271	321	14,771	17,682	37	46	45,877	51,557
RMBS: other	5,067	8,558	6,243	8,105	4,719	6,593	507	627	16,536	23,883
CMBS	3,201	2,144	1,199	1,395	1,017	1,646	145	142	5,562	5,327
CDOs & CLOs	10,094	14,703	224	588	2,185	3,046	176	300	12,679	18,637
Other ABS	2,966	3,582	1,252	1,622	4,694	5,098	890	1,437	9,802	11,739
Total	52,126	62,495	9,189	12,031	27,386	34,065	1,755	2,552	90,456	111,143

## Risk and capital management

### Market turmoil exposures (continued)

#### Asset-backed exposures (continued)

Asset backed securities ('ABS') are securities with an interest in an underlying pool of referenced assets. The risks and rewards of the referenced pool are passed on to investors by the issue by a special purpose entity of securities with varying seniority. The tables below analyse carrying values of the Group's ABS by rating, measurement classification and fair value hierarchy level.

30 June 2009	RMBS				CMBS £m	CDOs & CLOs £m	Other ABS £m	Total £m
	G10 govern- ments £m	Prime £m	Non conforming £m	Sub-prime £m				
AAA rated:(1)								
Held-for-trading	16,228	4,317	194	306	1,789	3,816	486	27,136
Available-for-sale	29,261	4,786	706	401	1,311	4,014	3,341	43,820
Loans and receivables	-	582	1,327	194	229	320	939	3,591
Designated at fair value	-	120	-	13	199	-	-	332
	45,489	9,805	2,227	914	3,528	8,150	4,766	74,879
BBB- and above rated:(1)								
Held-for-trading	-	640	67	230	416	771	634	2,758
Available-for-sale	388	867	245	200	271	461	988	3,420
Loans and receivables	-	163	156	159	1,169	549	1,972	4,168
Designated at fair value	-	-	-	-	5	-	16	21
	388	1,670	468	589	1,861	1,781	3,610	10,367
Non-investment grade:(1)								
Held-for-trading	-	24	91	92	36	1,439	70	1,752
Available-for-sale	-	257	265	111	3	411	17	1,064
Loans and receivables	-	6	5	10	7	-	285	313
Designated at fair value	-	-	-	-	-	-	-	-
	-	287	361	213	46	1,850	372	3,129
Not publicly rated:								
Held-for-trading	-	1	-	-	-	603	289	893
Available-for-sale	-	-	1	-	119	273	120	513
Loans and receivables	-	-	-	-	8	21	645	674
Designated at fair value	-	-	-	-	-	1	-	1
	-	1	1	-	127	898	1,054	2,081
Total:								
Held-for-trading	16,228	4,982	352	628	2,241	6,629	1,479	32,539
Available-for-sale	29,649	5,910	1,217	712	1,704	5,159	4,466	48,817
Loans and receivables	-	751	1,488	363	1,413	890	3,841	8,746
Designated at fair value	-	120	-	13	204	1	16	354
Total	45,877	11,763	3,057	1,716	5,562	12,679	9,802	90,456
Of which carried at fair value:								
Level 2(2)	45,877	10,562	1,559	1,342	3,794	9,611	5,301	78,046
Level 3(3)	-	448	11	11	355	2,180	658	3,663
	45,877	11,010	1,570	1,353	4,149	11,791	5,959	81,709

## Risk and capital management

### Market turmoil exposures (continued)

#### Asset-backed exposures (continued)

	RMBS				CMBS £m	CDOs & CLOs £m	Other ABS £m	Total £m
	G10 govern- ments £m	Prime £m	Non conforming £m	Sub- prime £m				
<b>31 December 2008</b>								
AAA rated:(1)								
Held-for-trading	18,622	6,226	203	393	2,306	4,698	380	32,828
Available-for-sale	32,926	8,384	1,914	522	982	6,459	4,826	56,013
Loans and receivables	-	476	1,415	431	405	652	1,443	4,822
Designated at fair value	-	166	-	16	9	-	-	191
	51,548	15,252	3,532	1,362	3,702	11,809	6,649	93,854
BBB- and above rated:(1)								
Held-for-trading	-	985	79	564	407	1,439	890	4,364
Available-for-sale	-	338	194	267	144	1,642	1,292	3,877
Loans and receivables	-	94	64	105	1,031	561	1,296	3,151
Designated at fair value	-	-	-	-	4	-	41	45
	-	1,417	337	936	1,586	3,642	3,519	11,437
Non-investment grade:(1)								
Held-for-trading	-	59	69	636	38	1,299	120	2,221
Available-for-sale	-	47	74	124	-	1,057	50	1,352
Loans and receivables	-	-	3	30	-	-	72	105
Designated at fair value	-	-	-	-	-	-	-	-
	-	106	146	790	38	2,356	242	3,678
Not publicly rated:								
Held-for-trading	9	2	1	1	-	338	115	466
Available-for-sale	-	-	1	-	-	421	404	826
Loans and receivables	-	-	-	-	1	71	810	882
Designated at fair value	-	-	-	-	-	-	-	-
	9	2	2	1	1	830	1,329	2,174
Total:								
Held-for-trading	18,631	7,272	352	1,594	2,751	7,774	1,505	39,879
Available-for-sale	32,926	8,769	2,183	913	1,126	9,579	6,572	62,068
Loans and receivables	-	570	1,482	566	1,437	1,284	3,621	8,960
Designated at fair value	-	166	-	16	13	-	41	236
Total	51,557	16,777	4,017	3,089	5,327	18,637	11,739	111,143
Of which carried at fair value:								
Level 2(2)	51,322	16,062	2,485	2,459	3,316	14,643	6,677	96,964
Level 3(3)	235	145	50	64	574	2,710	1,441	5,219
	51,557	16,207	2,535	2,523	3,890	17,353	8,118	102,183

#### Notes:

- (1) Credit ratings are based on those from rating agencies Standard & Poor's (S&P). Moody's and Fitch and have been mapped onto the S&P scale.
- (2) Valuation is based significantly on observable market data. Instruments in this category are valued using:
  - (a) quoted prices for identical instruments in markets which are not considered to be active; or quoted prices for similar instruments trading in active or not so active markets; or
  - (b) valuation techniques where all the inputs that have a significant effect on the valuation are directly or indirectly based on observable market data.
- (3) Instruments in this category have been valued using a valuation technique where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data.

### Market turmoil exposures (continued)

#### Residential mortgage-backed securities

Residential mortgage backed securities ('RMBS') are securities that represent an interest in a portfolio of residential mortgages. Repayments made on the underlying mortgages are used to make payments to holders of the RMBS. The risk of the RMBS will vary primarily depending on the quality of the underlying mortgages and the credit enhancement in the securitisation structure.

Several tranches of notes are issued, each secured against the same portfolio of mortgages, but providing differing levels of seniority to match the risk appetite of investors. The most junior (or equity) notes will suffer early capital and interest losses experienced by the referenced mortgage collateral, with each more senior note benefiting from the protection provided by the subordinated notes below. Additional credit enhancements may be provided to the holder of senior RMBS notes, including guarantees over the value of the exposures, often provided by monoline insurers.

The Group's ABS are analysed below by geographic region and nature of collateral. The US market has more established definitions for the quality of the underlying mortgage collateral and these are used as the basis for the Group's RMBS categorisation:

**G10 governments** – collateral comprises guaranteed mortgages and covered mortgage bonds. Guaranteed mortgages are mortgages that form part of a mortgage backed security issuance by a government agency, or in the US, an entity that benefits from a guarantee (direct or indirect) provided by the US government. For US RMBS, this category includes, amongst others, RMBS issued by US agencies such as Ginnie Mae, Freddie Mac and Fannie Mae. For European RMBS this includes mortgages guaranteed by the Dutch government. Covered mortgage bonds, primarily referencing Dutch and Spanish government-backed loans, are debt instruments that have recourse to a pool of mortgage assets, where investors have a preferred claim if a default occurs. These underlying assets are segregated from the other assets held by the issuing entity.

**Prime** – the underlying mortgages are of a higher credit quality than non-conforming and sub-prime mortgages (see below), but exclude G10 government mortgages.

**Non-conforming (or 'Alt-A' used for US exposures)** – the underlying mortgages have a higher credit quality than sub-prime mortgages, but lower than those for prime borrowers. Within the US mortgage industry, non-conforming mortgages are those that do not meet the lending criteria for US agency mortgages (described above). For non-US mortgages, judgement is applied in identifying loans with similar characteristics to US non-conforming loans, and also includes self-certified loans. Alt-A describes a category of mortgages in which lenders consider the risk to be greater than prime mortgages though less than sub-prime. The offered interest rate is usually representative of the associated risk level.

**Sub-prime** – the underlying mortgages are loans to sub-prime borrowers typically having weakened credit histories that include payment delinquencies, and potentially more severe problems such as court judgements and bankruptcies. They may also display reduced repayment capacity as measured by credit scores, high debt-to-income ratios, or other criteria indicating heightened risk of default.

## Risk and capital management

### Market turmoil exposures (continued)

#### Residential mortgage-backed securities (continued)

The tables below show the Group's RMBS net exposures and carrying values by underlying asset type, measurement classification, the geographical location of the property securing the mortgage and the year in which the underlying securitisation was originated.

	30 June 2009					31 December 2008				
	G10 govern- ments £m	Prime £m	Non conforming £m	Sub- prime £m	Total £m	G10 govern- ments £m	Prime £m	Non conforming £m	Sub- prime £m	Total £m
<b>Total</b>										
Net exposure:(1)										
Held-for-trading	16,228	3,218	346	439	20,231	18,631	5,140	346	345	24,462
Available-for-sale	29,649	5,910	1,217	432	37,208	32,926	8,768	2,184	572	44,450
Loans and receivables	-	751	1,488	363	2,602	-	569	1,482	527	2,578
Designated at fair value	-	120	-	13	133	-	166	-	16	182
	45,877	9,999	3,051	1,247	60,174	51,557	14,643	4,012	1,460	71,672
Carrying values:(2)										
Held-for-trading	16,228	4,982	352	628	22,190	18,631	7,272	352	1,594	27,849
Available-for-sale	29,649	5,910	1,217	712	37,488	32,926	8,769	2,183	913	44,791
Loans and receivables	-	751	1,488	363	2,602	-	570	1,482	566	2,618
Designated at fair value	-	120	-	13	133	-	166	-	16	182
	45,877	11,763	3,057	1,716	62,413	51,557	16,777	4,017	3,089	75,440

#### Notes:

- (1) Net exposures represent the carrying value after taking account of hedge protection purchased from monolines and other counterparties but excludes the effect of counterparty credit valuation adjustment. Carrying value is the amount recorded on the balance sheet.
- (2) Carrying value is the amount recorded on the balance sheet.
- (3) G10 government RMBS net exposures and carrying values include:
  - (a) £6.7 billion (2008 - £7.6 billion) available-for-sale exposures guaranteed by the Dutch government.
  - (b) £6.9 billion (2008 - £5.7 billion) guaranteed by the US government via Ginnie Mae of which £1.1 billion (2008 - £0.5 billion) are held-for-trading.
  - (c) £23.8 billion (2008 - £27.8 million) effectively guaranteed by the US government by way of its support for Freddie Mac and Fannie Mae of which £15.1 billion (2008 - £18.1 billion) are held-for-trading.
  - (d) £8.0 billion (2008 - £10.0 billion) all classified as available-for-sale, covered bonds.



## Risk and capital management

### Market turmoil exposures (continued)

#### Residential mortgage-backed securities (continued)

	30 June 2009					31 December 2008				
	US agency £m	Prime £m	Alt-A £m	Sub-prime £m	Total £m	US agency £m	Prime £m	Alt-A £m	Sub-prime £m	Total £m
<b>United States</b>										
Net exposure:										
Held-for-trading	16,191	433	346	439	17,409	18,577	968	346	302	20,193
Available-for-sale	14,607	2,667	566	51	17,891	14,932	4,364	760	53	20,109
Loans and receivables	-	84	-	3	87	-	215	-	3	218
	30,798	3,184	912	493	35,387	33,509	5,547	1,106	358	40,520
Carrying values:										
Held-for-trading	16,191	490	353	575	17,609	18,577	1,043	352	1,427	21,399
Available-for-sale	14,607	2,668	566	328	18,169	14,932	4,364	760	394	20,450
Loans and receivables	-	84	-	3	87	-	215	-	3	218
	30,798	3,242	919	906	35,865	33,509	5,622	1,112	1,824	42,067
Of which originated in:										
2004 and earlier	8,260	701	95	308	9,364	5,534	709	122	474	6,839
2005	3,131	801	501	164	4,597	6,014	2,675	718	259	9,666
2006	1,039	925	105	187	2,256	1,690	614	115	718	3,136
2007 and later	18,368	815	218	247	19,648	20,271	1,624	157	373	22,425
	30,798	3,242	919	906	35,865	33,509	5,622	1,112	1,824	42,067

	30 June 2009					31 December 2008				
	Guaranteed £m	Prime £m	Non conforming £m	Sub-prime £m	Total £m	Guaranteed £m	Prime £m	Non conforming £m	Sub-prime £m	Total £m
<b>United Kingdom</b>										
Net exposure:										
Held-for-trading	-	239	-	-	239	9	249	-	33	291
Available-for-sale	271	2,493	651	79	3,494	313	3,133	1,423	154	5,023
Loans and receivables	-	314	1,364	248	1,926	-	118	1,482	205	1,805
Designated at fair value	-	120	-	13	133	-	166	-	16	182
	271	3,166	2,015	340	5,792	322	3,666	2,905	408	7,301
Carrying values:										
Held-for-trading	-	954	-	5	959	9	1,336	-	70	1,415
Available-for-sale	271	2,493	651	81	3,496	313	3,133	1,423	154	5,023
Loans and receivables	-	314	1,364	248	1,926	-	118	1,482	205	1,805
Designated at fair value	-	120	-	13	133	-	166	-	16	182
	271	3,881	2,015	347	6,514	322	4,753	2,905	445	8,425
Of which originated in:										
2004 and earlier	7	273	-	32	312	9	806	-	72	887
2005	-	776	-	24	800	-	1,000	652	42	1,694
2006	8	1,957	464	127	2,556	13	2,295	756	209	3,273
2007 and later	256	875	1,551	164	2,846	300	652	1,497	122	2,571
	271	3,881	2,015	347	6,514	322	4,753	2,905	445	8,425

## Risk and capital management

### Market turmoil exposures (continued)

#### Residential mortgage-backed securities (continued)

	30 June 2009					31 December 2008				
	Guaranteed (1) £m	Covered bonds (2) £m	Prime and non-conforming (3) £m	Sub- prime £m	Total £m	Guaranteed (1) £m	Covered bonds (2) £m	Prime £m	Sub-prime £m	Total £m
<b>Europe</b>										
Net exposure										
Held-for-trading	-	-	2,542	-	2,542	-	-	3,898	10	3,908
Available-for-sale	6,722	8,049	592	41	15,404	7,642	10,040	1,106	57	18,845
Loans and receivables	-	-	450	103	553	-	-	208	313	521
	6,722	8,049	3,584	144	18,499	7,642	10,040	5,212	380	23,274
Carrying values										
Held-for-trading	-	-	3,525	8	3,533	-	-	4,839	30	4,869
Available-for-sale	6,722	8,049	592	41	15,404	7,642	10,040	1,107	57	18,846
Loans and receivables	-	-	451	102	553	-	-	208	352	560
	6,722	8,049	4,568	151	19,490	7,642	10,040	6,154	439	24,275
Of which originated in:										
2004 and earlier	377	632	684	25	1,718	418	702	954	48	2,122
2005	1,033	2,364	754	27	4,178	1,165	2,993	1,090	17	5,265
2006	1,758	3,822	1,585	84	7,249	2,059	4,466	2,466	148	9,139
2007 and later	3,554	1,231	1,545	15	6,345	4,000	1,879	1,644	226	7,749
	6,722	8,049	4,568	151	19,490	7,642	10,040	6,154	439	24,275

#### Notes:

- (1) Guaranteed by the Dutch government
- (2) Covered bonds referencing primarily Dutch and Spanish mortgages
- (3) Non-conforming net exposures and carrying values: £123 million at 30 June 2009 (2008 – nil)

## Risk and capital management

### Market turmoil exposures (continued)

#### Residential mortgage-backed securities (continued)

	30 June 2009				31 December 2008			
	Guaranteed £m	Prime £m	Sub-prime £m	Total £m	Guaranteed £m	Prime £m	Sub-prime £m	Total £m
<b>Rest of the World</b>								
Net exposure								
Held-for-trading	37	4	-	41	46	24	-	70
Available-for-sale	-	156	263	419	-	164	308	472
Loans and receivables	-	28	8	36	-	28	6	34
	37	188	271	496	46	216	314	576
Carrying values								
Held-for-trading	37	11	41	89	46	54	67	167
Available-for-sale	-	157	262	419	-	164	308	472
Loans and receivables	-	28	8	36	-	28	6	34
	37	196	311	544	46	246	381	673
Of which originated in:								
2004 and earlier	-	25	58	83	-	37	65	102
2005	-	1	33	34	-	30	34	64
2006	37	3	175	215	46	2	187	235
2007 and later	-	167	45	212		177	95	272
	37	196	311	544	46	246	381	673

## Risk and capital management

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### Market turmoil exposures (continued)

#### Residential mortgage-backed securities (continued)

**US** - the Group's largest concentration of RMBS assets is the portfolio of US agency asset-backed securities comprising mainly current year vintage positions amounting to £30.8 billion at 30 June 2009 (2008: £33.5 billion). Due to the US government backing, explicit or implicit, in these securities, the counterparty credit risk exposure is low. £16.2 billion (2008: £18.6 billion) is held in actively traded portfolios, actively transacted, and possesses a high degree of liquidity. Trading in this portfolio has driven a shift to more recent vintages. However, the majority of the decrease in exposure during the period has been due to the strengthening of sterling against the US dollar. Available-for-sale exposures of £14.6 billion (£14.9 billion) relate to liquidity portfolios held by US Retail & Commercial.

**Europe** - these are liquidity portfolios comprising £6.7 billion (2008 - £7.6 billion) available-for-sale portfolio of European RMBS, referencing primarily Dutch and Spanish government-backed loans and £8.0 billion (2008 - £10.0 billion) of European RMBS comprised covered mortgage bonds. The decrease in both of these portfolios primarily reflects exchange rate movements. These exposures are part of the liquidity portfolios held by Group Treasury.

**UK and the rest of the world** - the Group has other portfolios of RMBS from secondary trading activities, warehoused positions previously acquired with the intention of further securitisation and a portfolio of assets from the unwinding of a securities arbitrage conduit. This conduit was established to benefit from the margin between the assets purchased and the notes issued.

Material disposals of prime RMBS occurred in the period, in particular £1.5 billion of 2005 vintage US securities, £0.5 billion of Spanish and Portuguese mortgages and £0.6 billion of positions which have synthetic hedges against them. Other declines were due to redemptions and foreign exchange movements. Sub-prime balances reduced across ratings, geographies and vintages, due to pay downs, maturities and sales during the period, while non-conforming exposures fell mainly due to UK available-for-sale redemptions.

## Risk and capital management

### Market turmoil exposures (continued)

#### Commercial mortgage-backed securities

Commercial mortgage-backed securities ('CMBS') are securities that are secured by loans mortgaged on commercial land and buildings. The securities are structured in the same way as an RMBS but typically the underlying assets referenced will be of greater individual value. The performance of the securities is dependent on the sector of the occupier of the commercial property and the geographical region.

The Group accumulated CMBS for the purpose of re-securitisation and secondary trading. The largest holding of CMBS arose as a result of the Group's purchase of senior tranches in mezzanine and high grade CMBS structures from third parties. These securities are predominantly hedged with monoline insurers. As a result, the Group's risk is limited to the counterparty credit risk exposure on the hedge provider.

The following table shows the composition of the Group's holdings of CMBS portfolios.

	30 June 2009					31 December 2008				
	US £m	UK £m	Europe £m	RoW £m	Total £m	US £m	UK £m	Europe £m	RoW £m	Total £m
US federal agency	1,418	n/a	n/a	n/a	1,418	649	n/a	n/a	n/a	649
Office	641	770	242	-	1,653	428	915	402	-	1,745
Retail	460	45	66	39	610	295	43	2	49	389
Mixed use	62	27	473	3	565	20	99	975	45	1,139
Multi-family	279	131	3	-	413	159	143	-	-	302
Hotel	119	26	-	-	145	40	35	-	-	75
Healthcare	1	30	75	-	106	24	13	81	-	118
Leisure	-	77	-	-	77	-	76	-	-	76
Industry	63	-	8	-	71	40	-	49	-	89
Other	159	92	150	103	504	490	71	137	47	745
	3,202	1,198	1,017	145	5,562	2,145	1,395	1,646	141	5,327

Underlying CMBS carrying values declined due to foreign exchange movements driven by the strengthening of sterling against the US dollar and the euro, as well as modest pay downs, sales and write-downs. This was partially offset by revised asset classifications, including US federal agency issued securities.

There have been no material acquisitions of CMBS by the Group in the period. Where exposures within CMBS types have increased, this is due to a change of sector exposure from permitted substitutions, particularly within US structures, and revised sector classifications.

#### Asset-backed collateralised debt and loan obligations

Collateralised debt obligations ('CDOs') are securities whose performance is dependant on a portfolio of underlying cash and synthetic exposures to referenced assets generally ABS, but may also include other classes of assets. The collateralised loan obligations ('CLOs') have referenced portfolios which primarily consist of leveraged loans.

The Group's ABS CDO and CLO net exposures comprised:

	30 June 2009 £m	31 December 2008 £m
Super senior CDOs	548	1,182
Other CDOs	909	1,658
CLOs	2,146	3,443
	3,603	6,283

## Risk and capital management

### Market turmoil exposures (continued)

The Group's CDO exposures comprise:

- Super senior CDO risk structured by the Group from 2003 to 2007 that the Group was unable to sell to third parties due to prevailing illiquid markets, with net exposures of £0.5 billion (2008: £1.2 billion).
- Other CDO net exposures of £0.9 billion (2008: £1.7 billion) purchased from third parties, some of which are fully hedged through CDS with other banks or monoline insurers.

Given the significance of net losses incurred on super senior CDOs in recent years, additional disclosures on these exposures are discussed below.

#### Super senior CDOs

Super senior CDOs represent the most senior positions in a CDO. Instruments subordinate to the super senior CDO (usually a combination of equity, mezzanine and senior notes) absorb losses before the super senior note is affected. Losses will only be suffered by the super senior note holders once defaults on the underlying reference assets exceed a specified threshold. This threshold is usually referred to in terms of a percentage of defaults in the asset pool; known as the 'attachment point'. These super senior instruments carry an AAA rating at origination or are senior to other AAA rated notes in the same structure. The level of defaults occurring on recent vintage sub-prime mortgages and other asset classes has been higher than originally expected. As a result the protection afforded by the subordinate securities has been significantly eroded and consequently the super senior notes have a higher probability of suffering losses than at origination. The majority of the underlying collateral is now rated below investment grade.

Depending on the quality of the underlying reference assets on issue, the super senior tranches will be either classified as high grade or mezzanine. The majority of the Group's exposure relates to high grade super senior tranches of ABS CDOs. The table below summarises the carrying amounts and net exposures after hedge protection of the Group's super senior CDOs as at 30 June 2009. The collateral rating is determined with reference to S&P ratings where available. Where S&P ratings are not available the lower of Moody's and Fitch ratings have been used.

	30 June 2009 <sup>(1)</sup>			31 December 2008 <sup>(2)</sup>		
	High grade £m	Mezzanine £m	Total £m	High grade £m	Mezzanine £m	Total £m
Gross exposure	6,314	2,586	8,900	7,104	2,884	9,988
Hedges and protection	(3,040)	(614)	(3,654)	(3,423)	(691)	(4,114)
	3,274	1,972	5,246	3,681	2,193	5,874
Write-downs on net open positions and amortisations	(2,756)	(1,942)	(4,698)	(2,592)	(2,100)	(4,692)
Net exposure after hedges and write-downs	518	30	548	1,089	93	1,182
Average price	17%	3%	16%	29%	6%	23%

Notes:

- (1) Net exposure represents the carrying value after taking account of hedge protection purchased from monolines and other counterparties but excludes the effect of counterparty credit valuation adjustment; includes portfolios carried at fair value only.
- (2) Exposures at 31 December 2008 have been restated to reflect transactions that have been liquidated and now represent long positions in asset-backed securities.

## Risk and capital management

### Market turmoil exposures (continued)

The change in net exposure during the year is analysed in the table below.

	High grade £m	Mezzanine £m	Total £m
Net exposure at 1 January 2009	1,089	93	1,182
Write downs	(417)	(50)	(467)
Foreign exchange and other movements	(154)	(13)	(167)
Net exposure at 30 June 2009	518	30	548

During 2009 the super senior exposures, which are predominantly US positions, have fallen by approximately 50%. This reflects the further price declines in the underlying collateral as well as the foreign exchange effect as sterling has strengthened against the US dollar in the first half of 2009.

#### Other CDOs

The net exposure of the Group's other senior CDO exposures was £0.9 billion after hedge protection with financial institutions (more than 80%) or monolines. The unhedged exposures comprise smaller positions with various types of underlying collateral, rating and vintage characteristics. The positions hedged with derivative protection from financial institutions include a number of positions referencing early vintages of RMBS and other ABS assets. The Group therefore has no net exposure to these CDOs before credit valuation adjustment. Due to the early vintage, the assets underlying these structures have not deteriorated to the same degree as the more recently issued securities. During 2009 the other CDO exposures, which are predominantly US positions, have fallen significantly. This reflects further price declines in the underlying collateral as well as the strengthening of sterling against the US dollar in the first half of 2009. The price declines relate to exposures with more recent vintages.

#### CLOs

The Group's CLO exposures arise from its trading activities and consist of retained interests and from notes purchased from third-party structures. The Group holds super senior securities in two CLO structures which were originated by the Group in 2005 and 2007. The underlying collateral of these structures predominantly references leveraged loans.

In the first half of 2009, there were further write downs in line with the decline in the market, some deal amortisations and disposal of positions where market opportunities occurred.

## Risk and capital management

### Market turmoil exposures (continued)

#### Other asset backed securities

Other asset backed securities are securities issued by securitisation vehicles, similar to those in RMBS and CMBS structures, which reference cash flow generating assets other than mortgages. The wide variety of referenced underlying assets results in diverse asset performance levels.

The Group has accumulated these assets from a range of trading and funding activities. The carrying value of the Group's other asset-backed securities by underlying asset type and geographical region are shown below.

	30 June 2009					31 December 2008				
	US £m	UK £m	Europe £m	RoW £m	Total £m	US £m	UK £m	Europe £m	RoW £m	Total £m
Covered bonds	-	-	2,190	-	2,190	-	-	3,301	-	3,301
Consumer	245	182	1,071	499	1,997	956	408	118	729	2,211
Aircraft leases	380	13	8	65	466	459	23	-	273	755
Other leases	16	611	286	-	913	1	492	455	-	948
Student loans	694	-	-	-	694	953	-	-	-	953
Trade receivables	623	7	-	-	630	15	9	-	-	24
Utilities and energy	241	2	283	177	703	47	19	48	143	257
Auto and equipment	90	8	337	3	438	160	30	466	29	685
Film/entertainment	-	-	-	-	-	86	-	-	-	86
Other	677	429	519	146	1,771	904	641	710	263	2,518
	2,966	1,252	4,694	890	9,802	3,581	1,622	5,098	1,437	11,738

The covered bonds comprise asset-backed securities issued by Spanish financial institutions. These securities benefit from credit enhancement provided by the issuing institutions. The reduction in carrying value of the Group's Other ABS exposures reflects asset disposals, and the strengthening of sterling against the US dollar and the euro. There have been no material acquisitions of other ABS by the Group in the period. Where exposures within specific asset types have increased, this is due to a combination of permitted substitutions within structures and revised sector classifications, particularly in relation to other consumer and trade receivable positions.



## Risk and capital management

### Market turmoil exposures (continued)

#### Counterparty valuation adjustments

##### Credit valuation adjustments

Counterparty valuation adjustments ('CVAs') represent an estimate of the adjustment to fair value that a market participant would make to incorporate the credit risk inherent in counterparty derivative exposures. During 2009, as credit spreads of monoline insurers have generally widened, there has been an increase in the total CVA as set out in the table below.

	30 June 2009 £m	31 December 2008 £m
Monoline insurers	6,845	5,988
CDPCs	821	1,311
Other counterparties	1,821	1,738
Total CVA adjustments	9,487	9,037

The Group has purchased protection from monoline insurers ("monolines") mainly against specific ABS, CDOs and CLOs. Monolines are entities which specialise in providing credit protection against the notional and interest cash flows due to the holders of debt instruments in the event of default by the debt security counterparty. This protection is typically held in the form of derivatives such as credit default swaps ('CDS') referencing the underlying exposures held by the Group.

The Group has also purchased credit protection, both tranching and single name credit derivatives, from credit derivative product companies ('CDPC'). CDPCs are similar to monolines however they are not regulated as insurers. The Group's exposure to CDPCs is predominantly due to tranching credit derivatives ("tranches"). A tranche references a portfolio of assets and provides protection against total portfolio default losses exceeding a certain percentage of the portfolio notional (the attachment point) up to another percentage (the detachment point). The Group has predominantly traded senior tranches with CDPCs, the average attachment and detachment points are 15% and 50% respectively, and the majority of the loans and bonds in the reference portfolios are investment grade.

The CVA for monolines is calculated on a trade-by-trade basis, and is derived using market observable monoline credit spreads. The majority of the monoline CVA relates to credit derivatives hedging exposures to ABS. The CDPC CVA is calculated using a similar approach. However, in the absence of market observable credit spreads, the cost of hedging the counterparty risk is estimated by analysing the underlying trades and the cost of hedging expected default losses in excess of the capital available in each vehicle.

The CVA for all other counterparties is calculated with reference to observable credit spreads. The calculation is performed on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the risk.

The widening of monoline credit spreads during the year contributed to a significant increase in the total size of CVA adjustments recorded.

## Risk and capital management

### Market turmoil exposures (continued)

#### Monoline insurers

The Group's monoline exposures are predominantly denominated in US dollars and the weakening of the US dollar against sterling has significantly reduced the gross exposure to these counterparties. This has been partially offset by an increase in the fair value of the CDS protection from monolines as the market price of the securities protected continued to decline.

The perceived credit quality of the monolines has also continued to deteriorate as reflected by ratings downgrades, wider credit spreads and lower recovery rate assumptions seen in the market. This has resulted in increased levels of CVA being recorded against the Group's monoline exposure.

Summary of the Group's exposure to monoline counterparties:

	30 June 2009 £m	31 December 2008 £m
Gross exposure to monolines	10,950	11,581
Hedges with financial institutions	(524)	(789)
Credit valuation adjustment	(6,845)	(5,988)
Net exposure to monolines	3,581	4,804

The net income statement effect arising from the change in level of monoline CVA and related trades is shown below. The US dollar weakening against sterling is the primary cause of the loss arising on foreign exchange, hedges and other movements.

	£m
Credit valuation adjustment at 1 January 2009	(5,988)
Credit valuation adjustment at 30 June 2009	(6,845)
Increase in credit valuation adjustment	(857)
Foreign exchange and other movements	(937)
Net effect relating to reclassified debt securities	(27)
	(1,821)

## Risk and capital management

### Market turmoil exposures (continued)

#### Monoline insurers (continued)

The asset categories protected by CDSs written by monolines and the related CVA by monoline credit rating at the balance sheet date are analysed in the table below.

	30 June 2009				31 December 2008			
	Notional amount: protected assets £m	Fair value: Protected assets £m	Gross exposure £m	Credit valuation adjustment £m	Notional amount: protected assets £m	Fair value: protected assets £m	Gross exposure £m	Credit valuation adjustment £m
AAA/AA rated:								
CDO of RMBS	-	-	-	-	-	-	-	-
RMBS	3	2	1	-	3	2	1	-
CMBS	503	357	146	61	613	496	117	51
CLOs	5,610	4,219	1,391	599	6,506	4,882	1,624	718
Other ABS	1,308	849	459	206	1,548	990	558	251
Other	265	174	91	44	267	167	100	47
	<b>7,689</b>	<b>5,601</b>	<b>2,088</b>	<b>910</b>	<b>8,937</b>	<b>6,537</b>	<b>2,400</b>	<b>1,067</b>
A/BBB rated:								
CDO of RMBS	-	-	-	-	5,385	1,363	4,022	1,938
RMBS	-	-	-	-	90	63	27	10
CMBS	-	-	-	-	4,236	1,892	2,344	1,378
CLOs	-	-	-	-	6,009	4,523	1,486	778
Other ABS	-	-	-	-	910	433	477	243
Other	-	-	-	-	265	122	143	79
	-	-	-	-	<b>16,895</b>	<b>8,396</b>	<b>8,499</b>	<b>4,426</b>
Sub-investment grade:								
CDO of RMBS	4,972	687	4,285	2,745	394	32	362	263
RMBS	76	64	12	2	-	-	-	-
CMBS	3,757	1,212	2,545	1,886	-	-	-	-
CLOs	4,953	3,795	1,158	797	350	268	82	60
Other ABS	1,747	1,129	618	353	1,208	1,037	171	123
Other	488	244	244	152	237	169	68	49
	<b>15,993</b>	<b>7,131</b>	<b>8,862</b>	<b>5,935</b>	<b>2,189</b>	<b>1,506</b>	<b>683</b>	<b>495</b>
Total:								
CDO of RMBS	4,972	687	4,285	2,745	5,779	1,395	4,384	2,201
RMBS	79	66	13	2	93	65	28	10
CMBS	4,260	1,569	2,691	1,947	4,849	2,388	2,461	1,429
CLOs	10,563	8,014	2,549	1,396	12,865	9,673	3,192	1,557
Other ABS	3,055	1,978	1,077	559	3,666	2,460	1,206	616
Other	753	418	335	196	769	458	311	176
	<b>23,682</b>	<b>12,732</b>	<b>10,950</b>	<b>6,845</b>	<b>28,020</b>	<b>16,439</b>	<b>11,581</b>	<b>5,988</b>

The Group also has indirect exposure to monolines through wrapped securities and other assets with credit enhancement monolines. These securities are traded with the benefit of this credit enhancement. Any deterioration in the credit rating of the monoline is reflected in the fair value of these assets.

## Risk and capital management

### Market turmoil exposures (continued)

#### Credit derivative product companies

The Group's exposure to CDPCs has reduced considerably due to a combination of tighter credit spreads and a decrease in the relative value of senior tranches compared to the underlying reference portfolios. The trades with CDPCs are predominantly denominated in US and Canadian dollars and therefore the strengthening of sterling against these currencies has further reduced the exposure.

The overall level of CVA has decreased in line with the reduction in the exposure, however, on a relative basis the CVA has increased. This reflects the perceived deterioration of the credit quality of the CDPCs as reflected by ratings downgrades.

Summary of the Group's exposure to CDPC:

	30 June 2009 £m	31 December 2008 £m
Gross exposure to CDPCs	2,303	4,776
Credit valuation adjustment	(821)	(1,311)
Net exposure to CDPCs	1,482	3,465

The net income statement effect arising from the change in level of CVA and related trades is shown in the table below. The Group has additional market risk hedges in place which effectively cap the exposure to CDPCs where the Group has significant risk. As the exposure to these CDPCs has reduced, losses have been incurred on the additional hedges. These losses, together with losses arising on trades hedging CVA, are the primary cause of the loss arising on hedges, foreign exchange and other movements.

	£m
Credit valuation adjustment at 1 January 2009	(1,311)
Credit valuation adjustment at 30 June 2009	(821)
Decrease in credit valuation adjustment	490
Hedges, foreign exchange and other movements	(1,059)
	(569)

## Risk and capital management

### Market turmoil exposures (continued)

#### Credit derivative product companies (continued)

Further analysis of the Group's exposure to CDPCs by CDPC credit rating is shown below. Some of the CDPCs with the AAA/AA and A/BBB rating at 31 December 2008 were subsequently downgraded or had ratings withdrawn.

	30 June 2009				31 December 2008			
	Notional amount: protected assets £m	Fair value: protected reference assets £m	Gross exposure £m	Credit valuation adjustment £m	Notional amount: protected assets £m	Fair value: protected reference assets £m	Gross exposure £m	Credit valuation adjustment £m
AAA/AA rated	1,636	1,580	56	18	19,092	15,466	3,626	908
A/BBB rated	15,965	14,484	1,481	470	6,147	4,997	1,150	403
Sub-investment grade	1,399	1,097	302	151	-	-	-	-
Rating withdrawn	3,914	3,450	464	182	-	-	-	-
	22,914	20,611	2,303	821	25,239	20,463	4,776	1,311

## Risk and capital management

### Market turmoil exposures (continued)

#### Leveraged finance

Leveraged finance is employed to facilitate corporate finance transactions, such as acquisitions or buy-outs. A bank acting as a lead manager will typically underwrite a loan, alone or with others, and then syndicate the loan to other participants ('syndicate portfolio'). The Group has typically also held a portion of these loans as part of its long term portfolio once primary syndication is completed ('hold portfolio').

Since the beginning of the credit market dislocation in the second half of 2007, investor appetite for leveraged loans and similar risky assets has fallen dramatically, with secondary prices falling due to selling pressure and margins increasing, and reduced activity in the primary market. There were a small number of modest deals with reduced leverage executed in the first half of 2008 priced at less than mid-2007 levels. Concerted efforts to sell positions during the first half of 2008 were only partially successful due to the rapid deterioration in market conditions since origination of the loans. Most of the leveraged finance loans held as part of syndicated lending activity were reclassified from the held-for-trading to loans and receivables in the second half of 2008.

During the first half of 2009, there have been a small number of sales and further impairments have been recorded. The strengthening of sterling against other major currencies also had a substantial impact on this book, which has significant US dollar and euro positions.

The table below shows the Group's leveraged finance exposures by industry and geography.

	30 June 2009					31 December 2008				
	Americas £m	UK £m	Europe £m	RoW £m	Total £m	Americas £m	UK £m	Europe £m	RoW £m	Total £m
Gross exposure:										
TMT (1)	1,625	1,652	1,477	506	5,260	2,507	1,484	2,001	535	6,527
Industrial	1,616	1,553	1,641	175	4,985	1,686	1,612	1,924	188	5,410
Retail	69	1,134	1,327	79	2,609	268	1,285	1,440	89	3,082
Other	350	1,566	1,228	131	3,275	487	1,391	1,282	126	3,286
	3,660	5,905	5,673	891	16,129	4,948	5,772	6,647	938	18,305
Net exposure:										
TMT (1)	1,283	1,517	1,367	506	4,673	2,247	1,385	1,982	534	6,148
Industrial	578	1,126	1,416	172	3,292	607	1,157	1,758	186	3,708
Retail	69	537	1,257	79	1,942	223	978	1,424	89	2,714
Other	350	1,383	1,204	131	3,068	484	1,307	1,281	127	3,199
	2,280	4,563	5,244	888	12,975	3,561	4,827	6,445	936	15,769
Of which:										
Drawn	1,825	3,859	4,193	813	10,690	2,511	4,125	5,159	824	12,619
Undrawn	455	704	1,051	75	2,285	1,050	702	1,286	112	3,150
	2,280	4,563	5,244	888	12,975	3,561	4,827	6,445	936	15,769
Of which:										
Syndicate portfolio (2)	1,428	1,398	1,125	88	4,039	2,138	2,121	1,663	101	6,023
Hold portfolio	852	3,165	4,119	800	8,936	1,423	2,707	4,783	835	9,746
	2,280	4,563	5,244	888	12,975	3,561	4,827	6,445	936	15,769

Notes:

- (1) Telecommunications, media and technology
- (2) includes held-for-trading exposures of £38 million (2008 - £102 million)

## Risk and capital management

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### Market turmoil exposures (continued)

#### Leveraged finance (continued)

The table below analyses the movement in the amounts reported above.

	Drawn £m	Undrawn £m	Total £m
Balance at 1 January 2009	12,619	3,150	15,769
Transfers in (from credit trading business)	506	41	547
Sales	(327)	(147)	(474)
Repayments and facility reductions	(549)	(314)	(863)
Funded deals	97	(97)	-
Lapsed/collapsed deals	(28)	(19)	(47)
Changes in fair value	(34)	(6)	(40)
Accretion of interest	71	n/a	71
Impairment provisions	(679)	n/a	(679)
Exchange and other movements	(986)	(323)	(1,309)
Balance at 30 June 2009	10,690	2,285	12,975

## Risk and capital management

### Market turmoil exposures (continued)

#### SPEs and conduits

##### SPEs

For background on the Group's involvement with securitisations and special purpose entities ('SPEs'), refer to Business Review – SPEs and conduits in the Annual Report and Accounts 2008.

The table below sets out the asset categories together with the carrying amount of the assets and associated liabilities for those securitisations and other asset transfers, other than conduits (discussed below), where the assets continue to be recorded on the Group's balance sheet.

	30 June 2009		31 December 2008	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Residential mortgages	62,799	17,812	49,184	20,075
Credit card receivables	2,975	1,567	3,004	3,197
Other loans	10,472	1,031	1,679	1,071
Finance lease receivables	950	750	1,077	857

The increase in residential mortgage and other loan assets above primarily relate to balances that have been securitised to facilitate access to central bank special liquidity schemes. As all the notes issued by the SPEs are purchased by Group companies, securitised assets are significantly greater than secured liabilities.

##### Conduits

The Group sponsors and administers a number of asset-backed commercial paper ('ABCP') conduits. A conduit is an SPE that issues commercial paper and uses the proceeds to purchase or fund a pool of assets. The commercial paper is secured on the assets and is redeemed either by further commercial paper issuance, repayment of assets or funding from liquidity facilities. Commercial paper is short-dated, typically up to three months.

The Group's conduits can be divided into multi-seller conduits and own-asset conduits. The Group consolidates both types of conduit where the substance of the relationship between the Group and the conduit vehicle is such that the vehicle is controlled by the Group. The Group also extends liquidity commitments to multi-seller conduits sponsored by other banks, but typically does not consolidate these entities.

##### Funding and liquidity

The Group's multi-seller conduits have continued to fund the vast majority of their assets solely through ABCP issuance. There have been no significant systemic failures within the financial markets similar to that experienced in the second half of 2008 following Lehman Brothers bankruptcy filing in September 2008. The improvement in market conditions has allowed these conduits to move towards more normal ABCP funding and reduced the need for backstop funding from the Group.

The Group's own-asset conduit programmes have been established to diversify the Group's funding. The conduits allow the Group to access central government funding schemes and the external ABCP market.

The average maturity of ABCP issued by the Group's conduits as at 30 June 2009 was 55.2 days compared with 72.1 days at 31 December 2008 due to a combination of restructured deals having shorter terms than normal rolling periods and effect of issuers seeking longer terms at end of any year due to general illiquidity at the end of the year/early January.



## Risk and capital management

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### Market turmoil exposures (continued).

The total assets held by the Group's sponsored conduits are £35.0 billion (31 December 2008 - £49.9 billion). Since the related backstop liquidity facilities are sanctioned on the basis of total conduit purchase commitments, the liquidity facility commitments exceed the level of assets held, with the difference representing undrawn commitments.

### Multi-seller conduits

The Group sponsors six multi-seller conduits which finance assets from Europe, North America and Asia-Pacific. Assets purchased or financed by the multi-seller conduits include auto loans, residential mortgages, credit card receivables, consumer loans and trade receivables. These conduits were established to provide customers of the Group access to diversified and flexible funding sources.

The third-party assets financed by the conduits receive credit enhancement from the originators of the assets. This credit enhancement, which is specific to each transaction, can take the form of over-collateralisation, excess spread or subordinated loan, and typically ensures the asset acquired by the conduit has a rating equivalent to at least a single-A credit. In addition, in line with general market practice, the Group provides a small second-loss layer of programme-wide protection to the multi-seller conduits. Given the nature and investment grade equivalent quality of the first loss enhancement provided by the originators of the assets, the Group has only a minimal risk of loss on its programme wide exposure. The issued ABCP is rated A-1 / P-1 by Moody's and Standard & Poor's.

The Group provides liquidity back-up facilities to the conduits it sponsors. The conduits are able to draw funding under these facilities in the event of a disruption in the ABCP market, or when certain trigger events prevent the issue of ABCP. The maturity of commercial paper issued by the Group's conduits is managed to mitigate the short-term contingent liquidity risk of providing back-up facilities. Group limits sanctioned for such liquidity facilities as at 30 June 2009 totalled approximately £28.2 billion (31 December 2008 - £42.9 billion). For a very small number of transactions within one multi-seller conduit the liquidity facilities have been provided by third-party banks, this typically occurs on transactions where the third-party bank does not use, or have, its own conduit vehicles.

The multi-seller conduits form the majority of the Group's conduit business (64.2% (31 December 2008 - 69.4%).

The Group's maximum exposure to loss on its multi-seller conduits is £28.3 billion (31 December 2008 - £43.2 billion), being the total amount of the Group's liquidity commitments plus the extent of programme-wide credit enhancements of conduit assets for which liquidity facilities were provided by third parties.

### Own-asset conduits

The Group also holds three own-asset conduits which have assets that have previously been funded by the Group. These vehicles represent 28% (31 December 2008 - 25%) of the Group's conduit business (as a percentage of the total liquidity and credit enhancements committed by the Group), with £11.8 billion of ABCP outstanding at 30 June 2009 (31 December 2008 - £14.8 billion). The Group's maximum exposure to loss on its own-asset conduits is £12.9 billion (31 December 2008 - £15.9 billion), being the total drawn and undrawn amount of the Group's liquidity commitments to these conduits.

### Securitisation arbitrage conduits

The Group no longer sponsors any securitisation arbitrage conduits.

## Risk and capital management

### Market turmoil exposures (continued).

#### Conduits (continued)

The Group's exposure from conduits which are consolidated by the Group including those to which the Group is economically exposed on a shared basis with other consortium members and its involvement with third-party conduits, are set out below.

	30 June 2009			31 December 2008		
	Sponsored conduits £m	Third party £m	Total £m	Sponsored conduits £m	Third party £m	Total £m
Total assets held by the conduits	35,007			49,857		
Commercial paper issued	33,452			48,684		
Liquidity and credit enhancements:						
Deal specific liquidity:						
- drawn	1,440	2,361	3,801	1,172	3,078	4,250
- undrawn	39,744	1,161	40,905	57,929	198	58,127
Programme-wide liquidity:						
- drawn	-	99	99	-	102	102
- undrawn	-	-	-	-	504	504
PWCE (1)	1,663	-	1,663	2,391	-	2,391
	42,847	3,621	46,468	61,492	3,882	65,374
Maximum exposure to loss (2)	41,184	3,621	44,805	59,101	3,882	62,983

Notes:

(1) Programme-wide credit enhancement

(2) Maximum exposure to loss is determined as the Group's total liquidity commitments to the conduits and additionally programme-wide credit support which would absorb first loss on transactions where liquidity support is provided by a third party.

The Group's exposures from the conduit shared with the other consortium members is set out below:

	30 June 2009 £m	31 December 2008 £m
Total assets held by the conduits	11,189	13,286
Commercial paper issued	11,189	13,028
Liquidity and credit enhancements:		
Deal specific liquidity:		
- drawn	-	258
- undrawn	11,311	13,566
	11,311	13,824
Maximum exposure to loss	11,311	13,824

During the period both multi-seller and own asset conduit assets have been reduced in line with the wider Group balance sheet management.

## Risk and capital management

### Market turmoil exposures (continued)

#### Conduits (continued)

Collateral analysis, geographic, profile, credit ratings and weighted average lives of the assets in the assets relating to the Group's consolidated conduits and related undrawn commitments are set out in the tables below.

	Funded assets			Undrawn £m	Liquidity for third parties £m	Total exposure £m
	Loans £m	Securities £m	Total £m			
<b>30 June 2009</b>						
Auto loans	5,785	280	6,065	1,838	-	7,903
Corporate loans	213	9,193	9,406	186	-	9,592
Credit card receivables	3,375	-	3,375	1,601	-	4,976
Trade receivables	1,437	-	1,437	790	-	2,227
Student loans	1,260	-	1,260	265	(132)	1,393
Consumer loans	1,742	-	1,742	520	-	2,262
Mortgages:						
- Prime	3,971	1,900	5,871	230	-	6,101
- Non-conforming	1,821	-	1,821	468	-	2,289
- Sub-prime	-	-	-	-	-	-
- Commercial	656	499	1,155	87	(22)	1,220
- Buy-to-let	-	-	-	-	-	-
CDOs	-	-	-	-	-	-
Other	1,349	1,526	2,875	292	-	3,167
	<b>21,609</b>	<b>13,398</b>	<b>35,007</b>	<b>6,277</b>	<b>(154)</b>	<b>41,130</b>
<b>31 December 2008</b>						
Auto loans	9,924	383	10,307	1,871	-	12,178
Corporate loans	430	11,042	11,472	534	-	12,006
Credit card receivables	5,844	-	5,844	922	-	6,766
Trade receivables	2,745	-	2,745	1,432	(71)	4,106
Student loans	2,555	-	2,555	478	(132)	2,901
Consumer loans	2,371	-	2,371	409	-	2,780
Mortgages						
- Prime	4,416	2,250	6,666	1,188	-	7,854
- Non-conforming	2,181	-	2,181	727	-	2,908
- Sub-prime	-	-	-	-	-	-
- Commercial	1,228	507	1,735	66	(23)	1,778
- Buy-to-let	-	-	-	-	-	-
CDOs	-	-	-	-	-	-
Other	1,851	2,130	3,981	1,615	-	5,596
	<b>33,545</b>	<b>16,312</b>	<b>49,857</b>	<b>9,242</b>	<b>(226)</b>	<b>58,873</b>

## Risk and capital management

### Market turmoil exposures (continued)

#### Conduits (continued)

	CP funded assets										
	Geographic distribution					Weighted average life Years	Credit ratings (S&P equivalent)				
	UK £m	Europe £m	US £m	RoW £m	Total £m		AAA £m	AA £m	A £m	BBB £m	Below BBB £m
<b>30 June 2009</b>											
Auto loans	595	1,075	3,846	549	6,065	1.9	3,085	2,274	706	-	-
Corporate loans	1,266	3,640	2,738	1,762	9,406	1.7	9,078	223	105	-	-
Credit card receivables	390	-	2,796	189	3,375	1.0	2,794	212	369	-	-
Trade receivables	-	465	637	335	1,437	1.1	349	561	496	31	-
Student loans	116	-	1,144	-	1,260	1.2	1,144	116	-	-	-
Consumer loans	657	999	86	-	1,742	2.4	71	132	1,539	-	-
Mortgages											
Prime	-	1,896	-	3,975	5,871	2.8	2,364	3,448	20	-	39
Non-conforming	808	1,013	-	-	1,821	4.5	316	460	1,045	-	-
Sub-prime	-	-	-	-	-	-	-	-	-	-	-
Commercial	685	373	57	40	1,155	15.1	-	31	745	373	6
Buy-to-let	-	-	-	-	-	-	-	-	-	-	-
CDOs	-	-	-	-	-	-	-	-	-	-	-
Other	243	900	383	1,349	2,875	2.4	90	432	2,210	143	-
	<b>4,760</b>	<b>10,361</b>	<b>11,687</b>	<b>8,199</b>	<b>35,007</b>	<b>2.4</b>	<b>19,291</b>	<b>7,889</b>	<b>7,235</b>	<b>547</b>	<b>45</b>
<b>31 December 2008</b>											
Auto loans	801	1,706	7,402	398	10,307	1.7	6,075	883	3,349	-	-
Corporate Loans	1,714	4,347	3,289	2,122	11,472	4.9	10,767	132	573	-	-
Credit card receivables	633	-	4,999	212	5,844	0.7	3,465	62	2,171	146	-
Trade receivables	68	922	1,371	384	2,745	0.7	120	1,025	1,600	-	-
Student loans	144	-	2,411	-	2,555	2.6	2,296	144	115	-	-
Consumer loans	708	1,195	468	-	2,371	1.7	387	993	923	68	-
Mortgages											
Prime	-	2,244	-	4,422	6,666	2.8	2,675	3,876	115	-	-
Non-conforming	960	1,221	-	-	2,181	4.6	351	368	475	987	-
Sub-prime	-	-	-	-	-	-	-	-	-	-	-
Commercial	713	453	74	495	1,735	11.0	274	518	474	469	-
Buy-to-let	-	-	-	-	-	-	-	-	-	-	-
CDOs	-	-	-	-	-	-	-	-	-	-	-
Other	166	1,198	684	1,933	3,981	1.2	3	958	2,786	234	-
	<b>5,907</b>	<b>13,286</b>	<b>20,698</b>	<b>9,966</b>	<b>49,857</b>	<b>3.0</b>	<b>26,413</b>	<b>8,959</b>	<b>12,581</b>	<b>1,904</b>	<b>-</b>

## Risk and capital management

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### Market turmoil exposures (continued)

#### Structured investment vehicles

The Group does not sponsor any structured investment vehicles.

#### Investment funds set up and managed by the Group

The Group has established and manages a number of money market funds for its customers. When a new money market fund is launched, the Group typically provides a limited amount of seed capital to the funds. The Group has investments in these funds of £723.2 million at 30 June 2009 (31 December 2008: £107.0 million). These funds are not consolidated by the Group.

#### Money market funds

The Group's money market funds held assets of £13.2 billion at 30 June 2009 (31 December 2008 - £13.9 billion). The sub-categories of money market funds are:

- £9.1 billion (31 December 2008 - £8.3 billion) in money market funds managed by the Group denominated in sterling, US dollars and euro. The funds invest in short-dated, highly rated money market securities with the objective of ensuring stability of capital and net asset value per share, appropriate levels of liquid assets, together with an income which is comparable to the short dated money market interest rate in the relevant currency.
- £0.7 billion (31 December 2008 - £0.8 billion) in money market 'Plus' funds managed by the Group denominated in sterling, US dollars and euro. The funds invest in longer-dated, highly rated securities with the objective of providing enhanced returns over the average return on comparable cash deposits.
- £3.4 billion (31 December 2008 - £4.8 billion) in third party multi-manager money market funds denominated in sterling, US dollars and euro. The funds invest in short dated, highly rated securities with the objective of maximising current income consistent with the preservation of capital and liquidity.

#### Non-money market funds

The Group has also established a number of non-money market funds to enable investors to invest in a range of assets including bonds, equities, hedge funds, private equity and real estate. As the Group does not have significant holdings in these funds, they are not consolidated by the Group.

The Group non-money market funds had total assets of £14.2 billion at 30 June 2009 (31 December 2008 - £17.7 billion). The sub-categories of non-money market funds are:

- £1.1 billion (31 December 2008 - £1.1 billion) in committed capital to generate returns from equity and equity-like investments in private companies.
- £12.8 billion (31 December 2008 - £16.5 billion) in third party, multi-manager funds. These funds offer multi-manager and fund of funds' products across bond, equity, hedge fund, private equity and real estate asset classes.
- £0.3 billion (31 December 2008 - £0.1 billion) in various derivative instruments with the objective of providing returns linked to the performance of underlying equity indices.

The investors in both money market and non money market funds have recourse to the assets of the funds only. At 30 June 2009 the Group had exposure to one fund amounting to £145 million (31 December 2008 - £144 million).