

# Interim Results for the half year ended 30 June 2009

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## Forward-looking statements

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Certain sections in this document contain 'forward-looking statements' as that term is defined in the United States Private Securities Litigation Reform Act of 1995, such as statements that include the words 'expect', 'estimate', 'project', 'anticipate', 'should', 'intend', 'plan', 'probability', 'risk', 'Value-at-Risk ("VaR")', 'target', 'goal', 'objective', 'will', 'endeavour', 'outlook', 'optimistic', 'prospects' and similar expressions or variations on such expressions.

In particular, this document includes forward-looking statements relating, but not limited, to the Group's potential exposures to various types of market risks, such as interest rate risk, foreign exchange rate risk and commodity and equity price risk. Such statements are subject to risks and uncertainties. For example, certain of the market risk disclosures are dependent on choices about key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market risk disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated.

Other factors that could cause actual results to differ materially from those estimated by the forward-looking statements contained in this document include, but are not limited to: the extent and nature of future developments in the credit markets, including the sub-prime market, and their impact on the financial industry in general and the Group in particular; the effect on the Group's capital of write downs in respect of credit market exposures; general economic conditions in the UK and in other countries in which the Group has significant business activities or investments, including the United States; the monetary and interest rate policies of the Bank of England, the Board of Governors of the Federal Reserve System and other G-7 central banks; inflation; deflation; unanticipated turbulence in interest rates, foreign currency exchange rates, commodity prices and equity prices; changes in UK and foreign laws, regulations and taxes; changes in competition and pricing environments; natural and other disasters; the inability to hedge certain risks economically; the adequacy of loss reserves; acquisitions or restructurings; technological changes; changes in consumer spending and saving habits; and the success of the Group in managing the risks involved in the foregoing.

The forward-looking statements contained in this document speak only as of the date of this announcement, and the Group does not undertake to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The information, statements and opinions contained in this presentation do not constitute a public offer under any applicable legislation or an offer to sell or solicitation of any offer to buy any securities or financial instruments or any advice or recommendation with respect to such securities or other financial instruments.

## Presentation of information

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### Acquisition of ABN AMRO

On 17 October 2007, RFS Holdings B.V. ('RFS Holdings'), a company jointly owned by The Royal Bank of Scotland Group plc ('RBS'), Fortis Bank Nederland (Holding) N.V. ('Fortis') and Banco Santander S.A. ('Santander') (together, the 'Consortium Members'), completed the acquisition of ABN AMRO Holding N.V. ('ABN AMRO').

RFS Holdings is implementing an orderly separation of the business units of ABN AMRO with RBS retaining the following ABN AMRO business units:

- Continuing businesses of Business Unit North America;
- Business Unit Global Clients and wholesale clients in the Netherlands (including former Dutch wholesale clients) and Latin America (excluding Brazil);
- Business Unit Asia (excluding Saudi Hollandi); and
- Business Unit Europe (excluding Antonveneta).

Certain other assets will continue to be shared by the Consortium Members.

On 3 October 2008, the State of the Netherlands acquired Fortis Bank Nederland (Holding) N.V. including Fortis' participation in RFS Holdings that represents the acquired activities of ABN AMRO.

The separation of platforms shared between RBS and its Dutch state-owned partner has been completed and the Group is now on track, subject to legal process and regulatory approvals, for the legal separation of the constituent parts of ABN AMRO by the end of the year. From that point RBS will cease to consolidate the Dutch state's interest in RBS Group statutory accounts.

### Pro forma results

Pro forma results have been prepared that include only those business units of ABN AMRO that will be retained by RBS. The financial review and divisional performance and discussion of risk and capital management in this Company Announcement focus on the pro forma results. The basis of preparation of the pro forma results is detailed on page 72.

### Statutory results

RFS Holdings is jointly owned by the Consortium Members. It is controlled by RBS and is therefore fully consolidated in its statutory financial statements. The interests of the State of the Netherlands and Santander in RFS Holdings are included in minority interests.

### Restatements

Divisional results for 2008 have been restated to reflect the Group's new organisational structure that includes a Non-Core division comprising individual assets, portfolios and lines of business that the Group intends to run off or dispose of. The Non-Core division is reported separately from the divisions which form the Core Group. In addition, separate reporting of Group Manufacturing and Centre results has changed and, with the exception of certain items of a one off nature, costs incurred are now allocated to the customer-facing divisions and included in the measurement of the returns which they generate. The changes do not affect the Group's results. Comparatives have been restated accordingly. Descriptions of business for the new divisions are set out on page 27.

The pro forma and statutory results for 2008 have been restated for the amendment to IFRS 2 'Share-based Payment'. This has resulted in an increase in staff costs amounting to £35 million for the first half of 2008 and £169 million for the full year 2008.

The pro forma and statutory results for the first half of 2008 have been restated for the finalisation of the ABN AMRO acquisition accounting.

## Results summary – pro forma

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m
<b>Core</b>				
Total income (1)	17,793	14,192	25	24,437
Operating expenses (2)	(7,745)	(7,218)	7	(13,856)
Operating profit before impairment losses (3)	8,471	5,385	57	7,364
Impairment	(2,177)	(670)	-	(2,512)
Operating profit (3)	6,294	4,715	33	4,852
<b>Non-Core</b>				
Total income (1)	(3,002)	(2,541)	18	(3,838)
Operating expenses (2)	(988)	(1,175)	(16)	(2,332)
Operating loss before impairment losses (3)	(4,304)	(4,054)	6	(6,870)
Impairment	(5,344)	(809)	-	(4,920)
Operating loss (3)	(9,648)	(4,863)	98	(11,790)
<b>Total</b>				
Total income (1)	14,791	11,651	27	20,599
Operating expenses (2)	(8,733)	(8,393)	4	(16,188)
Operating profit before impairment losses (3)	4,167	1,331	-	494
Impairment	(7,521)	(1,479)	-	(7,432)
Operating loss (3)	(3,354)	(148)	-	(6,938)
Profit/(loss) before tax (4)	15	(726)	-	(8,296)
Loss attributable to ordinary shareholders	(1,042)	(827)	26	(24,306)
<b>Performance ratios</b>				
Return on equity (5)	(18.1%)	(2.0%)	(1,610bp)	(13.9%)
Net interest margin	1.69%	2.07%	(38bp)	2.08%
Cost:income ratio (8)	59.0%	72.0%	(1,300bp)	78.6%
Adjusted cost:income ratio (9)	67.7%	86.3%	(1,860bp)	97.0%
<b>Capital and balance sheet (Pre-APS)</b>	<b>30 June 2009</b>	<b>31 December 2008</b>	<b>Change</b>	
Total assets	£1,644.4bn	£2,218.7bn	(26%)	
Funded balance sheet (10)	£1,088.6bn	£1,227.2bn	(11%)	
Loan:deposit ratio	144.5%	152.4%	(790bp)	
RWAs	£547.3bn	£577.8bn	(5%)	
Total equity	£57.8bn	£64.3bn	(10%)	
Core Tier 1 ratio	6.4%	5.9%	50bp	
Tier 1 ratio	9.0%	9.9%	(90bp)	
Tier 1 leverage ratio (6)	21.7x	21.2x	2%	
Net tangible equity per share	58.0p	73.8p	(15.8p)	
Tangible equity leverage ratio (7)	3.0%	2.4%	60bp	

For definitions of the notes see page 26.

### Performance highlights

*"This was a momentous half year for RBS. We gave a full and clear account of our vulnerabilities to the 'credit crunch'. We set out comprehensive restructuring plans, now with clear performance targets. And implementation is well under way, though uncertainties remain.*

*Our first half results, as we had clearly warned, are poor with a net attributable loss of £1,042 million. However, they highlight well our core business potential, the hard work of our people in difficult times, the strength of our customer franchises and the vulnerabilities and economic headwinds we grapple with."*

Stephen Hester, Group Chief Executive

### Pro-forma

- **Group financial performance**

- Group pre-tax profit\* of £15 million.
- Gain of £3.8 billion on debt exchange.
- Net attributable loss of £1,042 million, after minority interests and preference dividends.
- Impairments rising across the Group to £7.5 billion.

- **Core Bank**

- Core Bank recovery with operating profit of £6.3 billion.
- Strong income growth to £17.8 billion, with GBM benefiting from favourable market conditions.
- Resilient performance in Core retail and commercial banking pre-impairments, despite margin attrition from higher deposit and funding costs.
- Cost saving programme delivers £0.6bn, with adjusted Group cost:income ratio improving.
- Market positions sustained in chosen markets, with good growth in customer numbers.

- **Financial restructuring**

- Total assets reduced by £574 billion, or 26%, since December 2008.
- New Non-Core Division begins run-off; £94 billion reduction in third party assets.
- Non-Core run-off plan targets c.£230 billion reduction by 2013.
- Core Tier 1 ratio improves to 6.4% - + >5% pro-forma for Asset Protection Scheme.†
- APS key to RBS's short-term ability to withstand stressed scenarios, though important issues remain to be confirmed.
- Loan:deposit ratio improved to 144% from 152% in December 2008.
- Liquidity and funding positions steadily improving since December 2008.

\* Excluding write-down of goodwill. Operating loss before tax of £244 million on a statutory basis. See appendix 1 for a reconciliation between pro forma and statutory basis.

† See page 17 for conditionality

## Results summary – statutory

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### Highlights

- Income up 58% to £21.8 billion.
- Pre-tax loss of £244 million.
- Core Tier 1 ratio 7.0%

	<b>First half 2009 £m</b>	<b>First half 2008 £m</b>	<b>Change %</b>	<b>Full year 2008 £m</b>
Total income	<b>21,841</b>	13,842	58	25,868
Operating expenses	<b>(11,891)</b>	(10,719)	11	(54,202)
Operating profit/(loss) before impairment losses	<b>7,816</b>	934	-	(32,764)
Impairment	<b>(8,060)</b>	(1,661)	-	(8,072)
Operating loss before tax	<b>(244)</b>	(727)	(66)	(40,836)
Loss attributable to ordinary shareholders	<b>(1,042)</b>	(827)	26	(24,306)



## Chief Executive's letter to shareholders

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This has been a tumultuous half year for RBS, which started with our share price falling to 10 pence per share on full disclosure of the damage sustained by RBS from the "credit crunch" and our vulnerability to it. With this "call to action" as backdrop, we have devised and now set out restructuring plans and targets to rebuild RBS whilst serving customers well. We are putting those plans into action. At the same time we are sustaining our businesses and operating through unprecedented pressures, challenges and change. The "new RBS" will be a very different bank than before, in both what we do and the way we do it, and rightly so.

Let me be clear, I am optimistic for RBS's future. We can restore the Bank to standalone strength and viability. We will thereby rebuild attractive, sustainable shareholder value and, I believe, allow Government support to be recouped in full. But there will be no miracle cures. Our task is no less than one of the largest bank restructurings ever done, in the face of strong economic headwinds. Overall results may not substantially improve until 2011 and full recovery will take time. Along the way we will still need the Government support that gives us time and strength to restructure. We will repay that with results and responsible support to the communities who in turn are supporting us.

Given the agenda before us and the high levels of customer, shareholder and public interest, I attempt to set out herein, what we are doing, why and how we propose to be measured.

### Building the new RBS on strong foundations

We have a strong plan in place that I believe can get us to where we need to be by 2013. To achieve the goals of our different stakeholders we need to remake RBS as one of the world's most admired, valuable and stable universal banks powered by market-leading businesses in large customer-driven markets. We will target a sustainable 15% plus return on equity with an AA category risk profile and well capitalised balance sheet. The business mix should produce an attractive blend of profitability, stability and sustainable growth. Anchored in the UK and in retail and commercial banking, we will retain strong but more focused global capabilities in the areas required to serve our customers well.

We are not starting from scratch. The foundations of RBS derive from the rock of our customer franchises around the world. Our first half performance demonstrates this in the face of every possible contrary reason, with customer numbers steady or growing in each of our major businesses. This tells me that we provide services and products that matter to our customers. And that our people, despite all their own challenges and disappointments, are hard at work serving our customers well. Our new strategy will build on these important realities.

### Understanding what went wrong

While the banking crisis has many roots, its economic foundations lie in a long era of easy money. As a bank with deep exposures in economies which are structurally indebted, we were more exposed to the crisis than many. The balance between saving and borrowing remains out of step in many parts of our core markets, and it is the same with the banks, which generally mirror the economies they serve. The answer to our collective problem is not to go back to lending or borrowing too much.

That said, it would be a serious error to suggest that RBS merely reflected the macro-economic context in which it operated. RBS made mistakes and had vulnerabilities of its own doing. We set these out clearly in February and the plans we confirm today are designed to address each and every aspect.

### Strategy and Performance Targets

Our strategy has three interlocking elements.

- **Financial Restructuring**

We plan to radically restructure RBS's balance sheet, reducing management stretch and risk exposures. We target a c.£500bn gross reduction in "funded" assets (which we are over halfway through). This will be achieved primarily through the run-down and sale of assets placed in our newly established Non-Core Division. This is a big and vital task. We have disclosed today for the first time the targeted profile of that asset run-off, with milestones along the way and subject to the important risk factors I identify later in this letter. The Non-Core Division also helps protect the Group's core customer-facing businesses by freeing up their management to focus on delivery for customers.

- **Core Business Restructuring**

As I have said, at the heart of RBS are inherently strong and valuable businesses driven by enduring customer franchises. Every one of these businesses can and must be made better. Along the way we will refocus on serving customers well, restructure to cure past vulnerabilities and retool to meet the changed market realities likely to prevail in future. This is also a major endeavour. Like every other business, major efficiency improvements are a survival necessity but so too is renewed investment to revitalise our customer proposition and service levels.

- **Cross Cutting Management and Cultural Change**

Throughout all we do, these binding disciplines will be implemented: Careful long-term strategic thinking over short-term opportunism. Empowerment of our people with corresponding accountability. Combining the "make it happen" drive for results with a new found (but enduring) humility, transparency and openness. A realisation that our customers' health and our own are interdependent, and a fundamental change to risk sensitivity, with business growth focused on quality, achieved organically and facilitated but not driven by balance sheet and risk resources.

To show we are both serious and accountable, we set out clear targets today for our return to financial viability and the rebuild of sustainable shareholder value.

Measure	2008 Actual	2013 Targets
<b>Risk and Viability</b>		
Stand-alone Credit Rating (1)	BBB category	AA category
Core Tier 1 Capital Ratio	4% (2)	>8%
Loan:Deposit Ratio	156% (3)	c.100%
Wholesale funding reliance (4)	£343bn (5)	<£150bn
Liquidity reserves (6)	£90bn (7)	c.£150bn
<b>Shareholder value</b>		
Return on Equity (8)	(28%)	>15%
Cost/Income Ratio (C:I)	79%	<45% (9)
C:I Net of insurance claims	97%	<50% (9)

(1) Standard & Poors rating, ex HMG support (2) As at 1 January 2008 (3) As at October 2008 (4) Amount of unsecured wholesale funding under 1 year (£bn) (5) As at December 2008 (6) Eligible assets held for contingent liquidity purposes including cash, Government-issued securities and other securities eligible with central banks (7) As at December 2008 (8) After tax return on tangible equity normalised for APS in 2013 (9) Core Bank

## **Chief Executive's letter to shareholders (continued)**

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These targets are not forecasts. Events will ensure we either beat them or fall short. In particular the risks we flag herein remain real threats. But they are a serious statement of intent. Every Division has subsidiary targets we have also published today. And while 2013 seems a long way away, each year we intend to make measurable progress towards these goals.

### **First Half Results and Actions to date**

Our first half results, as we had clearly warned, are poor with a net attributable loss of £1 billion. However, presented as they are now in alignment with the new strategy, they highlight well our core business potential, the hard work of our people in difficult times and the vulnerabilities and economic headwinds we grapple with.

Our Core Business Divisions reported an Operating Profit of £6.3 billion on revenues up 25% to £17.8 billion. This result was driven by a creditable rebound in GBM, our investment banking business, reversing the terrible losses of 2008, though this performance level is likely to weaken substantially in the second half. Nevertheless, the complementary balance to our retail and commercial banking businesses which were strong last year but now suffer the margin squeeze and rising credit costs of economic recession is helpful. However, across all our businesses, customers were served well, and steps taken to rebuild margins and efficiency ratios for future years. In fact, a strong start has been made to increasing efficiency, with £0.6 billion of savings so far, though these have been offset by foreign exchange movements making clear that more is needed.

We took important steps to reduce risk, whilst still early days. Our total balance sheet is down from a £2,219 billion peak in 2008 to £1,644 billion. Our gross funded assets are down £350 billion in constant currency terms, from their peak. Our important loan-to-deposit ratio has improved by 8 percentage points since the end of 2008 to 144% and vital steps have been made to a more secure liquidity and funding profile.

RBS's vulnerabilities and the harsh recessionary conditions also show through clearly. Our Non-Core Division shows an Operating Loss of £9.6 billion. Across the Group, impairments rose 409% to £7.5 billion and are set to stay high for a while.

In addition to intense business activity, the strategy and cultural moves described above have been fundamental changes for RBS. We have also achieved comprehensive renewal of Board and management (outlined below), are pressing ahead with all the implementation plans and a range of targeted disposals. And have made further strides in financial and business disclosure, evidence of the open, investor friendly approach we mean to take.

### **Asset Protection Scheme (APS)**

The APS, agreed in principle with the UK Government (HMG) in February, has significant uncertainties though we still anticipate that it can be concluded in the autumn. APS remains essential to RBS to give us additional resilience during the time it will take to regain standalone strength. Without the combination of asset insurance and "B" share issuance, RBS would not pass the FSA-mandated stress tests and would be vulnerable to ratings downgrades and funding difficulties as a consequence.

Notwithstanding APS's importance, it is by no means "free". Our central case estimates suggest that the cost to HMG of APS will be broadly recouped through the substantial fees and tax give-ups to be paid by RBS, although other more positive and negative outcomes remain very real. Additionally, EU approval for the "state aid" given to RBS is uncertain as to both timing and outcome. RBS's massive restructuring programme provides a comprehensive and rigorous path back to standalone viability which the EU needs to review. Additionally it seems likely to require weakening of our core UK banking franchise, especially for business customers. Negotiations are ongoing here and we are very cognisant of the business disruption risks to customers and our ability to serve them, as well as to our own prospects of successful recovery.

The APS itself, while conceptually straightforward, has enormous operational complexity which is taking time to resolve. For example, HMG has requested regular reporting on up to one billion lines of data covering assets in the scheme and our own systems and data quality are not well designed for the APS purpose. The principal commercial aspects of the APS announced in February remain in place including coverage and pricing on the basis of asset evaluation as from 1 January, 2009. The overall economic impact of the APS, in conjunction with RBS's own extensive restructuring measures laid out herein, is expected to enable RBS to meet the FSA stress tests during its restructuring period. However, issues still outstanding include the final sign-off of assets to be covered, confirmation of the price of the coverage in the light of completed due diligence and state aid requirements and some detailed aspects of the structure of the scheme. Accordingly until these issues can be confirmed and state aid approval has been received care must be taken in assessing the complete economic impact on RBS of the APS. Discussion on these points continues and we will provide updates when we can. APS's merits will be more fully assessed at the time a general meeting is necessary for shareholder approval.

### **In the Limelight**

We are in the limelight - understandably but uncomfortably so.

Everyone at RBS is acutely aware of the fact that we are in a fortunate position to be able to restructure the Bank with the support of the UK Government behind us. This support exists because of our central position in the fabric of society and the economy, both in the UK and internationally. With that come responsibilities large and small to our shareholders, customers, staff and the communities where we do business. Our mission is to fulfil them all and remake RBS as a premier financial institution by serving our customers better. This will enable us to restore our financial strength, allowing the UK Government to sell down its investment in us, at a profit.

And it would be wrong not to acknowledge the effectiveness of UKFI – our new majority shareholder – in treading a constructive and commercial but demanding and engaged path. "Fidelity with nuclear weapons" they are dubbed in the press – an apposite if colourful description.

However, we especially, but all banks too, have become regrettably high profile. We sometimes feel as if commentators variously want us to go back to over-lending, to operate on a 'not-for-profit' basis, to never entertain a client and to offer employment conditions that deter the best and brightest. Oh yes, and at the same time to pull off a recovery enabling taxpayers to recoup the support given. Thankfully, our serious engagement with Government, Central Banks, Regulators, customers and other political parties is generally more balanced and insightful.

### **Fulfilling lending commitments**

One of the fundamental changes in the wider economic environment is a shift in power from borrowers to savers following the end of the credit boom. This means banks' borrowing costs are often much higher than reference rates like the Bank of England Base Rate. We need to charge borrowers higher margins in return to simply do no more than stay even, though customers' absolute cost of borrowing is generally much reduced. Borrowers have found this a difficult transition and there is understandably much public discourse on the issue. But today's results make crystal clear, that RBS is making less profit from banking customers than before, not more, and currently not enough to return to the financial stability that is necessary.

Against a recessionary backdrop we face a challenge of finding enough credit worthy borrowers wishing to take on new debt when their own business prospects and customer demand is weaker. This is, of course, normal in a recession as most prudent households and companies aim to reduce debt levels. And indeed, without increased saving overall, soundly based economic recovery will be difficult.

Our UK lending performance in the first half of the year reflects these factors and is detailed fully on page 20 herein. I am pleased to report that we have made new loans totalling £36 billion to UK homeowners and businesses in the first half. This includes a healthy proportion of mortgage loans to first time buyers and 100,000 loans to businesses, representing an 85% acceptance rate in the SME sector.

However, customers have also been actively paying down existing debt and have not been increasing overdraft borrowing. And despite our lending successes, loan applications by small businesses in the half were 37% down on the prior year. As a result, while we are on track to grow net mortgage lending by £9 billion as planned, achieving the business lending targets remains challenging.

But we are only four months into the period of our lending commitments. We will continue doing everything we can to make loans available to creditworthy customers at fair rates. Let there be no doubt we want to support our customers and are ready, willing and able to increase lending in line with our undertakings if the demand is there.

### **Our People**

At the heart of all we need to do lie our people. Those with accountability for past mistakes have gone. Looking forward, however, if we are to change, recover and to serve customers well it will be because we can retain, attract and motivate good people – for whom there are always alternative jobs.

Our people have also suffered – financially, in their job security, dented pride in RBS and from relentless media hostility and controversy. I would like to be clear. They are doing a great job overall. Without their efforts, enthusiasm, dedication and resilience we would surely fail in our recovery mission.

We have needed to make important changes. We are doing this swiftly to minimise uncertainty.

People represent half of our operating costs so it is deeply regrettable but inevitable that job losses are happening. We will continue to put communication with staff and their representatives first and be as transparent and open in the process as we can be. We believe this approach is the most appropriate for the position we are in and intend to stick to it. I am pleased that fewer than 25% of the job cuts we have made to date in our UK banking businesses have resulted in compulsory redundancy. We want to keep this figure as low as we can.

Our new Chairman, Philip Hampton, has made substantial progress in restructuring our Board to be smaller, more focused and with a new composition. Since October 2008, 12 members have left and five have joined. Today I am also very pleased to welcome our new Finance Director, Bruce Van Saun. His recruitment completes our new Executive Committee line up, all 9 members of which are new to role over the last 18 months.

One of the most difficult issues we face is balancing our need to attract, retain and reward talented staff whilst making reforms to pay in a way that recognises the reality of the position we are in and how society views our sector. For right or for wrong, in all walks of life, the pay levels people are offered for doing similar jobs elsewhere are a key benchmark. We know to our cost, having suffered significant resignations of valuable staff members this year, that we cannot ignore competitor pay practices or we will fail as a business. However, we can and have led in the way that we structure our rewards to staff and we hope that the rest of the industry follows this lead. Unusually among banks, bonuses across the RBS Group where merited are now subject to deferral and clawback as standard.

### **The risks we face**

The magnitude and urgency of the change we need to bring about is a major additional challenge to delivering 'business as usual'. This has its risks and opportunities. These range from how good we prove to be at delivering our plans, to the pace of economic recovery and impact of unforeseen events. The five main risk factors I believe that we need to be alert to are:

- the economic environment,
- our ability to sell or run down those businesses that we are seeking to exit,
- how long it takes us to get to a position whereby we lend only what we take in deposits, and the stability of funding along the way,
- regulatory pressure and requirements from the EU, from HMG (especially around the APS) and from regulators, in particular the Financial Services Authority, and
- our own ability to implement the plans we have set out.

There is much that we can and are getting on with now and although I cannot be certain how long it will take us to achieve our vision, or how difficult the journey will be, I am confident that we have the right people and the right roadmap to get there.

### **Towards the new RBS**

There is every sign that our financial performance over the next two years, at a Group level, will be poor due to the severe economic downturn in 2008 and 2009 and consequent impact on impairments and funding costs. But, once successfully restructured, each of our businesses will be highly attractive and valuable in its own right. Each will have a strong customer base, offer shareholders a sustainable return and potential for growth, and each will be disciplined in its use of capital and funding.

We will have businesses that are connected and that work together; sharing costs and expertise to improve the service they provide to customers, and doing so more efficiently. In addition, across RBS as a whole, our businesses will 'complement' each other so that we have a balanced mix of funding sources, ways of generating income, stable earnings and options for growth.

This combination of operational synergy and a balanced portfolio means that each business will have a greater value as part of RBS than it does standing alone. But we will continue to be rational in assessing our business mix and changes may occur where so merited.

There is a lot of hard work to be done before we know the level of success and therefore the ultimate value of the restructuring plan and of RBS. But I am heartened and encouraged by the effort, determination and commitment that I see from colleagues across the Group. They are rising to what is probably the greatest professional challenge we will ever face. At the end of it, I believe we will have earned our way back to the respect, self and otherwise, that our company so badly needs.

Stephen Hester

Group Chief Executive

Gogarburn, Edinburgh

7 August 2009



### Financial performance – pro forma results

#### Group organisational structure

Following the conclusion of the Strategic Review, the Group has realigned its Core divisions, including in particular the separation of RBS UK into UK Retail and UK Corporate. A Non-Core division has also been established to manage and run off or dispose of a number of assets and businesses that do not meet the Group's target criteria. Further details of the new divisional structure are on page 27. The initial discussion of Group performance relates to both Core and Non-Core operations. Commentary on divisional performance on pages 31-55 relates to Core activities only.

#### Group operating performance

The Group delivered strong income generation, up 27% to £14,791 million, with expenses up 4% to £8,733 million to yield operating profit before impairment losses of £4,167 million in the first half of 2009, compared with £1,331 million in the first half of 2008. At constant exchange rates, income rose by 21% while costs declined by 5%, with Group operating profit before impairment losses up 270%. Impairments, however, rose sharply to £7,521 million, compared with £1,479 million in the first half of 2008. Over 70% of the impairment costs arose in the Non-Core division, but the Group also experienced a significant rise in credit costs in all core divisions, reflecting the continuing deterioration in economic conditions. Approximately 70% of the impairments and write-downs incurred in the first half are attributable to assets covered by the Asset Protection Scheme, subject to any changes to the Scheme, where some important issues remain open.

After a gain of £3,790 million on the redemption of a number of outstanding debt securities, the Group recorded profit before tax, excluding the write-down of goodwill and other intangible assets, of £15 million, compared with a loss of £726 million in the same period of 2008. After tax, minority interests and preference share dividends the loss attributable to ordinary shareholders was £1,042 million, up 26% from the loss recorded in the first half of 2008. This represents a basic loss per ordinary share of 2.2p, including discontinued operations.

#### Group margin

Group net interest margin fell to 1.69%, compared with 2.07% in the first half of 2008 and 2.08% for the full year 2008. While new business asset margins have improved, these will take some time to feed through to the back book and have so far fallen well short of the increase in funding costs. In the very low interest rate environment prevailing in all the Group's major markets, deposit pricing floors and active competition have compressed liability margins. In addition, markedly increased costs of term funding and of increasing our stock of liquid assets have contributed to the reduction in net interest margin.

In these prevailing conditions, margins in the core banking divisions are expected to remain under pressure in the second half.



### Group credit and risk metrics

Loan impairments increased to £6,796 million in the first half, representing 2.25% of gross loans and advances excluding reverse repos, on an annualised basis, compared with 0.83% in the first half of 2008 and 1.33% in the second half of 2008. Impairments continued to increase in the second quarter, particularly in the Group's UK retail and corporate banking divisions, and included an incremental provision on our UK corporate book, to reflect the materially increased flow of companies into restructuring during the period. While a degree of stabilisation has occurred in financial markets, the impact of economic recession continues to feed through into the Group's credit portfolios.

Non-performing and potential problem loans at 30 June 2009 totalled £31.0 billion, an increase of 246% from 30 June 2008, or 236% at constant exchange rates, and of 63% from 31 December 2008, or 69% at constant exchange rates. These categories represented 5.08% of gross loans and advances, excluding reverse repos, compared with 1.47% at 30 June 2008 and 2.69% at 31 December 2008.

Provision coverage was 44%, a decrease of 12% compared with 30 June 2008 and a decrease of 6% compared with 31 December 2008. The declining trend is mainly attributable to the increasingly secured composition of the Group's non performing loan portfolio. In addition, during the first half of 2009, a small number of large corporate exposures assessed as requiring limited provisions, because of the structure of the transactions and the expected restructuring outcomes, moved into the non-performing category.

The availability of equity funding in the capital markets has provided some relief to companies, particularly in the UK, but corporate default rates have continued to rise. While personal unsecured lending has been reduced, arrears on these exposures have continued to increase, in line with rising unemployment trends. Arrears on residential mortgage lending have risen more modestly, with the arrears rate on the NatWest and RBS UK mortgage portfolio increasing to 1.8% at 30 June 2009 from 1.16% at 30 June 2008 and 1.5% at December 2008. The average loan-to-value for new business was 65% in the first half of 2009 versus 67% for 2008.

The Group has made good progress in strengthening its risk management practices, with the implementation of updated limit frameworks for credit and market risk and further refinement of the credit approval process.

**Group balance sheet, capital and funding**

The Group made good progress in its financial restructuring during the first six months of 2009, achieving a reduction of £574 billion in total assets to £1,644 billion – a fall of 26%. Excluding mark-to-market derivative assets, third party assets were reduced by £139 billion to £1,089 billion, principally reflecting substantial repayments of loans to banks and customers and a reduction of 17%, or 13% in constant currency terms, in trading assets. Mark-to-market derivative assets fell by 44% to £556 billion, with a corresponding fall in derivative liabilities.

Group risk-weighted assets totalled £547.3 billion at 30 June 2009, an increase of £55.6 billion from June 2008 but a decrease of £30.5 billion from December 2008. Although the Group has continued to reduce its balance sheet throughout the half year, the pro-cyclical effects of the Basel 2 methodology have resulted in higher risk-weightings. Undrawn facilities and other commitments to lend have been reduced to £296.6 billion, down 6% from June 2008 and 15% from December 2008. The effect of currency movements during the latter half of 2008, in particular the marked weakening of sterling against the dollar, has been partially reversed during the first half of 2009. On a constant currency basis RWAs were up 4% from June 2008 and flat compared with December 2008.

The Group's Core Tier 1 ratio at 30 June 2009 was 6.4%, compared with 5.3% a year earlier, reflecting the preference share conversion and debt exchange carried out earlier this year, as well as 2008 equity issuance.

In April, the Group concluded a series of exchange offers and tender offers with the holders of a number of Tier 1 and Upper Tier 2 securities which resulted in an aggregate pre-tax gain of £4.6 billion, of which approximately £3.8 billion was taken through income and the remainder through equity.

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

## Business and strategic update (continued)

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While the quantum of funding available in the markets has increased, funding costs remain high compared with pre-crisis levels. Money market conditions have improved, with spreads between Libor and overnight indexed swap rates narrowing somewhat, though they remain substantially in excess of average levels experienced in previous years. The short and medium end of the yield curve remains steep.

The Group's average credit spreads in the first half were significantly higher than in the same period of 2008 but spreads have now narrowed from their peaks. During the period the Group was able to resume issuance of term debt without the requirement for a government guarantee and has made significant progress towards extending the maturity profile of its funding. It has also made good progress in building up its liquidity portfolio, although this has been at the expense of margins.

The Group's loan:deposit ratio improved from 152% at December 2008 to 144% at June 2009. Each division has been set targets for further improvements in this ratio over the next five years, and these are outlined on page 22.

### Core Bank

The Core Bank achieved a good recovery in operating performance in the first half, with underlying operating profit before tax, purchased intangibles amortisation, gain on redemption of own debt, strategic disposals, write-down of goodwill and other intangibles, integration and restructuring costs, up 33% to £6,294 million.

Operating income grew strongly, reflecting favourable trading conditions during the first half, with strong volumes and volatility benefiting Global Banking & Markets. There were more modest improvements in Wealth and Global Transaction Services, offset to a significant degree by increased funding costs. The core UK retail and corporate banking businesses put in a resilient performance, with severe margin attrition from higher deposit and funding costs but some improvement in new asset margins. Non-interest income was also affected by slower economic conditions. Total income rose by 25%, or 16% on a constant currency basis, to £17,793 million, with net interest income 8% lower at £6,043 million and non-interest income 54% higher at £11,750 million.

Expense discipline remained good, both in the customer-facing divisions and in Manufacturing operations, with total expenses up 7% to £7,745 million. On a constant currency basis, expenses were reduced by 2%. Operating profit before impairment losses increased by 57% to £8,471 million, or by 45% at constant exchange rates. The Group has made good progress in its £2.5 billion expense reduction programme, with £0.6 billion of cost savings delivered in the first half.

Impairments increased markedly across all banking divisions, totalling £2,177 million, an increase of 225% from the first half of 2008. Impairments in the second quarter were 11% higher than in the first, with a small net recovery in GBM but incremental impairments taken to reflect the accelerating flow of credit problems in the UK corporate sector, and a further increase in personal delinquencies in the UK and US, in line with the continuing deterioration in economic conditions and the rising level of unemployment.

### Non-Core Division

Non-Core division third party assets at 30 June 2009, including derivatives, totalled £231.1 billion, down from £324.7 billion at 31 December 2008. The division recorded an operating loss of £9,648 million in the first half, driven largely by credit market and other write-downs of £4.2 billion and impairments of £5.3 billion. Approximately 44% of the assets of the Non-Core division are expected to be covered by the Asset Protection Scheme.

The Group has established targets for a reduction of approximately £230 billion in Non-Core's third party assets, excluding derivatives mark to market, by 2013, as compared with December 2008. This includes asset run-off of approximately £200 billion as well as £50 billion to £60 billion of asset sales, offset by rollovers and additional drawings. Achieving this run-off profile will depend on sufficient recovery in market conditions to allow assets to be disposed of at acceptable valuations, and on the securitisation or sale of some APS assets in the outer years of the five year plan, for which HM Treasury's permission may be needed.

### Disposals

In January the Group announced that it had disposed of its 4.26% equity stake in Bank of China for a net consideration of £1.6 billion.

In April 2009 the Group disposed of its 50% stake in Linea Directa Aseguradora to its joint venture partner, Bankinter, for a cash consideration of €426 million. This disposal is consistent with the Group strategy announced on 26 February 2009. As a 50/50% joint venture, Linea Directa Aseguradora had operated as a largely independent Spanish insurance operation with limited connection to the Group.

RBS announced on 4 August 2009 that it had reached agreement with ANZ on the sale of a number of its Asian assets, and remains in advanced discussions on the sale of its remaining Asian retail and commercial businesses.

### Asset Protection Scheme

Although full documentation of the Asset Protection Scheme has not yet been finalised, the key terms of the APS were agreed in principle and announced in February. RBS's most recent APS submission is for coverage of assets with a gross value of £316 billion and a carrying value, net of impairments and write-downs incurred before 1 January 2009, of £294 billion. These assets are individually identified and documented and comprise primarily corporate loans, bonds and mortgages, as well as more complex credit exposures such as collateralised debt obligations and derivative transactions with monoline insurers.

Subject to the detailed terms and conditions of the Scheme and state aid approval, RBS will bear the first loss on these specified assets up to £19.5 billion, plus historical impairments and write-downs. Once this first loss is exceeded, HMT will bear 90% of further losses, while the remaining 10% of the losses will remain with RBS. The APS applies to losses incurred on or after 1 January 2009 in respect of assets held on RBS's balance sheet as at 31 December 2008.

The Group will pay a fee of £6.5 billion for this protection. In addition, it has agreed to forgo certain tax reliefs, including the ability to carry back 2008 losses to 2007. RBS's agreement to forfeit these tax reliefs will continue until 31 December 2013 when the Group returns to profitability, whichever occurs earlier. The cost of this tax agreement will depend on results but is currently estimated at £9-11 billion.

Before RBS's participation in the APS can begin, state aid clearance must also be received by the UK Government from the European Commission in respect of all aspects of the scheme including asset coverage and pricing. As referenced in the Chief Executive's letter on page 10, both the terms of the APS announced in February and the asset coverage outlined above remain open and may change as negotiations continue with HM Treasury and the European Commission regarding the Scheme. This remains an important risk factor for RBS.

### UK Lending Commitments

In February, as a result of the APS, the Group agreed to make available an additional £25 billion of lending to creditworthy customers on commercial terms, and subject to market demand, over the ensuing 12 months, and a similar amount over the following year. In the first four months since entering into this commitment RBS has achieved strong results in the mortgage market, with gross lending over £7 billion despite generally weak demand, and remains on track to achieve its targets. UK mortgage balances, including Ulster at 30 June 2009 totalled £80.8 billion, up 9% year on year and 5% higher than at the end of 2008.

In business markets, RBS has achieved gross new lending of £28.6 billion. However, demand has been comparatively muted, with companies cutting inventories and expansion plans and reducing their bank borrowing requirements. Additionally, the anticipated withdrawal of non-UK and wholesale-funded lenders which has characterised the mortgage market has not occurred in corporate markets, and the anticipated "gap" in the market for creditworthy corporate borrowers has not emerged. After taking account of loan repayments and overdraft movements, RBS's UK business lending, including Ulster, at 30 June 2009 totalled £155.1 billion, a decrease of 1% from 30 June 2008 and a decline of 4% since the end of 2008.

In the SME segment of business markets, gross lending in the first half totalled £17 billion notwithstanding weaker demand. However, repayments have been accelerating since the third quarter of 2008, leaving balances at the end of June of £66.6 billion, up 2% from June 2008. As a result of RBS's price pledge, 94% of customers who renewed their overdrafts in the second quarter of 2009 did so at the same margin or lower and in June, the average interest rate paid by customers on term loans was half its level a year earlier. Total credit applications in the first half were down 22% on the same period of 2008. While there has been some recovery in recent months in the number of applications for term loans, the average size of each application has fallen, reflecting, among other factors, falling property values. As a result, term loan applications by value were 37% lower. The acceptance rate across all categories of SME credit remains stable at 85%.

Among larger corporates, RBS advanced £12 billion of gross new lending in the first half. However, many larger companies are actively deleveraging, and RBS has helped many of its clients to raise new finance in the equity and bonds markets, which has been used to reduce bank borrowing substantially. Demand for acquisition finance remains minimal.

## Business and strategic update (continued)

RBS has undertaken a range of initiatives aimed at demonstrating that it remains open for business, and is determined to do its part in meeting demand for lending from creditworthy homeowners and businesses. There have been some recent signs of a modest increase in demand in certain segments of the market, but in the absence of a more general recovery in borrowing appetite the targets will remain challenging.

	30 June 2008 £bn	31 December 2008 £bn	Gross lending during H1 2009 £bn	Net lending during H1 2009 £bn	30 June 2009 £bn
Mortgages	74.2	76.7	7.2	4.1	80.8
Total Business	156.8	162.4	28.6	(7.3)	155.1
SME	65.0	66.9	17.0	(0.3)	66.6
Mid-corporate	47.3	49.4	7.3	(2.6)	46.8
Large corporate	44.5	46.1	4.3	(4.4)	41.7
Total Lending	231.0	239.1	35.8	(3.2)	235.9

Lending figures represent drawn balances, with the exception of Large Corporate figures, which are committed lending (as per RBS's Lending Commitments agreement). Wealth lending balances, unsecured personal lending and non-UK lending are not included in the above data.

### Customer Franchises

Crucial to the Group's prospects for future success and return to standalone health is the resilience of its customer franchises. It was, therefore, significant that, excepting the extensive activities earmarked for restructuring, run-off or exit, RBS generally sustained its customer market positions during the first half despite the headwinds of reputational damage and financial weakness. In the UK personal sector, the RBS and NatWest banking brands made good headway, increasing the number of current account customers to 12.6 million, up 3% from June 2008, and the number of savings accounts to 9.7 million, up 18%. Our mortgage business has also made particularly good progress despite weak market demand, driven by the requirement to fulfil our lending commitments with market share increased from historically modest levels as wholesale-funded lenders have pulled out of the market. UK Corporate maintained its market-leading position among businesses, ranking first in customer satisfaction. Ulster Bank increased consumer accounts by 5%, while Citizens achieved good success in converting mortgage customers into checking account customers, with checking accounts up 2% to 4.1 million, and increased the number of business checking account customers by 3%. In GBM, good progress was made in chosen market positions, moving from fifth to fourth in the Euromoney global foreign exchange rankings and sustaining top 3 positions in key government bond markets. A number of other market shares slipped back, reflecting deliberate strategy and business disruption. RBS Insurance achieved a strong performance, with own-brand motor policies up 8% and own-brand non-motor policies also up 8%.

## Business and strategic update (continued)

### Core Bank - divisional targets

As part of the Group's strategic plan, targets have been established for each division. These targets do not constitute forecasts, but it is the Group's intention to make measurable progress towards these goals during the period covered.

Return on equity for the banking divisions is defined as divisional operating profit (after tax) divided by divisional notional equity (based on 7% of divisional risk-weighted assets (except for Global Banking & Markets, 10% and UK Corporate, 8% of RWAs) adjusted for regulatory capital deductions.

#### UK Retail

	Return on equity %	Cost:income %	Loans:deposits %
2011	>1	<60	<120
2013	>15	c.50	<105

#### UK Corporate

	Return on equity %	Cost:income %	Loans:deposits %
2011	>5	<45	<135
2013	>15	<35	<130

#### GBM

	Return on equity %	Cost:income %
2011	c15	<65
2013	15-20	c.55

#### GTS

	Return on equity %	Cost:income %	Loans:deposits %
2011	n.m.	c.55	<25
2013	n.m.	<50	<20

#### Wealth

	Return on equity %	Cost:income %	Loans:deposits %
2011	n.m.	<60	<35
2013	n.m.	<50	<30

#### Ulster Bank

	Return on equity %	Cost:income %	Loans:deposits %
2011	>0	<75	<175
2013	>15	c.50	<150

#### US Retail & Commercial

	Return on equity %	Cost:income %	Loans:deposits %
2011	c.10	<70	<90
2013	>15	<55	<90

#### Insurance

	Return on equity %	Cost:income less claims %
2011	>15	<70
2013	>20	<60

### Outlook

The exceptionally favourable market conditions from which GBM benefited in the first half of 2009 are not expected to continue in the second half, and this is likely to have a material effect on Core Bank operating income. In the retail and corporate banking divisions, income is expected to be more stable. Costs are expected to remain well controlled, while impairments are expected to remain at elevated levels. Restructuring charges will continue to be a feature over the next three years.



**Summary consolidated income statement  
for the half year ended 30 June 2009 – pro forma (unaudited)**

In the income statements set out below, amortisation of purchased intangible assets, gain on redemption of own debt, strategic disposals, write-down of goodwill and other intangible assets and integration and restructuring costs are shown separately. In the statutory condensed consolidated income statement on page 147, these items are included in income and operating expenses as appropriate. First half 2008 and full year 2008 have been restated for the amendment to IFRS 2 'Share-based payment'.

	<b>First half 2009 £m</b>	First half 2008 £m	Change %	Full Year 2008 £m
<b>Core</b>				
<b>Net interest income</b>	<b>6,043</b>	6,581	(8)	13,587
Non-interest income (excluding insurance net premium income)	<b>9,533</b>	5,235	82	6,127
Insurance net premium income	<b>2,217</b>	2,376	(7)	4,723
<b>Non-interest income</b>	<b>11,750</b>	7,611	54	10,850
<b>Total income (1)</b>	<b>17,793</b>	14,192	25	24,437
<b>Operating expenses (2)</b>	<b>(7,745)</b>	(7,218)	7	(13,856)
<b>Profit before other operating charges</b>	<b>10,048</b>	6,974	44	10,581
Insurance net claims	<b>(1,577)</b>	(1,589)	(1)	(3,217)
<b>Operating profit before impairment losses</b>	<b>8,471</b>	5,385	57	7,364
Impairment losses	<b>(2,177)</b>	(670)	-	(2,512)
<b>Operating profit (3)</b>	<b>6,294</b>	4,715	33	4,852
<b>Non-Core</b>				
<b>Net interest income</b>	<b>612</b>	920	(33)	2,177
Non-interest income (excluding insurance net premium income)	<b>(4,054)</b>	(3,946)	3	(7,001)
Insurance net premium income	<b>440</b>	485	(9)	986
<b>Non-interest income</b>	<b>(3,614)</b>	(3,461)	4	(6,015)
<b>Total income (1)</b>	<b>(3,002)</b>	(2,541)	18	(3,838)
<b>Operating expenses (2)</b>	<b>(988)</b>	(1,175)	(16)	(2,332)
<b>Operating loss before other operating charges and impairment losses</b>	<b>(3,990)</b>	(3,716)	7	(6,170)
Insurance net claims	<b>(314)</b>	(338)	(7)	(700)
Impairment losses	<b>(5,344)</b>	(809)	-	(4,920)
<b>Operating loss (3)</b>	<b>(9,648)</b>	(4,863)	98	(11,790)

For definitions of the notes see page 26.



**Summary consolidated income statement  
for the half year ended 30 June 2009 – pro forma (unaudited) (continued)**

Summary consolidated income statement	First half 2009 £m	First half 2008 £m	Change %	Full Year 2008 £m
<b>Total</b>				
<b>Net interest income</b>	<b>6,655</b>	7,501	(11)	15,764
Non-interest income (excluding insurance net premium income)	<b>5,479</b>	1,289	-	(874)
Insurance net premium income	<b>2,657</b>	2,861	(7)	5,709
<b>Non-interest income</b>	<b>8,136</b>	4,150	96	4,835
<b>Total income (1)</b>	<b>14,791</b>	11,651	27	20,599
<b>Operating expenses (2)</b>	<b>(8,733)</b>	(8,393)	4	(16,188)
<b>Profit before other operating charges</b>	<b>6,058</b>	3,258	86	4,411
Insurance net claims	<b>(1,891)</b>	(1,927)	(2)	(3,917)
<b>Operating profit before impairment losses (3)</b>	<b>4,167</b>	1,331	-	494
Impairment losses	<b>(7,521)</b>	(1,479)	-	(7,432)
<b>Operating loss (3)</b>	<b>(3,354)</b>	(148)	-	(6,938)
Amortisation of purchased intangible assets	<b>(140)</b>	(262)	(47)	(443)
Integration and restructuring costs	<b>(734)</b>	(316)	132	(1,357)
Gain on redemption of own debt	<b>3,790</b>	-	-	-
Strategic disposals	<b>453</b>	-	-	442
<b>Operating profit/(loss) before tax (4)</b>	<b>15</b>	(726)	-	(8,296)
Tax	<b>412</b>	303	36	1,280
<b>Profit/(loss) from continuing operations</b>	<b>427</b>	(423)	-	(7,016)
Loss from discontinued operations, net of tax	<b>(58)</b>	(41)	41	(86)
<b>Profit/(loss) for the period</b>	<b>369</b>	(464)	180	(7,102)
Minority interests	<b>(554)</b>	(148)	-	(412)
Preference share and other dividends	<b>(546)</b>	(215)	154	(596)
<b>Loss attributable to ordinary shareholders before write-down of goodwill and other intangible assets</b>	<b>(731)</b>	(827)	(12)	(8,110)
Write-down of goodwill and other intangible assets	<b>(311)</b>	-	-	(16,196)
<b>Loss attributable to ordinary shareholders</b>	<b>(1,042)</b>	(827)	26	(24,306)

For definitions of the notes see page 26.

**Condensed consolidated statement of comprehensive income  
for the half year ended 30 June 2009 (unaudited) – pro forma**

	<b>First half 2009 £m</b>	<b>First half 2008 £m</b>	<b>Full year 2008 £m</b>
<b>Profit/(loss)/ for the period</b>	<b>58</b>	<b>(464)</b>	<b>(23,298)</b>
Other comprehensive income:			
Available-for-sale financial assets	<b>(1,633)</b>	<b>(1,615)</b>	<b>(7,270)</b>
Cash flow hedges	<b>521</b>	<b>(123)</b>	<b>(405)</b>
Currency translation	<b>(2,447)</b>	<b>733</b>	<b>7,327</b>
Actuarial losses on defined benefit plans	<b>-</b>	<b>-</b>	<b>(1,807)</b>
Tax on other comprehensive income	<b>408</b>	<b>491</b>	<b>2,572</b>
<b>Other comprehensive income for the period, net of tax</b>	<b>(3,151)</b>	<b>(514)</b>	<b>417</b>
<b>Total comprehensive income for the period</b>	<b>(3,093)</b>	<b>(978)</b>	<b>(22,881)</b>
<b>Attributable to:</b>			
Equity shareholders	<b>(3,146)</b>	<b>(936)</b>	<b>(23,148)</b>
Minority interests	<b>53</b>	<b>(42)</b>	<b>267</b>
	<b>(3,093)</b>	<b>(978)</b>	<b>(22,881)</b>

**Summary consolidated balance sheet  
at 30 June 2009 (unaudited) – pro forma**

	<b>30 June 2009 £m</b>	<b>31 December 2008 £m</b>
Loans and advances to banks	<b>83,700</b>	129,499
Loans and advances to customers	<b>640,762</b>	731,265
Debt securities and equity shares	<b>243,279</b>	275,357
Derivatives and settlement balances	<b>579,134</b>	1,009,307
Other assets	<b>97,570</b>	73,265
<b>Total assets</b>	<b>1,644,445</b>	2,218,693
Owners' equity	<b>55,666</b>	58,879
Minority interests	<b>2,123</b>	5,436
Subordinated liabilities	<b>32,106</b>	43,678
Deposits by banks	<b>179,743</b>	262,609
Customer accounts	<b>490,282</b>	518,461
Derivatives, settlement balances and short positions	<b>594,914</b>	1,023,673
Other liabilities	<b>289,611</b>	305,957
<b>Total liabilities and equity</b>	<b>1,644,445</b>	2,218,693

## Key metrics (pre-APS)

	First half 2009	First half 2008	Change	Full Year 2008
<b>Performance ratios</b>				
Return on equity (5)	<b>(18.1%)</b>	(2.0%)	(1610bp)	(13.9%)
Net interest margin	<b>1.69%</b>	2.07%	(38bp)	2.08%
Cost:income ratio (8)	<b>59.0%</b>	72.0%	(1,300bp)	78.6%
Adjusted cost:income ratio (9)	<b>67.7%</b>	86.3%	(1,860bp)	97.0%
Basic loss per ordinary share from continuing operations	<b>(2.1p)</b>	(6.4p)	4.3p	(146.2p)
	<b>30 June 2009</b>	30 June 2008		31 December 2008
<b>Capital and balance sheet</b>				
Funded balance sheet (10)	<b>£1,088.6bn</b>	£1,247.9bn	(13%)	£1,227.2bn
Risk-weighted assets	<b>£547.3bn</b>	£491.7bn	11%	£577.8bn
Core tier 1 ratio	<b>6.4%</b>	5.3%	110bp	5.9%
Tier 1 ratio	<b>9.0%</b>	8.6%	40bp	9.9%
Non-performing loans	<b>£30.7bn</b>	£8.8bn	-	£18.8bn
Non-performing loans as a % of loans and advances	<b>5.01%</b>	1.45%	356bp	2.67%
Provision balance as % of NPL/PPLs	<b>44%</b>	57%	(1,200bp)	50%
Loan:deposit ratio	<b>144.5%</b>	137.3%	720bp	152.4%
Tier 1 leverage ratio (6)	<b>21.7x</b>	28.7x	(24%)	21.2x
Tangible equity leverage ratio (7)	<b>3.0%</b>	2.1%	90bp	2.4%
Net tangible equity per share	<b>58.0p</b>	159.5p	(64%)	73.8p

### Notes:

- (1) Excluding gain on redemption of own debt and strategic disposals.
- (2) Excluding purchased intangibles amortisation, write-down of goodwill and other intangible assets, integration and restructuring costs.
- (3) (Loss)/profit before tax, purchased intangibles amortisation, gain on redemption of own debt, strategic disposals, write-down of goodwill and other intangible assets, integration and restructuring costs.
- (4) Excluding write-down of goodwill and other intangible assets.
- (5) Loss before tax, purchased intangibles amortisation, integration and restructuring costs, gain on redemption of own debt, strategic disposals and write-down of goodwill and other intangible assets divided by average ordinary shareholders equity.
- (6) The Tier 1 leverage ratio is based on total tangible assets (after netting derivatives) divided by Tier 1 capital.
- (7) The tangible equity leverage ratio is based on total tangible equity divided by total tangible assets (after netting derivatives).
- (8) The cost:income ratio is based on total income and operating expenses as defined in (1) and (2) above.
- (9) The adjusted cost:income ratio is based on total income and operating expenses as defined in (1) and (2) above and after netting insurance claims against income.
- (10) Funded balance sheet is defined as total assets less derivatives.

## Description of business

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**UK Retail** offers a comprehensive range of banking products and related financial services to the personal market. It serves customers through the RBS and NatWest networks of branches and ATMs in the United Kingdom, and also through telephone and internet channels.

**UK Corporate** is a provider of banking, finance, and risk management services to the corporate and SME sector in the United Kingdom. It offers a full range of banking products and related financial services through a nationwide network of relationship managers, and also through telephone and internet channels. The product range includes asset finance through the Lombard brand.

**Wealth** provides private banking and investment services in the UK through Coutts & Co and Adam & Company, offshore banking through RBS International, NatWest Offshore and Isle of Man Bank, and international private banking through RBS Coutts.

**Global Banking & Markets** is a leading banking partner to major corporations and financial institutions around the world, providing an extensive range of debt and equity financing, risk management and investment services to its customers. The division is organised along seven principal business lines: money markets; rates flow trading; currencies; commodities (including RBS Sempra Commodities LLP, the commodities-marketing joint venture between RBS and Sempra Energy); equities; credit markets and portfolio management & origination.

**Global Transaction Services** ranks among the top five global transaction services providers, offering global payments, cash and liquidity management, and trade finance, United Kingdom and international merchant acquiring and commercial card products and services. It includes the Group's corporate money transmission activities in the United Kingdom and the United States.

**Ulster Bank** is the leading retail and commercial bank in Northern Ireland and the third largest banking group on the island of Ireland. It provides a comprehensive range of financial services through both its Retail Markets division which has a network of branches and operates in the personal and bancassurance sectors, while its Corporate Markets division provides services to SME business customers, corporates and institutional markets.

**US Retail & Commercial** provides financial services primarily through the Citizens and Charter One brands. US Retail is engaged in retail and corporate banking activities through its branch network in 12 states in the United States and through non-branch offices in other states. It ranks among the top five banks in New England and the Mid Atlantic regions.

**RBS Insurance** sells and underwrites retail and SME insurance over the telephone and internet, as well as through brokers and partnerships. Its brands include Direct Line, Churchill and Privilege, which sell general insurance products direct to the customer, as well as Green Flag and NIG. Through its international division, RBS Insurance sells general insurance, mainly motor, in Germany and Italy. The Intermediary and Broker division sells general insurance products through independent brokers.

**Group Manufacturing** comprises the Group's worldwide manufacturing operations. It supports the customer-facing businesses and provides operational technology, customer support in telephony, account management, lending and money transmission, global purchasing, property and other services. Manufacturing drives efficiencies and supports income growth across multiple brands and channels by using a single, scalable platform and common processes wherever possible. It also leverages the Group's purchasing power and is the Group's centre of excellence for managing large-scale and complex change.

## Description of business (continued)

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**Central items** comprises group and corporate functions, such as treasury, funding and finance, risk management, legal, communications and human resources. The Centre manages the Group's capital resources and Group-wide regulatory projects and provides services to the operating divisions.

**Non-Core Division** manages separately assets that the Group intends to run off or dispose of. The division contains a range of businesses and asset portfolios primarily from the GBM division, linked to proprietary trading, higher risk profile asset portfolios including excess risk concentrations, and other illiquid portfolios. It also includes a number of other portfolios and businesses including regional markets businesses that the Group has concluded are no longer strategic.

## Divisional performance

The operating profit/(loss) of each division before amortisation of purchased intangible assets, write-down of goodwill and other intangible assets, integration and restructuring costs, gain on redemption of own debt and strategic disposals.

	First half 2009 £m	First half 2008 £m	Change %	Full Year 2008 £m
<b>Operating profit before impairment losses</b>				
UK Retail	877	954	(8)	1,772
UK Corporate	872	1,035	(16)	1,965
Wealth	240	190	26	377
Global Banking & Markets	5,110	1,132	-	(774)
Global Transaction Services	509	497	2	1,103
Ulster Bank	149	190	(22)	324
US Retail & Commercial	318	417	(24)	965
RBS Insurance	223	300	(26)	626
Central items	173	670	(74)	1,006
Core	8,471	5,385	57	7,364
Non-Core	(4,304)	(4,054)	(6)	(6,870)
<b>Group operating profit before impairment losses</b>	<b>4,167</b>	<b>1,331</b>	<b>-</b>	<b>494</b>
Included in the above are movements in fair value of own debt of:				
Global Banking & Markets	164	584	(72)	357
Central items	(93)	228	(141)	875
	71	812	(91)	1,232
<b>Impairment losses by division</b>				
UK Retail	824	440	87	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	193	437
RBS Insurance	6	-	-	42
Central items	(2)	(36)	(94)	(18)
Core	2,177	670	-	2,512
Non-Core	5,344	809	-	4,920
<b>Group impairment losses</b>	<b>7,521</b>	<b>1,479</b>	<b>-</b>	<b>7,432</b>
<b>Operating profit/(loss) by division</b>				
UK Retail	53	514	(90)	753
UK Corporate	321	939	(66)	1,644
Wealth	218	185	18	361
Global Banking & Markets	4,873	1,115	-	(1,315)
Global Transaction Services	496	493	1	1,055
Ulster Bank	(8)	172	(105)	218
US Retail & Commercial	(51)	291	(118)	528
RBS Insurance	217	300	(28)	584
Central items	175	706	(75)	1,024
Core	6,294	4,715	33	4,852
Non-Core	(9,648)	(4,863)	98	(11,790)
<b>Group operating loss</b>	<b>(3,354)</b>	<b>(148)</b>	<b>-</b>	<b>(6,938)</b>

## Divisional performance (continued)

	First half 2009 £m	First half 2008 £m	Change %	Full Year 2008 £m
<b>Analysis of impairment losses</b>				
Loan impairment losses	6,796	1,406	-	6,478
Impairment losses on available-for-sale securities	725	73	-	954
<b>Total impairment losses</b>	<b>7,521</b>	<b>1,479</b>	<b>-</b>	<b>7,432</b>
Loan impairment charge as % of gross loans and advances excluding reverse repurchase agreements	2.22%	0.46%	176bp	0.91%
	30 June 2009 £bn	30 June 2008 £bn	31 December 2008 £bn	
<b>Risk-weighted assets by division</b>				
UK Retail	54.0	44.7	45.7	
UK Corporate	85.1	84.9	81.5	
Wealth	10.5	10.4	11.0	
Global Banking & Markets	126.6	137.7	166.5	
Global Transaction Services	16.7	16.9	17.1	
Ulster Bank	26.2	21.5	24.5	
US Retail & Commercial	55.6	44.8	63.9	
Other	8.6	8.2	7.0	
Core	383.3	369.1	417.2	
Non-Core	164.0	122.6	160.6	
<b>Total risk-weighted assets</b>	<b>547.3</b>	<b>491.7</b>	<b>577.8</b>	

## UK Retail

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m
Net interest income	1,684	1,530	10	3,229
Net fees and commissions - banking	658	814	(19)	1,524
Other non-interest income (net of insurance claims)	122	139	(12)	227
Non-interest income	780	953	(18)	1,751
Total income	2,464	2,483	(1)	4,980
Direct expenses				
- staff	(428)	(445)	(4)	(924)
- other	(221)	(219)	1	(436)
Indirect expenses	(938)	(865)	8	(1,848)
	(1,587)	(1,529)	4	(3,208)
Operating profit before impairment losses	877	954	(8)	1,772
Impairment losses	(824)	(440)	87	(1,019)
Operating profit	53	514	(90)	753
<b>Analysis of income by product:</b>				
Personal advances	609	633	(4)	1,234
Mortgages	480	219	119	497
Personal deposits	741	998	(26)	2,013
Bancassurance	122	132	(8)	217
Cards	416	418	-	831
Other	96	83	16	188
Total income	2,464	2,483	(1)	4,980
<b>Analysis of impairment by sector:</b>				
Mortgages	63	13	-	31
Personal	494	255	94	568
Cards	267	172	55	420
	824	440	87	1,019
Loan impairment charge as % of gross customer loans and advances by sector				
Mortgages	0.16%	0.04%	12bp	0.04%
Personal	7.01%	3.29%	372bp	3.76%
Cards	8.75%	5.06%	369bp	6.67%
Total	1.70%	0.96%	74bp	1.09%



## UK Retail (continued)

	First half 2009 £bn	First half 2008 £bn	Change %	Full year 2008 £bn
<b>Performance ratios</b>				
Return on equity (1)	1.8%	19.3%	(1,750bp)	13.7%
Net interest margin	3.62%	3.52%	10bp	3.62%
Cost:income ratio	63.7%	60.0%	370bp	62.1%
	30 June 2009 £bn	30 June 2008 £bn	Change %	31 December 2008 £bn
<b>Capital and balance sheet</b>				
Loans and advances to customers – gross				
- mortgages	76.9	69.7	10	72.4
- personal	14.1	15.5	(9)	15.1
- cards	6.1	6.8	(10)	6.3
Customer deposits (excluding bancassurance)	83.4	76.6	9	78.9
Assets under management – excluding deposits	4.7	6.6	(29)	5.7
Non-performing loans	4.5	3.3	36	3.8
Loan:deposit ratio (excluding repos)	116.4%	120.1%	(370bp)	118.9%
Risk-weighted assets	54.0	44.7	21	45.7

Note:

- (1) Return on equity is based on divisional operating profit after tax, divided by divisional notional equity (based on 7% of divisional risk-weighted assets, adjusted for capital deductions).

UK Retail banking income declined marginally with growth in net interest income offset by declining fees. However, impairment losses have continued to rise, reflecting the wider economic environment, and consequently the division reported a much reduced operating profit of £53 million in the first half.

Net interest income grew by 10% to £1,684 million, driven by growth in both loan and deposit balances. Net interest margin increased slightly to 3.62% (2008 - 3.52%), with improved asset pricing, primarily in mortgages, offsetting the impact of the low interest rate environment on savings margins. Continued competitive pressure on savings margins and reduced volumes in unsecured lending may put pressure on the net interest margin in coming periods.

Non-interest income declined 18% to £780 million. Of this decline, £117 million reflected the withdrawal of the single premium payment protection insurance product and lower related income due to higher claims, with the remainder being largely due to the impact of the weak economic environment on credit card, private banking and bancassurance fees.

Direct expenses were reduced by 2% to £649 million, with a 4% reduction in direct staff costs reflecting lower staff compensation and the benefits of cost saving initiatives. Indirect costs rose by 8% to £938 million, including the effect of an additional £61 million Financial Services Compensation Scheme Levy. Total costs increased by 4% and the cost:income ratio deteriorated to 63.7%.

## UK Retail (continued)

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Impairment losses increased by 87% to £824 million reflecting the deterioration in the economic environment, and its impact on customer finances. The mortgage impairment charge was £63 million (2008 - £13 million) on a total book of £76.9 billion, while the unsecured lending impairments charge was £761 million (2008 - £427 million) on a book of £20.2 billion. Impairment provisions have been increased to reflect the reduction in expected cash recoveries. In mortgages, arrears rates remain below the industry average as reported by the Council of Mortgage Lenders. Repossessions have not increased as RBS seeks to support its customers in difficult times wherever possible. Current expectations are for the upward pressure on impairments to continue for the remainder of this year and into 2010.

Loans and advances to customers increased by 6% with particularly strong growth in mortgage lending, which grew by 10%. The strong performance in mortgages reflects good volumes of new business delivered primarily through organic channels as well as very good customer retention resulting from a competitively priced product range. Gross mortgage lending market share increased to 10.5% (2008 – 6.5%) and the Group is on track to deliver its commitments to the Government on net lending. Unsecured lending has continued to slow reflecting reduced customer demand and rising risk.

Customer deposits have grown 9% reflecting the strength of the UK Retail customer franchise in an increasingly competitive environment and despite depressed market growth. This is essential in order to fund the increased lending. Personal current account customers increased 3% both year on year and annualised in the first half to 12.6 million. Personal savings accounts increased 18% year on year to 9.7 million. The division's loan:deposit ratio improved by 4 percentage points compared with June 2008 to 116%.

Risk-weighted assets increased 21% to £53.8 billion, reflecting the upward pressure from procyclicality, including the impact of rising default probability and reduced levels of expected recoveries reflecting house price declines.

RBS continues to progress towards a more convenient, lower cost operating model, with over 3.8 million active users of online banking. A record share of new sales was achieved through direct channels. In the first half 700,000 additional accounts switched to paperless statements, taking the total number of paperless accounts to 2.3 million. In support of this lower cost operating model there has also been a 6% FTE reduction year on year. In Branches, a significant number of 'Cash & Deposits Machines' (CDMs) have been rolled out, giving customers in 121 branches access to this technology. The machines can accept cheque, notes and coin deposits, and can provide an 'image' receipt for customer reassurance.

## UK Corporate

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m
Net interest income	1,006	1,194	(16)	2,344
Net fees and commissions	387	377	3	791
Other non-interest income	182	218	(17)	388
Non-interest income	569	595	(4)	1,179
Total income	1,575	1,789	(12)	3,523
Direct expenses				
- staff	(342)	(368)	(7)	(752)
- other	(106)	(137)	(23)	(288)
Indirect expenses	(255)	(249)	2	(518)
	(703)	(754)	(7)	(1,558)
Operating profit before impairment losses	872	1,035	(16)	1,965
Impairment losses	(551)	(96)	-	(321)
Operating profit	321	939	(66)	1,644
Analysis of income by business:				
Corporate and commercial lending	692	792	(13)	1,460
Asset and invoice finance	233	245	(5)	486
Corporate deposits	544	573	(5)	1,246
Other	106	179	(41)	331
Total income	1,575	1,789	(12)	3,523
Analysis of impairment by sector:				
Manufacturing	21	10	110	25
Housebuilding and construction	61	5	-	18
Property	167	7	-	71
Asset and invoice finance	68	38	79	102
Other	234	36	-	105
Total impairment	551	96	-	321
Loan impairment charge as % of gross customer loans and advances excluding reverse repurchase agreements by sector:				
Manufacturing	0.88%	0.44%	44bp	0.47%
Housebuilding and construction	2.30%	0.19%	211bp	0.31%
Property	1.02%	0.05%	97bp	0.22%
Asset and invoice finance	1.55%	0.92%	63bp	1.20%
Other	0.92%	0.13%	79bp	0.19%
	1.08%	0.18%	90bp	0.30%

## UK Corporate (continued)

	First half 2009 £bn	First half 2008 £bn	Change %	Full year 2008 £bn
<b>Performance ratios</b>				
Return on equity (1)	6.3%	19.6%	(1,330bp)	17.5%
Net interest margin	2.14%	2.64%	(50bp)	2.54%
Cost:income ratio	44.6%	42.2%	240bp	44.2%
	30 June 2009 £bn	30 June 2008 £bn	Change %	31 December 2008 £bn
<b>Capital and balance sheet</b>				
Total assets	106.0	108.2	(2)	109.8
Loans and advances to customers – gross				
- Manufacturing	4.8	4.5	7	5.3
- Housebuilding and construction	5.3	5.4	(2)	5.8
- Property	32.9	29.2	13	32.1
- Asset and invoice finance	8.8	8.3	6	8.5
- Other	50.6	57.0	(11)	54.1
Customer deposits	84.1	83.9	-	79.9
Non-performing loans	2.4	0.9	167	1.3
Loan:deposit ratio	121.8%	124.5%	(270bp)	132.4%
Risk-weighted assets	85.1	84.9	-	81.5

Note:

- (1) Return on equity is based on divisional operating profit after tax, divided by divisional notional equity (based on 8% of divisional risk-weighted assets, adjusted for capital deductions).

The first half of 2009 has been a challenging period, with operating profit falling to £321 million. Results were severely affected by worsening income and higher impairments, partially offset by cost reductions. Increases in the cost of funding, the low base rate environment and lower levels of economic activity reduced margins, driving income lower by 12%, while costs were reduced by 7%. Impairment losses were significantly higher at £551 million.

Net interest income fell by 16% to £1,006 million with narrowed margins as a result of the significant increase in the cost of funding. New business margins on lending have widened, partly reflecting repricing from Base rate to LIBOR to better reflect the Group's costs of funding. Deposit margins narrowed sharply as savings floors were reached on a range of deposit products, although the impact on net interest income was partly mitigated by hedging programmes. Overall, net interest margin reduced by 50 basis points to 2.1%, and is expected to remain under pressure while interest rates remain low and deposit competition strong.

Non-interest income has also been adversely impacted by the slowdown in the UK economy, with lower levels of activity across most sectors leading to a 4% fall to £569 million.

Total direct costs fell by 11% to £448 million, reflecting lower staff compensation and a business-wide cost reduction programme which will generate further savings into the second half. Indirect costs from Manufacturing and Group Central functions increased by 2% to £255 million.

## UK Corporate (continued)

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Impairment losses increased materially to £551 million. While there was a rise in the number of significant corporate delinquencies requiring a specific provision, increased impairments of £271 million have also been recognised to cover losses in the portfolio not yet specifically identified. The impairment charge has been biased towards the housebuilding, property and construction sectors, but this is expected to spread more widely as the adverse economic conditions begin to impact other sectors of the economy for the remainder of 2009.

Loans and advances to customers were slightly down compared with 30 June 2008 at £102.4 billion. The division has stepped up its efforts to provide support to UK businesses, reflecting the lending commitments made in February to HM Government. Demand for credit, however, remains subdued, with the value of applications for Business & Commercial term loans 37% lower than in the first half of 2008.

Deposit balances remained stable at £84.1 billion, building on the improved stability and confidence provided by the recapitalisations of 2008. Specific campaigns aimed at generating new deposits have yielded benefits in the first half of the year. Improving our capability and product offering is a key step in improving deposit-gathering performance. The loan:deposit ratio improved from 132% at the end of 2008 to 122% at June 2009.

Risk-weighted assets were stable at £85 billion, compared with June 2008, but increased by 4% from December 2008, reflecting the effect of procyclicality under Basel 2.

## Wealth

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m
Net interest income	339	271	25	588
Net fees and commissions	182	212	(14)	409
Other non-interest income	43	39	10	77
Non-interest income	225	251	(10)	486
Total income	564	522	8	1,074
Direct expenses				
- staff	(169)	(187)	(10)	(379)
- other	(68)	(72)	(6)	(156)
Indirect expenses	(87)	(73)	19	(162)
	(324)	(332)	(2)	(697)
Operating profit before impairment losses	240	190	26	377
Impairment losses	(22)	(5)	-	(16)
Operating profit	218	185	18	361
Analysis of income:				
Private Banking	469	395	19	835
Investments	95	127	(25)	239
Total income	564	522	8	1,074
	£bn	£bn	Change %	£bn
<b>Performance ratios</b>				
Net interest margin	4.64%	4.42%	22bp	4.52%
Cost:income ratio	57.5%	63.6%	(610bp)	64.9%
	30 June 2009 £bn	30 June 2008 £bn	Change %	31 December 2008 £bn
<b>Capital and balance sheet</b>				
Loans and advances to customers – gross				
- mortgages	5.8	5.2	12	5.4
- personal	4.7	4.3	9	5.0
- other	2.2	1.8	22	2.2
Customer deposits	35.7	36.1	(1)	34.5
Assets under management – excluding deposits	29.8	34.7	(14)	34.7
Non-performing loans	0.2	0.1	-	0.1
Loan:deposit ratio	35.6%	31.3%	420bp	36.6%
Risk-weighted assets	10.5	10.4	1	11.0

## Wealth (continued)

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Wealth delivered a resilient performance with income growing by 8% to £564 million and operating profit increasing by 18% to £218 million. Increases in income and reductions in direct costs were partly offset by higher provisions and higher internal allocations for support services.

Net interest income rose 25% to £339 million, primarily driven by increased internal pricing applied to the Wealth deposit base. The effect of this change improved divisional income, compared with the first half of 2008, by £89 million. Reported income also benefited from the appreciation of the Swiss franc against sterling. At constant exchange rates net interest income was 21% higher. Deposit balances have continued to grow in the second quarter of 2009 and recovered much of the outflow seen in the last quarter of 2008, demonstrating the underlying strength of the division's client relationships. The effect of lower base rates, and to a lesser extent lower average balances in the first half of 2009 (down 2% compared with the first half of 2008), was partially offset by an uplift in lending income. New deposit products have been designed to match evolving client needs for yield and liquidity. Lending volumes were strong, up 12%, particularly in mortgages and small business. Lending margins have improved, particularly for mortgages, and credit metrics for new business remain satisfactory.

Non-interest income, primarily comprising fees and commissions (for lending, payments and investments) declined 10% to £225 million as a result of two major factors: first, the significant fall in equity markets (the FTSE 100 index at 30 June 2009 was 24% lower than a year earlier while the S&P 500 index was down 28% for the same period) lowered overall investment portfolio values; second, ongoing lack of investor appetite led to lower than expected investment product sales as well as a preference for lower margin products. Furthermore, investors' use of leverage in investment portfolios was significantly lower. Together these contributed to an overall decline in investment assets under management of 14% to £29.8 billion.

Direct expenses fell 9% to £237 million reflecting three major influences: an increase due to foreign exchange effects (with the Swiss franc strengthening versus sterling), a decrease in remuneration and a further decrease from cost management. Headcount has been reduced 3% to 5,013. Indirect expenses increased by 19% to £87 million due to higher Group Centre allocations, most notably the Financial Services Compensation Scheme levies. At constant exchange rates total expenses were reduced by 8%.

Impairment losses increased by £17 million to £22 million, reflecting some isolated instances of difficulty in UK and offshore mortgage books (representing second property mortgages for expatriates). Impairment losses as a percentage of lending to customers increased to 0.35% (annualised).

Customer numbers have held steady, increasing by 1% compared with June 2008 despite the significant shrinkage in the population of high net worth individuals.

## Global Banking & Markets

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m
Net interest income from banking activities	1,560	868	80	2,473
Net fees and commissions receivable	728	643	13	1,259
Income from trading activities	5,733	2,234	157	116
Other operating income (net of related funding costs)	(191)	(69)	177	(170)
Non-interest income	6,270	2,808	123	1,205
Total income	7,830	3,676	113	3,678
Direct expenses				
- staff	(1,787)	(1,603)	11	(2,433)
- other	(539)	(640)	(16)	(1,356)
Indirect expenses	(394)	(301)	31	(663)
	(2,720)	(2,544)	7	(4,452)
Operating profit/(loss) before impairment losses	5,110	1,132	-	(774)
Impairment losses	(237)	(17)	-	(541)
Operating profit/(loss)	4,873	1,115	-	(1,315)
Analysis of income by product:				
Rates - money markets	1,356	500	171	1,150
Rates - flow	1,942	1,403	38	1,445
Currencies	976	699	40	1,524
Commodities	467	349	34	798
Equities	733	561	31	368
Credit markets	1,452	(1,028)	-	(3,496)
Portfolio management and origination	740	608	22	1,532
Fair value of own debt	164	584	(72)	357
Total income	7,830	3,676	113	3,678
Analysis of impairment by sector:				
Manufacturing and infrastructure	39	-	-	39
Property and construction	50	12	-	12
Transport	1	-	-	-
Telecommunications, media and technology	-	-	-	-
Banks and financial institutions	43	(9)	-	185
Other	104	14	-	305
	237	17	-	541
Loan impairment charge as % of gross customer loans and advances excluding reverse repurchase agreements	0.37%	0.02%	35bp	0.27%



## Global Banking & Markets (continued)

	First half 2009 £bn	First half 2008 £bn	Change %	Full year 2008 £bn
<b>Performance ratios</b>				
Return on equity (1)	51.6%	11.4%	4,020bp	(5.6%)
Net interest margin	1.69%	0.93%	76bp	1.26%
Cost:income ratio	34.7%	69.2%	(3,450bp)	121.0%
	30 June 2009 £bn	30 June 2008 £bn	Change %	31 December 2008 £bn
<b>Capital and balance sheet</b>				
Loans and advances (including banks)	166.4	175.2	(5)	236.4
Reverse repos	75.2	179.9	(58)	88.8
Securities	115.5	147.6	(22)	127.5
Cash and eligible bills	51.5	48.6	6	20.2
Other	46.3	47.6	(3)	42.9
Total third party assets (excluding derivatives mark to market)	454.9	598.9	(24)	515.8
Net derivative assets (after netting)	70.7	57.0	24	113.0
Customer deposits (excluding repos)	66.0	82.8	(20)	90.2
Non-performing loans	1.1	0.4	175	0.7
Loan:deposit ratio	195.8%	174.0%	2,180bp	200.6%
Risk-weighted assets	126.6	137.7	(8)	166.5

Note:

- (1) Return on equity is based on divisional operating profit after tax, divided by divisional notional equity (based on 10% of divisional risk-weighted assets, adjusted for capital deductions).

Following a particularly strong first quarter performance, notably in its rates and currencies businesses, Global Banking & Markets (GBM) continued to deliver robust income across all business lines throughout the first half of 2009. Total income was £7,830 million, up 113% from the first half of 2008. Costs were up 7% and credit impairments rose sharply, resulting in a first half 2009 operating profit of £4,873 million. On a constant currency basis total income was up 86% from the first half of 2008, while costs fell 1%.

The performance was particularly creditable given the immense pressures of business restructuring following 2008 losses. Significant people issues arising from competitors' hiring activities resulted in a net loss of people and revenues from GBM. GBM's ability to benefit from favourable market conditions demonstrates the core strength of its franchise. It is important to note, however, that first half revenues are likely to prove unsustainable, with a significantly lower run-rate expected in the second half of 2009.

Net interest income grew 80% to £1,560 million, with money markets income showing an especially strong performance, driven by global interest rate movements and volatility. Portfolio margins have improved, reflecting the rapid repricing taking place in the market. Fees and commissions rose 13% to £728 million, while income from trading activities advanced markedly to £5,733 million.

By business line, the rates flow business saw continued good performance in the first half of 2009 with increased market volatility and strong customer demand, albeit at a more moderate level in the second quarter than in the first, which saw exceptional levels of activity. This resulted in a 38% increase in income to £1,942 million. The currencies business continued to make good progress in consolidating its leading position, generating income of £976 million in the first half of 2009, up 40%. The Semptra Commodities joint venture, which began in April 2008, contributed income of £467 million for the first half of 2009. Money markets delivered very strong revenue of £1,356 million, benefiting from the rapid reduction in short-term rates.

Core equities and equity derivatives performed well in an active market. Core equities revenue growth was driven by a strong equity capital markets (ECM) performance, with RBS rising from 5th to 4th position in Non-US ECM from the first half of 2008 to the first half of 2009.

As the impact of various government schemes globally began to take effect credit markets benefited from greater liquidity and a more positive trading environment, driving increased activity particularly in the US liquid mortgage trading business. The legacy illiquid mortgage origination and trading portfolio that incurred losses in 2008 has been substantially closed out.

Portfolio management income remained resilient and debt capital markets origination revenues grew strongly across both Corporate and FI client sectors. Total portfolio management and origination income grew by 22% to £740 million for the first half of 2009. Gains on the fair value of own debt began to reverse as credit spreads narrowed, with a loss of £483 million booked in the second quarter compared with a gain of £647 million in the first quarter.

While total income grew by 113%, total expenses increased 7% to £2,720 million but reduced by 1% at constant exchange rates. Besides currency effects, the expense line reflects the inclusion of Semptra for the full six months and the phasing of performance-related accruals. Compensation structures have undergone far-reaching review to align reward with long-term value creation, adjusted for risk; the compensation ratio for the half year was 23%, at the lower end of the expected range for this ratio for the full year. The ratio is likely to increase modestly in 2010/11 as the full accounting impact of new deferral policies accrues. Notwithstanding adverse exchange rate movements, non-staff costs were cut by 16%, primarily reflecting restructuring and efficiency benefits. Headcount reduced by 1,500, or 8%, compared with June 2008. The overall cost:income ratio improved significantly to 34.7%, reflecting the exceptionally strong income performance.

Impairments increased sharply to £237 million, representing 0.37% of loans & advances to customers. This compares with 0.02% for the first half of 2008 which was the low point in the economic cycle.

## Global Banking & Markets (continued)

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GBM's total third party assets excluding derivatives were reduced to £455 billion at 30 June 2009, a reduction of 24% on a year earlier, or 30% at constant exchange rates, reflecting continued progress in managing down the inventories supporting the trading businesses, with significant reductions in reverse repos and securities holdings. Within this, total loans and advances were £166 billion, a decrease of 5% from June 2008 or 13% at constant exchange rates, reflecting higher levels of corporate repayments particularly in Europe and the USA. GBM continued to provide direct support for key clients, notably in the UK, while at the same time facilitating their access to the global equity and debt capital markets. Net derivative assets totalled £70.7 billion, compared with £113.0 billion at 31 December 2008.

Risk-weighted assets reduced by 8% from a year earlier to £126.6 billion and were 24% lower than at 31 December 2008. The movement was principally affected by lower non-UK lending, reduced derivatives and foreign exchange movements.

Good progress was made in increasing market share in core markets, moving from fifth to fourth in the Euromoney global foreign exchange rankings and sustaining top 3 positions in key government bond markets. A number of other market shares slipped back, reflecting deliberate strategy and business disruption.

## Global Transaction Services

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m
Net interest income	446	445	-	939
Non-interest income	782	710	10	1,491
Total income	1,228	1,155	6	2,430
Direct expenses				
- staff	(183)	(179)	2	(363)
- other	(72)	(66)	9	(100)
Indirect expenses	(464)	(413)	12	(864)
	(719)	(658)	9	(1,327)
Operating profit before impairment losses	509	497	2	1,103
Impairment losses	(13)	(4)	-	(48)
Operating profit	496	493	1	1,055
Analysis of income by product:				
Domestic cash management	404	381	6	793
International cash management	350	344	2	723
Trade finance	152	110	38	240
Merchant acquiring	260	263	(1)	555
Commercial cards	62	57	9	119
Total income	1,228	1,155	6	2,430
	£bn	£bn	Change %	£bn
<b>Performance ratios</b>				
Net interest margin	8.75%	8.27%	48bp	8.27%
Cost: income ratio	58.6%	57.0%	(160bp)	54.6%
	30 June 2009 £bn	30 June 2008 £bn	Change %	31 December 2008 £bn
<b>Capital and balance sheet</b>				
Total third party assets	19.7	21.0	(6)	22.5
Loans and advances	13.8	15.7	(12)	15.2
Customer deposits	54.0	59.7	(10)	62.0
Non-performing loans	0.1	-	-	0.1
Loan:deposit ratio	26.4%	27.6%	(120bp)	25.7%
Risk-weighted assets	16.7	16.9	(1)	17.1

## Global Transaction Services (continued)

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Global Transaction Services increased operating profit by 1% to £496 million, with results benefiting from currency movements. Income increased by 6% to £1,228 million, but declined 2% at constant exchange rates. Expenses were up 9%, but 2% in constant currency terms, as cost savings and efficiencies offset the impact of prudent investment in staffing and infrastructure in the second half of 2008.

Growth was driven by a solid performance in cash management, where income rose 4% in the first half of the year to £754 million, with growth in UK and US domestic cash management. The division continued to win new cash management business, reflecting the strength of the domestic platforms and the international network.

In the UK domestic market income grew by 5% despite the low interest rate environment and increased competition for deposits. Average deposits increased 13% to £15 billion, attributable to growth with UK financial institutions. US domestic fee income benefited from re-pricing strategies implemented in the second half of 2008 as income grew 9%, with currency effects mitigating the migration of some balances to Citizens.

International cash management income increased by 2% but was 7% lower at constant exchange rates. Income benefited primarily from the increased internal pricing applied to the GTS deposit base, but this was more than offset by the negative impact on margins caused by low base rates. Average deposit balances remained stable, but there was some attrition of international deposit customers affecting the period end spot balances. Interest rates are negatively impacting deposit margins as zero rate floors are reached on a range of products. The continued benefit of overdraft re-pricing has increased margins on asset balances versus the first half of 2008. International fee income from payment transactions has increased 19% on H1 2008.

The trade finance business increased income by 38%, with improving penetration into the Asia-Pacific region. The strength of the product platform resulted in new customer mandates particularly in the UK corporate sector, where the Supply chain service has continued to expand.

Merchant services and commercial cards income remained stable at £322 million in the face of changing consumer spending patterns. The value of individual transactions has decreased together with a switch from credit card to debit card usage as households pay down debt. Volume growth in the UK domestic acquiring market was up 5%, exceeding UK economic growth, which partly offset the decreasing value of individual transactions. Commercial cards income grew 9% driven by improved margins, compensating for the downturn in corporate spending.

Total expenses for the division rose 9% in the first half of 2009 to £719 million, largely reflecting exchange rate movements, with direct expenses up 4% to £255 million and indirect expenses up 12% to £464 million. In constant currency terms, direct expenses were reduced by 1% as a result of the division's continued implementation of cost saving initiatives and operating model efficiencies, while indirect expenses increased by 4%. The cost: income ratio was 58.6%, a deterioration of 2.4% in constant currency terms.

Impairment losses were £13 million for the first half 2009, up from £4 million in the first half of 2008. Overall defaults remain modest at 0.1% of loans and advances.

### **Global Transaction Services (continued)**

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Average deposit balances for the period remained stable, but deposits at 30 June 2009 were down 10% on the first half of 2008, driven in part by US domestic transfers within the wider Group and some attrition in international cash management. Loans and advances were down 12% from June 2008 due to lower overdraft utilisation. In constant currency terms, deposits fell by 12% and loans and advances by 15%. Divisional net funding contribution has remained stable. Risk-weighted assets were 6% lower in constant currency terms.

## Ulster Bank

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m
Net interest income	410	392	5	773
Net fees and commissions	85	104	(18)	228
Other non-interest income	23	39	(41)	38
Non-interest income	108	143	(24)	266
Total income	518	535	(3)	1,039
Direct expenses				
- staff	(170)	(159)	7	(330)
- other	(47)	(46)	2	(93)
Indirect expenses	(152)	(140)	9	(292)
	(369)	(345)	7	(715)
Operating profit before impairment losses	149	190	(22)	324
Impairment losses	(157)	(18)	-	(106)
Operating (loss)/profit	(8)	172	(105)	218
Analysis of income by business:				
Corporate	299	319	(6)	618
Retail	194	197	(2)	396
Other	25	19	32	25
Total income	518	535	(3)	1,039
Analysis of impairment by sector:				
Mortgages	23	7	-	17
Corporate	107	-	-	44
Other	27	11	145	45
	157	18	-	106
Loan impairment charge as % of gross customer loans and advances excluding reverse repurchase agreements by sector				
Mortgages	0.29%	0.09%	20bp	0.09%
Corporate	1.00%	-	100bp	0.18%
Other	3.38%	0.92%	246bp	2.14%
	0.81%	0.10%	71bp	0.24%

## Ulster Bank (continued)

	£bn	£bn	Change %	£bn
<b>Performance ratios</b>				
Return on equity (1)	<b>(0.7%)</b>	18.2%	(1,890bp)	10.1%
Net interest margin	<b>1.95%</b>	1.92%	3bp	1.89%
Cost:income ratio	<b>71.2%</b>	64.5%	670bp	68.8%

	30 June 2009 £bn	30 June 2008 £bn	Change %	31 December 2008 £bn
<b>Capital and balance sheet</b>				
Loans and advances to customers – gross				
- mortgages	<b>16.0</b>	15.7	2	18.1
- corporate	<b>21.2</b>	18.8	13	23.8
- other	<b>1.8</b>	2.4	(25)	2.1
Customer deposits	<b>18.9</b>	22.9	(17)	24.3
Non-performing loans				
- mortgages	<b>0.4</b>	0.2	-	0.3
- corporate	<b>1.1</b>	0.2	-	0.8
- other	<b>0.1</b>	0.1	-	0.1
Loan:deposit ratio	<b>206.3%</b>	161.1%	4,520bp	181.1%
Risk-weighted assets	<b>26.2</b>	21.5	22	24.5

Note:

- (1) Return on equity is based on divisional operating profit after tax, divided by divisional notional equity (based on 7% of divisional risk-weighted assets, adjusted for capital deductions).

Ulster Bank's results have been severely affected by economic conditions across the island of Ireland. Income fell by 3%, or by 14% at constant exchange rates, to £518 million, reflecting reduced volumes and narrowing margins. Although expense growth remained under tight control, impairments rose sharply, resulting in an operating loss of £8 million.

Net interest income declined to £410 million in the first half of 2009, a reduction of 8% at constant exchange rates, with net interest margin up 3 basis points to 1.95%. There was some easing of wholesale funding costs over the course of the period, and a re-pricing of some new lending, but this was largely offset by the increasing cost of acquiring and retaining customer deposits. Margins are expected to decline reflecting the highly competitive deposit market. Loans to customers were flat year on year as new lending reduced significantly reflecting subdued demand, although redemption levels have also fallen. Ulster Bank remains on track to deliver its portion of the Group's lending commitments in Northern Ireland. Non-wholesale customer deposits were broadly flat reflecting the highly competitive deposit market in Ireland. Customer deposits were down by 21% in constant currency terms, primarily as a result of the impact of the Irish Government guarantee scheme and a reduction in wholesale deposits in the first quarter but this has since stabilised.

Non-interest income fell by 30% at constant currency rates in the first half of 2009 reflecting reduced fee income from bancassurance products sales and lower activity levels, particularly in the banking and Capital Markets businesses.



## Ulster Bank (continued)

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Direct expenses were £217 million, a reduction of 5% in constant currency terms, driven by a 4% reduction in staff costs, reflecting the initial benefits of the Bank's restructuring programme. On the same constant currency basis, other costs were 10% lower as a result of a range of cost reduction initiatives across the business, with indirect costs held flat.

Impairment charges increased to £157 million, reflecting the significant continuing deterioration in the Irish economic outlook and the resultant change in underlying credit metrics. Impairments are expected to continue to rise in the second half of 2009.

Ulster Bank continues to launch products aimed at supporting existing and new customers through the changing economic environment. These include the Momentum mortgage and Co-ownership Scheme in Northern Ireland and the Secure Step mortgage in the Republic of Ireland. For business customers, €1billion of funding has been made available across the island of Ireland including £250 million of SME funding in Northern Ireland. Support is also being provided to customers through the launch of the "MoneySense for Adults" and "Flex" propositions, as well as the "Small Business Can" website.

Ulster Bank launched its 'One Bank' programme in January which is on track for completion by the end of 2009. The programme will see the merger of the First Active and Ulster Bank businesses and the implementation of a number of cost management initiatives across all business areas. The creation of a single franchise across the island of Ireland will increase efficiency and result in further cost reductions whilst providing customers with an improved level of service. Customer numbers have grown across the Ulster Bank brand and across the island of Ireland, with strong growth in current and savings accounts driving a 5% increase in total consumer accounts compared with June 2008.

## US Retail & Commercial

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m	First half 2009 \$m	First half 2008 \$m	Change %	Full year 2008 \$m
Net interest income	942	774	22	1,726	1,407	1,529	(8)	3,200
Net fees and commissions	407	310	31	664	608	612	(1)	1,231
Other non-interest income	97	84	15	197	144	168	(14)	362
Non-interest income	504	394	28	861	752	780	(4)	1,593
Total income	1,446	1,168	24	2,587	2,159	2,309	(6)	4,793
Direct expenses								
- staff	(402)	(311)	29	(645)	(600)	(614)	(2)	(1,194)
- other	(331)	(142)	133	(354)	(495)	(281)	76	(654)
Indirect expenses	(395)	(298)	33	(623)	(589)	(588)	-	(1,157)
	(1,128)	(751)	50	(1,622)	(1,684)	(1,483)	14	(3,005)
Operating profit before impairment losses	318	417	(24)	965	475	826	(42)	1,788
Impairment losses	(369)	(126)	193	(437)	(551)	(249)	121	(811)
Operating (loss)/profit	(51)	291	(118)	528	(76)	577	(113)	977
Analysis of income by product:								
Mortgages and home equity	272	175	55	375	407	346	18	695
Personal lending and cards	220	157	40	333	328	310	6	617
Retail deposits	433	465	(7)	1,000	647	919	(30)	1,853
Commercial lending	281	179	57	405	419	354	18	751
Commercial deposits	193	169	14	377	288	334	(14)	698
Other	47	23	104	97	70	46	52	179
Total income	1,446	1,168	24	2,587	2,159	2,309	(6)	4,793
Average exchange rate - US\$/£	1.494	1.975		1.853				

## US Retail & Commercial (continued)

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m	First half 2009 \$m	First half 2008 \$m	Change %	Full year 2008 \$m
Analysis of impairment by sector:								
Residential mortgages	35	12	192	41	52	24	117	76
Home equity	72	25	188	67	107	50	114	125
Corporate & Commercial	169	40	-	181	253	78	-	335
Other consumer	93	49	90	148	139	97	43	275
	369	126	193	437	551	249	121	811
Loan impairment charge as % of gross customer loans and advances excluding reverse repurchase agreements by sector								
Residential mortgages	0.96%	0.30%	66bp	0.43%	0.87%	0.30%	57bp	0.55%
Home equity	0.91%	0.37%	54bp	0.36%	0.82%	0.37%	45bp	0.46%
Corporate & Commercial	1.65%	0.47%	118bp	0.76%	1.50%	0.47%	103bp	0.97%
Other consumer	2.25%	1.35%	90bp	1.51%	2.04%	1.36%	68bp	1.92%
	1.42%	0.55%	87bp	0.71%	1.29%	0.55%	74bp	0.90%
<b>Performance ratios</b>								
Return on equity (1)	(1.7%)	12.1%	(1,380bp)	7.7%	(1.5%)	12.0%	(1,350bp)	9.70%
Net interest margin	2.31%	2.61%	(30bp)	2.65%	2.32%	2.61%	(29bp)	2.68%
Cost:income ratio	78.0%	64.2%	1,380bp	62.7%	78.0%	64.2%	1,380bp	62.7%
	30 June 2009 £bn	30 June 2008 £bn	Change %	31 December 2008 £bn	30 June 2009 £bn	30 June 2008 £bn	Change %	31 December 2008 £bn
<b>Capital and balance sheet</b>								
Total assets	75.6	68.9	10	87.5	124.4	137.0	(9)	127.8
Loans and advances to customers (gross):								
- Residential mortgages	7.3	8.0	(9)	9.5	12.0	15.9	(25)	13.9
- home equity	15.9	13.5	18	18.7	26.1	26.8	(3)	27.2
- corporate and commercial	20.5	16.6	23	23.7	33.6	33.0	2	34.7
- other consumer	8.3	7.2	15	9.8	13.7	14.4	(5)	14.3
Customer deposits	60.2	52.5	15	64.4	99.0	104.5	(5)	94.0
Non-performing loans								
- retail	0.3	0.1	-	0.2	0.4	0.2	-	0.3
- commercial	0.1	-	-	0.2	0.3	0.1	-	0.2
Loan:deposit ratio	86.7%	87.4%	(70bp)	96.6%	86.7%	87.4%	(70bp)	96.6%
Risk-weighted assets	55.6	44.8	24	63.9	91.3	89.2	2	93.2
Spot exchange rate - US\$/£	1.644	1.989		1.460				

Note:

- (1) Return on equity is based on divisional operating profit after tax, divided by divisional notional equity (based on 7% of divisional risk-weighted assets, adjusted for capital deductions).

## US Retail & Commercial (continued)

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US Retail & Commercial Banking results were challenged by the recessionary economic environment in the United States and historically low interest rates. Credit conditions worsened as the housing market continued to deteriorate and unemployment rose, exacerbating already difficult conditions. As a result, income declined by 6% to \$2,159 million, producing an operating loss of \$76 million. In sterling terms, total income increased by 24% to £1,446 million with an operating loss of £51 million, reflecting a significant weakening of sterling against the dollar.

Net interest income was down 8% to \$1,407 million with lower net interest margin at 2.31% for the first half of 2009 compared with 2.61% for the first half of 2008. The low interest rate environment contributed to a decline of 30 basis points in deposit margins, only partially offset by wider loan margins, reflecting deteriorating credit conditions and tighter underwriting standards. Non-interest income was down 4% primarily due to lower gains, which declined by \$29 million. Net fees and commissions were flat, with higher mortgage origination fees resulting from record refinancing activity offsetting weaker consumer banking fees. Depending upon the prevailing rate environment and local market competition, net interest margins are expected to remain stable / range-bound in the second half, largely driven by pricing around deposits.

Total expenses increased by 14% to \$1,684 million, largely as a result of higher deposit insurance costs including a one-off FDIC special assessment of \$72 million, as well as increased costs relating to loan workout and collection activity which is expected to mitigate the impact of future impairments. Half year results include the successful execution of restructuring actions announced at the end of 2008. These actions impacted approximately 1,000 employees and resulted in savings of \$32 million reflected in the first half results. With income weak, the cost:income ratio deteriorated markedly to 78%.

Impairment losses totalled \$551 million in the first half of 2009 compared with \$249 million in the first half of 2008 impacting both the retail and commercial loan portfolios. Actual charge-offs were \$376 million or 0.87% of loans, an increase of 44bps compared with the first half of 2008. There was a net increase of \$175 million in provision balances in the half. Consumer loan delinquencies have continued to rise throughout the first half reflecting the difficult economic conditions, representing 1.80% of loans compared with 1.04% of loans in the first half of 2008. Likewise, commercial non-performing loans rose to 0.87% of total loans compared with 0.20% in the first half of 2008. The challenging economic environment continues to affect credit losses; however, Citizens' asset quality remains superior to peers as measured by non performing loans as a percentage of total loans.

Loans and advances were down 5% at \$85.4 billion reflecting mortgage securitisations and subdued customer demand, partly offset by a modest increase in commercial loan balances, which rose 2%. Total customer deposits including wholesale funding at 30 June 2009 were 5% lower at \$99 billion, principally due to a planned reduction in wholesale funding. However, despite a very competitive deposit market, core customer deposits were up 5% to \$99 billion, partly driven by strong growth in checking balances. The loan:deposit ratio improved to 87%.

## **US Retail & Commercial** (continued)

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US Retail & Commercial is a top 5 bank in New England and the Mid Atlantic regions and is among the top five participants in eight out of the ten largest sub-markets in which it has a presence. Its strategy is based on building market share through dedicated marketing and competitive pricing strategies within its footprint and on capturing opportunities in underpenetrated segments by building relationships with small and medium-sized companies.

## RBS Insurance

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m
Earned premiums	2,225	2,263	(2)	4,512
Reinsurers' share	(85)	(107)	(21)	(206)
Insurance net premium income	2,140	2,156	(1)	4,306
Net fees and commissions	(187)	(201)	(7)	(396)
Investment income	115	180	(36)	367
Other income	97	87	11	153
Total income	2,165	2,222	(3)	4,430
Direct expenses				
- staff	(139)	(145)	(4)	(286)
- other	(121)	(127)	(5)	(225)
Indirect expenses	(131)	(124)	6	(261)
	(391)	(396)	(1)	(772)
Gross claims	(1,574)	(1,571)	-	(3,136)
Reinsurers' share	23	45	(49)	104
Net claims	(1,551)	(1,526)	2	(3,032)
Operating profit before impairment losses	223	300	(26)	626
Impairment losses	(6)	-	-	(42)
Operating profit	217	300	(28)	584
Analysis of income by product:				
Motor own-brand	972	959	1	1,942
Household and Life own-brands	414	400	4	806
Motor partnerships and broker	290	353	(18)	686
Household and Life, partnerships and broker	164	181	(9)	354
Other (International, commercial and central)	325	329	(1)	642
Total income	2,165	2,222	(3)	4,430
<b>Key business metrics</b>				
In-force policies (thousands)				
- Motor own-brand	4,789	4,424	8	4,492
- Own-brand non-motor (home, rescue, pet, HR24)	5,890	5,449	8	5,560
- Partnerships & broker (motor, home, rescue, pet, HR24)	5,609	6,417	(13)	5,898
- Other (International, commercial and central)	1,210	1,123	8	1,206
Gross written premium (£m)	2,270	2,224	2	4,384
<b>Performance ratios</b>				
Return on equity (1)	13.6%	18.8%	(520bp)	18.3%
Cost:income ratio	18.1%	17.8%	30bp	17.4%
Adjusted cost:income ratio (2)	63.7%	56.9%	680bp	55.2%
<b>Balance sheet</b>				
General insurance reserves – total (£m)	6,601	6,658	(1)	6,672

Note:

- (1) Return on equity is based on divisional operating profit after tax, divided by divisional notional equity (based on regulatory capital).
- (2) The adjusted cost:income ratio is based on total income and operating expenses above and after netting insurance claims against income.

## RBS Insurance (continued)

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For RBS Insurance, insurance premium income was stable at £2,140 million, reflecting 4% growth in the Group's own brands offset by a 10% decline in the partnerships and broker segment. This reflects the division's strategy of maximising profitability while focusing on growth in the Group's own-brand businesses. Investment income declined by 36% to £115 million, largely as a result of a year over year reduction in interest rates. The division has a very conservative investment policy for its £8.4 billion of invested funds, with 84% in short duration deposits and fixed income bonds. Net fees and commissions payable were 7% lower, mainly as a result of lower sales of the creditor product. Operating profit in the first half was £217 million, a decline of £83 million or 28% from the first half of 2008, of which £71 million directly related to lower investment returns and impairment losses.

In the UK motor market, the Churchill and Privilege brands continued to be successfully deployed on selected price comparison web sites. Direct Line, Churchill and Privilege motor policy numbers increased by 2%, 22% and 13% respectively over the period. In total, over previous year, own-brand motor policy numbers have increased by 8% to 4.8 million.

In own-brand non-motor insurance RBS Insurance has continued to achieve strong sales through RBS and NatWest, where home insurance policies in force increased by 16%. Direct Line has achieved a 2% increase in the number of policy renewals in the period. In addition, Privilege and Churchill have grown home policies by 223% and 29% respectively, mainly due to successful entry onto price comparison websites. Overall own-brand non-motor policies in force have grown by 8% to 5.9 million.

Direct expenses improved by 4% to £260 million, mainly driven by lower staff costs and reduced marketing spend.

Net claims were 2% higher at £1,551 million due to increases in creditor claims, home claims relating to the very cold weather in the first quarter of 2009, and a rise in personal injury motor claims costs. Impairment losses of £6 million reflect impairments of available for sale securities.

Gross written premium increased by 2% over the period, reflecting the strong growth in own-brand businesses. Own-brand motor gross written premium increased by 10% year on year and own-brand home gross written premium increased by 11%.

The UK combined operating ratio for the first half of 2009, including manufacturing costs, rose to 95.3%, compared with 94.8% a year earlier, reflecting a higher loss ratio partly offset by an improved expense base.

In April 2009 the Group disposed of its 50% stake in Linea Directa to Bankinter, its joint venture partner. In 2008 it also disposed of its 50% stake in Tesco Personal Finance. All financial data have been restated to exclude Linea Directa and Tesco Personal Finance.

## Central items

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m
Fair value of own debt	(93)	228	(141)	875
Other	268	478	(44)	149
Central items not allocated	175	706	(75)	1,024

Funding and operating costs have been allocated to operating divisions, based on direct service usage, requirement for market funding and other appropriate drivers where services span more than one division. Residual unallocated items relate to volatile corporate items that do not naturally reside within a division.

Items not allocated amounted to a net credit of £175 million (first half 2008 - £706 million) and comprised an increase in the carrying value of own debt more than offset by a net credit on a number of other volatile items including foreign exchange translation and the impact of economic hedges which do not qualify for IFRS hedge accounting.



## Non-Core

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m
Net interest income from banking activities	612	920	(33)	2,177
Net fees and commissions receivable	256	495	(48)	923
Loss from trading activities	(4,276)	(5,286)	(19)	(8,529)
Insurance net premium income	440	485	(9)	986
Other operating income	(34)	845	(104)	605
Non-interest income	(3,614)	(3,461)	4	(6,015)
Total income	(3,002)	(2,541)	18	(3,838)
Direct expenses				
- staff	(259)	(410)	(37)	(658)
- other	(450)	(509)	(12)	(1,135)
Indirect expenses	(279)	(256)	9	(539)
	(988)	(1,175)	(16)	(2,332)
Operating loss before other operating charges and impairment losses	(3,990)	(3,716)	7	(6,170)
Insurance net claims	(314)	(338)	(7)	(700)
Impairment losses	(5,344)	(809)	-	(4,920)
Operating loss	(9,648)	(4,863)	98	(11,790)
			Change %	
<b>Performance ratios</b>				
Net interest margin	0.49%	0.83%	(34bp)	0.90%
Cost:income ratio	(32.9%)	(46.2%)	1,330bp	(60.8%)
	30 June 2009 £bn	30 June 2008 £bn	Change %	31 December 2008 £bn
<b>Capital and balance sheet*</b>				
Total third party assets (including derivatives)	231.1	276.3	(16)	324.7
Loans and advances to customers - gross	166.3	164.9	1	190.2
Customer deposits	20.8	25.1	(17)	26.5
Non-performing loans	20.5	3.5	-	11.2
Loan:deposit ratio	819.6%	654.7%	-	720.2%
Risk-weighted assets	164.0	122.6	34	160.6
Income by donating division:				
UK Retail	3	147	(98)	288
UK Corporate	244	324	(25)	609
Wealth	209	243	(14)	454
Global Banking & Markets	(4,221)	(3,957)	7	(6,694)
Global Transaction Services	85	60	42	132
Ulster Bank	112	191	(41)	317
US Retail & Commercial	170	162	5	342
RBS Insurance	406	543	(25)	1,105
Central items	(10)	(254)	(96)	(391)
	(3,002)	(2,541)	18	(3,838)

\* includes disposal groups.

## Non-Core (continued)

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m
Included in income donated by Global Banking & Markets above are credit and other market write-downs as follows:				
Monoline exposures	1,547	2,120	(27)	3,090
CDPCs	569	80	-	615
Super senior CDOs	537	1,892	(72)	2,976
Leveraged finance	-	863	-	1,088
CLO's	-	113	-	240
Other credit exotics	542	361	50	947
Equities	22	36	(39)	948
Other	35	(61)	-	268
	3,252	5,404	(40)	10,172
CDS Hedging	996	(148)	-	(1,690)
	4,248	5,256	(19)	8,482
Impairment losses by donating division:				
UK Retail	34	47	(28)	105
UK Corporate	1,092	106	-	508
Wealth	156	61	156	167
Global Banking & Markets	2,987	277	-	3,105
Global Transaction Services	17	6	183	11
Ulster Bank	484	78	-	420
US Retail & Commercial	574	234	145	604
	5,344	809	-	4,920
Loan impairment charge as % of gross customer loans and advances by donating division				
UK Retail	2.34%	1.67%	67bp	3.23%
UK Corporate	8.94%	0.92%	802bp	2.03%
Wealth	12.19%	5.13%	706bp	5.28%
Global Banking & Markets	4.38%	0.53%	385bp	1.90%
Global Transaction Services	2.85%	0.86%	199bp	0.78%
Ulster Bank	5.97%	1.07%	490bp	2.38%
US Retail & Commercial	9.34%	3.96%	538bp	3.88%
Total	5.65%	1.00%	465bp	2.20%

## Non-Core (continued)

	30 June 2009 £bn	30 June 2008 £bn	Change %	31 December 2008 £bn
Loans and advances by donating division:				
UK Retail	2.9	5.6	(48)	3.3
UK Corporate	24.4	23.1	6	25.0
Wealth	2.6	2.4	8	3.2
Global Banking & Markets	106.4	105.7	1	123.7
Global Transaction Services	1.2	1.4	(14)	1.4
Ulster Bank	16.2	14.6	11	17.7
US Retail & Commercial	12.3	11.8	4	15.6
RBS Insurance	0.2	0.2	-	0.2
Group centre	0.1	0.1	-	0.1
	<b>166.3</b>	<b>164.9</b>	<b>1</b>	<b>190.2</b>
Risk-weighted assets by donating division:				
UK Retail	2.0	5.0	(60)	2.0
UK Corporate	18.9	19.4	(3)	17.8
Wealth	2.9	3.4	(15)	3.7
Global Banking & Markets	118.1	72.5	63	112.6
Global Transaction Services	1.9	2.2	(14)	2.8
Ulster Bank	8.4	8.9	(6)	6.8
US Retail & Commercial	11.5	10.6	8	14.1
Group centre	0.3	0.6	-	0.8
	<b>164.0</b>	<b>122.6</b>	<b>34</b>	<b>160.6</b>

## Non-Core (continued)

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The establishment of the Non-Core Division of RBS was announced on 26 February 2009 as one of the key outcomes of the Group Strategic Review.

The Non-Core Division comprises a number of businesses and assets, including a number of overseas branches and subsidiaries which did not meet the target criteria of the new core bank. These criteria covered franchise strength, return on equity over the economic cycle, organic growth potential, capital and funding efficiency, and connectivity with other businesses of the Group.

The objective of the Division is to run off or dispose of the resulting pool of assets over a three to five year period whilst maximising shareholder value and minimising any negative impact on the core franchises of the bank. The Division will seek to achieve this first and foremost by optimising the timing, cost and method of exit of the Non-Core businesses and assets. The terms of the APS may constrain the Group in certain respects. In addition it will aim to achieve a reduction in the amount of capital and funding required to support the Group and over time to reduce the Group's cost base.

Following further detailed review of the Non-Core asset portfolio during the first half of 2009, a total of £325 billion of third party assets, as at 31 December 2008, were confirmed for transfer to the new Division. This total comprises £251 billion of on-balance sheet funded third party assets and £73 billion of derivative marked-to-market third party assets, compared with the estimates of £240 billion and £145 billion, respectively, announced on 26 February. In addition, the Division had outstanding undrawn commitments of £85 billion. The revised portfolio equates to £161 billion of RWAs, compared with £155 billion announced in February.

GBM's contribution made up 77% of starting third party assets (including derivative marked-to-market exposures) and 70% of RWAs comprising a number of illiquid medium to long-term structured finance lending books, exotic credits, illiquid asset-backed securities and proprietary trading assets. The balance of the Division's asset pool was contributed by other divisions in the Group and comprises a range of businesses and corporate, commercial and consumer loan books.

In order to provide a coherent management framework for the run-off and disposal of the Division's assets, a new management team has been established to exclusively focus on this task, utilising the Group's infrastructure. The opening asset pool has been divided into three groupings, each of which is managed on a global basis by one or more executives:

- Banking & Portfolio comprises the structured finance portfolios – mainly real estate finance, leveraged finance and project and asset-based finance which originated within GBM.
- Retail, Commercial & Countries mainly comprises the retail, commercial and in some cases wholesale banking activities of the Group in the UK and overseas locations which have been determined to be non-core.
- Trading comprises a number of exotic credit and highly illiquid asset-backed securities and proprietary trading books.

## Non-Core (continued)

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Approximately 44% of the assets (50% of RWAs) in the Non-Core Division are expected to be covered by the UK Asset Protection Scheme (APS). The precise extent of the asset coverage and the terms of APS are still under negotiation with HMT. RBS also intends to clarify the eligibility of certain Ulster Bank assets for the Irish Government's National Asset Management Agency scheme. Given the overlap and interdependencies between the APS and the Non-Core Division, the management of the two programmes is integrated within the Non-Core Division.

Between December 2008 and June 2009, total third party assets were reduced by £94 billion to £231 billion, including a £51 billion reduction in funded third party assets (excluding derivatives). The reduction in funded third party assets was assisted by foreign exchange movements, which resulted in a £14 billion decline. In addition, net balance run-off totalled £20 billion, and £9 billion of disposals were recorded, including the sale of Linea Directa in Spain (£0.5 billion) and Bank of China (£3.9 billion). Mark-to-market derivative assets decreased by £43 billion, largely as a result of the significant rally in credit markets which led to spreads tightening.

The Division has large hedging exposures on a number of portfolios, so a similar movement in mark-to-market derivative liabilities was recorded.

RWAs remained flat at £164 billion, compared with £161 billion in December 2008. The movements in RWAs were broadly consistent with the movements in nominal assets in Citizens, UK Retail, Wealth and Global Transaction Services. In the case of UK Corporate Banking and Ulster, nominal assets decreased but RWAs increased, primarily as a result of procyclicality.

Non-Core's GBM funded third party assets fell by a total of £36.3 billion, while its' RWAs increased by a net £5.6 billion. Reductions in RWAs as a result of foreign exchange rates (£8.7 billion), reductions in market risk (other than in relation to CDPC exposures) (£9.2 billion) the movement of certain counterparties to default status (causing their removal from the calculation) (£6.1 billion) and other reductions of £13.0 billion, were more than offset by increases in RWAs of £26.3 billion in respect of market and counterparty risk associated with CDPC exposures and of £16.3 billion, from the impact of procyclicality on probability of default and loss given default factors.

The Non-Core Division recorded an operating loss of £9,648 million in the first half of 2009. Net interest income was £612 million, down 33%, but non-interest income totalled a negative £3,614 million, including £4,248 million of credit market and other write-downs, compared with £5,256 million in the first half of 2008. These write-downs included £1,547 million of monoline losses, which were largely incurred in the first quarter and reflected the further widening in monoline credit spreads in February. The Division uses a portfolio of CDSs to manage the capital consumption, concentration and credit risk of its loans. The CDSs are carried at fair value while the loans are recorded at cost less provisions for impairment. The tightening of spreads in the first half of 2009 reduced income by £996 million compared with a positive income impact of £148 million in the first half of 2008 and £1,690 million for full year 2008.

## Non-Core (continued)

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The operating loss was largely due to the increase in impairment charges, compared with the first half of 2008, on assets contributed by GBM (£2,709 million), UK Corporate (£986 million), US Retail & Commercial (£340 million) and Ulster (£406 million).

Targets have been set for a reduction of third party assets, excluding derivatives, to approximately £20 billion by 2013. This includes asset run-off of approximately £200 billion as well as £50 billion to £60 billion of asset sales, offset by rollovers and additional drawings. Achieving this run-off profile will depend on sufficient recovery in market conditions to allow assets to be disposed of at acceptable valuations, and on the securitisation or sale of some APS assets in the outer years of the five year plan, for which HM Treasury's permission may be required.

In the first half of 2009, a number of financial institutions and larger investment grade corporates with strong underlying businesses were able to take advantage of more favourable conditions in the bond and equity markets to refinance borrowing and generally deleverage their balance sheets in advance of their legal maturity. However, smaller corporates without access to the public markets and with less robust underlying businesses, which are more typical of the Non-Core asset portfolio, have continued to rely on their banks for finance. Given the economic environment, it is expected that a number of these businesses will require their banking facilities to be rolled over or refinanced or to make greater use of any undrawn committed facilities they may have in the remainder of this year. This trend is expected to continue into 2010.

In later years, financial markets and market liquidity may improve to a sufficient extent to allow access to alternative sources of finance, including securitisation, reducing the need to roll over banking facilities and allowing a reduction in commitments.

## Allocation methodology for indirect costs

Manufacturing directly attributable costs have been allocated to the operating divisions, based on their service usage. Where services span more than one division an appropriate measure is used to allocate the costs on a basis which management considers reasonable. Manufacturing costs are fully allocated and there are no residual unallocated costs.

Group centre directly attributable costs have been allocated to the operating divisions, based on their service usage. Where services span more than one division, the costs are allocated on a basis management considers reasonable. The residual unallocated costs remaining in the Group centre, relate to volatile corporate items that do not naturally reside within a division.

Treasury costs are allocated to operating divisions as follows; term funding costs are allocated or rewarded based on long term funding gap or surplus; liquidity buffer funding costs are allocated based on share of overall liquidity buffer derived from divisional stresses; and capital cost or benefit is allocated based on share of divisional risk-adjusted RWAs.

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m
<b>Manufacturing costs:</b>				
Property	959	815	18	1,705
Operations	734	716	3	1,471
Technology services and support functions	930	874	6	1,795
	<b>2,623</b>	<b>2,405</b>	<b>9</b>	<b>4,971</b>
Allocated to divisions:				
UK Retail	(796)	(791)	1	(1,636)
UK Corporate	(219)	(218)	-	(449)
Wealth	(61)	(59)	3	(123)
Global Banking & Markets	(277)	(228)	21	(472)
Global Transaction Services	(431)	(392)	10	(811)
Ulster Bank	(132)	(124)	6	(255)
US Retail & Commercial	(360)	(271)	33	(560)
RBS Insurance	(113)	(110)	3	(227)
Non-Core	(234)	(212)	10	(438)
	-	-	-	-
<b>Group centre costs</b>	<b>472</b>	<b>314</b>	<b>50</b>	<b>799</b>
Allocated to divisions:				
UK Retail	(142)	(74)	92	(212)
UK Corporate	(36)	(31)	16	(69)
Wealth	(26)	(14)	86	(39)
Global Banking & Markets	(117)	(73)	60	(191)
Global Transaction Services	(33)	(21)	57	(53)
Ulster Bank	(20)	(16)	25	(37)
US Retail & Commercial	(35)	(27)	30	(63)
RBS Insurance	(18)	(14)	29	(34)
Non-Core	(45)	(44)	2	(101)
	-	-	-	-

## Allocation methodology for indirect costs (continued)

	First half 2009 £m	First half 2008 £m	Change %	Full year 2008 £m
<b>Treasury funding</b>	<b>754</b>	707	7	1,372
Allocated to divisions:				
UK Retail	(78)	(105)	(26)	(182)
UK Corporate	(134)	(96)	40	(183)
Wealth	39	(50)	-	(86)
Global Banking & Markets	164	(56)	-	(198)
Global Transaction Services	59	37	59	93
Ulster Bank	(3)	(39)	(92)	(76)
US Retail & Commercial	(37)	(58)	(36)	(91)
RBS Insurance	(18)	(17)	6	(25)
Non-Core	(746)	(323)	131	(624)
	-	-	-	-



## Average balance sheet – pro forma

	First half 2009			First half 2008		
	Average balance £m	Interest £m	Rate %	Average Balance £m	Interest £m	Rate %
<b>Assets</b>						
Loans and advances to banks	49,484	508	2.05	51,505	1,126	4.37
Loans and advances to customers	602,236	11,698	3.88	582,765	17,434	5.98
Debt securities	124,059	2,278	3.67	72,710	1,886	5.19
Interest-earning assets – banking business	775,779	14,484	3.73	706,980	20,446	5.78
Trading business	306,304			477,634		
Non-interest earning assets	929,398			566,820		
Total assets	2,011,481			1,751,434		
<b>Liabilities</b>						
Deposits by banks	141,778	1,254	1.77	132,668	3,002	4.53
Customer accounts	365,187	2,730	1.50	393,530	7,188	3.65
Debt securities in issue	222,999	3,658	3.28	201,589	4,344	4.31
Subordinated liabilities	36,234	732	4.04	32,085	871	5.43
Internal funding of trading business	(77,925)	(431)	1.11	(112,856)	(2,273)	4.03
Interest-bearing liabilities – banking business	688,273	7,943	2.31	647,016	13,132	4.06
Trading business	352,953			510,554		
Non-interest-bearing liabilities						
- demand deposits	36,664			31,477		
- other liabilities	876,440			509,000		
Shareholders' equity	57,151			53,387		
Total liabilities and shareholders' equity	2,011,481			1,751,434		

### Notes:

- (1) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.
- (2) Interest-earning assets and interest-bearing liabilities exclude the Retail bancassurance assets and liabilities, in view of their distinct nature. As a result, interest income has been adjusted by £15 million (2008 - £45 million).
- (3) Changes in the fair value of interest-bearing financial instruments designated as at fair value through profit or loss are recorded in other operating income in the consolidated income statement. In the average balance sheet shown above, interest includes interest income and interest expense related to these instruments of £25 million (2008 - £146 million) and £154 million (2008 - £378 million) respectively and the average balances have been adjusted accordingly.

## Average balance sheet – pro forma (continued)

	First half 2009 %	First half 2008 %
<b>Average yields, spreads and margins of the banking business</b>		
Gross yield on interest-earning assets of banking business	3.73	5.78
Cost of interest-bearing liabilities of banking business	(2.31)	(4.06)
<b>Interest spread of banking business</b>	1.42	1.72
Benefit from interest-free funds	0.27	0.35
<b>Net interest margin of banking business</b>	1.69	2.07
 <b>Average interest rates</b>		
The Group's base rate	0.79	5.19
London inter-bank three month offered rates:		
- Sterling	1.73	5.81
- Eurodollar	1.05	3.02
- Euro	1.66	4.67

**Condensed consolidated balance sheet  
at 30 June 2009 – pro forma (unaudited)**

	<b>30 June 2009 £m</b>	<b>31 December 2008 £m</b>
<b>Assets</b>		
Cash and balances at central banks	34,302	11,830
Net loans and advances to banks	48,624	70,728
Reverse repurchase agreements and stock borrowing	35,076	58,771
Loans and advances to banks	83,700	129,499
Net loans and advances to customers	593,277	691,976
Reverse repurchase agreements and stock borrowing	47,485	39,289
Loans and advances to customers	640,762	731,265
Debt securities	229,059	253,159
Equity shares	14,220	22,198
Settlement balances	23,244	17,812
Derivatives	555,890	991,495
Intangible assets	15,117	16,415
Property, plant and equipment	16,292	17,181
Deferred taxation	7,573	5,786
Prepayments, accrued income and other assets	20,620	21,573
Assets of disposal groups	3,666	480
<b>Total assets</b>	<b>1,644,445</b>	<b>2,218,693</b>
<b>Liabilities</b>		
Bank deposits	135,601	178,943
Repurchase agreements and stock lending	44,142	83,666
Deposits by banks	179,743	262,609
Customer deposits	415,267	460,318
Repurchase agreements and stock lending	75,015	58,143
Customer accounts	490,282	518,461
Debt securities in issue	248,710	269,458
Settlement balances and short positions	60,282	54,264
Derivatives	534,632	969,409
Accruals, deferred income and other liabilities	21,543	24,140
Retirement benefit liabilities	1,363	1,564
Deferred taxation	3,344	3,177
Insurance liabilities	7,186	7,480
Subordinated liabilities	32,106	43,678
Liabilities of disposal groups	7,465	138
<b>Total liabilities</b>	<b>1,586,656</b>	<b>2,154,378</b>
<b>Equity:</b>		
Minority interests	2,123	5,436
Owners' equity*	55,666	58,879
<b>Total equity</b>	<b>57,789</b>	<b>64,315</b>
<b>Total liabilities and equity</b>	<b>1,644,445</b>	<b>2,218,693</b>
*Owners' equity attributable to:		
Ordinary shareholders	47,820	45,525
Other equity owners	7,846	13,354
	<b>55,666</b>	<b>58,879</b>

## Overview of condensed consolidated balance sheet – pro forma

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Total assets of £1,644.4 billion at 30 June 2009 were down £574.2 billion, 26%, compared with 31 December 2008.

Cash and balances at central banks were up £22.5 billion to £34.3 billion from seasonal lows.

Loans and advances to banks decreased by £45.8 billion, 35%, to £83.7 billion reflecting lower reverse repurchase agreements and stock borrowing ("reverse repos"), down by £23.7 billion, 40% to £35.1 billion, and reduced bank placings, down by £22.1 billion, 31%, to £48.6 billion largely as a result of reduced cash collateral balances in Global Banking & Markets.

Loans and advances to customers were down £90.5 billion, 12%, at £640.8 billion. Within this, reverse repos increased by 21%, £8.2 billion to £47.5 billion. Excluding reverse repos, customer lending declined by £98.7 billion, 14% to £593.3 billion or £94.4 billion, 13% before impairment provisions. This reflected reductions in Global Banking & Markets of £38.5 billion, Non-Core, £11.6 billion including £3.5 billion transfer to disposal groups in respect of the Asian businesses, UK Corporate & Commercial £3.4 billion, US Retail & Commercial, £2.8 billion, and Ulster Bank, £1.4 billion, together with the effect of exchange rate movements, £36.4 billion, following the strengthening of sterling during the first half of 2009.

Debt securities were down £24.1 billion, 10%, to £229.1 billion and equity shares decreased by £8.0 billion, 36%, to £14.2 billion, principally due to lower holdings in Global Banking & Markets.

Settlement balances rose by £5.4 billion, 30% to £23.2 billion as a result of increased customer activity.

Movements in the value of derivatives, assets and liabilities, primarily reflect reductions in interest rates and the strengthening of sterling during the first half of 2009.

Intangible assets declined by £1.3 billion, 8%, to £15.1 billion mainly due to the £0.3 billion write-down of goodwill in the Non-Core division and the effect of exchange rates.

Deferred tax assets increased £1.8 billion, 31%, to £7.6 billion principally due to carried forward trading losses.

Increases in assets and liabilities of disposal groups largely reflect the inclusion of the Asian businesses at 30 June 2009.

Deposits by banks declined by £82.9 billion, 32% to £179.7 billion. This reflected decreased repurchase agreements and stock lending ("repos"), down £39.5 billion, 47% to £44.1 billion and reduced inter-bank deposits, down £43.4 billion, 24%, to £135.6 billion principally in Global Banking & Markets, in part due to lower collateral deposits.

Customer accounts were down £28.2 billion, 5% to £490.3 billion. Within this, repos increased £16.9 billion, 29% to £75.0 billion. Excluding repos, deposits declined by £45.1 billion, 10%, to £415.3 billion primarily due to exchange rate movements, £20.2 billion, the transfer of £7.3 billion to disposal groups in respect of the Asian businesses and reductions in Global Banking & Markets, £17.6 billion.

Debt securities in issue decreased £20.7 billion, 8%, to £248.7 billion mainly as a result of movements in exchange rates together with reductions in Global Banking & Markets and Non-Core.

Settlement balances and short positions were up £6.0 billion, 11%, to £60.3 billion reflecting increased customer activity.

Accruals, deferred income and other liabilities decreased £2.6 billion, 11%, to £21.5 billion.

Subordinated liabilities were down £11.6 billion, 26%, to £32.1 billion, reflecting the redemption of £5.0 billion undated loan capital, £1.5 billion trust preferred securities and £0.9 billion dated loan capital, together with the effect of exchange rates and other adjustments.

Equity minority interests decreased by £3.3 billion, 61% to £2.1 billion. Equity withdrawals of £3.1 billion, reflecting the disposal of the investment in Bank of China attributable to minority shareholders and the redemption, in part, of certain Trust Preferred Securities, the recycling of related available-for-sale reserves to income, £0.4 billion, and dividends paid of £0.3 billion, were partially offset by attributable profits of £0.6 billion.

## Overview of condensed consolidated balance sheet – pro forma (continued)

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Owners' equity declined by £3.2 billion, 5% to £55.7 billion. The placing and open offer in April 2009 raised £5.3 billion to fund the redemption of the £5.0 billion preference shares issued to HM Treasury in December 2008. A £0.7 billion decrease in available-for-sale reserves, net of tax, the payment of other owners dividends of £0.5 billion including £0.3 billion to HM Treasury on the redemption of preference shares, the partial redemption of paid-in equity of £0.3 billion, the attributable loss for the period of £0.5 billion and exchange rate movements of £2.3 billion, were partly offset by an increase in the cash flow hedging reserve of £0.4 billion and the equity owners gain on withdrawal of minority interests, net of tax, of £0.5 billion arising from the redemption of Trust Preferred Securities.

**Condensed consolidated statement of changes in equity  
for the half year ended 30 June 2009 (unaudited) – pro forma**

	<b>First half 2009 £m</b>	<b>First half 2008 £m</b>	<b>Full year 2008 £m</b>
<b>Called-up share capital</b>			
At beginning of period	<b>9,898</b>	2,530	2,530
Ordinary shares issued in respect of rights issue	-	1,531	1,531
Ordinary shares issued in respect of capitalisation issue	-	-	101
Ordinary shares issued in respect of placing and open offers	<b>4,227</b>	-	5,728
Preference shares issued in respect of placing and open offer	-	-	5
Other shares issued during the period	-	3	3
Preference shares redeemed during the period	<b>(5)</b>	-	-
At end of period	<b>14,120</b>	4,064	9,898
<b>Paid-in equity</b>			
At beginning of period	<b>1,073</b>	1,073	1,073
Securities redeemed during the period	<b>(308)</b>	-	-
Transfer to retained earnings	<b>(200)</b>	-	-
At end of period	<b>565</b>	1,073	1,073
<b>Share premium account</b>			
At beginning of period	<b>27,471</b>	17,322	17,322
Ordinary shares issued in respect of rights issue, net of £246 million expenses	-	10,469	10,469
Ordinary shares issued in respect of capitalisation issue	-	-	(101)
Ordinary shares issued in respect of placing and open offer, net of £95 million expenses	<b>1,047</b>	-	-
Expenses of placing and open offer	-	-	(265)
Other shares issued during the year	-	46	46
Preference shares redeemed during the period	<b>(4,995)</b>	-	-
At end of period	<b>23,523</b>	27,837	27,471
<b>Merger reserve</b>			
At beginning of period	<b>10,881</b>	10,881	10,881
Placing and open offer	-	-	14,273
Transfer to retained earnings	-	-	(14,273)
At end of period	<b>10,881</b>	10,881	10,881
<b>Available-for-sale reserves</b>			
At beginning of period	<b>(3,561)</b>	1,032	1,032
Unrealised losses in the period	<b>(1,494)</b>	(1,322)	(6,808)
Realised losses in the period	<b>197</b>	60	842
Taxation	<b>592</b>	343	1,373
At end of period	<b>(4,266)</b>	113	(3,561)
<b>Cash flow hedging reserve</b>			
At beginning of period	<b>(876)</b>	(555)	(555)
Amount recognised in equity during the period	<b>415</b>	(297)	(603)
Amount transferred from equity to earnings in the period	<b>106</b>	174	198
Taxation	<b>(138)</b>	36	84
At end of period	<b>(493)</b>	(642)	(876)

**Condensed consolidated statement of changes in equity  
for the half year ended 30 June 2009 (unaudited) – pro forma (continued)**

	<b>First half 2009 £m</b>	<b>First half 2008 £m</b>	<b>Full year 2008 £m</b>
<b>Foreign exchange reserve</b>			
At beginning of period	<b>6,385</b>	(426)	(426)
Retranslation of net assets	<b>(2,724)</b>	1,748	11,970
Foreign currency gains/(losses) on hedges of net assets	<b>442</b>	(1,177)	(5,801)
Taxation	<b>(46)</b>	111	642
At end of period	<b>4,057</b>	256	6,385
<b>Capital redemption reserve</b>			
At beginning and end of period	<b>170</b>	170	170
<b>Retained earnings</b>			
At beginning of period	<b>7,542</b>	21,072	21,072
Loss attributable to ordinary shareholders and other equity owners	<b>(496)</b>	(612)	(23,710)
Ordinary dividends paid	-	(2,312)	(2,312)
Equity preference dividends paid	<b>(510)</b>	(188)	(536)
Paid-in equity dividends paid, net of tax	<b>(36)</b>	(27)	(60)
Transfer from paid-in equity	<b>200</b>	-	-
Equity owners gain on withdrawal of minority interest			
- gross	<b>629</b>	-	-
- taxation	<b>(176)</b>	-	-
Transfer from merger reserve	-	-	14,273
Actuarial losses recognised in retirement benefit schemes			
- gross	-	-	(1,807)
- taxation	-	-	472
Net cost of shares bought and used to satisfy share-based payments	<b>(13)</b>	(16)	(19)
Share-based payments, net of tax	<b>60</b>	51	169
At end of period	<b>7,200</b>	17,968	7,542
<b>Own shares held</b>			
At beginning of period	<b>(104)</b>	(61)	(61)
Shares purchased during the period	-	(39)	(64)
Shares issued under employee share schemes	<b>13</b>	17	21
At end of period	<b>(91)</b>	(83)	(104)
<b>Owners' equity at end of period</b>	<b>55,666</b>	61,637	58,879

**Condensed consolidated statement of changes in equity  
for the half year ended 30 June 2009 (unaudited) – pro forma (continued)**

	<b>First half 2009 £m</b>	<b>First half 2008 £m</b>	<b>Full year 2008 £m</b>
<b>Minority interests</b>			
At beginning of period	<b>5,436</b>	5,391	5,391
Currency translation adjustments and other movements	<b>(165)</b>	162	1,158
Profit/(loss) attributable to minority interests	<b>554</b>	148	412
Dividends paid	<b>(310)</b>	(137)	(285)
Losses on available-for-sale securities			
- net losses in the period	<b>(336)</b>	(353)	(1,304)
- taxation	<b>-</b>	1	1
Equity raised	<b>9</b>	810	1,071
Equity withdrawn and disposals	<b>(2,436)</b>	(214)	(1,008)
Transfer to retained earnings	<b>(629)</b>	-	-
At end of period	<b>2,123</b>	5,808	5,436
<b>Total equity at end of period</b>	<b>57,789</b>	67,445	64,315
<b>Total comprehensive income recognised in the statement of changes in equity is attributable as follows:</b>			
Equity shareholders	<b>(3,146)</b>	(936)	(23,148)
Minority interests	<b>53</b>	(42)	267
	<b>(3,093)</b>	(978)	(22,881)



## Notes to pro forma results

### 1. Basis of preparation

The pro forma financial information shows the underlying performance of the Group including the results of the ABN AMRO businesses to be retained by the Group. This information is prepared using the Group's accounting policies as referred to on page 157 and is being provided to give a better understanding of the results of the RBS operations excluding the results attributable to the other Consortium Members.

Group operating profit on a pro forma basis excludes:

- amortisation of purchased intangible assets;
- write-down of goodwill and other intangible assets;
- integration and restructuring costs;
- gain on redemption of own debt; and
- gain on sale of strategic investments.

### 2. Analysis of income and expenses

	First half 2009			First half	Full year
	Core	Non-Core	Total	2008	2008
	£m	£m	£m	£m	£m
Fees and commissions receivable	4,031	435	4,466	4,470	8,845
Fees and commissions payable					
- banking	(980)	(111)	(1,091)	(1,090)	(2,010)
- insurance related	(187)	(73)	(260)	(202)	(401)
<b>Net fees and commissions</b>	<b>2,864</b>	<b>251</b>	<b>3,115</b>	<b>3,178</b>	<b>6,434</b>
Foreign exchange	1,575	84	1,659	953	1,940
Interest rate	2,906	(49)	2,857	1,436	1,266
Credit	864	(4,283)	(3,419)	(6,218)	(12,181)
Other	970	(23)	947	552	268
<b>Income from trading activities</b>	<b>6,315</b>	<b>(4,271)</b>	<b>2,044</b>	<b>(3,341)</b>	<b>(8,829)</b>
Operating lease and other rental income	332	330	662	845	1,469
Changes in the fair value of own debt	(60)	-	(60)	527	977
Changes in the fair value of securities and other financial assets and liabilities	(11)	(46)	(57)	(582)	(1,364)
Changes in the fair value of investment properties	(8)	(139)	(147)	(22)	(86)
Profit on sale of securities	151	(88)	63	16	113
Profit on sale of property, plant and equipment	6	19	25	85	177
Profit on sale of subsidiaries and associates	(21)	10	(11)	554	501
Life company profits/(losses)	24	-	24	(44)	(52)
Dividend income	29	9	38	50	275
Share of profits less losses of associated entities	8	(62)	(54)	5	10
Other income	(96)	(67)	(163)	18	(499)
<b>Other operating income</b>	<b>354</b>	<b>(34)</b>	<b>320</b>	<b>1,452</b>	<b>1,521</b>
<b>Non-interest income (excluding insurance premiums)</b>	<b>9,533</b>	<b>(4,054)</b>	<b>5,479</b>	<b>1,289</b>	<b>(874)</b>
<b>Insurance net premium income</b>	<b>2,217</b>	<b>440</b>	<b>2,657</b>	<b>2,861</b>	<b>5,709</b>
<b>Total non-interest income</b>	<b>11,750</b>	<b>(3,614)</b>	<b>8,136</b>	<b>4,150</b>	<b>4,835</b>

## Notes to pro forma results (continued)

### 2. Analysis of income and expenses (continued)

	First half 2009			First half	Full year
	Core £m	Non-Core £m	Total £m	2008 £m	2008 £m
Staff costs	4,401	259	4,660	4,558	7,990
Premises and equipment	1,216	15	1,231	881	2,099
Other	1,728	233	1,961	2,120	4,267
<b>Administrative expenses</b>	<b>7,345</b>	<b>507</b>	<b>7,852</b>	<b>7,559</b>	<b>14,356</b>
Depreciation and amortisation	679	202	881	834	1,832
<b>Direct expenses</b>	<b>8,024</b>	<b>709</b>	<b>8,733</b>	<b>8,393</b>	<b>16,188</b>
Indirect expenses	(279)	279	-	-	-
<b>Operating expenses</b>	<b>7,745</b>	<b>988</b>	<b>8,733</b>	<b>8,393</b>	<b>16,188</b>
General insurance	1,551	314	1,865	1,863	3,733
Bancassurance	26	-	26	64	184
<b>Insurance net claims</b>	<b>1,577</b>	<b>314</b>	<b>1,891</b>	<b>1,927</b>	<b>3,917</b>

Note:

The data above exclude amortisation of purchased intangibles, write-down of goodwill and other intangible assets, integration and restructuring costs, gain on redemption of own debt and strategic disposals.

### 3. 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	Full year
	Core £m	Non-Core £m	Total £m	2008 £m	2008 £m
At beginning of period	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)
At end of period	5,575	8,198	13,773	5,034	9,451

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.

### 4. Strategic disposals

	First half 2009 £m	First half 2008 £m	Full year 2008 £m
Gain on sale of investments in:			
Bank of China (1)	241	-	-
Linea Directa	212	-	-
Tesco Personal Finance	-	-	442
	453	-	442

Note:

(1) Includes £359 million attributable to minority interests.

## Notes to pro forma results (continued)

### 5. Goodwill

	<b>First half 2009 £m</b>	First half 2008 £m	Full year 2008 £m
Write-down of goodwill and other intangible assets	<b>311</b>	-	16,196

The write down of goodwill for the half year ended 30 June 2009 principally relates to ABN AMRO and NatWest goodwill allocated to non-core businesses.

### 6. Taxation

The credit for taxation represents differs from the tax credit computed by applying the standard UK corporation tax rate of 28% (2008 – 28.5%) as follows:

	<b>First half 2009 £m</b>	First half 2008 £m	Full year 2008 £m
Profit/(loss) before tax	<b>15</b>	(726)	(8,296)
Expected tax charge/(credit) at 28% (2008 – 28.5%)	<b>4</b>	(207)	(2,364)
Unrecognised timing differences	<b>16</b>	4	274
Other non-deductible items	<b>73</b>	162	371
Non-taxable items;			
- Gain on redemption of own debt	<b>(692)</b>	-	-
- Other	<b>(176)</b>	(225)	(491)
Taxable foreign exchange movements	<b>(23)</b>	7	80
Foreign profits taxed at other rates	<b>47</b>	(22)	271
Losses in year not recognised	<b>184</b>	40	942
Other	<b>(23)</b>	-	(11)
Adjustments in respect of prior periods	<b>178</b>	(62)	(352)
Actual tax credit	<b>(412)</b>	(303)	(1,280)

### 7. Minority interests

	<b>First half 2009 £m</b>	First half 2008 £m	Full year 2008 £m
Trust preferred securities	<b>45</b>	45	65
Investment in Bank of China	<b>359</b>	-	78
Sempra joint venture	<b>144</b>	96	164
ABN AMRO	<b>2</b>	(14)	91
Other	<b>4</b>	21	14
Profit attributable to minority interests	<b>554</b>	148	412

## Notes to pro forma results (continued)

### 8. Other owners' dividends

	First half 2009 £m	First half 2008 £m	Full year 2008 £m
Non-cumulative preference shares of US\$0.01	179	136	293
Non-cumulative preference shares of €0.01	57	52	183
Non-cumulative preference shares of £1			
- issued to UK Financial Investments Limited (1)	274	-	-
- other	-	-	60
Interest on securities classified as equity, net of tax	36	27	60
	546	215	596

Note:

(1) Includes £50 million redemption premium on repayment of preference shares.

### 9. Earnings per share

Earnings per share have been calculated based on the following:

	First half 2009 £m	First half 2008 £m	Full year 2008 £m
<b>Earnings</b>			
Loss from continuing operations attributable to ordinary shareholders	(984)	(786)	(24,220)
Loss from discontinued operations attributable to ordinary shareholders	(58)	(41)	(86)
<b>Weighted average number of ordinary shares (millions)</b>			
In issue during the period	46,719	12,197	16,563
<b>Basic loss per share from continuing operations</b>	<b>(2.1p)</b>	(6.4p)	(146.2p)
Intangibles amortisation	0.2p	1.6p	2.1p
Write-down of goodwill and other intangible assets	0.7p	-	97.8p
Integration and restructuring costs	1.1p	1.8p	5.9p
Gain on redemption of own debt	(7.3p)	-	-
Strategic disposals	(1.0p)	-	(2.7p)
<b>Adjusted loss per share from continuing operations</b>	<b>(8.4p)</b>	(3.0p)	(43.1p)
<b>Basic loss per share from discontinued operations</b>	<b>(0.1p)</b>	(0.4p)	(0.5p)

## Notes to pro forma results (continued)

### 10. Segmental analysis

#### Analysis of divisional contribution

The table below provides an analysis of the divisional contribution for the first half of 2009 by main income statement captions. The pro forma divisional income statements on pages 31 to 61 reflect certain presentational reallocations as described in the notes below. These do not affect the overall contribution.

	Net Interest Income £m	Non- interest income £m	Total income £m	Operating expenses £m	Net Insurance claims £m	Impairment losses £m	Operating profit/(loss) £m
UK Retail (1)	1,684	806	2,490	(1,587)	(26)	(824)	53
UK Corporate Wealth	1,006	569	1,575	(703)	-	(551)	321
	339	225	564	(324)	-	(22)	218
Global Banking & Markets (2)	1,584	6,246	7,830	(2,720)	-	(237)	4,873
Global Transaction Services	446	782	1,228	(719)	-	(13)	496
Ulster Bank	410	108	518	(369)	-	(157)	(8)
US Retail & Commercial	942	504	1,446	(1,128)	-	(369)	(51)
RBS Insurance	182	1,983	2,165	(391)	(1,551)	(6)	217
Central items	(388)	365	(23)	196	-	2	175
<b>Core</b>	<b>6,205</b>	<b>11,588</b>	<b>17,793</b>	<b>(7,745)</b>	<b>(1,577)</b>	<b>(2,177)</b>	<b>6,294</b>
<b>Non-Core (3)</b>	<b>450</b>	<b>(3,452)</b>	<b>(3,002)</b>	<b>(988)</b>	<b>(314)</b>	<b>(5,344)</b>	<b>(9,648)</b>
Amortisation of purchased intangible assets	-	-	-	(140)	-	-	(140)
Integration and restructuring costs	-	-	-	(734)	-	-	(734)
Gain on redemption of own debt	-	3,790	3,790	-	-	-	3,790
Strategic disposals	-	453	453	-	-	-	453
Write-down of goodwill and other intangible assets	-	-	-	(311)	-	-	(311)
<b>RFS Holdings minority interest</b>	<b>6,655</b>	<b>12,379</b>	<b>19,034</b>	<b>(9,918)</b>	<b>(1,891)</b>	<b>(7,521)</b>	<b>(296)</b>
	1,514	1,293	2,807	(1,973)	(243)	(539)	52
<b>Total statutory</b>	<b>8,169</b>	<b>13,672</b>	<b>21,841</b>	<b>(11,891)</b>	<b>(2,134)</b>	<b>(8,060)</b>	<b>(244)</b>

Notes:

Notes:

- (1) reallocation of netting of bancassurance claims of £26 million from non-interest income.
- (2) reallocation of £27 million between net interest income and non-interest income in respect of funding costs of rentals assets, and to record interest on financial assets and liabilities designated as at fair value through profit or loss, £51 million.
- (3) reallocation of £140 million between net interest income and non-interest income in respect of funding costs of rental assets and to record interest on financial assets and liabilities designated as at fair value through profit or loss, £22 million.

## Notes to pro forma results (continued)

### 11. Financial instruments

#### Classification

The following tables analyse the Group's financial assets and liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS39 are shown separately.

	Held-for-trading	Designated as at fair value through profit or loss	Available-for-sale	Loans and receivables	Other (amortised cost)	Finance leases	Other assets/liabilities	Total
	£m	£m	£m	£m	£m	£m	£m	£m
<b>At 30 June 2009</b>								
Cash and balances at central banks	-	-	-	34,302	-	-	-	34,302
Loans & advances to banks	35,849	-	-	47,851	-	-	-	83,700
Loans and advances to customers	51,987	1,963	-	573,246	-	13,566	-	640,762
Debt securities	107,410	4,446	105,858	11,345	-	-	-	229,059
Equity shares	9,694	1,865	2,661	-	-	-	-	14,220
Settlement balances	-	-	-	23,244	-	-	-	23,244
Derivatives (1)	555,890	-	-	-	-	-	-	555,890
Intangible assets	-	-	-	-	-	-	15,117	15,117
Property, plant and equipment	-	-	-	-	-	-	16,292	16,292
Deferred taxation	-	-	-	-	-	-	7,573	7,573
Prepayments, accrued income and other assets	-	-	-	1,461	-	-	19,159	20,620
Assets of disposal groups	-	-	-	-	-	-	3,666	3,666
<b>Total assets</b>	<b>760,830</b>	<b>8,274</b>	<b>108,519</b>	<b>691,449</b>	<b>-</b>	<b>13,566</b>	<b>61,807</b>	<b>1,644,445</b>
Deposits by banks	58,017	-	-	-	121,726	-	-	179,743
Customer accounts	64,743	4,456	-	-	421,083	-	-	490,282
Debt securities in issue	1,051	34,198	-	-	213,461	-	-	248,710
Settlement balances and short positions	37,224	-	-	-	23,058	-	-	60,282
Derivatives (1)	534,632	-	-	-	-	-	-	534,632
Accruals, deferred income and other liabilities	-	-	-	-	1,618	24	19,901	21,543
Retirement benefit liabilities	-	-	-	-	-	-	1,363	1,363
Deferred taxations	-	-	-	-	-	-	3,344	3,344
Insurance liabilities	-	-	-	-	-	-	7,186	7,186
Subordinated liabilities	-	1,291	-	-	30,815	-	-	32,106
Liabilities of disposal groups	-	-	-	-	-	-	7,465	7,465
<b>Total liabilities</b>	<b>695,667</b>	<b>39,945</b>	<b>-</b>	<b>-</b>	<b>811,761</b>	<b>24</b>	<b>39,259</b>	<b>1,586,656</b>
Equity								57,789
								1,644,445

## Notes to pro forma results (continued)

### 11. Financial instruments (continued)

#### Classification (continued)

	Held-for-trading	Designated as at fair value through profit or loss	Available-for- sale	Loans and receivables	Other (amortised cost)	Finance leases	Other assets/ liabilities	Total
	£m	£m	£m	£m	£m	£m	£m	£m
<b>At 31 December 2008</b>								
Cash and balances at central banks	-	-	-	11,830	-	-	-	11,830
Loans & advances to banks	56,234	-	-	73,265	-	-	-	129,499
Loans and advances to customers	51,501	2,141	-	663,170	-	14,453	-	731,265
Debt securities	116,159	5,294	118,722	12,984	-	-	-	253,159
Equity shares	13,314	2,075	6,809	-	-	-	-	22,198
Settlement balances	-	-	-	17,812	-	-	-	17,812
Derivatives (1)	991,495	-	-	-	-	-	-	991,495
Intangible assets	-	-	-	-	-	-	16,415	16,415
Property, plant and equipment	-	-	-	-	-	-	17,181	17,181
Deferred taxation	-	-	-	-	-	-	5,786	5,786
Prepayments, accrued income and other assets	-	-	-	1,326	-	-	20,247	21,573
Assets of disposal groups	-	-	-	-	-	-	480	480
<b>Total assets</b>	<b>1,228,703</b>	<b>9,510</b>	<b>125,531</b>	<b>780,387</b>	<b>-</b>	<b>14,453</b>	<b>60,109</b>	<b>2,218,693</b>
Deposits by banks	81,154	-	-	-	181,455	-	-	262,609
Customer accounts	55,926	4,349	-	-	458,186	-	-	518,461
Debt securities in issue	3,992	46,022	-	-	219,444	-	-	269,458
Settlement balances and short positions	42,536	-	-	-	11,728	-	-	54,264
Derivatives (1)	969,409	-	-	-	-	-	-	969,409
Accruals, deferred income and other liabilities	260	-	-	-	1,619	22	22,239	24,140
Retirement benefit liabilities	-	-	-	-	-	-	1,564	1,564
Deferred taxations	-	-	-	-	-	-	3,177	3,177
Insurance liabilities	-	-	-	-	-	-	7,480	7,480
Subordinated liabilities	-	1,410	-	-	42,268	-	-	43,678
Liabilities of disposal groups	-	-	-	-	-	-	138	138
<b>Total liabilities</b>	<b>1,153,277</b>	<b>51,781</b>	<b>-</b>	<b>-</b>	<b>914,700</b>	<b>22</b>	<b>34,598</b>	<b>2,154,378</b>
Equity								64,315
								2,218,693

Note:

(1) Held-for-trading derivatives include hedging derivatives

## Notes to pro forma results (continued)

### 11. Financial instruments (continued)

#### Valuation techniques

Refer to Note 11 of the Annual Report and Accounts 2008.

#### Valuation hierarchy

The table below shows financial instruments carried at fair value by valuation method.

	30 June 2009				31 December 2008			
	Level 1 (1) £bn	Level 2 (2) £bn	Level 3 (3) £bn	Total £bn	Level 1 (1) £bn	Level 2 (2) £bn	Level 3 (3) £bn	Total £bn
<b>Assets</b>								
Fair value through profit or loss:								
Loans and advances to banks	-	35.8	-	35.8	-	56.2	-	56.2
Loans and advances to customers	-	52.8	1.1	53.9	-	50.4	3.1	53.5
Debt securities	53.3	55.0	3.6	111.9	52.4	65.4	3.8	121.6
Equity shares	9.3	1.8	0.5	11.6	9.1	5.5	0.8	15.4
Derivatives	0.9	546.3	8.7	555.9	3.7	977.5	10.3	991.5
	63.5	691.7	13.9	769.1	65.2	1,155.0	18.0	1,238.2
Available-for-sale:								
Debt securities	33.9	70.3	1.6	105.8	18.3	97.3	3.1	118.7
Equity shares	0.9	1.3	0.5	2.7	4.6	1.9	0.3	6.8
	34.8	71.6	2.1	108.5	22.9	99.2	3.4	125.5
	98.3	763.3	16.0	877.6	88.1	1,254.2	21.4	1,363.7
<b>Liabilities</b>								
Deposits by banks and customers	-	127.0	0.3	127.3	-	141.1	0.3	141.4
Debt securities in issue	-	32.1	3.1	35.2	-	45.6	4.4	50.0
Short positions	29.9	6.9	0.4	37.2	35.4	7.1	-	42.5
Derivatives	1.6	528.8	4.2	534.6	3.5	962.0	4.0	969.5
Other financial liabilities (4)	-	1.3	-	1.3	-	1.3	0.3	1.6
	31.5	696.1	8.0	735.6	38.9	1,157.1	9.0	1,205.0

Notes:

- (1) Valued using unadjusted quoted prices in active markets for identical financial instruments. This category includes listed equity shares, certain exchange-traded derivatives, G10 government securities and certain US agency securities.
- (2) Valued using techniques 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.

Instruments that trade in markets that are not considered to be active, but for which valuations are based on quoted market prices, broker dealer quotations, or alternative pricing sources with reasonable levels of price transparency and instruments valued using techniques include: most government agency securities, investment-grade corporate bonds, certain mortgage products, certain bank and bridge loans, repos and reverse repos, less liquid listed equities, state and municipal obligations, most physical commodities, investment contracts issued by the Group's life assurance businesses and certain money market securities and loan commitments and most OTC derivatives.



**11. Financial instruments (continued)**

Notes (continued):

- (3) Valued using a technique where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data. Where inputs can be observed from market data without undue cost and effort, the observed input is used. Otherwise, the Group determines a reasonable level for the input.

Financial instruments included within level 3 of the fair value hierarchy primarily include cash instruments which trade infrequently, certain syndicated and commercial mortgage loans, unlisted equity shares, certain residual interests in securitisations, super senior tranches of high grade and mezzanine collateralised debt obligations (CDOs), other mortgage-based products and less liquid debt securities, certain structured debt securities in issue, and OTC derivatives where valuation depends upon unobservable inputs such as certain credit and exotic derivatives. No gain or loss is recognised on the initial recognition of a financial instrument valued using a technique incorporating significant unobservable data.

- (4) Comprise subordinated liabilities and write downs relating to undrawn syndicated loan facilities.

**Level 3 portfolios**

Level 3 portfolios have reduced since 31 December 2008 (by £5.4 billion) due to disposals, write downs, reclassification between levels 2 and 3 and reclassification of a number of assets from held-for-trading ('HFT') to loans and receivables ('LAR'). Level 3 liabilities have reduced by £1.0 billion.

Level 3 loans and advances to customers decreased by £2.0 billion primarily reflecting the reclassification of certain HFT loans (leveraged finance and other corporate loans) to LAR.

Debt securities categorised as level 3 at 30 June 2009 included £3.7 billion asset-backed securities and £1.5 billion of corporate and other debt securities. The decrease during the first half reflects liquidations, mark-downs and the unwinding of part of the fund derivative portfolio in the US.

Equity shares categorised as level 3 decreased by £0.3 billion primarily reflecting the movement of strategic investments from level 3 to level 2 and reduction in value of certain private equity investments, partly offset by other small increases.

Level 3 derivative assets at 30 June 2009 included credit derivative trades with credit derivative product companies ('CDPCs') with a fair value of £1.5 billion after credit valuation adjustments of £0.8 billion. At 31 December 2008 these credit derivative trades with CDPCs had a fair value of £3.5 billion after a credit valuation adjustment of £1.3 billion. Other level 3 derivative assets included illiquid credit default swaps ('CDSs'), other credit derivatives and illiquid interest rate derivatives.

Debt securities in issue, categorised as level 3 were structured medium term notes, with the decrease in the period primarily reflects the movement of £1 billion of guaranteed investment certificates from level 3 at the end of 2008 to level 2 at the end of June due to increased price availability in the market.

## Notes to pro forma results (continued)

### 11. Financial instruments (continued)

#### Level 3 portfolios (continued)

			Reasonably possible alternative assumptions		
	Valuation basis/technique	Main assumptions	Carrying value £bn	Increase in fair value £m	Decrease in fair value £m
<b>Assets</b>					
Loans and advances	Proprietary model	Credit spreads, indices	1.1	33	33
Debt securities:					
- RMBS (1)	Industry standard model	Prepayment rates, probability of default, loss severity and yield	0.4	24	28
- CMBS (2)	Industry standard model	Prepayment rates, probability of default, loss severity and yield	0.4	16	16
- CDOs (3)	Proprietary model	Implied collateral valuation, defaults rates, housing prices, correlation	1.5	311	288
- CLOs (4)	Industry standard simulation model	Credit spreads, recovery rates, correlation	0.7	27	27
- other	Proprietary model	Credit spreads	2.2	54	55
Equity shares	Private equity - valuation statements	Fund valuations	1.0	106	127
Derivatives:					
- credit	Proprietary CVA model, industry option models, correlation model	Counterparty credit risk, correlation, volatility	5.1	497	365
- other	Proprietary model	Volatility, correlation, dividends	3.6	170	174
<b>30 June 2009</b>			<b>16.0</b>	<b>1,238</b>	<b>1,113</b>
31 December 2008			21.4	1,880	2,200
<b>Liabilities</b>					
Debt securities in issue	Proprietary model	Correlation, volatility	3.1	65	65
Derivatives					
- credit	Proprietary CVA model, industry option models, correlation model	Correlation, volatility	2.7	196	196
- other	Proprietary model	Volatility, correlation	1.5	54	52
Other portfolios	Proprietary model	Credit spreads, correlation	0.7	11	11
<b>30 June 2009</b>			<b>8.0</b>	<b>326</b>	<b>324</b>
31 December 2008			9.0	490	550

#### Notes:

- (1) Residential mortgage-backed securities.
- (2) Commercial mortgage-backed securities.
- (3) Collateralised debt obligations.
- (4) Collateralised loan obligations.

## 11. Financial instruments (continued)

### Level 3 portfolios (continued)

For each of the portfolio categories shown in the above table, a description is set out below of the types of products that comprise the portfolio and the valuation techniques that are applied in determining fair value, and inputs to those models and techniques. These techniques are also used where the product is categorised as level 2. Where reasonably possible alternative assumptions of unobservable inputs used in models would change the fair value of the portfolio significantly, the alternative inputs are indicated along with the impact this would have on the fair value. Where there have been significant changes to valuation techniques during the year, an explanation of the reasons for this is also included. Amounts relating to 31 December 2008 are also included where relevant.

### Loans and advances to customers

Loans in level 3 primarily comprise US commercial mortgages and syndicated loans.

#### Commercial mortgages

These senior and mezzanine commercial mortgages are loans secured on commercial land and buildings that were originated or acquired for securitisation. Senior commercial mortgages carry a variable interest rate and mezzanine or more junior commercial mortgages may carry a fixed or variable interest rate. Factors affecting the value of these loans may include, but are not limited to, loan type, underlying property type and geographic location, loan interest rate, loan to value ratios, debt service coverage ratios, prepayment rates, cumulative loan loss information, yields, investor demand, market volatility since the last securitisation, and credit enhancement. Where observable market prices for a particular loan are not available, the fair value will typically be determined with reference to observable market transactions in other loans or credit related products including debt securities and credit derivatives. Assumptions are made about the relationship between the loan and the available benchmark data. Using reasonably possible alternative assumptions for credit spreads (taking into account all other applicable factors) would reduce the fair value of these mortgages of £0.3 billion (2008 - £1.1 billion) by up to £8 million (2008 - £18 million) or increase the fair value by up to £8 million (2008 - £25 million).

#### Syndicated lending

The Group's syndicated lending activities are conducted by the syndicate business in conjunction with the loan origination business. When a commitment to lend is entered into, the Group estimates the proportion of the loan that it intends to syndicate and the proportion it anticipates to retain on its balance sheet as a loan and receivable. Where the commitment is intended to be syndicated, the commitment to lend is fair valued through the income statement. On drawdown, the portion of the loan expected to be syndicated is classified as a held-for-trading asset, and the expected hold portion is classified as loan or receivables.

The Group values the portion of the loan expected to be syndicated at fair value by using market observable syndication prices in the same or similar assets. Where these prices are not available, a discounted cash flow model is used. The model incorporates observable assumptions such as current interest rates and yield curves, the notional and tender amount of the loan, and counterparty credit quality which is derived from credit default swap spreads quoted in the market. The model also incorporates unobservable assumptions, including expected refinancing periods, and counterparty credit quality derived from the Group's internal risk assessments. Derivatives arising from commitments to lend are measured using the same model, based on proxy notional amounts.

Using reasonably possible alternative assumptions for expected cash flows to value these assets of £0.8 billion would reduce the fair value by up to £25 million (2008 - £32 million) or increase the fair value by up to £25 million (2008 - £45 million). The assumptions to determine these amounts were based on restructuring scenarios and expected margins.

## 11. Financial instruments (continued)

### Level 3 portfolios (continued)

#### Debt securities

##### Residential mortgage backed securities

RMBS where the underlying assets are US agency-backed mortgages and there is regular trading are generally classified as level 2 in the fair value hierarchy. RMBS are also classified as level 2 when regular trading is not prevalent in the market, but similar executed trades or third-party data including indices, broker quotes and pricing services can be used to substantiate the fair value. RMBS are classified as level 3 when trading data are unavailable, and in these cases a model using significant unobservable data is utilised for valuation purposes.

In determining whether an instrument is similar to that being valued, the Group considers a range of factors, principally: the lending standards of the brokers and underwriters that originated the mortgages, the lead manager of the security, the issue date of the respective securities, the underlying asset composition (including origination date, loan-to-value ratios, historic loss information and geographic location of the mortgages), the credit rating of the instrument, and any credit protection that the instrument may benefit from, such as insurance wraps or subordinated tranches. Where there are instances of market observable data for several similar RMBS tranches, the Group considers the extent of similar characteristics shared with the instrument being valued, together with the frequency, tenor and nature of the trades that have been observed. This method is most frequently used for US and UK RMBS. The RMBS of Dutch and Spanish originated mortgages guaranteed by those governments are valued using the credit spreads of the respective government debt and certain assumptions made by the Group, or based on observable prices from Bloomberg or consensus pricing services.

Where there is no trading activity in respect of RMBS, models are used for valuation purposes. The Group primarily uses an industry standard model to project the expected future cash flows to be received from the underlying mortgages and to forecast how these cash flows will be distributed to the various holders of the RMBS. This model utilises data provided by the servicer of the underlying mortgage portfolio, layering on assumptions for mortgage prepayments, probability of default, expected losses, and yield. The Group uses data from third-party sources to calibrate its assumptions, including pricing information from third party pricing services, independent research, broker quotes, and other independent sources. An assessment is made of the third-party data source to determine its applicability and reliability. The Group adjusts the model price with a liquidity premium to reflect the price that the instrument could be traded at in the market and may also make adjustments for model deficiencies.

The weighted average of the key significant inputs utilised in valuing US level 3 RMBS positions are shown in the table below.

	Weighted-average inputs	
	Non-agency prime RMBS	Alt-A RMBS
Yield	12%	18%
Probability of default	3.0% CDR (1)	40.0% CDR(1)
Loss severity	40%	65%
Prepayment	15% CPR(2)	10% CPR(2)

Notes:

(1) Constant default rate or probability of default

(2) Constant prepayment rate

**11. Financial instruments (continued)**

**Level 3 portfolios (continued)**

**Debt securities (continued)**

The fair value of securities within each class of asset changes on a broadly consistent basis in response to changes in given market factors. However, the extent of the change, and therefore the range of reasonably possible alternative assumptions, may be either more or less pronounced, depending on the particular terms and circumstances of the individual security. The Group believes that the probability of default is the least transparent input into Alt-A and prime RMBS modelled valuations and is most sensitive to variations for valuation purposes. The Group believes that a range of 500 basis points greater than and 300 basis points less than the weighted average constant default rate, and a range of 300 basis points greater than and 200 basis points less than the weighted average constant default rate represents a reasonably possible set of acceptable pricing alternatives for Alt-A and prime RMBS, respectively. These assumptions consider the inherently risky nature of Alt-A over prime securities, as well as declining economic conditions leading to an increased likelihood of default at year-end. While other key inputs may possess characteristics of unobservability in both Alt-A and prime modelled valuations, the effect of utilising reasonably possible alternatives for these inputs would have an immaterial effect on the overall valuation. Using these reasonably possible alternative assumptions the fair value of RMBS of £0.4 billion (2008 - £0.5 billion) would be £28 million (2008 - £90 million) lower or £24 million (2008 - £40 million) higher.

Commercial mortgage backed securities

CMBS are valued using an industry standard model and the inputs, where possible, are corroborated using observable market data.

For senior CMBS and subordinated tranches, the Group has determined that the most sensitive input to reasonably possible alternative valuation is probability of default and yield respectively. Using reasonably possible alternative assumptions for these inputs, the fair value of CMBS of £0.4 billion (2008 - £0.6 billion) would be £16 million (2008 - £30 million) lower or £16 million (2008 - £30 million) higher.

Collateralised debt obligations

CDOs purchased from third parties are valued using independent, third-party quotes or independent lead manager indicative prices. For super senior CDOs which have been originated by the Group no specific third-party information is available. The valuation of these super senior CDOs therefore takes into consideration available market data and appropriate valuation adjustments.

A collateral net asset value methodology is considered which uses dealer buy side marks to determine an upper bound for super senior CDO valuations. An ABS index implied collateral valuation methodology is also used, which provides a market calibrated valuation data point. Both the ABS index implied valuation and the collateral net asset value methodology apply an assumed immediate liquidation approach.

The output from using these alternative assumptions has been compared with inferred pricing from other published data. The Group believes that reasonably possible alternative assumptions could reduce or increase valuations by up to 4%. Using these alternative assumptions would reduce the fair value of level 3 CDOs of £1.5 billion (2008 - £1.7 billion) by up to £288 million (2008 - £440 million) (super senior CDOs: £179 million (2008 - £292 million)) and increase the fair value by up to £311 million (2008 - £410 million) (super senior CDOs: £202 million (2008 - £292 million)).

## 11. Financial instruments (continued)

### Level 3 portfolios (continued)

#### Debt securities (continued)

##### Collateralised loan obligations

To determine the fair value of CLOs purchased from third parties, the Group uses third-party broker or lead manager quotes as the primary pricing source. These quotes are benchmarked to consensus pricing sources where they are available.

For CLOs originated and still held by the Group, the fair value is determined using a correlation model based on a Monte Carlo simulation framework. The main model inputs are credit spreads and recovery rates of the underlying assets and their correlation. A credit curve is assigned to each underlying asset based on prices, from third-party dealer quotes, and cash flow profiles, sourced from an industry standard model. Losses are calculated taking into account the attachment and detachment point of the exposure. As the correlation inputs to this model are not observable CLOs are deemed to be level 3. Using reasonably possible alternative assumptions the fair value of CLOs of £0.7 billion (2008 - £1.0 billion) would be £27 million (2008 - £40 million) lower or £27 million higher (2008 - £40 million).

##### Other debt securities

Other level 3 debt securities comprise £0.7 billion (2008 - £1.4 billion) of other asset-backed securities ('ABS') and £1.5 billion (2008 - £1.7 billion) of other debt securities. Where observable market prices for a particular debt security are not available, the fair value is typically determined with reference to observable market transactions in other related products, such as similar debt securities or credit derivatives. Assumptions are made about the relationship between the individual debt security and the available benchmark data. Where significant management judgement has been applied in identifying the most relevant related product, or in determining the relationship between the related product and the instrument itself, the valuation is shown in level 3. Using differing assumptions about this relationship would result in different fair values for these assets. The main assumption made is that of relative creditworthiness. Using reasonably possible alternative credit assumptions, taking into account the underlying currency, tenor, and rating of the debt securities within each portfolio, would reduce the fair value of other debt securities of £2.2 billion (2008 - £3.1 billion) by up to £55 million (2008 - £50 million) or increase the fair value by up to £54 million (2008 - £50 million).

#### Equity shares

Private equity investments include unit holdings and limited partnership interests primarily in corporate private equity funds, debt funds and fund of hedge funds. Externally managed funds are valued using recent prices where available. Where not available, the fair value of investments in externally managed funds is generally determined using statements or other information provided by the fund managers.

Although such valuations are provided from third parties, the Group recognises that such valuations may rely significantly on the judgements and estimates made by those fund managers, particularly in assessing private equity components. Following the decline in liquidity in world markets, the Group believes that there is sufficient subjectivity in such valuations to report them in level 3.

Reasonably possible alternative valuations have been determined based on the historical trends in valuations received, and by considering the possible impact of market movements towards the end of the reporting period, which may not be fully reflected in valuations received. Using these reasonably possible alternate assumptions would reduce the fair value of externally managed funds of £1.0 billion (2008 - £1.1 billion) by up to £127 million (2008 - £150 million) or increase the fair value by up to £106 million (2008 - £80 million).

## 11. Financial instruments (continued)

### Level 3 portfolios (continued)

#### Derivatives

Level 3 derivative assets comprise credit derivatives £5.1 billion (2008 - £8 billion), and interest rate, foreign exchange rate and commodity derivative contracts of £3.6 billion (2008 - £2.2 billion). Derivative liabilities comprise credit derivatives of £2.7 billion (2008 - £2.6 billion), and interest rate, foreign exchange rate and commodity derivatives contracts of £1.5 billion (2008 - £1.4 billion).

Derivatives are priced using quoted prices for the same or similar instruments where these are available. However, the majority of derivatives are valued using pricing models. Inputs for these models are usually observed directly in the market, or derived from observed prices. However, it is not always possible to observe or corroborate all model inputs. Where there are no observable inputs in respect of certain or all of the parameters, inputs are based on estimates taking into account a range of available information including historical analysis, historical traded levels, market practice, comparison to other relevant benchmark observable data and consensus pricing data.

#### Credit derivatives

The Group's credit derivatives include vanilla and bespoke portfolio tranches, gap risk products and certain other unique trades. The bespoke portfolio tranches are synthetic tranches referenced to a bespoke portfolio of corporate names on which the Group purchases credit protection. Bespoke portfolio tranches are valued using Gaussian Copula, a standard method which uses observable market inputs (credit spreads, index tranche prices and recovery rates) to generate an output price for the tranche via a mapping methodology. In essence this method takes the expected loss of the tranche expressed as a fraction of the expected loss of the whole underlying portfolio and calculates which detachment point on the liquid index, and hence which correlation level, coincides with this expected loss fraction. Where the inputs into this valuation technique are observable in the market, bespoke tranches are considered to be level 2 assets. Where inputs are not observable, bespoke tranches are considered to be level 3 assets. However, all transactions executed with CDPCs are considered level 3 as the counterparty credit risk assessment is a significant component of these valuations.

Gap risk products are leveraged trades, with the counterparty's potential loss capped at the amount of the initial principal invested. Gap risk is the probability that the market will move discontinuously too quickly to exit a portfolio and return the principal to the counterparty without incurring losses, should an unwind event be triggered. This optionality is embedded within these portfolio structures and is very rarely traded outright in the market. Gap risk is not observable in the markets and, as such, these structures are deemed to be level 3 instruments.

Other unique trades are valued using a specialised model for each instrument with the same market data inputs as all other trades where applicable. By their nature, the valuation is also driven by a variety of other model inputs, many of which are unobservable in the market. Where these instruments have embedded optionality it is valued using a variation of the Black-Scholes option pricing formula, and where they have correlation exposure it is valued using a variant of the Gaussian Copula model. The volatility or unique correlation inputs required to value these products are generally unobservable and the instruments are therefore deemed to be level 3 instruments.



**11. Financial instruments (continued)**

**Level 3 portfolios (continued)**

**Derivatives (continued)**

Equity derivatives

Equity derivative products are split into equity exotic derivatives and equity hybrids. Equity exotic derivatives have payouts based on the performance of one or more stocks, equity funds or indices. Most payouts are based on the performance of a single asset and are valued using observable market option data. Unobservable equity derivative trades are typically complex basket options on stocks. Such basket option payouts depend on the performance of more than one equity asset and require inputs based on the correlations between the individual components of the stock market. Valuation is then performed using industry standard valuation models, with unobservable correlation inputs calculated by reference to correlations observed between similar underlying instruments.

Equity hybrids have payouts based on the performance of a basket of underlying instruments where the underlying instruments are all from different asset classes. Correlations between these different underlying instruments are typically unobservable with no market information for closely related assets available. Where no market for the correlation input exists, these inputs are based on historical time series.

For equity exotic derivatives and equity hybrids, reasonable possible alternative valuations are determined on the basis of parameter uncertainty calculations for the unobservable parameters. The range of valuations is inferred from consensus data and market quotes. Where day one reserves exist for a given product, the worst case valuation is mitigated by these reserves. For certain products, day one reserves exceed valuation uncertainty and in these instances the worst case is deemed to be current book value.

Other derivatives

Interest rate and commodity options provide a payout (or series of payouts) linked to the performance of one or more underlying rates, including interest rates, foreign exchange rates and commodity prices. Included in commodities derivatives are energy contracts entered into by RBS Sempra Commodities. Most of these contracts are valued using models that incorporate observable data. A small number are more complex, structured derivatives which incorporate in their valuation assumptions regarding power price volatilities and correlation between inputs, which are not market observable. These include certain tolling agreements, where power is purchased in return for a given quantity of fuel, and load deals, where a seller agrees to deliver a fixed proportion of power used by a client's utility customers.

Exotic options do not trade in active markets except in a small number of cases. Consequently, the Group uses models to determine fair value using valuation techniques typical for the industry. These techniques can be divided, firstly, into modelling approaches and, secondly, into methods of assessing appropriate levels for model inputs. The Group uses a variety of proprietary models for valuing exotic trades.

Exotic valuation inputs include correlation between interest rates, foreign exchange rates and commodity prices. Correlations for more liquid rate pairs are valued using independently sourced consensus pricing levels. Where a consensus pricing benchmark is unavailable, these instruments are categorised as level 3.

Reasonably possible alternative assumptions have been determined by stressing unobservable model input parameters by levels determined by a qualitative assessment of historical data.



## 11. Financial instruments (continued)

### Level 3 portfolios (continued)

#### Derivatives (continued)

##### Reasonably possible alternative assumptions for derivatives

In determining the effect of reasonably possible alternative assumptions for unobservable inputs, the Group has considered credit derivative trades with CDPCs separately from all other level 3 derivatives due to the significant element of subjectivity in determining the counterparty credit risk.

The fair value of credit derivative trades with CDPCs as at 30 June 2009 was £2.3 billion (2008 - £4.8 billion) before applying a CVA of £0.8 billion (2008 - £1.3 billion). The Group's credit derivative exposures to CDPCs are valued using pricing models with inputs observed directly in the market. An adjustment is made to the model valuation as the creditworthiness of CDPCs differs from that of the credit risk assumptions used in the model. The adjustment reflects the estimated cost of hedging the counterparty risk arising from each trade. In the absence of market observable credit spreads of CDPCs, the cost of hedging the counterparty risk is estimated from an analysis of the underlying trades and the cost of hedging expected default losses in excess of the capital available in each vehicle. A reasonably possible alternative approach would be to estimate the cost of hedging the counterparty risk from market observable credit spreads of entities considered similar to CDPCs (for example monoline insurers with similar business or similarly rated entities). These reasonably possible alternative approaches would reduce the fair value credit derivatives with CDPCs by up to £111 million (2008 - £740 million) or increase the fair value by up to £245 million (2008 - £600 million).

For all other level 3 derivatives, unobservable inputs are principally comprised of correlations and volatilities. Where a derivative valuation relies significantly on an unobservable input, the valuation is shown in level 3. It is usual for such derivative valuations to depend on several observable, and one or few unobservable model inputs. In determining reasonably possible alternative assumptions, the relative effect of unobservable inputs compared to those which may be observed was considered. Using reasonably possible alternative assumptions the fair value of all other level 3 derivative assets (excluding CDPCs) would be reduced by up to £428 million (2008 - £600 million) or increased by up to £422 million (2008 - £560 million), and derivative liabilities of £4.2 billion (2008 - £4.0 billion) would be reduced by up to £248 million (2008 - £300 million) or increased by up to £250 million (2008 - £280 million).

#### Other financial instruments

The carrying value of debt securities in issue is represented partly by underlying cash and partly through a derivative component. The classification of the amount in level 3 is driven by the derivative component and not by assumptions.

In addition to the portfolios discussed above, there are other financial instruments which are held at fair value determined from data that are not market observable, or incorporating material adjustments to market observed data. Using reasonably possible alternate assumptions appropriate to the liability in question, such as credit spreads, derivative inputs and equity correlations, would reduce the fair value of other financial instruments held at fair value of £3.5 billion (2008 - £5.0 billion), primarily debt securities in issue of £3.1 billion (2008 - £4.4 billion), by up to £76 million (2008 - £250 million) or increase the fair value by up to £76 million (2008 - £210 million).

## Notes to pro forma results (continued)

### 11. Financial instruments (continued)

#### Own credit

When valuing financial liabilities recorded at fair value, the Group takes into account the effect of its own credit standing. The categories of financial liabilities on which own credit spread adjustments are made are issued debt, including issued structured notes, and derivatives. An own credit adjustment is applied to positions where it is believed that counterparties would consider the Group's creditworthiness when pricing trades.

For issued debt and structured notes, this adjustment is based on independent quotes from market participants for the debt issuance spreads above average inter-bank rates (at a range of tenors) which the market would demand when purchasing new senior or sub-debt issuances from the Group. Where necessary, these quotes are interpolated using a curve shape derived from CDS prices.

The fair value of the Group's derivative financial liabilities has also been adjusted to reflect the Group's own credit risk. The adjustment takes into account collateral posted by the Group and the effects of master netting agreements.

The table below shows the own credit spread adjustments on liabilities recorded in the income statement during the first half of the year.

	Debt securities in issue		Total £m	Derivatives £m	Total £m
	Held-for- trading £m	Designated at fair value through profit and loss £m			
At 1 January 2009	1,346	1,027	2,373	450	2,823
Net effect of changes to credit spreads	242	(73)	169	54	223
Foreign exchange movements	(189)	(31)	(220)	-	(220)
New issues and redemptions (net)	(22)	11	(11)	-	(11)
At 30 June 2009	1,377	934	2,311	504	2,815

The effect of change in credit spreads could be reversed in future periods.

#### Reclassification of financial instruments

During 2008, as permitted by amended IAS 39, the Group reclassified financial assets from the held-for-trading and available-for-sale categories into the loans and receivables category and from the held-for-trading category into the available-for-sale category.. There were further reclassifications from the held-for-trading category to the loans and receivables category in the first half of 2009. The effect of the reclassifications and the balance sheet values of the assets were as follows.

	Additional losses that would have been recognised in H1 2009 if reclassifications had not occurred		
	Total £m	Reclassified in: H1 2009 £m	2008 £m
From held-for-trading to:			
Available-for-sale	(284)	-	(284)
Loans and receivables	526	178	348
Total	242	178	64

## Notes to pro forma results (continued)

### 11. Financial instruments (continued)

#### Reclassification of financial instruments (continued)

	Assets reclassified in 2009  carrying value £m	30 June 2009 All reclassifications		31 December 2008 All reclassifications (1)	
		Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
From held-for-trading to:					
Available-for-sale	-	8,442	8,442	12,047	12,047
Loans and receivables	1,871	16,458	12,158	20,774	16,628
	1,871	24,900	20,600	32,821	28,675
From available-for-sale to:					
Loans and receivables	-	866	741	1,016	956
	1,871	25,766	21,341	33,837	29,631

Note:

(1) 31 December 2008 amounts have been restated.

During the period, the balance sheet value of reclassified assets reduced by £8.1 billion. This was primarily due to disposals and repayments of £6.0 billion across a range of asset backed securities and loans, foreign exchange rate movements of £3.2 billion and impairment losses of £1.5 billion offset by reclassifications in the period of £1.9 billion.

For assets reclassified from held-for-trading to available-for-sale, net unrealised losses recorded in equity at 30 June 2009 were £1.9 billion (31 December 2008 - £2.2 billion).

### 12. Debt securities

	UK central and local government £m	US central and local government £m	Other central and local government £m	Bank and building society £m	Asset backed securities £m	Corporate £m	Other £m	Total £m
<b>30 June 2009</b>								
Held-for-trading	7,753	9,526	43,289	5,079	32,539	8,266	958	107,410
Designated as at fair value through profit or loss	1,943	3	439	624	354	1,074	9	4,446
Available-for-sale	5,401	9,616	26,727	7,800	48,817	7,010	487	105,858
Loans and receivables	-	-	31	97	8,746	2,416	55	11,345
	15,097	19,145	70,486	13,600	90,456	18,766	1,509	229,059
<b>31 December 2008</b>								
Held-for-trading	5,373	9,858	37,519	4,333	39,879	17,627	1,570	116,159
Designated as at fair value through profit or loss	2,085	510	456	-	236	1,551	456	5,294
Available-for-sale	11,330	6,145	21,735	10,549	62,067	5,689	1,207	118,722
Loans and receivables	-	-	-	114	8,961	3,749	160	12,984
	18,788	16,513	59,710	14,996	111,143	28,616	3,393	253,159

## Notes to pro forma results (continued)

### 13. Derivatives

	30 June 2009		31 December 2008	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
<b>Exchange rate contracts</b>				
Spot, forwards and futures	29,060	28,178	82,963	83,433
Currency swaps	32,678	30,841	53,231	54,413
Options purchased	18,384	-	36,688	-
Options written	-	17,908	-	34,946
<b>Interest rate contracts</b>				
Interest rate swaps	330,175	316,416	547,566	530,843
Options purchased	61,058	-	99,176	-
Options written	-	60,122	-	102,210
Futures and forwards	3,635	2,836	7,600	6,620
<b>Credit derivatives</b>	64,382	59,715	142,367	132,734
<b>Equity and commodity contracts</b>	16,518	18,616	21,904	24,210
	<b>555,890</b>	<b>534,632</b>	<b>991,495</b>	<b>969,409</b>

Note: of the total above at 30 June 2009, £30.5 billion assets and £27.9 billion of liabilities relate to non core.

The Group enters into master netting agreements in respect of its derivatives activities. These arrangements, which give the Group a legal right to set-off derivative assets and liabilities with the same counterparty, do not result in a net presentation in the Group's balance sheet for which IFRS requires an intention to settle net or to realise the asset and settle the liability simultaneously as well as a legally enforceable right to set off. They are, however, effective in reducing the Group's credit exposure from derivative assets. The Group has executed master netting agreements with the majority of its derivative counterparties resulting in a significant reduction in its net exposure to derivative assets. Of the £556 billion derivatives assets shown above, £461 billion (31 December 2008 - £834 billion) were under such agreements. Furthermore, the Group holds substantial collateral against this net derivative asset exposure.

### 14. Analysis of contingent liabilities and commitments

	30 June 2009			31 December 2008 £m	30 June 2008 £m
	Core £m	Non-Core £m	Total £m		
<b>Contingent liabilities</b>					
Guarantees and assets pledged as collateral security	37,214	859	38,073	45,931	40,445
Other contingent liabilities	15,161	891	16,052	21,765	16,063
	<b>52,375</b>	<b>1,750</b>	<b>54,125</b>	<b>67,696</b>	<b>56,508</b>
<b>Commitments</b>					
Undrawn formal standby facilities, credit lines and other commitments to lend	266,013	30,571	296,584	349,416	316,090
Other commitments	4,148	34	4,182	6,876	3,361
	<b>270,161</b>	<b>30,605</b>	<b>300,766</b>	<b>356,292</b>	<b>319,451</b>
<b>Total contingent liabilities and commitments</b>	<b>322,536</b>	<b>32,355</b>	<b>354,891</b>	<b>423,988</b>	<b>375,959</b>

Additional contingent liabilities arise in the normal course of the Group's business. It is not anticipated that any material loss will arise from these transactions.

## **Independent review report to The Royal Bank of Scotland Group plc**

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We have been engaged by the company to review the pro forma financial information in the half yearly financial report for the six months ended 30 June 2008, the year ended 31 December 2008 and the six months ended 30 June 2009 which comprises the pro forma summary consolidated income statement, the pro forma condensed consolidated balance sheet, the pro forma condensed consolidated statement of changes in equity, the pro forma divisional performance disclosures, the related notes 1 to 14 on pro forma results and parts of Risk and capital management set out on pages 96, 105 to 115 and 118 to 144 (together "the pro forma financial information").

This report is made solely to the company in accordance with the International Standard on Review Engagements 2410 issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the company those matters we are required to state to them in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company, for our review work, for this report, or for the conclusions we have formed.

### **Directors' responsibilities**

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the pro forma financial information in accordance with the basis of preparation described in note 1 on page 72.

### **Our responsibility**

Our responsibility is to express to the company a conclusion on the pro forma financial information in the half-yearly financial report based on our review.

### **Scope of review**

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### **Conclusion**

Based on our review we are not aware of any material modifications that should be made to the pro forma financial information for the six months ended 30 June 2009, year ended 31 December 2008 or six months ended 30 June 2008.

Deloitte LLP  
Chartered Accountants and Statutory Auditors  
Edinburgh, United Kingdom  
6 August 2009