OMEGA HEALTHCARE INVESTORS INC
Form S-4/A
May 13, 2011

As filed with the Securities and Exchange Commission on May 13, 2011

Registration No. 333-172616

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

PRE-EFFECTIVE
AMENDMENT NO. 1
TO

FORM S-4

REGISTRATION STATEMENT
UNDER THE SECURITIES ACT OF 1933

OMEGA HEALTHCARE INVESTORS, INC.
and the Subsidiary Guarantors listed on Schedule A
(Exact name of registrant as specified in its charter)

Maryland	6798	38-3041398
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification No.)

200 International Circle, Suite 3500
Hunt Valley, Maryland 21030
(410) 427-1700
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

C. Taylor Pickett
Chief Executive Officer
Omega Healthcare Investors, Inc.
200 International Circle, Suite 3500
Hunt Valley, Maryland 21030
(410) 427-1700
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies of communications to:

Eliot W. Robinson
Terrence A. Childers
Bryan Cave LLP
One Atlantic Center, Fourteenth Floor
1201 West Peachtree Street, NW
Atlanta, Georgia 30309-3488
(404) 572-6600

Approximate date of commencement of proposed sale to the public: As soon as practicable after this registration statement becomes effective.

If the securities being registered on this Form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

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If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o

If applicable, place an X in the box to designate the appropriate rule provision relied upon in conducting this transaction:

Exchange Act Rule 13e04(i) (Cross-Border Issuer Tender Offer)	o
Exchange Act Rule 14d-1(d) (Cross-Border Third Party Tender Offer)	o

Schedule A
Subsidiary Guarantors

Exact name of registrant as specified in its charter (1)	State or other jurisdiction of formation	Primary Standard Industrial Classification Code No.	I.R.S. Employer Identification No.
Arizona Lessor - Infinia, Inc.	Maryland	6798	32-0008074
Baldwin Health Center, Inc.	Pennsylvania	6798	25-1495708
Bayside Alabama Healthcare Second, Inc.	Alabama	6798	38-3517839
Bayside Arizona Healthcare Associates, Inc.	Arizona	6798	38-3518309
Bayside Arizona Healthcare Second, Inc.	Arizona	6798	38-3520329
Bayside Colorado Healthcare Associates, Inc.	Colorado	6798	38-3517837
Bayside Colorado Healthcare Second, Inc.	Colorado	6798	38-3520325
Bayside Indiana Healthcare Associates, Inc.	Indiana	6798	38-3517842
Bayside Street II, Inc.	Delaware	6798	38-3519969
Bayside Street, Inc.	Maryland	6798	38-3160026
Canton Health Care Land, Inc.	Ohio	6798	20-1914579
Carnegie Gardens LLC	Delaware	6798	20-2442381
Center Healthcare Associates, Inc.	Texas	6798	38-3517844
Cherry Street – Skilled Nursing, Inc.	Texas	6798	38-3592148
Colonial Gardens, LLC	Ohio	6798	26-0110549
Colorado Lessor - Conifer, Inc.	Maryland	6798	32-0008069
Copley Health Center, Inc.	Ohio	6798	34-1473010
CSE Albany LLC	Delaware	6798	20-5885886
CSE Amarillo LLC	Delaware	6798	20-5862752
CSE Anchorage LLC	Delaware	6798	26-1866499
CSE Arden L.P.	Delaware	6798	20-5888680
CSE Augusta LLC	Delaware	6798	20-5885921
CSE Bedford LLC	Delaware	6798	20-5886082
CSE Blountville LLC	Delaware	6798	20-8295288
CSE Bolivar LLC	Delaware	6798	20-8295024
CSE Cambridge LLC	Delaware	6798	20-5886976
CSE Cambridge Realty LLC	Delaware	6798	20-5959318
CSE Camden LLC	Delaware	6798	20-8295066
CSE Canton LLC	Delaware	6798	20-5887312
CSE Casablanca Holdings II LLC	Delaware	6798	26-0595183
CSE Casablanca Holdings LLC	Delaware	6798	20-8724466
CSE Cedar Rapids LLC	Delaware	6798	20-5884941
CSE Centennial Village	Delaware	6798	20-6974959
CSE Chelmsford LLC	Delaware	6798	20-5920451
CSE Chesterton LLC	Delaware	6798	20-5885195
CSE Claremont LLC	Delaware	6798	20-5883891

CSE Corpus North LLC	Delaware	6798	20-5186415
CSE Crane LLC	Delaware	6798	20-8684704
CSE Denver Iliff LLC	Delaware	6798	20-8037772
CSE Denver LLC	Delaware	6798	20-5884311
CSE Douglas LLC	Delaware	6798	20-5883761
CSE Dumas LLC	Delaware	6798	20-5883692
CSE Elkton LLC	Delaware	6798	20-5887006
CSE Elkton Realty LLC	Delaware	6798	20-5959253
CSE Fairhaven LLC	Delaware	6798	20-8281491
CSE Fort Wayne LLC	Delaware	6798	20-5885125
CSE Frankston LLC	Delaware	6798	20-5862947
CSE Georgetown LLC	Delaware	6798	20-5886126
CSE Green Bay LLC	Delaware	6798	20-5888029
CSE Hilliard LLC	Delaware	6798	20-5887347
CSE Huntingdon LLC	Delaware	6798	20-8295191
CSE Huntsville LLC	Delaware	6798	20-5887764
CSE Indianapolis-Continental LLC	Delaware	6798	20-5885046
CSE Indianapolis-Greenbriar LLC	Delaware	6798	20-5885096
CSE Jacinto City LLC	Delaware	6798	20-5186519
CSE Jefferson City LLC	Delaware	6798	20-8295101

Exact name of registrant as specified in its charter (1)	State or other jurisdiction of formation	Primary Standard Industrial Classification Code No.	I.R.S. Employer Identification No.
CSE Jeffersonville-Hillcrest Center LLC	Delaware	6798	20-5885261
CSE Jeffersonville-Jennings House LLC	Delaware	6798	20-5885346
CSE Kerrville LLC	Delaware	6798	20-8684872
CSE King L.P.	Delaware	6798	20-5888725
CSE Kingsport LLC	Delaware	6798	20-5887736
CSE Knightdale L.P.	Delaware	6798	20-5888653
CSE Lake City LLC	Delaware	6798	20-5863259
CSE Lake Worth LLC	Delaware	6798	20-5863173
CSE Lakewood LLC	Delaware	6798	20-5884352
CSE Las Vegas LLC	Delaware	6798	20-5887216
CSE Lawrenceburg LLC	Delaware	6798	20-5887802
CSE Lenoir L.P.	Delaware	6798	20-5888528
CSE Lexington Park LLC	Delaware	6798	20-5886951
CSE Lexington Park Realty LLC	Delaware	6798	20-5959280
CSE Ligonier LLC	Delaware	6798	20-5885484
CSE Live Oak LLC	Delaware	6798	20-5863086
CSE Logansport LLC	Delaware	6798	20-5885583
CSE Lowell LLC	Delaware	6798	20-5885381
CSE Marianna Holdings LLC	Delaware	6798	20-1411422
CSE Memphis LLC	Delaware	6798	20-8295130
CSE Mobile LLC	Delaware	6798	20-5883572
CSE Moore LLC	Delaware	6798	20-5887574
CSE North Carolina Holdings I LLC	Delaware	6798	20-5888397
CSE North Carolina Holdings II LLC	Delaware	6798	20-5888430
CSE Omro LLC	Delaware	6798	20-5887998
CSE Orange Park LLC	Delaware	6798	20-5863371
CSE Orlando-Pinar Terrace Manor LLC	Delaware	6798	20-5863043
CSE Orlando-Terra Vista Rehab LLC	Delaware	6798	20-5863223
CSE Pennsylvania Holdings	Delaware	6798	20-6974946
CSE Piggott LLC	Delaware	6798	20-5883659
CSE Pilot Point LLC	Delaware	6798	20-5862827
CSE Ponca City LLC	Delaware	6798	20-5887495
CSE Port St. Lucie LLC	Delaware	6798	20-5863294
CSE Richmond LLC	Delaware	6798	20-5885427
CSE Ripley LLC	Delaware	6798	20-8295238
CSE Ripon LLC	Delaware	6798	26-0480886
CSE Safford LLC	Delaware	6798	20-5883807
CSE Salina LLC	Delaware	6798	20-5885669
CSE Seminole LLC	Delaware	6798	20-5887615
CSE Shawnee LLC	Delaware	6798	20-5887524

CSE Spring Branch LLC	Delaware	6798	20-5186484
CSE Stillwater LLC	Delaware	6798	20-5887548
CSE Taylorsville LLC	Delaware	6798	20-5886196
CSE Texarkana LLC	Delaware	6798	20-5862880
CSE Texas City LLC	Delaware	6798	20-5862791
CSE The Village LLC	Delaware	6798	20-5186550
CSE Upland LLC	Delaware	6798	20-5891148
CSE Walnut Cove L.P.	Delaware	6798	20-5888502
CSE West Point LLC	Delaware	6798	20-5887119
CSE Whitehouse LLC	Delaware	6798	20-8294979
CSE Williamsport LLC	Delaware	6798	26-0480953
CSE Winter Haven LLC	Delaware	6798	20-5863327
CSE Woodfin L.P.	Delaware	6798	20-5888619
CSE Yorktown LLC	Delaware	6798	20-5885163
Dallas – Skilled Nursing, Inc.	Texas	6798	38-3592151
Delta Investors I, LLC	Maryland	6798	54-2112455
Delta Investors II, LLC	Maryland	6798	54-2112456
Desert Lane LLC	Delaware	6798	20-3098022
Dixon Health Care Center, Inc.	Ohio	6798	34-1509772

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Florida Lessor – Crystal Springs, Inc.	Maryland	6798	75-3116533
Florida Lessor – Emerald, Inc.	Maryland	6798	22-3872569
Florida Lessor – Lakeland, Inc.	Maryland	6798	22-3872564
Florida Lessor – Meadowview, Inc.	Maryland	6798	56-2398721
Florida Real Estate Company, LLC	Florida	6798	20-1458431
Georgia Lessor - Bonterra/Parkview, Inc.	Maryland	6798	16-1650494
Greenbough, LLC	Delaware	6798	27-0258266
Hanover House, Inc.	Ohio	6798	34-1125264
Heritage Texarkana Healthcare Associates, Inc.	Texas	6798	38-3517861
House of Hanover, Ltd	Ohio	6798	34-6691713
Hutton I Land, Inc.	Ohio	6798	20-1914403
Hutton II Land, Inc.	Ohio	6798	20-1914470
Hutton III Land, Inc.	Ohio	6798	20-1914529
Indiana Lessor – Jeffersonville, Inc.	Maryland	6798	22-3872575
Indiana Lessor – Wellington Manor, Inc.	Maryland	6798	32-0008064
Jefferson Clark, Inc.	Maryland	6798	38-3433390
LAD I Real Estate Company, LLC	Delaware	6798	20-1454154
Lake Park – Skilled Nursing, Inc.	Texas	6798	38-3592152
Leatherman 90-1, Inc.	Ohio	6798	20-1914625
Leatherman Partnership 89-1, Inc.	Ohio	6798	34-1656489
Leatherman Partnership 89-2, Inc.	Ohio	6798	34-1656491
Long Term Care – Michigan, Inc.	Michigan	6798	04-3833330
Long Term Care – North Carolina, Inc.	North Carolina	6798	04-3833335
Long Term Care Associates – Illinois, Inc.	Illinois	6798	38-3592159
Long Term Care Associates – Indiana, Inc.	Indiana	6798	38-3592160
Long Term Care Associates – Texas, Inc.	Texas	6798	38-3592142
Meridian Arms Land, Inc.	Ohio	6798	20-1914864
North Las Vegas LLC	Delaware	6798	20-3098036
NRS Ventures, L.L.C.	Delaware	6798	38-4236118
OHI (Connecticut), Inc.	Connecticut	6798	06-1552120
OHI (Florida), Inc.	Florida	6798	65-0523484
OHI (Illinois), Inc.	Illinois	6798	37-1332375
OHI (Indiana), Inc.	Indiana	6798	38-3568359
OHI (Iowa), Inc.	Iowa	6798	38-3377918
OHI (Kansas), Inc.	Kansas	6798	48-1156047
OHI Asset (CA), LLC	Delaware	6798	04-3759925
OHI Asset (CO), LLC	Delaware	6798	84-1706510
OHI Asset (CT) Lender, LLC	Delaware	6798	75-3205111

OHI Asset (FL), LLC	Delaware	6798	13-4225158
OHI Asset (FL) Lender, LLC	Delaware	6798	27-4450390
OHI Asset (ID), LLC	Delaware	6798	04-3759931
OHI Asset (IL), LLC	Delaware	6798	14-1951802
OHI Asset (IN), LLC	Delaware	6798	04-3759933
OHI Asset (LA), LLC	Delaware	6798	04-3759935
OHI Asset (MI), LLC	Delaware	6798	27-3378345
OHI Asset (MI/NC), LLC	Delaware	6798	04-3759928
OHI Asset (MO), LLC	Delaware	6798	04-3759939
OHI Asset (OH) Lender, LLC	Delaware	6798	51-0529744
OHI Asset (OH) New Philadelphia, LLC	Delaware	6798	51-0529741
OHI Asset (OH), LLC	Delaware	6798	04-3759938
OHI Asset (PA) Trust	Maryland	6798	54-6643405
OHI Asset (PA), LLC	Delaware	6798	90-0137715
OHI Asset (SMS) Lender, Inc.	Maryland	6798	33-1067711
OHI Asset (TX), LLC	Delaware	6798	04-3759927
OHI Asset CSB LLC	Delaware	6798	27-2820083
OHI Asset CSE – E, LLC	Delaware	6798	27-1675861
OHI Asset CSE – U, LLC	Delaware	6798	27-1675768
OHI Asset Essex (OH), LLC	Delaware	6798	83-0379722
OHI Asset II (CA), LLC	Delaware	6798	20-1000879

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OHI Asset II (FL), LLC	Delaware	6798	27-1813906
OHI Asset II (PA) Trust	Maryland	6798	84-6390330
OHI Asset III (PA) Trust	Maryland	6798	84-6390331
OHI Asset IV (PA) Silver Lake Trust	Maryland	6798	80-6146794
OHI Asset, LLC	Delaware	6798	32-0079270
OHI of Texas, Inc.	Maryland	6798	38-3506136
OHI Sunshine, Inc.	Florida	6798	82-0558471
OHI Tennessee, Inc.	Maryland	6798	38-3509157
OHIMA, Inc.	Massachusetts	6798	06-1552118
Omega (Kansas), Inc.	Kansas	6798	32-0142534
Omega TRS I, Inc.	Maryland	6798	38-3587540
Orange Village Care Center, Inc.	Ohio	6798	34-1321728
OS Leasing Company	Kentucky	6798	38-3221641
Panama City Nursing Center LLC	Delaware	6798	20-2568041
Parkview – Skilled Nursing, Inc.	Texas	6798	38-3592157
Pavillion North Partners, Inc.	Pennsylvania	6798	20-2597892
Pavillion North, LLP	Pennsylvania	6798	75-3202956
Pavillion Nursing Center North, Inc.	Pennsylvania	6798	25-1222652
Pine Texarkana Healthcare Associates, Inc.	Texas	6798	38-3517864
Reunion Texarkana Healthcare Associates, Inc.	Texas	6798	38-3517865
San Augustine Healthcare Associates, Inc.	Texas	6798	38-3517866
Skilled Nursing – Gaston, Inc.	Indiana	6798	38-3592171
Skilled Nursing – Herrin, Inc.	Illinois	6798	38-3592162
Skilled Nursing – Hicksville, Inc.	Ohio	6798	38-3592172
Skilled Nursing – Paris, Inc.	Illinois	6798	38-3592165
Skyler Maitland LLC	Delaware	6798	20-3888672
South Athens Healthcare Associates, Inc.	Texas	6798	38-3517880
St. Mary’s Properties, Inc.	Ohio	6798	20-1914905
Sterling Acquisition Corp.	Kentucky	6798	38-3207992
Sterling Acquisition Corp. II	Kentucky	6798	38-3207991
Suwanee, LLC	Delaware	6798	20-5223977
Texas Lessor – Stonegate GP, Inc.	Maryland	6798	32-0008071
Texas Lessor – Stonegate, Limited, Inc.	Maryland	6798	32-0008072
Texas Lessor – Stonegate, LP	Maryland	6798	32-0008073
Texas Lessor – Treemont, Inc.	Maryland	6798	16-1650495
The Suburban Pavilion, Inc.	Ohio	6798	34-1035431
Washington Lessor – Silverdale, Inc.	Maryland	6798	56-2386887

Waxahachie Healthcare Associates, Inc.	Texas	6798	38-3517884
West Athens Healthcare Associates, Inc.	Texas	6798	38-3517886
Wilcare, LLC	Ohio	6798	26-0110550

(1) Address, including zip code, and telephone number, including area code, of the principal executive offices of each subsidiary guarantor listed in Schedule A is c/o Omega Healthcare Investors, Inc., 200 International Circle, Suite 3500, Hunt Valley, Maryland, 21030 and the telephone number is (410) 427-1700.

The information in this prospectus is not complete and may be changed. We may not exchange these securities until the registration statement filed with the Securities and Exchange Commission is effective. The prospectus is not an offer to exchange these securities and is not soliciting an offer to exchange these securities in any state where the offer or sale is not permitted.

Subject to completion, dated May 13, 2011

Omega Healthcare Investors, Inc.
Exchange Offer

$575,000,000 6¾% Senior Notes due 2022
for $575,000,000 6¾% Senior Notes due 2022
that have been registered under the Securities Act of 1933

We are offering, upon the terms and subject to the conditions set forth in this prospectus and the accompanying letter of transmittal, to exchange an aggregate principal amount of up to $575,000,000 of our new 6¾% Senior Notes due 2022, which we refer to as the exchange notes, for all of our outstanding unregistered 6¾% Senior Notes due 2022, which we refer to as the initial notes, in a transaction registered under the Securities Act of 1933, as amended, or the Securities Act. We collectively refer to the initial notes and the exchange notes as the notes. We refer to the offer described in this prospectus to exchange the initial notes for the exchange notes as the exchange offer.

The notes are unconditionally guaranteed by our existing and future subsidiaries that guarantee our other existing senior notes, revolving credit facility or any other indebtedness of ours or of the subsidiary guarantors, which we refer to as the subsidiary guarantors. The guarantees of the notes are unsecured senior obligations of the subsidiary guarantors and rank equally with existing and future unsecured senior debt of the subsidiary guarantors and senior to existing and future subordinated debt of the subsidiary guarantors. The guarantees are effectively subordinated to existing and future secured debt of the subsidiary guarantors and structurally subordinated to existing and future debt of our non-guarantor subsidiaries.

Terms of the exchange offer:

We will exchange all initial notes that are validly tendered and not withdrawn prior to the expiration of the exchange offer.

You may withdraw tenders of initial notes at any time prior to the expiration of the exchange offer.

We believe that the exchange of initial notes for exchange notes will not be a taxable event for U.S. federal income tax purposes.

The form and terms of the exchange notes are identical in all material respects to the form and terms of the initial notes.

The exchange offer will expire at 5:00 p.m., New York City time, on , 2011, unless we extend the offer. We will announce any extension by press release or other permitted means no later than 9:00 a.m. on the business day after the expiration of the exchange offer. If you fail to tender your initial notes, you will continue to hold unregistered securities and your ability to transfer your initial notes could be adversely affected.

Any broker-dealer that acquires exchange notes for its own account in exchange for initial notes must represent that the initial notes to be exchanged for the exchange notes were acquired by it as a result of market-making activities or other trading activities and acknowledge that it will deliver a prospectus meeting the requirements of the Securities Act in connection with any offer to resell, resale or other retransfer of the exchange notes. During the period ending 90 days after the consummation of the exchange offer, subject to extension in limited circumstances, a participating broker-dealer may use this prospectus for an offer to sell, a resale or other retransfer of exchange notes received in exchange for initial notes which it acquired through market-making activities or other trading activities. See "The Exchange Offer—Resales of Exchange Notes."

No public market currently exists for the exchange notes. We do not intend to apply for listing of the exchange notes on the New York Stock Exchange or any other securities exchange.

For a discussion of factors you should consider in determining whether to tender your initial notes, see the information under "Risk Factors" beginning on page 12 of this prospectus.

Neither the Securities and Exchange Commission, or the SEC, nor any state securities commission has approved or disapproved of these securities, or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is , 2011.

We have not authorized anyone to give any information or to make any representations concerning this exchange offer except that which is in this prospectus, or which is referred to under "Where You Can Find More Information." If anyone gives or makes any other information or representation, you should not rely on it. This prospectus is not an offer to sell or a solicitation of an offer to buy securities in any circumstances in which the offer or solicitation is unlawful. You should not interpret the delivery of this prospectus, or any sale of securities, as an indication that there has been no change in our affairs since the date of this prospectus. You should also be aware that information in this prospectus may change after this date.

This prospectus incorporates by reference business and financial information about us that is not included in or delivered with this prospectus. This information is available without charge upon written or oral request directed to:

Omega Healthcare Investors, Inc.
200 International Circle
Suite 3500
Hunt Valley, MD 21030
Attn: Chief Financial Officer
(410) 427-1700

If you would like to request copies of these documents, please do so by , 2011 (which is five business days before the scheduled expiration of the exchange offer) in order to receive them before the expiration of the exchange offer.

TABLE OF CONTENTS

CAUTIONARY DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

All statements other than statements of historical facts included or incorporated by reference in this prospectus, including, without limitation, statements under “Risk Factors” and elsewhere in this prospectus regarding our future financial position, business strategy, budgets, projected costs and plans and objectives of management for future operations, are forward-looking statements. In addition, forward-looking statements generally can be identified by the use of forward-looking terminology such as “may,” “will,” “expect,” “intend,” “estimate,” “anticipate,” “believe” or “continu negative thereof or variations thereon or similar terminology. Although we believe that the expectations reflected in these forward-looking statements are reasonable, these expectations may not prove to be correct. Important factors that could cause actual results to differ materially from our expectations, which we refer to as cautionary statements, are disclosed under “Risk Factors” and elsewhere in this prospectus, including, without limitation, in conjunction with the forward-looking statements included or incorporated in this prospectus. These forward-looking statements involve risks and uncertainties that may cause our actual future activities and results of operations to be materially different from those suggested or described in this prospectus.

There are a number of factors that could cause our actual results to differ materially from those projected in such forward-looking statements. These factors include, without limitation:

those items discussed under “Risk Factors” herein and under “Risk Factors” in Item 1A to our annual reports on Form 10-K and as supplemented from time-to-time in Part II, Item 1A to our quarterly reports on Form 10-Q;

uncertainties relating to the business operations of the operators of our assets, including those relating to reimbursement by third-party payors, regulatory matters and occupancy levels;

the ability of any operators in bankruptcy to reject unexpired lease obligations, modify the terms of our mortgages and impede our ability to collect unpaid rent or interest during the process of a bankruptcy proceeding and retain security deposits for the debtors’ obligations;

our ability to sell closed or foreclosed assets on a timely basis and on the terms that allow us to realize the carrying value of these assets;

our ability to negotiate appropriate modifications to the terms of our credit facilities;

our ability to manage, re-lease or sell any owned and operated facilities;

the availability and cost of capital;

changes in our credit ratings and the ratings of our debt securities;

competition in the financing of healthcare facilities;

regulatory and other changes in the healthcare sector;

changes in the financial position of our operators;

the effect of economic and market conditions generally and, particularly, in the healthcare industry;

changes in interest rates;

the amount and yield of any additional investments;

changes in tax laws and regulations affecting real estate investment trusts, or REITs; and

our ability to maintain our status as a REIT.

All subsequent written and oral forward-looking statements attributable to us, or persons acting on any of our behalf, are expressly qualified by the cautionary statements. We undertake no obligation to update forward-looking statements to reflect developments or information obtained after the date on the cover page of this prospectus.

PROSPECTUS SUMMARY

The following summary highlights certain information contained in this prospectus. Because it is only a summary, it does not contain all of the information you should consider before participating in the exchange offer. You should carefully read this entire prospectus before participating in the exchange offer. In particular, you should read the section entitled "Risk Factors," and our financial statements and the notes relating thereto presented herein and incorporated by reference into this prospectus. All references to "Omega," "the Company," "we," "our," "us," and similar ter in this prospectus refer to Omega Healthcare Investors, Inc. together with its subsidiaries through which it operates. Unless otherwise indicated, the non-financial information presented herein is as of the date of this prospectus.

Company Overview

We are a self-administered real estate investment trust, or REIT, investing in income-producing healthcare facilities, principally long-term care facilities, located in the United States. We provide lease or mortgage financing to qualified operators of skilled nursing facilities, which we refer to as SNFs, and, to a lesser extent, assisted living facilities, independent living facilities and rehabilitation and acute care facilities.

Our portfolio of investments at March 31, 2011 , consisted of 400 healthcare facilities, located in 35 states and operated by 50 third-party operators. Our gross investment in these facilities totaled approximately $ 2.4 billion at March 31, 2011 , with 99% of our real estate investments related to long-term healthcare facilities. This portfolio is made up of (i) 370 SNFs, (ii) 10 assisted living facilities, (iii) five specialty facilities, (iv) fixed rate mortgages on 13 SNFs, and (v) two SNFs that are held for sale. At March 31, 2011 , we also held other investments of approximately $ 28.3 million, consisting primarily of secured loans to third-party operators of our facilities.

Corporate Information

We were incorporated in the State of Maryland on March 31, 1992. Our principal executive offices are located at 200 International Circle, Suite 3500, Hunt Valley, Maryland 21030, and our telephone number is (410) 427-1700. Additional information regarding our company is set forth in documents on file with the SEC and incorporated by reference in this prospectus. See "Incorporation of Documents by Reference" and "Where You Can Find More Information."

Our filings with the SEC, including our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports are accessible free of charge on our website at www.omegahealthcare.com. Information on our website does not constitute part of this prospectus.

The Exchange Offer

In two separate issuances on October 4, 2010 and November 23, 2010, we issued an aggregate principal amount of $575,000,000 of 6¾% Senior Notes due 2022 to a group of initial purchasers in reliance on exemptions from, or in transactions not subject to, the registration requirements of the Securities Act and applicable securities laws. In connection with each sale of the initial notes to the initial purchasers, we entered into a registration rights agreement pursuant to which we agreed, among other things, to deliver this prospectus to you, to commence this exchange offer and to use our commercially reasonable efforts to complete the exchange offer not later than 360 days after the first issue date of the initial notes. The summary below describes the principal terms and conditions of the exchange offer. Some of the terms and conditions described below are subject to important limitations and exceptions. See "The Exchange Offer" for a more detailed description of the terms and conditions of the exchange offer and "Description of Notes" for a more detailed description of the terms of the exchange notes.

The Exchange Offer	We are offering to exchange up to $575,000,000 aggregate principal amount of our new 6¾% Senior Notes due 2022, which have been registered under the Securities Act, in exchange for your initial notes. For each initial note surrendered to us pursuant to the exchange offer, the holder of such initial note will receive an exchange note having a principal amount equal to that of the surrendered initial note. Exchange notes will only be issued in denominations of $2,000 and integral multiples of $1,000. The form and terms of the exchange notes will be substantially the same as the form and terms of the surrendered initial notes. The exchange notes will evidence the same indebtedness as, and will replace the initial notes tendered in exchange therefor and will be issued pursuant to, and entitled to the benefits of, the indenture governing the initial notes. As of the date of this prospectus, initial notes representing $575,000,000 aggregate principal amount are outstanding. See "The Exchange Offer."
Resale of Exchange Notes	Based on interpretations by the staff of the SEC as detailed in a series of no-action letters issued to third parties, we believe that, as long as you are not a broker-dealer, the exchange notes offered in the exchange offer may be offered for resale, resold or otherwise transferred by you without compliance with the registration and prospectus delivery requirements of the Securities Act as long as: you are acquiring the exchange notes in the ordinary course of your business; you are not participating in, do not intend to participate in and have no arrangement or understanding with any person to participate in a "distribution" of the exchange notes; and you are not an "affiliate" of ours within the meaning of Rule 405 of the Securities Act.

	If any of these conditions is not satisfied and you transfer any exchange notes issued to you in the exchange offer without delivering a proper prospectus or without qualifying for a registration exemption, you may incur liability under the Securities Act. Moreover, our belief that transfers of exchange notes would be permitted without registration or prospectus delivery under the conditions described above is based on SEC interpretations given to other, unrelated issuers in similar exchange offers. We cannot assure you that the SEC would make a similar interpretation with respect to our exchange offer. We will not be responsible for or indemnify you against any liability you may incur under the Securities Act. Any broker-dealer that acquires exchange notes for its own account in exchange for initial notes must represent that the initial notes to be exchanged for the exchange notes were acquired by it as a result of market-making activities or other trading activities and acknowledge that it will deliver a prospectus meeting the requirements of the Securities Act in connection with any offer to resell, resale or other retransfer of the exchange notes. However, by so acknowledging and by delivering a prospectus, such participating broker-dealer will not be deemed to admit that it is an "underwriter" within the meaning of the Securities Act. During the period ending 90 days after the consummation of the exchange offer, subject to extension in limited circumstances, a participating broker-dealer may use this prospectus for an offer to sell, a resale or other retransfer of exchange notes received in exchange for initial notes which it acquired through market-making activities or other trading activities. See "The Exchange Offer—Resales of Exchange Notes."
Registration Rights Agreement	We sold the initial notes in two private offerings in reliance on Section 4(2) of the Securities Act. The initial notes issued in each of the two closings were immediately resold by the initial purchasers in reliance on Rule 144A under the Securities Act. In connection with each of the two closings, we entered into the registration rights agreement with the initial purchasers of the initial notes requiring us to make this exchange offer. See "The Exchange Offer—Purpose and Effect; Registration Rights."
Expiration Date	The exchange offer will expire at 5:00 p.m., New York City time, on , 2011, unless we extend the expiration date. See "The Exchange Offer—Expiration Date; Extension; Amendments."
Withdrawal	You may withdraw your tender of initial notes at any time before the exchange offer expires. Any initial notes so withdrawn will be deemed not to have been validly tendered for purposes of the exchange offer. See "The Exchange Offer—Withdrawal Rights."
Interest on the Exchange Notes and the Initial Notes	We will pay interest on the notes twice a year, on each April 15 and October 15. The exchange notes will bear interest from the most recent date to which interest has been paid on the initial notes, or if interest has not been paid on the initial notes, then from October 4, 2010. If your initial notes are accepted for exchange, then you will receive interest on the exchange notes and not on the initial notes. Any initial notes not tendered will remain outstanding and continue to accrue interest according to their terms.

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Procedures for Tendering Initial Notes

Each holder of initial notes that wishes to tender their initial notes must either:

- complete, sign and date the accompanying letter of transmittal or a facsimile copy of the letter of transmittal, have the signatures on the letter of transmittal guaranteed, if required, and deliver the letter of transmittal, together with any other required documents (including the initial notes), to the exchange agent; or

- if initial notes are tendered pursuant to book-entry procedures, the tendering holder must deliver a completed and duly executed letter of transmittal or arrange with Depository Trust Company, or DTC, to cause an agent's message to be transmitted with the required information (including a book-entry confirmation) to the exchange agent; or

- comply with the procedures set forth below under "—Guaranteed Delivery Procedures."

Holders of initial notes that tender initial notes in the exchange offer must represent that the following are true:

- the holder is acquiring the exchange notes in the ordinary course of its business;

- the holder is not participating in, does not intend to participate in, and has no arrangement or understanding with any person to participate in a "distribution" of the exchange notes within the meaning of the Securities Act; and

- the holder is not an "affiliate" of us within the meaning of Rule 405 of the Securities Act.

Do not send letters of transmittal, certificates representing initial notes or other documents to us or DTC. Send these documents only to the exchange agent at the appropriate address given in this prospectus and in the letter of transmittal. We may reject your tender of initial notes if you tender them in a manner that does not comply with the instructions provided in this prospectus and the accompanying letter of transmittal. See "Risk Factors—There are significant consequences if you fail to exchange your initial notes" and "The Exchange Offer—Procedures for Tendering Initial Notes."

Special Procedures for Beneficial Owners	balance		Interest(1)	Rate
		€m	€m	%
Assets				
Loans and advances to banks	– Domestic	17,893	769	4.3%
	– Foreign	15,324	717	4.7%
Loans and advances to customers	– Domestic	181,576	2,322	1.3%
	– Foreign	124,254	5,741	4.6%
Debt securities	– Domestic	67,512	3,017	4.5%
	– Foreign	15,634	527	3.4%
Interest-earning assets	– banking business	422,193	13,093	3.1%
	– trading business(2)	169,897		
Interest-earning assets		592,090		
Non-interest-earning assets		260,672		
Total assets		852,762		
Percentage of assets applicable to foreign operations		63.6%		
Liabilities				
Deposits by banks	– Domestic	60,664	2,536	4.2%
	– Foreign	39,069	2,041	5.2%
Customer accounts: demand deposits	– Domestic	46,443	177	0.4%
	– Foreign	28,456	471	1.7%
Customer accounts: savings deposits	– Domestic	52,919	10	0.0%
	– Foreign	13,724	140	1.0%
Customer accounts: other time deposits	– Domestic	37,041	977	2.6%
	– Foreign	47,806	1,282	2.7%
Debt securities in issue	– Domestic	80,803	2,315	2.9%
	– Foreign	30,915	1,139	3.7%
Subordinated liabilities	– Domestic	11,115	347	3.1%
	– Foreign	2,718	163	6.0%
Internal funding of trading business	– Domestic			
	– Foreign	(34,760)	(1,340)	3.9%
Interest-bearing liabilities	– banking business	416,913	10,258	2.5%
	– trading business (2)	179,273		
Interest-bearing liabilities		596,186		
Non-interest-bearing liabilities:				
Demand deposits	– Domestic	5,278		
	– Foreign	218,614		
Other liabilities (2)				
Owners' equity		32,684		
Total liabilities and owners' equity		852,762		
		65.0%		

Percentage of liabilities applicable to foreign operations

The analysis of Domestic and Foreign has been compiled on the basis of location of office.

Notes:
(1) 2009 and 2008 comparatives have been re-presented for the classification of the Dutch State acquired businesses as discontinued operations.
(2) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.

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Business Review

Analysis of results continued

Analysis of change in net interest income – volume and rate analysis

Volume and rate variances have been calculated based on movements in average balances over the period and changes in interest rates on average interest-earning assets and average interest-bearing liabilities. Changes due to a combination of volume and rate are allocated pro rata to volume and rate movements.

	2010 over 2009 Increase/(decrease) due to changes in:		
	Average volume	Average rate	Net change
	€m	€m	€m
Interest-earning assets			
Loans and advances to banks			
Domestic	(84)	(293)	209
Foreign	(61)	192	(253)
Loans and advances to customers			
Domestic	(433)	(1,366)	933
Foreign	(872)	(1,006)	134
Debt securities			
Domestic	(173)	(197)	24
Foreign	(79)	(78)	(1)
Total interest receivable of the banking business			
Domestic	(690)	(1,856)	1,166
Foreign	(1,012)	(892)	(120)
	(1,702)	(2,748)	1,046
Interest-bearing liabilities			
Deposits by banks			
Domestic	390	(18)	408
Foreign	(510)	241	(751)
Customer accounts: demand deposits			
Domestic	(106)	(259)	153
Foreign	(3)	-	(3)
Customer accounts: savings deposits			
Domestic	-	-	-
Foreign	(49)	(88)	39
Customer accounts: other time deposits			
Domestic	(365)	(502)	137
Foreign	(59)	(248)	189
Debt securities in issue			
Domestic	(323)	(558)	235
Foreign	(122)	(165)	43
Subordinated liabilities			
Domestic	(34)	(102)	68
Foreign	5	6	(1)
Internal funding of trading business			

Domestic	-	-	-
Foreign	157	247	(90)
Total interest payable of the banking business			
Domestic	(438)	(1,439)	1,001
Foreign	(581)	(7)	(574)
	(1,019)	(1,446)	427
Movement in net interest income			
Domestic	(1,128)	(3,295)	2,167
Foreign	(1,593)	(899)	(694)
	(2,721)	(4,194)	1,473

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Business
review continued

Business Review

Analysis of results continued

Analysis of change in net interest income – volume and rate analysis continued

	2009 over 2008 Increase/(decrease) due to changes in:		
	Average volume	Average rate	Net change
	€m	€m	€m
Interest-earning assets			
Loans and advances to banks			
Domestic	(520)	258	(778)
Foreign	(464)	(247)	(217)
Loans and advances to customers			
Domestic	(1,527)	(189)	(1,338)
Foreign	(3,257)	(2,495)	(762)
Debt securities			
Domestic	(1,498)	(343)	(1,155)
Foreign	(224)	(216)	(8)
Total interest receivable of the banking business			
Domestic	(3,545)	(274)	(3,271)
Foreign	(3,945)	(2,958)	(987)
	(7,490)	(3,232)	(4,258)
Interest-bearing liabilities			
Deposits by banks			
Domestic	(2,402)	(752)	(1,650)
Foreign	(1,447)	(1,101)	(346)
Customer accounts: demand deposits			
Domestic	18	15	3
Foreign	(322)	(85)	(237)
Customer accounts: savings deposits			
Domestic	(4)	1	(5)
Foreign	(22)	(45)	23
Customer accounts: other time deposits			
Domestic	(566)	(253)	(313)
Foreign	(946)	(451)	(495)
Debt securities in issue			
Domestic	(1,631)	(437)	(1,194)
Foreign	(893)	(577)	(316)
Subordinated liabilities			
Domestic	(203)	(21)	(182)
Foreign	4	2	2
Internal funding of trading business			
Domestic	-	-	-
Foreign	1,085	241	844
Total interest payable of the banking business			

Domestic	(4,788)	(1,447)	(3,341)
Foreign	(2,541)	(2,016)	(525)
	(7,329)	(3,463)	(3,866)
Movement in net interest income			
Domestic	(8,333)	(1,721)	(6,612)
Foreign	(6,486)	(4,974)	(1,512)
	(14,819)	(6,695)	(8,124)

Note:
The analysis into the Domestic and Foreign has been compiled on the basis of location of the Groups entity in which the transaction takes place.

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Analysis of results continued
Credit market exposures

Credit and other market losses (1)	2010 €m	2009 €m	2008 €m
Monoline exposures	22	(1,279)	(3,515)
CDPCs (2)	(98)	95	(1,223)

Notes:
(1) Included in 'Income from trading activities' within non-interest income
(2) Credit derivative product companies.

2010 compared with 2009
Gains relating to monoline exposures were €22 million in 2010 compared with losses of € 1,279 million in 2009.

The net gain through trading income in 2010 amounts to €22 million and relates mainly to release of the CVAs partially netted off by hedges and other movements. Hedges with bank counterparties include the overlay swap transacted with RBS plc which transfers the daily movement in the CVA between the Group and RBS plc for these trades. The mark-to-market of this swap with RBS plc was €769 million in favour of RBS plc at 31 December 2010 (€405 million at 31 December 2009).

Losses relating to CDPC exposures were €98 million in 2010, compared to a gain of €95 million in 2009. The Group has fully novated its CDPCs exposure to RBS plc in the course of 2010.

The positions in mortgage and other asset backed securities (€ 18.4 billion at 31 December 2010) have seen a further decrease in 2010. The held for trading positions have been fully matured or sold off in 2010. The composition of the remaining AFS portfolio has not changed substantially from 31 December 2009. Included are € 6.9 billion residential mortgage-backed securities covered by the Dutch mortgage guarantee scheme and € 9.1 billion residential mortgage covered bonds, 98% of which originated in Europe, of which 81% in Spain.

83% of residential mortgage covered bonds were AAA rated at 31 December 2010. The net exposure to ABSs backed by assets other than residential mortgages, such as sovereign or public entities debt, amounts to €2.2 billion and is mainly related to AAA European (23% Germany, 21% Spain) covered bonds held in the treasury portfolios. The decrease is mainly due to the maturing of papers.

The CDO and CLO exposure decreased further in 2010 mainly due to the maturing of positions.

2009 compared with 2008
The gross exposure to monoline counterparties decreased primarily due the transfer of these assets to RBS plc during the first half of 2009. The net loss through trading income in 2009 amounted to €1.3 billion and related mainly to increased levels of CVA recorded against the exposures prior to entering into an overlay swap with RBS Group as well as the cost of the overlay swap with RBS plc thereafter.

Gains relating to CDPC exposures were €95 million in 2009 compared with losses of €1,223 million in 2008.

The gross exposure to CDPC counterparties reduced primarily due to novations in 2009 to RBS Group.

The CVA on remaining positions decreased due to increases in the fair value of the insured assets.

The ABS positions (€ 24.3 billion at 31 December 2009) decreased slightly in 2009. The held for trading position consisted of prime European RMBS positions held as part of the RBS acquired Group Asset and Liability Management portfolios. The available-for-sale RMBS positions were backed by mortgages covered by the Dutch mortgage guarantee scheme and 98% of them were AAA rated at 31 December 2009.

96% of residential mortgage covered bonds were AAA rated at 31 December 2009. 99% of residential mortgage covered bonds were originated in Europe, of which 76% in Spain. The net exposure to ABSs backed by assets other than residential mortgages, amounted to €2.5 billion (31 December 2008– €3.6 billion) and was mainly related to AAA European (43% Germany, 36% Spain) covered bonds held in the RBS acquired Group treasury portfolios. The decrease was mainly due to maturing of the papers and transfers to RBS Group.

The CDO and CLO exposure decreased significantly due to transfers to RBS Group in the first half of 2009. As part of the transfer, all super senior CDO positions (31 December 2008 €636 million) were sold to RBS Group. A loss of €203 million was recognised on those positions in 2009 prior to the transfer. The remaining available-for-sale portfolio comprises of other senior CDOs (€200 million), which were held in the treasury portfolios and were AAA rated at 31 December 2009.

Losses on other mortgage-backed securities were substantially reduced in 2009 as many of these positions were sold or substantially written-down in 2008 resulting in reduced net exposure in 2009.

Additional disclosures on these and other related exposures can be found in the following sections.

Disclosure	Section	Sub-section	Page
Further analysis of credit market exposures	Risk and balance sheet management	Other risk exposures	71
Valuation aspects	Financial statements	Note 9 Financial instruments - valuation	122
	Financial statements	Critical Accounting policies	110

Business Review

Divisional performance

The results of each segment are set out below.

Operating profit/(loss) before tax	2010 €m	2009 €m	2008 €m
Global Banking & Markets	856	39	(4,235)
Global Transaction Services	(64)	(4)	147
Central items	40	(385)	536
Core	832	(350)	(3,552)
Non-Core	(407)	(4,501)	(12,560)
Reconciling items (1)	-	4	11
Group total	425	(4,847)	(16,101)

Notes:

(1) Segments are stated as they are reviewed by management and therefore exclude the effect of the consolidation of Private Equity businesses which is shown as a reconciling item in 2009 and 2008.

Employee numbers at 31 December

(full time equivalents rounded to the nearest hundred)

	2010	2009	2008
Global Banking & Markets	6,700	8,300	11,200
Global Transaction Services	5,500	5,400	5,700
Central items	700	900	800
Core	12,900	14,600	17,700
Non-Core	6,400	13,000	18,600
Group total	19,300	27,600	36,300

 Business Review

Global Banking & Markets (GBM)

	2010	2009	2008
	€m	€m	€m
Net interest income	451	818	1,492
Non-interest income/(loss)	1,924	1,761	(1,480)
Total income	2,375	2,579	12
Direct expenses			
– staff costs	(967)	(1,368)	(2,026)
– other	(670)	(915)	(1,435)
Indirect expenses	24	1	(223)
	(1,613)	(2,282)	(3,684)
Profit/(loss) before impairment losses	762	297	(3,672)
Impairment losses	94	(258)	(563)
Operating profit/(loss) before tax	856	39	(4,235)
	€bn	€bn	€bn
Balance sheet			
Total assets	130	180	357
Total liabilities	130	173	357

2010 compared with 2009
Operating profit before tax increased by €817 million to €856 million compared with €39 million for 2009.

Total income decreased by €204 million to €2,375 million. The reduction is mainly due to a significantly lower net interest income, partially offset by higher non-interest income. The results reflect continuing transfers of business to RBS plc as well as unfavourable market conditions.

Net interest income decreased by €367 million, as a result of higher liquidity costs in 2010 compared to 2009, when money markets benefited from rapidly falling short term interest rates, as well as ongoing transfer of the interest generating assets to RBS plc.

Non-interest income increased by €163 million to €1,924 million in 2010 compared to €1,761 million in 2009. The improvement reflects reduced losses attributable to movements in credit spreads, compared to the prior year when fair value losses were recognised on a portfolio of credit default swaps used to hedge the loan book following tightening of credit spreads. These losses amounted to €606 million in 2009 as compared to nil in 2010. Additional improvement in the non-interest income is due to a €111 million gain resulting from APS back-to-back fee agreement true-up. These improvements are offset by a decrease in trading income as a result of the absence of favourable market conditions which prevailed in 2009 especially in emerging market currency trading. In addition the reduced business origination and general market activity, have led to lower brokerage fees. Ongoing transfers of significant assets to RBS plc have resulted in lower earnings generating capabilities of the business.

Operating expenses have decreased by €669 million to €1,613 million from €2,282 million in 2009. This reflects the transfer of business to RBS plc, thus reducing the scale of operations in 2010.

Loan impairments in 2010 amounted to a credit of €94 million in comparison to a charge of €258 million in 2009. 2010 impairments reflect a small number of single name provisions, mainly on APS back-to-back covered assets, which are more than offset by several recoveries following the restructuring of impaired exposures.

2009 compared with 2008
Operating profit before tax increased to a profit of €39 million in 2009 compared to a loss of €4,235 million in 2008.

Net interest income reduced by €674 million to €818 million. This reflects the transfer of interest generating conduits to RBS plc and the overall interest margin pressure as a consequence of increased funding costs.

Non-interest income improved significantly from a loss of €1,480 million to a profit of €1,761 million due to an increase in income from trading activities. Trading income in 2008 included losses of €1,638 million on trading counterparties including Lehman Brothers and Bernard L. Madoff which did not re-occur in 2009. In addition, the increase in trading income was a result of an improvement in the equity business. This increase was partially offset by a decrease in other operating income resulting from tightening credit spreads which impacted the fair value gain on own credit and foreign exchange losses on the sale of the Japanese securities business to RBS plc.

Operating expenses decreased by €1,402 million to €2,282 million in 2009. This reflects a reduction in headcount following the transfer of employees to RBS plc and related reductions in personnel costs including bonuses and general administrative expenses.

Impairment losses reduced from €563 million in 2008 to €258 million in 2009. 2008 impairments include specific commercial provisions reflecting the challenging credit environment, which gradually improved over the course of 2009.

Business Review

Global Transaction Services (GTS)

	2010	2009	2008
	€m	€m	€m
Net interest income	306	355	457
Non-interest income	305	318	384
Total income	611	673	841
Direct expenses			
– staff	(283)	(236)	(231)
– other	(401)	(427)	(394)
Indirect expenses	5	13	(38)
	(679)	(650)	(663)
(Loss)/profit before impairment losses	(68)	23	178
Impairment losses	4	(27)	(31)
Operating (loss)/profit before tax	(64)	(4)	147
	€bn	€bn	€bn
Balance sheet			
Total assets	12	9	11
Total liabilities	12	9	11

2010 compared with 2009
Operating loss before tax was €64 million compared with a loss of €4 million in 2009.

Total income decreased by €62 million to €611 million with decreases in both net interest income and non-interest income.

Net interest income decreased by €49 million following transfers of businesses in Japan and Australia to RBS plc during 2009 and lower interest margins from transactions in Asia and Eastern Europe in 2010.

The decrease in non-interest income mainly relates to a decrease in net fee and commission income in the Netherlands as a result of client attrition in the second half of 2009 and lower margins on trade settlement products in Asia as the risk profile of the region improved.

Operating expenses have increased by €29 million from €650 million in 2009 reflecting increased investment in support infrastructure.

2009 compared with 2008
Operating profit before tax decreased to a loss of €4 million in 2009 compared to a profit of €147 million in 2008.

Net interest income reduced by €102 million to €355 million due to reduced income in the International Cash Management business, following on from the overall macro economic liquidity crisis resulting in margin pressure, as well as lower cash balances in 2009 compared to 2008. In addition, client attrition levels increased.

Non-Interest income decreased from €384 million to €318 million due to a fall in fee and commission income due to strong pricing competition, lower volumes of international transactions and client attrition in the second half of 2009.

Operating expenses decreased by €13 million to €650 million in 2009. This reflects a reduction in headcount following the transfer of employees to RBS plc which was largely offset by higher separation and integration expenses incurred in 2009.

 Business Review

Central Items

	2010	2009	2008
	€m	€m	€m
Net interest income/(loss)	43	(127)	(36)
Non-interest income	301	103	834
Total income/(loss)	344	(24)	798
Direct expenses			
– staff	(216)	(79)	(77)
– other	(71)	(280)	(259)
Indirect expenses	(17)	(2)	71
	(304)	(361)	(265)
Profit/(loss) before impairment losses	40	(385)	533
Impairment losses	-	-	3
Operating profit/(loss) before tax	40	(385)	536
	€bn	€bn	€bn
Balance sheet			
Total assets	38	51	49
Total liabilities	34	51	49

2010 compared with 2009
Operating profit before tax was €40 million compared with a loss of €385 million in 2009.

Total income increased by €368 million to €344 million. This follows the improvement in both net interest and non-interest income.

Net interest income improved by €170 million. This increase is largely due to an adjustment made to the carrying value of the Tier 1 hybrid capital securities of €273 million. RBS Group's legal ownership of RFS Holdings was increased to 98% on 31 December 2010 thereby giving RBS Group majority legal ownership. The RFS restructure legally bound the Group to the EC Burden Sharing restrictions already applied to RBS Group. These restrictions result in an adjustment to the carrying value of the amortised cost securities.

Non-interest income increased by €198 million to €301 million from €103 million in 2009. The increase relates mainly to the gain on sale of US treasury bonds of €268 million. These instruments were divested as a consequence of a revised hedging strategy. The increase in non-interest income is partially offset by losses on the sales of Spanish, Greek and Portuguese bonds. In addition, following the Basel II implementation several Basel I securitisation programs were discontinued in the course of 2010 resulting in a €120 million reduction in fees and commissions payable.

Operating expenses decreased by €57 million to €304 million for the year ended 2010. The decrease is due mainly from the exceptional items in 2009 expenses including legal provisions and a goodwill impairment in Pakistan.

2009 compared with 2008
Operating profit before tax decreased to a loss of €385 million in 2009 compared to a profit of €536 million in 2008.

Net interest income decreased by €91 million. This is mainly due to the lower interest income on the proceeds from the sale of LaSalle bank, which decreased from €576 million in 2008 to €108 million in 2009, following the steady reduction in the interest rates and the balance. This was partially offset by lower funding costs within Group treasury which gradually moved to the businesses reducing the centrally incurred interest expense.

Non-interest income decreased from €834 million to €103 million in 2009. This is largely due to a decrease in other operating income due to large gains in 2008 on credit default swaps of €1.1 billion, which did not reoccur in 2009 and due to foreign exchange losses on the sale of the Japanese securities business to RBS plc. This was partially offset by an increase in income from trading activities mainly due to a gradual improvement in market conditions for asset backed securities trading in Group treasury in 2009.

Operating expenses have increased by €96 million to €361 million in 2009, mainly due to higher transition and integration costs, which included impairments of information technology licences and information technology projects that were no longer required under the current structure of the Group. In addition a significant legal provision and goodwill impairment in Pakistan negatively impacted the 2009 expenses.

 Business Review

Non-Core

	2010	2009	2008
	€m	€m	€m
Net interest income	627	788	967
Non-interest income	(85)	(2,647)	(9,600)
Total income/(loss)	542	(1,858)	(8,633)
Direct expenses			
– staff	(310)	(412)	(766)
– other	(462)	(882)	(1,022)
Indirect expenses	(12)	(11)	190
	(784)	(1,305)	(1,598)
Loss before other operating charges and impairment losses	(242)	(3,163)	(10,231)
Impairment losses	(165)	(1,338)	(2,329)
Operating loss before tax	(407)	(4,501)	(12,560)
	€bn	€bn	€bn
Balance sheet			
Total assets	19	44	71
Total liabilities	19	37	62

2010 compared with 2009
Operating loss before tax was €407 million compared with a loss of €4,501 million in the year 2009.

Total income increased by €2,400 million to €542 million. This is due to an increase in non-interest income which is partly offset by a decrease in net interest income.

Net interest income decreased by €162 million. This decrease is largely due to the significant divestitures of the retail and commercial business activities in Asia (Taiwan, Hong Kong, Singapore, Pakistan and Indonesia), Americas (Chile, Colombia and Venezuela) and EMEA (United Arab Emirates and Kazakhstan) in the course of 2010.

The improvement in non-interest income relates to an increase in income from trading activities, which is due to the non-reoccurrence of high losses in the prior year on counterparty CVA adjustments against monoline insurers following transfers of the positions to RBS plc. These losses amounted to €1,279 million in 2009. In addition the result on credit default swaps used to hedge the loan portfolio were €1,418 higher in 2010 compared to the prior year.

Net fees and commissions income for 2010 includes an additional gain of €334 million resulting from a true-up in the fee calculation for the APS back-to-back agreement. The improvement in non-interest income was offset by an overall reduction in business activities as well as losses on sale of mentioned above operations.

Operating expenses decreased by €521 million from €1,305 million for the year 2009. This results mainly from the 2009 charges related to costs incurred on the sale of businesses in Asia and the related goodwill impairments. In addition, operating expenses decreased following Non-Core disposals during 2010.

Impairment losses in 2010 amounted to €165 million, as compared to €1,338 million in 2009. Impairment losses in 2009 included a specific impairment for LyondellBasell lndustries ('LyondellBasell'). LyondellBasell filed Chapter 11 bankruptcy in January 2009. At the time LyondellBasell entered Chapter 11, the Group's exposure was €2.3 billion. During 2009, the Group recorded an impairment provision charge of €548 million in respect of this exposure, the provision balance as at 31 December 2009 was €1,688 million, and the remaining Group's exposure was €591 million. The Group's exposures to LyondellBasell were covered assets under the APS back-to-back financial guarantee contract with RBS plc, effectively transferring the risk of future losses and the right to recoveries. Accordingly, in 2010 €197 million recovered from LyondellBasell was passed on to RBS plc.

In April 2010, LyondellBasell announced that it had emerged from Chapter 11 bankruptcy protection following creditor and court approval for its Plan of Reorganisation ('PoR'). Following the PoR, the Group's retained exposure was €689 million comprising a loan of €173 million (classified as loans and receivables), a 7.2% common equity stake of €501 million (designated as at fair value through profit or loss) and equity warrants of €15 million (classified as derivatives); a reversal of impairment losses of €336 million was recorded and passed on to RBS plc. The loan and common equity stake were sold in December 2010. The carrying value of the remaining LyondellBasell exposure, made up of warrants, was €32 million at 31 December 2010.

Business Review

Non-Core continued

2009 compared with 2008

Operating loss before tax decreased to €4,501 million in 2009 compared to a loss of €12,560 million in 2008.

Net interest income decreased by €178 million, mainly due to changes in the composition of assets and liabilities in the balance sheet following the disposal of businesses in Asia and Latin America.

Non-interest income increased by €6,953 million. This is mainly driven by the lower credit valuation adjustments on monoline insurers, credit derivative product companies and write-offs on CDO positions following the transfer of these assets to RBS plc at the end of the first quarter of 2009. Credit valuation adjustments in 2008 amounted to a negative €4,291 million, compared with negative €1,279 million in 2009. Write downs in CDO positions reduced by €1,315 million to €211 million in 2009. Other operating income increased due to lower losses and impairments on the sales and transfers of credit portfolios and Non-Core assets to RBS plc in 2009.

Operating expenses decreased by €293 million to €1,305 million. This reflects a reduction in head count, continued redundancies and divestitures of Non-Core businesses.

Impairment losses have reduced from €2,329 million in 2008 to €1,338 million in 2009. The significant improvement comes mainly from a lower provision for LyondellBasell which amounted to €1,154 million in 2008 compared to €548 million in 2009.

Business Review

Consolidated balance sheet at 31 December 2010

	2010 €m	2009 €m	2008 €m
Assets			
Cash and balances at central banks	8,323	28,382	5,854
Net loans and advances to banks	22,433	31,343	36,192
Reverse repurchase agreements and stock borrowing	4,272	6,376	35,298
Loans and advances to banks	26,705	37,719	71,490
Net loans and advances to customers	40,608	210,712	260,642
Reverse repurchase agreements and stock borrowing	3,888	9,246	11,868
Loans and advances to customers	44,496	219,958	272,510
Debt securities	52,260	84,800	87,048
Equity shares	22,634	17,236	18,741
Settlement balances	3,573	3,398	7,667
Derivatives	28,272	57,392	185,209
Intangible assets	199	645	924
Property, plant and equipment	283	1,961	2,035
Deferred taxation	5,440	5,427	4,517
Prepayments, accrued income and other assets	5,388	7,538	9,239
Assets of disposal groups	2,809	4,889	1,583
Total assets	200,382	469,345	666,817
Liabilities			
Bank deposits	27,178	40,728	68,121
Repurchase agreements and stock lending	4,807	4,220	25,709
Deposits by banks	31,985	44,948	93,830
Customers deposits	49,886	198,388	208,157
Repurchase agreements and stock lending	5,019	2,710	4,236
Customer accounts	54,905	201,098	212,393
Debt securities in issue	53,411	96,291	112,223
Settlement balances and short positions	5,202	7,503	8,985
Derivatives	35,673	62,959	193,912
Accruals, deferred income and other liabilities	5,213	13,675	13,369
Retirement benefit liabilities	75	154	167
Deferred taxation	195	241	250
Subordinated liabilities	6,894	14,666	13,701
Liabilities of disposal groups	1,857	8,894	864
Total liabilities	195,410	450,429	649,694
Non-controlling interests	24	36	46
Equity attributable to shareholders of the parent company	4,948	18,880	17,077
Total equity	4,972	18,916	17,123

Total liabilities and equity	200,382	469,345	666,817

Business Review

Commentary on consolidated balance sheet

2010 compared with 2009

Total assets were €200.4 billion at 31 December 2010, a decrease of €269.0 billion, or 57%, when compared with €469.4 billion at 31 December 2009. The decrease in the balance sheet categories Loans and advances to customers, Intangible assets, Property plant and equipment, Prepayments, accrued income and other assets was mostly due to the sale of Dutch State acquired businesses included in the new ABN AMRO Bank on 1 April 2010.

Cash and balances at central banks decreased by €20.1 billion or 71% to €8.3 billion at 31 December 2010 compared with €28.4 billion at 31 December 2009 due to a reduction in surplus cash balances held at central banks and other liquid assets, which had been built up as a prudent measure ahead of the legal separation of the Dutch State acquired businesses. Following successful separation on 1 April 2010, the liquid assets and associated short-term wholesale funding were managed down to business as usual levels.

Loans and advances to banks decreased by €11.0 billion, or 29%, to €26.7 billion at 31 December 2010 compared with €37.7 billion at 31 December 2009. This decrease is predominantly attributable to a decrease in time deposits placed of €7.5 billion due to a dividend settlement with Santander, as well as the sale of Dutch State acquired businesses included in the new ABN AMRO Bank.

Debt securities decreased by €32.5 billion to €52.3 billion, reflecting the sale of Dutch State acquired businesses as well as a decrease in the fair value of government securities, and significant divestments of debt securities. Equity shares increased by €5.4 billion, to €22.6 billion, largely due to a recovery of the equity markets in 2010.

Derivative assets decreased by €29.1 billion, or 51%, to €28.3 billion at 31 December 2010 compared with €57.4 billion at 31 December 2009. Derivative liabilities decreased by €27.3 billion, or 43%, to €35.7 billion at 31 December 2010 compared to the balance of €63.0 billion at 31 December 2009. This was partly attributable to the sale of Dutch State acquired businesses included in the new ABN AMRO Bank, the novation to RBS plc of derivative financial instruments and the lower volume of over the counter traded derivatives.

Total liabilities were €195.4 billion as at 31 December 2010, a decrease of € 255.0 billion, or 57% decrease when compared with €450.4 billion at 31 December 2009. The balance sheet categories Deposits by banks, Customer accounts, Debt securities in issue, Subordinated liabilities, and Accruals, deferred income and other liabilities have significantly decreased due to the sale of Dutch State acquired businesses included in the new ABN AMRO Bank N.V. on 1 April 2010.

Total equity at 31 December 2010 was €5.0 billion, a decrease of €14.0 billion compared to 31 December 2009. This was mainly due to a decrease in share premium and retained earnings as a result of the €9.0 billion dividend distributions by RBS Holdings to RFS Holdings for the benefit of Santander, coupled with a €6.5 billion dividend distribution for the benefit of the Dutch State as part of the sale of the new ABN AMRO Bank on 1 April 2010. In addition, during the period, €1.4 billion in unrealized losses were recorded in other comprehensive income predominantly relating to available-for-sale debt securities. Cash flow hedging reserves improved by €1.0 billion due to the realization of reserves following the sale of the new ABN AMRO Bank. In order to capitalize the remaining shared assets and the remaining Dutch State acquired businesses, Santander and the Dutch state injected €0.1 billion and €0.3 billion, respectively in capital. RBS Group injected €0.5 billion in the second half of 2010 in order to further strengthen the Group's capital position.

2009 compared with 2008
Total assets were €469 billion at 31 December 2009, a decrease of €197 billion, or 30%, when compared with €667 billion at 31 December 2008. This decrease is primarily related to the continued transfer and sale of businesses and portfolios to RBS Group. The impact from the dislocation in the financial markets was not as significant in 2009, in comparison to 2008. However, it was still a prevalent factor in the reduction of some balance sheet activities.

Cash and balances at central banks increased by €22.5 billion to €28.4 billion due to the placing of short-term cash surpluses with central banks as a prudent measure ahead of legal separation of the new ABN AMRO Bank on 1 April 2010.

Loans and advances to banks decreased by €33.7 billion, or 47%, to €37.7 billion at 31 December 2009 compared to the balance of €71.5 billion at 31 December 2008. The decrease is predominantly attributable to a decrease in professional securities transactions of €28.9 billion due to the transfer of reverse repurchase activity to RBS plc during the first half of 2009 and no new transactions being generated in the Group. Loans also decreased as a result of a decrease in global exposures on derivative collateral with banks due to the maturing of trades and the decreasing net exposures as a result of derivative novations.

Loans and advances to customers decreased by €52.6 billion, or 19%, to €219.9 billion at 31 December 2009 compared to the balance of €272.5 billion at 31 December 2008. Commercial loans and receivables decreased by €35 billion due to continued transfers of business activities to RBS plc and the maturing of loans. The level of public sector loans and receivables has decreased mainly as a result of the maturing of loans with the Ministry of Finance of Japan. Furthermore, multi-seller conduits balances decreased by €5 billion due to the transfer to RBS plc of the multi-seller conduits Orchid Funding Corporation and Abel Tasman Holdings. Also impacting on the overall decrease in this balance is the reclassification of approximately €3.3 billion of loans and receivables to disposal groups relating to certain Asian operations.

Debt securities decreased by €2.2 billion to €84.8 billion and equity shares decreased by €1.5 billion, to €17.2 billion, principally due to lower holdings in Global Banking & Markets and Non-Core, largely offset by growth in interest earning securities issued by other OECD governments in Group Treasury.

Derivative assets decreased by €127.8 billion, or 69%, to €57.4 billion at 31 December 2009 compared to the balance of €185.2 billion at 31 December 2008. Derivative liabilities decreased by €131.0 billion, or 67.5%, to €63 billion at 31 December 2009 compared to the

 Business Review

Commentary on consolidated balance sheet continued

2009 compared with 2008 continued
balance of €193.9 billion at 31 December 2008. This was predominantly due to trading positions that matured or were transferred to RBS plc as part of the overall integration plan.

Total liabilities were €450.4 billion at 31 December 2009, a decrease of €199.3 billion, or 30.7%, when compared with €649.7 billion at 31 December 2008 for reasons related to the decrease in total assets.

Deposits by banks were €45 billion at 31 December 2009, a decrease of €49 billion, or 52 % when compared with €94 billion at 31 December 2008. The majority of the reduction is related to professional securities transactions (€21 billion decrease) and is due to the roll-off of existing repurchase agreements with new business flowing to RBS plc.

Customer accounts decreased by €11.3 billion, or 5%, to €201.1 billion at 31 December 2009 compared to the balance of €212.4 billion at 31 December 2008. A significant proportion of the decrease (€7.8 billion) is due to the reclassification of certain Asian operations to disposal groups.

Debt securities in issue of €96.3 billion at 31 December 2009 compare to €112.2 billion at 31 December 2008. The decrease of €15.9 billion, or 14%, was due to transfers to RBS Group during the year. This includes a fall in issued commercial paper following the transfer of the remaining multi-seller conduits Orchid Funding Corporation and Abel Tasman Holdings. The decrease in bonds issued was due to debt redemptions and the buy back of own issued debt.

Subordinated liabilities increased €1.0 billion, or 7%, to €14.7 billion at 31 December 2009 compared to €13.7 billion at 31 December 2008. The increase in 2009 is a result of the issuance of €2.6 billion of Mandatory Convertible Securities. This increase was partly offset by the redemption of €1.5 billion of subordinated notes falling due.

Risk and balance sheet management

Introduction

Risk Management has an integral role to play in the delivery of the 5 year Strategic Plan of RBS Group. With the need for financial strength and resilience at the heart of this, the key strategic objectives of risk management are:

- Maintain capital adequacy
- Maintain Market Confidence
- Deliver Stable Earnings Growth
- Stable and efficient access to funding and liquidity

These risk objectives are the bridge between the RBS Group level business strategy and the frameworks, measures and metrics which we use to manage risk in our business divisions.

Risk Management within the Group is conducted in accordance with the policies and processes of RBS Group.

Governance

Risk and balance sheet management are conducted on an overall basis within the RBS Group. Therefore the discussion on risk and balance sheet management on pages 28 to 79 refers principally to policies and procedures in the RBS Group that also apply to the Group.

Risk and balance sheet management strategies are owned and set by the Managing Board of the Group and implemented by executive management. There are a number of committees and executives that support the execution of the business plan and strategy. Two of these risk committees are dedicated to the Group and report to the Managing Board and the Supervisory Board of the Group: the Group Risk & Control Committee and the Group Asset and Liability Management Committee. These are depicted and described in the graph and table below.

There are also risk committees that cover the Group and (parts of) RBS Group reflecting the integrated manner in which the business is managed within RBS Group. The Group is represented in these committees by members who have delegated authority from the Group to facilitate an integrated and efficient decision process, these specialist risk sub-committee are shown below.

Committee	Focus	Membership
Supervisory Board	The Supervisory Board is responsible for supervising the Group’s management and the Group’s general affairs and the business connected with it and for advising the Managing Board.	Consists of five members. Two members are executives of RBS Group.
Managing Board	Reports to Supervisory Board and is the principal decision-making forum for the Group. Sets policy framework, operating structure and yearly plan (including objectives and budgets)	Six members led by the Chairman, Chief Administrative Officer (CAO), Chief Financial Officer (CFO), Chief Risk Officer (CRO), Head of GBM and Head of GTS.
Risk and Control Committee ('RCC')	A sub-committee of the Managing Board. The responsibilities of the RCC include: · advise the Managing Board on the risk appetite of the Group and receive direction from the Managing Board on the Group risk appetite; provide input to the RBS Group risk appetite-setting process in the context of the Group's overall risk appetite; · oversee the risk framework within the Group and report directly to the Managing Board on the performance of the framework and on issues arising from it; · monitor the actual risk profile of the Group and ensure that this remains within the boundaries of the agreed risk appetite or escalate excesses to the Managing Board.	Chaired by the CRO. Members include CFO, CAO, Head of GBM, Head of GTS, Heads of Credit- , Market-, and Operational Risk & Regulatory Risk, Head of Risk for EMEA, APAC and Americas.
Asset and Liability Committee ('ALCO')	A sub-committee of the Managing Board. The Managing Board has fully delegated responsibility for the management of capital, liquidity, interest rate risk and foreign exchange risk to the ALCO. The mandate of ALCO therefore covers the following specific areas in respect of the Group: · the review, approval and allocation of balance sheet, capital, liquidity and funding limits	Eleven permanent voting members led by the Chairman, CFO, CAO, CRO, Treasurer, Head of GBM, Head of GTS, GBM Treasurer, Head of Treasury Balance Sheet Management, Head of Treasury Capital Management, Head of Short Term Markets & Financing. Four permanent non-voting guests: GTS Treasurer, Non-Core Treasurer, Global Head of Equity Treasury, Europe Treasurer.

	· the liquidity, funding, FX and interest rate exposures of the Group's balance sheet · the balance sheet structure and risk weighted asset position of the Group. · decisions on capital repatriation and management. · the approval and implementation within the Group of RBS Group Treasury policies and procedures.	
Risk & Audit Committee ('R&A Cte')	The R&A Cte is responsible for the review of all matters relative to accounting policies, internal control, financial reporting functions, internal audit, external audit, risk assessment and regulatory compliance. The R&A Cte reports to the Supervisory Board and the RBS Group Audit Committee.	The members of the R&A Cte are appointed by the Supervisory Board from its own members.

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Introduction continued

Risk appetite
Risk appetite is an expression of the maximum level of risk that the Group is prepared to accept in order to deliver its business objectives. Risk and capital management across the Group is based on the risk appetite set by the Managing Board and Supervisory Board, who regularly review and monitor the Group's performance in relation to risk.

Risk appetite is defined in both quantitative and qualitative terms and serves as a way of tracking risk management performance in implementation of the agreed strategy.

- Quantitative: encompassing scenario stress testing, risk concentrations, VaR, liquidity and credit related metrics; operational, business risk and regulatory measures.

- Qualitative: ensuring that the Group applies the correct principles, policies and procedures, manages reputational risk and develops risk control and culture.

Key developments in 2010
Against a backdrop of further market instability, the Group maintained very strong liquidity metrics. Progress was made in reducing reliance on short-term wholesale funding and the loan-to-deposit ratio improved significantly.

Risk Mitigation
The structural integrity of the balance sheet was strengthened through active management of both asset and liability portfolios and a deleveraging of the balance sheet. A centrally-managed liquidity portfolio (€25.7bn) is in place.

Introduction continued

Risk coverage
The main risk types facing the Group which are covered by the Risk Appetite Framework and managed by the above Committees are as follows:

Risk type	Definition	Features	Key developments in 2010	Risk mitigation
Credit risk (including country and political risks)	The risk that the Group will incur losses owing to the failure of customers to meet their financial obligations to the Group.	Loss characteristics vary materially across portfolios Significant correlation between losses and the macroeconomic environment Concentration risk – potential for large material losses	Asset quality improved across the portfolios, as a result, aggregate loan impairments decreased in 2010.	Further enhancements were made to the Group's credit risk frameworks as well as the systems and tools that support credit risk management processes. The Group continues to reduce the risk associated with legacy exposures through further reductions in Non-Core assets. In addition the risk is further mitigated through the protection resulting from the APS back-to-back agreement with RBS plc, see page 78.
Funding and liquidity risk	The risk that the Group does not have sufficient financial resources to meet its commitments when they fall due, or can secure them only at excessive cost.	Potential to disrupt the business model and stop normal functions of the Group. Potential to fail to meet the supervisory requirements of regulators. Significantly correlates with credit risk losses	Against a backdrop of further market instability, progress was made in meeting strategic objectives: reduced reliance on short-term wholesale funding; expanded customer deposit franchise; and reduction in term assets within non-core.	The structural integrity of the balance sheet was strengthened through active management of both asset and liability portfolios. Also a centrally-managed liquidity portfolio is held of €25.7bn.
Market risk				

	The risk that the value of an asset or liability may change as a result of a change in market factors.	Potential for large material losses Potential for losses due to stress events	Modeled market risk remained largely stable during 2010. Market volatility remained largely stable, though characterised by periods of market volatility arising from uncertainty of the economic outlook particularly within the EuroZone.	Market risk positions in Non-Core and in portfolios outside the target booking model for the Group continued to be reduced during 2010. Significant enhancements were made to the market risk framework within the Group which was integrated into RBS Group's market risk framework.
Operational risk	The risk of loss resulting from inadequate or failed processes, people, systems or from external events.	Frequent small losses. Infrequent material losses.	The level of operational risk remains high due to the scale of structural change occurring across the Group; increased government and regulatory scrutiny; and external threats (e.g. e-crime).	The RBS Group Policy Framework (GPF) supports the risk appetite setting process and underpins the control environment. The three lines of defence model gives assurance that the standards in GPF are being adhered to.

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Introduction continued
Risk coverage continued

Risk type	Definition	Features	Key developments in 2010	Risk mitigation
Regulatory risk	The risks arising from regulatory changes and enforcement.	Adverse impacts on business/operating models, including increased complexity. Financial costs adapting to changes or from penalties. Reputational damage from enforcement action.	The scale and scope of regulatory change remains at unprecedented levels, particularly in the area of prudential regulation (capital, liquidity, governance and risk management). Increased attention was paid to the treatment of systemically important areas such as recovery and resolution plans, remuneration and capital.	The Group manages regulatory change through pro-active engagement with DNB, other regulators and governments.
Compliance risk	Risks arising from non-compliance with laws, rules, regulations or other standards applicable to the Group.	Breach or alleged breach could result in public or private censure or fine, could have an adverse impact on the Group's business model (including applicable authorisations and licenses), reputation, results of operations and/or financial condition.	The Group, other global financial institutions and the banking industry have faced increased legal, regulatory and public scrutiny. The Group has continued to engage in discussions with relevant stakeholders, regulators and other governmental and non-governmental bodies, including those in the Netherlands, UK and US, regarding the	The Group has continued to review and enhance its regulatory policies, procedures and operations. During 2010, there has been specific, targeted focus on enhancing arrangements for managing the risks associated with money laundering, and sanctions and terrorism financing.

			Group's efforts to satisfy all relevant standards and ensure compliance with applicable existing and prospective laws, rules and regulations.	
Reputational risk	The risks arising from the failure to meet stakeholders' perceptions and expectations.	Failure of the business to provide an experience which meets customers, regulators and other stakeholder's expectations.	Government support brings heightened public scrutiny of the way we manage our business including: staff remuneration, how we manage our customers, and our environmental impact.	In 2010 RBS Group established the Group Corporate Sustainability Committee, and also developed a framework for managing environmental, social and ethical risks to support its lending decisions. The Group considers potential reputational risks and appropriate mitigants.
Pension Risk	Pension risk is the risk that the Group may have to make additional contributions to its defined benefit pension schemes.	Volatile funding position caused by the uncertainty of future investment returns and the discounted value of schemes' liabilities.	After the legal separation of ABN AMRO Bank N.V., the RBS AA Pension Scheme in the UK is the Groups main pension scheme.	The schemes are invested in diversified portfolios of equities, government and corporate fixed-interest and index-linked bonds, and other assets including property. Interest and inflation risks are mitigated partially by investment in suitable physical assets and appropriate derivative contracts.

Balance sheet management

Group Treasury in conjunction with the Divisions and Risk Management, in respect of risk-weighted assets ('RWAs'), manage and control the Group's balance sheet risks and consequent impact on the Group's capital, funding, liquidity, interest rate risk and currency risks.

Capital

It is the Group's policy to maintain a strong capital base and to utilise it efficiently throughout its activities to optimise the return to shareholders, while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Group has regard to the supervisory requirements of De Nederlandsche Bank (DNB). DNB uses Capital Ratios as a measure of capital adequacy in the Dutch banking sector, comparing a bank's capital resources with its risk-weighted assets (RWAs) (the assets and off-balance sheet exposures are weighted to reflect the inherent credit and other risks). At 31 December 2010, the Group's Total Capital Ratio was 15.8% (2009 - 25.5%; 2008 – 14.4%) and the Tier 1 Capital Ratio was 11.0% (2009 - 19.9%; 2008 – 10.9%).

	2010	2009	2008
Risk-weighted assets	€m	€m	€m
Credit risk	64,200	115,953	162,959
Market risk	1,272	1,582	13,069
Operational risk	4,324	-	-
	69,796	117,535	176,028
Capital ratios	%	%	%
Core Tier 1	8.7	16.9	10.1
Tier 1	11.0	19.9	10.9
Total	15.8	25.5	14.4

Note:
(1) The data for 2010 is on a Basel II basis; prior periods are on a Basel I basis.

With effect from 30 June 2010, the Group migrated to Basel II status. For the majority of credit risk, the Group uses the advanced internal ratings based approach for calculating RWAs. For operational risk, the Group uses the standardised approach, which calculates operational RWAs based on gross income.

The risk-adjusted assets and capital ratios published for 2009 and 2008 were calculated on a Basel I basis and reflect the inclusion of the Dutch State and Santander acquired businesses existing in the period prior to the legal separation of ABN AMRO Bank on 1 April 2010.

The Group remains well capitalised and is committed to maintaining sound capital ratios.

In addition to the calculation of minimum capital requirements for credit, market and operational risk, banks are required to undertake an Individual Capital Adequacy Assessment Process (ICAAP) for other risks.

The Group's ICAAP, in particular, focuses on concentration risk, stress VaR, pension fund risk, interest rate risk in the banking book, FX translation risk together with stress tests to assess the adequacy of capital over two years.

The Group is consolidated for regulatory reporting within the RBS Group. Pillar 3 information for the Group is included within the RBS Group Pillar 3 disclosures. RBS Group publishes its Pillar 3 (Market disclosures) on its website www.rbs.com, providing a range of additional information relating to Basel II and risk and capital management across the RBS Group. The disclosures focus on RBS Group level capital resources and adequacy, discuss a range of credit risk approaches and their associated RWAs under various Basel II approaches such as credit risk mitigation, counterparty credit risk and provisions.

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Balance sheet management: Capital continued

The Group's regulatory capital resources in accordance with DNB definitions were as follows:

Composition of regulatory capital	2010 €m	2009 €m	2008 €m
Tier 1			
Equity attributable to shareholders of the parent company	4,948	18,880	17,077
Non-controlling interests	24	36	46
Adjustment for:			
– Goodwill and other intangible assets	(25)	(103)	(309)
– Unrealised losses on available-for-sale debt securities	2,530	1,059	1,015
– Unrealised gains on available-for-sale equities	(112)	(219)	(150)
– Other regulatory adjustments	(1,265)	192	99
Core Tier 1 capital	6,100	19,845	17,778
Preference shares	2,421	5,014	3,317
Less deductions from Tier 1 capital	(838)	(1,485)	(1,943)
Total Tier 1 capital	7,683	23,374	19,152
Tier 2			
Unrealised gains on available-for-sale equities	112	219	150
Perpetual subordinated debt	4,105	7,841	7,774
Less deductions from Tier 2 capital	(838)	(1,485)	(1,943)
Total Tier 2 capital	3,379	6,575	5,981
Tier 3	-	-	272
Total regulatory capital	11,062	29,949	25,405

Movement in Core Tier 1 capital	2010 €m
As at 1 January 2010	19,845
Regulatory adjustment: fair value changes in own credit spreads	(143)
Foreign currency reserves	(105)
Loss of non-controlling interest and reduction in goodwill	(78)
Distributions to the shareholders of the parent company	(15,534)
Capital injection	915
Result current year	1,110
Other	90
As at 31 December 2010	6,100

Balance sheet management: Capital continued
Regulatory developments
Basel III and CRD IV
The Basel Committee released the final text on the new Basel III Capital and Liquidity Frameworks in December 2010, the contents of which were broadly as expected. Whilst most of the new rules are 'final' there are lengthy observation periods for the more novel elements (the liquidity coverage ratio, the net stable funding ratio and the leverage ratio) designed to identify any unintended consequences prior to full implementation and it is possible that some of the detail may be amended. The capital requirements for credit valuation adjustments (CVAs) with respect to counterparty risk are subject to a final impact assessment which is being carried out in the first quarter of 2011. The Committee's guidance on the countercyclical capital buffers allows for significant judgement which will need to be clarified by national regulators. The potential impacts for RBS Group are set out below.

- national implementation of increased capital requirements will begin on 1 January 2013;
- there will be a phased five year implementation of new deductions and regulatory adjustments to Core Tier 1 capital commencing 1 January 2014;
- the de-recognition of non-qualifying non common Tier 1 and Tier 2 capital instruments will be phased in over 10 years from 1 January 2013; and
- requirements for changes to minimum capital ratios, including conservation and countercyclical buffers, as well as additional requirements for Systemically Important Financial Institutions, will be phased in from 2013 to 2019.

The focus will now be on the EU's implementation of the Basel framework. The Commission's legislative proposal - the Capital Requirements Directive ('CRD') IV - is expected to appear in summer 2011.

Contingent capital and loss absorbency
The Basel Committee issued its final rules on the requirements to ensure all classes of capital instruments fully absorb losses at the point of non-viability, before tax payers are exposed to loss. These are designed to combat the experience during the crisis where holders of Tier 2 capital instruments did not suffer any losses when banks were bailed out by the public sector. Debate continues, meanwhile, over possible requirements for bailing-in senior debt holders, as a further means of protecting the taxpayer.

Basel III capital deductions and regulatory adjustments
In addition to the changes outlined above, Basel III will also result in revisions to regulatory adjustments and capital deductions. These will be phased in over a five year period from 1 January 2014. The initial deduction is expected to be 20%, rising 20 percentage points each year until full deduction by 1 January 2018. However, this is subject to final implementation rules determined by the FSA. The proportion not deducted in the transition years will continue to be subject to existing national treatments.

The major categories of deductions include:

- expected loss net of provisions;
- deferred tax assets not relating to timing differences;

- unrealised losses on available-for-sale securities; and
- significant investments in non-consolidated financial institutions.

The net impact of these adjustments is expected to be manageable as most of these drivers reduce or are eliminated by 2014.

Other regulatory developments

Treatment of Systemically Important Financial Institutions (SIFIs)

Policy development around contingent capital and loss absorbency forms part of a wider policy initiative on addressing systemic institutions. A Financial Stability Board outline framework and plan of action was endorsed by G20 leaders at the November 2010 Seoul Summit. This now forms the main focus of global policy making following the finalisation of the Basel III framework. Policy initiatives in this area may include proposals for greater loss absorbency for systemic firms, the development of enhanced supervision and resolution frameworks, as well as recovery and resolution plans.

The EU Commission Consultation

Crisis management proposals

The EU Commission issued a consultation paper on crisis management measures in January 2011. It covers prevention tools (such as recovery planning requirements, supervisory powers and new ideas on intra-group financial support mechanisms), as well as resolution tools (including partial transfer powers and possible approaches to debt write-down. The consultation will inform draft implementing legislation expected this summer, and is intended to help shape the global framework for SIFIs.

Markets in Financial Instruments Directive Review

The EU Commission published a consultation on revising the Directive on Markets in Financial Instruments (MiFID2). The main proposals in the consultation are the extension of the transparency rules to include bonds and over the counter derivatives, measures to reinforce regulation of commodity derivatives and high frequency trading, strengthening investor protection and detailing the role of the new European Securities and Markets Authority.

Financial activities tax

In a recent speech, the EU Tax Commissioner talked about the introduction of a potential Financial Activities Tax at a European level. There will be an impact assessment in 2011 to review the cumulative impact on financial institutions of new regulation, bank levy and taxes, as part of the Commission's on-going examination of possible tax measures.

Balance sheet management: Capital continued
Regulatory developments continued

Dodd-Frank
In the United States the Dodd-Frank Wall Street Reform and Consumer Reform Act ('Dodd-Frank') contains very significant reforms, the full effect of which can only be assessed when the implementation rules are finalised. There have also been numerous derivative proposals from the Commodity Futures Exchange Commission ('CFTC') and the Securities and Exchange Commission ('SEC') plus joint agency proposals to implement minimum capital standards (Collins Amendment) and market risk capital guidelines.

Stress and scenario testing
Stress testing forms part of the Group's risk and capital framework and an integral component of Basel II. As a key risk management tool, stress testing highlights to senior management potential adverse unexpected outcomes related to a mixture of risks and provides an indication of how much capital might be required to absorb losses, should adverse scenarios occur. Stress testing is used at Group level to assess risk concentrations, estimate the impact of stressed earnings, impairments and write-downs on capital.

It determines the overall capital adequacy under a variety of adverse scenarios. The principal business benefits of the stress testing framework include: understanding the impact of recessionary scenarios; assessing material risk concentrations; forecasting the impact of market stress and scenarios on the Group's balance sheet liquidity.

At Group level, a series of stress events are monitored on a regular basis to assess the potential impact of an extreme yet plausible event on the Group.

Balance sheet management: Funding and liquidity risk

Introduction
The objective of the Group's funding and liquidity management framework is to ensure that at all times the Group can meet its obligations as they fall due, and that access to the wholesale markets is co-ordinated and cost-effective.

The Group's balance sheet composition is a function of the broad array of product offerings and diverse markets served by its Core divisions. The structural integrity of the balance sheet is augmented as needed through active management of both asset and liability portfolios. The objective of these activities is to optimise liquidity transformation in normal business environments while ensuring adequate coverage of all cash requirements under extreme stress conditions.

The Group acts to enhance its flexibility through an unsecured term debt issuance in numerous geographies, currencies and maturities.

Stress testing
Simulated liquidity stress testing is periodically performed for each business and applied to the major operating subsidiary balance sheets. A variety of firm-specific and market related scenarios are used at the consolidated level and in individual countries. These scenarios include assumptions about significant changes in key funding sources, credit ratings, contingent uses of funding, and political and economic conditions in certain countries. Stress tests are regularly updated based on changing market conditions.

Contingency planning
The Group has a Contingency Funding Plan ('CFP') which is maintained and updated as the balance sheet evolves. The CFP is linked to stress test results and forms the foundation for liquidity risk limits. Limits in the business-as-usual environment are bounded by capacity to satisfy the Group's liquidity needs in the stress environments. The CFP provides a detailed description of the availability, size and timing of all sources contingent liquidity available to the Group Treasurer in a stress event. These are ranked in order of economic impact and effectiveness to meet the anticipated stress requirement. The CFP includes documented procedures and signoffs for actions that may require businesses to provide access to customer assets for collateralised borrowing, securitisation or sale. Roles and responsibilities for the effective implementation of the CFP are also documented.

Liquidity reserves
The Group maintains central liquidity reserves sufficient to satisfy cash requirements in the event of a severe disruption in its access to either wholesale or corporate funding sources. The reserves consist of high quality unencumbered European Central Bank eligible securities and cash held on deposit at central banks. The Group also maintains local liquidity reserves, where the securities vary by type and currency based on local regulatory considerations.

Regulatory oversight
The Group operates in multiple jurisdictions and is subject to a number of regulatory regimes. The Group's lead regulator in the Netherlands is DNB. The Group is a subsidiary of the RBS Group whose lead regulator is the UK is the FSA.

There have been a number of significant developments in the regulation of liquidity risk.

In December 2010, the BCBS issued the 'International framework for liquidity risk measurement, standards and monitoring' which confirmed the introduction of two liquidity ratios, the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR). The introduction of both of these will be subject to an observation period, which includes review clauses to address and identify any unintended consequences.

After an observation period beginning in 2011, the LCR, including any revisions, will be introduced on 1 January 2015. The NSFR, including any revisions, will move to a minimum standard by 1 January 2018.

Balance sheet management: Funding and liquidity risk continued

The table below shows the composition of the Group's primary funding sources, excluding repurchase agreements:

	2010		2009		2008	
	€m	%	€m	%	€m	%
Deposits by banks	27,178	19.8	40,728	11.6	68,121	16.9
Debt securities in issue						
- Commercial paper	5,843	4.3	19,368	5.5	26,106	6.5
- Certificates of deposits	2,882	2.1	1,811	0.5	8,770	2.2
- Medium term notes and other bonds	44,369	32.3	74,330	21.3	70,942	17.6
- Securitisations	317	0.2	782	0.2	6,405	1.6
	53,411	38.9	96,291	27.5	112,223	27.9
Subordinated liabilities	6,894	5.0	14,666	4.2	13,701	3.4
Total wholesale funding	87,483	63.7	151,685	43.3	194,045	48.2
Customer deposits	49,886	36.3	198,388	56.7	208,157	51.8
Total funding	137,369	100.0	350,073	100.0	402,202	100.0

The tables below show the Group's debt securities and subordinated liabilities by maturity.

	Debt securities in issue	Subordinated liabilities	Total	
2010	€m	€m	€m	%
Less than one year	14,462	4	14,466	24.0
1-3 years	10,562	-	10,562	17.5
3-5 years	11,194	2,592	13,786	22.9
More than 5 years	17,193	4,298	21,490	35.6
	53,411	6,894	60,305	100.0
2009				
Less than one year	39,759	857	40,616	36.6
1-5 years	26,761	9	26,770	24.1
More than 5 years	29,771	13,800	43,571	39.3
	96,291	14,666	110,957	100.0
2008				
Less than one year	45,350	1,512	46,862	37.2
1-5 years	42,366	864	43,230	34.3
More than 5 years	24,507	11,325	35,832	28.5
	112,223	13,701	125,924	100.0

Key Points

The Group has improved its relative funding and liquidity position through deleveraging of the balance sheet while maintaining a significant liquidity reserve.

The proportion of debt instruments with a remaining maturity of greater than one year has increased from 63.4% at 31 December 2009 to 76.0% at 31 December 2010.

Balance sheet management: Funding and liquidity risk continued

Short term borrowings

The table below shows details of the Group's short-term borrowings.

Short term borrowings comprise repurchase agreements, commercial paper and certificates of deposit.

	Repos	Commercial paper	Certificates of deposits	Total 2010	Total 2009	Total 2008
At year end						
- balance (€bn)	13	5	3	21	27	67
- weighted average interest rate	0.4%	1.1%	0.9%	0.6%	1.7%	2.8%
During the year						
- maximum balance (€bn)	18	17	9	44	66	278
- average balance (€bn)	12	10	6	28	40	173
- weighted average interest rate	0.3%	0.9%	0.7%	0.6%	1.8%	3.0%

Balances are generally based on monthly data. Average interest rates during the year are computed by dividing total interest expense by the average amount borrowed. Average interest rates at year end are average rates for a single day and as such may reflect one-day market distortions which may not be indicative of generally prevailing rates.

Balance sheet management: Funding and liquidity risk continued

Assets and liabilities by contractual cash flow maturity

The table below shows the contractual undiscounted cash flows receivable and payable up to a period of twenty years including future receipts and payments of interest of on-balance sheet assets by contractual maturity. The balances in the table below do not agree directly to the consolidated balance sheet, as the table includes all cash flows relating to principal and future coupon payments presented on an undiscounted basis.

2010	0-3 months €m	3-12 months €m	1-3 years €m	3-5 years €m	5-10 years €m	10-20 years €m
Assets by contractual maturity						
Cash and balances at central banks	8,294	-	-	-	-	29
Loans and advances to banks	24,290	1,056	716	164	470	10
Debt securities	7,257	4,674	12,255	12,352	10,485	6,811
Settlement balances	3,573	-	-	-	-	-
Other financial assets	-	-	235	402	-	-
Total maturing assets	43,414	5,730	13,206	12,918	10,955	6,850
Loans and advances to customers	19,329	5,925	10,687	6,063	4,161	1,634
Derivatives held for hedging	45	65	303	139	129	69
	62,788	11,720	24,196	19,120	15,245	8,553
Liabilities by contractual maturity						
Deposits by banks	27,450	1,659	899	706	812	245
Debt securities in issue	8,239	6,590	12,757	11,412	12,628	3,048
Subordinated liabilities	88	324	504	3,507	1,465	1,162
Settlement balances and other liabilities	4,287	65	139	266	436	-
Total maturing liabilities	40,064	8,638	14,299	15,891	15,341	4,455
Customer accounts	46,612	1,484	1,199	1,263	2,672	1,948
Derivatives held for hedging	323	449	1,373	627	459	260
	86,999	10,571	16,871	17,781	18,472	6,663
Maturity gap	3,350	(2,908)	(1,093)	(2,973)	(4,386)	2,395
Cumulative maturity gap	3,350	442	(651)	(3,624)	(8,010)	(5,615)

Balance sheet management: Funding and liquidity risk continued
Assets and liabilities by contractual cash flow maturity continued

2009	0-3 months €m	3-12 months €m	1-3 years €m	3-5 years €m	5-10 years €m	10-20 years €m
Assets by contractual maturity						
Cash and balances at central banks	28,400	-	-	-	-	24
Loans and advances to banks	34,253	614	901	927	1,063	187
Debt securities	14,299	9,182	12,257	13,069	27,234	7,195
Settlement balances	3,397	-	-	-	-	-
Other financial assets	-	166	194	204	-	-
Total maturing assets	80,349	9,962	13,352	14,200	28,297	7,406
Loans and advances to customers	58,564	9,662	19,335	20,938	28,021	35,599
Derivatives held for hedging	345	345	1,487	1,487	511	-
	139,258	19,969	34,174	36,625	56,829	43,005
Liabilities by contractual maturity						
Deposits by banks	31,531	9,789	1,535	1,615	1,003	90
Debt securities in issue	20,634	20,085	14,132	15,019	30,312	1,967
Subordinated liabilities	122	847	23	24	9,310	192
Settlement balances and other liabilities	7,569	-	-	-	-	-
Total maturing liabilities	59,856	30,721	15,690	16,658	40,625	2,249
Customer accounts	183,244	6,548	2,109	2,206	4,125	3,030
Derivatives held for hedging	482	482	1,777	1,778	3,684	-
	243,582	37,751	19,576	20,642	48,434	5,279
Maturity gap	20,493	(20,759)	(2,338)	(2,458)	(12,328)	5,157
Cumulative maturity gap	20,493	(266)	(2,604)	(5,062)	(17,390)	(12,233)

Balance sheet management: Funding and liquidity risk continued
Assets and liabilities by contractual cash flow maturity continued

2008	0-3 months €m	3-12 months €m	1-3 years €m	3-5 years €m	5-10 years €m	10-20 years €m
Assets by contractual maturity						
Cash and balances at central banks	5,820	-	-	-	-	48
Loans and advances to banks	45,521	23,383	1,439	1,566	1,065	148
Debt securities	23,464	5,893	8,247	8,978	55,835	1,633
Settlement balances	7,667	-	-	-	-	-
Other financial assets	-	477	4	2	-	-
Total maturing assets	82,472	29,753	9,690	10,546	56,900	1,829
Loans and advances to customers	86,336	22,310	24,782	27,197	33,622	41,190
Derivatives held for hedging	988	988	75	75	547	-
	169,796	53,051	34,547	37,818	91,069	43,019
Liabilities by contractual maturity						
Deposits by banks	76,989	12,210	2,316	2,500	1,111	201
Debt securities in issue	37,243	9,093	22,989	24,932	18,498	12,958
Subordinated liabilities	157	1,557	480	525	11,707	315
Settlement balances and other liabilities	8,985	-	-	-	-	-
Total maturing liabilities	123,374	22,860	25,785	27,957	31,316	13,474
Customer accounts	176,284	23,724	4,006	4,256	3,898	3,404
Derivatives held for hedging	1,202	1,202	218	218	2,303	-
	300,860	47,786	30,009	32,431	37,517	16,878
Maturity gap	(40,902)	6,893	(16,095)	(17,411)	25,584	(11,645)
Cumulative maturity gap	(40,902)	(34,009)	(50,104)	(67,515)	(41,931)	(53,576)

Guarantees and commitments	2010 €m	2009 €m	2008 €m
Guarantees (1)	24,458	33,568	37,509
Commitments (2)	37,995	51,520	63,436
	62,453	85,088	100,945

Notes:
(1) The Group is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Group expects most guarantees it provides to expire unused.
(2) The Group has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Group does not expect all facilities to be drawn, and some may lapse before drawdown.

The tables above have been prepared on the following basis:

The contractual maturity of on-balance sheet assets and liabilities above highlight the maturity transformation which underpins the role of banks to lend long-term but funded predominantly by short-term liabilities such as customer deposits. In practice, the behavioural profile of many assets and liabilities exhibit greater stability and longer maturity than the contractual maturity.

Financial assets have been reflected in the time band of the latest date on which they could be repaid, unless earlier repayment can be demanded by the Group. Financial liabilities are included at the earliest date on which the counterparty can require repayment regardless of whether or not such early repayment results in a penalty. If the repayment of a financial instrument is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the asset is included in the time band which contains the latest date on which it can be repaid regardless of early repayment. The liability is included in the time band which contains the earliest possible date that the conditions could be fulfilled without considering the probability of the conditions being met.

For example, if a structured note is automatically prepaid when an equity index exceeds a certain level, the cash outflow will be included in the less than three months period whatever the level of the index at the year end. The settlement date of debt securities in issue, issued by certain securitisation vehicles consolidated by the Group, depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date. As the repayment of assets and liabilities are linked, the repayment of assets in securitisations are shown on the earliest date that the asset can be prepaid as this is the basis used for liabilities.

Assets and liabilities with a contractual maturity of greater than twenty years - the principal amounts of financial assets and liabilities that are repayable after twenty years or where the counterparty has no right to repayment of the principal are excluded from the table, as are interest payments after twenty years.

Balance sheet management: Interest rate risk

The banking book consists of interest bearing assets, liabilities and derivative instruments used to mitigate risks which are primarily accounted for on an accrual basis, as well as non interest bearing balance sheet items which are not subjected to fair value accounting.

The Group provides financial products to satisfy a variety of customer requirements. Loans and deposits are designed to meet out customers' objectives with regard to repricing frequency, tenor, index, prepayment, optionality and other features. These characteristics are aggregated to form portfolios of assets and liabilities with varying degrees of sensitivity to changes in market rates. Mismatches in these sensitivities give rise to interest rate risk if interest rates rise or fall.

Interest rate risk in the banking book (IRRBB) is assessed using a set of standards to define, measure and report the market risk.

It is the Group's policy to minimise interest rate sensitivity in banking book portfolios and where interest rate risk is retained to ensure that appropriate measures and limits are applied. Key conventions in evaluating IRRBB are subjected to approval granted by the Group ALCO. Limits on IRRBB are set according to the Non-Trading Interest Rate Risk Policy and are subject to Group ALCO approval.

IRRBB is measured using a version of the same VaR methodology that is used by RBS Group, that is, on the basis of historical simulation using two years of unweighted data. The holding period is one day and the confidence level 99%.

The Group is required to manage banking book exposures through transactions with RBS plc to the greatest extent possible.

Group Treasury aggregates exposures arising from its own external activities and positions transferred in from the Regional Treasuries. Where appropriate, Group Treasury nets offsetting risk exposures to determine a residual exposure to rate movements. Hedging transactions with RBS plc, using cash and derivative instruments, are executed to manage the net positions according to the Non-Trading Interest Rate Risk Policy.

Residual risk positions are routinely reported to the Group ALCO, the Group Managing and Supervisory Board and the Group RCC.

IRRBB VaR for the Group's retail and commercial banking activities at a 99% confidence level was as follows. The figures exclude the banking books of Short Term Markets and Finance ('STMF') which are reported within the Market Risk section.

	Average	Period end	Maximum	Minimum
	€m	€m	€m	€m
2010	30.1	16.2	69.9	16.2
2009	50.4	39.0	75.2	32.5
2008	20.9	27.8	31.9	10.9

Key points

- VaR reduced in 2010 following the legal separation of the Dutch State acquired businesses.

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Structural foreign currency exposures

Structural foreign exchange exposures represent net investment in subsidiaries, associates and branches, the functional currencies of which are currencies other than the Euro. The Group hedges structural foreign exchange exposures in limited circumstances. The Group's policy objective is to ensure, where practical, that its consolidated capital ratios are largely protected from the effect of changes in exchange rates. The Group attempts to limit the sensitivity to its Core Tier 1 ratio to 15 basis points in a 10% rate shock scenario. The Group's structural foreign exchange position is reviewed by ALCO regularly.

The tables below set out the Group structural foreign exchange exposures:

	Net investments in foreign operations	Net investment hedges	Structural foreign currency exposures
2010	€m	€m	€m
US dollar	1,271	(730)	541
Pound sterling	1,358	(1,238)	120
Other non-euro	3,779	(2,298)	1,481
	6,408	(4,266)	2,142
2009			
US dollar	768	(543)	225
Pound sterling	(873)	(72)	(945)
Other non-euro	4,064	(2,876)	1,188
	3,959	(3,491)	468
2008			
US dollar	802	435	1,237
Pound sterling	(5,867)	(272)	(6,139)
Other non-euro	3,323	(1,505)	1,818
	(1,742)	(1,342)	(3,084)

Note:

(1) Includes minority participations.

Sensitivity of equity to exchange rates

Changes in foreign currency exchange rates will affect equity in proportion to the structural foreign currency exposure. The table shows the sensitivity of the Group's equity capital to a 10%appreciation and 10% depreciation in the Euro against all foreign currencies

2010 (1)		2009		2008	
Euro appreciates 10%	Euro depreciates 10%	Euro appreciates 10%	Euro depreciates 10%	Euro appreciates 10%	Euro depreciates 10%
€m	€m	€m	€m	€m	€m
(367)	435	(259)	259	312	(312)

Note:

(1) The basis used to calculate the sensitivity to a percentage change in the Euro against all foreign currencies was revised in line with RBS Group methodology.

Credit risk management
Credit risk is the risk of financial loss owing to the failure of customers or counterparties to meet payment obligations. The quantum and nature of credit risk assumed across the Group's different businesses varies considerably, while the overall credit risk outcome usually exhibits a high degree of correlation to the macroeconomic environment.

Credit risk organisation
The existence of a strong credit risk management organisation is vital to support the ongoing profitability of the Group. The potential for loss through economic cycles is mitigated through the embedding of a robust credit risk culture within the business units and through a focus on the importance of sustainable lending practices. The role of the credit risk management organisation is to own the credit approval, concentration and risk appetite frameworks and to act as the ultimate authority for the approval of credit. This, together with strong independent oversight and challenge, enables the business to maintain a sound lending environment within risk appetite.

Responsibility for development of RBS Group-wide policies, credit risk frameworks, RBS Group-wide portfolio management and assessment of provision adequacy sits within the functional RBS Group Credit Risk organisation (“GCR”) under the management of the RBS Group Chief Credit Officer. Execution of these policies and frameworks is the responsibility of the risk management organisations located within the RBS Group’s business divisions. These divisional credit risk functions work together with GCR to ensure that the RBS Groups' Board’s expressed risk appetite is met within a clearly defined and managed control environment. Each credit risk function within the division is managed by a Chief Credit Officer who reports jointly to a divisional Chief Risk Officer and to the RBS Group Chief Credit Officer. Divisional activities within credit risk include credit approval, transaction and portfolio analysis, early problem recognition and ongoing credit risk stewardship.

GCR is additionally responsible for verifying compliance by the Group with all RBS Group credit policies. It is assisted in this by a credit quality assurance function owned by the RBS Group Chief Credit Officer.

Credit risk appetite
The Group's Credit risk appetite is managed and controlled through a series of frameworks designed to limit concentration by sector, counterparty, country or asset class. These are supported by a suite of RBS Group-wide and divisional policies setting out the risk parameters within which business units may operate. Information on the Group’s credit portfolios is reported to the Managing Board via the divisional and Group level risk committees described in the Governance section on page 28.

Sector
Across wholesale portfolios, exposures are assigned to, and reviewed in the context of, a defined set of industry sectors. Through this sector framework, appetite and portfolio strategies are agreed and set at aggregate and more granular levels where exposures have the potential to represent excessive concentration or where trends in both external factors and internal portfolio performance give cause for concern. Formal periodic reviews are undertaken at RBS Group or at Group level depending on materiality; these may include an assessment of the Group’s franchise in a particular sector, an analysis of the outlook (including downside outcomes), identification of key vulnerabilities and stress/scenario tests. Specific reporting on trends in sector risk and on status versus agreed appetite and portfolio strategies is provided to senior management and the Board.

Single name

Within wholesale portfolios, much of the activity undertaken by the credit risk function is organised around the assessment, approval and management of the credit risk associated with a borrower or group of related borrowers.

A formal single name concentration framework addresses the risk of outsized exposure to a borrower or borrower group. The framework includes specific and elevated approval requirements; additional reporting and monitoring; and the requirement to develop plans to address and reduce excess exposures over an appropriate timeframe.

Credit approval authority is discharged by way of a framework of individual delegated authorities that requires at least two individuals to approve each credit decision, one from the business and one from the credit risk management function. Both parties must hold sufficient delegated authority under the RBS Group-wide authority grid. Whilst both parties are accountable for the quality of each decision taken, the credit risk management approver holds ultimate veto. The level of authority granted to an individual is dependent on their experience and expertise with only a small number of senior executives holding the highest authority provided under the framework. Daily monitoring of individual counterparty limits is undertaken. For certain counterparties early warning indicators are also in place to detect deteriorating trends of concern in limit utilisation or account performance.

At a minimum, credit relationships are reviewed and re-approved annually. The renewal process addresses: borrower performance, including reconfirmation or adjustment of risk parameter estimates; the adequacy of security; and compliance with terms and conditions.

Single name concentrations

Reducing the risk arising from concentrations to single names remains a key focus of management attention. Notwithstanding continued market illiquidity, and the impact of negative credit migration caused by the current economic environment, significant progress was made in 2010.

Credit risk management continued

Country
Country risk arises from sovereign events (default or restructuring); economic events (contagion of sovereign default to other parts of the economy, cyclical economic shock); political events (convertibility restrictions and expropriation or nationalisation); and natural disaster or conflict. Such events have the potential to impact elements of the Group’s credit portfolio that are directly or indirectly linked to the affected country and can also give rise to market, liquidity, operational and franchise risk related losses.

The risk appetite for country risk is set in the form of limits by country risk grade. Authority is delegated to the RBS Group Country Risk Committee to manage exposures within the framework with escalation where needed. Specific limits are set for individual countries based on a risk assessment taking into account the Group’s franchise and business mix in that country. Additional limitations (for example, on foreign-currency exposure and product types with higher potential for loss in case of country events) may be established to address specific vulnerabilities in the context of a country's outlook and/or the RBS Group's business strategy in a particular country. A country watch list framework is in place to proactively monitor emerging issues and facilitate the development of mitigation strategies.

Global Restructuring Group
The RBS Group Global Restructuring Group (GRG) manages problem and potential problem exposures in the Group's wholesale credit portfolios. Its primary function is to manage actively the exposures to minimise loss for the Group and, where feasible, to return the exposure to the Group’s mainstream loan book.

Originating business units consult with GRG prior to transfer to GRG when a potentially negative event or trend emerges which might affect a customer’s ability to service its debt or increase the Group’s risk exposure to that customer. Such circumstances include deteriorating trading performance, likely breach of covenant, challenging macroeconomic conditions, a missed payment or the expectation of a missed payment to the Group or another creditor.

On transfer of the relationship, GRG devises a bespoke strategy that optimises recoveries from the debt. This strategy may also involve GRG reviewing the business operations and performance of the customer. A number of alternative approaches will typically be considered including:

- Covenant relief: the temporary waiver or recalibration of covenants may be granted to mitigate a potential or actual covenant breach. Such relief is usually granted in exchange for fees, increased margin, additional security, or a reduction in maturity profile of the original loan.

- Amendment of restrictive covenants: restrictions in loan documents may be amended or waived as part of an overall remedial strategy to allow: additional indebtedness; the granting of collateral; the sale of a business; the granting of junior lien on the collateral; or other fundamental change in capital or operating structure of the enterprise.

- Variation in margin: contractual margin may be amended to bolster the customer’s day-to-day liquidity, with the aim of helping to sustain the customer’s business as a going concern. This would normally be accompanied by the Group receiving an exit payment, payment in kind or deferred fee.

- Payment holidays and loan rescheduling: payment holidays or changes to the contracted amortisation profile including extensions in contracted maturity or roll-overs may be granted to improve customer liquidity. Such concessions often depend on the expectation that liquidity will recover when market conditions improve or from capital raising initiatives that access alternative sources of liquidity.

- Forgiveness of all or part of the outstanding debt: debt may be forgiven or exchanged for equity where a fundamental shift in the customer's business or economic environment means that other forms of restructuring strategies are unlikely to succeed in isolation and the customer is incapable of servicing current debt obligations.

Depending on the case in question, GRG may employ a combination of these options in order to achieve the best outcome. It may also consider alternative approaches, either alone or together with the options listed above.

The following are generally considered as options of last resort:

- Enforcement of security or otherwise taking control of assets: where the Group holds underlying collateral or other security interest and is entitled to enforce its rights, it may take ownership or control of the assets. The Group preferred strategy is to consider other possible options prior to exercising these rights.

- Insolvency: where there is no suitable restructuring option or the business is no longer regarded as sustainable, insolvency will be considered. Insolvency may be the only option that ensures that the assets of the business are properly and efficiently distributed to relevant creditors.

As discussed above GRG will consider a range of possible restructuring strategies. At the time of execution the ultimate outcome of the strategy adopted is unknown and highly dependent on the cooperation of the borrower and the continued existence of a viable business. The customer's financial position, its anticipated future prospects and the likely effect of the restructuring including any concessions are considered by the GRG relationship manager to establish whether an impairment provision is required, subject to Group governance.

Credit risk mitigation

The Group employs a number of structures and techniques to mitigate credit risk. Netting of debtor and creditor balances will be undertaken in accordance with relevant regulatory and internal policies; Exposure on over-the-counter derivative and secured financing transactions is further mitigated by the exchange of financial collateral and documented on market standard terms.

Credit risk management continued

Credit risk mitigation continued

Further mitigation may be undertaken in a range of transactions, from retail mortgage lending to large wholesale financing, by structuring a security interest in a physical or financial asset; credit derivatives, including credit default swaps, credit linked debt instruments, and securitisation structures; and guarantees and similar instruments (for example, credit insurance) from related and third parties are used in the management of credit portfolios, typically to mitigate credit concentrations in relation to an individual obligor, a borrower group or a collection of related borrowers.

The use and approach to credit risk mitigation varies by product type, customer and business strategy. Minimum standards applied across the Group cover: general requirements, including acceptable credit risk mitigation types and any conditions or restrictions applicable to those mitigants; the means by which legal certainty is to be established, including required documentation and all necessary steps required to establish legal rights; acceptable methodologies for the initial and any subsequent valuations of collateral and the frequency with which they are to be revalued (for example, daily in the trading book); actions to be taken in the event the current value of mitigation falls below required levels; management of the risk of correlation between changes in the credit risk of the customer and the value of credit risk mitigation; management of concentration risks, for example, setting thresholds and controls on the acceptability of credit risk mitigants and on lines of business that are characterised by a specific collateral type or structure; and collateral management to ensure that credit risk mitigation remains legally effective and enforceable.

Credit risk measurement

Credit risk models are used throughout the Group to support the quantitative risk assessment element of the credit approval process, ongoing credit risk management, monitoring and reporting and portfolio analytics. Credit risk models used by the Group may be divided into three categories.

Probability of default/customer credit grade (PD)

These models assess the probability that a customer will fail to make full and timely repayment of their obligations. The probability of a customer failing to do so is measured over a one year period through the economic cycle.

Wholesale businesses: as part of the credit assessment process, each counterparty is assigned an internal credit grade derived from a default probability. There are a number of different credit grading models in use across the RBS Group, each of which considers risk characteristics particular to that type of customer. The credit grading models score a combination of quantitative inputs (for example, recent financial performance) and qualitative inputs, (for example, management performance or sector outlook).

Exposure at default

Facility usage models estimate the expected level of utilisation of a credit facility at the time of a borrower's default. For revolving and variable draw down type products which are not fully drawn, the exposure at default (EAD) will typically be higher than the current utilisation. The methodologies used in EAD modelling provide an estimate of potential exposure and recognise that customers may make more use of their existing credit facilities as they approach default.

Counterparty credit risk exposure measurement models are used for derivative and other traded instruments where the amount of credit risk exposure may be dependent upon one or more underlying market variables such as interest or foreign exchange rates. These models drive internal credit risk activities such as limit and excess management.

Loss given default

These models estimate the economic loss that may be experienced (the amount that cannot be recovered) by the Group on a credit facility in the event of default. The Group's loss given default (LGD) models take into account both borrower and facility characteristics for unsecured or partially unsecured facilities, as well as the quality of any risk mitigation that may be in place for secured facilities, plus the cost of collections and a time discount factor for the delay in cash recovery.

Risk Management: Credit risk continued

Balance sheet analysis
The following tables provide an analysis of financial assets by industry sector, geography and internal credit quality grading.

Financial Assets: Industry analysis
The tables below analyse total financial assets by industry, gross of provisions.

2010	Loans and advances €m	Securities €m	Derivatives €m	Other (1) €m	Total €m	Netting and offset (2) €m
Total						
Central and local government	1,544	26,038	383	7	27,972	-
Finance	39,786	45,413	25,194	3,858	114,251	7,865
Residential mortgages	984	-	-	-	984	-
Personal lending	427	72	-	-	499	-
Property	1,110	53	142	-	1,305	-
Construction	921	46	47	-	1,014	-
Manufacturing	9,213	170	404	-	9,787	-
Service industries and business activities	18,297	1,874	2,102	-	22,273	2
Agriculture, forestry and fishing	165	-	-	-	165	-
Finance lease and instalment credit	54	-	-	-	54	-
Interest accruals	272	1,228	-	-	1,500	-
Total gross of provisions	72,773	74,894	28,272	3,865	179,804	7,867
Provisions	(1,572)	-	-	-	(1,572)	n/a
Total	71,201	74,894	28,272	3,865	178,232	7,867
Comprising:						
Derivative balances						2,864
Derivative collateral						4,999
Other						4
						7,867
2009						
Central and local government	2,624	48,596	100	37	51,357	3
Finance	74,289	40,862	50,984	2,550	168,685	7,243
Residential mortgages	102,687	14	259	-	102,960	-
Personal lending	3,017	-	196	1	3,214	45
Property	5,323	517	484	119	6,443	-
Construction	1,426	413	22	20	1,881	-
Manufacturing	19,890	1,806	2,838	115	24,649	74
	47,504	8,249	1,639	911	58,303	33

Service industries and business activities						
Agriculture, forestry and fishing	5,202	269	23	10	5,504	-
Finance lease and instalment credit	19	14	-	-	33	-
Interest accruals	1,407	1,296	847	2	3,552	-
Total gross of provisions	263,388	102,036	57,392	3,765	426,581	7,398
Provisions	(5,711)	-	-	-	(5,711)	n/a
Total	257,677	102,036	57,392	3,765	420,870	7,398

For notes to this table refer to page 52.

Risk Management: Credit risk continued
Balance sheet analysis continued
Financial Assets: Industry analysis continued

2008	Loans and advances €m	Securities €m	Derivatives €m	Other (1) €m	Total €m	Netting and offset (2) €m
Total						
Central and local government	8,434	32,829	2,155	16	43,434	367
Finance	122,132	51,591	172,141	6,458	352,321	97,749
Residential mortgages	101,669	23	4	-	101,696	-
Personal lending	9,072	1	226	-	9,299	53
Property	6,037	427	66	72	6,602	43
Construction	1,964	107	61	27	2,159	7
Manufacturing	30,439	1,574	6,588	130	38,731	2,587
Service industries and business activities	59,796	17,528	3,877	1,025	82,226	926
Agriculture, forestry and fishing	5,020	107	-	14	5,141	-
Finance lease and instalment credit	114	21	-	-	135	30
Interest accruals	3,887	1,581	91	5	5,564	-
Total gross of provisions	348,564	105,789	185,209	7,747	647,308	101,762
Provisions	(4,564)	-	-	-	(4,564)	n/a
Total	344,000	105,789	185,209	7,747	642,744	101,762

For notes to this table refer to page 52.

Loans and advances to banks and customers by geography
The table below analyses loans and advances net of provisions by geography.

	2010 €m	2009 €m	2008 €m
Loans and advances to banks			
Netherlands	6,072	9,910	10,732
US	280	42	512
Rest of world	20,353	27,767	60,246
	26,705	37,719	71,490
Loans and advances to customers			
Netherlands	9,621	155,034	163,100
US	1,531	4,078	10,674
Rest of world	33,344	60,846	98,736
Total	44,496	219,958	272,510
	71,201	257,677	344,000

Risk Management: Credit risk continued
Balance sheet analysis continued
Financial Assets: Industry and geographical analysis continued
The tables below analyses total financial assets net of provisions, by geography and by industry.

2010	Loans and advances €m	Securities €m	Derivatives €m	Other (1) €m	Total €m	Netting and offset (2) €m
Netherlands						
Central and local government	372	19,081	-	-	19,453	-
Finance	7,671	18,900	3,550	28	30,149	-
Residential mortgages	425	-	-	-	425	-
Personal lending	6	72	-	-	78	-
Property	245	49	24	-	318	-
Construction	388	7	2	-	397	-
Manufacturing	1,745	90	1	-	1,836	-
Service industries and business activities	4,703	763	68	-	5,534	-
Agriculture, forestry and fishing	65	-	-	-	65	-
Finance lease and instalment credit	-	-	-	-	-	-
Interest accruals	73	661	-	-	734	-
Total net of provisions	15,693	39,623	3,645	28	58,989	-
US						
Central and local government	163	34	-	-	197	-
Finance	472	109	-	402	983	-
Residential mortgages	-	-	-	-	-	-
Personal lending	-	-	-	-	-	-
Property	18	-	-	-	18	-
Construction	2	-	-	-	2	-
Manufacturing	606	-	-	-	606	-
Service industries and business activities	540	21	33	-	594	-
Agriculture, forestry and fishing	-	-	-	-	-	-
Finance lease and instalment credit	-	-	-	-	-	-
Interest accruals	10	-	-	-	10	-
Total net of provisions	1,811	164	33	402	2,410	-
Rest of world						
Central and local government	1,007	6,923	383	7	8,320	-
Finance	31,117	26,404	21,644	3,428	82,593	7,865
Residential mortgages	533	-	-	-	533	-
Personal lending	240	-	-	-	240	-

Property	780	4	118	-	902	-
Construction	522	39	45	-	606	-
Manufacturing	6,599	80	403	-	7,082	-
Service industries and business activities	12,558	1,090	2,001	-	15,649	2
Agriculture, forestry and fishing	98	-	-	-	98	-
Finance lease and instalment credit	54	-	-	-	54	-
Interest accruals	189	567	-	-	756	-
Total net of provisions	53,697	35,107	24,594	3,435	116,833	7,867

For notes to this table refer to page 52.

Risk Management: Credit risk continued
Balance sheet analysis continued
Financial Assets: Industry and geographical analysis continued

2009	Loans and advances €m	Securities €m	Derivatives €m	Other (1) €m	Total €m	Netting and offset (2) €m
Netherlands						
Central and local government	1,658	38,403	16	-	40,077	-
Finance	21,630	27,670	5,770	13	55,083	-
Residential mortgages	101,988	-	259	-	102,247	-
Personal lending	169	-	194	-	363	-
Property	3,839	15	374	4	4,232	-
Construction	848	-	6	1	855	-
Manufacturing	5,470	23	76	-	5,569	-
Service industries and business activities	23,740	351	1,001	59	25,151	-
Agriculture, forestry and fishing	4,814	32	23	-	4,869	-
Finance lease and instalment credit	-	-	-	-	-	-
Interest accruals	787	-	847	-	1,634	-
Total net of provisions	164,943	66,494	8,566	77	240,080	-
US						
Central and local government	92	19	-	-	111	-
Finance	334	105	22	370	831	-
Residential mortgages	-	-	-	-	-	-
Personal lending	-	-	-	-	-	-
Property	69	-	-	-	69	-
Construction	-	-	-	-	-	-
Manufacturing	1,723	25	-	-	1,748	-
Service industries and business activities	1,888	-	34	-	1,922	-
Agriculture, forestry and fishing	-	-	-	-	-	-
Finance lease and instalment credit	-	-	-	-	-	-
Interest accruals	14	-	-	-	14	-
Total net of provisions	4,120	149	56	370	4,695	-
Rest of world						
Central and local government	873	10,174	85	37	11,169	3
Finance	51,736	13,087	45,191	2,167	112,181	7,243
Residential mortgages	-	14	-	-	14	-
Personal lending	2,848	-	2	1	2,851	45
Property	1,267	502	110	115	1,994	-

Construction	542	412	16	19	989	-
Manufacturing	10,369	1,758	2,762	115	15,004	74
Service industries and business activities	20,098	7,898	604	852	29,452	33
Agriculture, forestry and fishing	255	237	-	10	502	-
Finance lease and instalment credit	19	14	-	-	33	-
Interest accruals	607	1,296	-	2	1,905	-
Total net of provisions	88,614	35,392	48,770	3,318	176,094	7,398

For notes to this table refer to page 52.

Risk Management: Credit risk continued
Balance sheet analysis continued
Industry and geographical analysis continued

2008	Loans and advances €m	Securities €m	Derivatives €m	Other (1) €m	Total €m	Netting and offset (2) €m
Netherlands						
Central and local government	621	21,155	226	-	22,002	-
Finance	25,207	27,525	17,950	3,658	74,340	-
Residential mortgages	100,774	-	-	-	100,774	-
Personal lending	3,696	-	202	-	3,898	-
Property	3,824	9	-	-	3,833	-
Construction	1,137	-	-	-	1,137	-
Manufacturing	8,836	-	-	-	8,836	-
Service industries and business activities	24,058	10,893	2,726	88	37,765	-
Agriculture, forestry and fishing	4,576	-	-	-	4,576	-
Finance lease and instalment credit	-	-	-	-	-	-
Interest accruals	1,103	1,088	87	-	2,278	-
Total net of provisions	173,832	60,670	21,191	3,746	259,439	-
US						
Central and local government	137	221	-	-	358	-
Finance	5,042	983	2,500	324	8,849	-
Residential mortgages	-	-	-	-	-	-
Personal lending	-	-	-	-	-	-
Property	109	-	-	-	109	-
Construction	-	-	-	-	-	-
Manufacturing	2,854	-	-	-	2,854	-
Service industries and business activities	3,045	379	-	-	3,424	-
Agriculture, forestry and fishing	-	-	-	-	-	-
Finance lease and instalment credit	-	-	-	-	-	-
Interest accruals	-	2	-	-	2	-
Total net of provisions	11,187	1,585	2,500	324	15,596	-
Rest of world						
Central and local government	7,662	11,453	1,929	16	21,060	367

Finance	91,585	23,083	151,691	2,477	268,836	97,748
Residential mortgages	-	23	4	-	27	-
Personal lending	5,376	1	24	-	5,401	53
Property	2,034	418	66	72	2,590	43
Construction	794	107	61	27	989	7
Manufacturing	16,819	1,574	6,588	130	25,111	2,587
Service industries and business activities	31,455	6,256	1,151	937	39,799	926
Agriculture, forestry and fishing	358	107	-	14	479	-
Finance lease and instalment credit	114	21	-	-	135	30
Interest accruals	2,784	491	4	5	3,284	-
Total net of provisions	158,981	43,534	161,518	3,678	367,711	101,761

Notes:

(1) Includes settlement balances.

(2) This shows the amount by which the Group's credit risk exposure is reduced through arrangements, such as master netting agreements, which give the Group a legal right to set-off the financial asset against a financial liability due to the same counterparty. In addition, the Group holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade debtors; and guarantees of lending from parties other than the borrower. The Group obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

Risk Management: Credit risk continued
Balance sheet analysis continued

Asset quality
The asset quality analysis presented below is based on the Group's internal asset quality ratings which have ranges for the probability of default, as set out below. Customers are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades across the Group map to both a Group level asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across portfolios. Debt securities are analysed by external ratings agencies and are therefore excluded from the table below and set out on page 54.

Asset quality band	Probability of default range
AQ1	0% - 0.03%
AQ2	0.03% - 0.05%
AQ3	0.05% - 0.10%
AQ4	0.10% - 0.38%
AQ5	0.38% - 1.08%
AQ6	1.08% - 2.15%
AQ7	2.15% - 6.09%
AQ8	6.09% - 17.22%
AQ9	17.22% - 100%
AQ10	100%

2010	Cash and balances at central banks €m	Loans and advances to banks €m	Loans and advances to customers €m	Settlement balances €m	Derivatives €m	Other financial instruments €m	Commitments €m	Contingent liabilities €m	Total €m
AQ1	7,923	12,758	11,047	3,174	12,200	235	13,289	4,844	65,470
AQ2	15	587	2,620	122	1,444	-	3,622	1,217	9,627
AQ3	53	732	4,431	11	1,140	-	4,168	2,687	13,222

AQ4	216	565	9,001	(1)	1,402	-	7,604	4,114	22,901
AQ5	111	2,502	7,069	5	945	-	4,066	1,757	16,455
AQ6	-	170	2,956	1	80	-	943	275	4,425
AQ7	-	131	2,973	-	229	-	1,129	1,725	6,187
AQ8	-	-	794	-	135	-	2,126	10,786	13,841
AQ9	-	118	1,333	-	193	-	319	509	2,472
AQ10	5	89	1,373	2	257	-	726	170	2,622
Balances with RBS Group	-	9,039	128	259	10,247	-	2	661	20,336
Accruing past due	-	4	190	-	-	-	-	-	194
Impaired	-	55	2,108	-	-	434	-	-	2,597
Impairment provision	-	(45)	(1,527)	-	-	(33)	-	-	(1,605)
Total	8,323	26,705	44,496	3,573	28,272	636	37,994	28,745	178,744
2009									
AQ1	28,382	22,775	21,047	3,298	20,343	370	6,676	4,762	107,653
AQ2	-	1,100	6,085	-	1,313	-	5,872	4,190	18,560
AQ3	-	309	10,762	-	694	-	5,911	4,219	21,895
AQ4	-	670	45,156	-	3,576	-	18,736	13,372	81,510
AQ5	-	3,156	55,390	-	3,091	-	6,693	4,776	73,106
AQ6	-	423	23,592	-	438	-	1,664	1,187	27,304
AQ7	-	96	24,366	-	445	-	1,855	1,325	28,087
AQ8	-	179	13,644	-	226	-	1,577	1,125	16,751
AQ9	-	267	10,480	-	247	-	1,902	1,358	14,254
AQ10	-	89	2,873	-	82	-	634	452	4,130
Balances with RBS Group	-	8,611	1,602	100	26,937		-	1	37,251
Accruing past due	-	-	2,626	-	-	-	-	-	2,626
Impaired	-	119	7,971	-	-	-	-	-	8,090
Impairment provision	-	(75)	(5,636)	-	-	-	-	-	(5,711)
Total	28,382	37,719	219,958	3,398	57,392	370	51,520	36,767	435,506

Risk Management: Credit risk continued
Balance sheet analysis continued
Asset quality continued

2008	Cash and balances at central banks €m	Loans and advances to banks €m	Loans and advances to customers €m	Settlement balances €m	Derivatives €m	Other financial instruments €m	Commitments €m	Contingent liabilities €m	Total €m
AQ1	2,927	31,174	41,527	3,757	58,222	164	18,831	211	156,813
AQ2	585	6,235	8,305	729	11,644	33	3,766	42	31,339
AQ3	1,171	12,469	16,611	1,457	23,289	65	7,533	84	62,679
AQ4	1,171	12,879	34,425	1,457	24,804	65	12,974	6,617	94,392
AQ5	-	1,022	40,030	-	4,182	-	7,947	15,173	68,354
AQ6	-	679	42,320	-	2,956	-	3,153	10,853	59,961
AQ7	-	199	60,315	-	867	-	1,942	6,639	69,962
AQ8	-	322	10,140	-	1,164	-	3,124	1,084	15,834
AQ9	-	322	10,140	-	1,164	-	3,124	1,084	15,834
AQ10	-	107	3,442	-	388	-	1,042	361	5,340
Balances with RBS Group	-	6,080	797	267	56,529	-	-	-	63,673
Accruing past due	-	-	3,004	-	-	-	-	-	3,004
Impaired	-	48	5,972	-	-	-	-	-	6,020
Impairment provision	-	(46)	(4,518)	-	-	-	-	-	(4,564)
Total	5,854	71,490	272,510	7,667	185,209	327	63,436	42,148	648,641

Debt securities
The table below analyses debt securities by issuer and external ratings.

	Central and local government		Banks and building societies	ABS (1)	Corporate	Other	Total
	US €m	Other €m	€m	€m	€m	€m	€m
2010							
AAA	2,328	15,413	184	14,466	430	-	32,821
AA to AA+	-	929	684	2,978	212	-	4,803
A to AA-	-	3,784	121	824	133	-	4,862
BBB- to A-	-	3,031	610	49	54	-	3,744
Non-investment grade	-	1,682	1,760	5	1,912	-	5,359
Unrated	-	-	67	67	537	-	671

Total	2,328	24,839	3,426	18,389	3,278	-	52,260
2009							
AAA	4,636	27,293	3,194	23,367	588	-	59,078
AA to AA+	-	4,497	1,182	845	74	-	6,598
A to AA-	-	9,188	515	75	220	-	9,998
BBB- to A-	-	3,406	1,480	29	1,498	-	6,413
Non-investment grade	-	194	38	59	692	-	983
Unrated	-	526	63	20	752	369	1,730
Total	4,636	45,104	6,472	24,395	3,824	369	84,800
2008							
AAA	5,402	22,984	2,536	29,679	719	-	61,320
BBB- to AA+	-	12,121	2,061	885	1,396	-	16,463
Non-investment grade	-	223	138	926	811	-	2,098
Unrated	-	560	1,248	252	1,615	3,492	7,167
Total	5,402	35,888	5,983	31,742	4,541	3,492	87,048

Note:
(1) Asset-backed securities.

Risk Management: Credit risk continued
Balance sheet analysis continued

Derivatives
The table below analyses the Group's derivative assets by internal credit quality banding and residual maturity. Master netting agreements in respect of mark-to-market (mtm) values set out below do not result in a net presentation in the Group's balance sheet under IFRS.

2010	0 - 3 months €m	3 - 6 months €m	6 - 12 months €m	1 - 5 years €m	Over 5 years €m	Gross assets €m
AQ1	1,745	428	1,741	5,163	3,123	12,200
AQ2	76	7	73	983	305	1,444
AQ3	189	63	90	493	305	1,140
AQ4	531	51	110	585	125	1,402
AQ5	538	12	44	203	148	945
AQ6	13	5	10	45	7	80
AQ7	14	19	9	121	66	229
AQ8	1	-	7	36	91	135
AQ9	105	3	1	44	40	193
AQ10	182	-	10	33	32	257
Balances with RBS Group	2,212	529	513	5,458	1,535	10,247
	5,606	1,117	2,608	13,164	5,777	28,272
Counterparty mtm netting						(2,864)
Cash collateral held against derivative exposures						(1,786)
Net exposure						23,622

Contract type	0 - 3 months €m	3 - 6 months €m	6 - 12 months €m	1 - 5 years €m	Over 5 years €m	Gross assets €m	Counterparty mtm netting €m	Net exposure €m
2010								
Exchange rate	2,018	629	777	3,182	1,139	7,745	(389)	7,356
Interest rate	2,297	187	327	6,008	3,806	12,625	(1,399)	11,226
Credit derivatives	514	3	32	372	676	1,597	(1,076)	521
Equity and commodity	777	298	1,472	3,602	156	6,305	-	6,305
	5,606	1,117	2,608	13,164	5,777	28,272		25,408
Cash collateral held against derivative exposures								(1,786)
Net exposure								23,622
2009								
Exchange rate	3,276	1,329	1,780	6,372	3,193	15,950	(1,821)	14,129
Interest rate	402	349	1,672	14,930	13,197	30,550	(1,728)	28,822
Credit derivatives	140	1	14	1,293	2,226	3,674	(1,255)	2,419

Equity and commodity	1,830	578	1,336	3,165	309	7,218	(2,431)	4,787
	5,648	2,257	4,802	25,760	18,925	57,932		50,157
2008								
Exchange rate	12,870	3,298	5,241	14,921	8,300	44,630	(13,521)	31,109
Interest rate	2,778	1,540	3,250	31,608	46,979	86,155	(55,342)	30,813
Credit derivatives	234	123	812	26,992	16,781	44,942	(30,959)	13,983
Equity and commodity	1,471	1,090	2,710	4,002	209	9,482	(1,056)	8,426
	17,353	6,051	12,013	77,523	72,269	185,209		84,331

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Risk Management: Credit risk continued
Balance sheet analysis continue

Cross border exposures
Cross border exposures are loans and advances including finance leases and instalment credit receivables and other monetary assets, such as debt securities and net derivatives, including non-local currency claims of overseas offices on local residents. The Group monitors the geographical breakdown of these exposures based on the country of domicile of the borrower or guarantor of ultimate risk. Cross border exposures exclude exposures to local residents in local currencies.

The table below sets out the Group's cross border exposures greater than 0.5% of the Group's total assets. None of these countries have experienced repayment difficulties that have required restructuring of outstanding debt.

	2010				2009		2008	
	Government	Banks	Other	Total	Total		Total	
	€m	€m	€m	€m	€m		€m	
United States	2,297	1,466	9,849	13,612	16,844		20,957	
Germany	6,593	1,783	1,374	9,750	16,725		15,572	
United Kingdom	6	3,604	5,992	9,602	31,697		32,590	
Spain	45	2,770	5,373	8,188	17,913		18,474	
France	2,675	505	1,673	4,853	12,814		33,595	
India	17	673	3,921	4,611	2,930		4,073	
China	173	1,321	1,595	3,089	1,859	*	2,577	*
Republic of Korea	4	185	2,730	2,919	2,276	*	2,068	*
Belgium	841	386	815	2,042	5,115		6,784	
Russian Federation	3	370	1,661	2,034	1,706	*	3,744	
Italy	1,074	175	683	1,932	6,135		6,419	
Luxembourg	29	304	1,505	1,838	4,147		5,027	
Switzerland	0	596	1,229	1,825	1,715	*	2,189	*
Turkey	398	170	1,099	1,667	2,022	*	3,154	*
Hong Kong	23	350	1,245	1,618	1,568	*	1,899	*
Greece	1,040	27	246	1,313	3,595		3,985	
Cayman Islands	0	98	1,149	1,247	1,055	*	4,039	
Sweden	34	356	833	1,223	2,110	*	1,811	*
Mexico	0	61	1,058	1,119	1,174	*	1,182	*
Brazil	710	146	254	1,110	461	*	935	*
Republic of Ireland	112	200	727	1,039	4,304		6,427	
Taiwan	434	148	438	1,020	614	*	332	*

* Less than 0.5% of Group total assets.

Risk Management: Credit risk continued

Risk elements in lending and impairments

The Group classifies impaired assets as either risk elements in lending (REIL) or potential problem loans (PPL). REIL represents impaired loans, and loans that are accruing but are past due 90 days. PPL represents impaired assets which are not included in REIL, but where information about possible credit problems cause management to have serious doubts about the future ability of the borrower to comply with loan repayment terms.

Both REIL and PPL are reported gross and take no account of the value of any security held which could reduce the eventual loss should it occur, nor of any provision marked. Therefore impaired assets which are highly collateralised, such as mortgages, will have a low coverage ratio of provisions held against the reported impaired balance.

The analysis of risk elements in lending and impairments below, form a key part of the data provided to senior management on the credit performance of the Group's portfolios.

The table below analyses the Group's REIL and PPL and takes no account of the value of any security held which could reduce the eventual loss, should it occur, nor of any provisions.

	2010			2009			2008
	Core	Non-Core	Group	Core	Non-Core	Group	Group
	€m	€m	€m	€m	€m	€m	€m
Impaired loans (1)							
Domestic	133	312	445	130	5,268	5,398	3,429
Foreign	541	1,178	1,719	776	1,915	2,691	2,592
	674	1,490	2,164	906	7,183	8,089	6,021
Accruing loans past due 90 days or more (2)							
Domestic	48	3	51	56	36	92	63
Foreign	5	4	9	31	30	61	55
	53	7	60	87	66	153	118
Total REIL	727	1,497	2,224	993	7,249	8,242	6,139
Potential problem loans (3)							
Domestic	3	10	13	94	72	166	239
Foreign	40	80	120	59	307	366	433
Total PPL	43	90	133	153	379	532	672
REIL as a % of gross loans to customers (4)			4.8 %			3.9 %	2.3 %
REIL and PPL as a % of gross loans to customers (4)			5.1 %			4.1 %	2.6 %

Notes:

(1) Loans which have defaulted and against which an impairment provision is held.

(2) Loans where an impairment event has taken place but no impairment recognised. This category is used for fully collateralised non-revolving credit facilities.

(3)

Loans for which an impairment event has occurred but no impairment provision is necessary. This category is used for advances and revolving credit facilities where the past due concept is notapplicable.

(4) Excludes reverse repos.

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Risk Management: Credit risk continued

Movement in REIL and PPL

The table below details the movement in REIL and PPL for the year ended 31 December 2010.

	REIL			PPL			Total		
	Core	Non-Core	Total	Core	Non-Core	Total	Core	Non-Core	Total
	€m	€m	€m	€m	€m	€m	€m	€m	€m
At 1 January 2010	993	7,249	8,242	153	379	532	1,146	7,628	8,774
Currency translation and other adjustments	45	(3,248)	(3,203)	4	(13)	(9)	49	(3,261)	(3,212)
Additions	189	500	689	1,035	291	1,326	1,224	791	2,015
Transfers	83	46	129	(83)	(46)	(129)	-	-	-
Disposals, restructurings and repayments	(461)	(760)	(1,221)	(1,065)	(521)	(1,586)	(1,526)	(1,281)	(2,807)
Amounts written-off	(122)	(2,290)	(2,412)	(1)	-	(1)	(123)	(2,290)	(2,413)
At 31 December 2010	727	1,497	2,224	43	90	133	770	1,587	2,357

Past due analysis

The following loans and advances to customers were past due at the balance sheet date but not considered impaired:

	2010			2009			2008
	Core	Non-Core	Total	Core	Non-Core	Total	Total
	€m	€m	€m	€m	€m	€m	€m
Past due 1-29 days	11	40	51	126	1,590	1,716	1,745
Past due 30-59 days	22	20	42	11	520	531	840
Past due 60-89 days	10	30	40	12	214	226	301
Past due 90 days or more	53	7	60	87	66	153	118
	96	97	193	236	2,390	2,626	3,004

Note:

Includes collectively assessed balances that are past due as a result of administrative and other delays in recording payments or in finalising documentation and other events unrelated to credit quality.

Risk Management: Credit risk continued
Loans, REIL and impairments by industry and geography

The tables below analyse gross loans and advances to customers (excluding reverse repos), REIL, provisions, impairment charges and amounts written-off relating to these loans, by industry and geography (by location of office).

	2010							
	Gross loans €m	REIL €m	Provisions €m	REIL as a % of loans %	Provisions as a % of REIL %	Provisions as a % gross loans %	Impairment charge €m	Amounts written-off €m
Central and local government	1,544	-	-	0.0 %	0.0 %	0.0 %	66	-
Finance	13,083	570	372	4.4 %	65.2 %	2.8 %	157	46
Residential mortgages	984	54	26	5.5 %	48.1 %	2.6 %	22	1
Personal lending	427	331	290	77.5 %	87.7 %	68.0 %	29	266
Property	1,110	112	62	10.1 %	55.4 %	5.6 %	-	-
Construction	919	8	8	0.9 %	98.8 %	0.9 %	4	2
Manufacturing	9,213	398	260	4.3 %	65.3 %	2.8 %	(253)	1,555
Service industries and business activities	18,297	692	391	3.8 %	56.6 %	2.1 %	17	60
Agriculture, forestry and fishing	165	4	2	2.4 %	50.0 %	1.0 %	1	-
Finance leases and instalment credit	54	-	-	-	-	-	-	-
Interest accruals	227	-	-	-	-	-	-	-
Latent	-	-	116				77	-
	46,023	2,169	1,527	4.7 %	70.4 %	3.3 %	120	1,930
of which:								
Domestic	9,844	574	223	5.8 %	38.9 %	2.3 %	80	1,506
Foreign	36,179	1595	1304	4.4 %	81.8 %	3.6 %	40	424
Total	46,023	2,169	1,527	4.7 %	70.4 %	3.3 %	120	1,930

	2009							
	Gross loans €m	REIL €m	Provisions €m	REIL as a % of loans %	Provisions as a % of REIL %	Provisions as a % gross loans %	Impairment charge €m	Amounts written-off €m
Central and local government	2,623	3	1	0.1 %	33.3 %	0.0 %	1	16
Finance	36,811	966	513	2.6 %	53.1 %	1.4 %	497	247
Residential mortgages	102,678	473	104	0.5 %	22.0 %	0.1 %	116	73

Personal lending	3,026	678	-	22.4 %	0.0 %	0.0 %	208	139
Property	5,324	229	148	4.3 %	64.6 %	2.8 %	104	47
Construction	1,426	51	36	3.6 %	70.6 %	2.5 %	20	16
Manufacturing	19,890	3,101	2,328	15.6 %	75.1 %	11.7 %	1,044	278
Service industries and business activities	47,503	2,338	1,778	4.9 %	76.0 %	3.7 %	699	441
Agriculture, forestry and fishing	5,202	284	133	5.5 %	46.8 %	2.6 %	94	18
Finance leases and instalment credit	19	-	-	-	-	-	-	-
Interest accruals	1,092	-	-	-	-	-	-	-
Latent	-	-	595				(19)	-
	225,594	8,123	5,636	3.6 %	69.4 %	2.5 %	2,764	1,275
of which:								
Domestic	159,119	5,490	4,085	3.5 %	74.4 %	2.6 %	1,644	756
Foreign	66,475	2,633	1,551	4.0 %	58.9 %	2.3 %	1,120	519
Total	225,594	8,123	5,636	3.6 %	69.4 %	2.5 %	2,764	1,275

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Risk Management: Credit risk continued
Impairment loss provision methodology
There are two components to the Group's loan impairment provisions:

- Individually assessed provisions: provisions required for individually significant impaired assets which are assessed on a case by case basis, taking into account the financial condition of the counterparty and any guarantee and other collateral held after being stressed for downside risk. This incorporates an estimate of the discounted value of any recoveries and realisation of security or collateral. The asset continues to be assessed on an individual basis until it is repaid in full, transferred to the performing portfolio or written-off;

- Collectively assessed provisions: provisions on impaired credits below an agreed threshold which are assessed on a portfolio basis, to reflect the homogeneous nature of the assets, such as credit cards or personal loans. The provision is determined from a quantitative review of the relevant portfolio, taking account of the level of arrears, security and average loss experience over the recovery period. It incorporates loss experience adjustments, where appropriate, in the light of current economic and credit conditions. These include review of current cash collections profile performance against historic trends, updates to metric inputs - including model recalibrations and monitoring of operational processes used in managing exposure – including the time taken to process non-performing exposures; and

- Latent loss provisions: provisions held against impairments in the performing portfolio that have been incurred as a result of events occurring before the balance sheet date but which have not been identified at the balance sheet date. The Group has developed methodologies to estimate latent loss provisions that reflect:

– Historical loss experience adjusted where appropriate, in light of current economic and credit conditions; and

– The period ('emergence period') between an impairment event occurring and a loan being identified and reported as impaired.

- Recoverable cash flows or proceeds are estimated using two parameters: loss given default (LGD) - this is the estimated loss amount, expressed as a percentage, that will be incurred if the borrower defaults; and the probability that the borrower will default (PD).

- Emergence periods are estimated at a portfolio level and reflect the portfolio product characteristics such as a coupon period and repayment terms, and the duration of the administrative process required to report and identify an impaired loan as such. Emergence periods vary across different portfolios from 2 to 225 days. They are based on actual experience within the particular portfolio and are reviewed regularly.

Once a loss event has occurred, a loan is assessed for an impairment provision. In the case of loans that are restructured due to the financial condition of the borrower, the loss event and consequent loan impairment provision assessment (based on management's best estimate of the incurred loss) almost invariably take place prior to the restructuring. The quantum of the loan impairment provision may change once the terms of the restructuring are known resulting in an additional provision charge or a release of provision in the period in which the restructuring takes place.

Provision and AFS reserves analyses

The Group's consumer portfolios, which consist of high volume, small value credits, have highly efficient largely automated processes for identifying problem credits and very short timescales, typically three months, before resolution or adoption of various recovery methods. Corporate portfolios consist of higher value, lower volume credits, which tend to be structured to meet individual customer requirements.

Provisions are assessed on a case by case basis by experienced specialists with input from professional valuers and accountants. The Group operates a transparent provisions governance framework, setting thresholds to trigger enhanced oversight and challenge.

Analysis of provisions is set out on page 59.

Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs and are subsequently measured at fair value with changes in fair value reported in shareholders' equity until disposal, at which stage the cumulative gain or loss is recognised in profit or loss. When there is objective evidence that an available-for-sale financial asset is impaired, any decline in its fair value below original cost is removed from equity and recognised in profit or loss.

Impairment losses are recognised when there is objective evidence of impairment. The Group reviews its portfolios of available-for-sale financial assets for such evidence which includes: default or delinquency in interest or principal payments; significant financial difficulty of the issuer or obligor; and it becoming probable that the issuer will enter bankruptcy or other financial reorganisation. However, the disappearance of an active market because an entity's financial instruments are no longer publicly traded is not evidence of impairment. Furthermore, a downgrade of an entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortised cost is not necessarily evidence of impairment. Determining whether objective evidence of impairment exists requires the exercise of management judgment.

Analysis of AFS debt securities and related AFS reserves are set out on page 63.

Risk Management: Credit risk continued

Movement in loan impairment provisions

The movement in provisions balance by division is shown in the table below.

	2010	2009	2008
2010	€m	€m	€m
At 1 January	5,711	4,564	3,001
Transfer to disposal groups	(2,377)	756	(293)
Currency translation and other adjustments	74	151	83
Disposal of subsidiaries	-	(73)	-
Amounts written-off	(1,943)	(1,275)	(857)
Recoveries of amounts previously written-off	59	10	43
Charged to the income statement	60	1,621	2,611
Unwind of discount	(12)	(43)	(24)
At 31 December	1,572	5,711	4,564
Individually assessed:			
- banks	45	75	46
- customers	1,261	4,365	1,225
Collectively assessed	150	676	2,649
Latent	116	595	644
	1,572	5,711	4,564

Risk Management: Credit risk continued
Analysis of loan impairment charge
The following table analyses impairment losses.

	2010 €m	2009 €m	2008 €m
Latent loss	(120)	(125)	236
Collectively assessed	101	11	287
Individually assessed	79	1,735	2,088
Charge to income statement continuing operations	60	1,621	2,611
Loans to customers	75	1,591	2,565
Loans to banks	(15)	30	46
Securities	7	2	309
Charge to income statement continuing operations	67	1,623	2,920
Charge to income statement discontinuing operations	45	1,172	776
Charge to income statement	112	2,795	3,696
Charge relating to customer loans as a % of gross customer loans (1)	0.2%	1.2%	1.3%

Note:
(1) Gross of provisions and excluding reverse repurchase agreements.

	2010			2009			2008
	Core €m	Non-Core €m	Group €m	Core €m	Non-Core €m	Group €m	Group €m
Loan impairment losses							
- customers	29	46	75	173	1,418	1,591	2,565
- banks	6	(21)	(15)	5	25	30	46
	35	25	60	178	1,443	1,621	2,611
Impairment losses on securities							
- debt securities	-	7	7	-	-	-	-
- equity securities	-	-	-	2	-	2	309
Charge to income statement continuing operations	35	32	67	180	1,443	1,623	2,920
Charge to income statement discontinuing operations	-	45	45	-	1,172	1,172	776

Credit risk: Available-for-sale debt securities and related reserves

Available-for-sale (AFS) debt securities and related AFS reserves relating to securities issued by governments and other entities by country.

	2010				
	Government	ABS	Other	Total	AFS reserve
	€m	€m	€m	€m	€m
Netherlands	3,526	7,113	171	10,810	(720)
Germany	6,680	1,331	132	8,143	(25)
Spain	45	7,838	-	7.883	(1,143)
France	2,729	623	5	3,357	(50)
USA	2,294	164	124	2,582	4
Italy	1,050	196	-	1,246	(99)
Greece	1,038	-	-	1,038	(600)
Belgium	877	-	-	877	(47)
India	636	-	161	797	2
Hong Kong	759	-	7	766	2
Denmark	730	-	-	730	0
Austria	314	60	154	528	(23)
China	499	-	1	500	(1)
Sweden	34	312	-	346	(2)
Romania	302	-	-	302	(5)
South Korea	302	-	-	302	1
Ireland	115	170	-	285	(75)
UK	-	242	8	250	(21)
Singapore	211	-	24	235	1
Portugal	107	123	-	230	(41)
Malaysia	193	-	-	193	0
Other	1,069	217	196	1,482	312
Total	23,510	18,389	983	42,882	(2,530)

Key points

- The Group holds €42.9 billion of debt securities classified as available-for-sale, the majority of which forms part of the treasury liquidity buffer. Of the portfolio, €20.4 billion is OECD government issued debt, comprising exposures to European (€17.5 billion) and US (€2.3 billion) governments and government-related entities. Included therein are €1.0 billion Greek sovereign debt positions, with unrealised losses of €600 million net of tax.

- Further positions in financial investments comprise €18.4 billion of mortgage and other asset-backed securities. The composition of this portfolio has not changed substantially from 31 December 2009 as disclosed on page 72 of the business review.

Market risk

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

RBS Group provides services to the Group to enable appropriate market risk management within the Group.

Organisation and structure

The Executive Risk Forum approves market risk appetite for trading and non-trading activities for RBS Group. The Global Head of Market & Insurance Risk is responsible for the Group Market Risk Control Framework and under delegated authority from the Executive Risk Forum, sets a limit framework within the context of the approved market risk appetite, which is cascaded down through legal entity, division, business and desk level market risk limits. The market risk appetite for the Group is approved by the Managing Board and Supervisory Board.

A daily report summarising the Group's market risk exposures including exposures against agreed limits is sent to Head of Group Market Risk and appropriate business Risk Managers.

The head of each business, assisted by the business risk management team, is accountable for all market risks associated with its activities. Oversight and support is provided to the business by the Global Head of Market & Insurance Risk for RBS Group, assisted by the Group and business Market Risk teams. The Global Market Risk Committee for RBS Group reviews and makes recommendations concerning the market risk profile across the RBS Group, including risk appetite, limits and utilisation. The Committee meets monthly and is chaired by the Global Head of Market Risk & Insurance Risk for RBS Group. Attendees include respective business Risk Managers and Group Market Risk.

Risk measurement and control

At RBS Group level, the risk appetite is expressed in the form of a combination of VaR, sensitivity and stress testing limits. VaR is a technique that produces estimates of the potential change in the market value of a portfolio over a specified time horizon at given confidence level. For internal risk management purposes, RBS Group's VaR assumes a time horizon of one trading day and a confidence level of 99%. RBS Group's VaR model is based on a historical simulation model, utilising data from the previous two years.

At the Group level a different VaR model is employed. It remains based on a historical simulation model and assumes a time horizon of one trading day and a confidence level of 99%. However, it uses 401 observations of historic market data exponentially weighted with a weighted average history of 6 months.

The VaR model employed by the Group has been approved by DNB to calculate regulatory capital for the trading book. The approval covers general market risk in interest rate, currency, equity and commodity products and specific risk in interest rate and equity products.

As the VaR model is an important market risk measurement and control tool and is used for determining a significant component of the market risk capital, it is regularly assessed. The main approach employed is the technique known as back-testing which counts the number of days when a loss exceeds the corresponding daily VaR estimate, measured at a 99% confidence level. The VaR model is categorised as green, amber or red. A green model is consistent with a good working model and is achieved for models that have four or less back-testing exceptions in a 12 month period. For the Group's trading book, a green model status was maintained throughout 2010.

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

- Historical Simulation VaR may not provide the best estimate of future market movements. It can only provide a prediction of the future based on events that occurred in the historical time series used. Therefore, events that are more severe than those in the historical data series cannot be predicted.

- The use of a 99% confidence level does not reflect the extent of potential losses beyond that percentile.

- The use of a one-day time horizon will not fully capture the profit and loss implications of positions that cannot be liquidated or hedged within one day.

- The Group computes the VaR of trading portfolios at the close of business. Positions may change substantially during the course of the trading day and intra-day profit and losses will be incurred.

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

A risk not in VaR framework has been developed to quantify those market risks not adequately captured by the market standard VaR methodology. Where risks are not included in the model, various non-VaR controls (for example, position monitoring, sensitivity limits, triggers or stress limits) are in place.

Market risk continued

The Group undertakes daily stress testing to identify the potential losses in excess of VaR. Stress testing is used to calculate a range of trading book exposures which result from extreme market events. Stress testing measures the impact of exceptional changes in market rates and prices on the fair value of the Group's trading portfolios. The Group calculates historical stress tests and hypothetical stress tests.

Historical stress tests calculate the loss that would be generated if the market movements that occurred during historical market events were repeated. Hypothetical stress tests calculate the loss that would be generated if a specific set of adverse market movements were to occur.

The RBS Group Global Market Risk Stress Testing Committee reviews and discusses all matters relating to Market Risk Stress Testing. Stress test exposures are discussed with senior management and relevant information is reported to the RBS Group Risk Committee, Executive Risk Forum and the Board. Breaches in RBS Group's market risk stress testing limits are monitored and reported. A range of historic stress tests are calculated specifically for the Group on a daily basis and are reported to the Group Risk Control Committee.

In addition to VaR and stress testing, the Group calculates a wide range of sensitivity and position risk measures, for example interest rate ladders or option revaluation matrices. These measures provide valuable additional controls, often at individual desk or strategy level.

Model validation governance

Pricing models are developed and owned by the front office. Where pricing models are used as the basis of books and records valuations, they are all subject to independent review and sign-off. Models are assessed by the RBS Group Model Product Review Committee (GMPRC) as having either immaterial or material model risk (valuation uncertainty arising from choice of modelling assumptions), the assessment being made on the basis of expert judgement. Those models assessed as having material model risk are prioritised for independent quantitative review. Independent quantitative review aims to quantify model risk (i.e., the impact of missing risk factors in the front office model or the possibility that we may be mismarking these products relative to other market participants who may be using an alternative model) by comparing model outputs against alternative independently developed models.

The results of the independent quantitative review are used by Market Risk to inform risk limits and by Finance to inform reserves. Governance over this process is provided by GMPRC, a forum which brings together Front Office Quantitative Analysts, Market Risk, Finance and Quantitative Research Centre (QuaRC), RBS Group Risk's independent quantitative model review function.

Risk (market risk, incremental default risk, counterparty credit risk) models are developed both within business units and by RBS Group functions. Risk models are also subject to independent review and sign-off.

During 2010 the risk systems and market data history used by the Group to calculate sensitivities, VaR and stress testing for the majority of its portfolios containing market risk have been migrated to those used for similar exposures in the rest of the RBS Group.

Traded portfolios

The primary focus of RBS Group's trading activities is to provide an extensive range of debt and equity financing, risk management and investment services to its customers, including private clients and major corporations and financial institutions around the world. The Group's activity is organised similarly to the rest of RBS Group's trading activity. This is organised along six principal business lines: money markets; rates flow trading; currencies and commodities; equities; credit markets and portfolio management & origination. Financial instruments held in the Group's trading portfolios include, but are not limited to: debt securities, loans, deposits, equities, securities sale and repurchase agreements and derivative financial instruments (futures, forwards, swaps and options).

The Group participates in exchange traded and over-the-counter (OTC) derivatives markets. The Group buys and sells financial instruments that are traded or cleared on an exchange, including interest rate swaps, futures and options. Holders of exchange traded instruments provide margin daily with cash or other security at the exchange, to which the holders look for ultimate settlement.

The Group also buys and sells financial instruments that are traded OTC, rather than on a recognised exchange. These instruments range from commoditised transactions in derivative markets, to trades where the specific terms are tailored to the requirements of the Group's customers. In many cases, industry standard documentation is used, most commonly in the form of a master agreement, with individual transaction confirmations.

Market risk continued

The VaR for the trading portfolios segregated by type of market risk exposure, including idiosyncratic risk, is presented in the table below.

	2010				2009			
Trading VaR summary	Average €m	Period end €m	Maximum €m	Minimum €m	Average €m	Period end €m	Maximum €m	Minimum €m
Interest rate	5.6	4.1	10.1	2.8	25.8	14.1	74.6	9.0
Credit spread	6.3	4.0	9.6	1.7	-	-	-	-
Currency	1.6	2.0	4.7	0.6	5.1	1.7	16.4	0.4
Equity	7.6	7.0	14.8	2.0	11.2	12.0	21.0	2.6
Commodity	0.8	1.1	4.1	0.1	0.8	0.6	2.5	0.3
Diversification	-	(8.7)	-	-	-	(14.3)	-	-
	11.5	9.5	19.0	3.4	24.4	14.1	70.7	7.0

	2008			
	Average €m	Period end €m	Maximum €m	Minimum €m
Interest rate	49.6	68.8	93.8	28.5
Credit spread	-	-	-	-
Currency	8.5	13.9	19.6	2.7
Equity	29.7	19.4	79.9	12.6
Commodity	2.2	2.0	12.7	0.4
Diversification	-	(33.4)	-	-
	57.4	70.7	113.5	30.7

Key points

- 2009 and 2008 VaR figures reflect the inclusion of the Dutch State and Santander acquired businesses existing in the period prior to the legal separation of ABN AMRO Bank on 1 April 2010.

- The average total VaR utilisation fell in 2010 compared with 2009 largely as a result of a reduction in trading book exposure due to transfers of businesses to RBS Group and reduced market volatility experienced throughout the period.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Operational risk is an integral and unavoidable part of the Group's business as it is inherent in the processes it operates to provide services to customers and generate profit for shareholders. An objective of operational risk management is not to remove operational risk altogether, but to manage the risk to an acceptable level, taking into account the cost of minimising the risk as against the resultant reduction in exposure. Strategies to manage operational risk include avoidance, transfer, acceptance and mitigation by controls.

Group policy framework

The RBS Group Policy Framework (GPF) supports a consistent approach to how the Group does business and helps everyone understand their individual and collective responsibilities. It is a core component of the Group's risk appetite framework; it not only supports the risk appetite setting process, it also underpins the control environment.

Work to design, implement and embed GPF has continued throughout 2010 and will extend into 2011. RBS Group's plans for ongoing development of GPF will support increased consistency in risk appetite setting across all risk types faced by the Group, including alignment to RBS Group's strategic business and risk objectives.

Appropriate and effectively implemented Policy Standards are a fundamental component of GPF and support attainment and maintenance of a satisfactory control framework.

The GPF requires consideration and agreement through Group governance of the level of risk appetite the Group has and how this is justifiable in the context of the Group's strategic objectives.

There will be ongoing reassessment of risks, risk appetite and controls within the GPF and where appropriate, potential issues will be identified and addressed to ensure the Group moves in line with the set objectives and remains constantly aligned with these objectives and market practice at all times.

Through our three lines of defence model we obtain assurance that the standards in the GPF are being adhered to and GPF defines requirements for testing and gathering evidence which demonstrates that each division and function is appropriately controlled.

GPF is owned and managed by RBS Group's operational risk function and relies upon RBS Group's operational risk framework for effective implementation and ongoing maintenance.

Three lines of defence model

To ensure appropriate responsibility is allocated for the management, reporting and escalation of operational risk, the Group operates a three lines of defence model which outlines principles for the roles, responsibilities and accountabilities for operational risk management.

1st line of defence	2nd line of defence	3rd line of defence
The businesses	Operational Risk	Group Internal Audit
Accountable for the ownership and day-to-day management and control	Responsible for the implementation and maintenance of the operational	Responsible for providing independent assurance on the design,

of operational risk. Responsible for implementing processes in compliance with Group policies. Responsible for testing key controls and monitoring compliance with Group policies.	risk framework, tools and methodologies. Responsible for oversight and challenge on the adequacy of the risk and control processes operating in the business.	adequacy and effectiveness of the Group’s system of internal controls.

Operational risk continued

RBS Group's Operational Risk Policy Standards (ORPS) are incorporated in the GPF. They provide the direction for delivering effective operational risk management and are designed to enable the consistent identification, assessment, management, monitoring and reporting of operational risk across the Group.

The three lines of defence model and the ORPS apply throughout the Group and are implemented taking into account the nature and scale of the underlying business. The following key operational risk management techniques are included in the ORPS;

- Risk and control assessments: business units identify and assess operational risks to ensure that they are effectively managed, prioritised, documented and aligned to risk appetite;

- Scenario analysis: scenarios for operational risk are used to assess the possible impact of extreme but plausible operational risk loss events. Scenario assessments provide a forward looking basis for managing exposures that are beyond the Group's risk appetite;

- Loss data management: the business units have processes in place to capture operational loss events above certain minimum thresholds. The data is used to enhance the adequacy and effectiveness of controls, identify opportunities to prevent or reduce the impact of recurrence, identify emerging themes, enable formal loss event reporting and inform risk and control assessments and scenario analysis. Escalation of individual events to senior management is determined by the seriousness of the event. Operational loss events are categorised under the following headings:

  – Clients, products and business practices;
  – Technology and infrastructure failures;
  – Employment practices and workplace safety;
  – Internal fraud;
  – External fraud;
  – Execution, delivery and process management;
  – Malicious damage; and
  – Disaster and public safety.

- New product approval process: this process ensures that all new products or significant variations to existing products are subject to a comprehensive risk assessment. Products are evaluated and approved by specialist areas and are subject to executive approval prior to launch; and

- Self Certification Process: this requires management to monitor and report regularly on the internal control framework for which they are responsible, confirming its adequacy and effectiveness. This includes certifying compliance with the requirements of the GPF.

Each business unit must manage its operational risk exposure within an acceptable level, testing the adequacy and effectiveness of controls and other risk mitigants (for example, insurance) regularly and documenting the results. Where material control weaknesses are identified, action plans must be produced and tracked to completion.

Operational risk metrics

Reporting forms an integral part of operational risk management. The Group's risk management processes are designed to ensure that issues are identified, escalated and managed on a timely basis. Exposures for each division are reported through monthly risk and control reports, which provide detail on the risk exposures and action plans. Events that have a material, actual or potential impact on the Group's finances, reputation or customers, are escalated and reported to divisional and Group executive.

Operational risk events by risk category - % of total by value
The charts below show a similar distribution of losses by value across the risk categories, captured at the date the event occurred and updated as losses crystallise.

Note: no losses occurred in the categories 'Employment practices and workplace', 'Disaster and Public safety' or 'Malicious damage'.

Operational risk continued

Fraud prevention

Fraud remains a big challenge to the Group, and the rest of the financial services industry. The Group continues to respond to this threat, continually investing in people and processes for both detective and preventative measures, especially in relation to the impact of organised crime against the Group.

Physical security

The Group continues to implement strong security measures to ensure the safety of our staff, our customers and our businesses from physical harm. Against an ever-changing threat environment, these measures are kept under constant review and adapted accordingly. The Group also continues to mitigate against the threat posed by international related terrorism.

Information security

The Group is committed to protecting customer, employee and Group information with regard to loss of confidentiality, integrity and availability. This extends to all physical and electronic information. All employees and related third parties of the Group are responsible for the protection of Group assets, systems and information. All customer information is treated as confidential and appropriate security is applied to protect the information. Additionally, the Group’s Information Security Policy is reviewed regularly and includes processes for managing and monitoring compliance with the policy. The same standards apply to information controlled by the Group or managed by authorised third parties.

The Group continues to invest in programmes to enhance and maintain information security controls and systems. For example, during 2010 we have risk assessed the Group's externally facing websites and penetration tested those websites that contain confidential, high-risk Group data and established an assurance team to implement an ongoing programme of third party reviews.

Business continuity

The need to ensure the continuity of business across the Group and the management of crisis situations is a key activity within the risk function. Key risks and threats that the Group is consistently monitoring from a business continuity perspective include pandemics, terrorism, environmental impacts and technology disruptions. Business continuity plans are in place to ensure that the Group can continue key products, services, and operations. A consistent crisis management framework has been developed that includes a six step methodology and allows incidents to be managed and resolved through skilled global teams.

Regulatory risk

Regulatory risk arises from the non-adherence to international and national rules and regulations. The Group manages regulatory risk through a regulatory risk and compliance framework that seeks to ensure the Group is in compliance with all banking, securities and anti-money laundering regulations defined by more than 120 different regulatory bodies and central banks across the world. This framework comprises global regulatory risk policies, tracking of regulatory developments, training and awareness, assurance and monitoring and regulatory relationship management.

Global regulatory risk policies

Within the RBS Group Policy Framework (GPF), regulatory risk and compliance policies define minimum standards for all businesses to adhere to on a global basis. These global minimum standards are supplemented by division specific policies where appropriate (product specific or local market specific requirements).

Regulatory developments

Regulatory environments are constantly evolving and it is critical that the Group both understands early on the drivers for this change and be able to assess the potential impact of prospective rules and regulations on the different businesses. The regulatory developments tracker seeks to identify, track and monitor all such material changes and ensure that an appointed senior executive is responsible for assessing the potential impacts on the Group's business. Such activity supports both effective engagement in the regulatory consultation process, and planning for the introduction of new or changed rules and regulations.

Training and awareness

Maintaining compliance with existing rules and regulations requires a continued investment in professional training and maintaining risk awareness. The group undertakes extensive training both with group wide learning initiatives (e.g. anti money laundering) as well as divisional or product specific training. To support the professional development of the Group's regulatory risk staff RBS Group has a comprehensive progressive training programme that is deployed on a global basis.

Assurance and monitoring

Assurance and monitoring activities are key to ensuring that the Group can demonstrate ongoing compliance with existing rules and regulations. Such activities are conducted in both the 1st line and 2nd line of defence. Work to design, implement and embed enhanced monitoring tools was undertaken in 2010 and will continue into 2011.

Regulatory relationship management

The Group is committed to working with its regulators in an open and constructive way as it deals with both the evolution of regulatory frameworks as well as the ongoing compliance to existing rules and regulations.

Reputation risk

Reputation risk is defined as the potential loss in reputation that could lead to negative publicity, loss of revenue, costly litigation, a decline in the customer base or the exit of key Group employees.

Reputation risk can arise from actions taken by the Group or a failure to take action, such as failing to assess the environmental, social or ethical impacts of clients or projects that the Group has provided products or services to.

The Group seeks to safeguard its reputation by considering the impact on the value of its franchise from how it conducts business, its choice of customers and the way stakeholders view the Group. Managing the Group's reputation is the joint responsibility of all employees, and reputational considerations should, as part of standard practise, be integrated into the Group's day-to-day decision making structures.

Reputation risk continued
Currently RBS Group manages reputational risk through a number of functions, RBS Group Communications, RBS Group Sustainability and an RBS Group Environmental, Social and Ethical (ESE) risk management function. The latter function is responsible for assessing ESE risks associated with business engagements and business divisions.

The Managing Board has ultimate responsibility for managing any impact on the reputation of the Group arising from its operations. The RBS Group Sustainability Committee (established at the beginning of 2010) sets the overall strategy and approach for the management of Group Sustainability. However, all parts of the Group take responsibility for reputation management.

Pension risk
The Group is exposed to risk from its defined benefit pension schemes to the extent that the assets of the schemes do not fully match the timing and amount of the schemes' liabilities. Pension scheme liabilities vary with changes to long-term interest rates, inflation, pensionable salaries and the longevity of scheme members as well as changes in legislation. Ultimate responsibility of the Group's pension schemes is separate from Group management. The Group is exposed to the risk that the market value of the schemes' assets, together with future returns and any additional future contributions could be considered insufficient to meet the liabilities as they fall due. In such circumstances, the Group could be obliged, or may choose, to make additional contributions to the schemes.

The RBS AA Pension Scheme in the UK and the Stichting Pensioenfonds RBS Nederland in the Netherlands are the largest of the schemes and the main sources of pension risk. The Trustee or Pension Boards of these schemes are solely responsible for the investment of the schemes' assets which are held separately from the assets of the Group.

Risk appetite and investment policy are agreed by the Trustee or Pension Board with quantitative and qualitative input from the scheme actuaries and investment advisers. The schemes are invested in diversified portfolios of equities, government and corporate fixed-interest and index-linked bonds, and other assets including property. Interest and inflation risks are mitigated partially by investment in suitable physical assets and appropriate derivative contracts.

Other risk exposures

Explanatory note

These disclosures provide information on certain elements of the Group's credit market, the majority of which reside in Non-Core and, to a lesser extent, Global Banking & Markets (GBM).

Definitions of acronyms used in this section are explained in the Glossary of terms on page 232 to 236.

Debt Securities

The Group structures, originates, distributes and trades debt in the form of loan, bond and derivative instruments in all major currencies and debt capital markets in North America, Western Europe, Asia and major emerging markets. The table below analyses the carrying value of the Group's debt securities.

	2010	2009	2008
	€bn	€bn	€bn
Securities issued by central and local governments	27.2	49.7	41.3
Asset-backed securities	18.4	24.4	31.7
Securities issued by corporates, US federal agencies and other entities	3.3	4.2	8.0
Securities issued by banks and building societies	3.4	6.5	6.0
Total debt securities	52.3	84.8	87.0

Asset-backed securities (ABS)

The Group's credit market activities gave rise to risk concentrations in ABS. The Group has exposures to ABS which are predominantly debt securities but can also be held in derivative form. ABS have an interest in an underlying pool of referenced assets. The risks and rewards of the referenced pool are passed onto investors by the issue of securities with varying seniority, by a special purpose entity.

ABS include residential mortgage backed securities (RMBS), commercial mortgage backed securities (CMBS), collateralised debt obligations (CDOs), collateralised loan obligations (CLOs) and other ABS. In many cases the risk on these assets is hedged by way of credit derivative protection purchased over the specific asset or relevant ABS indices. The counterparty to some of these hedge transactions are monoline insurers.

The following tables summarise the Groups' net exposures and carrying values of these securities by geography of the underlying assets at 31 December 2010, 2009 and 2008.

Gross exposures represent the principal amounts relating to ABS. G10 government RMBS comprises securities that are mostly guaranteed by the Dutch government. Net exposures represent the carrying value after taking account of the hedge protection purchased from monoline insurers and other counterparties, but exclude the effect of counterparty credit valuation adjustments. The hedge provides credit protection of both principal and interest cash flows in the event of default by the counterparty. The value of this protection is based on the underlying instrument being protected.

Other risk exposures continued
Asset-backed securities by product, geography and measurement classification

2010	US €m	UK €m	Other Europe €m	RoW (1) €m	Total €m	FVTP(2) HFT(3) €m	AFS (4) €m	LAR(5) €m
Gross exposure								
RMBS: G10 governments	-	-	7,449	-	7,449	-	7,449	-
RMBS: covered bond	160	242	9,887	-	10,289	-	10,289	-
RMBS: prime	-	-	-	-	-	-	-	-
RMBS: non-conforming	-	-	-	-	-	-	-	-
RMBS: sub-prime	-	-	-	-	-	-	-	-
CMBS	-	-	-	-	-	-	-	-
CDOs	-	-	163	-	163	9	154	-
CLOs	-	-	-	-	-	-	-	-
Other ABS	-	-	2,229	31	2,260	-	2,260	-
	160	242	19,728	31	20,161	9	20,152	-
Net exposure								
RMBS: G10 governments	-	-	6,909	-	6,909	-	6,909	-
RMBS: covered bond	164	242	8,724	-	9,130	-	9,130	-
RMBS: prime	-	-	-	-	-	-	-	-
RMBS: non-conforming	-	-	-	-	-	-	-	-
RMBS: sub-prime	-	-	-	-	-	-	-	-
CMBS	-	-	-	-	-	-	-	-
CDOs	-	-	146	-	146	-	146	-
CLOs	-	-	-	-	-	-	-	-
Other ABS	-	-	2,173	31	2,204	-	2,204	-
	164	242	17,952	31	18,389	-	18,389	-

2009	US €m	UK €m	Other Europe €m	RoW (1) €m	Total €m	FVTP(2) HFT(3) €m	AFS (4) €m	LAR(5) €m
Gross exposure								
RMBS: G10 governments	-	-	7,902	106	8,008	106	7,902	-
RMBS: covered bond	55	335	10,786	-	11,176	-	11,176	-
RMBS: prime	-	183	3,165	4	3,352	3,352	-	-
RMBS: non-conforming	-	-	-	-	-	-	-	-
RMBS: sub-prime	-	-	-	9	9	-	9	-
CMBS	-	-	-	-	-	-	-	-
CDOs	5	148	238	-	391	8	234	148
CLOs	-	-	-	-	-	-	-	-
Other ABS	-	-	2,849	29	2,878	429	2,449	-
	60	666	24,940	148	25,814	3,895	21,770	148

Net exposure								
RMBS: G10 governments	-	-	7,735	37	7,772	37	7,735	-
RMBS: covered bond	56	324	10,490	-	10,870	-	10,870	-
RMBS: prime	-	168	2,850	4	3,022	3,022	-	-
RMBS: non-conforming	-	-	-	-	-	-	-	-
RMBS: sub-prime	-	-	-	9	9	-	9	-
CMBS	-	-	-	-	-	-	-	-
CDOs	-	58	200	-	258	-	200	58
CLOs	-	-	-	-	-	-	-	-
Other ABS	-	-	2,434	29	2,463	20	2,443	-
	56	550	23,709	79	24,394	3,079	21,257	58

For notes to these tables refer to page 73.

Other risk exposures continued

Asset-backed securities by product, geography and measurement classification continued

2008	US €m	UK €m	Other Europe €m	RoW (1) €m	Total €m	FVTP(2) HFT(3) €m	AFS (4) €m	LAR(5) €m
Gross exposure								
RMBS: G10 governments	-	-	7,997	48	8,045	48	7,997	-
RMBS: covered bond	46	304	10,507	-	10,857	-	10,858	-
RMBS: prime	-	160	3,568	6	3,734	3,734	-	-
RMBS: non-conforming	-	-	-	-	-	-	-	-
RMBS: sub-prime	2	11	297	19	329	314	14	-
CMBS	195	12	350	39	596	592	-	-
CDOs	3,550	137	329	-	4,016	3,689	327	-
CLOs	349	38	148	-	535	535	-	-
Other ABS	-	-	3,606	27	3,633	258	3,376	-
	4,142	662	26,802	139	31,745	9,170	22,572	-
Net exposure								
RMBS: G10 governments	-	-	7,997	48	8,045	48	7,997	-
RMBS: covered bond	46	304	10,507	-	10,857	-	10,858	-
RMBS: prime	-	160	3,568	6	3,734	3,734	-	-
RMBS: non-conforming	-	-	-	-	-	-	-	-
RMBS: sub-prime	-	2	255	14	271	257	14	-
CMBS	22	12	275	39	348	344	-	-
CDOs	670	-	327	-	997	671	327	-
CLOs	-	34	148	-	182	182	-	-
Other ABS	-	-	3,606	27	3,633	258	3,376	-
	738	512	26,683	134	28,067	5,494	22,572	-

Notes:
(1) Rest of World
(2) Designated as at fair value through profit or loss
(3) Held-for-trading
(4) Available-for-sale
(5) Loans and receivables

Other risk exposures continued
Asset-backed securities by product, geography and measurement classification continued
The table below summarises the ratings levels of ABS carrying values. Credit ratings are based on those from rating agencies Standard & Poor's (S&P), Moody's and Fitch and have been mapped onto the S&P scale.

	AAA	AA to AA+	A to AA-	BBB- to A-	Non-investment grade	Unrated	Total
2010	€m	€m	€m	€m	€m	€m	€m
RMBS: G10 governments	5,136	1,774	-	-	-	-	6,910
RMBS: covered bond	8,241	414	474	-	-	-	9,129
RMBS: prime	-	-	-	-	-	-	-
RMBS: sub-prime	-	-	-	-	-	-	-
CMBS	-	-	-	-	-	-	-
CDOs	-	-	127	19	-	-	146
CLOs	-	-	-		-	-	-
Other ABS	1,088	790	223	31	5	67	2,204
	14,465	2,978	824	50	5	67	18,389
2009							
RMBS: G10 governments	7,634	138	-	-	-	-	7,772
RMBS: covered bond	10,389	406	75	-	-	-	10,870
RMBS: prime	3,022	-	-	-	-	-	3,022
RMBS: sub-prime	9	-	-	-	-	-	9
CMBS	-	-	-	-	-	-	-
CDOs	200	-	-	-	58	-	258
CLOs	-	-	-	-	-	-	-
Other ABS	2,113	301	-	29	-	20	2,463
	23,367	845	75	29	58	20	24,394
2008							
RMBS: G10 governments	8,045	-	-	-	-	-	8,045
RMBS: covered bond	10,858	-	-	-	-	-	10,858
RMBS: prime	3,725	-	-	9	-	-	3,734
RMBS: sub-prime	224	-	-	61	43	-	328
CMBS	562	-	-	31	-	-	593
CDOs	2,243	-	-	742	883	148	4,016
CLOs	495	-	-	35	-	5	535
Other ABS	3527	-	-	8	-	98	3,633
	29,679	-	-	886	926	251	31,742

Key points

- Carrying values of asset-backed securities decreased by €6 billion during 2010 with net reductions across all portfolios.

- The RMBS held for trading positions fully matured or were sold off in 2010. The composition of the remaining AFS portfolio has not changed substantially since 31 December 2009.The available-for-sale RMBS: G10 governments positions are backed by mortgages covered by the Dutch mortgage guarantee scheme. The available-for-sale RMBS: covered bond positions originated largely in Europe and relate mostly to Spanish securities.

- The CDO & CLO exposure decreased significantly due to transfers to RBS Group in the first half of 2009. As part of the transfer, all super senior CDO positions were sold to RBS Group. The remaining available-for-sale portfolio comprises other senior CDOs. The CDO & CLO exposure decreased further in 2010 mainly due to the maturing of positions.

Other risk exposures continued
Non-investment grade and unrated ABS

The table below summarises the carrying values by accounting classification of ABS rated as non-investment grade or not publicly rated:

	Non-investment grade				Unrated			
	HFT	AFS	LAR	Total	HFT	AFS	LAR	Total
2010	€m	€m	€m	€m	€m	€m	€m	€m
RMBS: sub-prime	-	-	-	-	-	-	-	-
CMBS	-	-	-	-	-	-	-	-
CDOs	-	-	-	-	-	-	-	-
CLOs	-	-	-	-	-	-	-	-
Other ABS	-	5	-	-	-	67	-	72
	-	5	-	-	-	67	-	72
2009								
RMBS: sub-prime	-	-	-	-	-	-	-	-
CMBS	-	-	-	-	-	-	-	-
CDOs	-	-	58	-	-	-	-	58
CLOs	-	-	-	-	-	-	-	-
Other ABS	-	-	-	-	20	-	-	20
	-	-	58	-	20	-		78
2008								
RMBS: sub-prime	43	-	-	-	-	-	-	43
CMBS	-	-	-	-	-	-	-	-
CDOs	883	-	-	-	148	-	-	1,031
CLOs	-	-	-	-	5	-	-	5
Other ABS	-	-	-	-	98	-	-	98
	926	-	-	-	251	-	-	1,177

Key points

- The CDO & CLO exposure decreased significantly due to transfers to RBS Group in the first half of 2009.

Other risk exposures continued

Credit valuation adjustments

Credit valuation adjustments (CVA) represent an estimate of the adjustment to arrive at fair value that a market participant would make to incorporate the credit risk inherent in counterparty derivative exposures.

The CVAs are set out below.

	2010 €m	2009 €m	2008 €m
Monoline insurers	1,905	2,107	2,822
CDPCs	-	4	591
Other counterparties	122	211	679
Total CVA adjustments	2,027	2,322	4,092

Monoline insurers

The Group has purchased protection from monolines, mainly against specific asset-backed securities. Monolines specialise in providing credit protection against the principal and interest cash flows due to the holders of debt instruments in the event of default by the debt instrument counterparty. This protection is typically held in the form of derivatives such as credit default swaps (CDSs) referencing underlying exposures held directly or synthetically by the Group.

The gross mark-to-market of the monoline protection depends on the value of the instruments against which protection has been bought. A positive fair value, or a valuation gain, in the protection is recognised if the fair value of the instrument it references decreases. For the majority of trades the gross mark-to-market of the monoline protection is determined directly from the fair value price of the underlying reference instrument, however for the remainder of the trades, the gross mark-to-market is determined using industry standard models.

The methodology employed to calculate the monoline CVA uses CDS spreads and internally assessed recovery levels to determine the market's implied level of expected loss on monoline exposures of different maturities. CVA is calculated at a trade level by applying the expected loss corresponding to each trade's expected maturity to the gross mark-to-market of the monoline protection. The expected maturity of each trade reflects the scheduled notional amortisation of the underlying reference instruments and whether payments due from the monoline insurer are received at the point of default or over the life of the underlying reference instruments.

The €695 million hedges with bank counterparties include the overlay swap transacted with RBS Group which transfers the daily movement in the CVA between the Group and RBS Group for these trades.

The table below summarises the Group's exposure to monolines; all of which are in Non-Core.

	2010 €m	2009 €m	2008 €m
Gross exposure to monolines	2,600	2,913	5,278
Hedges with financial institutions (including an overlay swap with RBS Group)	(695)	(806)	(283)
Credit valuation adjustment	(1,905)	(2,107)	(2,822)
Net exposure to monolines	-	-	2,173

CVA as a % of gross exposure	73%	72%	41%
Credit risk RWAs	64,200	115,953	162,959

The net income statement effect relating to monoline exposures is shown below.

	2010	2009	2008
	€m	€m	€m
Credit valuation adjustment at 1 January 2010	(2,107)	(2,822)	(606)
Credit valuation adjustment at 31 December 2010	(1,905)	(2,107)	(2,822)
Decrease/(increase) in credit valuation adjustment	202	715	(2,216)
Net (debit) relating to realisation, hedges, foreign exchange and other movements	(180)	(1,994)	(1,299)
Net credit/(debit) to income statement	22	(1,279)	(3,515)

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Other risk exposures continued
Credit valuation adjustments continued

Credit derivative product companies
A credit derivative product company (CDPC) is a company that sells protection on credit derivatives. CDPCs are similar to monoline insurers, however, they are not regulated as insurers.

The Group purchased credit protection from CDPCs through tranched and single name credit derivatives.

The Group has fully novated its exposure to CDPCs to RBS plc in the course of 2010 and 2009.

Other counterparties
The CVA for all other counterparties is calculated on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the credit risk.

Expected losses are determined from the market implied probability of defaults and internally assessed recovery levels. The probability of default is calculated with reference to observable credit spreads and observable recovery levels. For counterparties where observable data do not exist, the probability of default is determined from the average credit spreads and recovery levels of baskets of similarly rated entities. A weighting of 50% to 100% is applied to arrive at the CVA. The weighting reflects portfolio churn and varies according to the counterparty credit quality.

Expected losses are applied to estimated potential future exposures which are modelled to reflect the volatility of the market factors which drive the exposures and the correlation between those factors. Potential future exposures arising from vanilla products (including interest rate and foreign exchange derivatives) are modelled jointly using the Group's core counterparty risk systems. The majority of the Group's CVA held in relation to other counterparties arises on these vanilla products. The exposures arising from all other product types are modelled and assessed individually. The potential future exposure to each counterparty is the aggregate of the exposures arising on the underlying product types.

The correlation between exposure and counterparty risk is also incorporated within the CVA calculation where this risk is considered significant. The risk primarily arises on trades with emerging market counterparties where the gross mark-to-market value of the trade, and therefore the counterparty exposure, increases as the strength of the local currency declines.

Collateral held under a credit support agreement is factored into the CVA calculation. In such cases where the Group holds collateral against counterparty exposures, CVA is held to the extent that residual risk remains.

Participation in UK Government's Asset Protection Scheme
In 2009, RBS plc, entered into an agreement (the Asset Protection Scheme (APS)) with HM Treasury (HMT), acting on behalf of the UK Government, under which it purchased credit protection over a portfolio of specified assets and exposures (covered assets) from HMT. Although the portfolio of covered assets includes assets recorded on the Group's balance sheet, the Group is not entitled to benefit under this contract.

However, the Group entered into credit protection agreements in 2009 in the form of a financial guarantee contract and a credit derivative contract with RBS plc that provides full principal protection over those covered assets attributable to the Group for their remaining life.

Under the terms of these contracts on impairment of a covered asset the Group is entitled to receive from RBS plc the present value of the difference between contractual and expected cash flows from the asset; subsequent reductions in the estimated lost cash flows are paid by the Group to RBS plc and increases paid by RBS plc to the Group.

The credit derivative which protects a portfolio of financial assets, principally derivative financial assets, measured at fair value with changes in fair value taken to profit or loss, meets the definition of a derivative in IAS 39 and is carried at fair value with changes in fair value reflected in profit or loss.

The financial guarantee contract protects a portfolio of assets classified as loans and receivables. It meets the definition of a financial guarantee contract in IAS 39 and was recorded initially at its transaction value. It is being amortised to profit or loss over the expected remaining life of the assets in the portfolio it guarantees.

No adjustments are made to the measurement of the covered assets to reflect the protection provided by the financial guarantee contract and the credit derivative. Impairment provisions on covered assets classified as loans and receivables are assessed and charged in accordance with the Group's accounting policy; covered assets that are held-for-trading, designated at fair value or classified as available-for-sale continue to be measured at fair value with no adjustments to reflect the protection received. There is no change in how gains and losses on the covered assets are recognised in the income statement or in other comprehensive income. As a result the Group's credit quality ratios are unaffected.

At the time an impairment loss is recognised on a covered asset classified as loans and receivables, a reimbursement asset representing the amount receivable from RBS plc is recognized in the balance sheet with a corresponding entry to profit or loss offsetting the impairment charge.

On inception of the contract in 2009, the Group paid a premium of €3.8 billion. During 2010, the premium was revised to €3.3 billion. The initial covered portfolio totalled €27.3 billion with an average remaining maturity of 6 years. At 31 December 2010 the carrying values of the financial guarantee contract and the credit derivative were €617 million and €206 million respectively.

Covered assets
The table below provides a breakdown of assets covered under the Asset Protection Scheme back-to-back agreement.

2010	Residential mortgages €m	Consumer finance €m	Commercial real estate finance €mm	Leveraged finance €mm	Project finance €mm	Structured finance €mm	Loans €mm	Bonds €mm	Derivatives €mm	Total €mm
Financial institutions	150	198	-	156	-	230	2,123	26	3,705	6,588
Manufacturing	-	-	-	318	-	-	3890	56	459	4,723
Natural resources	-	-	-	-	58	-	447	-	15	520
Property	-	-	89	-	-	-	132	17	15	253
Retail and leisure	-	-	-	407	6	-	822	-	5	1,240
Services	-	-	77	635	-	-	369	15	181	1,277
TMT	-	-	-	317	-	-	1,327	7	30	1,681
Transport	-	-	-	32	38	-	431	313	214	1,028
Personal and SME	-	-	37	-	-	-	89	14	-	140
Total	150	198	203	1,865	102	230	9,630	448	4,624	17,450

2009	Residential mortgages €m	Consumer finance €m	Commercial real estate finance €m	Leveraged finance €m	Project finance €m	Structured finance €m	Loans €mm	Bonds €m	Derivatives €mm	Total €m
Financial institutions	-	-	-	237	-	301	3,030	267	4,867	8,702
Manufacturing	-	-	-	2,273	56	-	5,945	96	666	9,036
Natural resources	-	-	-	392	70	-	744	-	89	1,295
Property	-	-	79	-	-	-	346	14	184	623
Retail and leisure	-	-	-	513	-	-	1,205	-	86	1,804
Services	-	-	76	600	-	27	947	14	478	2,142
TMT	-	-	-	395	-	-	1,965	6	88	2,454
Transport	-	-	-	28	-	-	637	-	77	742
Personal and SME	-	-	33	2	-	-	104	12	1	152
Other	137	176	-	-	-	-	-	-	-	313
Total	137	176	188	4,440	126	328	14,923	409	6,536	27,263

Credit quality of credit risk assets
The table below analyses the credit quality of the credit risk assets by risk bands of covered assets.

Asset quality band	Probability of default range	2010 €m	2009 €m
AQ1	0% - 0.03%	851	1,191
AQ2	0.03% - 0.05%	977	1,280

AQ3	0.05% - 0.10%	1,518	2,032
AQ4	0.10% - 0.38%	1,607	4,181
AQ5	0.38% - 1.08%	3,058	3,260
AQ6	1.08% - 2.15%	1,064	1,444
AQ7	2.15% - 6.09%	1,169	2,618
AQ8	6.09% - 17.22%	236	1,245
AQ9	17.22% - 100%	4,029	5,017
AQ10	100%	2,941	4,995
Total		17,450	27,263

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Introduction

The Group has always maintained high corporate governance standards. Good corporate governance is critical in order to realise its strategic goal of creating sustainable long-term value for all the Group's stakeholders – including its shareholders, clients, employees and society at large. It is the foundation of the Group's licence to operate.

In order to achieve good corporate governance the Group organises the business in a way that promotes first-class stewardship by the Managing Board and effective supervision by the Supervisory Board. Integrity, transparency and accountability are key elements of the Group's corporate governance, as they are embedded in the Group's business as a whole. These key elements ensure that the controls and oversight necessary for effective risk management, compliance with regulations, and accurate and complete disclosure of information to the market are effective.

The Group's guiding compass in these matters is provided by its Code of conduct, which constitutes the Group's 'code of ethics'.

Corporate governance in the Netherlands

Dutch Corporate Governance Code ('Code Frijns')

On 25 March 2008 the Group announced that it had resolved to apply for delisting of its ordinary shares and the (formerly convertible) preference shares from Euronext Amsterdam, the regulated market of Euronext Amsterdam N.V. ('Euronext Amsterdam') and to apply for the delisting of its American Depositary Shares ('ADSs') from the New York Stock Exchange ('NYSE'). Its ordinary shares and its ADSs were delisted from Euronext Amsterdam and the NYSE respectively, effective 25 April 2008. The (formerly convertible) preference shares were delisted shortly after finalisation of the squeeze-out proceedings on 22 September 2008. As a result of the delisting, the Company is no longer required to adhere to Code Frijns. The Group ensures proper corporate governance by focusing on the Dutch Banking Code which caters for specific corporate governance rules for banks.

The Dutch Banking Code ('Code Banken')

The Code Banken was drawn up by the Netherlands Bankers' Association (NVB) in response to the report entitled 'Restoring Trust' ('Naar herstel van vertrouwen'), which was published by the Advisory Committee on the Future of Banks (Adviescommissie Toekomst Banken) on 7 April 2009. The recommendations of the Advisory Committee's report have been used as the basis for this Code Banken. The Code Banken came into force on 1 January 2010.

Capital Requirement Directive III ('CRD III')

CRD III was adopted by the European Parliament and Council on 24 November 2010. It contains certain provisions on capital requirements for trading portfolios and securitisations. It also contains principles on sound compensation policies. Each member state of the European Union has the requirement to implement the directive in their national legislation.

The principles of sound compensation policies were implemented by the publication of the Regulation by the Dutch Central Bank on Sound Compensation Policies for Financial Institutions, which came into effect on 1 January 2011. The Group adheres fully to the principles of CRD III that were implemented in the Netherlands.

Corporate governance in the United States

As SEC-registered company, the Group is subject to US securities laws, including the Sarbanes-Oxley Act, as well as certain corporate governance rules in connection with the Group's listing of NYSE Alternext debt. To meet the requirements of the Sarbanes-Oxley Act, the Group established a Disclosure Committee that formalised the roles, tasks and disciplines that were already in place for ensuring the accuracy and completeness of information disclosed to the market.

The Group's report on internal control over financial reporting under Section 404 of the US Sarbanes-Oxley Act is included in this Annual Report 2010 that is also filed on Form 20-F with the SEC.

Approval of Annual Report

The Managing Board has approved the Annual Report in its meeting on 22 March 2011. The Supervisory Board has approved the Annual Report in its meeting on 24 March 2011. The Group has proposed to its Shareholders that it adopts the 2010 financial statements, as included in this annual report, and discharge the Managing Board and Supervisory Board in respect of their management and supervision respectively.

Boards and Committees

RBS Holdings and RBS N.V. are both companies with limited liability incorporated under the laws of the Netherlands. Both companies have a two-tier system of corporate governance; consisting of a Supervisory Board and a Managing Board. The day to day management of the companies vests with the Managing Board. The Supervisory Board provides oversight and advice to the Managing Board.

There is a personal union in place between the Managing Boards of RBS Holdings and RBS N.V. and between the Supervisory Boards of RBS Holdings and RBS N.V. This means that the members of the Managing Board and Supervisory Board of RBS Holdings and RBS N.V. are the same.

Supervisory Board

The Supervisory Board supervises the Managing Board, as well as the general affairs of RBS Holdings and the enterprises connected to it. In addition, it is charged with assisting and advising management and supervising the corporate governance structure of RBS Holdings.

In performing their duties, the members of the Supervisory Board are guided by the interests of the Group and the businesses connected to it and shall take into account the relevant interests of the Group's stakeholders. Certain powers vest in the Supervisory Board, including the approval of certain resolutions by the Managing Board.

The Supervisory Board is an independent corporate body. Members of the Supervisory Board are appointed at the General Meeting of Shareholders. The Supervisory Board nominates one or more candidates for each vacant seat.

Under the Code Frijns, all members of the Supervisory Board must be independent with the exception of not more than one person. The Group is not compliant with that standard. The Group has four Supervisory Board members who can not be considered as independent within the scope of the Code Frijns.

Boards and Committees continued

Supervisory Board continued

Supervisory Board members are appointed for a term of four years and may be re-appointed after that term. The Supervisory Board members may serve a maximum term of 12 years from the date of their first appointment. Each member is required to resign at the first General Meeting of Shareholders after reaching the age of 70.

Candidates recommended for appointment or re-appointment to the Supervisory Board must meet the criteria of the membership profile, which are set out in the Rules Governing the Supervisory Board's Principles and Best Practices of the Group. The Rules Governing the Supervisory Board's Principles and Best Practices of RBS Holdings are also applicable to the Supervisory Board of RBS N.V.

Newly appointed Supervisory Board members undertake an induction programme. The new Supervisory Board members receive relevant documentation necessary for their role in the Group and undertake a series of meetings with the management of the Group to gain insight and understanding of the Group and its enterprises.

In addition meetings are set up with management of RBS Group to provide for an introduction to RBS Group and its businesses. The programme is tailor-made and is adjusted to the specific needs of the new Supervisory Board member.

In case of a (potential) conflict of interest of material significance between a member of the Supervisory Board and RBS Holdings, the Chairman of the Supervisory Board shall be notified. If the Chairman of the Supervisory Board has a (potential) conflict of interest of material significance, the Vice-Chairman is notified. The Supervisory Board member concerned will not take part in the assessment by the Supervisory Board where a conflict of interest exists.

Details of the Supervisory Board's remuneration can be found on page 185.

The company has not entered into any service contracts with any Supervisory Board members providing for benefits upon termination of employment.

The Chairman and Vice-Chairman of the Supervisory Board are appointed by the Supervisory Board from its members. The Supervisory Board also appoints from its own members, the members of the Risk & Audit Committee.

The Rules Governing the Supervisory Board's Principles and Best Practices of RBS Holdings are available on the Group's website at www.rbs.nl. These rules are also applicable to the Supervisory Board and include the Terms of Reference of the Risk & Audit Committee.

Composition of the Supervisory Board

The members of the Supervisory Board, and their respective Supervisory Board committee membership, as at 28 March 2011 are as follows:

		Date of first appointment	Date for re-election
Bruce Van Saun (Chairman)	(53, American, m) RA*	1 April 2010	1 April 2014
Henk Rottinghuis	(55, Dutch, m) RA**	1 September 2010	1 September 2014
Miller McLean	(61, British, m) RA*	16 February 2009	16 February 2013
	(50, Dutch, m) RA*	1 April 2010	1 April 2014

Ron Teerlink (Vice-Chairman)			
Sietze Hepkema	(57, Dutch, m) RA**	1 September 2010	1 September 2014

RA member of the Risk & Audit Committee.
* as of 9 April 2010.
** as of 2 November 2010.

Please note that the composition of the Supervisory Board was different in the first quarter of 2010; see page 185.

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Boards and Committees continued
Supervisory Board continued

Bruce Van Saun - Chairman of the Supervisory Board
Mr. Van Saun was appointed to the Supervisory Board on 1 April 2010. Appointed to the RBS Group Board in October 2009 as Group Finance Director, Mr. Van Saun has more than 25 years of financial services experience. From 1997 to 2008 he held a number of senior positions with Bank of New York and later Bank of New York Mellon, most recently as Vice Chairman and Chief Financial Officer and before that responsible for the Asset Management and Market Related businesses. Prior to that, he held senior positions with Deutsche Bank, Wasserstein, Perella Group and Kidder Peabody & Co. He has served on several corporate boards as a nonexecutive director and has been active in numerous community organisations.

Miller McLean
Mr. McLean was appointed as a member of the Supervisory Board on 16 February 2009. He was Group General Counsel and Group Secretary for RBS Group, a position he has held since 2003. His responsibilities included group legal and company secretarial services including acting as general counsel to the RBS Group Board of Directors, stock exchange listings, corporate governance and special projects such as acquisitions, disposals and joint ventures. Mr. McLean has had a long and distinguished career with the RBS Group which he joined in 1970 as a graduate trainee, becoming a member of the executive in 1985. He is a Chartered Banker and Solicitor and was appointed a Fellow of the Chartered Institute of Bankers in Scotland in 1992, later becoming President from 2007-2009. Mr. McLean retired as Group General Counsel and Group Secretary to RBS Group on 30 April 2010.

Ron Teerlink - Vice-Chairman of the Supervisory Board
Mr. Teerlink was appointed to the Supervisory Board on 1 April 2010. In April 2008 Mr Teerlink joined RBS Group as Chief Executive of Business Services, becoming the Group Chief Administrative Officer in February 2009. At the same time he was re-appointed to the Managing Board of the Group to oversee the integration programme. Ron started his career with ABN Bank in 1986 as an IT/Systems analyst and held various functional positions before becoming Chief Operating Officer of the Wholesale Clients Business in 2002. He was appointed Chief Executive Officer of Group Shared Services in 2004 and joined ABN AMRO Holding N.V.'s Managing Board in January 2006, where he was responsible for Services and Market Infrastructure. Mr Teerlink holds a Masters degree in Economics from Amsterdam's Vrije Universiteit.

Henk Rottinghuis
Mr. Rottinghuis has been a member of the Executive Board of Pon Holdings B.V. since 1999 and was appointed Chairman in 2002. Before joining the Supervisory Board, he worked as the Managing Director of Pon's Automobielhandel, the importer of Volkswagen, Audi and Porsche in the Netherlands, and was responsible for all import activities in the automotive arm of Pon Holdings. Mr. Rottinghuis started his career in 1982 at the Royal Nedlloyd Group, a shipping and transport group, where he held various management positions for a period of ten years. He holds a Master of Laws from the Rijksuniversiteit Groningen, and has followed an executive programme at Harvard Business School. Mr. Rottinghuis was appointed to the Supervisory Board on 1 September 2010.

Sietze Hepkema
Mr. Hepkema is a corporate and Mergers and Acquisitions lawyer and Co-head of the Global Corporate Practice at Allen & Overy, where he has been working since 2000. He was Senior Partner of the Amsterdam office from 1999 - 2009 and a member of the firm's Board from 2000 - 2010. Before joining Allen & Overy, Mr. Hepkema was Partner at Loeff Claeys Verbeke for 12 years, where he was appointed to the Managing Board in 1989. Between 1981 and 1987

he worked at Graham & James in San Francisco and Singapore. Over the past ten years, Mr Hepkema has advised many major transactions in the Netherlands including the merger of KLM and Air France, the merger of NYSE and Euronext, and the acquisition of Organon by ScheringPlough. He holds a Master of Laws from the Erasmus University Rotterdam and an LLM from Harvard Law School. Mr. Hepkema joined the Supervisory Board on 1 September 2010.

Activities of the Supervisory Board

The Supervisory Board met on twenty one occasions during 2010. The meetings took place in person, via conference call by telephone and on a few occasions the members were also asked to give their approval on a few matters via email procedure.

In view of the legal separation that took place in 2010 no formal assessment of the functioning of the Managing Board and Supervisory Board their members and the committee of the Supervisory Board took place in 2010 by the Supervisory Board. The assessment of the functioning of the Managing Board members and Supervisory Board, their members and the committee of the Supervisory Board has taken place in the first quarter of 2011.

The Chairman of the Supervisory Board and the Company Secretary prepared the agenda for the meetings of the Supervisory Board in close co-operation with the Chairman of the Managing Board.

The Supervisory Board reviewed and adopted the full year 2010 results at its meeting on 24 March 2011 and reviewed and adopted the half-year financial report 2010 on 27 August 2010. The Board reviewed in these meetings regulatory, control and audit issues, including Sarbanes-Oxley Act 404 compliance.

During the first quarter of 2010, the Supervisory Board received regular updates on the transition program and transition risk and discussed and approved the demerger of a number of (major) assets, disposals and requests for Declaration of No Objection ('DNO') connected to the transition. During this period, the agenda of the Supervisory Board was predominantly governed by matters relating to the legal demerger and separation. Please note that the composition of the Supervisory Board was different during the first quarter of 2010. See page 185.

The financial performance of the Group was extensively discussed during a number of Supervisory Board meetings, which were attended by a number of Managing Board members who gave an explanation of the results. Also, relevant members discussed findings of internal and external auditors.

The meetings were preceded by meetings of the Risk & Audit Committee, which advised the Supervisory Board on the adoption of

Boards and Committees continued

Supervisory Board continued

the financial results. Comprehensive information provided by the Managing Board and reviewed by the Risk & Audit Committee gave the Supervisory Board a clear picture of the Group's risks, results, and capital and liquidity position. The Risk & Audit committee continued to report their deliberations and findings to the Supervisory Board for further discussion and, where appropriate, decision.

The strategy of the Group was determined in conjunction with the divisional strategy of RBS Group and was adopted by the Supervisory Board during its meeting on 9 April 2010.

The Supervisory Board nominated a new Managing Board member during 2010. The Shareholder adopted the nomination of Pieter van der Harst on 25 June 2010, which became effective as at 27 July 2010.

The Shareholder reappointed Deloitte Accountants B.V. as the external auditors of RBS Holdings N.V. for the 2010 financial year.

All members of the Supervisory Board have complied with the requirement to attend meetings on a frequent basis.

Supervisory Board committee

The Supervisory Board has one sub-committee, the Risk & Audit Committee. The Risk & Audit Committee is responsible for all matters relating to Accounting policies, internal control, financial reporting functions, internal audit, risk assessment and regulatory compliance of the Group.

Risk & Audit Committee

The members of the Risk & Audit Committee are appointed by the Supervisory Board from its own members. The Committee derives its authority from the Supervisory Board, the RBS Group Board Risk Committee and the RBS Group Audit Committee. Its Terms of Reference are set out in annex C of the Rules Governing the Supervisory Board's Principles and Best Practices.

In line with good corporate governance, the Terms of Reference governing the Risk & Audit Committee have been reviewed to ensure that objectives are, where possible, fully aligned and consistent with the Terms of Reference of both the RBS Group Audit Committee and the RBS Group Board Risk Committee and adequate and appropriate oversight and escalation mechanisms are implemented.

Also, the Terms of Reference have been reviewed and adjusted in light of the requirements as stated in the Code Frijns.

The external auditor is appointed or reappointed by the General Meeting of Shareholders for a period of one year on the advice of the Supervisory Board. The Risk & Audit Committee has the delegated responsibility for the engagement of the external auditor. For this purpose it evaluates and reports the independence of the external auditor, the measures used to control the quality of the external auditor's work, and the annual audit budget. The Risk & Audit Committee's policy on auditor independence governs the appointment, compensation, and oversight of the external auditor. To ensure the external auditor's independence, the Auditor Independence Policy prohibits the external auditor from providing certain non-audit services to the Group.

The Risk & Audit Committee has delegated responsibility for pre-approving audit, audit-related and permitted non-audit services provided by the external auditor, to the CFO. In exercising its pre-approval authority, the CFO considers whether the proposed services are consistent with the continued independence of the external auditor. During each meeting of the Risk & Audit Committee, an overview is presented of the non-audit services that were initiated during the period under review.

Composition of the Risk & Audit Committee
In 2010, the Risk & Audit Committee was chaired from 9 April 2010 onwards by Bruce Van Saun. Other members included Miller McLean and Ron Teerlink. During the Supervisory Board meeting of 2 November 2010, both Sietze Hepkema and Henk Rottinghuis were appointed as members of the Risk & Audit Committee

The members of the Risk & Audit Committee collectively have sufficient accounting and financial management expertise to understand the Group’s business, financial statements and risk profile. Furthermore, the Supervisory Board has determined that Bruce Van Saun possesses the necessary relevant expertise in financial administration and accounting for listed companies and other large companies and therefore qualifies as a financial expert within the meaning of the Code Frijns. It has also been determined that Bruce Van Saun qualifies as an audit committee financial expert in accordance with Section 407 of the Sarbanes-Oxley Act.

Activities of the Risk & Audit Committee
The Risk & Audit Committee convened three times during the course of 2010. All of the meetings were scheduled meetings. The Risk & Audit Committee reviewed, discussed and advised the Supervisory Board with regard to the interim financial statements, the Annual Report, the external auditor’s report, the external auditor&