ACROSS AMERICA REAL ESTATE CORP
Form 10QSB
August 14, 2007

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-QSB
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly period ended June 30, 2007
Commission File No. 000-50764
Across America Real Estate Corp.
(Exact Name of Small Business Issuer as specified in its charter)

Colorado	20-0003432
(State or other jurisdiction of incorporation)	(IRS Employer File Number)
700 17th Street, Suite 1200 Denver, Colorado	80202
(Address of principal executive offices)	(zip code)

(303) 893-1003
(Registrant s telephone number, including area code)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports); and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes o No þ

As of May 7, 2007, registrant had outstanding 16,036,625 shares of the registrant s common stock, and the aggregate market value of such shares held by non-affiliates of the registrant (based upon the closing bid price of such shares as listed on the OTC Bulletin Board on May 7, 2007) was approximately $2,592,225.

Transitional Small Business Disclosure Format (check one): Yes o No þ

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PART I FINANCIAL INFORMATION

References in this document to us, we, AARD or Company refer to Across America Real Estate Corp. and subsidiaries.

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ITEM 1. FINANCIAL STATEMENTS
Across America Real Estate Corp.
Condensed Consolidated Balance Sheet
June 30, 2007

Assets	
Cash and Equivalents	$ 1,609,850
Deposits held by an affiliate	759,993
Accounts Receivable, net	75,474
Property and equipment, net of accumulated depreciation (note 6)	129,470
Real estate held for sale (note 3)	4,112,002
Construction in progress	3,304,348
Land held for development	11,015,587
Deferred tax asset (note 8)	1,037,698
Current tax asset (note 8)	418,585
Deposits and prepaids	53,620
Total assets	$ 22,516,627
Liabilities and Shareholders Equity	
Liabilities	
Accounts payable	$ 127,490
Accrued liabilities	87,453
Dividends payable	77,338
Income tax liability	6,585
Senior subordinated note payable, related parties (note 4)	7,463,983
Senior subordinated revolving note, related parties (note 4)	7,850,000
Note payable (note 12)	3,512,889
Capital lease obligations (note 13)	11,781
Unearned Revenue	137,668
Total liabilities	19,275,187
Shareholders equity	
Noncontrolling interest (note 9)	(56,805)
Convertible preferred stock, $.10 par value; 1,000,000 shares authorized, 517,000 shares issued and outstanding	51,700
Common stock, $.001 par value; 50,000,000 shares authorized, 16,036,625 shares issued and outstanding	16,037
Additional paid-in-capital	6,381,905
Retained earnings	(3,151,397)
Total shareholders equity	3,241,440
Total liabilities and shareholders equity	$ 22,516,627

See accompanying notes to condensed consolidated financial statements

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Across America Real Estate Corp.
Condensed Consolidated Statements of Operations

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Revenue:				
Sales	$ 4,924,336	$	$ 4,924,336	$ 1,723,000
Financing Activities	48,173		48,173	
Rental income	15,875	143,917	52,204	268,995
Management fees	22,943		214,598	27,000
Total revenue	5,011,327	143,917	5,239,311	2,018,995
Operating expenses:				
Cost of Sales	4,645,324		4,645,324	1,462,852
Impairment loss on real estate (note 15)	1,939,513		1,939,513	
Selling, general and administrative (note 16)	1,081,704	348,639	1,907,906	630,100
Total Operating expenses	7,666,541	348,639	8,492,743	2,092,952
Loss from operations	(2,655,214)	(204,722)	(3,253,432)	(73,957)
Non-operating expense:				
Interest Income			385	
Interest Expense	(155,584)	(142,568)	(175,317)	(236,280)
Other Income (Expense)	1,128		(1,061)	
Loss before income taxes and noncontrolling interest	(2,809,670)	(347,290)	(3,429,425)	(310,237)
Income tax provision	(953,865)	123,367	(1,166,600)	142,398
Loss before noncontrolling interest	(1,855,805)	(223,923)	(2,262,825)	(167,839)
Noncontrolling interest in income of consolidated subsidiaries	67,304	(10,611)	73,751	89,490
Net loss	$ (1,923,108)	$ (213,312)	$ (2,336,575)	$ (257,329)
Other comprehensive income				
Preferred stock dividends declared	77,338		153,826	
Comprehensive loss applicable to common	$ (2,000,446)	$ (213,312)	$ (2,490,401)	$ (257,329)
Basic and diluted loss per common share	$ (0.12)	$ (0.01)	$ (0.16)	$ (0.02)

Basic and diluted weighted average common shares outstanding	16,036,625	16,036,625	16,036,625	16,036,625

See accompanying notes to condensed consolidated financial statements

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Across America Real Estate Corp.
Condensed Consolidated Statements of Cash Flows

	Six Months Ended June 30,	
	2007	2006
Cash flows from operating activities:		
Net loss	$ (2,336,575)	$ (257,329)
Adjustments to reconcile net income to net cash used by operating activities:		
Depreciation (note 6)	14,151	3,613
Impairment of Assets	1,939,513	
Allowance for Bad Debt	215,953	
Stock option compensation expense (note 7)	68,144	
Changes in operating assets and operating liabilities:		
Construction in progress (note 2)	(1,038,805)	(545,342)
Real estate held for sale (note 3)	(1,332,260)	168,810
Land held for development (note 2)	(1,137,892)	(953,977)
Accounts receivable	(43,644)	(31,416)
Prepaids and Deposits	12,710	
Accounts payable and accrued liabilities	(93,412)	(131,872)
Income tax assets and liabilities (note 8)	(1,160,015)	(165,440)
Unearned revenue		128,183
Indebtedness to related party (note 4)	4,480,569	1,876,641
Net cash (used in) operating activities	(411,564)	91,871
Cash flows from investing activities:		
Payment of deposits	(399,622)	(45,270)
Proceeds from repayment of notes recievable		10,000
Issuance of notes recievable		(80,318)
Payments for property and equipment (note 6)	(57,068)	(3,942)
Net cash (used in) provided by investing activities	(456,690)	(119,530)
Cash flows from financing activities:		
Preferred stock dividends paid	(156,375)	
Distributions received from members		37,132
Proceeds from note payable (note 12 and 14)	1,541,076	746,294
Repayment of note payable		(929,403)
Repayment of lease obligation (note 13)	(4,038)	(805)
Net cash provided by financing activities	1,380,663	(146,782)
Net change in cash	512,410	(174,441)
Cash and cash equivalents, beginning of the period	1,097,440	291,177

Cash and cash equivalents, end of the period	$ 1,609,850	$ 116,736
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Income taxes	$	$ 27,921
Interest	$ 634,445	$ 225,181
Supplemental disclosure of non-cash investing and financing activities		
Dividends Declared	$ (153,826)	$

See accompanying notes to condensed consolidated financial statements

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1) Nature of Organization and Summary of Significant Accounting Policies

Organization and Basis of Presentation

Across America Real Estate Corp. (AARD or the Company) was incorporated under the laws of Colorado on April 22, 2003. The Company is a co-developer, principally as a financier, for build-to-suit real estate development projects for retailers who sign long-term leases for use of the property. Land acquisition and project construction operations are conducted through the Company s subsidiaries. The Company creates each project such that it will generate income from the placement of the construction loan, rental income during the period in which the property is held, and the capital appreciation of the facility upon sale. Affiliates, subsidiaries and management of the Company will develop the construction and permanent financing for the benefit of the Company.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Across America Real Estate Corp. and the following subsidiaries, which were active at June 30, 2007:

Name of Subsidiary Ownership

Name of Subsidiary	Ownership
CCI Southeast, LLC (CCISE)	100.00%
Riverdale Carwash Lot 3A, LLC (Riverdale)	100.00%
AARD-Cypress Sound, LLC (Cypress Sound)	51.00%
AARD-TSD-CSK Firestone, LLC (Firestone)	51.00%
South Glen Eagles Drive, LLC (West Valley)	51.00%
119th and Ridgeview, LLC (Ridgeview)	51.00%
53rd and Baseline, LLC (Baseline)	51.00%
Hwy 278 and Hwy 170, LLC (Bluffton)	51.00%
State and 130th, LLC (American Fork)	51.00%
Clinton Keith and Hidden Springs, LLC (Murietta)	51.00%
Hwy 46 and Bluffton Pkwy, LLC (Bluffton 46)	51.00%
AARD Bader Family Dollar Flat Shoals, LLC (Flat Shoals)	51.00%
AARD Westminster OP7, LLC (Westminster OP7)	51.00%
Eagle Palm I, LLC (Eagle)	51.00%
AARD Econo Lube Stonegate, LLC (Econo Lube)	51.00%
AARD Bader Family Dollar MLK, LLC (MLK)	51.00%
AARD-Charmar Greeley, LLC (Starbucks)	51.00%
AARD-Charmar Greeley Firestone, LLC	51.00%
AARD 5020 Lloyd Expy, LLC (Evansville)	51.00%
AARD 2245 Main Street, LLC (Plainfield)	51.00%
AARD-Buckeye, LLC (Buckeye)	51.00%
AARD Esterra Mesa 1, LLC (Esterra Mesa 1)	51.00%
AARD Esterra Mesa 2, LLC (Esterra Mesa 2)	51.00%
AARD Esterra Mesa 3, LLC (Esterra Mesa 3)	51.00%
AARD Esterra Mesa 4, LLC (Esterra Mesa 4)	51.00%
AARD MDJ Goddard, LLC (Goddard)	51.00%
AARD Charmar Arlington Boston Pizza, LLC (Charmar Boston Pizza)	51.00%
L-S Corona Pointe, LLC (L-S Corona)	50.01%
AARD NOLA St Claude LLC (NOLA)	51.00%

All significant intercompany accounts and transactions have been eliminated in consolidation.

2) Current Development Projects

Bader Family Dollar

On October 5, 2006, we through our subsidiary, Eagle Palm I, LLC (Bader Family Dollar) entered into an arrangement with WB Properties of Georgia/MLK, LLC (WB Properties) an unaffiliated developer of commercial property, to develop a Family Dollar Store in Atlanta, GA. WB Properties owns 49%, and AARD owns 51% of Bader Family Dollar. Construction of the project has commenced and upon completion, all profits from the sale of the project will be distributed in accordance with the terms and conditions agreed upon by both parties in the operating agreement of Bader Family Dollar.

AARD Plainfield

On November 30, 2006, we through our subsidiary, 2245 Main St, LLC (AARD Plainfield) entered into an arrangement with Situs Development Corp (Situs) an unaffiliated builder and developer of Fed Ex Kinko s stores. We intend to develop a Fed Ex Kinko s located in Plainfield, IN. Situs owns 49%, and AARD owns 51% of AARD Plainfield. All profits from the sale of the project will be distributed in accordance with the terms and conditions agreed upon by both parties in the operating agreement of AARD Plainfield

AARD Evansville

On December 5, 2006, we through our subsidiary, 5020 Lloyd Expressway, LLC (AARD Evansville) entered into an arrangement with Situs Development Corp (Situs) an unaffiliated builder and developer of Fed Ex Kinko s stores. We intended to develop a Fed Ex Kinko s in a location in Evansville, IN, but have changed our plans to develop a Cingular Wireless Store at this location Situs owns 49%, and AARD owns 51% of AARD Evansville. All profits from the sale of the project will be distributed in accordance with the terms and conditions agreed upon by both parties in the operating agreement of AARD Evansville.

AARD Greeley

On November 30, 2006, we through our subsidiary, AARD-Charmar Greeley, LLC (AARD Greeley) entered into an arrangement with Charmar Properties, an unaffiliated developer of commercial property. We purchased two adjoining sites in Greeley, CO and intend to develop a Firestone Tire Center on one site and a Starbuck s and additional retail on the other. Charmar Properties owns 49%, and AARD owns 51% of AARD Greeley. All profits from the sale of the project will be distributed in accordance with the terms and conditions agreed upon by both parties in the operating agreement of AARD Greeley.

West Valley

On November 21, 2005, we through our subsidiary, South Glen Eagles Drive, LLC (West Valley) entered into an arrangement with ADG, an unaffiliated builder and developer of Grease Monkey International automotive stores. We intend to develop a Grease Monkey located in West Valley, Utah. ADG owns 49%,, and AARD owns 51% of West Valley. All profits from the sale of the project will be distributed in accordance with the terms and conditions agreed upon by both parties in the operating agreement of West Valley. In November, 2006 we broke ground on the Grease Monkey project and it is currently under construction. We also subdivided the property and have an additional retail lot which is currently under contract to sell to an unaffiliated third party.

AARD Stonegate Econolube

On October 25, 2005 we through our subsidiary, AARD Stonegate Econolube, LLC Stonegate entered into an arrangement with Charmar Properties, an unaffiliated developer of commercial property. We intend to develop an Econolube located in Parker, CO. Charmar Properties owns 49%, and AARD owns 51% of Stonegate. All profits from the sale of the project will be distributed in accordance with the terms and conditions agreed upon by both parties in the operating agreement of Stonegate. As of June 30, 2007, we had not yet begun construction on the project, but are in the final preconstruction phase and are preparing to move forward with construction.

Buckeye

On November 8, 2006, we through our subsidiary, AARD Buckeye, LLC (Buckeye) entered into an arrangement with Simon Development Corp (Simon) an unaffiliated builder and developer and operator of convenience stores and gas stations. We intend to develop a C Store, Gas Station and Carwash located in Buckeye, AZ. Simon owns 49%, and AARD owns 51% of Buckeye. All profits from the sale of the project will be distributed in accordance with the terms and conditions agreed upon by both parties in the operating agreement of Buckeye.

AARD Charmar Arlington Boston Pizza

On December 28, 2006, we through our subsidiary, AARD Charmar Arlington Boston Pizza, LLC (Charmar Boston Pizza) entered into an arrangement with Charmar Property Acquisitions (Charmar) an unaffiliated developer of commercial properties. We intend to develop a Boston Pizza restaurant located in Arlington, TX. Charmar owns 49%, and AARD owns 51% of Charmar Boston Pizza. All profits from the sale of the project will be distributed in accordance with the terms and conditions agreed upon by both parties in the operating agreement of Charmar Boston Pizza.

AARD MDJ Goddard LLC

On February, 2007, we through our subsidiary, AARD MDJ Goddard, LLC (Goddard) entered into an arrangement with MDJ Development LLC (MDJ) an unaffiliated builder and developer of Goddard School locations. We intend to develop a Goddard School located in San Antonio, TX. MDJ owns 49%, and AARD owns 51% of Goddard. All profits from the sale of the project will be distributed in accordance with the terms and conditions agreed upon by both parties in the operating agreement of Goddard.

AARD Esterra Mesa 1,2,3 & 4, LLC s

In October 2006, we purchased approximately 3.75 acres of commercial property in Mesa, AZ, which are intended to be subdivided into four separate commercial sites. On March 19, 2007, through four subsidiaries, AARD Esterra Mesa 1, LLC, AARD Esterra Mesa 2, LLC, AARD Esterra Mesa 3, LLC and AARD Esterra Mesa 4, LLC (collectively, Esterra Mesa 1-4) , we entered into an arrangement with Esterra Development LLC (Esterra) an unaffiliated developer of commercial properties. We intend to obtain leases and develop the sites. Esterra owns 49%, and AARD owns 51% of Esterra Mesa 1-4. All profits from the sale of the projects will be distributed in accordance with the terms and conditions agreed upon by both parties in the operating agreement of Esterra Mesa 1-4.

AARD NOLA St. Claude

On June 20, 2007, we through our subsidiary, AARD NOLA St. Claude LLC, (NOLA) entered into an arrangement with Mainstream Development, LLC, (Mainstream) an unaffiliated builder and developer of Family Dollar Stores. We intend to develop a Family Dollar Store located in New Orleans, Louisiana. Mainstream owns 49% and AARD owns 51% of NOLA. All profits from the sale of the project will be distributed in accordance with the terms and conditions agreed upon by both parties in the operating agreement of NOLA.

(3) Real Estate Held for Sale

AARD Plainfield

On November 30, 2006, we through our subsidiary, 2245 Main St, LLC (AARD Plainfield) entered into an arrangement with Situs Development Corp (Situs) an unaffiliated builder and developer of Fed Ex Kinko s stores. We intend to develop a Fed Ex Kinko s located in Plainfield, IN. Situs owns 49%, and AARD owns 51% of AARD Plainfield. All profits from the sale of the project will be distributed in accordance with the terms and conditions agreed upon by both parties in the operating agreement of AARD Plainfield

Cypress Sound

On March 22, 2005, we entered into an arrangement with Mr. Daniel S. Harper (Harper), an unaffiliated builder and developer of commercial property. We and Mr. Harper had intended to develop and construct a six unit, three-story condominium project located in Orlando, Florida. The parties have formed a limited liability company for the development of the identified property. The name of the limited liability company is AARD-Cypress Sound LLC (Cypress Sound). Harper owns 49% of Cypress Sound and we own 51%. As of June 30, 2007, the Cypress Sound project had not yet progressed forward and we are currently in negotiations with Mr. Harper to purchase our interest in Cypress Sound.

American Fork

On June 14, 2005, we through our subsidiary, State & 130th, LLC (American Fork) entered into an arrangement with ADG, an unaffiliated builder and developer of Grease Monkey International automotive stores.

In September, 2005 we purchased property located in American Fork, UT, which was subsequently subdivided into two separate lots, each owned by State & 130th, LLC. We developed a Grease Monkey and a Fed Ex Kinko s on the two sites and both were completed and occupied in the fourth quarter of 2006.

On December 13, 2006, we sold the Grease Monkey to an unaffiliated third party for $1,060,000. As of June 30, 2007, the Fed Ex Kinko s property is under contract to be sold to an unaffiliated third party.

Bluffton 278

On June 14, 2005, we through our subsidiary, Hwy 278 & Hwy 170, LLC, (Bluffton 278) entered into an arrangement with ADG, an unaffiliated builder and developer of Grease Monkey International automotive stores. We intended to develop a Grease Monkey located in Bluffton, South Carolina. ADG owns 49%, and AARD owns 51% of Bluffton 278. All profits from the sale of the project will be distributed in accordance with the terms and conditions agreed upon by both parties in the operating agreement of Bluffton 278. As of June 30, 2007 we have made no progress towards developing the project. We are currently assessing alternatives to moving forward which include finding other retail uses for the property or selling the raw land in the open market.

Bluffton 46

On April 1, 2006, we through our subsidiary, Hwy 46 and Bluffton Pkwy, LLC (Bluffton 46) entered into an arrangement with ADG, an unaffiliated builder and developer of Grease Monkey International automotive stores. We intended to develop a Grease Monkey located in Bluffton, South Carolina. ADG owns 49%, and AARD owns 51% of Bluffton 46. All profits from the sale of the project will be distributed in accordance with the terms and conditions agreed upon by both parties in the operating agreement of Bluffton 46. As of June 30, 2007, we have made no progress towards developing the project. We are currently assessing alternatives to moving forward which include finding other retail uses for the property or selling the raw land in the open market.

(4) Related Party Transactions

GDBA Investments, LLLP

On November 26, 2004, we entered into a three-year Agreement to Fund our real estate projects with GDBA Investments, LLLP (GDBA), our largest shareholder On September 28, 2006, GDBA Investments replaced the Agreement to Fund with a new investment structure that included 250,000 shares of Series A Convertible Preferred Stock at $12.00 per share, a $3.5 million Senior Subordinated Note and a $3.5 million Senior Subordinated Revolving Note.

The Series A Convertible Preferred Stock issued under these transactions pays a 5% annual dividend on the Original Issue Price of $12.00, payable quarterly and is convertible to common stock at a $3.00 conversion price. Each share of Series A Convertible Preferred Stock is convertible, at the option of the holder, at any time after the issuance of the such share.

In the event the Company issues or sells additional shares of common stock for consideration less than the Series A conversion price in effect on the date of such issuance or sale (currently $3.00 per share), then the Series A conversion price will be reduced to a price equal to the consideration per share paid for such additional shares of common stock.

At any time following the one-year anniversary of the Series A original issuance date (September 28, 2006), the Company may cause the conversion of all, but not less than all, of the Series A Preferred Stock. However, the Company may not complete the mandatory conversion unless a registration statement under the Securities Act of 1933 is effective, registering for resale the shares of common stock to be issued upon conversion of the Series A Preferred Stock.

The Senior Subordinated Note and the Senior Subordinated Revolving Note both mature on September 28, 2009 and carry a floating interest rate equal to the higher of 11% or the 90 day average of the 10 year U.S. Treasury Note plus 650 basis points, which resets and is payable quarterly. Both the Senior Subordinated Notes and the Senior Subordinated Revolving Notes are subordinated to our Senior Credit Facilities.

On April 14, 2007, we completed a related transaction with GDBA Investments, LLLP which included an additional $3 million in subordinated debt. The facility matures December 31, 2007 with the provision for one six-month extension. The facility has a floating interest rate equal to the 10 year Treasury plus 650 basis points, which is payable and resets quarterly.

On June 30, 2007, we had dividends payable of $34,854 to GDBA Investments, LLLP.

BOCO Investments, LLC

On September 28, 2006, we completed a $10 million private placement with BOCO Investments, LLC consisting of 250,000 shares of Series A Convertible Preferred Stock at $12.00 per share and $7 million in Senior Subordinated Debt, $3.5 million of which was drawn at closing and $3.5 million of which has a revolving feature and can be drawn as needed. Additionally Mr. Joseph Zimlich, BOCO Investments, LLC s Chief Executive Officer, purchased 17,000 shares of Series A Convertible Preferred Stock at $12.00 per share in his own name.

The Series A Convertible Preferred Stock issued under these transactions pays a 5% annual dividend on the Original Issue Price of $12.00, payable quarterly and is convertible to common stock at a $3.00 conversion price. Each share of Series A Convertible Preferred Stock is convertible, at the option of the holder, at any time after the issuance of the such share.

In the event the Company issues or sells additional shares of common stock for consideration less than the Series A conversion price in effect on the date of such issuance or sale (currently $3.00 per share), then the Series A conversion price will be reduced to a price equal to the consideration per share paid for such additional shares of common stock.

At any time following the one-year anniversary of the Series A original issuance date (September 28, 2006), the Company may cause the conversion of all, but not less than all, of the Series A Prefeerred Stock. However, the Company may not complete the mandatory conversion unless a registration statement under the Securities Act of 1933 is effective, registering for resale the shares of common stock to be issued upon conversion of the Series A Preferred Stock.

The Senior Subordinated Notes mature on September 28, 2009 and carry an interest rate equal to the higher of 11% or the 90 day average of the 10 year U.S. Treasury Note plus 650 basis points. The Revolving Notes mature on September 28, 2009 and carry an interest rate equal to the higher of 11% or the 90 day average of the 10 year U.S. Treasury Note plus 650 basis points. Both the Senior Subordinated Notes and the Senior Subordinated Revolving Notes are subordinated to our Senior Credit Facilities.

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On April 14, 2007, we completed a transaction with BOCO Investments, LLC which included an additional $3 million in subordinated debt. The facility matures December 31, 2007 with the provision for one six-month extension. The facility has a floating interest rate equal to the 10 year Treasury plus 650 basis points, which is payable and resets quarterly.
On June 30, 2007, we had dividends payable of $37,397 to BOCO Investments and $2,543 to Mr. Zimlich.
On June 30, 2007 our outstanding principal balances on our Senior Subordinated Note and Senior Subordinated Revolving Note were:

Senior subordinated note	GDBA Investments	$ 3,731,991
Senior subordinated note	BOCA Investments	3,731,991
		$ 7,463,983
Senior subordinated revolving note	GDBA Investments	$ 3,575,000
Senior subordinated revolving note	BOCA Investments	4,275,000
Total Senior subordinated revolving note		$ 7,850,000

DB Marketing LTD
We utilize the marketing services of DB Marketing LTD for most of our marketing efforts as well as some of our public relations and investor relations. The principal of DB Marketing, LTD is Mr. Doug Backman, who is the son of Mr. G. Brent Backman our majority shareholder and a director of our company. We paid a total of $22,936 to DB Marketing during the quarter ended June 30, 2007, $3,712 for DB Marketing Services and $19,224 for other vendors contracted by DB Marketing.

(5) Notes Receivable and Development Deposits

During the course of acquiring properties for development, Across America Real Estate Corp, on behalf of its subsidiaries and development partners, typically is required to provide capital for earnest money deposits that may or may not be refundable in addition to investing in entitlements for properties before the actual land purchase. Because these activities represent a risk of our capital in the event the land purchase is not completed, it is our policy to require our development partners to personally sign promissory notes to Across America Real Estate Corp. for all proceeds expended before land is purchased. Once the land has been purchased and can collateralize the capital invested by us, the promissory note is cancelled. AARD had $ 759,993 in earnest money deposits outstanding at June 30, 2007. These deposits were held by development partners who have each secured them through promissory notes held by us. These promissory notes generally are callable on demand and carry an interest rate of 12% per annum.

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(6) Property and Equipment

The Company s property and equipment consisted of the following at June 30, 2007:

Equipment	$	23,049
Furniture and fixtures		17,396
Computers and related equipment		34,018
Software and intangibles		76,107
Leasehold improvements		
	$	150,570
less accumulated depreciation		(21,100)
	$	129,470

Depreciation expense totaled $6,404 and $2,015 for the quarters ended June 30, 2007 and June 30, 2006 respectively. Depreciation expense for the quarter ended June 30, 2007 includes $642 related to the depreciation of equipment under capital lease.

(7) Shareholders Equity

Preferred Stock

The Board of Directors is authorized to issue shares of preferred stock in series and to fix the number of shares in such series as well as the designation, relative rights, powers, preferences, restrictions, and limitations of all such series.

Series A Convertible Preferred Stock

As of June 30, 2007 the Company has 517,000 shares of Series A Convertible Preferred Stock authorized and issued. Each share pays a 5% annual dividend on the Original Issue Price of $12.00, payable quarterly and is convertible to common stock at a $3.00 conversion price.

Common Stock

As of June 30, 2007 the Company has 50,000,000 shares of common stock that are authorized, 16,036,625 shares that are issued and outstanding at a par value of $.001 per share.

Stock Based Compensation

On November 8, 2006 Across America Real Estate Corp s Board of Directors approved the issuance of options under the Corporation s 2006 Incentive Compensation Plan. Under the plan the company is authorized issue shares or options to purchase shares up not to exceed 1,000,000 shares. Options granted shall not be exercisable more than ten years after the date of the grant. The exercise price of any option grant shall not be less than the fair market value of the stock price on the date of the grant.

Under the plan, three of the company s officers were granted options to purchase a total of 385,000 shares of common stock at the closing stock price as of November 8, 2006, which was $1.65 per share. The options were granted with a five year term and a vesting schedule of 25% per year for four years on the anniversary date of employment beginning with the next anniversary date for each employee.

The fair value of the each option was calculated on the grant date of November 8, 2006 using the Black-Scholes model and was valued at $0.94 using the following assumptions and inputs:

Risk free interest rate		4.61%
Expected life		5.0
Dividend yield		0.00%
Expected volatility		62.69%
Fair Value	$	0.94

On March 6, 2007, three of the Company s directors were granted options under the plan to purchase a total of 15,000 shares of common stock at the closing stock price as of March 6, 2007, which was $2.75 per share. The options were granted with a five year term and a vesting schedule of 25% per year for four years on the anniversary date of the

grant.

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The fair value of each option was calculated on the grant date of March 6, 2007 using the Black-Scholes model and was valued at $1.94 using the following assumptions and inputs:

Risk free interest rate		4.48%
Expected life		5.0
Dividend yield		0.00%
Expected volatility		86.87%
Fair Value	$	1.94

On April 2, 2007, employees were granted options under the plan to purchase a total 55,000 shares of common stock at the closing stock price as of April 2, 2007, which was $1.90 per share. The options were granted with a five year term and a vesting schedule of 25% per year for four years on the anniversary date of the grant.

The fair value of each option was calculated on the grant date of April 2, 2007 using the Black-Scholes model and was value at $1.34 using the following assumptions and inputs:

Risk free interest rate		4.54%
Expected life		5.0
Dividend yield		0.00%
Expected volatility		86.87%
Fair Value	$	1.34

There are a number of assumptions and estimates used in calculating the fair value of options. These include the expected term of the option, the expected volatility and the risk free interest rate. These assumptions are included in the charts above. The basis for our expected volatility and expected term estimates is a combination of our historical information. The risk-free interest rate is based upon yields of U.S. Treasury strips with terms equal to the expected life of the option or award being valued. Across America Real Estate Corp does not currently pay a dividend nor does the Company expect to pay a dividend.

The total amount of compensation calculated for the full amount of options granted is $465,923, of which $73,691 accounted for options granted during the quarter ended June 30, 2007. We accrue the stock based compensation expense in the periods in which the grants vest. For the quarter ended June 30, 2007, we accrued $36,981 in expense related to stock based compensation.

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Stock option activity for the six months ended June 30, 2007 is summarized as follows:

	Options Outstanding				Options Exercisable			
	Number of Options	Weighted Average Exercise Price	Weighted Remaining Contractual Term	Aggregate Intrinsic Value	Shares Exercisable	Weighted Average Exercise Price	Weighted Remaining Contractual Term	Aggregate Intrinsic Value
Balance at December 31, 2005								
Activity during 2006:								
Granted	385,000	1.65	4.9					
Expired/Cancelled								
Forfeited								
Exercised								
Balance at December 31, 2006	385,000	1.65	4.9	1,732,500				
Activity during 2007:								
Granted	70,000	2.08	4.7					
Expired/Cancelled								
Forfeited								
Exercised								
Balance, at June 30, 2007	455,000	1.72	4.4	447,500				

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(8) Income Taxes

The provision for income taxes consists of the following:

Income tax expense (benefit):

Current tax expense (benefit):	
Federal	$ (366,077)
State	(52,508)
Total current tax expense (benefit)	$ (418,585)

Significant components of the Company s deferred tax assets and liabilities are as follows:

Deferred tax assets:	
Impairment of Asset	$ 756,410
Partnership income	177,748
Bad Debt	84,221
Depreciation	19,320
Total deferred tax assets	$ 1,037,698

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for for income tax purposes.

Reconciliation of the income tax expense computed at U.S. federal statutory to the provision for income taxes is as follows:

Deferred tax expense (benefit):	
Federal	$ (652,116)
State	(95,899)
Total net deferred tax expense	$ (748,015)

Tax at US federal statutory rates	$ (366,076)
State income taxes, net of federal	(52,508)
Change in beginning deferred balance	(748,016)
Total income tax benefit	$ (1,166,600)

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the realization of future taxable income during the periods in which those temporary differences become deductible. Management considers past history, the scheduled reversal of taxable temporary differences, projected future taxable income, and tax planning strategies in making this assessment. A valuation allowance for deferred tax assets is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. It is the full intention of the Company, that any carryback and carryforward amounts will be utilized against future taxable income. As of June 30, 2007, the Company has a valuation allowance of $ -0-.

(9) Noncontrolling Interests

Following is a summary of the noncontrolling interests in the equity of the Company s subsidiaries. The Company establishes a subsidiary for each real estate project. Ownership in the subsidiaries is allocated between the Company and the co-developer/contractor.

	Balance March 31, 2007	Earnings allocated to Noncontrolling Interest	Earnings disbursed/accrued for Noncontrolling Interest	Balance June 30, 2007
Cypress	$ 4,594	$	$	$ 4,594
2245 Main	2,384	(2,384)		1
Bluffton	2,502			2,502
Bluffton 46	60			60
Laveen	298			298
West Valley	298			298
American Fork	12,719			12,719
OP7	(12,356)	(66,553)		(78,909)
Buckeye		1,633		1,633
Total	$ 10,499	$ (67,304)	$	$ (56,805)

(10) Concentration of Credit Risk for Cash

The Company has concentrated its credit risk for cash by maintaining deposits in financial institutions, which may at times exceed the amounts covered by insurance provided by the United States Federal Deposit Insurance Corporation (FDIC). The loss that would have resulted from that risk totaled $1,409,850 at June 30, 2007, for the excess of the deposit liabilities reported by the financial institution versus the amount that would have been covered by FDIC. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk to cash.

(11) Operating Lease Commitments

Lessee

The Company entered into an office sublease agreement on October 28, 2006, which commenced December 11, 2006 and expires December 31, 2007. The lease payment is $4,432 per month.

Combined future minimum lease payments under the leases are as follows:

December 31,	
2007	$ 26,592

(12) Notes Payable

Vectra Bank Senior Credit Facility:

On April 25, 2005, we received a $10,000,000 financing commitment under a Senior Credit Agreement from Vectra Bank of Colorado (Vectra Bank). This commitment permits us to fund construction notes for build-to-suit real estate projects for national and regional chain retailers. The financing is facilitated through a series of promissory notes. Each note is issued for individual projects under the facility and must be underwritten and approved by Vectra Bank and has a term of 12 months with one (1) allowable extension not to exceed 6 months subject to approval. Interest is funded from an interest reserve established with each construction loan. The interest rate on each note is equal to the 30 day LIBOR plus 2.25%. Each note under the facility is for an amount, as determined by Vectra Bank, not to exceed the lesser of 75% of the appraised value of the real property under the approved appraisal for the project or 75% of the project costs. Principal on each note is due at maturity, with no prepayment penalty. Vectra Bank retains a First Deed of Trust on each property financed and the facility has the personal guarantees of GDBA and its principals.

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On August 3, 2006 we executed a First Amendment to our Senior Credit Agreement with Vectra Bank extending the expiration date of the facility to July 21, 2007, which is renewable annually. The terms and conditions of each construction note issued under the facility remain unchanged, and any construction issued prior to the expiration date of the Credit Agreement, will survive the expiration of the facility and will be subject to its individual term as outlined in the Credit Agreement.

As of June 30, 2007, we had four outstanding notes under this facility with a principal amount totaling $2,354,647. Total interest accrued through June 30, 2007 was $70,061.

United Western Bank Senior Credit Facility

On May 7, 2007, we entered into a $25 million senior credit facility with United Western Bank. This commitment permits us to fund construction notes for build-to-suit real estate projects for national and regional chain retailers. The financing is facilitated through a series of promissory notes. Each note is issued for individual projects under the facility and must be underwritten and approved by United Western Bank and has a term of 12 months with one (1) allowable extension not to exceed 6 months subject to approval. Interest is funded from an interest reserve established with each construction loan. The interest rate on each note is equal to Prime rate minus 50 basis points Each note under the facility is for an amount, as determined by United Western Bank, not to exceed the lesser of 75% of the appraised value of the real property under the approved appraisal for the project or 75% of the project costs. Principal on each note is due at maturity, with no prepayment penalty. United Western Bank retains a First Deed of Trust on each property financed.

As of June 30, 2007, we had one outstanding note under this facility with a principal amount totaling $1,088,181.

As of June 30, 2007 our total outstanding principal due on all outstanding notes payable and our annual schedule of repayment is as follows:

2007	$ 436,794
2008	3,076,095
	$ 3,512,889

(13) Capital Lease Obligations

The Company entered into a capital equipment lease on October 4, 2005. The lease commenced on October 4, 2005 and expires September 26, 2010. The lease payment is $231 per month.

The Company entered into a sublease agreement with Matrix Tower Holdings, LLC on October 28, 2006. As part of the agreement, the Company has agreed to pay $500 per month for the use of the existing furniture at the premise. On December 1, 2007 AARD shall purchase the furniture for $10.

The future minimum lease payments under the leases are as follows:

2007	$ 4,386
2008	2,772
2009	2,772
2010	2,289
	$ 12,219
less imputed interest	438
	$ 11,781

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Assets held under capital leases are recorded at the fair value of the leased asset at the inception of the lease. Amortization expense is computed using the straight-line method over the shorter of the estimated useful lives of the assets or the period of the related lease.

(14) Spin Off of Subsidiaries

On January 10, 2007, the Company s directors approved, subject to the effectiveness of a registration with the Securities and Exchange Commission, a spin-off to Company shareholders of record as of March 1, 2007 (the Record Date), on a pro rata basis, with one share each of Across America Real Estate Exchange, Inc. and Across America Financial Services, Inc. to be issued for each ten shares issued and outstanding of Company common stock or common stock upon conversion of Company preferred stock owned by such shareholders as of the Record Date. The registration statements of Across America Real Estate Exchange, Inc. and Across America Financial Services, Inc. became effective on February 21, 2007 and March 19, 2007, respectively. The new shares of Across America Real Estate Exchange, Inc. and Across America Financial Services, Inc. were distributed to Company shareholders on or about March 23, 2007.

(15) Impairment of Assets

We invest significantly in real estate assets. Accordingly, our policy on asset impairment is considered a critical accounting estimate. Management periodically evaluates the Company s property and equipment to determine whether events or changes in circumstances indicate that a possible impairment in the carrying values of the assets has occurred. As part of this evaluation, and in accordance with Statement of Financial Accounting Standard (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS No. 144), the Company records the carrying value of the property at the lower of its carrying value or its estimated fair value, less estimated selling costs. The amount the Company will ultimately realize on these asset sales could differ from the amount recorded in the financial statements. The Company engages real estate brokers to assist in determining the estimated selling price or when external opinions are not available uses their own market knowledge. The estimated selling costs are based on the Company s experience with similar asset sales. The Company records an impairment charge and writes down an asset s carrying value if the carrying value exceeds the estimated selling price less costs to sell.

An impairment of assets of $1,939,513 was recorded during the three months ended June 30, 2007 included the following (amounts below are individually rounded):

$898,047 for Ridgeview which reflected the final disposition price of the property

$127,494 for Bluffton 46 which reflected current market value for undeveloped land and our cost to finance the property

$316,544 for Bluffton which reflected current market value for undeveloped land and our cost to finance the property

$442,925 for West Valley which reflected cost to complete project and the current market value for such properties

$154,504 for American Fork which reflected current market value for similar properties.

(16) Selling, General and Administrative Expense

The Company s selling, general and administrative expense for the quarter ended June 30, 2007 was $1,081,704 compared to $348,639 for the quarter ended June 30, 2006. The major components of selling, general and administrative expense are as follows:

Expense Type	Quarter Ending June 30, 2007	June 30, 2006
Payroll and related expenses	$ 613,667	$ 238,852
Bad Debt Expense	215,953	
Premise and Equipment	23,726	11,137
Computer	23,132	1,676
General Office	20,401	5,906
Professional Fees	108,407	37,717
Marketing	28,319	13,399
Other	48,099	39,952
Total Selling, General and Administrative	$ 1,081,704	$ 348,639

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS AND PLAN OF OPERATION

The following discussion of our financial condition and results of operations should be read in conjunction with, and is qualified in its entirety by, the consolidated financial statements and notes thereto included in, Item 1 in this Quarterly Report on Form 10-QSB. This item contains forward-looking statements that involve risks and uncertainties. Actual results may differ materially from those indicated in such forward-looking statements.

Forward-Looking Statements

This Quarterly Report on Form 10-QSB and the documents incorporated herein by reference contain forward-looking statements that have been made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are based on current expectations, estimates, and projections about our industry, management beliefs, and certain assumptions made by our management. Words such as anticipates , expects , intends plans , believes , seeks , estimates , variations of such words, and similar expressions are intended to identify s forward-looking statements. These statements are not guarantees of future performance and are subject to certain risks, uncertainties, and assumptions that are difficult to predict; therefore, actual results may differ materially from those expressed or forecasted in any such forward-looking statements. Unless required by law, we undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events, or otherwise. However, readers should carefully review the risk factors set forth herein and in other reports and documents that we file from time to time with the Securities and Exchange Commission, particularly the Report on Form 10-SB, and future Annual Reports on Form 10-KSB and any Current Reports on Form 8-K.

(a) RISK FACTORS

You should carefully consider the risks and uncertainties described below; and all of the other information included in this document. Any of the following risks could materially adversely affect our business, financial condition or operating results and could negatively impact the value of your investment.

WHILE WE HAVE GENERATED A MODEST PROFIT IN TWO OF OUR LAST THREE FISCAL YEARS, THERE IS NO GUARANTEE THAT WE WILL BE PROFITABLE IN THE FUTURE.

Our revenues for the fiscal year ended December 31, 2006 were $8,459,994. We had a net loss of $735,771 for the fiscal year ended December 31, 2006. On the other hand, our revenues for the fiscal year ended December 31, 2005 were $7,951,962. We had net income of $77,666 for the fiscal year ended December 31, 2005. Our revenues for the fiscal year ended December 31, 2004 were $1,787,922. We had net income of $25,686 for the fiscal year ended December 31, 2004. Although we have had a modest profit in two of the past three fiscal years, we cannot say whether we will be able to achieve sustained profitability. We were not profitable in our most recent fiscal quarter. In fact, we recorded an impairment to our assets of approximately $1,940,000. We cannot guarantee that we will not experience further impairments to our assets or other losses which could cause us to be unprofitable in our latest fiscal year. We have only completed a limited number of transactions, so it continues to be difficult for us to accurately forecast our quarterly and annual revenue. However, we use our forecasted revenue to establish our expense budget. Most of our expenses are fixed in the short term or incurred in advance of anticipated revenue. As a result, we may not be able to decrease our expenses in a timely manner to offset any revenue shortfall. We attempt to keep revenues in line with expenses but cannot guarantee that we will be able to do so.

WE WILL NEED ADDITIONAL FINANCING IN THE FUTURE BUT CANNOT GUARANTEE THAT IT WILL BE AVAILABLE TO US.

In order to expand our business, we will continue to need additional capital. To date, we have been successful in obtaining capital, but we cannot guarantee that additional capital will be available at all or under sufficient terms and conditions for us to utilize it. Because we have an ongoing need for capital, we may experience a lack of liquidity in our future operations. We will need additional financing of some type, which we do not now possess, to fully develop our business plan. We expect to rely principally upon our ability to raise additional financing, the success of which cannot be guaranteed. To the extent that we experience a substantial lack of liquidity, our development in accordance with our business plan may be delayed or indefinitely postponed, which would have a materially adverse impact on our operations and the investors investment.

AS A COMPANY WITH LIMITED OPERATING HISTORY, WE ARE INHERENTLY A RISKY INVESTMENT. OUR OPERATIONS ARE SUBJECT TO OUR ABILITY TO FINANCE REAL ESTATE PROJECTS.

Because we are a company with a limited history, our operations, which consist of real estate financing of build-to-suite projects for specific national retailers, must be considered an extremely risky business, subject to numerous risks. Our operations will depend, among other things, upon our ability to finance real estate projects and for those projects to be sold. Further, there is the possibility that our proposed operations will not generate income sufficient to meet operating expenses or will generate income and capital appreciation, if any, at rates lower than those anticipated or necessary to sustain the investment. The value of our assets may become impaired by a variety of factors, which would make it unlikely, if not impossible to profit from the sale of our real estate. Our operations may be affected by many factors, some of which are beyond our control. Any of these problems, or a combination thereof, could have a materially adverse effect on our viability as an entity.

WE HAVE A HEAVY RELIANCE ON OUR CURRENT FUNDING COMMITMENTS WITH TWO SIGNIFICANT SHAREHOLDERS.

We are currently dependant upon our relationships with GDBA Investments, LLLP,(GDBA), our largest shareholder, and BOCO Investments, LLC,(BOCO) a private Colorado limited liability company. Each has provided us with funding through a $10 million subordinated debt vehicle and a $3 million preferred convertible equity. We would be unable to fund any projects if we lose our current funding commitment from these shareholders. In addition, our senior credit facility with Vectra Bank Colorado, which is renewable annually, has been guaranteed by GDBA and its principals. We are currently seeking to renew our senior credit facility without the continuation of these guarantees but cannot guarantee that we will be able to do so. In any case, we expect to rely upon both GDBA and BOCO for funding commitments for the foreseeable future.

OUR INDEBTEDNESS UNDER OUR VARIOUS CREDIT FACILITIES ARE SUBSTANTIAL AND COULD LIMIT OUR ABILITY TO GROW OUR BUSINESS.

As of June 30, 2007, we had total indebtedness under our various credit facilities of approximately $18.8 million. Our indebtedness could have important consequences to you.

For example, it could:

- increase our vulnerability to general adverse economic and industry conditions;
- require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness if we do not maintain specified financial ratios, thereby reducing the availability of our cash flow for other purposes; or
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate, thereby placing us at a competitive disadvantage compared to our competitors that may have less indebtedness.

In addition, our credit facilities permit us to incur substantial additional indebtedness in the future. As of June 30, 2007, we had approximately $32.1 million available to us for additional borrowing under our $55 million various credit facilities. If we increase our indebtedness by borrowing under our various credit facilities or incur other new indebtedness, the risks described above would increase.

OUR VARIOUS CREDIT FACILITIES HAVE RESTRICTIVE TERMS AND OUR FAILURE TO COMPLY WITH ANY OF THESE TERMS COULD PUT US IN DEFAULT, WHICH WOULD HAVE AN ADVERSE EFFECT ON OUR BUSINESS AND PROSPECTS.

Our various credit facilities contain a number of significant covenants. These covenants limit our ability and the ability of our subsidiaries to, among other things:

- incur additional indebtedness;
- make capital expenditures and other investments above a certain level;
- merge, consolidate or dispose of our assets or the capital stock or assets of any subsidiary;
- pay dividends, make distributions or redeem capital stock in certain circumstances;
- enter into transactions with our affiliates;
- grant liens on our assets or the assets of our subsidiaries; and
- make or repay intercompany loans.

Our various credit facilities require us to maintain specified financial ratios. Our ability to meet these financial ratios and tests can be affected by events beyond our control, and we may not meet those ratios. A breach of any of these restrictive covenants or our inability to comply with the required financial ratios would result in a default under our various credit facilities or require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness. If the creditors accelerate amounts owing under our various credit facilities because of a default and we are unable to pay such amounts, the creditors have the right to foreclose on our assets.

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WE PAY INTEREST ON ALL OF OUR CREDIT FACILITIES AT VARIABLE RATES, RATHER THAN FIXED RATES, WHICH COULD AFFECT OUR PROFITABILITY.

All of our credit facilities provide for the payment of interest at variable rates. None of our credit facilities provide for the payment of interest at fixed rates. We can potentially realize profitability to the extent that we can borrow at a lower rate of interest and charge a higher rate of interest in our operations. Because our credit facilities are at variable rates, our profit margins could be depressed or even eliminated by rising interest rates on funds we must borrow. Rising interest rates could have a materially adverse affect on our operations.

WE DO NOT HAVE A LONG HISTORY OF BEING ABLE TO SELL PROPERTIES AT A PROFIT

We have only been in business since 2003. We do not have a significant track record and may be unable to sell properties upon completion. We may be forced to sell properties at a loss. Furthermore, in order to sell properties for a profit, we may be forced to hold properties for longer periods that we plan, which may require the need for additional financing sources. Any of these conditions would likely result in reduced operating profits and could likely strain current funding agreements.

MANAGEMENT OF POTENTIAL GROWTH.

We hope to experience rapid growth which, if achieved, will place a significant strain on our managerial, operational, and financial systems resources. To accommodate our current size and manage growth, we must continue to implement and improve our financial strength and our operational systems, and expand. There is no guarantee that we will be able to effectively manage the expansion of our operations, or that our systems, procedures or controls will be adequate to support our expanded operations or that we will be able to obtain facilities to support our growth. Our inability to effectively manage our future growth would have a material adverse effect on us.

THE MANNER IN WHICH WE FINANCE OUR PROJECTS CREATES THE POSSIBILITY OF A CONFLICT OF INTEREST.

We fund our projects with construction financing obtained through the efforts of our management and our shareholders, GDBA and BOCO. This arrangement could create a conflict of interest with respect to such financings. However, there may be an inherent conflict of interest in the arrangement until such time as we might seek such financings on a competitive basis.

LACK OF INDEPENDENT DIRECTORS.

We do not have a majority of independent directors on our board of directors and we cannot guarantee that our board of directors will have a majority of independent directors in the future. In the absence of a majority of independent directors, our executive officers, which are also principal stockholders and directors, could establish policies and enter into transactions without independent review and approval thereof. This could present the potential for a conflict of interest between our stockholders and us generally and the controlling officers, stockholders or directors.

INTENSE COMPETITION IN OUR MARKET COULD PREVENT US FROM DEVELOPING REVENUE AND PREVENT US FROM ACHIEVING ANNUAL PROFITABILITY.

We provide a defined service to finance real estate projects. The barriers to entry are not significant. Our service could be rendered noncompetitive or obsolete. Competition from larger and more established companies is a significant threat and expected to increase. Most of the companies with which we compete and expect to compete have far greater capital resources, and many of them have substantially greater experience in real estate development. Our ability to compete effectively may be adversely affected by the ability of these competitors to devote greater resources than we can.

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POTENTIAL FLUCTUATIONS IN QUARTERLY OPERATING RESULTS.

Our quarterly operating results may fluctuate significantly in the future as a result of a variety of factors, most of which are outside of our control, including: the demand for our products or services; seasonal trends in financing; the amount and timing of capital expenditures and other costs relating to the development of our properties; price competition or pricing changes in the industry; technical or regulatory difficulties; general economic conditions; and economic conditions specific to our industry. Our quarterly results may also be significantly impacted by the impact of the accounting treatment of acquisitions, financing transactions or other matters. Particularly at our early stage of development, such accounting treatment can have a material impact on the results for any quarter. Due to the foregoing factors, among others, it is likely that our operating results will fall below our expectations or those of investors in some future quarter.

OUR SUCCESS WILL BE DEPENDENT UPON OUR OPERATING PARTNERS EFFORTS.

Our success will be dependent, to a large extent, upon the efforts of our operating partners in our various projects. To the extent that these partners, individually or collectively, fail to develop projects in a timely or cost-effective manner, our profit margins could be depressed or even eliminated. If we cannot or do not select appropriate partners for our projects, our profitability and viability will suffer. The absence of one or more partners who develop projects in a timely or cost-effective manner could have a material, adverse impact on our operations.

OUR SUCCESS WILL BE DEPENDENT UPON OUR MANAGEMENT S EFFORTS.

Our success will be dependent upon the decision making of our directors and executive officers. These individuals intend to commit as much time as necessary to our business, but this commitment is no assurance of success. The loss of any or all of these individuals, particularly Ms. Ann L. Schmitt, our President, and James W. Creamer, III, our Chief Financial Officer, could have a material, adverse impact on our operations. We have no written employment agreements with any officers and directors, including Ms. Schmitt or Mr. Creamer. We have not obtained key man life insurance on the lives of any of these individuals.

LIMITATION OF LIABILITY AND INDEMNIFICATION OF OFFICERS AND DIRECTORS.

Our officers and directors are required to exercise good faith and high integrity in our management affairs. Our articles of incorporation provides, however, that our officers and directors shall have no liability to our stockholders for losses sustained or liabilities incurred which arise from any transaction in their respective managerial capacities unless they violated their duty of loyalty, did engaged in intentional misconduct or gross negligence. Our articles and bylaws also provide for the indemnification by us of the officers and directors against any losses or liabilities they may incur as a result of the manner in which they operate our business or conduct the internal affairs.

OUR STOCK PRICE MAY BE VOLATILE, AND YOU MAY NOT BE ABLE TO RESELL YOUR SHARES AT OR ABOVE THE PUBLIC SALE PRICE.

There has been, and continues to be, a limited public market for our common stock. Our common stock trades on the NASD Bulletin Board. However, an active trading market for our shares has not, and may never develop or be sustained. If you purchase shares of common stock, you may not be able to resell those shares at or above the initial price you paid. The market price of our common stock may fluctuate significantly in response to numerous factors, some of which are beyond our control, including the following:

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* actual or anticipated fluctuations in our operating results;

* changes in financial estimates by securities analysts or our failure to perform in line with such estimates;

* changes in market valuations of other real estate oriented companies, particularly those that market services such as ours;

* announcements by us or our competitors of significant innovations, acquisitions, strategic partnerships, joint ventures or capital commitments;

* introduction of technologies or product enhancements that reduce the need for our services;

* the loss of one or more key customers; and

* departures of key personnel.

Further, we cannot assure that an investor will be able to liquidate his investment without considerable delay, if at all. The factors which we have discussed in this document may have a significant impact on the market price of our common stock. It is also possible that the relatively low price of our common stock may keep many brokerage firms from engaging in transactions in our common stock.

As restrictions on resale end, the market price of our stock could drop significantly if the holders of restricted shares sell them or are perceived by the market as intending to sell them.

BUYING A LOW-PRICED PENNY STOCK SUCH AS OURS IS RISKY AND SPECULATIVE.

Our shares are defined as a penny stock under the Securities and Exchange Act of 1934, and rules of the Commission. The Exchange Act and such penny stock rules generally impose additional sales practice and disclosure requirements on broker-dealers who sell our securities to persons other than certain accredited investors who are, generally, institutions with assets in excess of $5,000,000 or individuals with net worth in excess of $1,000,000 or annual income exceeding $200,000, or $300,000 jointly with spouse, or in transactions not recommended by the broker-dealer. For transactions covered by the penny stock rules, a broker-dealer must make a suitability determination for each purchaser and receive the purchaser s written agreement prior to the sale. In addition, the broker-dealer must make certain mandated disclosures in penny stock transactions, including the actual sale or purchase price and actual bid and offer quotations, the compensation to be received by the broker-dealer and certain associated persons, and deliver certain disclosures required by the SEC. Consequently, the penny stock rules may affect the ability of broker-dealers to make a market in or trade our common stock and may also affect your ability to sell any of our shares you may own in the public markets.

WE DO NOT EXPECT TO PAY DIVIDENDS ON COMMON STOCK.

We have not paid any cash dividends with respect to our common stock, and it is unlikely that we will pay any dividends on our common stock in the foreseeable future. Earnings, if any, that we may realize will be retained in the business for further development and expansion.

Overview and History

Across America Real Estate Corp. was incorporated under the laws of the State of Colorado on April 22, 2003.

In 2003, we completed a registered offering of our common shares under the provisions of the Colorado securities laws and under an exemption from the federal securities laws. We raised a total of $34,325 in this offering.

We act as a co-developer, including as a financier, to develop built-to-suit real estate projects for specific retailers and other tenants who sign long-term leases for use of the property. Our primary source of revenue is from profits we receive upon the sale of our projects upon completion; however we also receive revenue from preferred dividends on our invested capital in projects, management fees we charge to our projects and rental income from our completed projects before their disposition. In addition we may share in certain revenues directly related to our projects with our development partners such as development fees and leasing and sales commissions

On September 28, 2006, we completed a $20 million dollar funding. BOCO Investments, LLC, a private Colorado limited liability company, agreed to provide us with new funding through a $7 million subordinated debt vehicle and a $3 million preferred convertible equity. Simultaneously, GDBA Investments, LLLP, has agreed to restructure its $10 million in subordinated debt to mirror the structure of the BOCO Investments, LLC contribution, including $3 million preferred convertible equity.

In October, 2006, management began to implement a national sales strategy where five sales regions were created throughout the United States, to include the Pacific Northwest, Southwest, South Central, Midwest and East regions. Regional vice presidents were hired to manage each of the regions, which encompass five to six states. Management focused on hiring people with significant experience and established contacts in real estate, specifically in the triple net small-box retail space. Each regional vice president is responsible for marketing our services to retailers and developers throughout their regions, as well as hire and manage sales representatives and utilize independent contractors to cover the smaller markets in their regions. Additionally, we also hired a national sales manager, who in addition to supervising the regional sales vice presidents, is responsible for the marketing the company to national retail chains.

On April 2, 2007, we hired a Senior Vice President of Operations. This individual will have the responsibility for the review of new project opportunities, oversight of projects in process and the sale of properties at project completion.

On April 14, 2007, we completed a related party transaction with GDBA Investments, LLLP and BOCO Investments, LLC which included an additional $6 million in subordinated debt, consisting of $3 million from each party. The facility matures December 31, 2007 with the provision for one six-month extension. The facility has a floating interest rate equal to the 10 year Treasury plus 650 basis points, which is payable and resets quarterly.

On May 7, 2007, we entered into a $25 million senior credit facility with United Western Bank. . This commitment permits us to fund construction notes for build-to-suit real estate projects for national and regional chain retailers. The financing is facilitated through a series of promissory notes. Each note is issued for individual projects under the facility and must be underwritten and approved by United Western Bank and has a term of 12 months with one (1) allowable extension not to exceed 6 months subject to approval. Interest is funded from an interest reserve established with each construction loan. The interest rate on each note is equal to Prime rate minus 50 basis points Each note under the facility is for an amount, as determined by United Western Bank, not to exceed the lesser of 75% of the appraised value of the real property under the approved appraisal for the project or 75% of the project costs. Principal on each note is due at maturity, with no prepayment penalty. United Western Bank retains a First Deed of Trust on each property financed.

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During the quarter ended June 30, 2007 we recognized impairment charges on five properties totaling $1,939,513 (please see footnote 15) All of the impaired properties plus $188,808 of our bad debt expense were related to business dealings with our former development partner Automotive Development Group, with whom we terminated our business relationship in October 2006.

Our principal business address is 700 17th Street, Suite 1200, Denver, Colorado 80202. We are in the business of financing and developing build-to-suit real estate projects for specific retailers who sign long-term leases for use of the property. We create each project such that it will generate income from the placement of the construction loan, rental income during the period in which the property is held, and capital appreciation upon sale of the facility. Our affiliates, subsidiaries and management develop the construction and permanent financing for our benefit.

We have not been subject to any bankruptcy, receivership or similar proceeding.

Results of Operations

The following discussion involves our results of operations for the quarters ending June 30, 2007 and June 30, 2006.

Our revenues for the quarter ended June 30, 2007 were $5,011,327compared to $143,917 for the quarter ended June 30, 2006. Project sales for the quarter ended June 30, 2007 were $4,924,336 compared to no project sales for the quarter ended June 30, 2006. Of the four properties sold during the quarter, three were land dispositions of properties that we were no longer going to develop and one property was a completed project. As we move current projects through our pipeline over the next several quarters, we would anticipate that project sales would likely increase. We had rental income for the quarter ended June 30, 2007 of $15,875 compared to $143,917 for the quarter ended June 30, 2006, which is attributable to having fewer rent producing properties in the current quarter versus the prior year. Because we target selling properties as soon as they are completed and occupied, we do not anticipate that these revenues will increase substantially over the next several quarters. Management fees and financing activity revenue, for the quarter ended June 30, 2007 were $22,943 and $48,173 respectively compared to no management fees or financing activity revenue for the quarter ended June 30, 2006. Management fees are primarily comprised of origination fees taken by us as we enter into new projects and financing activity revenues are recognized by us when a project is sold. We would anticipate these revenues will increase going forward as we continue our marketing efforts to increase our projects and as we continue to move projects through our pipeline.

We recognize cost of sales on projects during the period in which they are sold. Cost of sales for the quarter ended June 30, 2007 were $4,645,324 compared to no cost of sales recognized for the quarter ended June 30, 2006. Gross margin for the quarter ended June 30, 2007 was approximately 5.7%, which is significantly lower than our target gross margins of 15% to 20% primarily caused by the high ratio of raw land sales of our impaired property during the quarter.

Selling, general and administrative costs were $1,081,704 for the quarter ended June 30, 2007 compared to $348,639 for the quarter ended June 30, 2006. This increase was largely attributable to the substantial increase in staff over the past year in addition to increased sales and marketing activity to generate additional projects. We anticipate these costs will continue to increase as we continue to grow our business activities going forward. Included in selling, general and administrative costs for the quarter ended June 30, 2007 was $214,953 in bad debt expense which was a one time charge related to write-off of promissory notes with developers related with our impairment analysis.

During the quarter ended June 30, 2007 we recognized impairment charges on five properties totaling $1,939,513 (please see footnote 15) All of the impaired properties plus $188,808 of our bad debt expense were related to business dealings with our former development partner Automotive Development Group, with whom we terminated our business relationship in October 2006. We assessed the feasibility to moving forward and developing each project or liquidating the undeveloped properties. One project is completed and for sale, another project is under construction, two undeveloped properties are for sale and one undeveloped property, Ridgeview, was sold in June. Ridgeview represented an impairment of $898,047 or 46.3% if our total impairment. While this is a significantly larger impairment than we anticipated, of the size of the investment in this property, we made the determination that it was better to liquidate the asset. Although Automotive Development Group is contractually liable for 49% of any losses or impairments on these properties, Across America Real Estate has recognized the full effect of the impairment and we are currently evaluating our options to recoup any losses from our former development partner. While we believe that we have no other properties at immediate risk for impairment, we will continue to impairment test our portfolio on a quarterly basis.

We had a net loss of $1,923,108 for the quarter ended June 30, 2007 compared to a net loss of $213,312 for the quarter ended June 30, 2006. Comprehensive loss applicable to common shareholders, after preferred stock dividends was $2,000,446 for the quarter ended June 30, 2007 compared to $213,312 for the quarter ended June 30, 2006. The substantial increase in net loss was primarily a result of a lower than expected total gross margin for the quarter in addition to the substantial impairment charge we recognized. Additionally we have had a significant increase in selling, general and administrative costs incurred, particularly with the addition of new management and sales staff in the last year. Given that our targeted project cycle is between seven and eight months and we recognize the majority of our revenue once a project is sold upon completion, there is an expected lag of increased revenues to offset the increased cost of our additional sales and infrastructure. We anticipate that much of the increased revenue from our additional project sales efforts will be realized in the second half of 2007. We would anticipate generating enough revenue in 2007 to support the additional infrastructure and believe we could return to profitability within the next few quarters.

The following discussion involves our results of operations for the six months ending June 30, 2007 and June 30, 2006.

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Our revenues for the six-months ended June 30, 2007 were $5,239,311 compared to $2,018,995 for the six-months ended June 30, 2006. Project sales for the six-months ended June 30, 2007 were $4,924,336 compared to 1,723,000 for the six-months ended June 30, 2006. This represents four properties sold during the six-months ended June 30, 2007 compared to one property sold during the six-months ended June 30, 2006. We had rental income for the six-months ended June 30, 2007 of $52,204 compared to $268,995 for the six-months ended June 30, 2006, which is attributable to having fewer rent producing properties in the current quarter versus the prior year. Management fees and financing activity revenue, for the six-months ended June 30, 2007 were $214,598 and $48,173 respectively compared to management fees of $27,000 and no financing activity revenue for the six-months ended June 30, 2006. We would anticipate these revenues will increase going forward as we continue our marketing efforts to increase our projects and as we continue to move projects through our pipeline.

We recognize cost of sales on projects during the period in which they are sold. Cost of sales for the six-months ended June 30, 2007 were $4,645,324 compared to $1,462,852 for the six-months ended June 30, 2006. Gross margin for the six-months ended June 30, 2007 was approximately 5.7%, which is significantly lower than our target gross margins of 15% to 20% primarily because of the high ratio of raw land sales of our impaired property during the quarter. Gross margin for the six-months ended June 30, 2006 was approximately 15.1%.

Selling, general and administrative costs were $1,907,906 for the six-months ended June 30, 2007 compared to $630,100 for the six-months ended June 30, 2006. This increase was largely attributable to the substantial increase in staff over the past year in addition to increased sales and marketing activity to generate additional projects. We anticipate these costs will continue to increase as we continue to grow our business activities going forward. Also included in selling, general and administrative costs for the six-months ended June 30, 2007 was $214,953 in bad debt expense which was a one time charge related to write-off of promissory notes with developers related with our impairment analysis.

During the six-months ended June 30, 2007 we recognized impairment charges on five properties totaling $1,939,513 (please see footnote 15) All of the impaired properties plus $188,808 of our bad debt expense were related to business dealings with our former development partner Automotive Development Group, with whom we terminated our business relationship in October 2006. We assessed the feasibility to moving forward and developing each project or liquidating the undeveloped properties. One project is completed and for sale, another project is under construction, two undeveloped properties are for sale and one undeveloped property, Ridgeview, was sold in June. Ridgeview represented an impairment of $898,047 or 46.3% if our total impairment. While this is a significantly larger impairment than we anticipated, of the size of the investment in this property, we made the determination that it was better to liquidate the asset. Although Automotive Development Group is contractually liable for 49% of any losses or impairments on these properties, Across America Real Estate has recognized the full effect of the impairment and we are currently evaluating our options to recoup any losses from our former development partner. While we believe that we have no other properties at immediate risk for impairment, we will continue to impairment test our portfolio on a quarterly basis.

We had a net loss of $2,336,575 for the six-months ended June 30, 2007 compared to a net loss of $257,329 for the six-months ended June 30, 2006. Comprehensive loss applicable to common shareholders, after preferred stock dividends was $2,490,401 for the six-months ended June 30, 2007 compared to $257,329 for the six-months ended June 30, 2006. The substantial increase in net loss was primarily the result of a lower than expected total gross margin for the period in addition to the substantial impairment charge we recognized. Additionally we have had a significant increase in selling, general and administrative costs incurred, particularly with the addition of new management and sales staff in the last year. Given that our targeted project cycle is between seven and eight months and we recognize the majority of our revenue once a project is sold upon completion, there is an expected lag of increased revenues to offset the increased cost of our additional sales and infrastructure.

We anticipate that much of the increased revenue from our additional project sales efforts will be realized in the second half of 2007. We would anticipate generating enough revenue in 2007 to support the additional infrastructure and believe we could return to profitability within the next few quarters.

Liquidity and Capital Resources

Cash and cash equivalents, were $1,609,850 on June 30, 2007 compared to $1,097,440 on December 31, 2006.

Cash used in operating activities increased to $411,566 for the six-months ended June 30, 2007 compared to cash provided by operating activities of $91,871 for the six-months ended June 30, 2006. This was primarily the result of our increase project flow and funding construction in progress and investment in land, offset by additional indebtedness to related parties. As we continue to increase our project pipeline, we anticipate that cash used in operations will continue to be significant.

Cash used in investing activities increased to $456,690 for the six-months ended June 30, 2007 compared to $119,530 used in investing activities for the six-months ended June 30, 2006. We issue promissory notes to our development partners when we invest earnest money on potential new projects which are retired when we purchase the land into the subsidiary. The issuance of these notes receivable were substantially higher for the six-months ended June 30, 2007 compared to June 30, 2006 given our increased project pipeline activity, which we would expect to continue.

Cash provided by financing activities was $1,380,663 the six-months ended June 30, 2007 compared to cash used in financing activities of 146,782 for the six-months ended June 30, 2006. This shift is primarily the result of our increase project activity. As we continue to increase our project pipeline we expect that our cash provided by financing activities will continue to be significant. On June 30, 2007 we were had total availability on our three Senior Subordinated Revolving Notes of $4,686,017 and we had availability of $27,442,500 on our two Senior Credit Facilities as of June 30, 2007.

Because we recognized impairment charges on five properties totaling $1,939,513 (please see footnote 15) in one quarter, we became subject to an Event of Default provision under our Senior Subordinate Revolving Notes. This Event of Default provision was triggered when we recognized a net loss under GAAP of greater than $1,000,000 in any calendar quarter. This Event of Default provision has been waived by our Senior Subordinate Note Holders.

Management continues to assess our capital resources in relation to our ability to fund continued operations on an ongoing basis. As such, management may seek to access the capital markets to raise additional capital through the issuance of additional equity, debt or a combination of both in order to fund our operations and continued growth.

Recently Issued Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140. Companies are required to apply Statement 155 as of the first annual reporting period that begins after September 15, 2006. The Company does not believe adoption of SFAS No. 155 will have a material effect on its consolidated financial position, results of operations or cash flows.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140. Companies are required to apply Statement 156 as of the first annual reporting period that begins after September 15, 2006. The Company does not believe adoption of SFAS No. 156 will have a material effect on its consolidated financial position, results of operations or cash flows.

In June 2006, the FASB issued Interpretation No.48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 , (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes . FIN 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return that results in a tax benefit. Additionally, FIN 48 provides guidance on de-recognition, statement of operations classification of interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company will adopt FIN 48 as of January 1, 2007, as required. The Company has determined that there is no impact in adopting FIN 48.

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108 (SAB 108), Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, which addresses how uncorrected errors in previous years should be considered when quantifying errors in current-year financial statements. SAB 108 requires companies to consider the effect of all carry over and reversing effects of prior-year misstatements when quantifying errors in current-year financial statements and the related financial statement disclosures. SAB 108 must be applied to annual financial statements for the first fiscal year ending after November 15, 2006. We are currently assessing the impact of adopting SAB 108 but do not expect that it will have a material impact on our financial condition or results of operations.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurement , (FAS 157). This Standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We have not determined the effect that the adoption of FAS 157 will have on our consolidated results of operations, financial condition or cash flows.

On September 29, 2006, the FASB issued SFAS No.158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R). SFAS No. 158 requires an entity to recognize in its statement of financial position the overfunded or underfunded status of a defined benefit postretirement plan measured as the difference between the fair value of plan assets and the benefit obligation. An entity will be required to recognize as a component of other comprehensive income, net of tax, the actuarial gains and losses and the prior service costs and credits that arise pursuant to FASB Statements No. 87, Employers Accounting for Pensions and No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions. Furthermore, SFAS No. 158 requires that an entity use a plan measurement date that is the same as its fiscal year-end. An entity will be required to disclose additional information in the notes to financial statements about certain effects on net periodic benefit cost in the upcoming fiscal year that arise from delayed recognition of the actuarial gains and losses and the prior service costs and credits. The requirement to recognize the funded status of a defined benefit postretirement plan and the related disclosure requirements is effective for fiscal years ending after December 15, 2006. The requirement to change the measurement date to the year-end reporting date is for fiscal years ending after December 15, 2008. We do not anticipate this statement will have any impact on our results of operations or financial condition.

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Seasonality

At this point in our business operations our revenues are not impacted by seasonal demands for our products or services. As we penetrate our addressable market and enter new geographical regions, we may experience a degree of seasonality.

Critical Accounting Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make a number of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Such estimates and assumptions affect the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, we evaluate estimates and assumptions based upon historical experience and various other factors and circumstances. We believe our estimates and assumptions are reasonable in the circumstances; however, actual results may differ from these estimates under different future conditions.

We believe that the estimates and assumptions that are most important to the portrayal of our financial condition and results of operations, in that they require subjective or complex judgments, form the basis for the accounting policies deemed to be most critical to us. These relate to bad debts, impairment of intangible assets and long lived assets, contractual adjustments to revenue, and contingencies and litigation. We believe estimates and assumptions related to these critical accounting policies are appropriate under the circumstances; however, should future events or occurrences result in unanticipated consequences, there could be a material impact on our future financial conditions or results of operations.

ITEM 3. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, based on an evaluation of our disclosure controls and procedures (as defined in Rules 13a -15(e) and 15(d)-15(e) under the Exchange Act), each our Chief Executive Officer and the Chief Financial Officer has concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in our Exchange Act reports is recorded, processed, summarized, and reported within the applicable time periods specified by the SEC s rules and forms.

There were no changes in our internal controls over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

There are no legal proceedings, to which we are a party, which could have a material adverse effect on our business, financial condition or operating results.

ITEM 2. CHANGES IN SECURITIES

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Because we recognized impairment charges on five properties totaling $1,939,513 (please see footnote 15) in one quarter, we became subject to an Event of Default provision under our Senior Subordinate Revolving Notes. This Event of Default provision was triggered when we recognized a net loss under GAAP of greater than $1,000,000 in any calendar quarter. This Event of Default provision has been waived by our Senior Subordinate Note Holders.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

Exhibits

10.18 Amendment to Subordinated Note, BOCO, dated March 30, 2007

10.19 Amendment to Subordinated Note, BOCO, dated August 10, 2007

10.20 Amendment to Revolving Note, BOCO, dated March 30, 2007

10.21 Amendment to Revolving Note, BOCO, dated August 10, 2007

10.22 Amendment to Subordinated Note, GDBA, dated March 30, 2007

10.23 Amendment to Subordinated Note, GDBA, dated August 10, 2007

10.24 Amendment to Revolving Note, GDBA, dated March 30, 2007

10.25 Amendment to Revolving Note, GDBA, dated August 10, 2007

21 List of Subsidiaries

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15(d)-14(a)

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15(d)-14(a)

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Reports on Form 8-K

We filed the following reports under cover of Form 8K for the fiscal quarter ended June 30, 2007: April 11, 2007, April 13, 2007, and May 8, 2007, all relating to Form FD Disclosures.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has dully caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	ACROSS AMERICA REAL ESTATE CORP.
Dated: August 13, 2007	By: */s/ Ann L. Schmitt* Ann L. Schmitt President, Chief Executive Officer,
Dated: August 13, 2007	By: /s/ James W Creamer III James W Creamer III Treasurer, Chief Financial Officer

EXHIBIT INDEX

Exhibit No.	Description
10.18	Amendment to Subordinated Note, BOCO, dated March 30, 2007
10.19	Amendment to Subordinated Note, BOCO, dated August 10, 2007
10.20	Amendment to Revolving Note, BOCO, dated March 30, 2007
10.21	Amendment to Revolving Note, BOCO, dated August 10, 2007
10.22	Amendment to Subordinated Note, GDBA, dated March 30, 2007
10.23	Amendment to Subordinated Note, GDBA, dated August 10, 2007
10.24	Amendment to Revolving Note, GDBA, dated March 30, 2007
10.25	Amendment to Revolving Note, GDBA, dated August 10, 2007
21	List of Subsidiaries
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15(d)-14(a)
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15(d)-14(a)
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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(23)
29

- AFS

5,622
(12)
86

317
(457)
36

—
(995)
(1,778)
(4)
2,815

(131)
34

Liabilities

Deposits

22
87
—

50
—
7
—
—
—

2
168

78
(2)

Debt securities in issue

2,199
158
—

9
(1)
—
530
(1,521)
—
(11)
1,363

169
—

Short positions

291
(269)
—

—
—
3
—
—
(23)
—
2

—
—

Derivatives

3,811
(375)
—

877
(513)
161
12
(636)
24
(44)
3,317

(593)
—

6,323
(399)
—

936
(514)
171
542
(2,157)
1
(53)
4,850

(346)
(2)

Net (losses)/gains

(1,387)
77

(1,548)
166

For the notes to this table refer to the following page.

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Notes on the consolidated accounts

11 Financial instruments - valuation continued

2011	At 1 January £m	Amount recorded in the Income statement (1) £m	Amount recorded in the SOCI (2) £m	Level 3 transfers In £m	Level 3 transfers Out £m	Purchases £m	Issuances £m	Settlements £m	Sales £m	Foreign exchange and other £m	At 31 December £m	Amounts recorded in the Income statement on balances at year end £m
Assets												
FVTPL (3)												
Loans and advances												
- banks	383	3	—	60	—	51	—	(36)	(18)	1	444	2
- customers	460	(18)	—	85	—	650	—	(820)	(46)	5	316	(13)
Debt securities	3,784	(177)	—	164	(380)	1,014	—	(149)	(2,026)	13	2,243	(61)
Equity shares	716	(46)	—	143	(33)	56	—	(96)	(162)	(5)	573	(43)
Derivatives	5,737	(511)	—	3,042	(1,441)	681	3	(688)	(146)	55	6,732	(522)
FVTPL assets	11,080	(749)	—	3,494	(1,854)	2,452	3	(1,789)	(2,398)	69	10,308	(637)
AFS												
Debt securities	4,379	2	3	2,097	(21)	98	—	(817)	(47)	3	5,697	2
Equity shares	279	2	59	82	—	7	—	(1)	(29)	(4)	395	(4)
AFS assets	4,658	4	62	2,179	(21)	105	—	(818)	(76)	(1)	6,092	(2)
	15,738	(745)	62	5,673	(1,875)	2,557	3	(2,607)	(2,474)	68	16,400	(639)
Liabilities												
Deposits	84	(35)	—	—	(24)	—	—	(4)	—	1	22	(25)
Debt securities in issue	2,203	(201)	—	948	(520)	—	688	(886)	—	(33)	2,199	(50)
Short positions	776	(71)	—	58	(3)	14	20	(2)	(504)	3	291	(207)
Derivatives	1,740	279	—	1,822	(240)	534	4	(197)	(169)	38	3,811	325
Other financial liabilities	1	—	—	—	(1)	—	—	—	—	—	—	—
	4,804	(28)	—	2,828	(788)	548	712	(1,089)	(673)	9	6,323	43
Net (losses)/gains		(717)	62									(682)

Notes:

(1) Net losses on HFT instruments of £543 million (2012 - £1,528 million; 2011 - £860 million) and net gains on other instruments of £11 million (2012 - £141 million; 2011 - £143 million) were recorded in other operating income, interest income and impairment losses as appropriate.
(2) Consolidated statement of comprehensive income.
(3) Fair value through profit or loss comprises held-for-trading predominantly and designated at fair value through profit of loss.

Notes on the consolidated accounts

11 Financial instruments - valuation continued
Fair value of financial instruments not carried at fair value
The following table shows the carrying value and fair value of financial instruments carried at amortised cost on the balance sheet.

	Fair value approximates carrying value	Carrying value	Fair value	Fair value of hierarchy level	
				Level 2	Level 3
2013	£bn	£bn	£bn	£bn	£bn
Financial assets					
Cash and balances at central banks	82.7				
Loans and advances to banks					
- items in the course of collection from other banks	1.5				
- other		16.8	16.8	6.0	10.8
Loans and advances to customers					
UK Retail		111.0	110.3		
UK Corporate		99.7	96.4		
Wealth		16.6	16.6		
International Banking		35.5	35.1		
Ulster Bank		26.1	20.5		
US Retail & Commercial		49.3	49.5		
Markets and other		11.7	11.0		
Non-Core		21.7	20.6		
Total loans and advances to customers		371.6	360.0	13.5	346.5
Of which:					
Performing		354.6	343.9		
Non-performing		17.0	16.1		
Debt securities		3.8	3.2	1.9	1.3
Settlement balances	5.6				
Financial liabilities					
Deposits by banks					
- items in the course of transmission to other banks	0.8				
- other		20.3	20.3	6.9	13.4
Customer accounts					
- demand deposits	268.7				
- other		133.8	134.0	89.4	44.6
Debt securities in issue		43.4	44.7	40.5	4.2
Settlement balances	5.3				
Notes in circulation	1.8				
Subordinated liabilities		23.1	22.5	22.3	0.2

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Notes on the consolidated accounts

11 Financial instruments - valuation continued

	2012 Carrying value £bn	2012 Fair value £bn	2011 Carrying value £bn	2011 Fair value £bn
Financial assets				
Cash and balances at central banks	79.3	79.3	79.3	79.3
Loans and advances to banks	17.3	17.3	28.3	28.2
Loans and advances to customers	405.1	385.4	436.2	406.3
Debt securities	4.5	4.0	6.1	5.5
Settlement balances	5.7	5.7	7.8	7.8
Financial liabilities				
Deposits by banks	34.5	34.5	51.3	50.7
Customer accounts	420.7	421.0	417.5	417.6
Debt securities in issue	60.1	59.8	115.4	112.7
Settlement balances	5.9	5.9	7.5	7.5
Notes in circulation	1.7	1.7	1.7	1.7
Subordinated liabilities	25.6	24.3	25.4	19.2

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Quoted market values are used where available; otherwise, fair values have been estimated based on discounted expected future cash flows and other valuation techniques. These techniques involve uncertainties and require assumptions and judgments covering prepayments, credit risk and discount rates. Furthermore there is a wide range of potential valuation techniques. Changes in these assumptions would significantly affect estimated fair values. The fair values reported would not necessarily be realised in an immediate sale or settlement.

The fair values of intangible assets, such as core deposits, credit card and other customer relationships are not included in the calculation of these fair values as they are not financial instruments.

The assumptions and methodologies underlying the calculation of fair values of financial instruments at the balance sheet date are as follows:

For certain short-term financial instruments: cash and balances at central banks, items in the course of collection from other banks, settlement balances, items in the course of transmission to other banks, customer demand deposits and notes in circulation, fair value approximates to carrying value.

Loans and advances to banks and customers
In estimating the fair value of loans and advances to banks and customers measured at amortised cost, the Group's loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans. Two principal methods are used to estimate fair value:

(a) Contractual cash flows are discounted using a market discount rate that incorporates the current spread for the borrower or where this is not observable, the spread for borrowers of a similar credit standing. This method is used

for portfolios where counterparties have external ratings: large corporate loans in UK Corporate and institutional and corporate lending in International Banking and Markets.

(b) Expected cash flows (unadjusted for credit losses) are discounted at the current offer rate for the same or similar products. This approach is adopted for lending portfolios in UK Retail, Ulster Bank, US Retail & Commercial and Wealth and SME loans in UK Corporate reflecting the homogeneous nature of these portfolios.

For certain portfolios where there are very few or no recent transactions, such as Ulster Bank's portfolio of lifetime tracker mortgages, a bespoke approach is used based on available market data.

Debt securities
Fair values are determined using discounted cash flow valuation techniques.

Deposits by banks and customer accounts
Fair values of deposits are estimated using discounted cash flow valuation techniques.

Debt securities in issue and subordinated liabilities
Fair values are determined using quoted prices where available or by reference to valuation techniques, adjusting for own credit spreads where appropriate.

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12 Financial instruments - maturity analysis
Remaining maturity
The following table shows the residual maturity of financial instruments, based on contractual date of maturity.

	2013			2012			2011		
	Less than 12 months	More than 12 months	Total	Less than 12 months	More than 12 months	Total	Less than 12 months	More than 12 months	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets									
Cash and balances at central banks	82,659	—	82,659	79,290	—	79,290	79,269	—	79,269
Loans and advances to banks	53,206	865	54,071	63,143	808	63,951	80,905	2,405	83,310
Loans and advances to customers	169,314	271,408	440,722	197,855	302,280	500,135	197,338	318,268	515,606
Debt securities	19,542	94,057	113,599	26,363	131,075	157,438	45,311	163,769	209,080
Equity shares	—	8,811	8,811	—	15,232	15,232	—	15,183	15,183
Settlement balances	5,591	—	5,591	5,741	—	5,741	7,767	4	7,771
Derivatives	45,067	242,972	288,039	51,021	390,882	441,903	60,250	469,368	529,618
Liabilities									
Deposits by banks	61,108	2,871	63,979	90,704	10,701	101,405	100,499	8,305	108,804
Customer accounts	455,620	15,260	470,880	494,405	26,874	521,279	487,428	15,527	502,955
Debt securities in issue	16,547	51,272	67,819	20,296	74,296	94,592	68,889	93,732	162,621
Settlement balances and short positions	10,490	22,845	33,335	8,573	24,896	33,469	15,248	33,268	48,516
Derivatives	45,385	240,141	285,526	51,503	382,830	434,333	61,734	462,249	523,983
Subordinated liabilities	1,350	22,662	24,012	2,351	24,422	26,773	624	25,695	26,319

Assets and liabilities by contractual cash flow maturity
The tables below show the contractual undiscounted cash flows receivable and payable, up to a period of 20 years, including future receipts and payments of interest of financial assets and liabilities by contractual maturity. The balances in the following tables do not agree directly with the consolidated balance sheet, as the tables include all cash flows relating to principal and future coupon payments, presented on an undiscounted basis. The tables have been prepared on the following basis:

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 that contains the latest date on which it can be repaid, regardless of early repayment.

The liability is included in the time band that contains the earliest possible date on which 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 repayments of assets and liabilities are linked, the repayment of assets in securitisations is shown on the earliest date that the asset can be prepaid, as this is the basis used for liabilities.

The principal amounts of financial assets and liabilities that are repayable after 20 years or where the counterparty has no right to repayment of the principal are excluded from the table, as are interest payments after 20 years.

Held-for-trading assets of £452.1 billion and liabilities of £423.3 billion (2012 - £666.5 billion assets and £628.2 billion liabilities; 2011 - £763.3 billion assets and £708.0 billion liabilities) have been excluded from the following tables in view of their short-term nature.

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12 Financial instruments - maturity analysis continued

2013	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	82,659	—	—	—	—	—
Loans and advances to banks	16,096	1,876	279	4	74	5
Debt securities	3,078	5,044	10,667	11,310	14,189	7,238
Settlement balances	5,591	—	—	—	—	—
Total maturing assets	107,424	6,920	10,946	11,314	14,263	7,243
Loans and advances to customers	70,511	48,027	84,836	65,542	74,296	69,242
Derivatives held for hedging	545	1,282	2,148	427	115	93
	178,480	56,229	97,930	77,283	88,674	76,578
Liabilities by contractual maturity						
Deposits by banks	16,867	1,550	1,306	158	944	426
Debt securities in issue	11,457	7,601	16,375	7,356	9,879	4,840
Subordinated liabilities	324	1,982	6,473	6,140	11,376	3,345
Settlement balances and other liabilities	7,074	4	9	4	—	1
Total maturing liabilities	35,722	11,137	24,163	13,658	22,199	8,612
Customer accounts	388,322	9,524	5,889	2,356	698	35
Derivatives held for hedging	130	271	933	1,190	1,732	330
	424,174	20,932	30,985	17,204	24,629	8,977
Maturity gap	71,702	(4,217)	(13,217)	(2,344)	(7,936)	(1,369)
Cumulative maturity gap	71,702	67,485	54,268	51,924	43,988	42,619
Guarantees and commitments notional amount						
Guarantees (1)	20,179	—	—	—	—	—
Commitments (2)	213,046	—	—	—	—	—
	233,225	—	—	—	—	—

For the notes relating to this table refer to page 428.

Notes on the consolidated accounts

12 Financial instruments - maturity analysis continued

2012	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	79,290	—	—	—	—	—
Loans and advances to banks	15,592	1,393	272	27	20	62
Debt securities	6,320	4,505	13,330	19,369	25,772	10,644
Settlement balances	5,741	—	—	—	—	—
Total maturing assets	106,943	5,898	13,602	19,396	25,792	10,706
Loans and advances to customers	73,590	57,403	93,445	65,569	76,682	87,450
Derivatives held for hedging	571	1,878	3,909	1,879	429	67
	181,104	65,179	110,956	86,844	102,903	98,223
Liabilities by contractual maturity						
Deposits by banks	23,363	973	8,336	388	1,091	594
Debt securities in issue	15,072	14,555	23,733	13,118	20,154	4,975
Subordinated liabilities	318	2,979	7,045	3,182	11,134	3,603
Settlement balances and other liabilities	7,560	4	9	1	—	1
Total maturing liabilities	46,313	18,511	39,123	16,689	32,379	9,173
Customer accounts	386,504	24,123	11,791	2,186	1,246	63
Derivatives held for hedging	310	752	1,790	1,262	1,244	684
	433,127	43,386	52,704	20,137	34,869	9,920
Maturity gap	60,630	(12,613)	(25,521)	2,707	(6,587)	1,533
Cumulative maturity gap	60,630	48,017	22,496	25,203	18,616	20,149
Guarantees and commitments notional amount						
Guarantees (1)	19,025	—	—	—	—	—
Commitments (2)	215,808	—	—	—	—	—
	234,833	—	—	—	—	—

For the notes relating to this table refer to the following page.

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12 Financial instruments - maturity analysis continued

2011	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	79,269	—	—	—	—	—
Loans and advances to banks	26,326	1,294	544	121	114	—
Debt securities	7,237	9,569	23,137	21,003	39,148	15,869
Settlement balances	7,759	8	—	1	—	—
Other financial assets	397	158	—	16	738	—
Total maturing assets	120,988	11,029	23,681	21,141	40,000	15,869
Loans and advances to customers	97,318	90,894	108,331	55,785	62,085	56,259
Derivatives held for hedging	519	1,556	3,438	1,695	596	138
	218,825	103,479	135,450	78,621	102,681	72,266
Liabilities by contractual maturity						
Deposits by banks	39,139	5,104	5,513	461	1,121	364
Debt securities in issue	66,253	15,756	25,099	17,627	18,833	4,190
Subordinated liabilities	133	1,116	4,392	7,872	8,654	3,488
Settlement balances and other liabilities	9,015	37	36	62	16	15
Total maturing liabilities	114,540	22,013	35,040	26,022	28,624	8,057
Customer accounts	379,692	23,068	12,643	5,389	1,483	779
Derivatives held for hedging	525	788	1,981	1,186	1,101	821
	494,757	45,869	49,664	32,597	31,208	9,657
Maturity gap	6,448	(10,984)	(11,359)	(4,881)	11,376	7,812
Cumulative maturity gap	6,448	(4,536)	(15,895)	(20,776)	(9,400)	(1,588)
Guarantees and commitments notional amount						
Guarantees (1)	24,886	—	—	—	—	—
Commitments (2)	239,963	—	—	—	—	—
	264,849	—	—	—	—	—

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.

13 Financial assets - impairments

The following table shows the movement in the provision for impairment losses on loans and advances.

	Individually assessed £m	Collectively assessed £m	Latent £m	2013 £m	2012 £m	2011 £m

At 1 January	12,749	6,541	1,960	21,250	19,883	18,182
Transfers (to)/from disposal groups	—	—	(9)	(9)	764	(773)
Currency translation and other adjustments	77	36	8	121	(310)	(283)
Disposals	(4)	(73)	—	(77)	(5)	8
Amounts written-off	(2,652)	(1,694)	—	(4,346)	(4,266)	(4,527)
Recoveries of amounts previously written-off	95	161	—	256	341	527
Charge to income statement						
- continuing operations	6,904	1,464	44	8,412	5,315	7,241
- discontinued operations	—	—	—	—	4	(8)
Unwind of discount (recognised in interest income)	(260)	(131)	—	(391)	(476)	(484)
At 31 December (1)	16,909	6,304	2,003	25,216	21,250	19,883

Notes:
(1) Includes £63 million relating to loans and advances to banks (2012 - £114 million; 2011 - £123 million).
(2) The table above excludes impairments relating to securities.

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13 Financial assets – impairments continued

Impairment losses/(recoveries) charged to the income statement	2013 £m	2012 £m	2011 £m
Loans and advances to customers	8,427	5,292	7,241
Loans and advances to banks	(15)	23	—
	8,412	5,315	7,241
Debt securities	20	(67)	1,431
Equity shares	—	31	35
	20	(36)	1,466
	8,432	5,279	8,707

The following tables analyse impaired financial assets.

	2013			2012			2011		
	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m
Loans and receivables									
Loans and advances to banks (1)	70	63	7	134	114	20	137	123	14
Loans and advances to customers (2)	37,101	23,150	13,951	38,352	19,176	19,176	38,610	17,774	20,836
	37,171	23,213	13,958	38,486	19,290	19,196	38,747	17,897	20,850

Notes:

(1) Impairment provisions individually assessed.

(2) Impairment provisions individually assessed on balances of £26,939 million (2012 - £26,797 million; 2011 - £29,058 million).

	Carrying value 2013 £m	Carrying value 2012 £m	Carrying value 2011 £m
Available-for-sale securities			
Debt securities	145	225	873
Equity shares	30	31	57
Loans and receivables			
Debt securities	585	1,008	234
	760	1,264	1,164

The following table shows financial and non-financial assets, recognised on the Group's balance sheet, obtained during the year by taking possession of collateral or calling on other credit enhancements.

	2013 £m	2012 £m	2011 £m
Residential property	18	67	60

Other property	13	46	73
Cash	44	49	56
Other assets	2	1	2
	77	163	191

In general, the Group seeks to dispose of property and other assets not readily convertible into cash, obtained by taking possession of collateral, as rapidly as the market for the individual asset permits.

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14 Derivatives
Companies in the Group transact derivatives as principal either as a trading activity or to manage balance sheet foreign exchange, interest rate and credit risk.

The Group enters into fair value hedges, cash flow hedges and hedges of net investments in foreign operations. The majority of the Group's interest rate hedges relate to the management of the Group's non-trading interest rate risk. The Group manages this risk within approved limits. Residual risk positions are hedged with derivatives principally interest rate swaps. Suitable larger financial instruments are fair value hedged; the remaining exposure, where possible, is hedged by derivatives documented as cash flow hedges and qualifying for hedge accounting. The majority of the Group's fair value hedges involve interest rate swaps hedging the interest rate risk in recognised financial assets and financial liabilities. Cash flow hedges relate to exposures to the variability in future interest payments and receipts on forecast transactions and on recognised financial assets and financial liabilities. The Group hedges its net investments in foreign operations with currency borrowings and forward foreign exchange contracts.

For cash flow hedge relationships of interest rate risk, the hedged items are actual and forecast variable interest rate cash flows arising from financial assets and financial liabilities with interest rates linked to LIBOR, EURIBOR or the Bank of England Official Bank Rate. The financial assets are customer loans and the financial liabilities are customer deposits and LIBOR linked medium-term notes and other issued securities. At 31 December 2013, variable rate financial assets of £74 billion (2012 - £61 billion; 2011 - £49 billion) and variable rate financial liabilities of £10 billion (2012 - £9 billion; 2011 - £13 billion) were hedged in such cash flow hedge relationships.

For cash flow hedging relationships, the initial and ongoing prospective effectiveness is assessed by comparing movements in the fair value of the expected highly probable forecast interest cash flows with movements in the fair value of the expected changes in cash flows from the hedging interest rate swap. Prospective effectiveness is measured on a cumulative basis i.e. over the entire life of the hedge relationship. The method of calculating hedge ineffectiveness is the hypothetical derivative method. Retrospective effectiveness is assessed by comparing the actual movements in the fair value of the cash flows and actual movements in the fair value of the hedged cash flows from the interest rate swap over the life to date of the hedging relationship.

For fair value hedge relationships of interest rate risk, the hedged items are typically government bonds, large corporate fixed-rate loans, fixed rate finance leases, fixed rate medium-term notes or preference shares classified as debt. At 31 December 2013, fixed rate financial assets of £23 billion (2012 - £25 billion; 2011 - £33 billion) and fixed rate financial liabilities of £34 billion (2012 - £39 billion; 2011 - £41 billion) were hedged by interest rate swaps in fair value hedge relationships.

The initial and ongoing prospective effectiveness of fair value hedge relationships is assessed on a cumulative basis by comparing movements in the fair value of the hedged item attributable to the hedged risk with changes in the fair value of the hedging interest rate swap. Retrospective effectiveness is assessed by comparing the actual movements in the fair value of the hedged items attributable to the hedged risk with actual movements in the fair value of the hedging derivative over the life to date of the hedging relationship.

The following table shows the notional amounts and fair values of the Group's derivatives.

	2013			2012			2011		
	Notional amount	Assets	Liabilities	Notional amount	Assets	Liabilities	Notional amount	Assets	Liabilities

	£bn	£m	£m	£bn	£m	£m	£bn	£m	£m
Exchange rate contracts									
Spot, forwards and futures	2,041	24,495	24,136	2,259	23,237	22,721	2,127	30,249	28,868
Currency swaps	956	18,576	22,846	1,071	22,238	30,223	1,071	25,212	33,541
Options purchased	792	18,852	—	683	17,580	—	640	19,031	—
Options written	766	—	18,767	684	—	17,536	641	—	18,571
Interest rate contracts									
Interest rate swaps	27,483	179,891	172,618	25,474	300,907	286,620	29,976	346,682	333,968
Options purchased	1,568	37,437	—	1,934	61,798	—	2,398	74,600	—
Options written	1,513	—	35,410	1,884	—	58,289	2,592	—	71,998
Futures and forwards	5,025	712	669	4,191	749	653	3,756	874	743
Credit derivatives	253	5,306	5,388	553	11,005	10,353	1,054	26,836	26,743
Equity and commodity contracts	81	2,770	5,692	111	4,389	7,938	123	6,134	9,551
		288,039	285,526		441,903	434,333		529,618	523,983

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14 Derivatives continued
Included in the table above are derivatives held for hedging purposes as follows:

	2013		2012		2011	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m	£m	£m
Fair value hedging						
Interest rate contracts	2,086	2,587	3,779	4,488	3,550	4,288
Cash flow hedging						
Interest rate contracts	2,390	1,602	4,854	1,276	3,985	1,445
Net investment hedging						
Exchange rate contracts	55	38	6	32	148	148

Hedge ineffectiveness recognised in other operating income comprised:

	2013	2012	2011
	£m	£m	£m
Fair value hedging			
(Losses)/gains on the hedged items attributable to the hedged risk	(165)	178	557
Gains/(losses) on the hedging instruments	154	(132)	(541)
Fair value hedging ineffectiveness	(11)	46	16
Cash flow hedging ineffectiveness	(64)	26	20
	(75)	72	36

The following table shows when hedged cash flows are expected to occur and when they will affect income for designated cash flow hedges.

	0-1 years	1-2 years	2-3 years	3-4 years	4-5 years	5-10 years	10-20 years	Over 20 years	Total
2013	£m	£m	£m	£m	£m	£m	£m	£m	£m
Hedged forecast cash flows expected to occur									
Forecast receivable cash flows	303	284	243	206	144	271	—	—	1,451
Forecast payable cash flows	(33)	(22)	(18)	(15)	(14)	(64)	(101)	(19)	(286)
Hedged forecast cash flows affect on profit or loss									
Forecast receivable cash flows	302	281	239	201	138	261	—	—	1,422
Forecast payable cash flows	(32)	(22)	(18)	(16)	(13)	(64)	(101)	(19)	(285)
2012									
Hedged forecast cash flows expected to occur									
Forecast receivable cash flows	285	259	232	177	138	190	—	—	1,281

Forecast payable cash flows	(56)	(45)	(37)	(35)	(35)	(172)	(259)	(39)	(678)
Hedged forecast cash flows affect on profit or loss									
Forecast receivable cash flows	277	257	225	171	132	180	—	—	1,242
Forecast payable cash flows	(55)	(44)	(36)	(35)	(35)	(173)	(257)	(37)	(672)
2011									
Hedged forecast cash flows expected to occur									
Forecast receivable cash flows	407	415	360	306	200	280	—	—	1,968
Forecast payable cash flows	(120)	(106)	(73)	(70)	(71)	(344)	(568)	(160)	(1,512)
Hedged forecast cash flows affect on profit or loss									
Forecast receivable cash flows	422	402	355	291	188	265	—	—	1,923
Forecast payable cash flows	(122)	(102)	(72)	(70)	(70)	(346)	(568)	(159)	(1,509)

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15 Debt securities

	Central and local government				Other financial			Of which ABS
	UK	US	Other	Banks	institutions	Corporate	Total	(1)
2013	£m	£m	£m	£m	£m	£m	£m	£m
Held-for-trading	6,764	10,951	22,794	1,720	12,406	1,947	56,582	10,674
Designated as at fair value through profit or loss	—	—	104	—	17	1	122	15
Available-for-sale	6,436	12,880	10,303	5,974	17,330	184	53,107	24,174
Loans and receivables	10	1	—	175	3,466	136	3,788	3,423
	13,210	23,832	33,201	7,869	33,219	2,268	113,599	38,286
Available-for-sale								
Gross unrealised gains	201	428	445	70	386	11	1,541	458
Gross unrealised losses	(69)	(86)	(32)	(205)	(493)	(2)	(887)	(753)
2012								
Held-for-trading	7,692	17,349	27,165	2,243	21,876	2,015	78,340	18,619
Designated as at fair value through profit or loss	—	—	123	86	610	54	873	516
Available-for-sale	7,950	19,040	15,995	7,227	23,294	231	73,737	30,184
Loans and receivables	5	—	—	365	3,728	390	4,488	3,707
	15,647	36,389	43,283	9,921	49,508	2,690	157,438	53,026
Available-for-sale								
Gross unrealised gains	944	1,092	1,185	56	650	19	3,946	748
Gross unrealised losses	—	(1)	(14)	(498)	(1,319)	—	(1,832)	(1,816)
2011								
Held-for-trading	9,004	19,636	36,928	3,400	23,160	2,948	95,076	20,816
Designated as at fair value through profit or loss	1	—	127	53	457	9	647	558
Available-for-sale	13,436	20,848	25,552	13,175	31,752	2,535	107,298	40,735
Loans and receivables	10	—	1	312	5,259	477	6,059	5,200
	22,451	40,484	62,608	16,940	60,628	5,969	209,080	67,309
Available-for-sale								
Gross unrealised gains	1,428	1,311	1,180	52	913	94	4,978	1,001
Gross unrealised losses	—	—	(171)	(838)	(2,386)	(13)	(3,408)	(3,158)

Note:

(1) Includes asset-backed securities issued by US federal agencies and government sponsored entities, and covered bonds.

Gross gains of £1,111 million (2012 - £1,883 million; 2011 - £739 million) and gross losses of £353 million (2012 - £901 million; 2011- £60 million) were realised on the sale of available-for-sale securities in continuing operations.

Gross gains of £3 million (2012 - £78 million; 2011 - £87 million) and gross losses of nil (2012 - £12 million; 2011 - £34 million) were realised on the sale of available-for-sale securities in discontinued operations.

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15 Debt securities continued

The following table analyses the Group's available-for-sale debt securities and the related yield (based on weighted averages) by remaining maturity and issuer.

	Within 1 year		After 1 but within 5 years		After 5 but within 10 years		After 10 years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
2013	£m	%	£m	%	£m	%	£m	%	£m	%
Central and local governments										
- UK	251	4.4	1,792	2.3	3,167	3.0	1,226	3.4	6,436	2.9
- US	896	1.7	6,011	2.7	2,892	2.7	3,081	2.4	12,880	2.6
- other	2,347	1.3	4,417	2.7	1,745	2.5	1,794	3.7	10,303	2.5
Banks	2,071	1.1	3,284	1.2	438	3.7	181	1.9	5,974	1.4
Other financial institutions	1,013	1.7	3,416	2.4	3,950	2.8	8,951	1.8	17,330	2.1
Corporate	1	0.1	69	1.3	114	6.9	-	-	184	4.8
	6,579	1.5	18,989	2.3	12,306	2.9	15,233	2.3	53,107	2.3
Of which ABS (1)	920	2.1	5,781	2.1	5,346	3.0	12,127	2.0	24,174	2.3
2012										
Central and local governments										
- UK	-	-	1,559	2.0	4,105	3.3	2,286	3.5	7,950	3.1
- US	139	2.4	10,633	2.3	6,022	2.4	2,246	2.5	19,040	2.3
- other	3,346	0.6	5,849	3.0	5,273	3.0	1,527	3.4	15,995	2.6
Banks	1,764	1.6	3,294	2.8	1,685	1.2	484	1.6	7,227	2.1
Other financial institutions	741	3.0	5,289	2.5	4,378	3.0	12,886	1.4	23,294	2.0
Corporate	25	2.5	140	2.4	66	1.2	-	-	231	2.0
	6,015	1.2	26,764	2.5	21,529	2.7	19,429	2.0	73,737	2.3
Of which ABS (1)	1,385	1.8	6,413	2.9	6,773	2.4	15,613	1.4	30,184	2.0

Note:

(1) Includes asset-backed securities issued by US federal agencies and government sponsored entities, and covered bonds.

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16 Equity shares

	2013			2012			2011		
	Listed	Unlisted	Total	Listed	Unlisted	Total	Listed	Unlisted	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Held-for-trading	7,121	78	7,199	13,261	68	13,329	12,366	67	12,433
Designated as at fair value through profit or loss	172	228	400	251	282	533	373	401	774
Available-for-sale	196	1,016	1,212	221	1,149	1,370	609	1,367	1,976
	7,489	1,322	8,811	13,733	1,499	15,232	13,348	1,835	15,183
Available-for-sale									
Gross unrealised gains	73	177	250	58	172	230	69	317	386
Gross unrealised losses	(9)	(10)	(19)	(54)	(13)	(67)	(19)	(114)	(133)
	64	167	231	4	159	163	50	203	253

Gross gains of £76 million (2012 - £166 million; 2011 - £152 million) and gross losses of £4 million (2012 and 2011 - £2 million) were realised on the sale of available-for-sale equity shares in continuing operations. Gross gains of nil (2012 - £23 million; 2011 - nil) were realised on the sale of available-for-sale equity shares in discontinued operations.

Dividend income from available-for-sale equity shares was £87 million (2012 - £59 million; 2011 - £54 million).

Unquoted equity investments whose fair value cannot be reliably measured are carried at cost and classified as available-for-sale financial assets. They include capital stock (redeemable at cost) in the Federal Home Loan Bank and the Federal Reserve Bank of £0.6 billion (2012 and 2011 - £0.7 billion) that the Group's banking subsidiaries in the US are required to hold; and a number of individually small shareholdings in unlisted companies. Disposals in the year generated gains of £3 million (2012 and 2011 - £2 million).

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17 Intangible assets

2013	Goodwill £m	Core deposit intangibles £m	Other purchased intangibles £m	Internally generated software £m	Total £m
Cost					
At 1 January	25,288	178	830	5,010	31,306
Transfers to disposal groups	—	—	(43)	(24)	(67)
Currency translation and other adjustments	(5)	3	2	(14)	(14)
Additions	—	—	84	907	991
Disposals and write-off of fully amortised assets	(1)	(1)	(18)	(1,321)	(1,341)
At 31 December	25,282	180	855	4,558	30,875
Accumulated amortisation and impairment					
At 1 January	14,022	83	596	3,060	17,761
Transfers to disposal groups	—	—	(9)	(1)	(10)
Currency translation and other adjustments	62	13	(37)	(10)	28
Disposals and write-off of fully amortised assets	—	(1)	(10)	(1,221)	(1,232)
Charge for the year					
- continuing operations	—	31	122	404	557
Write-down of goodwill and other intangible assets					
- continuing operations	1,059	49	80	215	1,403
At 31 December	15,143	175	742	2,447	18,507
Net book value at 31 December	10,139	5	113	2,111	12,368
2012					
Cost					
At 1 January	26,843	620	2,432	5,448	35,343
Transfers to disposal groups	(984)	—	(15)	(341)	(1,340)
Currency translation and other adjustments	(486)	(16)	(74)	(368)	(944)
Acquisition of subsidiaries	—	—	—	5	5
Additions	—	—	39	909	948
Disposals and write-off of fully amortised assets	(85)	(426)	(1,552)	(643)	(2,706)
At 31 December	25,288	178	830	5,010	31,306
Accumulated amortisation and impairment					
At 1 January	14,419	495	1,951	3,620	20,485
Transfers to disposal groups	(444)	—	(10)	(136)	(590)
Currency translation and other adjustments	(289)	(13)	(55)	(356)	(713)
Disposals and write-off of fully amortised assets	(76)	(426)	(1,542)	(638)	(2,682)
Charge for the year					
- continuing operations	—	20	157	528	705
- discontinued operations	—	—	1	37	38
Write-down of goodwill and other intangible assets					
- continuing operations	18	7	94	5	124
- discontinued operations	394	—	—	—	394

At 31 December	14,022	83	596	3,060	17,761
Net book value at 31 December	11,266	95	234	1,950	13,545

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17 Intangible assets continued

2011	Goodwill £m	Core deposit intangibles £m	Other purchased intangibles £m	Internally generated software £m	Total £m
Cost					
At 1 January	27,139	612	2,458	4,575	34,784
Transfers to disposal groups	(95)	—	—	—	(95)
Currency translation and other adjustments	(219)	8	(60)	59	(212)
Acquisition of subsidiaries	18	—	—	—	18
Additions	—	—	34	1,050	1,084
Disposals and write-off of fully amortised assets	—	—	—	(236)	(236)
At 31 December	26,843	620	2,432	5,448	35,343
Accumulated amortisation and impairment					
At 1 January	14,611	462	1,822	3,441	20,336
Transfers to disposal groups	(80)	—	—	—	(80)
Currency translation and other adjustments	(203)	(5)	(55)	13	(250)
Disposals and write-off of fully amortised assets	—	—	—	(220)	(220)
Charge for the year					
- continuing operations	—	38	184	363	585
- discontinued operations	—	—	—	23	23
Write-down of goodwill and other intangible assets					
- continuing operations	80	—	—	—	80
- discontinued operations	11	—	—	—	11
At 31 December	14,419	495	1,951	3,620	20,485
Net book value at 31 December	12,424	125	481	1,828	14,858

The Group's goodwill acquired in business combinations is reviewed annually at 30 September for impairment by comparing the recoverable amount of each cash-generating unit (CGU) to which goodwill has been allocated with its carrying value.

Impairment testing involves the comparison of the carrying value of a CGU or group of CGUs with its recoverable amount. Recoverable amount is the higher of fair value and value in use. Value in use is the present value of expected future cash flows from the CGU or group of CGUs. Fair value is the price that would be received to sell an asset in an orderly transaction between market participants.

Impairment testing inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of CGUs; and the valuation of the separable assets of each business whose goodwill is being reviewed. Sensitivity to the more significant variables in each assessment are presented in the tables on the following page.

The recoverable amounts for all CGUs at 30 September 2013 were based on the value in use test, using management's latest five-year forecasts. The long-term growth rates have been based on respective country nominal GDP growth

rates. The risk discount rates are based on observable market long-term government bond yields and average industry betas adjusted for an appropriate risk premium.

Notes on the consolidated accounts

17 Intangible assets continued
In the light of downward revisions to its forecast financial performance, goodwill attributable to International Banking (IB) was tested for impairment as at 31 December 2013: recoverable amount was its value in use and the discount rate used in the calculation of value in use was 9.5% (30 September 2012 - 12.2%). The results showed IB goodwill in its entirety was impaired and an impairment loss of £1.1 billion has been recognised in profit or loss.

The Group will accelerate the divestment of RBS Citizens Financial Group, the Group's US banking subsidiary. A partial initial public offering is now planned for 2014 and the Group intends to fully divest the business by the end of 2016. Notwithstanding this planned course of action, the recoverable amount of the US Retail & Commercial CGU remains its value in use.

Direct Line Group was reclassified as a disposal group in 2012 and its goodwill was assessed as part of its fair value at 31 December 2012.

The results of the annual impairment test for 2011 are presented using the Group's 2011 reportable segments which differ as a result of the changes to the Group's structure implemented during 2012. The change in reportable segments in 2012 did not impact the impairment tests performed in 2011.

The analysis of goodwill by operating segment is shown in Note 38.

The carrying value of goodwill and amount by which it is exceeded by the recoverable amount is set out below by division along with the key assumptions applied in calculating the recoverable amount and sensitivities to changes in those assumptions.

		Assumptions		Recoverable	Consequential impact of 1% adverse movement in		Consequential impact of 5% adverse movement in forecast
	Goodwill	Terminal growth rate	Pre-tax discount rate	amount exceeded carrying value	Discount rate	Terminal growth rate	pre-tax earnings
September 2013	£bn	%	%	£bn	£bn	£bn	£bn
UK Retail	2.8	4.4	10.4	20.4	(4.2)	(3.3)	(1.7)
UK Corporate	2.8	4.4	10.5	7.3	(3.3)	(2.1)	(1.6)
Wealth	0.6	4.4	12.0	0.7	(0.4)	(0.3)	(0.2)
US Retail & Commercial	3.8	4.8	12.8	4.1	(1.5)	(0.8)	(0.8)
September 2012							
UK Retail	2.8	4.7	13.5	13.8	(2.5)	(2.4)	(1.3)
UK Corporate	2.8	4.7	13.5	6.3	(2.3)	(1.8)	(1.4)
Wealth	0.6	4.7	14.8	1.9	(0.5)	(0.4)	(0.3)
International Banking	1.0	4.7	12.2	0.3	(1.1)	(1.2)	(0.6)
US Retail & Commercial	3.8	5.3	16.9	2.0	(1.2)	(0.8)	(0.7)

September 2011

UK Retail	2.7	3.0	14.0	5.5	(1.1)	(0.6)	(0.8)
UK Corporate	2.7	3.0	14.1	2.1	(1.1)	(0.5)	(0.8)
Wealth	0.6	3.0	11.0	3.9	(1.0)	(0.7)	(0.4)
Global Transaction Services	2.4	3.0	11.4	4.7	(1.8)	(0.9)	(0.6)
US Retail & Commercial	2.8	5.0	14.4	0.2	(1.1)	(0.5)	(0.6)
Direct Line Group	0.9	3.0	12.3	0.8	(0.5)	(0.2)	(0.3)

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18 Property, plant and equipment 2013	Investment properties £m	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Operating lease assets £m	Total £m
Cost or valuation							
At 1 January	3,111	2,998	289	1,732	4,606	3,325	16,061
Transfers to disposal groups	(26)	(30)	—	(12)	(45)	—	(113)
Currency translation and other adjustments	34	(10)	(2)	(15)	(42)	(1)	(36)
Reclassifications	—	5	—	4	(9)	—	—
Additions	121	49	9	102	411	60	752
Expenditure on investment properties	13	—	—	—	—	—	13
Change in fair value of investment properties	(281)	—	—	—	—	—	(281)
Disposals and write-off of fully depreciated assets	(339)	(34)	(10)	(79)	(677)	(1,485)	(2,624)
At 31 December	2,633	2,978	286	1,732	4,244	1,899	13,772
Accumulated impairment, depreciation and amortisation							
At 1 January	—	852	151	924	3,228	1,122	6,277
Transfers to disposal groups	—	(6)	—	(9)	(35)	—	(50)
Currency translation and other adjustments	—	4	5	(7)	(35)	(4)	(37)
Write down of property, plant and equipment	—	15	3	—	—	—	18
Disposals and write-off of fully depreciated assets	—	(12)	(1)	(65)	(561)	(559)	(1,198)
Charge for the year	—	110	11	137	384	211	853
At 31 December	—	963	169	980	2,981	770	5,863
Net book value at 31 December	2,633	2,015	117	752	1,263	1,129	7,909
2012							
Cost or valuation							
At 1 January	4,468	2,855	273	1,823	4,479	3,892	17,790
Transfers (to)/from disposal groups	(129)	101	11	95	(135)	—	(57)
Currency translation and other adjustments	(51)	21	13	(124)	(182)	(53)	(376)
Reclassifications	24	(47)	21	(6)	8	—	—
Additions	372	153	8	121	519	402	1,575
Expenditure on investment properties	10	—	—	—	—	—	10
Change in fair value of investment properties							
- continuing operations	(153)	—	—	—	—	—	(153)
- discontinued operations	(5)	—	—	—	—	—	(5)
	(1,425)	(85)	(37)	(177)	(83)	(916)	(2,723)

Disposals and write-off of fully depreciated assets							
At 31 December	3,111	2,998	289	1,732	4,606	3,325	16,061
Accumulated impairment, depreciation and amortisation							
At 1 January	—	736	114	850	3,035	1,187	5,922
Transfers from/(to) disposal groups	—	43	6	66	(65)	—	50
Currency translation and other adjustments	—	(9)	11	(114)	(157)	(21)	(290)
Reclassifications	—	(7)	7	—	—	—	—
Write down of property, plant and equipment	—	9	7	1	—	—	17
Disposals and write-off of fully depreciated assets	—	(15)	(4)	(16)	(36)	(462)	(533)
Charge for the year							
- continuing operations	—	94	10	137	438	418	1,097
- discontinued operations	—	1	—	—	13	—	14
At 31 December	—	852	151	924	3,228	1,122	6,277
Net book value at 31 December	3,111	2,146	138	808	1,378	2,203	9,784

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18 Property, plant and equipment continued

2011	Investment properties £m	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Operating lease assets £m	Total £m
Cost or valuation							
At 1 January	4,170	2,938	291	1,832	4,239	9,235	22,705
Transfers to disposal groups	—	(107)	(12)	(93)	(49)	(5,355)	(5,616)
Currency translation and other adjustments	(103)	2	(4)	(6)	(77)	3	(185)
Reclassifications	57	8	(38)	(35)	8	—	—
Additions	1,262	68	46	174	532	1,384	3,466
Expenditure on investment properties	14	—	—	—	—	—	14
Change in fair value of investment properties							
- continuing operations	(139)	—	—	—	—	—	(139)
Disposals and write-off of fully depreciated assets	(793)	(54)	(10)	(49)	(174)	(1,375)	(2,455)
At 31 December	4,468	2,855	273	1,823	4,479	3,892	17,790
Accumulated impairment, depreciation and amortisation							
At 1 January	—	702	118	793	2,700	1,849	6,162
Transfers to disposal groups	—	(43)	(6)	(66)	(26)	(730)	(871)
Currency translation and other adjustments	—	6	4	(1)	(28)	15	(4)
Reclassifications	—	3	(9)	7	—	(1)	—
Write down of property, plant and equipment	—	—	3	1	1	—	5
Disposals and write-off of fully depreciated assets	—	(29)	—	(32)	(110)	(466)	(637)
Charge for the year							
- continuing operations	—	95	4	148	487	520	1,254
- discontinued operations	—	2	—	—	11	—	13
At 31 December	—	736	114	850	3,035	1,187	5,922
Net book value at 31 December	4,468	2,119	159	973	1,444	2,705	11,868

Investment property valuations principally employ present value techniques that discount expected cash flows. Expected cash flows reflect rental income, occupancy and residual market values; valuations are sensitive to changes in these factors. The fair value measurement of non-specialised properties in locations where the market for such properties is active and transparent are categorised as level 2 (46%); otherwise investment property fair value measurements are categorised as level 3 (54%).

Valuations were carried out by qualified surveyors who are members of the Royal Institution of Chartered Surveyors, or an equivalent overseas body; property with a fair value of £985 million was valued by independent valuers.

The fair value of investment properties includes £271 million of depreciation since purchase (2012 - £186 million; 2011 - £146 million).

Rental income from investment properties was £244 million (2012 - £267 million; 2011 - £270 million). Direct operating expenses of investment properties were £91 million (2012 - £125 million; 2011 - £110 million).

Property, plant and equipment, excluding investment properties, include £42 million (2012 - £35 million; 2011 - £186 million) assets in the course of construction.

19 Prepayments, accrued income and other assets

	2013	2012	2011
	£m	£m	£m
Prepayments	612	904	1,123
Accrued income	530	526	672
Deferred expenses	42	57	502
Pension schemes in net surplus (see Note 4)	214	144	188
Interests in associates	902	776	344
Other assets	5,314	5,413	8,147
	7,614	7,820	10,976

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20 Discontinued operations and assets and liabilities of disposal groups
The Group sold the first tranche of ordinary shares representing 34.7% of the share capital of Direct Line Insurance Group plc (DLG) in October 2012 via an Initial Public Offering. On 13 March 2013, the Group sold a further 16.8% of ordinary shares in DLG and ceded control. This fulfilled the Group's plan to cede control of DLG by the end of 2013 and is a step toward complete disposal by the end of 2014, as required by the European Commission. Consequently, DLG is treated as a discontinued operation until 12 March 2013 and as an associate thereafter.

On 20 September 2013, the Group sold a further 20% of ordinary shares in DLG and at 31 December held 28.5% of the issued ordinary share capital of DLG.

(a) Profit/(loss) from discontinued operations, net of tax

	2013	2012	2011
	£m	£m	£m
Direct Line Group			
Net premium income	699	3,718	4,256
Other income	62	(16)	30
Total income	761	3,702	4,286
Operating expenses	(171)	(1,406)	(892)
Profit before insurance net claims and impairment losses	590	2,296	3,394
Insurance net claims	(445)	(2,427)	(2,968)
Impairment losses	—	—	(2)
Operating profit/(loss) before tax	145	(131)	424
Tax charge	(18)	(53)	(123)
Profit/(loss) after tax from discontinued general insurance business	127	(184)	301
Other			
Total income	26	29	42
Operating expenses	(1)	(3)	(5)
Profit before impairment losses	25	26	37
Impairment losses	—	(4)	8
Profit before tax	25	22	45
Tax charge	(11)	(8)	(11)
Profit after tax	14	14	34
Businesses acquired exclusively with a view to disposal			
Profit/(loss) after tax	7	(2)	13
Profit from other discontinued operations, net of tax	21	12	47

Other discontinued operations reflect the results of RFS Holdings attributable to the State of the Netherlands and Santander following the legal separation of ABN AMRO Bank N.V. on 1 April 2010. The profit from discontinued operations includes a gain of £37 million (2012 - £112 million loss; 2011 - £42 million profit) attributable to non-controlling interests.

Notes on the consolidated accounts

20 Discontinued operations and assets and liabilities of disposal groups continued
(b) Cash flows attributable to discontinued operations
Included within the Group's cash flows are the following amounts attributable to discontinued operations:

	2013	2012	2011
	£m	£m	£m
Net cash flows from operating activities	101	(839)	(246)
Net cash flows from investing activities	45	1,724	(87)
Net cash flows from financing activities	(346)	(775)	(115)
Net (decrease)/increase in cash and cash equivalents	(210)	108	(454)

(c) Assets and liabilities of disposal groups

	2013	2012	2011
	£m	£m	£m
Assets of disposal groups			
Cash and balances at central banks	2	18	127
Loans and advances to banks	63	2,112	87
Loans and advances to customers	1,765	1,863	19,405
Debt securities and equity shares	24	7,191	5
Derivatives	1	15	439
Intangible assets	30	750	15
Settlement balances	—	—	14
Property, plant and equipment	32	223	4,749
Interests in associates	879	—	—
Other assets	58	1,666	456
Discontinued operations and other disposal groups	2,854	13,838	25,297
Assets acquired exclusively with a view to disposal	163	175	153
	3,017	14,013	25,450
Liabilities of disposal groups			
Deposits by banks	—	1	1
Customer accounts	3,273	753	22,610
Derivatives	1	7	126
Settlement balances	—	—	8
Insurance liabilities	—	6,193	—
Subordinated liabilities	—	529	—
Other liabilities	102	2,679	1,233
Discontinued operations and other disposal groups	3,376	10,162	23,978
Liabilities acquired exclusively with a view to disposal	2	8	17
	3,378	10,170	23,995

Notes on the consolidated accounts

20 Discontinued operations and assets and liabilities of disposal groups continued
DLG is included in disposal groups at 31 December 2013 and 2012.

In addition, disposal groups at 31 December 2013 include the Chicago area retail branches, small business operations and select middle market relationships in the Chicago market which form part of RBS Citizens Financial Group and the interest in associates in DLG. No adjustment was required to the carrying value of these assets and liabilities on reclassification. In accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', comparatives have not been restated.

At 31 December 2011, disposal groups comprised the RBS Aviation Capital business which was sold in the second half of 2012 and the RBS England and Wales and NatWest Scotland branch-based businesses, along with certain SME and corporate activities across the UK ('UK branch-based businesses').

Allocated goodwill of £80 million was written off against operating expenses in respect of the UK branch-based businesses. No adjustment was made in respect of the RBS Aviation Capital business.

Following Santander's withdrawal from the proposed sale of the UK branch-based businesses in October 2012, the Group concluded that a sale within 12 months was no longer highly probable; accordingly at 31 December 2012 the assets and liabilities of the UK branch-based businesses ceased to be classified as a disposal group. No adjustment was required to the carrying value of these assets and liabilities on reclassification. In accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', comparatives were not restated.

(d) Direct Line Group assets and liabilities

	2013	2012	2011
General insurance business assets and liabilities	£m	£m	£m
Loans and advances to banks	—	2,036	2,579
Loans and advances to customers	—	881	893
Debt securities and equity shares	—	7,156	7,992
Derivatives	—	12	—
Intangible assets	—	750	1,065
Property, plant and equipment	—	222	132
Interests in associates	879	—	—
Prepayments, accrued income and other assets	—	1,640	1,200
Assets of disposal group	879	12,697	—
Assets separately consolidated			13,861
Derivatives	—	4	—
Insurance liabilities	—	6,193	6,233
Subordinated liabilities	—	529	—
Accruals, deferred income and other liabilities	—	2,541	2,739
Liabilities of disposal group	—	9,267	—
Liabilities separately consolidated			8,972

The Group's interest in DLG at 31 December 2013 is recognised under equity accounting, being the fair value of its share of net equity on 13 March 2013 plus the subsequent attributable comprehensive income, less the dividends

received by the Group, less the share of net assets attributable to the subsequent disposal on 20 September 2013. At 31 December 2012, DLG's carrying amount exceeded its fair value less costs to sell (based on the quoted price for DLG shares on 31 December 2012) by £394 million and goodwill attributable to DLG was written down by this amount. The write down was recorded in other expenses within discontinued operations.

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Notes on the consolidated accounts

21 Short positions

	2013	2012	2011
	£m	£m	£m
Debt securities			
- Government	24,661	23,551	32,895
- Other issuers	3,102	3,429	6,164
Equity shares	259	611	1,980
	28,022	27,591	41,039

Note:
(1) All short positions are classified as held-for-trading.

22 Accruals, deferred income and other liabilities

	2013	2012	2011
	£m	£m	£m
Notes in circulation	1,759	1,684	1,683
Current tax	516	527	700
Accruals	3,116	3,579	4,941
Deferred income	589	875	3,481
Provisions for liabilities and charges (see table below)	5,489	3,147	1,311
Other liabilities (1)	4,548	4,989	11,088
	16,017	14,801	23,204

Note:
(1) Other liabilities include £25 million (2012 - £24 million; 2011 - £15 million) in respect of share-based compensation.

Provisions for liabilities and charges	Payment Protection Insurance (1)	Interest Rate Hedging Products (2)	Other customer redress (3)	LIBOR (4)	Other regulatory provisions (5)	Litigation (6)	Technology incident redress (7)	Property (8)	Other	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2013	895	676	162	381	200	168	28	392	245	3,147
Transfer from accruals and other liabilities	—	—	—	10	10	—	—	21	(21)	20
Currency translation and other movements	—	—	(3)	(2)	—	(25)	—	(2)	(2)	(34)

Charge to income statement	900	550	455	315	124	2,050	—	154	182	4,730
Releases to income statement		—	(3)	—	(123)	(28)	—	(91)	(63)	(308)
Provisions utilised	(869)	(149)	(274)	(288)	(61)	(147)	(28)	(95)	(155)	(2,066)
At 31 December 2013	926	1,077	337	416	150	2,018	—	379	186	5,489

Notes:

(1) The principal assumptions underlying the Group's provision in respect of PPI sales are: assessment of the total number of complaints that the Group will receive; the proportion of these that will result in redress; and the average cost of such redress. The number of complaints has been estimated from an analysis of the Group's portfolio of PPI policies sold by vintage and by product. Estimates of the percentage of policyholders that will lodge complaints (the take up rate) and of the number of these that will be upheld (the uphold rate) have been established based on recent experience, guidance in the FSA policy statements and expected rate of responses from proactive customer contact. The average redress assumption is based on recent experience and the calculation rules in the FSA statement. The table below shows the sensitivity of the provision to changes in the principal assumptions (all other assumptions remaining the same).

			Sensitivity	
Assumption	Actual to date	Current assumptions	Change in assumption %	Consequential change in provision £m
Take up rate	36%	38%	+/-5	+/-45
Uphold rate (1)	84%	83%	+/-5	+/-30
Average redress	£1,733	£1,646	+/-5	+/-26

Note:
(1) Uphold rates exclude claims where no PPI policy was held.

Interest that will be payable on successful complaints has been included in the provision as has the estimated cost to the Group of administering the redress process. The Group expects the majority of the cash outflows associated with this provision to have occurred by the end of 2014. There are uncertainties as to the eventual cost of redress which will depend on actual complaint volumes, take up and uphold rates and average redress costs.

Background information in relation to PPI claims is given in Note 32.

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Notes on the consolidated accounts

22 Accruals, deferred income and other liabilities continued

(2) The Group has estimated £1,250 million for its liability in respect of the sale of Interest Rate Hedging Products based on experience, having now agreed a substantial number of outcomes with the independent skilled person appointed to review all decisions. The provision includes redress that will be paid to customers, interest payable on customer redress, the cost to the Group of exiting the hedging positions and the cost of undertaking the review. It does not include provision for any consequential losses that customers may have suffered as the Group is unable to reliably measure any liability it may have for such losses.

The principal assumptions underlying the Group's provision are:

- the proportion of relevant customers that will not opt in to the review
- the number of transactions that qualify for redress
- the nature of the redress (in particular whether a product is terminated or replaced with an alternative product and/or a different profile)
- the cost of the review

	Sensitivity	
	Change in assumption	Consequential change in provision
Assumption	%	£m
Proportion of relevant customers that will not opt in to the review	+/-5	+/-47
Proportion of customer transactions qualifying for redress	+/-5	+/-71
Average redress	+/-5	+/-71

Uncertainties remain over the number of transactions that will qualify for redress and the nature and cost of that redress.

Background information in relation to Interest Rate Hedging Products claims is given in Note 32.

(3) The Group has provided for customer redress in relation to certain other retail products. None of these provisions are individually material.

(4) On 6 February 2013, the Group reached agreement with the FSA, the US Department of Justice and the Commodity Futures Trading Commission in relation to the setting of LIBOR and other trading rates, including financial penalties of £381 million and a provision for this amount was recognised in 2012. The Group continues to cooperate with other governmental and regulatory authorities and, as a result of progress on these matters in 2013, the provision was increased by £315 million. For further details see Note 32.

(5) The Group is subject to a number of investigations by regulatory and other authorities. Details of these investigations and a discussion of the nature of the associated uncertainties are given in Note 32.

(6) Arising out of its normal business operations, the Group is party to legal proceedings in the United Kingdom, the United States and other jurisdictions. Litigation provisions at 31 December 2012 related to a number of proceedings; no individual provision was material. An additional charge of £2,050 million was recorded in 2013 as a result of greater levels of certainty on expected outcomes, primarily in respect of matters relating to mortgage-backed securities and securities-related litigation following third party litigation settlements and regulatory decisions. Detailed descriptions of the Group's legal proceedings and discussion of the associated uncertainties are given in Note 32.

(7) In June 2012, the Group experienced a technology incident that affected its transaction batch processing. Provisions of £175 million were charged during 2012 to meet the waiver of fees and interest; redress for customers of the Group; and other costs principally staff costs. These costs have now been settled.

(8) The property provisions principally comprise provisions for onerous lease contracts. Provision is made for future rentals payable in respect of vacant leasehold property and for any shortfall where leased property is sub-let at a rental lower than the lease rentals payable by the Group.

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Notes on the consolidated accounts

23 Deferred tax

	2013 £m	2012 £m	2011 £m
Deferred tax liability	507	1,141	1,945
Deferred tax asset	(3,478)	(3,443)	(3,878)
Net deferred tax asset	(2,971)	(2,302)	(1,933)

Net deferred tax asset comprised:

	Pension £m	Accelerated capital allowances £m	Provisions £m	Deferred gains £m	IFRS transition £m	Fair value of financial instruments £m	Available-for-sale financial assets £m	Intangibles £m	Cash flow hedging £m	S sche
At 1 January 2012	(493)	2,306	(1,274)	359	(219)	(33)	(52)	252	550	
Transfers to disposal groups	1	—	—	—	—	—	2	—	—	
(Disposal)/acquisition of subsidiaries	(2)	(38)	(85)	—	—	(6)	(4)	—	—	
Charge/(credit) to income statement										
- continuing operations	43	(482)	237	(13)	84	25	(18)	(15)	(128)	
- discontinued operations	—	1	5	—	—	—	—	—	—	
(Credit)/charge to other comprehensive income	(352)	—	—	(10)	—	—	200	—	155	
Currency translation and otheradjustments	—	(43)	46	49	(25)	6	7	(10)	—	
At 1 January 2013	(803)	1,744	(1,071)	385	(160)	(8)	135	227	577	
(Disposal)/acquisition of subsidiaries	—	(21)	5	—	—	—	—	—	—	
Charge/(credit) to income statement										
- continuing operations	60	(445)	(439)	(60)	68	16	(60)	4	54	
Charge/(credit) to other comprehensive income	245	—	(3)	—	—	—	(93)	—	(633)	
Currency translation and other adjustments	—	(20)	25	2	1	(5)	3	(5)	3	
At 31 December 2013	(498)	1,258	(1,483)	327	(91)	3	(15)	226	1	

Deferred tax assets in respect of unused tax losses are recognised if the losses can be used to offset probable future taxable profits after taking into account the expected reversal of other temporary differences. Recognised deferred tax assets in respect of tax losses are analysed further below.

	2013	2012	2011
	£m	£m	£m
UK tax losses carried forward			
- The Royal Bank of Scotland plc	1,693	2,654	2,623
- UK branch of RBS N.V.	—	322	166
- National Westminster Bank Plc	718	66	93
- RBS Management Services (UK) Ltd	—	30	51
	2,411	3,072	2,933
Overseas tax losses carried forward			
- Ulster Bank Ireland	74	72	284
- RBS Citizens Financial Group	11	87	—
- RBS N.V. Australia	—	—	77
	85	159	361
	2,496	3,231	3,294

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23 Deferred tax continued
UK tax losses
Under UK tax rules, tax losses do not expire and can be carried forward indefinitely.

The Royal Bank of Scotland plc - the deferred tax asset in respect of tax losses brought forward at 1 January 2013 related mainly to trading losses that arose in the UK branch of RBS N.V. These were transferred following the transfer of the majority of the activities of the UK branch of RBS N.V. to The Royal Bank of Scotland plc. The UK branch tax losses attributable to credit market write-downs during the financial crisis were principally incurred between 2007 and 2009.

The Royal Bank of Scotland plc reported a taxable profit in 2011 and tax losses in 2012 and 2013. The taxable loss for 2012 reflected the reversal of previous own credit gains offset by core banking profitability. In 2013, core profitability remains strong; the UK tax losses of £3 billion are attributable to the loan impairment charges arising from the RCR accelerated recovery strategy recorded in the final quarter of the year and significant regulatory and conduct provisions. The additional restructuring costs anticipated by the latest strategic plan will constrain the utilisation of carried forward tax losses in the near-term. Consequently a reduction in the carrying value of deferred tax assets of £701 million has been recorded in 2013. In addition, deferred tax has not been recognised in respect of excess 2013 UK taxable losses of £750 million, representing an unprovided deferred tax asset of £150 million. The Group expects that the recognised deferred tax asset in respect of tax losses amounting to £8,465 million will be recovered within eight years. A 20% reduction in forecast profits would extend the recovery period by a year.

National Westminster Bank Plc - the deferred tax asset in respect of tax losses at 31 December 2013 relates to residual unrelieved trading losses that arose between 2009 and 2013. 60% of the losses that arose were relieved against taxable profits arising in other UK Group companies. Based on the Group’s strategic plan, the residual carried forward losses will be fully utilised against future taxable profits of the company by the end of 2018. A 20% reduction in forecast profits would extend the recovery period by one year.

Overseas tax losses
Ulster Bank Ireland - a deferred tax asset has been recognised in respect of £592 million of total tax losses of £11,575 million carried forward at 31 December 2013. These losses arose principally as a result of significant impairment charges reflecting deteriorating economic conditions in the Republic of Ireland. Impairment charges are expected to reduce in the future. Based on the Group’s strategic plan, the losses on which a deferred tax asset has been recognised will be utilised against future taxable profits of the company by the end of 2018. A 20% reduction in forecast profits would extend the recovery period by one year.

RBS Citizens Financial Group - a deferred tax asset of £11 million has been recognised in respect of total tax losses of £32 million carried forward at 31 December 2013. Based on the Group’s strategic plan, the losses on which a deferred tax asset has been recognised will be utilised against future taxable profits in 2014. A 20% reduction in forecast profits would not extend the recovery period beyond 2014.

Unrecognised deferred tax
Deferred tax assets of £4,942 million (2012 - £3,827 million; 2011 - £3,246 million) have not been recognised in respect of tax losses carried forward of £28,099 million (2012 - £20,432 million; 2011 - £16,691 million) in jurisdictions where doubt exists over the availability of future taxable profits. Of these losses, £187 million expire within one year, £1,901 million within five years and £8,673 million thereafter. The balance of tax losses carried forward has no time limit.

Deferred tax liabilities of £186 million (2012 - £214 million; 2011 - £249 million) have not been recognised in respect of retained earnings of overseas subsidiaries and held-over gains on the incorporation of overseas branches. Retained earnings of overseas subsidiaries are expected to be reinvested indefinitely or remitted to the UK free from further taxation. No taxation is expected to arise in the foreseeable future in respect of held-over gains. Changes to UK tax legislation largely exempts overseas dividends received on or after 1 July 2009 from UK tax.

24 Subordinated liabilities

	2013	2012	2011
	£m	£m	£m
Dated loan capital	17,597	20,210	19,654
Undated loan capital	5,376	5,488	5,549
Preference shares	1,039	1,075	1,116
	24,012	26,773	26,319

In March 2012, the Group exchanged certain subordinated debt securities for new subordinated debt securities. The exchanges involving instruments classified as liabilities all met the criteria in IFRS for treatment as the extinguishment of the original liability and the recognition of a new financial liability.

The Group has now resumed payments on all discretionary non-equity capital instruments following the end of the European Commission ban in 2012 for RBSG and 2013 for RBS N.V. Future coupons and dividends on hybrid capital instruments will only be paid subject to, and in accordance with, the terms of the relevant instruments.

Certain preference shares issued by the company are classified as liabilities; these securities remain subject to the capital maintenance rules of the Companies Act 2006.

Notes on the consolidated accounts

24 Subordinated liabilities continued
The following tables analyse the remaining contractual maturity of subordinated liabilities by the final redemption date and by the next call date.

	2014	2015	2016-2018	2019-2023	Thereafter	Perpetual	Total
2013 - final redemption	£m	£m	£m	£m	£m	£m	£m
Sterling	45	608	60	366	—	785	1,864
US dollar	706	961	1,386	4,735	91	4,486	12,365
Euro	200	1,005	2,985	1,946	166	823	7,125
Other	399	617	531	813	—	298	2,658
	1,350	3,191	4,962	7,860	257	6,392	24,012

	Currently	2014	2015	2016-2018	2019-2023	Thereafter	Perpetual	Total
2013 - call date	£m	£m	£m	£m	£m	£m	£m	£m
Sterling	1	103	695	290	518	59	198	1,864
US dollar	3,084	2,701	426	1,849	3,447	848	10	12,365
Euro	326	1,267	657	4,098	560	166	51	7,125
Other	761	1,230	292	375	—	—	—	2,658
	4,172	5,301	2,070	6,612	4,525	1,073	259	24,012

	2013	2014	2015-2017	2018-2022	Thereafter	Perpetual	Total
2012 - final redemption	£m	£m	£m	£m	£m	£m	£m
Sterling	214	—	630	464	—	994	2,302
US dollar	611	664	2,388	3,722	177	4,409	11,971
Euro	1,478	—	3,035	3,814	397	806	9,530
Other	48	425	790	1,381	—	326	2,970
	2,351	1,089	6,843	9,381	574	6,535	26,773

	Currently	2013	2014	2015-2017	2018-2022	Thereafter	Perpetual	Total
2012 - call date	£m	£m	£m	£m	£m	£m	£m	£m
Sterling	24	429	60	826	715	36	212	2,302
US dollar	2,577	3,546	664	1,767	2,408	1,009	—	11,971
Euro	—	3,509	289	2,863	2,427	397	45	9,530
Other	—	1,192	—	1,214	564	—	—	2,970
	2,601	8,676	1,013	6,670	6,114	1,442	257	26,773

	2012	2013	2014-2016	2017-2021	Thereafter	Perpetual	Total
2011 - final redemption	£m	£m	£m	£m	£m	£m	£m
Sterling	73	158	648	453	—	823	2,155
US dollar	302	555	3,903	1,793	190	4,619	11,362
Euro	220	1,299	2,389	4,296	513	832	9,549
Other	29	—	1,618	1,261	—	345	3,253
	624	2,012	8,558	7,803	703	6,619	26,319

	Currently	2012	2013	2014-2016	2017-2021	Thereafter	Perpetual	Total
2011 - call date	£m	£m	£m	£m	£m	£m	£m	£m
Sterling	15	127	218	855	593	176	171	2,155

US dollar	3,230	3,974	765	1,196	824	1,059	314	11,362
Euro	159	2,714	1,299	1,954	2,863	513	47	9,549
Other	9	1,407	489	1,306	42	—	—	3,253
	3,413	8,222	2,771	5,311	4,322	1,748	532	26,319

Notes on the consolidated accounts

24 Subordinated liabilities continued

Dated loan capital	Capital treatment	2013 £m	2012 £m	2011 £m
The Royal Bank of Scotland Group plc				
US$750 million 5% subordinated notes (redeemed November 2013) (1)	Lower Tier 2	—	485	522
US$750 million 5% subordinated notes 2014 (1)	Lower Tier 2	479	520	558
US$250 million 5% subordinated notes 2014 (1)	Lower Tier 2	153	152	163
US$675 million 5.05% subordinated notes 2015 (1)	Lower Tier 2	436	463	494
US$350 million 4.7% subordinated notes 2018 (1)	Lower Tier 2	243	262	271
US$2,250 million 6.125% subordinated notes 2022 (1)	Lower Tier 2	1,226	1,398	—
US$2,000 million 6% subordinated notes 2023 (issued December 2013) (1)	Lower Tier 2	1,183	—	—
US$1,000 million 6.1% subordinated notes 2023 (issued June 2013) (1)	Lower Tier 2	567	—	—
The Royal Bank of Scotland plc				
€1,000 million 6% subordinated notes (redeemed May 2013)	Lower Tier 2	—	869	921
US$50 million floating rate subordinated notes (redeemed October 2013)	Lower Tier 2	—	36	37
€500 million 6% subordinated notes (redeemed May 2013)	Lower Tier 2	—	415	426
£150 million 10.5% subordinated bonds (redeemed March 2013)	Lower Tier 2	—	164	171
AUD397 million (2011 - AUD590 million) floating rate subordinated notes 2014 (callable quarterly from October 2009) (2)	Lower Tier 2	216	257	392
AUD265 million (2011 - AUD410 million) floating rate subordinated notes 2014 (callable quarterly from October 2009) (2)	Lower Tier 2	144	171	272
CAD217 million (2011 - CAD700 million) floating rate subordinated notes 2015 (callable quarterly from March 2010) (2)	Lower Tier 2	123	135	444
£250 million 9.625% subordinated bonds 2015	Lower Tier 2	287	289	297
US$322 million (2011 - US$750 million) floating rate Bermudian callable subordinated notes 2015 (callable quarterly from September 2010) (2)	Lower Tier 2	195	199	485
€750 million 4.875% subordinated notes 2015	Lower Tier 2	678	688	709

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Notes on the consolidated accounts

24 Subordinated liabilities continued

Dated loan capital continued	Capital treatment	2013 £m	2012 £m	2011 £m
The Royal Bank of Scotland plc continued				
CHF400 million 2.375% subordinated notes 2015	Lower Tier 2	283	287	295
CHF100 million 2.375% subordinated notes 2015 (callable annually from November 2013)	Lower Tier 2	78	84	88
CHF200 million 2.375% subordinated notes 2015	Lower Tier 2	135	134	136
US$229 million (2011 - US$500 million) floating rate subordinated notes 2016 (callable quarterly from October 2011) (2)	Lower Tier 2	139	142	324
US$686 million (2011 - US$1,500 million) floating rate subordinated notes 2016 (callable quarterly from April 2011) (2)	Lower Tier 2	415	425	971
€227 million (2011 - €500 million) floating rate subordinated notes 2016 (callable quarterly from January 2011) (2)	Lower Tier 2	189	185	420
CHF34 million (2011 - CHF200 million) floating rate subordinated notes 2017 (callable annually from December 2012) (2)	Lower Tier 2	23	23	138
€100 million floating rate subordinated notes 2017	Lower Tier 2	83	82	84
€102 million (2011 - €500 million) floating rate subordinated notes 2017 (callable quarterly from January 2012) (2)	Lower Tier 2	85	84	419
€750 million 4.35% subordinated notes 2017	Lower Tier 2	712	721	723
AUD50 (2011 - AUD450 million) floating rate subordinated notes 2017 (callable quarterly from February 2012) (2)	Lower Tier 2	27	32	303
AUD90 million (2011 - AUD450 million) floating rate subordinated notes 2017 (callable quarterly from February 2012) (2)	Lower Tier 2	49	58	298
US$450 million (2011 - US$1,500 million) floating rate subordinated step-up notes 2017 (callable quarterly from August 2012) (2)	Lower Tier 2	272	279	971
€2,000 million 6.93% subordinated notes 2018	Lower Tier 2	1,996	2,033	2,023
US$125.6 million floating rate subordinated notes 2020	Lower Tier 2	76	78	81
€1,000 million 4.625% subordinated notes 2021 (callable quarterly from September 2016)	Lower Tier 2	925	938	948
€300 million CMS linked floating rate subordinated notes 2022	Lower Tier 2	234	272	271
€144.4 million floating rate subordinated notes 2023	Lower Tier 2	109	224	157
AUD883 million 13.125% subordinated notes 2022 (callable bi-annually from March 2017)	Lower Tier 2	506	585	—

CAD420 million 10.5% subordinated notes 2022 (callable bi-annually from September 2013)	Lower Tier 2	246	269	—
CHF124 million 9.375% subordinated notes 2022 (callable annually from March 2017)	Lower Tier 2	92	90	—
€564 million 10.5% subordinated notes 2022 (callable every 5 years from March 2017)	Lower Tier 2	511	497	—
US$2,132 million 9.5% subordinated notes 2022 (callable annually from March 2017)	Lower Tier 2	1,323	1,350	—

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Notes on the consolidated accounts

24 Subordinated liabilities continued
Dated loan capital continued

	Capital treatment	2013 £m	2012 £m	2011 £m
National Westminster Bank Plc				
£300 million 7.875% subordinated notes 2015	Lower Tier 2	341	360	371
£300 million 6.5% subordinated notes 2021	Lower Tier 2	373	410	400
Charter One Financial, Inc.				
US$400 million 6.375% subordinated notes		—	—	261
US$350 million 4.150% subordinated notes 2022	Ineligible	211	217	—
First Active plc				
£60 million floating rate subordinated bonds 2018	Lower Tier 2	60	63	64
RBS NV and subsidiaries				
€250 million floating rate subordinated notes 2019	Lower Tier 2	221	199	136
€100 million 5.13% flip flop Bermudan callable subordinated notes (redeemed July 2013)	Lower Tier 2	—	72	78
€13 million zero coupon subordinated notes (redeemed July 2013)	Lower Tier 2	—	11	14
€170 million floating rate sinkable subordinated notes 2041	Lower Tier 2	167	166	81
€15 million CMS linked floating rate subordinated notes 2020	Lower Tier 2	12	10	7
€415 million (2012 and 2011 - €1,500 million) floating rate Bermudan subordinated notes 2015 (callable quarterly from June 2010, partially redeemed June 2013)	Lower Tier 2	344	1,215	1,246
€5 million floating rate Bermudan callable subordinated notes 2015 (callable quarterly from October 2010)	Lower Tier 2	4	4	4
US$120 million (2011 - US$165 million) 6.14% subordinated notes 2019	Lower Tier 2	75	75	76
US$72 million 5.98% subordinated notes 2019	Lower Tier 2	36	57	47
US$500 million 4.65% subordinated notes 2018	Lower Tier 2	324	347	354
US$564 million (2012 and 2011 - US$1,500 million) floating rate Bermudan subordinated notes 2015 (callable quarterly from March 2010, partially redeemed March 2013)	Lower Tier 2	340	892	930
AUD575 million floating rate Bermudan subordinated notes 2018 (callable quarterly from May 2013)	Lower Tier 2	305	366	378

AUD175 million floating rate Bermudan subordinated notes 2018 (callable quarterly from May 2013)	Lower Tier 2	93	109	111
€26 million 7.42% subordinated notes 2016	Lower Tier 2	25	25	25
€7 million 7.38% subordinated notes 2016	Lower Tier 2	7	7	7
US$136 million (2011 - US$250 million) 7.75% fixed rate subordinated notes 2023	Lower Tier 2	83	85	90
US$150 million 7.13% fixed rate subordinated notes 2093	Lower Tier 2	91	94	100
The Royal Bank of Scotland Berhad				
MYR200 million 4.15% subordinated notes 2017 (callable annually from June 2012)	Ineligible	38	42	42
Non-controlling interests subordinated issues		9	9	20
		17,597	20,210	19,654

Notes:

(1) On-lent to The Royal Bank of Scotland plc on a subordinated basis.

(2) Partially repurchased following completion of an exchange offer in March 2012

(3) In the event of certain changes in tax laws, dated loan capital issues may be redeemed in whole, but not in part, at the option of the issuer, at the principal amount thereof plus accrued interest, subject to prior regulatory approval.

(4) Except as stated above, claims in respect of the Group's dated loan capital are subordinated to the claims of other creditors. None of the Group's dated loan capital is secured.

(5) Interest on all floating rate subordinated notes is calculated by reference to market rates.

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Notes on the consolidated accounts

24 Subordinated liabilities continued
Undated loan capital

	Capital treatment	2013 £m	2012 £m	2011 £m
The Royal Bank of Scotland Group plc				
€391 million floating rate 2042 (callable quarterly from June 2012) (2,3)	Tier 1	326	319	340
US$486 million 6.8% 2042 (callable quarterly from March 2008) (2,4)	Tier 1	294	302	309
US$318 million floating rate (callable quarterly from July 2013) (2,5)	Tier 1	192	199	210
US$394 million 6.425% 2043 (callable quarterly from January 2034) (2,6)	Tier 1	301	365	382
US$106 million undated floating rate primary capital notes (callable semi-annually from December 1990) (1)	Upper Tier 2	65	66	69
US$762 million 7.648% perpetual regulatory (callable quarterly from September 2031) (8)	Tier 1	465	477	497
The Royal Bank of Scotland plc				
£31 million 4.956% undated subordinated notes	Upper Tier 2	31	31	31
£51 million 6.25% undated subordinated notes (callable every five years from December 2012)	Upper Tier 2	50	51	53
£56 million 6% undated subordinated notes (callable every five years from September 2014)	Upper Tier 2	59	61	62
€176 million 5.125% undated subordinated notes (callable quarterly from July 2014)	Upper Tier 2	153	155	161
€170 million floating rate undated subordinated notes (callable quarterly from July 2014)	Upper Tier 2	141	138	141
£54 million 5.125% undated subordinated notes (callable every five years from March 2016)	Upper Tier 2	60	61	61
£35 million 5.5% undated subordinated notes (callable every five years from December 2019)	Upper Tier 2	39	39	37
£21 million 6.2% undated subordinated notes (callable every five years from March 2022)	Upper Tier 2	26	46	45
£103 million 9.5% undated subordinated bonds (callable every five years from August 2018) (3)	Upper Tier 2	127	137	137
£16 million (2011 - £22 million) 5.625% undated subordinated notes (callable every five years from September 2026)	Upper Tier 2	24	24	23
£19 million 5.625% undated subordinated notes (callable every five years from June 2032)	Upper Tier 2	21	13	13
£1 million floating rate undated subordinated notes (callable semi-annually from March 2011)	Upper Tier 2	1	1	1
CAD474 million 5.37% undated subordinated notes (callable quarterly from May 2016)	Upper Tier 2	291	328	347
National Westminster Bank Plc				
US$193 million primary capital floating rate notes, Series A (callable semi-annually from July 1990)	Upper Tier 2	117	119	124
		139	142	148

US$229 million primary capital floating rate notes, Series B (callable semi-annually from August 1990)	Upper Tier 2			
US$285 million primary capital floating rate notes, Series C (callable quarterly from November 1990)	Upper Tier 2	173	177	184
€178 million floating rate undated subordinated notes (callable quarterly from October 2009)	Upper Tier 2	149	146	150
€10 million floating rate undated step-up notes (callable quarterly from October 2009)	Upper Tier 2	9	9	9
£87 million floating undated subordinated step-up notes (callable every five years from January 2010)	Upper Tier 2	92	92	91
£53 million 7.125% undated subordinated step-up notes (callable every five years from October 2022)	Upper Tier 2	54	55	56
£35 million 11.5% undated subordinated notes (callable any time from December 2022) (1,9)	Upper Tier 2	35	38	42
First Active plc				
£20 million 11.75% perpetual	Lower Tier 2	25	25	26
€38 million 11.375% perpetual	Lower Tier 2	52	46	48
£1.3 million floating rate perpetual	Lower Tier 2	1	2	2
RBS NV and subsidiaries				
US$1,285 million 6.025% 2049 (callable any time from July 2008) (2,7,10)	Tier 1	730	713	684
US$200 million 6.375% 2033 (callable any time from September 2008) (2,7,11)	Tier 1	114	112	108
US$1,800 million 6.2% 2033 (callable any time from February 2009) (2,7,12)	Tier 1	1,020	999	958
		5,376	5,488	5,549

For the notes to this table refer to the following page.

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Notes on the consolidated accounts

24 Subordinated liabilities continued

Notes:

(1) On-lent to The Royal Bank of Scotland plc on a subordinated basis

(2) Subordinated notes issued to limited partnerships that have in turn issued partnership preferred securities to trusts that have issued trust preferred securities to investors. On maturity of the notes, the partnerships are required to reinvest in eligible capital instruments issued by the group. Prior to the implementation of IFRS 10, the limited partnerships and the trusts were consolidated, and the trust preferred securities included within subordinated liabilities.

(3) Preferred securities in issue are: €391 million RBS Capital Trust A, 6.467% non-cumulative trust preferred securities.

(4) Preferred securities in issue are: US$486 million RBS Capital Trust B, 6.8% non-cumulative trust preferred securities.

(5) Preferred securities in issue are: US$318 million RBS Capital Trust I, 4.709% non-cumulative trust preferred securities.

(6) Preferred securities in issue are: US$394 million RBS Capital Trust II, 6.425% non-cumulative trust preferred securities.

(7) Unconditionally guaranteed by the Royal Bank of Scotland Group plc

(8) Guaranteed by the company. The company can satisfy interest payment obligations by issuing sufficient ordinary shares to appointed Trustees to enable them, on selling these shares, to settle the interest payment.

(9) Exchangeable at the option of the issuer into 8.392% (gross) non-cumulative preference shares of £1 each of National Westminster Bank Plc at any time.

(10) Preferred securities in issue are: US$1,285 million Trust Preferred V, 5.9%

(11) Preferred securities in issue are: US$200 million Trust Preferred VI, 6.25%

(12) Preferred securities in issue are: US$1,800 million Trust Preferred VII, 6.08%

(13) Except as stated above, claims in respect of the Group's undated loan capital are subordinated to the claims of other creditors. None of the Group's undated loan capital is secured.

(14) In the event of certain changes in tax laws, undated loan capital issues may be redeemed in whole, but not in part, at the option of the Group, at the principal amount thereof plus accrued interest, subject to prior regulatory approval.

(15) Interest on all floating rate subordinated notes is calculated by reference to market rates.

Preference shares

	Capital treatment	2013 £m	2012 £m	2011 £m
The Royal Bank of Scotland Group plc (1)				
Non-cumulative preference shares of US$0.01				
Series F US$156 million 7.65% (callable any time from March 2007)	Tier 1	95	97	101
Series H US$242 million 7.25% (callable any time from March 2004)	Tier 1	146	150	157
Series L US$751 million 5.75% (callable any time from October 2009)	Tier 1	454	465	485
Non-cumulative convertible preference shares of US$0.01				
Series 1 US$65 million 9.118% (callable any time from March 2010)	Tier 1	40	41	43
Non-cumulative convertible preference shares of £0.01				
Series 1 £15 million 7.387% (callable any time from December 2010)	Tier 1	15	15	15

Cumulative preference shares of £1				
£0.5 million 11% and £0.4 million 5.5% (not callable)	Upper Tier 2	1	1	1
National Westminster Bank Plc				
Non-cumulative preference shares of £1				
Series A £140 million 9% (not callable)	Tier 1	143	145	145
Non-cumulative preference shares of US$25				
Series C US$246 million 7.7628% (callable quarterly from April 2002) (2)	Tier 1	145	161	169
		1,039	1,075	1,116

Notes:
(1) Further details of the contractual terms of the preference shares are given in Note 26.
(2) Series C preference shares each carry a gross dividend of 8.625% inclusive of associated tax credit. Redeemable at the option of the issuer at par.

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25 Non-controlling interests

	Direct Line Insurance Group plc £m	ABN AMRO £m	Other interests* £m	Total* £m
At 1 January 2012	—	283	403	686
Currency translation and other adjustments	—	(12)	(6)	(18)
(Loss)/profit attributable to non-controlling interests				
- continuing operations	—	(43)	19	(24)
- discontinued operations	(125)	13	—	(112)
Losses on available-for-sale financial assets, net of tax	—	25	—	25
Equity raised	873	—	2	875
Equity withdrawn and disposals	—	—	(23)	(23)
Transfer from retained earnings	361	—	—	361
At 1 January 2013	1,109	266	395	1,770
Currency translation and other adjustments	—	(8)	2	(6)
Profit/(loss) attributable to non-controlling interests				
- continuing operations	—	95	(12)	83
- discontinued operations	19	18	—	37
Dividends paid	—	—	(5)	(5)
Losses on available-for-sale financial assets, net of tax	—	23	—	23
Equity withdrawn and disposals	(1,128)	—	(301)	(1,429)
At 31 December 2013	—	394	79	473

* Restated

26 Share capital

	Alotted, called up and fully paid		
		Issued	
	1 January 2013 £m	during the year £m	31 December 2013 £m
Ordinary shares of £1	6,071	132	6,203
B shares of £0.01	510	—	510
Dividend access share of £0.01 (1)	—	—	—
Non-cumulative preference shares of US$0.01	1	—	1
Non-cumulative convertible preference shares of US$0.01	—	—	—
Non-cumulative preference shares of €0.01	—	—	—
Non-cumulative convertible preference shares of £0.01	—	—	—
Non-cumulative preference shares of £1	—	—	—
Cumulative preference shares of £1	1	—	1

	Allotted, called up and fully paid		
Number of shares - thousands	2013	2012	2011

Ordinary shares of 25p (2)	—	—	59,228,412
Ordinary shares of £1	6,203,022	6,070,765	—
B shares of £0.01	51,000,000	51,000,000	51,000,000
Dividend access share of £0.01 (1)	—	—	—
Non-cumulative preference shares of US$0.01	209,609	209,609	209,609
Non-cumulative convertible preference shares of US$0.01	65	65	65
Non-cumulative preference shares of €0.01	2,044	2,044	2,044
Non-cumulative convertible preference shares of £0.01	15	15	15
Non-cumulative preference shares of £1	54	54	54
Cumulative preference shares of £1	900	900	900

Notes on the consolidated accounts

26 Share capital continued

Movement in allotted, called up and fully paid ordinary shares - thousands

At 1 January 2012	59,228,412
Shares issued (ordinary shares of 25p)	325,907
Share sub-division and consolidation	(53,598,887)
Shares issued (ordinary shares of £1)	115,333
At 1 January 2013	6,070,765
Shares issued	132,257
At 31 December 2013	6,203,022

Notes:

(1) One dividend access share in issue.

(2) In June 2012, the ordinary shares of 25p each were initially sub-divided into 59,554,319,127 ordinary shares of 10p each and 59,554,319,127 deferred shares of 15p each. The deferred shares created by virtue of the sub-division were cancelled with the nominal value transferred to capital redemption reserve. The 59,554,319,127 ordinary shares of 10p were consolidated into 5,955,431,912 ordinary shares of £1 each.

Ordinary shares

There is no authorised share capital under the company's constitution. The directors have the authority to issue £17.7 billion nominal of ordinary shares in connection with a conversion of B shares. At 31 December 2013 they had a remaining authority granted at the 2013 Annual General Meeting to issue up to £227 million nominal of ordinary shares other than by pre-emption to existing shareholders.

During 2013, the company issued 53.7 million ordinary shares of £1 each in connection with employee share schemes.

In July 2013, the company allotted and issued 43.0 million new ordinary shares of £1 each at a subscription price of 314.188 pence each, the gross proceeds being £135 million.

In September 2013, the company allotted and issued 20.5 million new ordinary shares of £1 each at a subscription price of 341.898 pence each the gross proceeds being £70 million.

In December 2013, the company allotted and issued 15.1 million new ordinary shares of £1 each at a subscription price of 331.309 pence each, the gross proceeds being £50 million.

B shares and dividend access share

In December 2009, the company entered into an acquisition and contingent capital agreement with HM Treasury. HM Treasury agreed to acquire at 50p per share 51 billion B shares with a nominal value of £0.01 each and a dividend access share with a nominal value of £0.01; these shares were issued to HM Treasury on 22 December 2009. Net proceeds were £25.1 billion.

The B shares do not generally carry voting rights at general meetings of ordinary shareholders. Following the subdivision and consolidation of ordinary shares in 2012 and subject to anti-dilution adjustments, each B share is entitled to one tenth of the cash dividend of an ordinary share and may be converted at any time at the option of the holder into ordinary shares at the rate of ten B shares for each ordinary share.

HM Treasury has agreed not to convert its B shares into ordinary shares to the extent that its holding of ordinary shares following the conversion would represent more than 75% of the company's issued ordinary share capital.

The dividend access share entitles the holder to dividends equal to the greater of 7% of the aggregate issue price of B shares issued to HM Treasury and 250% of the ordinary dividend rate multiplied by the number of B shares issued, less any dividends paid on the B shares and on ordinary shares issued on conversion. Dividends on the dividend access share are discretionary unless a dividend has been paid on the ordinary shares, in which case dividends became mandatory.

The dividend access share does not generally carry voting rights at general meetings of ordinary shareholders and is not convertible into ordinary shares.

Preference shares
Under IFRS certain of the Group's preference shares are classified as debt and are included in subordinated liabilities on the balance sheet.

Other securities
Certain of the Group's subordinated securities in the legal form of debt are classified as equity under IFRS.

These securities entitle the holders to interest which may be deferred at the sole discretion of the company. Repayment of the securities is at the sole discretion of the company on giving between 30 and 60 days notice.

Non-cumulative preference shares
Non-cumulative preference shares entitle the holders thereof (subject to the terms of issue) to receive periodic non-cumulative cash dividends at specified fixed rates for each Series payable out of distributable profits of the company.

The non-cumulative preference shares are redeemable at the option of the company, in whole or in part from time to time at the rates detailed in the table below plus dividends otherwise payable for the then current dividend period accrued to the date of redemption.

Notes on the consolidated accounts

26 Share capital continued

Class of preference share	Number of shares in issue	Interest rate	Redemption date on or after	Redemption price per share	Debt/equity (1)
Non-cumulative preference shares of US$0.01					
Series F	6.3 million	7.65%	31 March 2007	US$25	Debt
Series H	9.7 million	7.25%	31 March 2004	US$25	Debt
Series L	30.0 million	5.75%	30 September 2009	US$25	Debt
Series M	23.1 million	6.40%	30 September 2009	US$25	Equity
Series N	22.1 million	6.35%	30 June 2010	US$25	Equity
Series P	9.9 million	6.25%	31 December 2010	US$25	Equity
Series Q	20.6 million	6.75%	30 June 2011	US$25	Equity
Series R	10.2 million	6.125%	30 December 2011	US$25	Equity
Series S	26.4 million	6.60%	30 June 2012	US$25	Equity
Series T	51.2 million	7.25%	31 December 2012	US$25	Equity
Series U	10,130	7.64%	29 September 2017	US$100,000	Equity
Non-cumulative convertible preference shares of US$0.01					
Series 1	64,772	9.118%	31 March 2010	US$1,000	Debt
Non-cumulative preference shares of €0.01					
Series 1	1.25 million	5.50%	31 December 2009	€1,000	Equity
Series 2	784,989	5.25%	30 June 2010	€1,000	Equity
Series 3	9,429	7.0916%	29 September 2017	€50,000	Equity
Non-cumulative convertible preference shares of £0.01					
Series 1	14,866	7.387%	31 December 2010	£1,000	Debt
Non-cumulative preference shares of £1					
Series 1	54,442	3 month LIBOR + 2.33%	5 October 2012	£1,000	Equity

Note:

(1) Those preference shares where the Group has an obligation to pay dividends are classified as debt; those where distributions are discretionary are classified as equity. The conversion rights attaching to the convertible preference shares may result in the Group delivering a variable number of equity shares to preference shareholders; these convertible preference shares are treated as debt.

In the event that the non-cumulative convertible preference shares are not redeemed on or before the redemption date, the holder may convert them into ordinary shares in the company at the prevailing market price.

Under existing arrangements, no redemption or purchase of any non-cumulative preference shares may be made by the company without the prior consent of the Prudential Regulation Authority.

On a winding-up or liquidation of the company, the holders of the non-cumulative preference shares are entitled to receive, out of any surplus assets available for distribution to the company's shareholders (after payment of arrears of dividends on the cumulative preference shares up to the date of repayment) pari passu with the cumulative preference shares and all other shares of the company ranking pari passu with the non-cumulative preference shares as regards participation in the surplus assets of the company, a liquidation distribution per share equal to the applicable redemption price detailed in the table above, together with an amount equal to dividends for the then current dividend period accrued to the date of payment, before any distribution or payment may be made to holders of the ordinary shares as regards participation in the surplus assets of the company.

Except as described above, the holders of the non-cumulative preference shares have no right to participate in the surplus assets of the company. Holders of the non-cumulative preference shares are not entitled to receive notice of or attend general meetings of the company except if any resolution is proposed for adoption by the shareholders of the company to vary or abrogate any of the rights attaching to the non-cumulative preference shares or proposing the winding-up or liquidation of the company. In any such case, they are entitled to receive notice of and to attend the general meeting of shareholders at which such resolution is to be proposed and are entitled to speak and vote on such resolution (but not on any other resolution). In addition, in the event that, prior to any general meeting of shareholders, the company has failed to pay in full the three most recent quarterly dividend payments due on the non-cumulative dollar preference shares (other than Series U), the two most recent semi-annual dividend payments due on the non-cumulative convertible dollar preference shares and the most recent dividend payments due on the non-cumulative euro preference shares, the non-cumulative sterling preference shares, the Series U non-cumulative dollar preference shares and the non-cumulative convertible sterling preference shares, the holders shall be entitled to receive notice of, attend, speak and vote at such meeting on all matters together with the holders of the ordinary shares. In these circumstances only, the rights of the holders of the non-cumulative preference shares so to vote shall continue until the company shall have resumed the payment in full of the dividends in arrears.

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Notes on the consolidated accounts

26 Share capital continued
The Group has now resumed payments on all discretionary non-equity capital instruments following the end of the European Commission ban in 2012 for RBSG and 2013 for RBS N.V. Future coupons and dividends on hybrid capital instruments will be paid subject to, and in accordance with, the terms of the relevant instruments.

27 Other equity
Paid-in equity - comprises equity instruments issued by the company other than those legally constituted as shares.

	£m
EMTN notes	
US$564 million 6.99% capital securities (callable October 2017)	275
CAD321 million 6.666% notes (callable October 2017)	156
Trust preferred issues: subordinated notes (1)	
US$357 million 5.512% 2044 (callable September 2014) (2)	195
US$276 million 3 month US$ LIBOR plus 0.80% 2044 (callable September 2014) (3)	150
€166 million 4.243% 2046 (callable January 2016) (4)	110
£93 million 5.6457% 2047 (callable June 2017) (5)	93
	979

Notes:
(1) Subordinated notes issued to limited partnerships that have in turn issued partnership preferred securities to trusts that have issued trust preferred securities to investors. The trust preferred securities are redeemable only at the issuer's option and dividends are payable at the Group's discretion. On maturity of the subordinated notes, the partnerships are required to reinvest in eligible capital instruments issued by the Group. Prior to the implementation of IFRS 10, the limited partnerships and the trusts were consolidated and the trust preferred securities recorded as non-controlling interests.
(2) Preferred securities in issue - US$357 million RBS Capital Trust III, fixed/floating non-cumulative trust preferred securities.
(3) Preferred securities in issue - US$276 million RBS Capital Trust IV, floating rate non-cumulative trust preferred securities.
(4) Preferred securities in issue - €166 million RBS Capital Trust C, fixed/floating rate non-cumulative trust preferred securities.
(5) Preferred securities in issue - £93 million RBS Capital Trust D, fixed/floating rate non-cumulative trust preferred securities.

Merger reserve - the merger reserve comprises the premium on shares issued to acquire NatWest, less goodwill amortisation charged under previous GAAP, and the premium arising on shares issued to acquire Aonach Mor Limited, less amounts realised through subsequent share redemptions by Aonach Mor Limited. No share premium was recorded in the company financial statements through the operation of the merger relief provisions of the Companies Act.

Capital redemption reserve - under UK companies legislation, when shares are redeemed or purchased wholly or partly out of the company's profits, the amount by which the company's issued share capital is diminished must be

transferred to the capital redemption reserve. The capital maintenance provisions of UK companies legislation apply to the capital redemption reserve as if it were part of the company's paid up share capital.

Contingent capital reserve - in December 2009, HM Treasury agreed to subscribe for up to 16 billion B shares of £0.01 each at 50p per share subject to certain conditions including the Group's Core Tier 1 capital ratio falling below 5%. The fair value of the consideration payable by the company on entering into this agreement amounted to £1,458 million to be settled in instalments; of this £1,208 million was debited to the contingent capital reserve. The reserve and £320 million in respect of the final instalment were transferred to Retained earnings on cancellation of the above contingent capital arrangements on 16 December 2013.

Own shares held - at 31 December 2013, 34 million ordinary shares of £1 each of the company (2012 - 51 million; 2011 - 164 million) were held by Employee Share Trusts in respect of share awards and options granted to employees. The 17 million reduction during the year relates to the sale of surplus shares to help neutralise any impact on Core Tier 1 capital as a result of the recommencement of capital and dividend payments on the Group's hybrid capital instruments, together with ordinary shares delivered in satisfaction of the exercise of options, the vesting of share awards and for equity funding of employee incentive awards under the employee share plans.

The Group optimises capital efficiency by maintaining reserves in subsidiaries, including regulated entities. Certain preference shares and subordinated debt are also included within regulatory capital. The remittance of reserves to the company or the redemption of shares or subordinated capital by regulated entities may be subject to maintaining the capital resources required by the relevant regulator.

UK law prescribes that only the reserves of the company are taken into account for the purpose of making distributions and in determining the permissible applications of the share premium account.

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Notes on the consolidated accounts

28 Leases

Year in which receipt will occur	Finance lease contracts and hire purchase agreements Gross amounts £m	Present value adjustments £m	Other movements £m	Present value £m	Operating lease assets: future minimum lease rentals £m
2013					
Within 1 year	3,513	(300)	(44)	3,169	186
After 1 year but within 5 years	6,014	(534)	(251)	5,229	341
After 5 years	4,244	(1,481)	(428)	2,335	141
Total	13,771	(2,315)	(723)	10,733	668
2012					
Within 1 year	3,605	(330)	(40)	3,235	293
After 1 year but within 5 years	5,963	(600)	(197)	5,166	512
After 5 years	4,984	(1,709)	(315)	2,960	291
Total	14,552	(2,639)	(552)	11,361	1,096
2011					
Within 1 year	3,996	(340)	(29)	3,627	406
After 1 year but within 5 years	6,806	(763)	(193)	5,850	605
After 5 years	5,822	(2,710)	(270)	2,842	359
Total	16,624	(3,813)	(492)	12,319	1,370

	2013 £m	2012 £m	2011 £m
Nature of operating lease assets on the balance sheet			
Transportation	822	1,501	1,592
Cars and light commercial vehicles	64	435	815
Other	243	267	298
	1,129	2,203	2,705
Amounts recognised as income and expense			
Finance leases - contingent rental income	(94)	(110)	(133)
Operating leases - minimum rentals payable	389	392	490
Finance lease contracts and hire purchase agreements			
Accumulated allowance for uncollectable minimum receivables	197	278	347

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28 Leases continued

Residual value exposures

The table below gives details of the unguaranteed residual values included in the carrying value of finance lease receivables (see pages 411 to 415) and operating lease assets (see pages 454 to 456).

	Year in which residual value will be recovered				
	Within 1 year	After 1 year but within 2 years	After 2 years but within 5 years	After 5 years	Total
2013	£m	£m	£m	£m	£m
Operating leases					
- transportation	197	34	217	134	582
- cars and light commercial vehicles	18	8	7	—	33
- other	24	25	32	1	82
Finance lease contracts	41	53	198	429	721
Hire purchase agreements	—	1	—	1	2
	280	121	454	565	1,420
2012					
Operating leases					
- transportation	284	182	207	333	1,006
- cars and light commercial vehicles	317	44	49	1	411
- other	30	19	39	3	91
Finance lease contracts	38	47	148	318	551
Hire purchase agreements	1	—	1	—	2
	670	292	444	655	2,061
2011					
Operating leases					
- transportation	244	314	187	390	1,135
- cars and light commercial vehicles	458	75	105	2	640
- other	23	21	33	8	85
Finance lease contracts	26	48	147	270	491
Hire purchase agreements	—	—	1	—	1
	751	458	473	670	2,352

The Group provides asset finance to its customers through acting as a lessor. It purchases plant, equipment and intellectual property, renting them to customers under lease arrangements that, depending on their terms, qualify as either operating or finance leases.

Notes on the consolidated accounts

29 Structured entities

A structured entity (SE) is an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose, they do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions. As well as being a key element of securitisations, SEs are also used in fund management activities to segregate custodial duties from the fund management advice.

The Group applies IFRS 10 ‘Consolidated Financial Statements’ in determining whether or not to consolidate an SE. Entities, including SEs, are consolidated where the Group has power over the investee; exposure, or rights, to variable returns from its involvement with the entity; and the ability to use its power over the entity to affect the amount of the Group’s returns.

Consolidated structured entities

Securitisations

In a securitisation, assets, or interests in a pool of assets, are transferred generally to an SE which then issues liabilities to third party investors. The majority of securitisations are supported through liquidity facilities or other credit enhancements. The Group arranges securitisations to facilitate client transactions and undertakes own asset securitisations to sell or to fund portfolios of financial assets. The Group also acts as an underwriter and depositor in securitisation transactions in both client and proprietary transactions.

The Group’s involvement in client securitisations takes a number of forms. It may: sponsor or administer a securitisation programme; provide liquidity facilities or programme-wide credit enhancement; and purchase securities issued by the vehicle.

Own asset securitisations

In own-asset securitisations, the pool of assets held by the SE is either originated by the Group, or (in the case of whole loan programmes) purchased from third parties.

The table below analyses the asset categories for those own-asset securitisations where the transferred assets continue to be recorded on the Group’s balance sheet.

	2013				2012				2011			
		Debt securities in issue				Debt securities in issue				Debt securities in issue		
	Assets	Held by third parties	Held by the Group (1)	Total	Assets	Held by third parties	Held by the Group (1)	Total	Assets	Held by third parties	Held by the Group (1)	Total
Asset type	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Mortgages												
- UK	14,434	4,876	10,978	15,854	16,448	6,462	11,963	18,425	49,549	10,988	47,324	58,312
- Irish	9,300	1,890	8,751	10,641	10,587	3,217	7,634	10,851	12,660	3,472	8,670	12,142
	3,261	500	1,625	2,125	3,019	1,243	1,736	2,979	4,037	500	110	610

UK credit cards												
UK personal loans	3,382	—	3,677	3,677	4,658	—	4,283	4,283	5,168	—	4,706	4,706
Other loans (2)	12,326	488	12,078	12,566	18,008	1,059	18,064	19,123	19,778	4	20,577	20,581
	42,703	7,754	37,109	44,863	52,720	11,981	43,680	55,661	91,192	14,964	81,387	96,351
Cash deposits	6,245				5,366				11,164			
	48,948				58,086				102,356			

Notes:

(1) Debt securities retained by the Group may be pledged with central banks.

(2) Corporate, social housing and student loans.

Commercial paper conduits

The Group consolidates a number of asset-backed commercial paper (ABCP) conduits. A conduit is an SE that issues commercial paper and uses the proceeds to purchase or fund a pool of assets. The commercial paper is secured on the assets and is redeemed by further commercial paper issuance, repayment of assets or funding from liquidity facilities. Commercial paper is typically short-dated, usually up to three months. At 31 December 2013 assets held by the conduits totalled £1.6 billion (2012 - £3.6 billion; 2011 - £13.1 billion). At 31 December 2013 and at 31 December 2012 the conduits were funded entirely by the Group.

Covered bond programme

Certain loans and advances to customers have been assigned to bankruptcy remote limited liability partnerships to provide security for issues of debt securities by the Group. The Group retains all of the risks and rewards of these loans, the partnerships are consolidated, the loans retained on the Group's balance sheet and the related covered bonds included within debt securities in issue. At 31 December 2013, £16,177 million of mortgages provided security for debt securities in issue of £9,041 million (2012: mortgages £15,990 million, bonds £10,139 million; 2011: mortgages £15,441 million, bonds £9,107 million).

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Notes on the consolidated accounts

29 Structured entities continued

Unconsolidated structured entities

The Group's interests in unconsolidated structured entities are analysed below.

2013	Asset backed securitisation vehicles - sponsored £m	Asset backed securitisation vehicles - not sponsored £m	Investment funds £m	Other £m	Total £m
Held for trading					
Loans and advances to customers	1	1	—	289	291
Debt securities	203	9,405	176	159	9,943
Equity shares	—	1	622	—	623
Derivatives assets	261	142	22	1,334	1,759
Derivatives liabilities	(112)	—	(140)	(424)	(676)
Total	353	9,549	680	1,358	11,940
Other than held-for-trading					
Loans and advances to customers	—	3,967	26	30	4,023
Debt securities	481	19,926	8	43	20,458
Total	481	23,893	34	73	24,481
Liquidity facilities/loan commitments	4	2,630	1	233	2,868
Guarantees	—	83	—	9	92
Total exposure	838	36,155	715	1,673	39,381

Notes:

(1) Income from interests in unconsolidated structured entities includes interest receivable, changes in fair value and other income less impairments that may be required.

(2) A sponsored entity is a structured entity established by the Group where the Group provides liquidity and/or credit enhancements or provides ongoing services to the entity. The Group can act as sponsor for its own or for customers' transactions.

(3) In 2013 the Group transferred £2,119 million of assets into sponsored structured entities which are not consolidated by the Group and for which the Group held no interest at 31 December 2013. The income arising from these entities was £192 million.

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Notes on the consolidated accounts

30 Asset transfers

Under IAS 39 a financial asset is transferred if the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. Following a transfer the financial asset will be derecognised; not derecognised and retained in full on the Group's balance sheet; or continue to be recognised on the balance sheet to the extent of the Group's continuing involvement.

Transfers that do not qualify for derecognition

Securities repurchase agreements and lending transactions

The Group enters into securities repurchase agreements and securities lending transactions under which it transfers securities in accordance with normal market practice.

Generally, the agreements require additional collateral to be provided if the value of the securities falls below a predetermined level. Under standard terms for repurchase transactions in the UK and US markets, the recipient of collateral has an unrestricted right to sell or repledge it, subject to returning equivalent securities on settlement of the transaction.

Securities sold under repurchase transactions are not derecognised if the Group retains substantially all the risks and rewards of ownership. The fair value (and carrying value) of securities transferred under such repurchase transactions included on the balance sheet, are set out below. All of these securities could be sold or repledged by the holder.

	2013	2012	2011
Assets subject to securities repurchase agreements or security lending transactions	£m	£m	£m
Debt securities	55,554	91,173	79,480
Equity shares	5,310	6,772	6,534

Transfers that continue to be recognised to the extent of the Group's continuing involvement (IAS 39)

In certain securitisations of US residential mortgages, substantially all the risks and rewards have been neither transferred nor retained, but the Group has retained control of the assets and continues to recognise the assets to the extent of its continuing involvement, as defined by IAS 39, which takes the form of retaining certain subordinated bonds issued by the securitisation vehicles.

These interests relate predominantly to mortgage-backed securities which were re-securitised. Retained interests are generally not held to maturity and are typically sold after settlement of the securitisation. Retained interests may be subordinated to other investors' interests. Third party investors and securitisation trusts have no recourse to the Group's other assets for failure of debtors to perform on the securitised loans or securities, effectively transferring the risk of future credit losses to the purchasers of the securities issued by the trust. The value of the retained interest varies and is subject to credit, interest rate, prepayment, and other risks of the transferred assets. In the ordinary course of business, the Group does not provide any other financial support to the securitisation trusts other than holding these retained interests.

At 31 December 2013, securitised assets were £0.3 billion (2012 - £0.4 billion; 2011 - £0.6 billion); retained interest at fair value £59 million (2012 - £61 million; 2011 - £72 million); subordinated assets £35 million (2012 - £1 million; 2011 - £3 million); and related liabilities £35 million (2012 - £1 million; 2011 - £3 million).

Transfers that qualify for derecognition but in which the Group has continuing involvement (IFRS 7)
The Group has transferred and derecognised certain assets but it has continuing involvement, as defined in IFRS 7, through holdings of debt securities with a carrying value at 31 December 2013 of £389 million and fair value of £345 million (31 December 2012: carrying value - £398 million; fair value - £339 million). Income for 2013 was £11 million (2012 - £13 million).

Assets pledged as collateral
The Group pledges collateral with its counterparties in respect of derivative liabilities and bank and other borrowings.

	2013	2012	2011
Assets pledged against liabilities	£m	£m	£m
Loans and advances to banks	10,342	12,784	19,691
Loans and advances to customers	23,594	25,186	52,225
Securities	8,673	24,236	3,713
	42,609	62,206	75,629
Liabilities secured by assets			
Deposits by banks	3,254	12,309	6,369
Customer accounts	2,766	3,000	2,663
Derivatives	42,691	60,434	82,356
	48,711	75,743	91,388

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Notes on the consolidated accounts

31 Capital resources

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

	2013	2012	2011
	£m	£m	£m
Shareholders' equity (excluding non-controlling interests)			
Shareholders' equity	58,742	68,678	75,367
Preference shares - equity	(4,313)	(4,313)	(4,313)
Other equity instruments	(979)	(979)	(979)
	53,450	63,386	70,075
Non-controlling interests			
Non-controlling interests	473	1,770	686
Regulatory adjustments to non-controlling interests	—	(1,367)	(259)
	473	403	427
Regulatory adjustments and deductions			
Own credit	726	691	(2,634)
Defined benefit pension fund adjustment	362	913	—
Net unrealised AFS losses	308	346	957
Cash flow hedging reserve	84	(1,666)	(879)
Other regulatory adjustments	(103)	(197)	571
Goodwill and other intangible assets	(12,368)	(13,545)	(14,858)
50% of expected losses less impairment provisions	(19)	(1,904)	(2,536)
50% of securitisation positions	(748)	(1,107)	(2,019)
50% of APS first loss	—	—	(2,763)
	(11,758)	(16,469)	(24,161)
Core Tier 1 capital	42,165	47,320	46,341
Other Tier 1 capital			
Preference shares - equity	4,313	4,313	4,313
Preference shares - debt	911	1,054	1,094
Innovative/hybrid Tier 1 securities	4,207	4,125	4,667
	9,431	9,492	10,074
Tier 1 deductions			
50% of material holdings (1)	(976)	(295)	(340)
Tax on expected losses less impairment provisions	6	618	915
	(970)	323	575
Total Tier 1 capital	50,626	57,135	56,990

Note:

(1) From 1 January 2013 material holdings in insurance companies are deducted 50% from Tier 1 and 50% from Tier 2.

Notes on the consolidated accounts

31 Capital resources continued

	2013 £m	2012 £m	2011 £m
Qualifying Tier 2 capital			
Undated subordinated debt	2,109	2,194	1,838
Dated subordinated debt - net of amortisation	12,436	13,420	14,527
Unrealised gains on AFS equity shares	114	63	108
Collectively assessed impairment provisions	395	399	635
Non-controlling Tier 2 capital	—	—	11
	15,054	16,076	17,119
Tier 2 deductions			
50% of securitisation positions	(748)	(1,107)	(2,019)
50% of standardised expected losses less impairment provisions	(25)	(2,522)	(3,451)
50% of material holdings (1)	(976)	(295)	(340)
50% of APS first loss	—	—	(2,763)
	(1,749)	(3,924)	(8,573)
Total Tier 2 capital	13,305	12,152	8,546
Supervisory deductions			
Unconsolidated investments			
- Direct Line Group (1)	—	(2,081)	(4,354)
- Other investments	(36)	(162)	(239)
Other deductions	(236)	(244)	(235)
	(272)	(2,487)	(4,828)
Total regulatory capital	63,659	66,800	60,708

Note:
(1) From 1 January 2013 material holdings in insurance companies are deducted 50% from Tier 1 and 50% from Tier 2.

It is the Group's policy to maintain a strong capital base, to expand it as appropriate 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 the PRA. The PRA uses risk asset ratio (RAR) as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are ‘weighted’ to reflect the inherent credit and other risks); by international agreement, the RAR should be not less than 8% with a Tier 1 component of not less than 4%. The Group has complied with the PRA’s capital requirements throughout the year.

A number of subsidiaries and sub-groups within the Group, principally banking and insurance entities, are subject to various individual regulatory capital requirements in the UK and overseas. Furthermore, the payment of dividends by subsidiaries and the ability of members of the Group to lend money to other members of the Group may be subject to restrictions such as local regulatory or legal requirements, the availability of reserves and financial and operating performance.

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Notes on the consolidated accounts

32 Memorandum items
Contingent liabilities and commitments
The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December 2013. Although the Group is exposed to credit risk in the event of non-performance of the obligations undertaken by customers, the amounts shown do not, and are not intended to, provide any indication of the Group's expectation of future losses.

	Less than 1 year £m	More than 1 year but less than 3 years £m	More than 3 years but less than 5 years £m	Over 5 years £m	2013 £m	2012 £m	2011 £m
Contingent liabilities							
Guarantees and assets pledged as collateral security	9,144	3,541	5,802	1,692	20,179	19,164	25,032
Other contingent liabilities	2,840	1,258	582	1,311	5,991	10,697	10,912
	11,984	4,799	6,384	3,003	26,170	29,861	35,944
Commitments (1)							
Undrawn formal standby facilities, credit lines and other commitments to lend							
- less than one year	77,592	—	—	—	77,592	83,461	100,092
- one year and over	9,943	44,214	66,174	15,123	135,454	132,347	139,871
Other commitments	2,598	136	44	15	2,793	1,976	2,912
	90,133	44,350	66,218	15,138	215,839	217,784	242,875
Contingent liabilities and commitments	102,117	49,149	72,602	18,141	242,009	247,645	278,819

Note:
(1) Includes liquidity facilities provided to Group sponsored conduits.

Banking commitments and contingent obligations, which have been entered into on behalf of customers and for which there are corresponding obligations from customers, are not included in assets and liabilities. The Group's maximum exposure to credit loss, in the event of non-performance by the other party and where all counterclaims, collateral or security proves valueless, is represented by the contractual nominal amount of these instruments included in the table above. These commitments and contingent obligations are subject to the Group's normal credit approval processes.

Contingent liabilities
Guarantees - the Group gives guarantees on behalf of customers. A financial guarantee represents an irrevocable undertaking that the Group will meet a customer's obligations to third parties if the customer fails to do so. The maximum amount that the Group could be required to pay under a guarantee is its principal amount as disclosed in the table above. The Group expects most guarantees it provides to expire unused.

Other contingent liabilities - these include standby letters of credit, supporting customer debt issues and contingent liabilities relating to customer trading activities such as those arising from performance and customs bonds, warranties and indemnities.

Commitments
Commitments to lend - under a loan commitment the Group agrees to make funds available to a customer in the future. Loan commitments, which are usually for a specified term may be unconditionally cancellable or may persist, provided all conditions in the loan facility are satisfied or waived. Commitments to lend include commercial standby facilities and credit lines, liquidity facilities to commercial paper conduits and unutilised overdraft facilities.

Other commitments - these include documentary credits, which are commercial letters of credit providing for payment by the Group to a named beneficiary against presentation of specified documents, forward asset purchases, forward deposits placed and undrawn note issuance and revolving underwriting facilities, and other short-term trade related transactions.

Notes on the consolidated accounts

32 Memorandum items continued
Contractual obligations for future expenditure not provided for in the accounts
The following table shows contractual obligations for future expenditure not provided for in the accounts at the year end.

	2013 £m	2012 £m	2011 £m
Operating leases			
Minimum rentals payable under non-cancellable leases (1)			
- within 1 year	348	399	468
- after 1 year but within 5 years	1,143	1,253	1,453
- after 5 years	2,144	2,286	2,714
	3,635	3,938	4,635
Property, plant and equipment			
Contracts to buy assets to be leased under operating leases (2)	—	—	2,607
Other capital expenditure	38	37	35
	38	37	2,642
Contracts to purchase goods or services (3)	1,162	959	1,130
	4,835	4,934	8,407

Notes:
(1) Predominantly property leases.
(2) Amount related to RBS Aviation Capital which was sold in 2012. Included £486 million due within one year.
(3) Of which due within 1 year: £373 million (2012 - £444 million; 2011 - £483 million).

Trustee and other fiduciary activities
In its capacity as trustee or other fiduciary role, the Group may hold or place assets on behalf of individuals, trusts, companies, pension schemes and others. The assets and their income are not included in the Group's financial statements. The Group earned fee income of £462 million (2012 - £476 million; 2011 - £502 million) from these activities.

The Financial Services Compensation Scheme
The Financial Services Compensation Scheme (FSCS), the UK's statutory fund of last resort for customers of authorised financial services firms, pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the industry. In relation to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year (which runs from 1 April to 31 March), subject to annual maxima set by the Prudential Regulation Authority. In addition, the FSCS has the power to raise levies on a firm that has ceased to participate in the scheme and is in the process of ceasing to be authorised for the costs that it would have been liable to pay had the FSCS made a levy in the financial year it ceased to be a participant in the scheme.

The FSCS has borrowed from HM Treasury to fund compensation costs associated with the failure of Bradford & Bingley, Heritable Bank, Kaupthing Singer & Friedlander, Landsbanki ‘Icesave’ and London Scottish Bank plc. The

interest rate on these borrowings is subject to a floor being the higher of 12 month LIBOR plus 100 basis points or the relevant gilt rate for the equivalent cost of borrowing from HMT. The FSCS and HM Treasury have agreed that the period of these loans will reflect the expected timetable for recoveries from the estates of Bradford & Bingley and the other failed banks. The FSCS will levy the deposit taking sector for its share of the balance of the principal outstanding for the non-Bradford & Bingley loan prior to the FSCS loan facility with HMT expiring in March 2016. In addition, the FSCS recently announced HMT's intention to collect an interim payment relating to resolution costs for Dunfermline Building Society of £100 million. The capital element of the levy is expected to rise to £399 million (£363 million in the 2013/14 scheme year).

The Group has accrued £144 million for its share of estimated FSCS levies for the 2013/14 and 2014/15 scheme years.

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Notes on the consolidated accounts

32 Memorandum items continued
Litigation, investigations and reviews
Arising out of their normal business operations, the Group and certain members of the Group are party to legal proceedings and the subject of investigation and other regulatory and governmental action in the United Kingdom, the United States and other jurisdictions.

The Group recognises a provision for a liability in relation to these matters when it is probable that an outflow of economic benefits will be required to settle an obligation resulting from past events, and a reliable estimate can be made of the amount of the obligation. While the outcome of the legal proceedings, investigations and regulatory and governmental matters in which the Group is involved is inherently uncertain, the directors believe that, based on the information available to them, appropriate provisions have been made in respect of legal proceedings, investigations and regulatory and governmental matters as at 31 December 2013 (see Note 22). The litigation provision reflects in large part the £1.9 billion provision taken in the last quarter of 2013 primarily related to mortgage-backed securities and securities related litigation and investigations. The future outflow of resources in respect of any matter may ultimately prove to be substantially greater than or less than the aggregate provision that the Group has recognised.

In many proceedings, it is not possible to determine whether any loss is probable or to estimate the amount of any loss. Numerous legal and factual issues may need to be resolved, including through potentially lengthy discovery and determination of important factual matters, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a liability can be reasonably estimated for any claim. The Group cannot predict if, how, or when such claims will be resolved or what the eventual settlement, fine, penalty or other relief, if any, may be, particularly for claims that are at an early stage in their development or where claimants seek substantial or indeterminate damages.

There are also situations where the Group may enter into a settlement agreement. This may occur in order to avoid the expense, management distraction or reputational implications of continuing to contest liability, even for those matters for which the Group believes it has credible defences and should prevail on the merits. The uncertainties inherent in all such matters affect the amount and timing of any potential outflows for both matters with respect to which provisions have been established and other contingent liabilities.

Other than those discussed below, no member of the Group is or has been involved in governmental, legal or regulatory proceedings (including those which are pending or threatened) that are material individually or in aggregate.

Litigation
Shareholder litigation
RBS and certain of its subsidiaries, together with certain current and former officers and directors were named as defendants in purported class actions filed in the United States District Court for the Southern District of New York involving holders of RBS preferred shares (the Preferred Shares litigation) and holders of American Depositary Receipts (the ADR claims).

In the Preferred Shares litigation, the consolidated amended complaint alleged certain false and misleading statements and omissions in public filings and other communications during the period 1 March 2007 to 19 January 2009, and variously asserted claims under Sections 11, 12 and 15 of the US Securities Act of 1933, as amended (Securities Act). The putative class is composed of all persons who purchased or otherwise acquired Group Series Q, R, S, T and/or U non-cumulative dollar preference shares issued pursuant or traceable to the 8 April 2005 US Securities and Exchange Commission (SEC) registration statement. In September 2012, the Court dismissed the Preferred Shares litigation with

prejudice. On 25 September 2013, the United States Court of Appeals for the Second Circuit (Second Circuit Court of Appeals) affirmed the lower Court's dismissal of the litigation. The deadline for plaintiffs to appeal from the Second Circuit Court of Appeals to the United States Supreme Court has expired.

With respect to the ADR claims, a consolidated amended complaint asserting claims under Sections 10 and 20 of the US Securities Exchange Act of 1934 and Sections 11, 12 and 15 of the Securities Act was filed in November 2011 on behalf of all persons who purchased or otherwise acquired the Group's American Depositary Receipts (ADRs) from issuance through 20 January 2009. In September 2012, the Court dismissed the ADR claims with prejudice. On 5 August 2013, the Court denied the plaintiffs' motions for reconsideration and for leave to re-plead their case. The plaintiffs have appealed the dismissal of this case to the Second Circuit Court of Appeals, and that appeal is in the process of being briefed by the parties.

Additionally, between March and July 2013, claims were issued in the High Court of Justice of England and Wales by sets of current and former shareholders, against the Group (and in one of those claims, also against certain former individual officers and directors) alleging that untrue and misleading statements and/or improper omissions were made in connection with the rights issue announced by the Group on 22 April 2008 in breach of the Financial Services and Markets Act 2000. On 30 July 2013 these and other similar threatened claims were consolidated by the Court via a Group Litigation Order. The Group's defence to the claims was filed on 13 December 2013.

32 Memorandum items continued
Other securitisation and securities related litigation in the United States
Group companies have been named as defendants in their various roles as issuer, depositor and/or underwriter in a number of claims in the United States that relate to the securitisation and securities underwriting businesses. These cases include actions by individual purchasers of securities and purported class action suits. Together, the pending individual and class action cases involve the issuance of more than US$67 billion of mortgage-backed securities (MBS) issued primarily from 2005 to 2007. Although the allegations vary by claim, in general, plaintiffs in these actions claim that certain disclosures made in connection with the relevant offerings contained materially false or misleading statements and/or omissions regarding the underwriting standards pursuant to which the mortgage loans underlying the securities were issued. Group companies remain as defendants in more than 40 lawsuits brought by purchasers of MBS, including the purported class actions identified below.

Among these MBS lawsuits are four cases filed on 2 September 2011 by the US Federal Housing Finance Agency (FHFA) as conservator for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). The primary FHFA lawsuit remains pending in the United States District Court for the District of Connecticut, and it relates to approximately US$32 billion of MBS for which Group entities acted as sponsor/depositor and/or lead underwriter or co-lead underwriter. Of these approximately US$10.5 billion were outstanding at 31 December 2013 with cumulative losses of approximately US$0.9 billion (being the loss of principal value suffered by security holders). On 30 September 2013, the Court denied the defendants' motion to dismiss FHFA's amended complaint in this case. Discovery is ongoing.

The other three FHFA lawsuits (against Ally Financial Group, Countrywide Financial Corporation and Nomura) name RBS Securities Inc. as a defendant by virtue of the fact that it was an underwriter of some of the securities at issue. Two of these cases are part of a coordinated proceeding in the United States District Court for the Southern District of New York in which discovery is underway. The third case (the Countrywide matter) is pending in the United States District Court for the Central District of California. Two other FHFA lawsuits (against JP Morgan and Morgan Stanley) in which RBS Securities Inc. was an underwriter defendant have been settled without any contribution from RBS Securities Inc.

Other MBS lawsuits against Group companies include three cases filed by the National Credit Union Administration Board (on behalf of US Central Federal Credit Union, Western Corporate Federal Credit Union, Southwest Corporate Federal Credit Union, and Members United Corporate Federal Credit Union) and six cases filed by the Federal Home Loan Banks of Boston, Chicago, Indianapolis, Seattle and San Francisco.

The purported MBS class actions in which Group companies are defendants include New Jersey Carpenters Health Fund v. Novastar Mortgage Inc. et al. and In re IndyMac Mortgage-Backed Securities Litigation. A third MBS class action, New Jersey Carpenters Vacation Fund et al. v. The Royal Bank of Scotland plc et al., has been settled in principle for US$275 million subject to documentation and court approval. There is a provision that fully covers the settlement amount. The case relates to more than US$15 billion of the issued MBS that are the subject of MBS claims pending against Group companies. The outcome in this case should not be seen as indicative of how other MBS lawsuits may be resolved.

RBS Securities Inc. was also a defendant in Luther v. Countrywide Financial Corp. et al. and related class action cases (the "Luther Litigation"). On 5 December 2013, the court granted final approval of a US$500 million settlement of plaintiffs' claims to be paid by Countrywide without contribution from RBS Securities Inc. Several members of the settlement class are appealing the court-approved settlement to the United States Court of Appeals for the Ninth

Circuit.

Certain other institutional investors have threatened to bring claims against the Group in connection with various mortgage-related offerings. The Group cannot predict whether any of these individual investors will pursue these threatened claims (or their outcome), but expects that several may. If such claims are asserted and were successful, the amounts involved may be material.

In many of these actions, the Group has or will have contractual claims to indemnification from the issuers of the securities (where a Group company is underwriter) and/or the underlying mortgage originator (where a Group company is issuer). The amount and extent of any recovery on an indemnification claim, however, is uncertain and subject to a number of factors, including the ongoing creditworthiness of the indemnifying party.

London Interbank Offered Rate (LIBOR)

Certain members of the Group have been named as defendants in a number of class actions and individual claims filed in the US with respect to the setting of LIBOR and certain other benchmark interest rates. The complaints are substantially similar and allege that certain members of the Group and other panel banks individually and collectively violated various federal laws, including the US commodities and antitrust laws, and state statutory and common law, as well as contracts, by manipulating LIBOR and prices of LIBOR-based derivatives in various markets through various means.

Most of the USD LIBOR-related actions in which Group companies are defendants, including all purported class actions relating to USD LIBOR, have been transferred to a coordinated proceeding in the United States District Court for the Southern District of New York. In the coordinated proceeding, consolidated class action complaints were filed on behalf of (1) exchange-based purchaser plaintiffs, (2) over-the-counter purchaser plaintiffs, and (3) corporate debt purchaser plaintiffs. On 29 March 2013, the Court dismissed plaintiffs' antitrust claims, claims under RICO (Racketeer Influenced and Corrupt Organizations Act), and certain state law claims, but declined to dismiss certain other claims. Discovery is stayed. Over 35 other USD LIBOR-related actions involving RBS have been stayed pending further order from the Court.

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32 Memorandum items continued
Certain members of the Group have also been named as defendants in class actions relating to (i) JPY LIBOR and Euroyen TIBOR (the "Yen action") and (ii) Euribor (the "Euribor action"), both of which are pending in the United States District Court for the Southern District of New York.

Details of LIBOR investigations and their outcomes affecting the Group are set out under 'Investigations and reviews' below.

Credit Default Swap Antitrust Litigation
Certain members of the Group, as well as a number of other financial institutions, are defendants in a consolidated antitrust class action pending in the United States District Court for the Southern District of New York. The plaintiffs generally allege that defendants violated the U.S. antitrust laws by restraining competition in the market for credit default swaps through various means and thereby causing inflated bid-ask spreads for credit default swaps.

FX antitrust litigation
Certain members of the Group, as well as a number of other financial institutions, have been named as defendants in multiple antitrust class action complaints filed in the United States District Court for the Southern District of New York since November 2013. The plaintiffs generally allege that the defendants violated the U.S. antitrust laws, state statutes, and the common law by conspiring to manipulate the foreign exchange market by manipulating benchmark foreign exchange rates.

Madoff
In December 2010, Irving Picard, as trustee for the bankruptcy estates of Bernard L. Madoff and Bernard L. Madoff Investment Securities LLC., filed a clawback claim against The Royal Bank of Scotland N.V. (RBS N.V.) in New York bankruptcy court. In the operative complaint, filed in August 2012, the trustee seeks to recover US$75.8 million in redemptions that RBS N.V. allegedly received from certain Madoff feeder funds and US$162.1 million that RBS N.V. allegedly received from its swap counterparties at a time when RBS N.V. allegedly 'knew or should have known of Madoff's possible fraud'. The Trustee alleges that those transfers were preferences or fraudulent conveyances under the US bankruptcy code and New York law and he asserts the purported right to claw them back for the benefit of Madoff's estate. A further claim, for US$21.8 million, was filed in October 2011.

Thornburg adversary proceeding
RBS Securities Inc. and certain other Group companies, as well as several other financial institutions, are defendants in an adversary proceeding filed in the U.S. bankruptcy court in Maryland by the trustee for TMST, Inc. (formerly known as Thornburg Mortgage, Inc.). The trustee seeks recovery of transfers made under certain restructuring agreements as, among other things, avoidable fraudulent and preferential conveyances and transfers.

Complex Systems
RBS N.V. is a defendant in an action pending in the United States District Court for the Southern District of New York filed by Complex Systems, Inc (CSI). The plaintiff alleges that RBS N.V. has since late 2007 been using the plaintiff's back-office trade finance processing software without a valid licence, in violation of the US Copyright Act. On 17 October 2013, the Court granted summary judgment to CSI on the issue of liability. The plaintiff was seeking in excess of US$300 million in alleged profits that the plaintiff claimed was attributable to RBS N.V.'s use of the disputed software, but on 8 November 2013, the Court barred the plaintiff from recovering any such profits although the plaintiff continues to seek actual damages of an unspecified amount. On 25 October 2013, the plaintiff filed a motion for a permanent injunction against RBS N.V.'s further use of the software, and a hearing on that motion, which

RBS N.V. opposes, has been scheduled for 14 March 2014.

CPDO Litigation

CPDO claims have been served on RBS N.V. in England, the Netherlands and Australia relating to the sale of a type of structured financial product known as a constant proportion debt obligation (CPDO). In November 2012, the Federal Court of Australia issued a judgment against RBS N.V. and others in one such case. It held that RBS N.V. and others committed certain wrongful acts in connection with the rating and sale of the CPDO. In March 2013, RBS N.V. was ordered to pay A$19.7 million. RBS N.V. has appealed this decision and the appeal is due to be heard in March 2014. The judgment may potentially have significance to the other claims served and to any future similar claims.

Investigations and reviews

The Group's businesses and financial condition can be affected by the fiscal or other policies and actions of various governmental and regulatory authorities in the United Kingdom, the European Union, the United States and elsewhere. The Group has engaged, and will continue to engage, in discussions with relevant governmental and regulatory authorities, including in the United Kingdom, the European Union, the United States and elsewhere, on an ongoing and regular basis regarding operational, systems and control evaluations and issues including those related to compliance with applicable anti-bribery, anti-money laundering and sanctions regimes. It is possible that any matters discussed or identified may result in investigatory or other action being taken by governmental and regulatory authorities, increased costs being incurred by the Group, remediation of systems and controls, public or private censure, restriction of the Group's business activities or fines. Any of the events or circumstances mentioned below could have a material adverse effect on the Group, its business, authorisations and licences, reputation, results of operations or the price of securities issued by it.

The Group is co-operating fully with the investigations and reviews described below.

Notes on the consolidated accounts

32 Memorandum items continued

LIBOR, other trading rates and foreign exchange rates

On 6 February 2013, the Group announced settlements with the Financial Services Authority in the United Kingdom, the United States Commodity Futures Trading Commission and the United States Department of Justice (DOJ) in relation to investigations into submissions, communications and procedures around the setting of the London Interbank Offered Rate (LIBOR). RBS agreed to pay penalties of £87.5 million, US$325 million and US$150 million to these authorities respectively to resolve the investigations. As part of the agreement with the DOJ, RBS plc entered into a Deferred Prosecution Agreement in relation to one count of wire fraud relating to Swiss Franc LIBOR and one count for an antitrust violation relating to Yen LIBOR. In addition, on 12 April 2013, RBS Securities Japan Limited entered a plea of guilty to one count of wire fraud relating to Yen LIBOR and on 6 January 2014, the US District Court for the District of Connecticut entered a final judgment in relation to the conviction of RBS Securities Japan Limited pursuant to the plea agreement. On 12 April 2013, RBS Securities Japan Limited received a business improvement order from Japan's Financial Services Agency requiring RBS to take remedial steps to address certain matters, including inappropriate conduct in relation to Yen LIBOR.

RBS Securities Japan Limited is taking steps to address the issues raised in compliance with that order. In June 2013, RBS was listed amongst the 20 banks found by the Monetary Authority of Singapore (MAS) to have deficiencies in the governance, risk management, internal controls and surveillance systems relating to benchmark submissions following a finding by the MAS that certain traders made inappropriate attempts to influence benchmarks in the period 2007 - 2011. RBS was ordered at that time to set aside additional statutory reserves with MAS of SGD1-1.2 billion and to formulate a remediation plan. RBS has submitted its remediation plan to the MAS.

The Group is co-operating with investigations and new and ongoing requests for information by various other governmental and regulatory authorities, including in the UK, US and Asia, into its submissions, communications and procedures relating to a number of trading rates, including LIBOR and other interest rate settings, ISDAFIX and non-deliverable forwards. The Group is also under investigation by competition authorities in a number of jurisdictions stemming from the actions of certain individuals in the setting of LIBOR and other trading rates, as well as interest rate-related trading.

In December 2013, the Group agreed to pay settlement penalties of approximately EUR 260 million and EUR 131 million to resolve investigations by the European Commission into Yen LIBOR competition infringements and EURIBOR competition infringements respectively.

In addition, various governmental and regulatory authorities have commenced investigations into foreign exchange trading activities apparently involving multiple financial institutions. The Group has received enquiries from certain of these authorities including the FCA. The Group is reviewing communications and procedures relating to certain currency exchange benchmark rates as well as foreign exchange trading activity. At this stage, the Group cannot estimate reliably what effect, if any, the outcome of the investigation may have on the Group.

Technology incident in June 2012

On 19 June 2012, the Group was affected by a technology incident, as a result of which the processing of certain customer accounts and payments were subject to considerable delay. The cause of the incident has been investigated by independent external counsel with the assistance of third party advisors. The Group agreed to reimburse customers for any loss suffered as a result of the incident and the Group made a provision of £175 million in 2012.

The incident, the Group's handling of the incident, and the systems and controls surrounding the processes affected, are the subject of regulatory investigations in the UK and in the Republic of Ireland.

On 9 April 2013, the UK Financial Conduct Authority (FCA) announced that it had commenced an enforcement investigation into the incident. This is a joint investigation conducted by the FCA together with the UK Prudential Regulation Authority (PRA). The FCA and PRA will reach their conclusions in due course and will decide whether or not to initiate enforcement action following that investigation. While the outcomes of the FCA and PRA investigations will be separate, the regulators have indicated that they will endeavour to co-ordinate the timescales of their respective investigations. Separately the Central Bank of Ireland has initiated an investigation.

Interest rate hedging products

In June 2012, following an industry wide review, the FSA announced that the Group and other UK banks had agreed to a redress exercise and past business review in relation to the sale of interest rate hedging products to some small and medium sized businesses who were classified as retail clients or private customers under FSA rules. On 31 January 2013, the FSA issued a report outlining the principles to which it wished the Group and other UK banks to adhere in conducting the review and redress exercise.

The Group will provide fair and reasonable redress to non-sophisticated customers classified as retail clients or private customers, who were mis-sold interest rate hedging products. In relation to non-sophisticated customers classified as retail clients or private customers who were sold interest rate products other than interest rate caps on or after 1 December 2001 up to 29 June 2012, the Group is required to (i) make redress to customers sold structured collars; and (ii) write to customers sold other interest rate hedging products offering a review of their sale and, if it is appropriate in the individual circumstances, the Group will propose fair and reasonable redress on a case by case basis. Furthermore, non-sophisticated customers classified as retail clients or private customers who have purchased interest rate caps during the period on or after 1 December 2001 to 29 June 2012 will be entitled to approach the Group and request a review.

The redress exercise and the past business review are being scrutinised by an independent reviewer, who will review and agree any redress, and will be overseen by the FCA.

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In addition to the redress exercise that is being overseen by the FCA, the Group is also dealing with a large number of active claims by customers who are eligible to be considered under the FCA redress programme as well as customers who are outside of such scope due to their sophistication. The Group is encouraging those customers that are eligible, to seek redress under the redress scheme overseen by the FCA. To the extent that claims are brought, the Group believes it has strong grounds for defending these claims.

The Group has decided to undertake a similar exercise and past business review in relation to the sale of interest rate hedging products to retail designated small and medium sized businesses in the Republic of Ireland and to customers of RBS International.

The Group has made provisions totalling £1.25 billion to date for this matter, including £550 million in 2013, of which £0.2 billion has been utilised at 31 December 2013.

Retail banking
Since initiating an inquiry into retail banking in the European Union (EU) in 2005, the European Commission (EC) continues to keep retail banking under review. In late 2010 the EC launched an initiative pressing for greater transparency of bank fees and is currently proposing to legislate for increased harmonisation of terminology across Member States. The Group cannot predict the outcome of these actions at this stage.

FSA mystery shopping review
On 13 February 2013, the FSA announced the results of a mystery shopping review it undertook into the investment advice offered by banks and building societies to retail clients. As a result of that review the FSA announced that firms involved were cooperative and agreed to take immediate action. The Group was one of the firms involved. The action required includes a review of the training provided to advisers, considering whether changes are necessary to advice processes and controls for new business, and undertaking a past business review to identify any historic poor advice (and where breaches of regulatory requirements are identified, to put this right for customers). The Group will be required to appoint an independent third party to either carry out or oversee this work. The scope and terms of the past business review and the appointment of the independent third party remain under discussion. The Group cannot predict the outcome of this review at this stage.

Card Protection Plan Limited
On 22 August 2013, the FCA announced that Card Protection Plan Limited (“CPP”) and 13 banks and credit card issuers, including the Group, had agreed to a compensation scheme in relation to the sale of card and/or identity protection insurance to certain retail customers. CPP has now written to affected policyholders to confirm the details of the proposed scheme, which requires approval by a policyholder vote and by the High Court of England and Wales. A creditors’ meeting was held on 7 January 2014, at which the creditors voted in favour of the proposed scheme. The Group has made appropriate levels of provision based on its estimate of ultimate exposure.

Tomlinson Report
On 25 November 2013, a report by Lawrence Tomlinson, entrepreneur in residence at the UK government’s Department for Business Innovation and Skills, was published (Tomlinson Report). The Tomlinson Report was critical of the Group’s Global Restructuring Group’s treatment of SMEs. The Tomlinson Report has been passed to the PRA and FCA. On 29 November 2013, the FCA announced that an independent skilled person will be appointed under Section 166 of the Financial Services and Markets Act to review the allegations in the report. On 17 January 2014, Promontory Financial Group and Mazars were appointed as the skilled person. The Group will fully cooperate with the FCA in its investigation.

In response to the Tomlinson Report, the Bank has instructed Clifford Chance to conduct an independent review of the principal allegation made in the Tomlinson Report: the Group's Global Restructuring Group was alleged to be culpable of systemic and institutional behaviour in artificially distressing otherwise viable businesses and through that putting businesses into insolvency. Clifford Chance is due to submit a report to the Board by the end of the first quarter of 2014.

Multilateral interchange fees
In 2007, the EC issued a decision that, while interchange is not illegal per se, MasterCard's multilateral interchange fee (MIF) arrangements for cross border payment card transactions with MasterCard and Maestro branded consumer credit and debit cards in the EEA were in breach of competition law. MasterCard was required to withdraw (i.e. set to zero) the relevant cross-border MIF by 21 June 2008. MasterCard appealed against the decision to the General Court in March 2008, with the Group intervening in the appeal proceedings. The General Court heard MasterCard's appeal in July 2011 and issued its judgment in May 2012, upholding the EC's original decision. MasterCard has appealed further to the Court of Justice and the Group has intervened in these appeal proceedings.

The appeal hearing took place on 4 July 2013 and the Advocate General's (AG) opinion (which is a non binding opinion and provided to the Court in advance of its final decision) was published on 30 January 2014. The AG opinion proposes that the Court should dismiss MasterCard's appeal. The Court's decision is awaited. MasterCard negotiated interim cross border MIF levels to apply for the duration of the General Court proceedings. These MIF levels remain in place during the appeal before the Court of Justice.

On 9 April 2013, the EC announced it was opening a new investigation into interbank fees payable in respect of payments made in the EEA by MasterCard cardholders from non-EEA countries.

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In March 2008, the EC opened a formal inquiry into Visa's MIF arrangements for cross border payment card transactions with Visa branded debit and consumer credit cards in the EEA. In April 2009 the EC announced that it had issued Visa with a formal Statement of Objections. In April 2010 Visa announced it had reached an agreement with the EC as regards immediate cross border debit card MIF rates only and in December 2010 the commitments were finalised for a four year period commencing December 2010 under Article 9 of Regulation 1/2003. In July 2012 Visa made a request to re-open the settlement in order to modify the fee. The EC rejected the request and in October 2012 Visa filed an appeal to the General Court seeking to have that decision annulled. That appeal is ongoing. The EC is continuing its investigations into Visa's cross border MIF arrangements for deferred debit and credit transactions. On 31 July 2012 the EC announced that it had issued Visa with a supplementary Statement of Objections regarding consumer credit cards in the EEA. On 14 May 2013, the EC announced it had reached an agreement with Visa regarding immediate cross border credit card MIF rates. The agreement has now been market tested and its final publication is awaited.

In addition, the EC has proposed a draft regulation on interchange fees for card payments. The draft regulation is subject to a consultation process, prior to being finalised and enacted. It is currently expected that the regulation will be enacted by the end of 2014/early 2015 at the earliest. The draft regulation proposes the capping of both cross-border and domestic MIF rates for debit and credit consumer cards, to take place in two phases. The draft regulation also sets out other proposals for reform including to the Honour All Cards Rule so merchants will be required to accept all cards with the same level of MIF but not cards with different MIF levels.

In the UK, the Office of Fair Trading (OFT) has ongoing investigations into domestic interchange fees applicable in respect of Visa and MasterCard consumer and commercial credit and debit card transactions. The OFT has not made a finding of an infringement of competition law and has not issued a Statement of Objections to any party in connection with those investigations. In February 2013 the OFT confirmed that while reserving its right to do so, it does not currently expect to issue Statements of Objections in respect of these investigations (if at all) prior to the handing down of the judgment of the Court of Justice in the matter of MasterCard's appeal against the EC's 2007 infringement decision.

The outcomes of these ongoing investigations, proceedings and proposed regulation are not yet known, but they may have a material adverse effect on the structure and operation of four party card payment schemes in general and, therefore, on the Group's business in this sector.

Payment Protection Insurance

The FSA conducted a broad industry thematic review of Payment Protection Insurance (PPI) sales practices and in September 2008, the FSA announced that it intended to escalate its level of regulatory intervention. Substantial numbers of customer complaints alleging the mis-selling of PPI policies have been made to banks and to the Financial Ombudsman Service (FOS) and many of these are being upheld by the FOS against the banks.

The FSA published a final policy statement in August 2010 imposing significant changes with respect to the handling of complaints about the mis-selling of PPI. In October 2010, the British Bankers' Association (BBA) filed an application for judicial review of the FSA's policy statement and of related guidance issued by the FOS. In April 2011 the High Court issued judgment in favour of the FSA and the FOS and in May 2011 the BBA announced that it would not appeal that judgment. The Group then reached agreement with the FSA on a process for implementation of its policy statement and for the future handling of PPI complaints. Implementation of the agreed processes is currently under way. The Group has made provisions totalling £3.1 billion to date for this matter, including £900 million in 2013, of which £2.2 billion has been utilised at 31 December 2013.

Personal current accounts/retail banking
In July 2008, the OFT published a market study report into Personal Current Accounts (PCAs) raising concerns as regards the way the market was functioning. In October 2009 the OFT summarised initiatives agreed with industry to address these concerns. In December 2009, the OFT published a further report in which it stated that it continued to have significant concerns about the operation of the PCA market in the UK, in particular in relation to unarranged overdrafts, and that it believed that fundamental changes were required for the market to work in the best interests of bank customers. In March 2010, the OFT announced that it had secured agreement from the banks on four industry-wide initiatives designed to address its concerns, namely minimum standards on the operation of opt-outs from unarranged overdrafts, new working groups on information sharing with customers, best practice for PCA customers in financial difficulties and incurring charges, and PCA providers to publish their policies on dealing with PCA customers in financial difficulties. The OFT also announced that it would conduct six-monthly reviews and would also review the market again fully in 2012 and undertake a brief analysis on barriers to entry.

The first six-monthly review was completed in September 2010. The OFT noted progress in switching, transparency and unarranged overdrafts for the period March to September 2010 and highlighted further changes it wanted to see in the market. In March 2011, the OFT published the next update report in relation to PCAs. This noted further progress in improving consumer control over the use of unarranged overdrafts. In particular, the Lending Standards Board had led on producing standards and guidance to be included in a revised Lending Code. The OFT stated it would continue to monitor the market and would consider the need for, and appropriate timing of, further update reports in light of other developments, in particular the work of the UK Government’s Independent Commission on Banking (ICB).

Additionally, in May 2010, the OFT announced its review of barriers to entry. The review concerned retail banking and banking for small and medium size enterprises (SMEs) (up to £25 million turnover). The OFT published its report in November 2010. It advised that it expected its review to be relevant to the ICB, the FSA, HM Treasury and the Department for Business, Innovation and Skills and to the devolved governments in the UK. The OFT did not indicate whether it would undertake any further work. The report maintained that barriers to entry remain, in particular regarding switching, branch networks and brands. At this stage, it is not possible to estimate the effect of the OFT’s report and recommendations regarding barriers to entry upon the Group.

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On 13 July 2012, the OFT launched its planned full review of the PCA market. The review was intended to consider whether the initiatives agreed by the OFT with banks to date have been successful and whether the market should be referred to the Competition Commission (CC) for a fuller market investigation.

The OFT's PCA report was published on 25 January 2013. The OFT acknowledged some specific improvements in the market since its last review but concluded that further changes are required to tackle ongoing concerns, including a lack of switching, the ability of consumers to compare products and the complexity of overdraft charges. However, the OFT recognised at the time it published the report that a number of major developments were expected over the coming months including divestment of branches, improvements in account switching and assistance to customers to compare products and services. Therefore the OFT decided not to refer the market to the CC but said that it expected to return to the question of a referral to the CC in 2015, or before. The OFT also announced that it will be carrying out behavioural economic research on the way consumers make decisions and engage with retail banking service, and will study the operation of payment systems as well as the SME banking market.

SME banking market study
The OFT announced its market study on competition in banking for SMEs in England and Wales, Scotland and Northern Ireland on 19 June 2013. The OFT has been seeking views on the scope of the market study and on 27 September 2013 published an update paper setting out its proposed scope. The OFT expects to report on the market study in early 2014.

Credit default swaps (CDS) investigation
The Group is a party to the EC's antitrust investigation into the CDS information market. The Group is co-operating fully with the EC's investigation and in July 2013 received a Statement of Objections from the EC. The EC has raised concerns that a number of banks, Markit and ISDA may have jointly prevented exchanges from entering the CDS market. At this stage, the Group cannot estimate reliably what effect the outcome of the investigation may have on the Group, which may be material.

Securitisation and collateralised debt obligation business
In the United States, the Group is involved in reviews, investigations and proceedings (both formal and informal) by federal and state governmental law enforcement and other agencies and self-regulatory organisations relating to, among other things, issuance, underwriting and trading in mortgage-backed securities, collateralised debt obligations (CDOs), and synthetic products. In connection with these inquiries, Group companies have received requests for information and subpoenas seeking information about, among other things, the structuring of CDOs, financing to loan originators, purchase of whole loans, sponsorship and underwriting of securitisations, due diligence, representations and warranties, communications with ratings agencies, disclosure to investors, document deficiencies, trading activities and repurchase requests.

On 7 November 2013, the Group announced that it had settled with the US Securities and Exchange Commission ('the SEC') over its investigation of RBS Securities Inc. relating to due diligence conducted in connection with a 2007 offering of residential mortgage-backed securities and corresponding disclosures. Pursuant to the settlement, RBS Securities Inc., without admitting or denying the SEC's allegations, consented to the entry of a final judgment ordering certain relief, including an injunction and the payment of approximately US$153 million in disgorgement, penalties, and interest. The settlement was subsequently approved by the United States District Court for the District of Connecticut. The Group co-operated fully with the SEC throughout the investigation.

Also in October 2010, the SEC commenced an inquiry into document deficiencies and repurchase requests with respect to certain securitisations, and in January 2011, this was converted to a formal investigation. Among other matters, the investigation seeks information related to document deficiencies and remedial measures taken with respect to such deficiencies. The investigation also seeks information related to early payment defaults and loan repurchase requests.

In 2007, the New York State Attorney General issued subpoenas to a wide array of participants in the securitisation and securities industry, focusing on the information underwriters obtained from the independent firms hired to perform due diligence on mortgages. The Group completed its production of documents requested by the New York State Attorney General in 2008, principally producing documents related to loans that were pooled into one securitisation transaction. In May 2011, at the New York State Attorney General's request, representatives of the Group attended an informal meeting to provide additional information about the Group's mortgage securitisation business. The investigation is ongoing and the Group continues to provide the requested information.

US mortgages - loan repurchase matters
The Group’s Markets business in North America has been a purchaser of non-agency US residential mortgages in the secondary market, and an issuer and underwriter of non-agency residential mortgage-backed securities (RMBS). Markets did not originate or service any US residential mortgages and it was not a significant seller of mortgage loans to government sponsored enterprises (GSEs) (e.g. the Federal National Mortgage Association and the Federal Home Loan Mortgage Association).

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In issuing RMBS, Markets generally assigned certain representations and warranties regarding the characteristics of the underlying loans made by the originator of the residential mortgages; however, in some circumstances, Markets made such representations and warranties itself. Where Markets has given those or other representations and warranties (whether relating to underlying loans or otherwise), Markets may be contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of such representations and warranties. In certain instances where it is required to repurchase loans or related securities, Markets may be able to assert claims against third parties who provided representations or warranties to Markets when selling loans to it, although the ability to recover against such parties is uncertain. Between the start of 2009 and 31 December 2013, Markets received approximately US$741 million in repurchase demands in respect of loans made primarily from 2005 to 2008 and related securities sold where obligations in respect of contractual representations or warranties were undertaken by Markets. However, repurchase demands presented to Markets are subject to challenge and rebuttal by Markets.

RBS Citizens Financial Group, Inc (RBS Citizens) has not been an issuer or underwriter of non-agency RMBS. However, RBS Citizens is an originator and servicer of residential mortgages, and it routinely sells such mortgage loans in the secondary market and to GSEs. In the context of such sales, RBS Citizens makes certain representations and warranties regarding the characteristics of the underlying loans and, as a result, may be contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of the representations and warranties concerning the underlying loans. Between the start of 2009 and 31 December 2013, RBS Citizens received US$208 million in repurchase demands in respect of loans originated primarily since 2003. However, repurchase demands presented to RBS Citizens are subject to challenge and rebuttal by RBS Citizens.

Although there has in recent times been disruption in the ability of certain financial institutions operating in the United States to complete foreclosure proceedings in respect of US mortgage loans in a timely manner or at all (including as a result of interventions by certain states and local governments), to date, RBS Citizens has not been materially impacted by such disruptions and the Group has not ceased making foreclosures.

The Group cannot currently estimate what the ultimate exposure may be with respect to repurchase demands. Furthermore, the Group is unable to estimate the extent to which the matters described above will impact it, and future developments may have an adverse impact on the Group’s net assets, operating results or cash flows in any particular period.

RBS Citizens consent orders

The activities of RBS Citizens' two US bank subsidiaries - RBS Citizens, N.A. and Citizens Bank of Pennsylvania - are subject to extensive US laws and regulations concerning unfair or deceptive acts or practices in connection with customer products. Certain of the bank subsidiaries’ practices with respect to overdraft protection and other consumer products have not met applicable standards. The bank subsidiaries have implemented and are continuing to implement changes to bring their practices in conformity with applicable laws and regulations. In April 2013, the bank subsidiaries consented to the issuance of orders by their respective primary federal banking regulators, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) (the Consent Orders). In the Consent Orders (which are publicly available and will remain in effect until terminated by the regulators), the bank subsidiaries neither admitted nor denied the regulators’ findings that they had engaged in deceptive marketing and implementation of the bank's overdraft protection programme, checking rewards programmes, and stop-payment process for pre-authorised recurring electronic fund transfers.

The Consent Orders require the bank subsidiaries to pay a total of US$10 million in civil monetary penalties, to develop plans to provide restitution to affected customers (the amount of which is anticipated to be approximately

US$8 million), to cease and desist any operations in violation of Section 5 of the Federal Trade Commission Act, and to submit to the regulators periodic written progress reports regarding compliance with the Consent Orders.

In addition, RBS Citizens, N.A. agreed to take certain remedial actions to improve its compliance risk management systems and to create a comprehensive action plan designed to achieve compliance with the Consent Order. Restitution plans have been prepared and submitted for approval, and RBS Citizens, N.A. has submitted for approval and is in the process of implementing its action plan for compliance with the Consent Order, as well as updated policies, procedures and programmes related to its compliance risk management systems. In addition to the above, the bank subsidiaries could face further formal administrative enforcement actions from their federal supervisory agencies, including the assessment of civil monetary penalties and restitution, relating to issues arising from other consumer products.

Governance and risk management consent order

On 27 July 2011, the Group agreed with the Board of Governors of the Federal Reserve System, the New York State Banking Department, the Connecticut Department of Banking, and the Illinois Department of Financial and Professional Regulation to enter into a consent Cease and Desist Order (the Order) to address deficiencies related to governance, risk management and compliance systems and controls in RBS plc and RBS N.V. branches. In the Order, the Group agreed to create the following written plans or programmes:

- a plan to strengthen board and senior management oversight of the corporate governance, management, risk management, and operations of the Group’s U.S. operations on an enterprise-wide and business line basis,

- an enterprise-wide risk management programme for the Group’s U.S. operations,

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- a plan to oversee compliance by the Group's U.S. operations with all applicable U.S. laws, rules, regulations, and supervisory guidance,

- a Bank Secrecy Act/anti-money laundering compliance programme for the RBS plc and RBS N.V. branches in the U.S. (the U.S. Branches) on a consolidated basis,

- a plan to improve the U.S. Branches' compliance with all applicable provisions of the Bank Secrecy Act and its rules and regulations as well as the requirements of Regulation K of the Federal Reserve,

- a customer due diligence programme designed to reasonably ensure the identification and timely, accurate, and complete reporting by the U.S. Branches of all known or suspected violations of law or suspicious transactions to law enforcement and supervisory authorities, as required by applicable suspicious activity reporting laws and regulations, and

- a plan designed to enhance the U.S. Branches' compliance with OFAC requirements.

The Order (which is publicly available) identified specific items to be addressed, considered, and included in each proposed plan or programme. The Group also agreed in the Order to adopt and implement the plans and programmes after approval by the regulators, to fully comply with the plans and programmes thereafter, and to submit to the regulators periodic written progress reports regarding compliance with the Order. The Group has created, submitted, and adopted plans and/or programmes to address each of the areas identified above. In connection with the Group's efforts to implement these plans and programmes, it has, among other things, made investments in technology, hired and trained additional personnel, and revised compliance, risk management, and other policies and procedures for the Group's U.S. operations. The Group continues to test the effectiveness of the remediation efforts undertaken by the Group to ensure they are sustainable and meet regulators' expectations. Furthermore, the Group continues to work closely with the regulators in its efforts to fulfil its obligations under the Order, which will remain in effect until terminated by the regulators.

The Group may become subject to formal and informal supervisory actions and may be required by its US banking supervisors to take further actions and implement additional remedial measures with respect to these and additional matters. The Group's activities in the United States may be subject to significant limitations and/or conditions.

US dollar processing consent order

The Group's operations include businesses outside the United States that are responsible for processing US dollar payments. On 11 December 2013 the Group and The Royal Bank of Scotland plc announced that they had reached a settlement with the Board of Governors of the Federal Reserve System (Fed), the New York State Department of Financial Services (DFS), and the Office of Foreign Assets Control (OFAC) with respect to The Royal Bank of Scotland plc's historical compliance with US economic sanction regulations outside the US. In settlement with the above authorities, The Royal Bank of Scotland plc agreed to pay US$100 million in total, including US$50 million to the Fed, of which US$33 million was deemed to satisfy the OFAC penalty, and US$50 million to DFS.

As part of the settlement, the Group and The Royal Bank of Scotland plc entered into a consent Cease and Desist Order with the Fed (the Order) indicating, among other things, that: (a) the Group and The Royal Bank of Scotland plc lacked adequate risk management and legal review policies and procedures to ensure that activities conducted outside the United States comply with applicable OFAC regulations; (b) from at least 2005 to 2008, certain business lines within The Royal Bank of Scotland plc developed and implemented policies and procedures for processing U.S.

dollar-denominated funds transfers through unaffiliated U.S. financial institutions involving parties subject to OFAC Regulations that omitted relevant information from payment messages necessary for the U.S. financial institutions to determine whether these transactions were carried out in a manner consistent with U.S. law; and (c) the Group continues to implement improvements in its oversight and compliance programme for activities involving offices outside the United States that impact the ability of U.S. financial institutions to comply with applicable OFAC sanctions. In the Order (which is publicly available), the Group agreed to create an OFAC compliance programme to ensure compliance with OFAC regulations by the Group's global business lines outside of the United States, and to adopt, implement, and comply with the programme. The programme is to be submitted to the Federal Reserve Bank of Boston (Reserve Bank) for approval by 11 March 2014.

Sixty days after approval of the programme, the Group is to complete a global OFAC risk assessment and submit it to the Reserve Bank and the FCA. The Group also agreed in the Order to hire an independent consultant (subject to approval by the Reserve Bank and the FCA) to conduct an annual OFAC compliance review involving a review of compliance policies and their implementation and an appropriate risk-focused sampling of U.S. dollar payments. The Order further requires the Group to submit quarterly written progress reports to the Reserve Bank detailing the form and manner of all actions taken to secure compliance with the Order.

It was also announced that the US Department of Justice and the New York County District Attorney’s Office had concluded their parallel criminal investigations and do not intend to take any action against The Royal Bank of Scotland plc.

US/Swiss tax programme
In August 2013, the DOJ announced a programme for Swiss banks (the Programme), to settle the long-running dispute between the US tax authorities and Switzerland regarding the role of Swiss banks in concealing the assets of US tax payers in offshore accounts. The Programme provides Swiss banks with an opportunity to obtain resolution, through non-prosecution agreements or non-target letters, concerning their status in connection with the DOJ’s investigations.

Coutts & Co AG (Coutts), a member of the Group incorporated in Switzerland, has notified the DOJ that it intends to participate in the Programme based on the possibility that some of its clients may not have declared their assets in compliance with US tax laws. The Programme requires a detailed review of all US related accounts. The review is due to be completed and the results presented to the DOJ later in 2014.

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33 Net cash (outflow)/inflow from operating activities	2013	2012*	2011*
	£m	£m	£m
Operating loss before tax - continuing operations	(8,243)	(5,277)	(1,396)
Operating profit/(loss) before tax - discontinued operations	177	(111)	482
Decrease in prepayments and accrued income	300	787	976
Interest on subordinated liabilities	886	841	740
Decrease in accruals and deferred income	(889)	(3,653)	(2,897)
Provisions for impairment losses	8,432	5,283	8,709
Loans and advances written-off net of recoveries	(4,090)	(3,925)	(4,000)
Unwind of discount on impairment losses	(391)	(476)	(484)
Profit on sale of property, plant and equipment	(44)	(20)	(22)
(Profit)/loss on sale of subsidiaries and associates	(240)	(95)	28
Profit on sale of securities	(830)	(1,235)	(882)
Charge for defined benefit pension schemes	517	558	555
Pension schemes curtailment and settlement gains	(7)	(41)	—
Cash contribution to defined benefit pension schemes	(821)	(977)	(1,059)
Other provisions charged net of releases	4,422	2,899	963
Other provisions utilised	(2,066)	(1,507)	(513)
Depreciation and amortisation	1,410	1,854	1,875
Gain on redemption of own debt	(175)	(454)	(255)
Write-down of goodwill and other intangible assets	1,403	518	91
Elimination of foreign exchange differences	(47)	7,140	2,702
Other non-cash items	(1,209)	1,809	1,340
Net cash (outflow)/inflow from trading activities	(1,505)	3,918	6,953
Decrease in loans and advances to banks and customers	49,314	30,719	15,800
Decrease in securities	29,140	13,537	10,418
(Increase)/decrease in other assets	(190)	1,672	4,991
Decrease/(increase) in derivative assets	153,864	88,134	(102,972)
Changes in operating assets	232,128	134,062	(71,763)
(Decrease)/increase in deposits by banks and customers	(84,364)	(7,848)	24,096
Decrease in insurance liabilities	—	(119)	(482)
Decrease in debt securities in issue	(26,868)	(68,029)	(55,496)
(Decrease)/increase in other liabilities	(885)	(4,022)	1,827
(Decrease)/increase in derivative liabilities	(148,807)	(89,763)	100,133
Increase/(decrease) in settlement balances and short positions	16	(13,017)	(1,759)
Changes in operating liabilities	(260,908)	(182,798)	68,319
Income taxes paid	(346)	(295)	(184)
Net cash (outflow)/inflow from operating activities	(30,631)	(45,113)	3,325

*Restated

Notes on the consolidated accounts

34 Analysis of the net investment in business interests and intangible assets

	2013	2012	2011
Acquisitions and disposals	£m	£m	£m
Fair value given for businesses acquired	—	(68)	(44)
Net assets sold	1,435	1,317	(299)
Non-cash consideration	3	(90)	—
Profit/(loss) on disposal	240	95	(28)
Net cash and cash equivalents disposed	210	—	—
Net inflow/(outflow) of cash in respect of disposals	1,888	1,322	(327)
Dividends received from associates	134	22	11
Cash expenditure on intangible assets	(872)	(924)	(1,068)
Net inflow/(outflow)	1,150	352	(1,428)

Note:
(1) Includes cash proceeds of £578 million in 2013 relating to the disposal of the controlling interest in Direct Line Group.

35 Interest received and paid

	2013	2012	2011
	£m	£m	£m
Interest received	17,948	19,238	21,777
Interest paid	(6,450)	(7,044)	(8,629)
	11,498	12,194	13,148

36 Analysis of changes in financing during the year

	Share capital, share premium, paid-in equity and merger reserve			Subordinated liabilities		
	2013	2012*	2011*	2013	2012	2011
	£m	£m	£m	£m	£m	£m
At 1 January	45,144	53,520	53,298	26,773	26,319	27,053
Issue of ordinary shares	264	120	2	—	—	—
Net proceeds from issue of subordinated liabilities	—	—	—	1,796	2,093	—
Repayment of subordinated liabilities	—	—	—	(3,500)	(258)	(627)
Net cash inflow/(outflow) from financing	264	120	2	(1,704)	1,835	(627)
Transfer to retained earnings	—	—	(50)	—	—	—
Share capital sub-division and consolidation	—	(8,933)	—	—	—	—
Ordinary shares issued in respect of employee share schemes	174	437	270	—	—	—
Other adjustments including foreign exchange	—	—	—	(1,057)	(1,381)	(107)
At 31 December	45,582	45,144	53,520	24,012	26,773	26,319

*Restated

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Notes on the consolidated accounts

37 Analysis of cash and cash equivalents

	2013	2012	2011
	£m	£m	£m
At 1 January			
- cash	91,658	109,888	102,573
- cash equivalents	41,183	42,767	49,957
	132,841	152,655	152,530
Net cash (outflow)/inflow	(11,664)	(19,814)	125
At 31 December	121,177	132,841	152,655
Comprising:			
Cash and balances at central banks	82,659	79,290	79,269
Treasury bills and debt securities	702	772	3,172
Loans and advances to banks	37,816	52,779	70,214
Cash and cash equivalents	121,177	132,841	152,655

Note:

(1) Includes cash collateral posted with bank counterparties in respect of derivative liabilities of £10,342 million (2012 - £12,784 million; 2011 - £19,691 million).

Certain members of the Group are required by law or regulation to maintain balances with the central banks in the jurisdictions in which they operate. These balances are set out below.

	2013	2012	2011
Bank of England	£0.6bn	£0.4bn	£0.4bn
US Federal Reserve	US$1.2bn	US$1.2bn	US$1.2bn
De Nederlandsche Bank	€0.2bn	€0.4bn	€1.0bn

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Notes on the consolidated accounts

38 Segmental analysis
(a) Divisions
The directors manage the Group primarily by class of business and present the segmental analysis on that basis. This includes the review of net interest income for each class of business - interest receivable and payable for all reportable segments is therefore presented net. Segments charge market prices for services rendered to other parts of the Group; funding charges between segments are determined by Group Treasury, having regard to commercial demands. The segment measure is operating profit/(loss).

The ceding of control which resulted from the partial disposal of the Group’s shareholding in Direct Line Group (DLG) has resulted in the Group no longer treating DLG as an operating segment. Comparative data have been restated.

The Group's reportable segments are on a divisional basis as follows:

UK Retail offers a comprehensive range of banking products and related financial services to the personal market. It serves customers through a number of channels including: the RBS and NatWest network of branches and ATMs in the United Kingdom, telephony, online and mobile.

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

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

International Banking serves the world’s largest companies with a leading client proposition focused on financing, risk management and transaction services. It serves as the delivery channel for Markets products to international corporate clients. The division also serves international subsidiaries of clients from other RBS Group divisions (e.g. UK Corporate, Ulster Bank and US Retail & Commercial) through its international network.

Ulster Bank is a leading retail and commercial bank in Northern Ireland and the Republic of Ireland. It provides a comprehensive range of financial services through both its Retail Banking division, which provides loan and deposit products through a network of branches and direct channels, and its Corporate Banking division, which provides services to businesses and corporate customers.

US Retail & Commercial provides financial services primarily through the Citizens and Charter One brands. US Retail & Commercial is engaged in retail and corporate banking activities through its branch network in 12 states in the United States and through non-branch offices in other states.

Markets is a leading origination, sales and trading business across debt finance, fixed income and currencies. The division offers a unified service to the Group’s corporate and institutional clients. The Markets’ origination, sales and research teams build strong ongoing client partnerships, provide market perspective and access, and work with the division’s trading and structuring teams to meet the client’s objectives across financing, risk management, investment, securitisation and liquidity.

A new strategy for the Markets division was announced in June 2013 enabling RBS to concentrate on its core customers' needs where the Markets business is strongest. Markets is now focused on our core fixed income capabilities across rates, foreign exchange, asset backed products, credit and debit capital markets, while de-emphasising some more capital intensive structured product areas.

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

Non-Core managed separately assets that the Group intended to run off or dispose of. The division contained a range of businesses and asset portfolios primarily from the legacy GBM businesses, higher risk profile asset portfolios including excess risk concentrations, and other illiquid portfolios. It also included a number of other portfolios and businesses including regional markets businesses that the Group had concluded were no longer strategic.

Notes on the consolidated accounts

38 Segmental analysis continued

2013	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses £m	Depreciation and amortisation £m	Impairment losses £m	Operating profit/(loss) £m
UK Retail	3,979	958	4,937	(2,670)	—	(324)	1,943
UK Corporate	2,874	1,593	4,467	(2,075)	(144)	(1,188)	1,060
Wealth	674	419	1,093	(839)	(4)	(29)	221
International Banking	713	1,135	1,848	(1,335)	(5)	(229)	279
Ulster Bank	631	240	871	(554)	—	(1,774)	(1,457)
US Retail & Commercial	1,916	1,073	2,989	(2,026)	(160)	(156)	647
Markets	157	3,165	3,322	(2,431)	(179)	(92)	620
Central items	147	114	261	394	(680)	(64)	(89)
Core	11,091	8,697	19,788	(11,536)	(1,172)	(3,856)	3,224
Non-Core	(99)	(247)	(346)	(526)	(79)	(4,576)	(5,527)
Managed basis	10,992	8,450	19,442	(12,062)	(1,251)	(8,432)	(2,303)
Reconciling items							
Own credit adjustments	—	(120)	(120)	—	—	—	(120)
Payment Protection Insurance costs	—	—	—	(900)	—	—	(900)
Interest Rate Hedging Products redress and related costs	—	—	—	(550)	—	—	(550)
Regulatory and legal actions	—	—	—	(2,394)	—	—	(2,394)
Integration and restructuring costs	—	—	—	(650)	(6)	—	(656)
Gain on redemption of own debt	—	175	175	—	—	—	175
Write-down of goodwill	—	—	—	(1,059)	—	—	(1,059)
Amortisation of purchased intangible assets	—	—	—	—	(153)	—	(153)
Strategic disposals	—	161	161	—	—	—	161
Bank levy	—	—	—	(200)	—	—	(200)
Write-down of other intangible assets	—	—	—	(344)	—	—	(344)
RFS Holdings minority interest	(11)	110	99	1	—	—	100
Statutory basis	10,981	8,776	19,757	(18,158)	(1,410)	(8,432)	(8,243)

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Notes on the consolidated accounts

38 Segmental analysis continued

2012*	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses £m	Depreciation and amortisation £m	Impairment losses £m	Operating profit/(loss) £m
UK Retail	3,990	979	4,969	(2,549)	—	(529)	1,891
UK Corporate	2,974	1,749	4,723	(1,916)	(173)	(838)	1,796
Wealth	720	450	1,170	(882)	1	(46)	243
International Banking	913	1,209	2,122	(1,417)	—	(111)	594
Ulster Bank	649	196	845	(521)	—	(1,364)	(1,040)
US Retail & Commercial	1,932	1,159	3,091	(2,050)	(196)	(91)	754
Markets	111	4,372	4,483	(2,707)	(230)	(37)	1,509
Central items	(116)	510	394	364	(634)	(40)	84
Core	11,173	10,624	21,797	(11,678)	(1,232)	(3,056)	5,831
Non-Core	244	44	288	(694)	(250)	(2,223)	(2,879)
Managed basis	11,417	10,668	22,085	(12,372)	(1,482)	(5,279)	2,952
Reconciling items							
Own credit adjustments	—	(4,649)	(4,649)	—	—	—	(4,649)
Payment Protection Insurance costs	—	—	—	(1,110)	—	—	(1,110)
Interest Rate Hedging Products redress and related costs	—	—	—	(700)	—	—	(700)
Regulatory and legal actions	—	—	—	(381)	—	—	(381)
Integration and restructuring costs	—	—	—	(1,273)	(142)	—	(1,415)
Gain on redemption of own debt	—	454	454	—	—	—	454
Write-down of goodwill	—	—	—	(18)	—	—	(18)
Asset Protection Scheme	—	(44)	(44)	—	—	—	(44)
Amortisation of purchased intangible assets	—	—	—	—	(178)	—	(178)
Strategic disposals	—	113	113	—	—	—	113
Bank levy	—	—	—	(175)	—	—	(175)
Write-down of other intangible assets	—	—	—	(106)	—	—	(106)
RFS Holdings minority interest	(15)	(3)	(18)	(2)	—	—	(20)
Statutory basis	11,402	6,539	17,941	(16,137)	(1,802)	(5,279)	(5,277)

*Restated

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Notes on the consolidated accounts

38 Segmental analysis continued

2011*	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses £m	Depreciation and amortisation £m	Impairment losses £m	Operating profit/(loss) £m
UK Retail	4,302	1,206	5,508	(2,699)	—	(788)	2,021
UK Corporate	3,092	1,771	4,863	(1,974)	(172)	(793)	1,924
Wealth	645	459	1,104	(846)	9	(25)	242
International Banking	1,157	1,398	2,555	(1,623)	(9)	(168)	755
Ulster Bank	736	211	947	(546)	(1)	(1,384)	(984)
US Retail & Commercial	1,879	1,152	3,031	(1,962)	(206)	(326)	537
Markets	67	4,348	4,415	(3,319)	(159)	(38)	899
Central items	(178)	205	27	648	(711)	2	(34)
Core	11,700	10,750	22,450	(12,321)	(1,249)	(3,520)	5,360
Non-Core	613	361	974	(919)	(357)	(3,917)	(4,219)
Managed basis	12,313	11,111	23,424	(13,240)	(1,606)	(7,437)	1,141
Reconciling items							
Own credit adjustments	—	1,914	1,914	—	—	—	1,914
Payment Protection Insurance costs	—	—	—	(850)	—	—	(850)
Sovereign debt impairment and related interest rate hedge adjustments	—	—	—	—	—	(1,268)	(1,268)
Integration and restructuring costs	(2)	(3)	(5)	(1,005)	(11)	—	(1,021)
Gain on redemption of own debt	—	255	255	—	—	—	255
Asset Protection Scheme	—	(906)	(906)	—	—	—	(906)
Amortisation of purchased intangible assets	—	—	—	—	(222)	—	(222)
Strategic disposals	—	(25)	(25)	(80)	—	—	(105)
Bonus tax	—	—	—	(27)	—	—	(27)
Bank levy	—	—	—	(300)	—	—	(300)
RFS Holdings minority interest	(8)	2	(6)	1	—	(2)	(7)
Statutory basis	12,303	12,348	24,651	(15,501)	(1,839)	(8,707)	(1,396)

*Restated

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Notes on the consolidated accounts

38 Segmental analysis continued

	2013			2012*			2011*		
		Inter			Inter			Inter	
	External	segment	Total	External	segment	Total	External	segment	Total
Total income	£m	£m	£m	£m	£m	£m	£m	£m	£m
UK Retail	4,925	12	4,937	5,054	(85)	4,969	5,550	(42)	5,508
UK Corporate	4,814	(347)	4,467	5,247	(524)	4,723	5,373	(510)	4,863
Wealth	601	492	1,093	492	678	1,170	492	612	1,104
International Banking	1,997	(149)	1,848	2,329	(207)	2,122	2,720	(165)	2,555
Ulster Bank	748	123	871	768	77	845	968	(21)	947
US Retail & Commercial	2,907	82	2,989	2,967	124	3,091	2,843	188	3,031
Markets	2,865	457	3,322	3,859	624	4,483	4,072	343	4,415
Central items	539	(278)	261	263	131	394	(899)	926	27
Core	19,396	392	19,788	20,979	818	21,797	21,119	1,331	22,450
Non-Core	44	(390)	(346)	1,104	(816)	288	2,305	(1,331)	974
Managed basis	19,440	2	19,442	22,083	2	22,085	23,424	—	23,424
Reconciling items									
Own credit adjustments	(120)	—	(120)	(4,649)	—	(4,649)	1,914	—	1,914
Integration and restructuring costs	—	—	—	—	—	—	(5)	—	(5)
Gain on redemption of own debt	175	—	175	454	—	454	255	—	255
Asset Protection Scheme	—	—	—	(44)	—	(44)	(906)	—	(906)
Strategic disposals	161	—	161	113	—	113	(25)	—	(25)
RFS Holdings minority interest	101	(2)	99	(16)	(2)	(18)	(6)	—	(6)
Statutory basis	19,757	—	19,757	17,941	—	17,941	24,651	—	24,651

*Restated

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Notes on the consolidated accounts

38 Segmental analysis continued

	2013			2012*			2011*		
	External	Inter segment	Total	External	Inter segment	Total	External	Inter segment	Total
Total revenue	£m	£m	£m	£m	£m	£m	£m	£m	£m
UK Retail	6,444	17	6,461	6,524	869	7,393	6,804	441	7,245
UK Corporate	4,557	83	4,640	4,933	121	5,054	4,985	120	5,105
Wealth	984	635	1,619	1,043	839	1,882	1,026	731	1,757
International Banking	2,222	446	2,668	2,652	470	3,122	3,193	394	3,587
Ulster Bank	1,022	67	1,089	1,076	—	1,076	1,298	104	1,402
US Retail & Commercial	3,208	94	3,302	3,413	132	3,545	3,480	198	3,678
Markets	4,009	4,427	8,436	5,299	5,586	10,885	5,757	7,025	12,782
Central items	2,738	8,676	11,414	2,927	14,249	17,176	2,948	13,136	16,084
Core	25,184	14,445	39,629	27,867	22,266	50,133	29,491	22,149	51,640
Non-Core	948	523	1,471	2,164	815	2,979	3,625	387	4,012
Managed basis	26,132	14,968	41,100	30,031	23,081	53,112	33,116	22,536	55,652
Reconciling items									
Own credit adjustments	(120)	—	(120)	(4,649)	—	(4,649)	1,914	—	1,914
Integration and restructuring costs	—	—	—	—	—	—	(5)	—	(5)
Gain on redemption of own debt	175	—	175	454	—	454	255	—	255
Asset Protection Scheme	—	—	—	(44)	—	(44)	(906)	—	(906)
Strategic disposals	161	—	161	113	—	113	(25)	—	(25)
RFS Holdings minority interest	110	—	110	(2)	—	(2)	(3)	—	(3)
Eliminations	—	(14,968)	(14,968)	—	(23,081)	(23,081)	—	(22,536)	(22,536)
Statutory basis	26,458	—	26,458	25,903	—	25,903	34,346	—	34,346

*Restated

Total assets	2013			2012*			2011*		
	Assets	Liabilities	Cost to acquire fixed assets and intangible assets	Assets	Liabilities	Cost to acquire fixed assets and intangible assets	Assets	Liabilities	Cost to acquire fixed assets and intangible assets
	£m	£m	£m	£m	£m	£m	£m	£m	£m
UK Retail	117,577	116,283	—	117,411	109,307	—	114,469	103,748	—
UK Corporate	104,985	127,123	83	110,158	129,618	345	114,237	129,231	712
Wealth	21,101	37,566	27	21,484	39,437	51	21,716	39,052	65
International Banking	48,526	46,776	33	53,091	52,582	24	69,987	68,086	18
Ulster Bank	28,170	27,028	11	30,754	28,745	4	34,810	27,782	45
US Retail & Commercial	71,738	61,284	267	72,902	63,112	308	76,095	67,376	271

Markets	495,106	462,207	475	714,303	694,747	366	826,947	835,710	1,553
Central items	108,569	84,040	842	115,239	104,601	991	130,164	133,011	960
Core	995,772	962,307	1,738	1,235,342	1,222,149	2,089	1,388,425	1,403,996	3,624
Non-Core	31,197	6,119	18	63,418	9,859	169	104,726	18,220	841
	1,026,969	968,426	1,756	1,298,760	1,232,008	2,258	1,493,151	1,422,216	4,465
Reconciling items									
Direct Line Group	—	—	—	12,697	9,267	275	12,912	8,077	99
RFS Holdings minority interest	909	237	—	838	572	—	804	521	—
	1,027,878	968,663	1,756	1,312,295	1,241,847	2,533	1,506,867	1,430,814	4,564

*Restated

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38 Segmental analysis continued
Segmental analysis of assets and liabilities included in disposal groups:

	2013		2012		2011	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m	£m	£m
UK Retail	—	—	—	—	7,048	8,808
UK Corporate	—	—	—	—	11,727	12,977
Wealth	3	—	—	—	—	—
International Banking	4	47	144	51	414	88
US Retail & Commercial	679	3,190	—	—	—	—
Markets	74	1	91	2	17	29
Central items	882	1	(74)	1	136	2
Non-Core	773	21	576	808	5,670	1,779
Direct Line Group	—	—	12,697	9,267	—	—
RFS Holdings minority interest	602	118	579	41	438	312
	3,017	3,378	14,013	10,170	25,450	23,995

Segmental analysis of goodwill is as follows:

	UK Retail	UK Corporate	Wealth	International Banking	US Retail & Commercial	Markets	Non-Core	Direct Line Group	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2011	2,799	2,882	812	1,092	3,980	2	15	946	12,528
Transfer to disposal groups	—	—	—	—	—	—	(15)	—	(15)
Currency translation and other adjustments	—	—	—	(28)	12	1	—	(1)	(16)
Acquisitions	—	—	—	—	—	18	—	—	18
Write-down of goodwill									
- continuing operations	(20)	(60)	—	—	—	—	—	—	(80)
- discontinued operations	—	—	—	—	—	—	—	(11)	(11)
At 1 January 2012	2,779	2,822	812	1,064	3,992	21	—	934	12,424
Transfers to disposal groups	—	—	—	—	—	—	—	(540)	(540)
Disposals	—	—	(9)	—	—	—	—	—	(9)
Currency translation and other adjustments	—	—	(3)	(24)	(169)	(1)	—	—	(197)
Write-down of goodwill									
- continuing operations	—	—	—	—	—	(18)	—	—	(18)
- discontinued operations	—	—	—	—	—	—	—	(394)	(394)
At 1 January 2013	2,779	2,822	800	1,040	3,823	2	—	—	11,266
Disposals	—	—	(1)	—	—	—	—	—	(1)
Currency translation and other adjustments	—	—	2	19	(88)	—	—	—	(67)
Write-down of goodwill	—	—	—	(1,059)	—	—	—	—	(1,059)

At 31 December 2013	2,779	2,822	801	—	3,735	2	—	—	10,139

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Notes on the consolidated accounts

38 Segmental analysis continued
(b) Geographical segments
The geographical analysis in the tables below has been compiled on the basis of location of office where the transactions are recorded.

2013	UK £m	USA £m	Europe £m	RoW £m	Total £m
Total revenue	16,015	5,515	2,913	2,015	26,458
Net interest income	7,794	2,200	746	241	10,981
Net fees and commissions	2,544	1,099	663	212	4,518
Income from trading activities	1,474	1,013	106	92	2,685
Other operating income	644	382	242	305	1,573
Total income	12,456	4,694	1,757	850	19,757
Operating (loss)/profit before tax	(2,444)	(615)	(5,262)	78	(8,243)
Total assets	747,347	197,789	40,113	42,629	1,027,878
Of which total assets held for sale	915	750	198	1,154	3,017
Total liabilities	692,861	185,952	50,107	42,146	968,663
Of which total liabilities held for sale	—	3,210	81	87	3,378
Net assets attributable to equity owners and non-controlling interests	54,486	11,837	(9,994)	483	59,215
Contingent liabilities and commitments	107,500	83,048	41,368	10,093	242,009
Cost to acquire property, plant and equipment and intangible assets	1,086	428	232	10	1,756
2012*					
Total revenue	12,396	6,824	3,790	2,893	25,903
Net interest income	8,212	2,157	770	263	11,402
Net fees and commissions	2,834	1,220	564	257	4,875
Income from trading activities	(314)	1,539	193	257	1,675
Other operating (loss)/income	(710)	282	356	61	(11)
Total income	10,022	5,198	1,883	838	17,941
Operating (loss)/profit before tax	(4,671)	1,821	(2,034)	(393)	(5,277)
Total assets	899,604	305,588	47,966	59,137	1,312,295
Of which total assets held for sale	11,638	291	1,001	1,083	14,013
Total liabilities	835,268	288,005	61,801	56,773	1,241,847
Of which total liabilities held for sale	8,405	129	871	765	10,170
Net assets attributable to equity owners and non-controlling interests	64,336	17,583	(13,835)	2,364	70,448
Contingent liabilities and commitments	105,018	84,788	49,341	8,498	247,645
Cost to acquire property, plant and equipment and intangible assets	1,953	325	186	69	2,533

2011*

Total revenue	18,212	7,271	5,067	3,796	34,346
Net interest income	8,367	2,430	962	544	12,303
Net fees and commissions	3,389	1,365	244	419	5,417
Income from trading activities	661	1,318	508	214	2,701
Other operating income/(loss)	2,950	219	1,079	(18)	4,230
Total income	15,367	5,332	2,793	1,159	24,651
Operating profit/(loss) before tax	667	1,794	(3,419)	(438)	(1,396)
Total assets	1,007,096	359,592	66,239	73,940	1,506,867
Of which total assets held for sale	19,343	53	6,011	43	25,450
Total liabilities	936,477	341,631	82,059	70,647	1,430,814
Of which total liabilities held for sale	21,903	104	1,988	—	23,995
Net assets attributable to equity owners and non-controlling interests	70,619	17,961	(15,820)	3,293	76,053
Contingent liabilities and commitments	118,702	95,703	51,465	12,949	278,819
Cost to acquire property, plant and equipment and intangible assets	2,522	500	1,484	58	4,564

*Restated

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Notes on the consolidated accounts

39 Directors' and key management remuneration

Directors' remuneration	2013 £000	2012 £000
Non-executive directors - emoluments	1,208	1,218
Chairman and executive directors		
- emoluments	3,632	3,825
- contributions and allowances in respect of money purchase schemes	348	436
	5,188	5,479
- amounts receivable under long-term incentive plans	—	1,223
	5,188	6,702

No directors are accruing benefits under defined benefit schemes (2012 - nil). One director is accruing benefits under a money purchase scheme (2012 - one).

The executive directors may participate in the company's long-term incentive plans, executive share option and sharesave schemes and details of their interests in the company's shares arising from their participation are given in the Directors' remuneration report. Details of the remuneration received by each director is also given in the Directors' remuneration report.

Compensation of key management
The aggregate remuneration of directors and other members of key management during the year was as follows:

	2013 £000	2012 £000
Short-term benefits	30,590	32,540
Post-employment benefits	238	699
Termination benefits	2,033	—
Share-based payments	13,003	24,533
	45,864	57,772

40 Transactions with directors and key management
(a) At 31 December 2013, amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions in the Group, as defined in UK legislation, were £850,762 in respect of loans to seven persons who were directors of the company at any time during the financial period.

(b) For the purposes of IAS 24 ‘Related Party Disclosures’, key management comprise directors of the company and members of the Group Management Committee. The captions in the Group's primary financial statements include the following amounts attributable, in aggregate, to key management:

	2013 £000	2012 £000
Loans and advances to customers	10,750	11,748
Customer accounts	33,279	36,250

Key management have banking relationships with Group entities which are entered into in the normal course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with other persons of a similar standing or, where applicable, with other employees. These transactions did not involve more than the normal risk of repayment or present other unfavourable features.

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Notes on the consolidated accounts

41 Related parties

UK Government

On 1 December 2008, the UK Government through HM Treasury became the ultimate controlling party of The Royal Bank of Scotland Group plc. The UK Government's shareholding is managed by UK Financial Investments Limited, a company wholly owned by the UK Government. As a result, the UK Government and UK Government controlled bodies became related parties of the Group.

The Group enters into transactions with many of these bodies on an arm's length basis. The principal transactions during 2013, 2012 and 2011 were: Bank of England facilities and the issue of debt guaranteed by the UK Government discussed below and the Asset Protection Scheme which the Group exited on 18 October 2012 having paid total premiums of £2.5 billion. In addition, the redemption of non-cumulative sterling preference shares and the placing and open offer in April 2009 was underwritten by HM Treasury and, in December 2009, B shares were issued to HM Treasury and a contingent capital agreement concluded with HM Treasury (see Note 27). Other transactions include the payment of: taxes principally UK corporation tax (page 396) and value added tax; national insurance contributions; local authority rates; and regulatory fees and levies (including the bank levy (page 385) and FSCS levies (page 465)); together with banking transactions such as loans and deposits undertaken in the normal course of banker-customer relationships.

Bank of England facilities

The Group also participates in a number of schemes operated by the Bank of England available to eligible banks and building societies.

- Open market operations - these provide market participants with funding at market rates on a tender basis in the form of short and long-term repos on a wide range of collateral and outright purchases of high-quality bonds to enable them to meet the reserves that they must hold at the Bank of England.

- The special liquidity scheme - this was launched in April 2008 to allow financial institutions to swap temporarily illiquid assets for treasury bills, with fees charged based on the spread between 3-month LIBOR and the 3-month gilt repo rate. The scheme officially closed on 30 January 2012.

At 31 December 2013, the Group had no amounts outstanding under these facilities (2012 and 2011 - nil).

Members of the Group that are UK authorised institutions are required to maintain non-interest bearing (cash ratio) deposits with the Bank of England amounting to 0.11% of their eligible liabilities. They also have access to Bank of England reserve accounts: sterling current accounts that earn interest at the Bank of England Rate.

Government credit and asset-backed securities guarantee schemes

These schemes guarantee eligible debt issued by qualifying institutions for a fee. The fee, payable to HM Treasury is based on a per annum rate of 25 (asset-backed securities guarantee scheme) and 50 (credit guarantee scheme) basis points plus 100% of the institution's median five-year credit default swap spread during the twelve months to 1 July 2008. The asset-backed securities scheme closed to new issuance on 31 December 2009 and the credit guarantee scheme on 28 February 2010.

At 31 December 2013, the Group had no debt outstanding guaranteed by the UK Government (2012 - nil; 2011 - £21.3 billion).

National Loan Guarantee Scheme

The Group participated in the National Loan Guarantee Scheme (NLGS), providing loans and facilities to eligible customers at a discount of one percent. It did not issue any guaranteed debt under the scheme and consequently, it was not committed to providing a particular volume of reduced rate facilities. At 31 December 2013 the Group had no amounts outstanding under the scheme (2012 - £898 million). The NLGS was superseded by the Funding for Lending Scheme.

The Funding for Lending Scheme

The Funding for Lending Scheme was launched in July 2012. Under the scheme UK banks and building societies are able to borrow UK treasury bills from the Bank of England in exchange for eligible collateral during the drawdown period (1 August 2012 to 31 January 2014). Borrowing is limited to 5% of the participant's stock of loans to the UK non-financial sector as at 30 June 2012, plus any expansion in lending from that date to the end of 2013. Eligible collateral comprises all collateral eligible for the Bank of England's discount window facility. The term of each transaction is four years from the date of drawdown. The price for borrowing UK treasury bills under the scheme depends on the participant's net lending to the UK non-financial sector between 30 June 2012 and the end of 2013. If lending is maintained or expanded over that period, the fee is 0.25% per year on the amount borrowed. If lending declines, the fee increases by 0.25% for each 1% fall in lending, up to a maximum fee of 1.5%. As at 31 December 2013, the Group had no amounts outstanding under the scheme (2012 - £749 million).

Other related parties

(a) In their roles as providers of finance, Group companies provide development and other types of capital support to businesses. These investments are made in the normal course of business and on arm's length terms. In some instances, the investment may extend to ownership or control over 20% or more of the voting rights of the investee company. However, these investments are not considered to give rise to transactions of a materiality requiring disclosure under IAS 24.

(b) The Group recharges The Royal Bank of Scotland Group Pension Fund with the cost of administration services incurred by it. The amounts involved are not material to the Group.

(c) In accordance with IAS 24, transactions or balances between Group entities that have been eliminated on consolidation are not reported.

(d) The captions in the primary financial statements of the parent company include amounts attributable to subsidiaries. These amounts have been disclosed in aggregate in the relevant notes to the financial statements.

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42 Post balance sheet events

RBS Capital Resolution

In November 2013, the Group announced the creation of RBS Capital Resolution (RCR), to manage a pool of assets with particularly high long term capital intensity and/or potentially volatile outcomes in stressed environments. RCR became operational on 1 January 2014 with a portfolio of £29 billion assets.

Sale of selected Chicago-area operations of RBS Citizens

On 7 January 2014, the Group announced that RBS Citizens Financial Group, Inc. had reached agreement to sell its Chicago-area retail branches, small business operations and select middle market relationships in the Chicago market to U.S. Bank National Association, a subsidiary of U.S. Bancorp. The sale includes 94 Charter One branches in the Chicago area, $5.3 billion in local deposits and $1.1 billion in locally originated loans for a deposit premium of approximately $315 million, or 6 percent of deposits. The transaction is subject to regulatory approval and is anticipated to close in mid-2014.

Disposal of Structured Retail Investor Products and Equity Derivatives Businesses

On 19 February 2014, the Group announced that it had reached agreement with BNP Paribas S.A. for the disposal of assets and liabilities related to its structured retail investor products and equity derivatives businesses, and associated market-making activities. The disposal is subject to competition approval and will be implemented on a phased basis during 2014 and 2015. The consideration is not material.

Strategic review

In November 2013, the Group announced that it was undertaking a comprehensive business review of its customer-facing businesses, IT and operations and organisational and decision making structures.

As described on page 10, the Group has announced the results of its Strategic review, resulting in it being realigned into three businesses: Personal & Business Banking, Commercial & Private Banking, and Corporate & institutional Banking. In addition, the Group will be rationalising and simplifying its systems, based on a target architecture with improved resilience.

Direct Line Insurance Group (DLG)

On 26 February 2014 RBS announced that it had entered into a placing agreement to complete the sale of its residual interest in DLG (except for 4.2 million shares held to satisfy long term incentive plan awards granted by RBS to DLG management). Accordingly, on settlement of the placing, the Group will have completed the disposal as required by the European Commission.

Other than as detailed above, there have been no significant events between 31 December 2013 and the date of approval of these accounts which would require a change to or additional disclosure in the accounts.

Notes on the consolidated accounts

43 Consolidating financial information

The Royal Bank of Scotland plc ('RBS plc') is a 100% owned subsidiary of The Royal Bank of Scotland Group plc ('RBSG plc') and is able to offer and sell certain securities in the US from time to time pursuant to a registration statement on Form F-3 filed with the SEC with a full and unconditional guarantee from RBSG plc.

RBS plc utilises an exception provided in Rule 3-10 of Regulation S-X, and therefore does not file its financial statements with the SEC. In accordance with the requirements to qualify for the exception, presented below is condensed consolidating financial information for:

- RBSG plc on a stand-alone basis as guarantor;
- RBS plc on a stand-alone basis as issuer;
- Non-guarantor Subsidiaries of RBSG plc and RBS plc on a combined basis ('Subsidiaries');
- Consolidation adjustments; and
- RBSG plc consolidated amounts ('RBSG Group').

Under IAS 27, RBSG plc and RBS plc account for investments in their subsidiary undertakings at cost less impairment. Rule 3-10 of Regulation S-X requires a company to account for its investments in subsidiary undertakings using the equity method, which would decrease the results for the period of RBSG plc and RBS plc in the information below by £9,580 million and £6,053 million respectively for the year ended 31 December 2013 (£5,083 million and £3,093 million for the year ended 31 December 2012; £2,044 million and £2,853 million for the year ended 31 December 2011). The net assets of RBSG plc and RBS plc in the information below would also be decreased by £1,575 million and £5,536 million respectively at 31 December 2013 (increased by £9,704 million and £1,178 million at 31 December 2011; £15,978 million and £6,389 million at 31 December 2011).

Income statement

	RBSG plc	RBS plc	Subsidiaries	Consolidation Adjustments	RBSG Group
For the year ended 31 December 2013	£m	£m	£m	£m	£m
Net interest income	258	3,370	7,102	251	10,981
Non-interest income	700	7,391	3,523	(2,838)	8,776
Total income	958	10,761	10,625	(2,587)	19,757
Operating expenses	40	(8,217)	(11,399)	8	(19,568)
Impairment losses	—	(2,536)	(5,704)	(192)	(8,432)
Operating profit/(loss) before tax	998	8	(6,478)	(2,771)	(8,243)
Tax	(34)	(1,207)	681	178	(382)
Profit/(loss) from continuing operations	964	(1,199)	(5,797)	(2,593)	(8,625)
Profit from discontinued operations, net of tax	—	—	76	72	148
Profit/(loss) for the year	964	(1,199)	(5,721)	(2,521)	(8,477)

Statement of comprehensive income

	RBSG plc	RBS plc	Subsidiaries	Consolidation Adjustments	RBSG Group
For the year ended 31 December 2013	£m	£m	£m	£m	£m
Profit/(loss) for the year	964	(1,199)	(5,699)	(2,543)	(8,477)
Items that do not qualify for reclassification					
Actuarial (losses)/gains on defined benefit plans	—	(13)	459	—	446

Tax	—	6	(252)	—	(246)
	—	(7)	207	—	200
Items that do qualify for reclassification					
Available-for-sale financial assets	—	(1,497)	789	302	(406)
Cash flow hedges	—	(1,857)	(125)	(309)	(2,291)
Currency translation	—	(66)	77	(240)	(229)
Tax	—	796	188	30	1,014
	—	(2,624)	929	(217)	(1,912)
Other comprehensive (loss)/income after tax	—	(2,631)	1,136	(217)	(1,712)
Total comprehensive income/(loss) for the year	964	(3,830)	(4,563)	(2,760)	(10,189)
Total comprehensive income/(loss) is attributable to:					
Non-controlling interests	—	—	6	131	137
Preference shareholders	349	58	—	(58)	349
Paid-in equity holders	30	—	—	19	49
Ordinary and B shareholders	585	(3,888)	(4,569)	(2,852)	(10,724)
	964	(3,830)	(4,563)	(2,760)	(10,189)

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Notes on the consolidated accounts

43 Consolidating financial information continued

Income statement

For the year ended 31 December 2012*	RBSG plc £m	RBS plc £m	Subsidiaries £m	Consolidation Adjustments £m	RBSG Group £m
Net interest income	390	4,038	6,816	158	11,402
Non-interest income	2,263	5,830	2,391	(3,945)	6,539
Total income	2,653	9,868	9,207	(3,787)	17,941
Operating expenses	12	(9,138)	(9,234)	421	(17,939)
Impairment losses	(3,194)	(1,548)	(1,825)	1,288	(5,279)
Operating loss before tax	(529)	(818)	(1,852)	(2,078)	(5,277)
Tax	(155)	37	(419)	96	(441)
Loss from continuing operations	(684)	(781)	(2,271)	(1,982)	(5,718)
Profit/(loss) from discontinued operations, net of tax	—	—	222	(394)	(172)
Loss for the year	(684)	(781)	(2,049)	(2,376)	(5,890)

Statement of comprehensive income

For the year ended 31 December 2012*	RBSG plc £m	RBS plc £m	Subsidiaries £m	Consolidation Adjustments £m	RBSG Group £m
Loss for the year	(684)	(781)	(2,049)	(2,376)	(5,890)
Items that do not qualify for reclassification					
Actuarial losses on defined benefit plans	—	(126)	(67)	(1,965)	(2,158)
Tax	—	26	28	298	352
	—	(100)	(39)	(1,667)	(1,806)
Items that do qualify for reclassification					
Available-for-sale financial assets	—	(693)	516	822	645
Cash flow hedges	—	554	240	212	1,006
Currency translation	—	11	(394)	(517)	(900)
Tax	—	117	(72)	(197)	(152)
	—	(11)	290	320	599
Other comprehensive (loss)/income after tax	—	(111)	251	(1,347)	(1,207)
Total comprehensive loss for the year	(684)	(892)	(1,798)	(3,723)	(7,097)
Total comprehensive loss is attributable to:					
Non-controlling interests	—	—	(15)	(114)	(129)
Preference shareholders	273	58	—	(58)	273
Paid-in equity holders	15	—	—	13	28
Ordinary and B shareholders	(972)	(950)	(1,783)	(3,564)	(7,269)
	(684)	(892)	(1,798)	(3,723)	(7,097)

*Restated

Notes on the consolidated accounts

43 Consolidating financial information continued

Income statement

For the year ended 31 December 2011*	RBSG plc £m	RBS plc £m	Subsidiaries £m	Consolidation Adjustments £m	RBSG Group £m
Net interest income	514	3,473	8,219	97	12,303
Non-interest income	(566)	8,122	6,074	(1,282)	12,348
Total income	(52)	11,595	14,293	(1,185)	24,651
Operating expenses	18	(8,195)	(9,398)	235	(17,340)
Impairment losses	—	(1,533)	(7,184)	10	(8,707)
Operating (loss)/profit before tax	(34)	1,867	(2,289)	(940)	(1,396)
Tax	(73)	(755)	(267)	20	(1,075)
(Loss)/profit from continuing operations	(107)	1,112	(2,556)	(920)	(2,471)
Profit from discontinued operations, net of tax	—	—	348	—	348
(Loss)/profit for the year	(107)	1,112	(2,208)	(920)	(2,123)

Statement of comprehensive income

For the year ended 31 December 2011*	RBSG plc £m	RBS plc £m	Subsidiaries £m	Consolidation Adjustments £m	RBSG Group £m
(Loss)/profit for the year	(107)	1,112	(2,208)	(920)	(2,123)
Items that do not qualify for reclassification					
Actuarial losses on defined benefit plans	—	(3)	18	(390)	(375)
Tax	—		12	22	34
	—	(3)	30	(368)	(341)
Items that do qualify for reclassification					
Available-for-sale financial assets	—	1,560	541	157	2,258
Cash flow hedges	—	1,083	333	8	1,424
Currency translation	—	15	(1,385)	930	(440)
Tax	—	(628)	(1,154)	224	(1,558)
	—	2,030	(1,665)	1,319	1,684
Other comprehensive income/(loss) after tax	—	2,027	(1,635)	951	1,343
Total comprehensive (loss)/income for the year	(107)	3,139	(3,843)	31	(780)
Total comprehensive (loss)/income is attributable to:					
Non-controlling interests	—	—	(5)	(19)	(24)
Preference shareholders	—	58	—	(58)	—
Ordinary and B shareholders	(107)	3,081	(3,838)	108	(756)
	(107)	3,139	(3,843)	31	(780)

*Restated

Notes on the consolidated accounts

43 Consolidating financial information continued

Balance sheet

At 31 December 2013	RBSG plc £m	RBS plc £m	Subsidiaries £m	Consolidation Adjustments £m	RBSG Group £m
Assets					
Cash and balances at central banks	—	75,792	6,867	—	82,659
Loans and advances to banks	24,574	77,768	193,024	(241,295)	54,071
Loans and advances to customers	153	225,374	269,326	(54,131)	440,722
Debt securities	1,517	92,327	52,316	(32,561)	113,599
Equity shares	—	7,301	2,274	(764)	8,811
Investments in Group undertakings	54,813	42,328	13,233	(110,374)	—
Settlement balances	—	3,492	2,417	(318)	5,591
Derivatives	164	292,880	9,638	(14,643)	288,039
Intangible assets	—	1,127	5,033	6,208	12,368
Property, plant and equipment	—	2,284	5,616	9	7,909
Deferred tax	—	2,298	1,402	(222)	3,478
Prepayments, accrued income and other assets	36	3,246	7,263	(2,931)	7,614
Assets of disposals groups	842	—	2,136	39	3,017
Total assets	82,099	826,217	570,545	(450,983)	1,027,878
Liabilities					
Deposits by banks	1,490	180,293	108,129	(225,933)	63,979
Customer accounts	740	193,553	328,090	(51,503)	470,880
Debt securities in issue	7,015	51,538	36,147	(26,881)	67,819
Settlement balances	—	2,274	3,328	(289)	5,313
Short positions	—	17,898	10,815	(691)	28,022
Derivatives	62	288,507	11,600	(14,643)	285,526
Accruals, deferred income and other liabilities	49	7,201	10,006	(1,239)	16,017
Retirement benefit liabilities	—	65	(336)	3,481	3,210
Deferred tax	—	—	1,617	(1,110)	507
Subordinated liabilities	12,426	30,566	6,009	(24,989)	24,012
Liabilities of disposal groups	—	—	3,378	—	3,378
Total liabilities	21,782	771,895	518,783	(343,797)	968,663
Non-controlling interests	—	—	1,194	(721)	473
Owners' equity	60,317	54,322	50,568	(106,465)	58,742
Total equity	60,317	54,322	51,762	(107,186)	59,215
Total liabilities and equity	82,099	826,217	570,545	(450,983)	1,027,878

Notes on the consolidated accounts

43 Consolidating financial information continued

Balance sheet

At 31 December 2012*	RBSG plc £m	RBS plc £m	Subsidiaries £m	Consolidation Adjustments £m	RBSG Group £m
Assets					
Cash and balances at central banks	—	70,374	8,916	—	79,290
Loans and advances to banks	24,066	109,571	229,459	(299,145)	63,951
Loans and advances to customers	1,266	271,549	283,552	(56,232)	500,135
Debt securities	1,522	122,447	72,097	(38,628)	157,438
Equity shares	—	12,766	3,240	(774)	15,232
Investments in Group undertakings	54,995	40,262	12,081	(107,338)	—
Settlement balances	—	3,090	2,709	(58)	5,741
Derivatives	511	449,838	15,828	(24,274)	441,903
Intangible assets	—	1,033	6,367	6,145	13,545
Property, plant and equipment	—	2,430	7,345	9	9,784
Deferred tax	—	2,878	763	(198)	3,443
Prepayments, accrued income and other assets	20	4,433	5,834	(2,467)	7,820
Assets of disposals groups	—	—	13,755	258	14,013
Total assets	82,380	1,090,671	661,946	(522,702)	1,312,295
Liabilities					
Deposits by banks	1,455	209,583	143,259	(252,892)	101,405
Customer accounts	838	256,334	354,409	(90,302)	521,279
Debt securities in issue	9,310	71,494	48,693	(34,905)	94,592
Settlement balances	—	2,878	3,025	(25)	5,878
Short positions	—	14,074	14,208	(691)	27,591
Derivatives	7	439,152	19,448	(24,274)	434,333
Accruals, deferred income and other liabilities	491	7,355	842	6,113	14,801
Retirement benefit liabilities	—	56	347	3,481	3,884
Deferred tax	—	—	2,175	(1,034)	1,141
Subordinated liabilities	11,305	31,635	9,363	(25,530)	26,773
Liabilities of disposal groups	—	—	10,167	3	10,170
Total liabilities	23,406	1,032,561	605,936	(420,056)	1,241,847
Non-controlling interests	—	—	928	842	1,770
Owners' equity	58,974	58,110	55,082	(103,488)	68,678
Total equity	58,974	58,110	56,010	(102,646)	70,448
Total liabilities and equity	82,380	1,090,671	661,946	(522,702)	1,312,295

*Restated

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Notes on the consolidated accounts

43 Consolidating financial information continued

At 31 December 2011*	RBSG plc £m	RBS plc £m	Subsidiaries £m	Consolidation Adjustments £m	RBSG Group £m
Assets					
Cash and balances at central banks	—	64,261	15,008	—	79,269
Loans and advances to banks	18,368	109,040	352,420	(396,518)	83,310
Loans and advances to customers	4,056	351,123	316,881	(156,454)	515,606
Debt securities	1,568	181,460	102,311	(76,259)	209,080
Equity shares	—	10,486	5,478	(781)	15,183
Investments in Group undertakings	53,871	32,164	12,107	(98,142)	—
Settlement balances	—	4,059	3,713	(1)	7,771
Derivatives	1,502	537,297	24,781	(33,962)	529,618
Intangible assets	—	876	7,251	6,731	14,858
Property, plant and equipment	—	2,244	9,629	(5)	11,868
Deferred tax	1	2,584	1,115	178	3,878
Prepayments, accrued income and other assets	24	5,338	8,046	(2,432)	10,976
Assets of disposals groups	—	18,715	6,709	26	25,450
Total assets	79,390	1,319,647	865,449	(757,619)	1,506,867
Liabilities					
Deposits by banks	1,091	234,297	235,983	(362,567)	108,804
Customer accounts	977	296,902	376,643	(171,567)	502,955
Debt securities in issue	8,373	114,524	113,307	(73,583)	162,621
Settlement balances	—	3,517	3,960	—	7,477
Short positions	—	24,858	16,950	(769)	41,039
Derivatives	79	530,855	27,011	(33,962)	523,983
Accruals, deferred income and other liabilities	704	8,840	14,941	(1,281)	23,204
Retirement benefit liabilities	—	25	423	1,791	2,239
Deferred tax	—	—	2,381	(436)	1,945
Insurance liabilities	—	—	6,268	(35)	6,233
Subordinated liabilities	8,777	30,014	9,393	(21,865)	26,319
Liabilities of disposal groups	—	20,478	3,517	—	23,995
Total liabilities	20,001	1,264,310	810,777	(664,274)	1,430,814
Non-controlling interests	—	—	1,022	(336)	686
Owners' equity	59,389	55,337	53,650	(93,009)	75,367
Total equity	59,389	55,337	54,672	(93,345)	76,053
Total liabilities and equity	79,390	1,319,647	865,449	(757,619)	1,506,867

*Restated

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Notes on the consolidated accounts

43 Consolidating financial information continued

Cash flow statement

	RBSG plc	RBS plc	Subsidiaries	Consolidation Adjustments	RBSG Group
For the year ended 31 December 2013	£m	£m	£m	£m	£m
Net cash flows from operating activities	(2,865)	(21,590)	(6,527)	351	(30,631)
Net cash flows from investing activities	1,206	20,758	1,143	(1,924)	21,183
Net cash flows from financing activities	1,993	(1,387)	(5,834)	2,500	(2,728)
Effects of exchange rate changes on cash and cash equivalents	14	604	(323)	217	512
Net increase/(decrease) in cash and cash equivalents	348	(1,615)	(11,541)	1,144	(11,664)
Cash and cash equivalents at 1 January 2013	997	126,243	125,045	(119,444)	132,841
Cash and cash equivalents at 31 December 2013	1,345	124,628	113,504	(118,300)	121,177
For the year ended 31 December 2012					
Net cash flows from operating activities	(984)	(50,033)	(32,975)	38,879	(45,113)
Net cash flows from investing activities	(2,008)	49,347	(22,387)	2,223	27,175
Net cash flows from financing activities	2,156	4,535	(2,898)	(1,776)	2,017
Effects of exchange rate changes on cash and cash equivalents	(50)	(2,938)	(1,708)	803	(3,893)
Net (decrease)/increase in cash and cash equivalents	(886)	911	(59,968)	40,129	(19,814)
Cash and cash equivalents at 1 January 2012	1,883	125,332	185,013	(159,573)	152,655
Cash and cash equivalents at 31 December 2012	997	126,243	125,045	(119,444)	132,841
For the year ended 31 December 2011					
Net cash flows from operating activities	3,815	2,084	23,256	(25,830)	3,325
Net cash flows from investing activities	(4,568)	5,933	(3,534)	2,183	14
Net cash flows from financing activities	334	4,258	(3,502)	(2,831)	(1,741)
Effects of exchange rate changes on cash and cash equivalents	(55)	(1,322)	(491)	395	(1,473)
Net (decrease)/increase in cash and cash equivalents	(474)	10,953	15,729	(26,083)	125
Cash and cash equivalents at 1 January 2011	2,357	114,379	169,284	(133,490)	152,530
Cash and cash equivalents at 31 December 2011	1,883	125,332	185,013	(159,573)	152,655

Trust preferred securities

The Group has issued trust preferred securities through trusts 100% owned by the Group (through partnership interests held by RBSG Capital Corporation and RBS) which meet the definition of a finance subsidiary in Regulation S-X, Rule 3-10. The securities represent undivided beneficial interests in the assets of the trusts, which consist of partnership preferred securities representing non-cumulative perpetual preferred limited partnership interests issued by Delaware limited partnerships. The Royal Bank of Scotland Group plc has provided subordinated guarantees for the benefit of the holders of the trust preferred securities and the partnership preferred securities. Under the terms of the guarantees, the Group has fully and unconditionally guaranteed on a subordinated basis, payments on such trust preferred securities and partnership preferred securities, to the extent they are due to be paid and have not been paid by, or on behalf of the trusts and the partnerships, as the case may be. Following implementation of IFRS 10 the trusts are no longer consolidated by the Group. For those trust preferred securities that were classified as non-controlling interests, the Group's outstanding instruments with the trusts have been classified as Other equity. For those securities that were classified as subordinated liabilities, the Group's outstanding instruments with the trusts are classified as

subordinated liabilities.

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Additional information

Financial summary

The Group's financial statements are prepared in accordance with IFRS. Selected data under IFRS for each of the last five years are presented below.

	2013	2012*	2011*	2010*	2009*
Summary consolidated income statement	£m	£m	£m	£m	£m
Net interest income	10,981	11,402	12,303	13,782	12,928
Non-interest income (1,2,3)	8,776	6,539	12,348	12,840	14,650
Total income	19,757	17,941	24,651	26,622	27,578
Operating expenses (4,5,6,7,8,9)	(19,568)	(17,939)	(17,340)	(17,600)	(16,652)
Profit before insurance net claims and impairment losses	189	2	7,311	9,022	10,926
Insurance net claims	—	—	—	(85)	(134)
Impairment losses (10)	(8,432)	(5,279)	(8,707)	(9,235)	(13,891)
Operating loss before tax	(8,243)	(5,277)	(1,396)	(298)	(3,099)
Tax (charge)/credit	(382)	(441)	(1,075)	(664)	515
Loss from continuing operations	(8,625)	(5,718)	(2,471)	(962)	(2,584)
Profit/(loss) from discontinued operations, net of tax	148	(172)	348	(809)	248
Loss for the year	(8,477)	(5,890)	(2,123)	(1,771)	(2,336)
Loss attributable to:					
Non-controlling interests	120	(136)	28	(675)	358
Preference shareholders	349	273	—	105	878
Paid-in equity holders	49	28	—	29	96
Ordinary and B shareholders	(8,995)	(6,055)	(2,151)	(1,230)	(3,668)

*Restated

Notes:

(1) Includes profit on strategic disposals of £161 million (2012 - £113 million profit; 2011 - £25 million loss; 2010 - £171 million profit; 2009 - £82 million loss).

(2) Includes gain on redemption of own debt of £175 million (2012 - £454 million; 2011 - £255 million; 2010 - £553 million; 2009 - £3,790 million).

(3) Includes own credit adjustments of £120 million loss (2012 - £4,649 million loss; 2011 - £1,914 million gain; 2010 - £242 million gain; 2009 - £97 million loss).

(4) Includes Payment Protection Insurance costs of £900 million (2012 - £1,110 million; 2011 - £850 million), Interest Rate Hedging Products redress and related costs of £550 million (2012 - £700 million) and regulatory and legal actions of £2,394 million (2012 - £381 million).

(5) Includes integration and restructuring costs of £656 million (2012 - £1,415 million; 2011 - £1,021 million; 2010 - £1,012 million; 2009 - £1,276 million).

(6) Includes amortisation of purchased intangible assets of £153 million (2012 - £177 million; 2011 - £222 million; 2010 - £369 million; 2009 - £272 million).

(7) Includes write-down of goodwill of £1,059 million (2012 - £18 million; 2011 - £80 million; 2010 - £1 million; 2009 - £296 million).

(8) Includes gains on pensions curtailment of £2,148 million in 2009.

(9) Includes write-down of other intangible assets of £344 million (2012 - £106 million).

(10) Includes sovereign debt impairment of £1,099 million and related interest rate hedge adjustments of £169 million in 2011.

Summary consolidated balance sheet	2013 £m	2012* £m	2011* £m	2010* £m	2009* £m
Loans and advances	494,793	564,086	598,916	655,778	820,146
Debt securities and equity shares	122,410	172,670	224,263	239,678	286,782
Derivatives and settlement balances	293,630	447,644	537,389	438,682	453,487
Other assets	117,045	127,895	146,299	119,438	136,071
Total assets	1,027,878	1,312,295	1,506,867	1,453,576	1,696,486
Owners' equity	58,742	68,678	75,367	75,680	78,392
Non-controlling interests	473	1,770	686	1,171	16,239
Subordinated liabilities	24,012	26,773	26,319	27,053	37,652
Deposits	534,859	622,684	611,759	609,483	756,346
Derivatives, settlement balances and short positions	318,861	467,802	572,499	478,076	475,017
Other liabilities	90,931	124,588	220,237	262,113	332,840
Total liabilities and equity	1,027,878	1,312,295	1,506,867	1,453,576	1,696,486

*Restated

Additional information

Financial summary continued
Other financial data

	2013	2012*	2011*	2010*	2009*
Loss per ordinary and equivalent B share from continuing operations - pence	(81.3)	(54.5)	(22.7)	(3.9)	(58.4)
Diluted loss per ordinary and equivalent B share from continuing operations - pence (1)	(81.3)	(54.5)	(22.7)	(3.9)	(58.4)
Share price per ordinary share at year end - £	3.38	3.25	2.02	3.91	2.92
Market capitalisation at year end - £bn	38.2	36.3	22.3	42.8	31.4
Net asset value per ordinary and equivalent B share - £	5.24	6.31	6.90	7.02	8.81
Return on average total assets (2)	(0.7%)	(0.4%)	(0.1%)	(0.1%)	(0.2%)
Return on average owners equity (3)	(12.6%)	(7.8%)	(2.8%)	(1.5%)	(4.9%)
Return on average ordinary and B shareholders' equity (4)	(14.5%)	(8.9%)	(3.1%)	(0.9%)	(7.4%)
Average owners' equity as a percentage of average total assets	5.6%	5.2%	4.9%	4.6%	2.8%
Risk asset ratio - Tier 1	13.1%	12.4%	13.0%	12.9%	14.1%
Risk asset ratio - Total	16.5%	14.5%	13.8%	14.0%	16.1%
Ratio of earnings to combined fixed charges and preference share dividends (5,6)					
- including interest on deposits	(0.34)	0.28	0.85	0.95	0.72
- excluding interest on deposits	(4.51)	(2.99)	(0.37)	0.50	(0.47)
Ratio of earnings to fixed charges only (5,6)					
- including interest on deposits	(0.36)	0.29	0.85	0.97	0.77
- excluding interest on deposits	(6.04)	(3.81)	(0.37)	0.58	(0.71)

*Restated

Notes:
(1) None of the convertible securities had a dilutive effect in 2013, 2012, 2011, 2010 or 2009.
(2) Return on average total assets represents (loss)/profit attributable to ordinary and B shareholders as a percentage of average total assets.
(3) Return on average owners equity represents (loss)/profit attributable to equity owners expressed as a percentage of average owners equity.
(4) Return on average ordinary and B shareholders' equity represents (loss)/profit attributable to ordinary and B shareholders expressed as a percentage of average ordinary and B shareholders' equity.
(5) For this purpose, earnings consist of income before tax and non-controlling interests, plus fixed charges less the unremitted income of associates (share of profits less dividends received). Fixed charges consist of total interest expense, including or excluding interest on deposits and debt securities in issue, as appropriate, and the proportion of rental expense deemed representative of the interest factor (one third of total rental expenses).
(6) The earnings for the year ended 31 December 2013 and for the years ended 31 December 2012, 2011, 2010 and 2009, were inadequate to cover total fixed charges and preference share dividends. The coverage deficiency for total fixed charges and preference share dividends for the year ended 31 December 2013 was £8,641 million and for the years ended 31 December 2012, 2011, 2010 and 2009 were £5,578 million, £1,396 million, £3,951 million and £422 million, respectively. The coverage deficiency for fixed charges only for the year ended 31 December 2013 was £8,243 million and for the years ended 31 December 2012,

2011, 2010 and 2009 were £5,277 million, £1,396 million, £1,396 million and £298 million, respectively.

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Additional information

Financial summary continued

Analysis of loans and advances to customers

The following table analyses loans and advances to customers excluding reverse repos, before impairment provisions by remaining maturity, geographical (location of office) area and type of customer.

	Within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	2013 Total £m	2012 £m	2011 £m	2010 £m	2009 £m
UK								
Central and local government	5,353	52	1,546	6,951	8,087	8,037	5,901	4,629
Finance	21,817	4,447	2,673	28,937	33,955	33,235	34,018	35,461
Residential mortgages	10,639	23,842	76,034	110,515	109,530	100,726	101,593	92,584
Personal lending	12,706	3,709	683	17,098	19,692	20,207	23,620	25,759
Property	17,738	16,177	10,337	44,252	53,730	55,751	65,462	71,830
Construction	3,106	1,085	500	4,691	6,507	7,173	9,351	10,604
Manufacturing	5,487	2,538	714	8,739	10,058	10,476	13,810	17,724
Service industries and business activities	22,357	19,691	10,205	52,253	56,435	59,190	70,006	78,806
Agriculture, forestry and fishing	994	1,029	864	2,887	2,699	2,736	2,939	3,084
Finance leases and instalment credit	3,671	4,321	2,532	10,524	10,532	11,216	13,374	16,186
Accrued interest	128	6	2	136	263	375	513	905
Total UK	103,996	76,897	106,090	286,983	311,488	309,122	340,587	357,572
Overseas								
US	11,426	32,556	16,458	60,440	63,496	72,933	74,598	83,373
Rest of the World	29,148	19,276	20,131	68,555	76,240	91,817	105,618	263,534
Total Overseas	40,574	51,832	36,589	128,995	139,736	164,750	180,216	346,907
Reverse repos								
UK	19,777	—	—	19,777	42,989	42,025	34,234	29,666
US	18,603	—	—	18,603	22,811	17,397	16,154	10,196
Rest of World	11,517	—	—	11,517	4,247	2,072	2,124	1,178
Total reverse repos	49,897	—	—	49,897	70,047	61,494	52,512	41,040
Loans and advances to customers - gross	194,467	128,729	142,679	465,875	521,271	535,366	573,315	745,519
Loan impairment provisions				(25,153)	(21,136)	(19,760)	(18,055)	(17,126)
Loans and advances to customers - net				440,722	500,135	515,606	555,260	728,393
Fixed rate	33,813	30,315	53,324	117,452	123,941	88,429	95,000	223,902
Variable rate	110,757	98,414	89,355	298,526	327,283	385,443	425,803	480,577
Reverse repos	49,897	—	—	49,897	70,047	61,494	52,512	41,040
	194,467	128,729	142,679	465,875	521,271	535,366	573,315	745,519

Loans and advances to
customers - gross

The Group provides credit facilities at variable rates to its corporate and retail customers. Variable rate credit extended to the Group's corporate and commercial customers includes bullet and instalment loans, finance lease agreements and overdrafts; interest is generally charged at a margin over a benchmark rate such as LIBOR or base rate. Interest on variable rate retail loans may also be based on LIBOR or base rate; other variable rate retail lending is charged at variable interest rates set by the Group such as its mortgage standard variable rate in the UK.

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Additional information

Financial summary continued

Loan impairment provisions

For a discussion of the factors considered in determining the amount of provisions, refer to the provisions policy on page 373 and 'Critical accounting policies and key sources of estimation uncertainty' on pages 378 to 381. The following table shows the movements in loan impairment provisions.

	2013	2012	2011	2010	2009
	£m	£m	£m	£m	£m
Provisions at the beginning of the year					
UK	9,754	8,222	8,537	7,004	4,634
Overseas	11,496	11,661	9,645	10,279	6,382
	21,250	19,883	18,182	17,283	11,016
Transfer (to)/from disposal groups					
UK	—	764	(773)	(25)	—
Overseas	(9)	—	—	(47)	(324)
	(9)	764	(773)	(72)	(324)
Currency translation and other adjustments					
UK	323	635	5	(23)	(244)
Overseas	(202)	(945)	(288)	66	(286)
	121	(310)	(283)	43	(530)
Disposals					
Overseas	(77)	(5)	8	(2,172)	(65)
Amounts written-off					
UK	(2,547)	(2,127)	(2,408)	(2,270)	(2,925)
Overseas	(1,799)	(2,139)	(2,119)	(3,772)	(4,014)
	(4,346)	(4,266)	(4,527)	(6,042)	(6,939)
Recoveries of amounts previously written-off					
UK	78	164	158	151	176
Overseas	178	177	369	260	223
	256	341	527	411	399
Charged to income statement - continuing operations (1)					
UK	3,593	2,351	2,937	3,916	5,593
Overseas	4,819	2,964	4,304	5,228	7,497
	8,412	5,315	7,241	9,144	13,090
Charged to income statement - discontinued operations					
Overseas	—	4	(8)	42	1,044
Unwind of discount (recognised in interest income)					
UK	(196)	(255)	(235)	(216)	(230)
Overseas	(195)	(221)	(249)	(239)	(178)
	(391)	(476)	(484)	(455)	(408)
Provisions at the end of the year (2)					
UK	11,005	9,754	8,222	8,537	7,004
Overseas	14,211	11,496	11,661	9,645	10,279
	25,216	21,250	19,883	18,182	17,283
Gross loans and advances to customers (3)					

UK	286,983	311,488	309,122	340,587	357,572
Overseas	128,995	139,736	164,750	180,216	346,907
	415,978	451,224	473,872	520,803	704,479

For the notes to this table refer to the following page.

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Additional information

Financial summary: Loan impairment provisions continued

	2013	2012	2011	2010	2009
Closing customer provisions as a % of gross loans and advances to customers (3, 4)					
UK	3.8%	3.1%	2.6%	2.5%	1.9%
Overseas	11.0%	8.2%	7.1%	5.3%	2.9%
Total	6.0%	4.7%	4.2%	3.5%	2.4%
Customer charge to income statement as a % of gross loans and advances to customers (3, 4)					
UK	1.3%	0.8%	1.0%	1.1%	1.6%
Overseas	3.7%	2.1%	2.6%	2.9%	2.2%
Total	2.0%	1.2%	1.5%	1.8%	1.9%

Notes:

(1) Includes £15 million release relating to loans and advances to banks (2012 - £23 million charge; 2011 - nil; 2010 - £13 million release; 2009 - £34 million charge).

(2) Includes closing provisions against loans and advances to banks - see table below.

(3) Excludes reverse repos.

(4) For the purpose of these ratios, closing provisions and charge relating to loans and advances to banks are excluded.

The following table shows additional information in respect of loan impairment provisions.

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Loan impairment provisions at end of year					
Customers	25,153	21,136	19,760	18,055	17,126
Banks	63	114	123	127	157
	25,216	21,250	19,883	18,182	17,283
Average loans and advances to customers (gross)	509,937	541,588	578,057	610,131	821,155
As a % of average loans and advances to customers during the year					
Total customer provisions charged to income statement	1.6%	1.0%	1.3%	1.5%	1.6%
Amounts written-off (net of recoveries) - customers	0.8%	0.7%	0.7%	0.9%	0.8%

Analysis of closing customer loan impairment provisions

The following table analyses customer loan impairment provisions by geographical area and type of UK customer.

	2013		2012		2011		2010		2009	
		% of loans		% of loans		% of loans		% of loans		% of loans

				to		to		to		to
	Closing	to total	Closing	total	Closing	total	Closing	total	Closing	total
	Provision	Loans	Provision	Loans	Provision	Loans	Provision	Loans	Provision	Loans
	£m	%	£m	%	£m	%	£m	%	£m	%
UK										
Central and local government	2	1.7	—	1.8	—	1.7	—	1.1	—	0.7
Manufacturing	140	2.1	134	2.2	135	2.2	99	2.7	166	2.5
Construction	515	1.1	483	1.4	502	1.5	605	1.8	355	1.5
Finance	73	7.0	104	7.5	64	7.0	97	6.5	27	5.0
Service industries and business activities	2,192	12.6	1,480	12.5	1,219	12.5	1,091	13.4	981	11.2
Agriculture, forestry and fishing	45	0.7	34	0.6	36	0.6	26	0.6	19	0.4
Property	5,190	10.6	3,944	11.9	2,860	11.8	2,124	12.6	1,100	10.2
Residential mortgages	319	26.6	457	24.3	397	21.3	313	19.5	196	13.1
Personal lending	1,718	4.1	2,152	4.4	1,926	4.3	2,517	4.5	2,546	3.7
Finance leases and instalment credit	136	2.5	184	2.3	367	2.4	436	2.6	340	2.3
Accrued interest	—	—	—	0.1	—	0.1	—	0.1	—	0.1
Total UK	10,330	69.0	8,972	69.0	7,506	65.4	7,308	65.4	5,730	50.7
Overseas	12,820	31.0	10,204	31.0	10,268	34.6	8,097	34.6	8,320	49.3
Impaired book provisions	23,150	100.0	19,176	100.0	17,774	100.0	15,405	100.0	14,050	100.0
Latent book provisions	2,003		1,960		1,986		2,650		3,076	
Total provisions	25,153		21,136		19,760		18,055		17,126	

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Additional information

Financial summary continued

Analysis of write-offs

The following table analyses amounts written-off by geographical area and type of UK customer.

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
UK					
Manufacturing	41	61	115	107	225
Construction	159	158	228	110	243
Finance	47	30	24	6	105
Service industries and business activities	422	542	383	410	706
Agriculture, forestry and fishing	6	11	4	5	3
Property	950	490	493	396	334
Residential mortgages	180	32	25	17	2
Personal lending	681	610	1,007	1,152	1,192
Finance leases and instalment credit	61	193	129	67	115
Total UK	2,547	2,127	2,408	2,270	2,925
Overseas	1,799	2,139	2,119	3,772	4,014
Total write-offs (1)	4,346	4,266	4,527	6,042	6,939

Note:

(1) Includes £40 million written-off in respect of loans and advances to banks (2012 - £29 million).

Analysis of recoveries

The following table analyses recoveries of amounts written-off by geographical area and type of UK customer.

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
UK					
Manufacturing	1	1	4	2	1
Construction	1	10	6	1	—
Finance	—	1	—	—	2
Service industries and business activities	21	16	10	7	14
Property	5	33	8	4	—
Residential mortgages	—	6	9	6	3
Personal lending	48	93	111	128	99
Finance leases and instalment credit	2	4	10	3	57
Total UK	78	164	158	151	176
Overseas	178	177	369	260	223
Total recoveries	256	341	527	411	399

Additional information

Financial summary continued

Risk elements in lending

Risk elements in lending (REIL) comprises impaired loans and accruing loans past due 90 days or more as to principal or interest.

Impaired loans are all loans (including loans subject to forbearance) for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans.

Accruing loans past due 90 days or more comprise loans past due 90 days where no impairment loss is expected and those awaiting individual assessment. A latent loss provision is established for the latter.

	2013	2012	2011	2010	2009
	£m	£m	£m	£m	£m
Impaired loans (1)					
UK	17,480	18,412	15,576	15,738	13,572
Overseas	19,691	20,074	23,171	19,963	21,453
Total	37,171	38,486	38,747	35,701	35,025
Accruing loans which are contractually overdue 90 days or more as to principal or interest					
UK	1,962	2,007	1,698	2,374	2,224
Overseas	259	634	400	523	1,000
Total	2,221	2,641	2,098	2,897	3,224
Total risk elements in lending	39,392	41,127	40,845	38,598	38,249
Closing provisions for impairment as a % of total risk elements in lending	64%	52%	49%	47%	45%
Risk elements in lending as a % of gross lending to customers excluding reverse repos (3)	9.5%	9.1%	8.6%	7.4%	5.4%

Notes:

(1) The write-off of impaired loans affects the closing provisions for impairment as a % of total risk elements in lending (the coverage ratio). The coverage ratio reduces if the loan written off carries a higher than average provision and increases if the loan written off carries a lower than average provision.

(2) Impaired loans at 31 December 2013 include £7,687 million (2012 - £6,009 million) of loans subject to forbearance granted during the year.

(3) Includes disposal groups.

	2013	2012	2011	2010	2009
	£m	£m	£m	£m	£m
Gross income not recognised but which would have been recognised under the original terms of impaired loans					
UK	571	665	636	579	625
Overseas	696	940	964	830	1,032
	1,267	1,605	1,600	1,409	1,657

Interest on impaired loans included in net interest income					
UK	196	255	235	216	230
Overseas	195	221	249	239	178
	391	476	484	455	408

Potential problem loans

Potential problem loans (PPL) are loans for which an impairment event has taken place but no impairment loss is expected. This category is used for advances which are not past due 90 days or revolving credit facilities where identification as 90 days overdue is not feasible.

	2013	2012	2011	2010	2009
	£m	£m	£m	£m	£m
Potential problem loans	789	807	739	633	1,009

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.

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Forbearance

The table below shows loans granted forbearance during the year. These loans are unimpaired: either the loan was performing before and after the granting of forbearance or the loan was non-performing before but subsequently transferred to the performing book. Loans with impairment provisions subject to forbearance continue to be reported as impaired loans.

	2013	2012	2011	2010	2009
	£m	£m	£m	£m	£m
Loans granted forbearance	7,901	11,196	7,674	5,758	2,698

Notes:

(1) Wholesale loans subject to forbearance include only those arrangements above thresholds set individually by the divisions, ranging from nil to £3 million.

(2) For 2013, wholesale loans subject to forbearance were £4,305 million (refer to page 239) and secured retail loans subject to forbearance were £3,596 million (refer to page 243). Unsecured retail loans subject to forbearance are not included. The balance of unsecured retail loans subject to forbearance amounts to £272 million.

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, 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.

	Government	Banks	Other	Total	Short positions	Net of short positions
2013	£m	£m	£m	£m	£m	£m
United States	9,016	2,062	24,722	35,800	7,984	27,816
Germany	12,308	2,931	4,819	20,058	4,435	15,623
France	4,686	10,234	4,406	19,326	2,352	16,974
Netherlands	4,979	1,685	6,023	12,687	1,192	11,495
Spain	1,461	5,748	4,814	12,023	801	11,222
Italy	5,350	646	1,141	7,137	3,302	3,835
Japan	34	4,872	1,876	6,782	2,556	4,226
Republic of Ireland	170	2,600	2,773	5,543	51	5,492
2012						
United States	18,936	1,736	30,983	51,655	12,080	39,575
Germany	14,678	4,289	6,812	25,779	1,956	23,823
France	6,563	13,285	6,224	26,072	2,157	23,915

Netherlands	5,350	2,227	11,200	18,777	1,124	17,653
Spain	893	4,789	6,328	12,010	515	11,495
Italy	3,767	373	1,165	5,305	2,301	3,004
Japan	4,338	6,822	1,410	12,570	2,326	10,244
Republic of Ireland	217	3,557	3,071	6,845	59	6,786
2011						
United States	20,932	7,300	38,721	66,953	13,329	53,624
Germany	34,615	5,952	9,787	50,354	2,946	47,408
France	11,633	14,800	8,189	34,622	5,903	28,719
Netherlands	4,466	2,210	10,711	17,387	982	16,405
Spain	340	3,656	10,282	14,278	973	13,305
Italy	5,190	548	1,489	7,227	4,826	2,401
Japan	8,350	7,505	3,375	19,230	3,141	16,089
Republic of Ireland	665	3,287	2,759	6,711	68	6,643

Additional information

Financial summary continued

Analysis of deposits - product analysis

The following table analyses the Group's deposits, excluding repos, by type and geographical area (location of office).

	2013 £m	2012 £m	2011 £m
UK			
Demand deposits			
- interest-free	85,268	73,439	66,840
- interest-bearing	169,580	173,384	132,047
Time deposits			
- savings	76,043	81,884	81,003
- other	8,357	34,859	63,930
Total UK	339,248	363,566	343,820
Overseas			
Demand deposits			
- interest-free	38,235	42,250	30,780
- interest-bearing	23,536	34,548	44,413
Time deposits			
- savings	23,920	26,891	25,296
- other	24,786	23,057	38,947
Total overseas	110,477	126,746	139,436
Total deposits	449,725	490,312	483,256
Held-for-trading	30,000	42,648	48,458
Designated as at fair value through profit or loss	5,862	6,323	5,627
Amortised cost	413,863	441,341	429,171
Total deposits	449,725	490,312	483,256
Overseas			
US	59,046	65,734	74,508
Rest of the World	51,431	61,012	64,928
Total overseas	110,477	126,746	139,436
Repos			
UK	40,018	62,055	56,826
US	38,085	63,744	61,411
Rest of the World	7,031	6,573	10,266
Total repos	85,134	132,372	128,503

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Certificates of deposit and other time deposits

The following table shows details of the Group's certificates of deposit and other time deposits over $100,000 or equivalent by remaining maturity.

2013	Within 3 months £m	Over 3 months but within 6 months £m	Over 6 months but within 12 months £m	Over 12 months £m	Total £m
UK based companies and branches					
Certificates of deposit	671	39	537	65	1,312
Other time deposits	21,575	1,776	2,579	3,505	29,435
Overseas based companies and branches					
Certificates of deposit	899	3	10	1	913
Other time deposits	8,427	2,337	1,760	1,252	13,776
	31,572	4,155	4,886	4,823	45,436

Short-term borrowings

Short-term borrowings comprise repurchase agreements, borrowings from financial institutions, commercial paper (CP) and certificates of deposit (CDs). Derivative collateral received from financial institutions is excluded from the table below, as are certain long-term borrowings.

	Repurchase agreements	Financial institutions (1,2)	CP	CDs	2013 Total	Repurchase agreements	Financial institutions (1,2)	CP	CDs	2012 Total	2011 Total
At year end											
- balance (£bn)	84	61	2	2	149	132	80	3	3	218	254
- weighted average interest rate	0.3%	0.6%	0.4%	0.6%	0.4%	0.5%	0.5%	0.3%	1.0%	0.5%	0.8%
During the year											
- maximum balance (£bn)	172	155	3	3	333	181	103	18	20	322	357
- average balance (£bn)	130	71	3	3	207	149	82	9	11	251	288
- weighted average interest rate	0.3%	0.6%	0.4%	0.9%	0.4%	0.5%	0.6%	0.6%	1.2%	0.5%	1.0%

Notes:

(1) Excludes derivative cash collateral of £26 billion at 31 December 2013 (2012 - £37 billion; 2011 - £41 billion), 2013 average of £31 billion (2012 - £38 billion; 2011 - £35 billion).

(2) Excludes Federal Home Loan Bank’s long-term borrowings of £2 billion at 31 December 2013 (2012 and 2011 - £1 billion), 2013 average of £1 billion (2012 and 2011 - £1 billion).

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.

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Other contractual cash obligations

The table below summarises the Group's other contractual cash obligations by payment date.

2013	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Operating leases	90	258	630	513	786	1,358
Contractual obligations to purchase goods or services	107	266	189	588	12	—
	197	524	819	1,101	798	1,358
2012						
Operating leases	214	185	694	559	910	1,376
Contractual obligations to purchase goods or services	110	334	500	15	—	—
	324	519	1,194	574	910	1,376

The Group's undrawn formal facilities, credit lines and other commitments to lend were £213,046 million (2012 - £215,808 million). While the Group has given commitments to provide these funds, some facilities may be 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.

Exchange rates

Except as stated, the following tables show, for the dates or periods indicated, the Noon Buying Rate in New York for cable transfers in sterling as certified for customs purposes by the Federal Reserve Bank of New York.

US dollars per £1	March 2014	February 2014	January 2014	December 2013	November 2013	October 2013
Noon Buying Rate						
High	1.6743	1.6750	1.6612	1.6574	1.6373	1.6224
Low	1.6491	1.6300	1.6335	1.6254	1.5916	1.5904

	2013	2012	2011	2010	2009
Noon Buying Rate					
Period end rate	1.6574	1.6262	1.5537	1.5392	1.6167
Average rate for the year (1)	1.5673	1.5924	1.6105	1.5415	1.5707
Consolidation rate (2)					
Period end rate	1.6542	1.6164	1.5475	1.5524	1.6222
Average rate for the year	1.5646	1.5850	1.6039	1.5455	1.5657

Notes:

(1) The average of the Noon Buying Rates on the last US business day of each month during the year.

(2) The rates used by the Group for translating US dollars into sterling in the preparation of its financial statements.

(3) On 25 April 2014, the Noon Buying Rate was £1.00 = US$1.6810.

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Supervision

United Kingdom

In April 2013, the Financial Services Authority (FSA) was replaced by two new regulators: the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). At that point, the PRA became the consolidated supervisor of the Group. The PRA, an operationally independent subsidiary of the Bank of England, is responsible for promoting the safety and soundness of systemically important financial institutions in the UK. The FCA's overall objective is to ensure financial markets function well. This is supported by its operational objectives of: securing an appropriate degree of protection for consumers; protecting and enhancing the integrity of the UK financial system; and promoting effective competition in the interests of consumers.

As at 31 December 2013, 16 companies in the Group, spanning a range of financial services sectors (banking, insurance and investment business), were authorised to conduct financial activities in the UK. The UK authorised banks in the Group include The Royal Bank of Scotland plc, National Westminster Bank Plc, Coutts & Co and Ulster Bank Limited. Wholesale activities, other than Group Treasury activities, are concentrated in the Group's Markets, International Banking and UK Corporate Banking divisions, and are undertaken under the names of The Royal Bank of Scotland plc and National Westminster Bank Plc. UK retail banking activities are managed by the UK Retail division and by Ulster Bank Limited in Northern Ireland. The banking service in the Republic of Ireland is provided by Ulster Bank Ireland Limited, which is supervised by the Central Bank of Ireland.

Investment management business is principally undertaken by companies in the Wealth division, including Coutts & Co, Adam & Company Investment Management Limited, and in the Markets and International Banking divisions, through RBS Asset Management Limited and The Royal Bank of Scotland plc.

The Group is subject to extensive regulations that impose obligations on financial institutions to maintain appropriate policies, procedures and controls to ensure compliance with the rules and regulations to which they are subject.

United States

The Royal Bank of Scotland Group plc (RBSG) is both a bank holding company and a financial holding company within the meaning of the US Bank Holding Company Act of 1956. As such, it is subject to the regulation and supervision of the Board of Governors of the Federal Reserve System (the “Federal Reserve”). Among other things, the Group's direct and indirect activities and investments in the United States are limited to those that are 'financial in nature' or 'incidental' or 'complementary' to a financial activity, as determined by the Federal Reserve. The Group is also required to obtain the prior approval of the Federal Reserve before acquiring directly or indirectly, the ownership or control of more than 5% of any class of the voting shares of any US bank or holding company. Under current Federal Reserve policy, the Group is required to act as a source of financial strength for its US bank subsidiaries. Among other things, this source of strength obligation could require the Group to inject capital into any of its US bank subsidiaries if any of them became undercapitalised.

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Anti-money laundering, anti-terrorism and economic sanctions regulations are a major focus of the US government for financial institutions and are rigorously enforced by the US government agencies.

The Group's US bank and non-bank subsidiaries and the Royal Bank's US branches are also subject to supervision and regulation by a variety of other US regulatory agencies. RBS Citizens N.A. is supervised by the Office of the Comptroller of the Currency, which is charged with the regulation and supervision of nationally chartered banks. RBS Citizens N.A. owns CCO Investments Services Corp., a US broker dealer subject to regulation and supervision by the US Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) with respect to its securities activities. Citizens Bank of Pennsylvania is subject to the regulation and supervision of the US Federal Deposit Insurance Corporation and the Pennsylvania Department of Banking. Both banks are subject to supervision and regulation by the Consumer Financial Protection Bureau (CFPB).

RBS Citizens Financial Group, Inc. is under the supervision of the Federal Reserve as a bank holding company. The Royal Bank's New York branch is supervised by the New York State Department of Financial Services and the Federal Reserve Bank of New York, and its Connecticut branch is supervised by the Connecticut Department of Banking. Both branches are also subject to supervisory oversight by the Federal Reserve Bank of Boston.

The Group's primary US broker dealer, RBS Securities Inc. (RBSSI), formerly known as Greenwich Capital Markets, Inc., is also subject to regulation and supervision by the SEC and FINRA with respect to its securities activities. The futures activities of RBSSI are subject to regulation and oversight by the US Commodity Futures Trading Commission and the Chicago Mercantile Exchange Group-owned exchanges.

Other jurisdictions
The Group operates in over 45 countries through a network of branches, local banks and non-bank subsidiaries and these activities are subject to supervision in most cases by a local regulator or central bank.

Description of property and equipment
The Group operates from a number of locations worldwide, principally in the UK. At 31 December 2013, the Royal Bank and NatWest had 608 and 1,392 retail branches, respectively, in the UK. Ulster Bank has a footprint of 214 branches and an extensive network of business banking offices across Northern Ireland and the Republic of Ireland. US Retail & Commercial had 1,366 retail banking offices (including in-store branches) covering Connecticut, Delaware, Illinois, Massachusetts, Michigan, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, Rhode Island and Vermont. A substantial majority of the UK branches are owned by the Royal Bank, NatWest and their subsidiaries or are held under leases with unexpired terms of over 50 years. The Group's principal properties include its headquarters at Gogarburn, Edinburgh, its principal offices in London at 135 and 280 Bishopsgate and the Drummond House administration centre located at South Gyle, Edinburgh.

Total capital expenditure on premises (excluding investment properties), computers and other equipment in the year ended 31 December 2013 was £571 million (2012 - £801 million; 2011 - £820 million).

Major shareholders
In December 2008, The Solicitor for the Affairs of Her Majesty's Treasury (HM Treasury) acquired 22,854 million ordinary shares representing 57.9% of the company's issued ordinary share capital. During 2009, HM Treasury acquired a further 16,791 million ordinary shares raising their holding to 70.3% of the company's issued ordinary share capital.

In December 2009, HM Treasury acquired 51 billion B shares in the company representing the entire issued B share capital. As a result of the ordinary share sub-division and consolidation which took place in June 2012, HM Treasury's holding in the company's ordinary shares became 3,964 million ordinary shares of £1 each. At 31 December 2013, HM Treasury's holding in the company's ordinary shares was 63.9%.

As far as the company is aware, there have been no significant changes in the percentage ownership of major shareholders of the company's ordinary, B and preference shares during the three years ended 26 February 2014. All shareholders within a class of the company's shares have the same voting rights.

As at 31 December 2013, almost all of the company's US$ denominated preference shares and American Depository Shares representing ordinary shares were held by shareholders registered in the US. All other shares were predominantly held by shareholders registered outside the US.

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Additional information

Material contracts
The company and its subsidiaries are party to various contracts in the ordinary course of business. Material contracts include the following:

Consortium and Shareholders Agreement (CSA)
On 28 May 2007, Fortis Bank Nederland, the company, Santander and RFS Holdings entered into the CSA. Fortis Bank Nederland acceded to the CSA on 26 July 2007. On 3 October 2008, the Dutch State acquired Fortis Bank Nederland. On 24 December 2008 the Dutch State acceded to the CSA following its acquisition of the shares held by Fortis Bank Nederland in RFS Holdings pursuant to a Deed of Accession entered into between RFS Holdings, the company, Fortis Bank Nederland, Santander and the Dutch State. On 1 April 2010 the CSA was restated. It was the subject of a further amendment on 18 July 2011. On 7 November 2012, Stichting Administratiekantoor Beheer Financiële Instellingen (the Foundation) acceded to the CSA (as amended and restated) as a shareholder following its acquisition of the shares held by the Dutch State in RFS Holdings pursuant to a Deed of Accession entered into between RFS Holdings, the company, Santander, the Dutch State and the Foundation. The Dutch State remains a party to the CSA. The CSA (as amended and restated) governs the relationships amongst the parties thereto in relation to the acquisition by RFS Holdings of ABN AMRO (now RBS Holdings N.V.). The CSA (as amended and restated) details, inter alia, the equity interests in RFS Holdings, the governance of RFS Holdings, the arrangements for the transfer of certain ABN AMRO businesses, assets and liabilities to the Dutch State (previously Fortis Bank Nederland), the company and Santander, further funding obligations of the Dutch State, the company and Santander where funding is required by regulatory authorities in connection with the ABN AMRO businesses, the allocation of taxes and conduct of tax affairs and the steps that the Dutch State, the company and Santander expect to take to enable the company to become the sole shareholder of RFS Holdings.

B Share Acquisition and Contingent Capital Agreement
On 26 November 2009, the company and HM Treasury entered into the Acquisition and Contingent Capital Agreement pursuant to which HM Treasury subscribed for the initial B shares and the Dividend Access Share (the "Acquisitions") and agreed the terms of HM Treasury's subscription (the “Contingent Subscription”) for an additional £8 billion in aggregate in the form of further B shares (the "Contingent B shares"), to be issued on the same terms as the initial B shares. The Acquisitions were subject to the satisfaction of various conditions, including the company having obtained the approval of its shareholders in relation to the Acquisitions.

The company and HM Treasury further agreed the terms of the £8 billion Contingent Subscription of the Contingent B shares in the Acquisition and Contingent Capital Agreement. For a period of five years from 22 December 2009 or, if earlier, until the occurrence of a termination event or until the company’s decision (with PRA (formerly FSA) consent) to terminate such Contingent Subscription (the "Contingent Period"), if the Core Tier 1 ratio of the company fell below five per cent (and if certain other conditions were met) HM Treasury would be committed to subscribe for the Contingent B shares in no fewer than two tranches of £6 billion and £2 billion (or such smaller amounts as the company and HM Treasury may agree). Any unused portion of the £8 billion could be subscribed in one or more further tranches.

On December 16, 2013, the company announced that, having received approval from the PRA, it had terminated the £8 billion Contingent Subscription. The Group was able to cancel the Contingent Subscription as a result of the actions announced in the second half of 2013 to further strengthen its capital position.

On entering into the Contingent Subscription in 2009, the company recognised the present value of the annual fees payable under the agreement (£1,208 million) as a liability and debited a contingent capital reserve within equity. Following termination of the Contingent Subscription, the outstanding final annual fee of £320 million was no longer

payable. The balance sheet liability for this fee has been extinguished with a corresponding entry to equity.

The company gave certain representations and warranties to HM Treasury on the date of the Acquisition and Contingent Capital Agreement, on the date the circular was posted to shareholders, on the first date on which all of the conditions precedent were satisfied, or waived, and on the date of the Acquisitions.

The company agreed to reimburse HM Treasury for its expenses incurred in connection with the Acquisitions.

The company agreed to a number of undertakings, including with respect to: (i) restrictions on the payment of dividends or other distributions on, and the redemption of, certain securities; (ii) expectations regarding the repurchase of the B shares by the company (which will be removed under the DRA (as defined below) subject to approval of the DRA by the company’s independent shareholders as set out below); (iii) negotiating in good faith to maintain the status of the B shares and Dividend Access Share as Core Tier 1 capital; and (iv) restrictions in relation to the company's share premium account.

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Material contracts continued
HM Treasury has agreed to waive its statutory pre-emption rights arising out of the B shares and the Dividend Access Share in respect of any future issue of equity securities by the company other than B shares or the Dividend Access Share and has agreed to vote its B shares and the Dividend Access Shares, as applicable, in favour of each special resolution to disapply its pre- emption rights under the B shares and/or the Dividend Access Share then held by HM Treasury every time they arise in respect of any such future issue. The pre-emption rights arising out of the B shares and the Dividend Access Share have also been disapplied in the Articles of Association.

HM Treasury has agreed that it shall not be entitled to exercise its option to convert B shares into ordinary shares to the extent that it holds more than 75 per cent of the ordinary shares of the company or to the extent that the exercise of such option would result in it holding more than 75 per cent of the ordinary shares of the company.

HM Treasury has agreed that it shall not be entitled to vote the B shares or the Dividend Access Share to the extent that votes cast on such B shares and the Dividend Access Share, together with any other votes which HM Treasury is entitled to cast in respect of any ordinary shares held by or on behalf of HM Treasury, would exceed 75 per cent of the total votes eligible to be cast on a resolution proposed at a general meeting of the company.

For as long as it is a substantial shareholder of the company (within the meaning of the UKLA's Listing Rules), HM Treasury has undertaken not to vote on related party transaction resolutions at general meetings and to direct that its affiliates do not so vote if HM Treasury is the related party for the purposes of such transaction.

DAS Retirement Agreement
The Dividend Access Share (“DAS”) was created in 2009 (see B Share Acquisition and Contingent Capital Agreement above). On 9 April 2014, the company entered into the DAS Retirement Agreement (the “DRA”) with HM Treasury. Pursuant to the terms of the DRA, and subject to approval by the company’s independent shareholders, it has been agreed that within 45 business days of such approval and subject to the satisfaction of certain other conditions, the company will pay HM Treasury an initial DAS dividend of £320 million. A further £1.18 billion shall be payable to HM Treasury (together with the initial dividend, the ‘DAS Retirement Dividend Amount’), in the form of one or more further DAS dividends, at the discretion of the directors of the company and with flexibility as to timing. Any unpaid portion of the DAS Retirement Dividend Amount will be subject to an increase of 5 per cent. per annum, calculated on a daily accruals basis from 1 January 2016, if such portion has not been paid before 1 January 2016 and an increase of 10 per cent. per annum, calculated on a daily accruals basis from 1 January 2021, on any part of the balance that has not been paid before 1 January 2021. Once the DAS Retirement Dividend Amount (subject to any increase) has been paid, the DAS will lose its enhanced dividend rights and will be redesignated as a single B share. In addition, if the independent shareholders of the company approve the DRA, the DRA will remove (i) the mechanism whereby the preferential dividend rights under the DAS fall away once the company’s ordinary share price trades at or above a certain level for a specified period of time and (ii) the expectation in the B Share Acquisition and Contingent Capital Agreement that the company would repurchase B shares if it is “prudent and practicable” to do so.

State Aid Commitment Deed
As a result of the State Aid granted to the company in 2008 and 2009, it was required to work with HM Treasury to submit a State Aid restructuring plan to the European Commission, which was then approved under the State Aid rules. The company agreed a series of measures which supplemented the measures in the company's strategic plan.

At the the same time, the company entered into a State Aid Commitment Deed with HM Treasury which provided that the Group would comply or procure compliance with these measures and behavioural commitments. The company agreed to do all acts and take all measures to ensure HM Treasury's compliance with its obligations under any

European Commission decision approving State Aid to the company.

The State Aid Commitment Deed also provides that if the European Commission adopts a decision that the UK Government must recover any State Aid (a "Repayment Decision") and the recovery order of the Repayment Decision has not been annulled or suspended by the Court of First Instance (now the General Court) or the European Court of Justice, then the Group must repay HM Treasury any aid ordered to be recovered under the Repayment Decision.

The State Aid Commitment Deed also provides for the company’s undertakings in respect of State Aid to be modified in certain limited circumstances. However, HM Treasury has undertaken that it will not, without the consent of the company, agree modifications to the company 's undertakings with respect to State Aid which are significantly more onerous to the company than those granted in order to obtain the State Aid approval.

The company has recently concluded discussions with HM Treasury and the European Commission in relation to certain amendments to the terms of the State Aid approval and has entered into the Revised State Aid Commitment Deed pursuant to which the company has agreed to comply or procure compliance with the revised state aid commitments. HMT’s obligations to the EC and the Company’s commitments under the Revised State Aid Commitment Deed will remain in effect even if the DRA is not approved by independent shareholders.

State Aid Costs Reimbursement Deed

Under the State Aid Costs Reimbursement Deed, the Group has agreed to reimburse HM Treasury for fees, costs and expenses associated with the State Aid and State Aid approval.

Sale of RBS England & Wales and NatWest Scotland branch based business

On 27 September 2013, the Group agreed a £600 million pre-IPO investment with a consortium of investors led by Corsair Capital and Centerbridge Partners, in relation to its RBS England and Wales and NatWest Scotland branch based business which centres around 314 branches in the UK. Following completion of the operational and legal separation of the business into a standalone bank to be branded Williams & Glyn, an exercise that is already well underway, the Group will pursue an Initial Public Offering (IPO). The pre-IPO investment took the form of a £600 million bond, which was issued by the Royal Bank on 21 October 2013, which will be exchangeable for a significant minority interest in Williams & Glyn at the time of IPO. The bond will convert into Williams & Glyn shares at the IPO price, subject to a minimum ownership level which will be linked to the tangible book value of Williams & Glyn prior to the IPO, and in any case no more than a stake of 49%. To the extent the maximum ownership level is reached, the bond will be partially redeemed in cash such that the investors will receive a total value of £600 million of cash and shares at the IPO price. At the IPO, subject to RBSG's consent, the investors will have the option to acquire up to 10% additionally at the IPO price, subject to their pro forma ownership being no more than 49% in aggregate. The Royal Bank Markets division provided a £270 million secured financing package to the investor-consortium in relation to the investment.

Additional information

ADR payment information

Fees paid by ADR holders

The depositary collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees.

The depository may collect its annual fee for depository services by deductions from cash distributions or by directly billing investors or by changing the book-entry system accounts of participants acting for them. The depository may generally refuse to provide fee-attracting services until its fees for those services are paid.

Persons depositing or withdrawing shares must pay:	For:
$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)	Issuance of ADSs, including issuances resulting from a distribution of shares or rights or other property. Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates.
$0.02 (or less) per ADS	Any cash distribution to ADS registered holders.
A fee equivalent to the fee that would be payable if securities distributed to you had been shares and the shares had been deposited for issuance of ADSs	Distribution of securities distributed to holders of securities of deposited securities to ADS registered holders.
Registration or transfer fees	Transfer and registration of shares on our share register to or from the name of the depository or its agent when you deposit or withdraw shares.
Expenses of the depository	Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement). Converting foreign currency to U.S. dollars.
Taxes and other governmental charges the depositary or the custodian have to pay on any ADS or share underlying an ADS, for example, stock transfer taxes, stamp duty or withholding taxes	As necessary.
Any charges incurred by the depository or its agents for servicing the deposited securities	As necessary.

Fees payable by the depository to the issuer

Fees incurred in past annual Period
From 1 January 2013 to 31 December 2013, the company received from the depository $300,000 for continuing annual stock exchange listing fees, standard out-of-pocket maintenance costs for the ADRs (consisting of the expenses of postage and envelopes for mailing annual and interim financial reports, printing and distributing dividend cheques, electronic filling of U.S. Federal tax information, mailing required tax forms, stationary, postage, facsimile, and telephone calls), any applicable performance indicators relating to the ADR facility, underwriting fees and legal fees.

Fees to be paid in the future.
The bank of New York Mellon, as depository, has agreed to reimburse the Company for expenses they incur that are related to establishment and maintenance expenses of the ADS program. The depository has agreed to reimburse the Company for its continuing annual stock exchange listing fees, the depository has also agreed to pay the standard out-of-pocket maintenance costs for the ADRs, which consist of the expenses of postage and envelopes for mailing annual and interim reports, printing and distributing dividend cheques, electronic filing of U.S. federal tax information, mailing required tax forms, stationary, postage, facsimile, and telephone calls. It has also agreed to reimburse the Company annually for certain investor relationship programs of special investor relations promotional activities. In certain instances, the depository has agreed to provide additional payments to the Company based on any applicable performance indicators relating to the ADR facility. There are limits on the amount of expenses for which the depository will reimburse the Company, but the amount of reimbursement available to the Company is not necessarily tied to the amount of fees the depository collects from investors

Additional information

Risk factors

Set out below are certain risk factors which could adversely affect the Group's future results, its financial condition and prospects and cause them to be materially different from what is expected. The factors discussed below and elsewhere in this report should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties facing the Group.

The Group’s ability to implement its new strategic plan and achieve its capital goals depends on the success of the Group's plans to refocus on its core strengths and the timely divestment of RBS Citizens

Since the beginning of the global economic and financial crisis in 2008 and as a result of the changed global economic outlook, the Group has been engaged in a financial and core business restructuring which has been focused on achieving appropriate risk-adjusted returns under these changed circumstances, reducing reliance on wholesale funding and lowering exposure to capital-intensive businesses. A key part of the restructuring programme announced in February 2009 was to run down and sell the Group’s non-core assets and businesses with a continued review of the Group’s portfolio to identify further disposals of certain non-core assets and businesses. Assets identified for this purpose and allocated to the Group’s Non-Core division totalled £258 billion, excluding derivatives, at 31 December 2008. By 31 December 2013, this total had reduced to £28.0 billion (31 December 2012 - £57.4 billion), excluding derivatives, as further progress was made in business disposals and portfolio sales during the course of 2013. This balance sheet reduction programme has been implemented alongside the disposals under the State Aid restructuring plan approved by the EC. During 2012 the Group implemented changes to its wholesale banking operations, including the reorganisation of its wholesale businesses and the exit and downsizing of selected existing activities (including cash equities, corporate banking, equity capital markets, and mergers and acquisitions).

During Q3 2013, the Group worked with HM Treasury as part of its assessment of the merits of creating an external “bad bank” to hold certain assets of the Group. Although the review concluded that the establishment of an external “bad bank” was not in the best interests of all stakeholders, the Group committed to take a series of actions to further de-risk its business and strengthen its capital position.

These actions include:

- The formation of the Capital Resolution Group (CRG), which is made up of four pillars: exiting the assets in RBS Capital Resolution (RCR), delivering the initial public offerings (IPO) for both RBS Citizens and Williams & Glyn and optimising the Group’s shipping business;

- The creation of RCR to manage the run-down of problem assets, which totalled £29 billion at the end of 2013, with the goal of removing 55-70% of these assets over the next two years with a clear aspiration to remove all these assets from the balance sheet in three years; and

- Lifting the Group’s capital targets including by:
  - accelerating the divestment of RBS Citizens, the Group’s US banking subsidiary, with a partial IPO now planned for 2014, and full divestment of the business intended by the end of 2016; and
  - intensifying management actions to reduce risk weighted assets.

Since the end of Q3 2013, the Group has been conducting a review of its activities which has resulted in additional changes to the Group’s strategic goals. It is now intended to further simplify and downsize the Group with an increased focus on service to its customers. As part of simplifying the Group, the current divisional structure will be replaced by three new customer segments, covering Personal & Business, Commercial & Private Banking and Corporate & Institutional Banking. As part of this reorganisation of the business, the intention will be to remain in businesses

where the Group can be number one for its customers. For those businesses where that is not the case, the Group will either fix, close or dispose of such businesses. This reorganisation, together with investment in technology and more efficient support functions are intended to deliver significant improvements in the Group's Return on Equity and costs: income ratio in the longer term.

Implementation of the Group's new strategic plan will require significant restructuring of the Group at the same time that it will also be implementing structural changes to comply with the Financial Services (Banking Reform) Act 2013 (the "Banking Reform Act" 2013) and its ring-fencing requirements. The level of structural change intended to be implemented within the Group over the medium term taken together with the overall scale of change to make the Group a smaller, more focused financial institution, are likely to be disruptive and increase operational risks for the Group. There can be no assurance that the Group will be able to successfully implement this new strategy together with other changes required of the Group in the time frames contemplated or at all.

The Group's ability to dispose of businesses, including RBS Citizens and the EC mandated branch divestment now known as Williams & Glyn, and assets and the price achieved for such disposals will be dependent on prevailing economic and market conditions, which remain volatile. As a result there is no assurance that the Group will be able to sell or run down (as applicable) the businesses it has planned to sell or exit or asset portfolios it is seeking to sell either on favourable economic terms to the Group or at all. Material tax or other contingent liabilities could arise on the disposal or run-down of assets or businesses and there is no assurance that any conditions precedent agreed will be satisfied, or consents and approvals required will be obtained in a timely manner, or at all. There is consequently a risk that the Group may fail to complete such disposals within time frames envisaged by the Group, its regulators and the EC.

The Group may be exposed to deteriorations in businesses or portfolios being sold between the announcement of the disposal and its completion, which period may be lengthy and may span many months. In addition, the Group may be exposed to certain risks, including risks arising out of ongoing liabilities and obligations, breaches of covenants, representations and warranties, indemnity claims, transitional services arrangements and redundancy or other transaction related costs.

The occurrence of any of the risks described above could negatively affect the Group's ability to implement its new strategic plan and achieve its capital targets and could have a material adverse effect on the Group's business, results of operations, financial condition and cash flows. There can also be no assurance that if the Group is able to execute its strategic plan that the new strategy will ultimately be successful or beneficial to the Group.

Additional information

Risk factors continued

The Group is subject to political risks

The Group and The Royal Bank of Scotland plc (“RBS” or the “Royal Bank”), its principal operating subsidiary, are both headquartered and incorporated in Scotland. The Scottish Government is holding a referendum in September 2014 on the question of Scottish independence from the UK. Although the outcome of such referendum is uncertain, subject to any mitigating factors, the uncertainties resulting from an affirmative vote in favour of independence would be likely to significantly impact the Group’s credit ratings and could also impact the fiscal, monetary, legal and regulatory landscape to which the Group is subject. Were Scotland to become independent, it may also affect Scotland’s status in the EU. The occurrence of any of the impacts above could significantly impact the Group’s costs and would have a material adverse effect on the Group’s business, financial condition, results of operations and prospects.

The Group is subject to a number of legal, regulatory and governmental actions and investigations. Unfavourable outcomes in such actions and investigations could have a material adverse effect on the Group’s operating results or reputation

The Group’s operations are diverse and complex, and it operates in legal and regulatory environments that expose it to potentially significant litigation, regulatory and governmental investigations and other regulatory risk. As a result, the Group has recently settled a number of legal and regulatory investigations and is, and may in the future be, involved in a number of legal and regulatory proceedings and investigations in the UK, the EU, the US and other jurisdictions.

The Group is involved in ongoing class action litigation, investigations into foreign exchange trading and rate setting activities, continuing LIBOR related litigation and investigations, securitisation and securities related litigation, and anti-money laundering, sanctions, mis-selling and compliance related investigations, in addition to a number of other matters. In respect of the LIBOR and other trading rate-related investigations, the Group reached settlements on 6 February 2013 with the Financial Services Authority, the Commodity Futures Trading Association and the United States Department of Justice and on 4 December 2013 with the EC. In addition, the Group and the Royal Bank reached a settlement with the Board of Governors of the Federal Reserve System, the New York State Department of Financial Services and the Office of Foreign Assets Control with respect to the Royal Bank’s historical compliance with US economic sanction regulations outside the United States. The Group continues to cooperate with these and other governmental and regulatory authorities in connection with ongoing investigations and the probable outcome is that it will incur additional financial penalties which may be material.

Legal, governmental and regulatory proceedings and investigations are subject to many uncertainties, and their outcomes, including the timing and amount of fines or settlements, which may be material, are often difficult to predict, particularly in the early stages of a case or investigation. Adverse regulatory proceedings or adverse judgments in litigation could result in restrictions or limitations on the Group’s operations or have a significant effect on the Group’s reputation, results of operations and capital position. It is expected that the Group will continue to have a material exposure to legacy litigation and regulatory matter proceedings in the medium term. For more detail on certain of the Group’s ongoing legal, governmental and regulatory proceedings, see pages 466 to 474.

The Group may be required to increase provisions in relation to ongoing legal proceedings, investigations and governmental and regulatory matters. In Q4 2013, the Group booked a £1.9 billion provision to cover various claims and conduct related matters affecting Group companies, primarily those related to mortgage-backed securities and securities related litigation, following recent third party litigation settlements and regulatory decisions. It also increased its provision for Payment Protection Insurance redress and related costs by an additional £465 million for a cumulative provision of £3.1 billion. The provision for Interest Rate Hedging Products redress and administration costs was also increased to be a cumulative provision of £1.25 billion at 31 December 2013. Significant increases in provisions may harm the Group’s reputation and may have an adverse effect on the Group’s financial condition and

results of operations.

The Group, like many other financial institutions, has come under greater regulatory scrutiny in recent years and expects that environment to continue for the foreseeable future, particularly as it relates to compliance with historical, new and existing corporate governance, employee compensation, conduct of business, anti-money laundering and anti-terrorism laws and regulations, as well as the provisions of applicable sanctions programmes. Past or current failure to comply with any one or more of these laws or regulations could have a significant adverse effect on the Group's reputation, financial condition and results of operations.

The Group could fail to attract or retain senior management, which may include members of the Board, or other key employees, and it may suffer if it does not maintain good employee relations
The Group's ability to implement its strategy and its future success depends on its ability to attract, retain and remunerate highly skilled and qualified personnel, including its senior management, which include directors and other key employees, competitively with its peers. This cannot be guaranteed, particularly in light of heightened regulatory oversight of banks and heightened scrutiny of, and (in some cases) restrictions placed upon, management and employee compensation arrangements, in particular those in receipt of Government support (such as the Group).

In addition to the effects of such measures on the Group's ability to retain senior management and other key employees, the marketplace for skilled personnel is more competitive, which means the cost of hiring, training and retaining skilled personnel may continue to increase. The failure to attract or retain a sufficient number of appropriately skilled personnel could place the Group at a significant competitive disadvantage and prevent the Group from successfully implementing its strategy, which could have a material adverse effect on the Group's financial condition and results of operations.

During 2013 the Group replaced its Group Chief Executive, Group Finance Director and Chief Risk Officer and its newly appointed Group Finance Director (October 2013) resigned. A new Chief Financial Officer was appointed with effect from 19 May 2014. The Group's changing strategy, particularly with respect to its Markets business and recently announced disposition of RBS Citizens, has led to the exodus of talented staff. The lack of continuity of senior management and the loss of important personnel within the Group could have an adverse impact on the implementation of the Group's strategic objectives and regulatory commitments.

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Additional information

Risk factors continued
In addition, certain of the Group's employees in the UK, continental Europe and other jurisdictions in which the Group operates are represented by employee representative bodies, including trade unions. Engagement with its employees and such bodies is important to the Group and a breakdown of these relationships could adversely affect the Group's business, reputation and results.

Operational risks are inherent in the Group's businesses
Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. The Group has complex and geographically diverse operations and operational risk and losses can result from internal and external fraud, errors by employees or third parties, failure to document transactions properly or to obtain proper authorisation, failure to comply with applicable regulatory requirements and conduct of business rules (including those arising out of anti-bribery, anti-money laundering and anti-terrorism legislation, as well as the provisions of applicable sanctions programmes), equipment failures, business continuity and data security system failures, natural disasters or the inadequacy or failure of systems and controls, including those of the Group's suppliers or counterparties. Although the Group has implemented risk controls and loss mitigation actions, and substantial resources are devoted to developing efficient procedures, to identify and rectify weaknesses in existing procedures and to train staff, it is not possible to be certain that such actions have been or will be effective in controlling each of the operational risks faced by the Group. Ineffective management of operational risks could have a material adverse effect on the Group's business, financial condition and results of operations.

The Group operates in markets that are highly competitive and its business and results of operations may be adversely affected
The competitive landscape for banks and other financial institutions in the UK, the US and throughout the rest of Europe is subject to rapid change and recent regulatory and legal changes are likely to result in new market participants and changed competitive dynamics in certain key areas, such as in retail banking in the UK. The competitive landscape in the UK will be particularly influenced by the UK government's implementation of the recommendations on competition included in the final report of the Independent Commission on Banking (ICB), including ring-fencing and other customer protection measures addressed in the Banking Reform Act 2013 which became law in the United Kingdom on 18 December 2013 and will be implemented through secondary legislation due to be completed by May 2015. In order to compete effectively, certain financial institutions may seek to consolidate their businesses or assets with other parties. This consolidation, in combination with the introduction of new entrants into the markets in which the Group operates is likely to increase competitive pressures on the Group.

In addition, certain competitors may have stronger and more efficient operations, including better IT systems allowing them to implement innovative technologies for delivering services to their customers, and may have access to lower cost funding and/or be able to attract deposits on more favourable terms than the Group. Furthermore, the Group's competitors may be better able to attract and retain clients and key employees, which may have a negative impact on the Group's relative performance and future prospects. In addition, recent and future disposals and restructurings by the Group and the compensation structure and restrictions imposed on the Group may also have an impact on its ability to compete effectively.

These and other changes to the competitive landscape could adversely affect the Group's business, margins, profitability, financial condition and prospects.

The Group's businesses and performance can be negatively affected by actual or perceived global economic and financial market conditions

The Group's businesses and performance are affected by local and global economic conditions, perceptions of those conditions and future economic prospects. The outlook for the global economy over the near to medium-term is for steady growth. Prospects for the UK and the US in 2014 are the strongest among the G7. The outlook for Ireland is improving but remains challenging. Risks to growth and stability stem mainly from continued imbalances – among and within countries – and from uncertainty about how economies will respond as the extraordinary monetary policy measures implemented during the crisis are unwound. The Group's businesses and performance are also affected by financial market conditions. Capital and credit markets around the world have been relatively stable since 2012. Although the risk of sovereign default relating to certain EU member states diminished during 2013, a number of EU countries including the UK had their credit ratings downgraded, and the lingering risk of a sovereign default continues to pose a threat to capital and credit markets. In addition, in response to actions of central banks, in particular the US Federal Reserve's actions with respect to tapering of its debt purchase program, there have been short periods of rapid movements in interest rates and significant sharp falls on equity markets and further market volatility is likely as tapering continues.

Challenging economic and market conditions create a difficult operating environment for the Group's businesses, which is characterised by:

- reduced activity levels, additional write-downs and impairment charges and lower profitability, especially in combination with regulatory changes or action of market participants, which either alone or collectively may restrict the ability of the Group to access funding and liquidity;

- central bank actions to engender economic growth which have resulted in a prolonged period of low interest rates constraining, through margin compression and low returns on assets, the interest income earned on the Group's interest earning assets; and

- the risk of increased volatility in yields and asset valuations as central banks start/accelerate the process of tightening or unwinding historically unprecedented loose monetary policy or extraordinary measures. The resulting environment of uncertainty for the market and consumers will lead to challenging trading and market conditions.

In particular, should economic recovery stagnate, particularly in the Group's key markets, or the scope and severity of the adverse economic conditions currently experienced by a number of EU member states and elsewhere worsen, the risks faced by the Group would be exacerbated. Developments relating to the current economic conditions and the risk of a return to a volatile financial environment, including those discussed above, could have a material adverse effect on the Group's business, financial condition, results of operations and prospects.

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Additional information

Risk factors continued

The Group has significant exposure to a weakening of the nascent economic recovery in Europe

In Europe, countries such as Ireland, Italy, Greece, Portugal and Spain have been particularly affected by the recent macroeconomic and financial conditions. Although the risk of sovereign default continued to decline in 2013 due to the continuing actions of the European Central Bank (ECB) and the EU, the risk of default remains and yields on the sovereign debt of many EU member states have remained well above pre-crisis levels. This default risk raises concerns, and the possibility remains that the contagion effect spreads to other EU economies, including the UK economy, that the euro could be abandoned as a currency by one or more countries that have already adopted its use, or in an extreme scenario, that the abandonment of the euro could result in the dissolution of the European Monetary Union (EMU). This would lead to the re-introduction of individual currencies in one or more EMU member states.

The effects on the UK, European and global economies of any potential dissolution of the EMU, exit of one or more EU member states from the EMU and the redenomination of financial instruments from the euro to a different currency, are impossible to predict fully. However, if any such events were to occur they would likely:

- result in significant market dislocation;
- heighten counterparty risk;
- result in downgrades of credit ratings for European borrowers, giving rise to increases in credit spreads and decreases in security values;
- disrupt and adversely affect the economic activity of the UK and other European markets; and
- adversely affect the management of market risk and in particular asset and liability management due, in part, to redenomination of financial assets and liabilities and the potential for mismatch.

The occurrence of any of these events would have a material adverse effect on the Group's financial condition, results of operations and prospects.

The Group has significant exposure to private sector and public sector customers and counterparties in the eurozone (at 31 December 2013 principally Ireland (£39.8 billion), Germany (£31.1 billion), The Netherlands (£25.9 billion), France (£23.8 billion), Spain (£11.2 billion) and Italy (£7.1 billion)). The Group's private and public sector exposures in the eurozone have been, and may in the future be, affected by credit losses and restructuring of their terms, principal, interest and maturity. In 2011, this included an impairment loss of £1.1 billion in respect of its holding of Greek government bonds. The public sector exposure comprises exposure to central and local governments and deposits with central banks. At 31 December 2013, the Group's eurozone government debt exposure amounted to £15.9 billion (largely AFS and HFT debt securities exposure) including aggregate exposure of £2.8 billion to Ireland, Spain, Italy, Portugal Greece and Cyprus (largely net HFT debt securities exposure to Italy and Spain).

The Group and its UK bank subsidiaries are subject to the provisions of the Banking Act 2009, as amended by the Banking Reform Act 2013, which includes special resolution powers including nationalisation and bail-in

Under the Banking Act 2009, substantial powers have been granted to HM Treasury, the Bank of England and the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) (together, the "Authorities") as part of a special resolution regime. These powers enable the Authorities to deal with and stabilise certain deposit-taking UK incorporated institutions that are failing, or are likely to fail, to satisfy the threshold conditions (within the meaning of section 41 of the Financial Services and Markets Act 2000 (FSMA), which are the conditions that a relevant entity

must satisfy in order to obtain its authorisation to perform regulated activities). The special resolution regime consists of three stabilisation options: (i) transfer of all or part of the business of the relevant entity and/or the securities of the relevant entity to a private sector purchaser, (ii) transfer of all or part of the business of the relevant entity to a 'bridge bank' wholly owned by the Bank of England and (iii) temporary public ownership (nationalisation) of the relevant entity. If HM Treasury decides to take the Group into temporary public ownership pursuant to the powers granted under the Banking Act 2009, it may take various actions in relation to any securities without the consent of holders of the securities.

Among the changes introduced by the Banking Reform Act 2013, the Banking Act 2009 is amended to insert a bail-in option as part of the powers of the UK resolution authority which option will come into force on such date as shall be stipulated by HM Treasury. The bail-in option will be introduced as an additional power available to the Bank of England to enable it to recapitalise a failed institution by allocating losses to its shareholders and unsecured creditors in a manner that seeks to respect the hierarchy of claims in liquidation. The bail-in option includes the power to cancel a liability, to modify the form of a liability (including the power to convert a liability from one form to another) or to provide that a contract under which the institution has a liability is to have effect as if a specified right had been exercised under it, each for the purposes of reducing, deferring or cancelling the liabilities of the bank under resolution, as well as to transfer a liability. The Banking Reform Act 2013 is consistent with the range of tools that Member States will be required to make available to their resolution authorities under the Recovery and Resolution Directive (RRD), although since the RRD remains in draft form, there can be no assurance that the bail-in option added under the Banking Reform Act will not need to change to comply with the RRD.

The Group is subject to a variety of risks as a result of implementing the State Aid restructuring plan
The Group was required to obtain State Aid approval for the aid given to the Group by HM Treasury as part of the placing and open offer undertaken by the Group in December 2008, the issuance to HM Treasury of £25.5 billion of B shares in the capital of the Group which are, subject to certain terms and conditions, convertible into ordinary shares in the share capital of the Group and a contingent commitment by HM Treasury (which has now been terminated) to subscribe for up to an additional £8 billion of B Shares if certain conditions are met in addition to the Group's participation in the Asset Protection Scheme (APS) (which has now been terminated). In that context, as part of the terms of the State Aid approval, the Group, together with HM Treasury, agreed the terms of a restructuring plan.

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Additional information

Risk factors continued
The Group is subject to a variety of risks as a result of implementing the State Aid restructuring plan, including required asset disposals. In particular, the Group agreed to undertake a series of measures including the disposal of a number of businesses now completed, the disposal of Direct Line Group (DLG) and the disposal of the Royal Bank branch-based business in England and Wales and the National Westminster Bank Plc (NatWest) branches in Scotland, along with the direct and other small and medium-size enterprise (SME) customers and certain mid-corporate customers across the UK. The initial sale of 34.7% of DLG through an IPO was completed in October 2012, with further sales in March and September 2013 reducing the Group's stake to 28.5% at year-end, marking the continuation of the Group's disposal strategy as part of its on-going delivery against EU-mandated commitments. In respect of the Royal Bank and NatWest branch-based business, the divestment process continues to progress following the withdrawal of its original buyer in October 2012 and a pre-IPO investment by a consortium of investors was announced in September 2013. RBS announced on 9 April 2014 that it had entered into an agreement ('DAS Retirement Agreement') with Her Majesty's Treasury ('HMT') to provide for the future retirement of the Dividend Access Share ('DAS'). The EC concluded that the new arrangements for the eventual retirement of the DAS did not constitute new State aid and approved the changes to RBS's restructuring plan in its State Aid Amendment Decision of 9 April 2014. RBS has entered into a Revised State Aid Commitment Deed under which it undertakes to do all acts and things necessary to ensure that HMT is able to comply with the revised State aid commitments made by HMT to the EC. HMT's obligations to the EC and RBS's commitments under the Revised State Aid Commitment Deed will remain in effect even if the DAS Retirement Agreement is not approved by independent shareholders.

There is no assurance that the price that the Group receives or has received for any assets sold pursuant to the State Aid restructuring plan will be or has been at a level the Group considers adequate or which it could obtain in circumstances in which the Group was not required to sell such assets in order to implement the State Aid restructuring plan or if such sale were not subject to the restrictions contained in the terms thereof. Further, if the Group fails to complete any of the required disposals within the agreed timeframes for such disposals, or fails to negotiate extensions in respect of such disposals, under the terms of the State Aid approval, a divestiture trustee may be empowered to conduct the disposals, with the mandate to complete the disposal at no minimum price.

Furthermore, if the Group is unable to comply with the terms of the State Aid approval, it could constitute a misuse of aid. In circumstances where the EC doubts that the Group is complying with the terms of the State Aid approval, it may open a formal investigation. At the conclusion of any such investigation, if the EC decided that there had been misuse of aid, it could issue a decision requiring HM Treasury to recover the misused aid, which could have a material adverse impact on the Group.

In implementing the State Aid restructuring plan, the Group has lost, and will continue to lose, existing customers, deposits and other assets (both directly through sale and potentially through the impact on the rest of the Group's business arising from implementing the State Aid restructuring plan) and the potential for realising additional associated revenues and margins that it otherwise might have achieved in the absence of such disposals.

The disposal of Global Merchant Services and RBS Sempra Commodities reduced the Group's assets by approximately £13.0 billion and £2.4 billion, respectively (based on total assets immediately prior to disposal). The quantum of assets and deposits that would be included in a divestment of the Royal Bank branch-based business in England and Wales and the NatWest branches in Scotland is not certain. However, at 31 December 2013, this business included approximately £19.4 billion of assets, £23.2 billion of deposits and two million customers.

The implementation of the State Aid restructuring plan may also result in disruption to the retained business and give rise to significant strain on management, employee, operational and financial resources, impacting customers and

employees and giving rise to separation costs which could be substantial.

The implementation of the State Aid restructuring plan may result in the emergence of one or more new viable competitors or a material strengthening of one or more of the Group's existing competitors in the Group's markets. The effect of this on the Group's future competitive position, revenues and margins is uncertain and there could be an adverse effect on the Group's operations and financial condition and its business generally.

The occurrence of any of the risks described above could have a material adverse effect on the Group's business, results of operations, financial condition, capital position and competitive position.

HM Treasury (or UK Financial Investments Limited (UKFI) on its behalf) may be able to exercise a significant degree of influence over the Group and any proposed offer or sale of its interests may affect the price of securities issued by the Group
The UK Government, through HM Treasury, currently holds 63.9% of the issued ordinary share capital of the Group. On 22 December 2009, the Group issued £25.5 billion of B Shares to the UK Government. The B Shares are convertible, at the option of the holder at any time, into ordinary shares. The UK Government has agreed that it shall not exercise the rights of conversion in respect of the B Shares if and to the extent that following any such conversion it would hold more than 75% of the total issued shares in the Group. Any breach of this agreement could result in the delisting of the Group from the Official List of the UK Listing Authority and potentially other exchanges where its securities are currently listed and traded. HM Treasury (or the UKFI on its behalf) may sell all or a part of the ordinary shares that it owns at any time. Any offers or sale of a substantial number of ordinary shares or securities convertible or exchangeable into ordinary shares by or on behalf of HM Treasury, or an expectation that it may undertake such an offer or sale, could negatively affect prevailing market prices for securities issued by the Group.

In addition, UKFI manages HM Treasury's shareholder relationship with the Group and, although HM Treasury has indicated that it intends to respect the commercial decisions of the Group and that the Group will continue to have its own independent board of directors and management team determining its own strategy, should its current intentions change, HM Treasury's position as a majority shareholder (and UKFI's position as manager of this shareholding) means that HM Treasury or UKFI may be able to exercise a significant degree of influence over, among other things, the election of directors and appointment of senior management, dividend policy, remuneration policy, or limiting the Group's operations. The manner in which HM Treasury or UKFI exercises HM Treasury's rights as majority shareholder could give rise to conflict between the interests of HM Treasury and the interests of other shareholders. The Board has a duty to promote the success of the Group for the benefit of its members as a whole.

Additional information

Risk factors continued

The Group is subject to other global risks

By virtue of the Group's global presence, the Group is exposed to risks arising out of geopolitical events, such as the existence of trade barriers, the implementation of exchange controls and other measures taken by sovereign governments that can hinder economic or financial activity levels. Furthermore, unfavourable political, military or diplomatic events, armed conflict, pandemics and terrorist acts and threats, and the response to them by governments could also adversely affect levels of economic activity and have an adverse effect upon the Group's business, financial condition and results of operations.

The Group's business performance could be adversely affected if its capital is not managed effectively or as a result of changes to capital adequacy and liquidity requirements

Effective management of the Group's capital is critical to its ability to operate its businesses, and to pursue its strategy of returning to standalone strength. The Group is required by regulators in the UK, the US and other jurisdictions in which it undertakes regulated activities to maintain adequate capital resources. The maintenance of adequate capital is also necessary for the Group's financial flexibility in the face of continuing turbulence and uncertainty in the global economy and specifically in its core UK, US and European markets.

The Basel Committee on Banking Supervision's package of reforms to the regulatory capital framework raises the quantity and quality of capital required to be held by a financial institution with an emphasis on Common Equity Tier 1 (CET1) capital and introduces an additional requirement for both a capital conservation buffer and a countercyclical buffer to be met with CET1 capital. The Basel Committee also has proposed that global systemically important banks (GSIBs) be subject to an additional CET1 capital requirement, depending on a bank's systemic importance. The Group has been identified by the Financial Stability Board (FSB) as a GSIB. The FSB list of GSIBs is updated annually, based on new data and changes to methodology. The November 2013 update placed the Group in the second from bottom bucket of GSIBs, subjecting it to more intensive oversight and supervision and requiring to have additional loss absorption capacity of 1.5% in CET1, to be phased in from the beginning of 2016.

The Basel III rules are dependent on local implementation. The EU legislative package of proposals to implement the changes with a new Directive and Regulation (collectively known as "CRD IV") was finalised in June 2013 paving the way for implementation of Basel III in the EU from 1 January 2014, subject to a number of transitional provisions and clarifications. A number of the requirements introduced under CRD IV will be further supplemented through the Regulatory and Implementing Technical Standards (RTSs/ITSs) produced by the European Banking Authority (EBA) which are not yet finalised. The EU rules deviate from the Basel III rules in certain aspects (e.g. in imposing an additional systemic risk buffer), and provide national flexibility to apply more stringent prudential requirements than set in the EU (or Basel) framework.

Since 1 January 2014, the Group has been required to comply with the requirements of CRD IV, the EBA's RTSs and ITSs and the PRA's Policy Statement PS 7/13 (Strengthening capital standards: implementing CRD IV, feedback and final rules). The Group must also operate by reference to the capital and leverage requirements set out by the PRA in its supervisory statement SS3/13 issued in November 2013 which is applicable to the eight major UK banks and building societies.

The provisions of PS7/13 embody PRA requirements to accelerate the introduction and phasing in of certain transitional provisions of CRD IV. The policy statement also sets out the intent of the PRA in respect of capital buffers as well as the approach to so-called Pillar 2 risks. By their nature, Pillar 2A risks, which contribute to the scaling of the Group's Individual Capital Guidance from the PRA, can include risks which the Group considers would only materialise at the point of non-viability, an example being pension obligation risk. PS7/13 does not recognise

this distinction and requires that Pillar 2A risks are met by at least 56% of CET1 by 1 January 2015.

The Banking Reform Act 2013, implementing the ICB recommendations, will introduce mechanisms requiring systemically important UK banks and building societies to hold loss-absorbing capacity, in addition to the capital held to satisfy their capital requirements under CRD IV as implemented by the PRA. These requirements, as well as other recommendations of the ICB, are to be established through secondary legislation and are expected to be phased in between 2015 and 2019. The US Federal Reserve has also recently adopted new rules relating to how it will regulate the US operations of foreign banking operations such as the Group that may affect the capital requirements of the Group's operations in the US. As the implementation of the ICB recommendations is the subject of secondary legislation not yet adopted and the Federal Reserve has only recently adopted its final rules, the Group cannot predict the impact such rules will have on the Group's overall capital requirements or how they will affect the Group's compliance with applicable capital and loss absorbency requirements.

To the extent the Group has estimated the indicative impact that CRD IV rules may have on its risk-weighted assets and capital ratios, such estimates are preliminary and subject to uncertainties and may change. In particular, the estimates assume mitigating actions will be taken by the Group (such as deleveraging of legacy positions and securitisations, including RCR as well as other actions being taken to de-risk market and counterparty exposures), which may not occur as anticipated, in a timely manner, or at all.

The Basel Committee changes and other future changes to capital adequacy and liquidity requirements in the European Union, the UK, the US and in other jurisdictions in which the Group operates, including any application of increasingly stringent stress case scenarios by the regulators in the UK, the US and other jurisdictions in which the Group undertakes regulated activities, may require the Group to raise additional Tier 1 (including CET1) and Tier 2 capital by way of further issuances of securities, and may result in existing Tier 1 and Tier 2 securities issued by the Group ceasing to count towards the Group's regulatory capital, either at the same level as at present or at all.

Additional information

Risk factors continued

The requirement to raise additional CET1 capital, which could be mandated by the Group's regulators, could have a number of negative consequences for the Group and its shareholders, including impairing the Group's ability to pay dividends on, or make other distributions in respect of, ordinary shares and diluting the ownership of existing shareholders of the Group. If the Group is unable to raise the requisite Tier 1 and Tier 2 capital, it may be required to reduce further the amount of its risk-weighted assets or total assets and engage in the disposal of core and other non-core businesses, which may not occur on a timely basis or achieve prices which would otherwise be attractive to the Group.

At 31 December 2013, the Group's Tier 1 and Core Tier 1 capital ratios were 13.1% and 10.9%, respectively, calculated in accordance with PRA requirements. On a fully loaded Basel III basis, the Group's equivalent CET1 ratio was 8.6%. The Group continues to target a fully loaded Basel III CET1 ratio of approximately 11% by the end of 2015 and to be at 12% or above by the end of 2016. The Group's ability to achieve such targets will turn on a number of factors, including the implementation of the Group's strategy which calls for a significant downsizing of the Group in part through the sale of RBS Citizens in the U.S. See "Forward looking Statements" and "The Group's ability to implement its new strategic plan and achieve its capital goals depends on the success of the Group's plans to refocus on its core strengths and the timely divestment of RBS Citizens".

Any change that limits the Group's ability to manage effectively its balance sheet and capital resources going forward (including, for example, reductions in profits and retained earnings as a result of write-downs or otherwise, increases in risk-weighted assets, regulatory changes, actions by regulators, delays in the disposal of certain key assets or the inability to syndicate loans as a result of market conditions, a growth in unfunded pension exposures or otherwise), to implement its capital plan or to access funding sources, could have a material adverse effect on its financial condition and regulatory capital position.

The Group's borrowing costs, its access to the debt capital markets and its liquidity depend significantly on its and the UK Government's credit ratings

The credit ratings of RBSG, RBS and other Group members have been subject to change and may change in the future, which could impact their cost of, access to and sources of financing and liquidity. A number of UK and other European financial institutions, including RBSG, the Royal Bank and other Group members, have been downgraded multiple times during the last three years in connection with rating methodology changes, a review of systemic support assumptions incorporated into bank ratings and the likelihood, in the case of UK banks, that the UK Government is more likely in the future to make greater use of its resolution tools to allow burden sharing with debt holders. Most recently credit ratings of RBSG, the Royal Bank and other Group members were downgraded in connection with the Group's creation of RCR, coupled with concerns about execution risk, litigation risk and the potential for conduct related fines. Furthermore, subject to any mitigating factors, uncertainties resulting from an affirmative vote in favour of Scottish independence would be likely to have a negative impact on the credit ratings of RBSG and the Royal Bank.

Rating agencies continue to evaluate the rating methodologies applicable to UK and European financial institutions and any change in such rating agencies' methodologies could materially adversely affect the credit ratings of Group companies. Any further reductions in the long-term or short-term credit ratings of RBSG or one of its principal subsidiaries (particularly the Royal Bank) would increase its borrowing costs, require the Group to replace funding lost due to the downgrade, which may include the loss of customer deposits, and may also limit the Group's access to capital and money markets and trigger additional collateral requirements in derivatives contracts and other secured funding arrangements. At 31 December 2013, a simultaneous one notch long-term and associated short-term downgrade in the credit ratings of RBSG and the Royal Bank by the three main ratings agencies would have required

the Group to post estimated additional collateral of £10 billion, without taking account of mitigating action by management.

Any downgrade in the UK Government's credit ratings could adversely affect the credit ratings of Group companies and may have the effects noted above. In December 2012, Standard & Poor's placed the UK's AAA credit rating on credit watch, with negative outlook and, in February 2013, Moody's downgraded the UK's credit rating one notch to Aa1. Credit ratings of RBSG, the Royal Bank, The Royal Bank of Scotland N.V. (RBS N.V.), Ulster Bank Limited and RBS Citizens are also important to the Group when competing in certain markets, such as over-the-counter derivatives. As a result, any further reductions in RBSG's long-term or short-term credit ratings or those of its principal subsidiaries could adversely affect the Group's access to liquidity and its competitive position, increase its funding costs and have a material adverse impact on the Group's earnings, cash flow and financial condition.

The Group's ability to meet its obligations including its funding commitments depends on the Group's ability to access sources of liquidity and funding

Liquidity risk is the risk that a bank will be unable to meet its obligations, including funding commitments, as they fall due. This risk is inherent in banking operations and can be heightened by a number of factors, including an over reliance on a particular source of wholesale funding (including, for example, short-term and overnight funding), changes in credit ratings or market-wide phenomena such as market dislocation and major disasters. Credit markets worldwide, including interbank markets, have experienced severe reductions in liquidity and term-funding during prolonged periods in recent years. Although credit markets continued to improve during 2013 (in part as a result of measures taken by central banks around the world, including the ECB), and the Group's overall liquidity position remained strong, certain European banks, in particular from the peripheral countries of Spain, Portugal, Greece, Italy and Ireland, remained reliant on central banks as one of their principal sources of liquidity. Although the measures taken by Central Banks have had a positive impact, the risk of volatility returning to the global credit markets remains.

Additional information

Risk factors continued

The market perception of bank credit risk has changed significantly as a result of the financial crisis and banks that are deemed by the market to be riskier have had to issue debt at a premium. Any uncertainty regarding the perception of credit risk across financial institutions may lead to reductions in levels of interbank lending and associated term maturities and may restrict the Group's access to traditional sources of funding or increase the costs of accessing such funding. The ability of the Group's regulator to bail-in senior debt which may be exercised as soon as either the provisions of the Banking Reform Act 2013 are implemented through secondary legislation or the RRD comes into effect, may also increase investors' perception of risk and hence affect the availability and cost of funding for the Group.

The Group's liquidity and funding management focuses, among other things, on maintaining a diverse and appropriate funding strategy for its assets in line with the Group's wider strategic plan. The Group has, at times, been required to rely on shorter-term and overnight funding with a consequent reduction in overall liquidity, and to increase its recourse to liquidity schemes provided by central banks. Such schemes require the pledging of assets as collateral and changes to asset valuations or eligibility criteria can negatively impact the available assets and reduce available liquidity access particularly during periods of stress when such lines may be needed most. Although conditions have improved, there have been recent periods where corporate and financial institution counterparties have reduced their credit exposures to banks and other financial institutions, limiting the availability of these sources of funding. Under certain circumstances, the Group may need to seek funds from alternative sources potentially at higher costs than has previously been the case, and/or with higher collateral or may be required to consider disposals of other assets not previously identified for disposal to reduce its funding commitments.

The Group relies on customer deposits to meet a considerable portion of its funding and it has targeted maintaining a loan to deposit ratio of around 100%. The level of deposits may fluctuate due to certain factors outside the Group's control, such as a loss of confidence, increasing competitive pressures for retail customer deposits or the encouraged or mandated repatriation of deposits by foreign wholesale or central bank depositors, which could result in a significant outflow of deposits within a short period of time. An inability to grow, or any material decrease in, the Group's deposits could, particularly if accompanied by one of the other factors described above, have a material adverse impact on the Group's ability to satisfy its liquidity needs.

The occurrence of any of the risks described above could have a material adverse impact on the Group's financial condition and results of operations.

The regulatory capital treatment of certain deferred tax assets recognised by the Group depends on there being no adverse changes to regulatory requirements

While there was no restriction on the recognition of deferred tax assets at 31 December 2013, the Capital Requirements Regulation, which took effect from 1 January 2014, requires the deduction in full from CET1 capital of deferred tax assets that rely on future profitability and do not arise from temporary differences (for example, deferred tax assets related to trading losses). Other deferred tax assets which rely on future profitability and arise from temporary differences are subject to a threshold test and only the amount in excess of the threshold is deducted from CET1 capital. The PRA has not adopted the transitional provisions in relation to the change in the treatment of deferred tax assets and therefore the threshold deduction has the potential to impact CET1 capital from 1 January 2014.

Each of the Group's businesses is subject to substantial regulation and oversight. Significant regulatory developments and changes in the approach of the Group's key regulators has had and is likely to continue to have a material adverse

effect on how the Group conducts its business and on its results of operations and financial condition
The Group is subject to extensive financial services laws, regulations, corporate governance requirements, administrative actions and policies in each jurisdiction in which it operates. Many of these have been changing and are subject to further change, particularly in the current regulatory and market environment, where there have been unprecedented levels of government intervention (including nationalisations and injections of government capital), changes to the regulations governing financial institutions and reviews of the industry, in the UK, in many other European countries, the US and at the EU level.

As a result of the environment in which the Group operates, increasing regulatory focus in certain areas and ongoing and possible future changes in the financial services regulatory landscape (including requirements imposed by virtue of the Group's participation in government or regulator-led initiatives), the Group is facing greater regulation and scrutiny in the UK, the US and other countries in which it operates (including in relation to compliance with anti-bribery, anti-money laundering, anti-terrorism and other similar sanctions regimes).

Although it is difficult to predict with certainty the effect that all of the recent regulatory changes, developments and heightened levels of public and regulatory scrutiny will have on the Group, the enactment of legislation and regulations in the UK and the EU, the other parts of Europe in which the Group operates and the US (such as the bank levy and Banking Reform Act 2013 in the UK, the RRD and CRD IV or the Dodd-Frank Wall Street Reform and Consumer Protection Act in the US) has resulted in increased capital and liquidity requirements, changes in other regulatory requirements and increased operating costs and has impacted, and will continue to impact, products offerings and business models. The Group may not be able to meet increased capital requirements by reducing lending which could result in the Group being obliged to continue to deploy capital in less profitable areas than it might otherwise have chosen. Such changes may also result in an increased number of regulatory investigations and proceedings. Any of these developments could have an impact on how the Group conducts its business, applicable authorisations and licences, the products and services it offers, its reputation, the value of its assets, and a material adverse effect on its funding costs and its results of operations and financial condition.

Additional information

Risk factors continued

Areas in which, and examples of where, governmental policies, regulatory and accounting changes and increased public and regulatory scrutiny could have an adverse impact (some of which could be material) on the Group include those set out above as well as the following:

- the monetary, fiscal, interest rate and other policies of central banks and other governmental or regulatory bodies;
- requirements to separate retail banking from investment banking;
- restrictions on proprietary trading and similar activities within a commercial bank and/or a group which contains a commercial bank;
- restructuring certain of the Group's non-retail banking activities in jurisdictions outside the UK in order to satisfy local capital, liquidity and other prudential requirements;
- the design and potential implementation of government mandated recovery, resolution or insolvency regimes;
- the imposition of government imposed requirements and/or related fines and sanctions with respect to lending to the UK SME market and larger commercial and corporate entities and residential mortgage lending;
- requirements to operate in a way that prioritises objectives other than shareholder value creation;
- changes to financial reporting standards (including accounting standards), corporate governance requirements, corporate structures and conduct of business rules;
- the imposition of restrictions on the Group's ability to compensate its senior management and other employees;
- regulations relating to, and enforcement of, anti-bribery, anti-money laundering, anti-terrorism or other similar sanctions regimes;
- rules relating to foreign ownership, expropriation, nationalisation and confiscation of assets;
- other requirements or policies affecting the Group's profitability, such as the imposition of onerous compliance obligations, further restrictions on business growth, product offering, capital, liquidity or pricing;
- the introduction of, and changes to, taxes, levies or fees applicable to the Group's operations (such as the imposition of a financial transaction tax and changes in tax rates that reduce the value of deferred tax assets); and
- the regulation or endorsement of credit ratings used in the EU (whether issued by agencies in EU member states or in other countries, such as the US).

Changes in laws, rules or regulations, or in their interpretation or enforcement, or the implementation of new laws, rules or regulations, including contradictory laws, rules or regulations by key regulators in different jurisdictions, may have a material adverse effect on the Group's business, financial condition and results of operations. In addition, uncertainty and lack of international regulatory coordination as enhanced supervisory standards are developed and implemented may adversely affect the Group's ability to engage in effective business, capital and risk management planning.

The Group is subject to a number of regulatory initiatives which may adversely affect its business. The Independent Commission on Banking's final report on competition and structural reforms in the UK banking industry has been substantially adopted by the UK Government through the passage of the Banking Reform Act 2013. In addition other proposals to ring fence certain business activities and the US Federal Reserve's proposal for applying US capital, liquidity and enhanced prudential standards to certain of the Group's US operations together with the UK reforms could require structural changes to the Group's business. Any of these changes could have a material adverse effect on the Group.
The UK Government published a White Paper on Banking Reform in September 2012, outlining proposed structural reforms in the UK banking industry. The measures proposed were drawn in large part from the recommendations of the ICB, which was appointed by the UK Government in June 2010. The ICB published its final report to the Cabinet Committee on Banking Reform on 12 September 2011, which set out the ICB's views on possible reforms to improve stability and competition in UK banking. The final report made a number of recommendations, including in relation to (i) promotion of competition, (ii) increased loss absorbency (including bail-in) and (iii) the implementation of a ring-fence of retail banking operations.

The measures in relation to the promotion of competition are already largely in process, including the development of an industry mechanism to make it easier for customers to switch their personal current accounts to a different provider, which was introduced in September 2013.

Bail-in mechanisms, will, if used, affect the rights of creditors, including holders of senior and subordinated bonds, and shareholders in the event of the implementation of a resolution scheme or an insolvency and could thereby materially affect the price of such securities. Such mechanics are being implemented through the Banking Reform Act 2013 and will also be part of the RRD. The implementation of a ring-fence of retail banking operations is also included in the Banking Reform Act 2013. The Banking Reform Act 2013 provides primary enabling legislation in the short term with a view to completing the legislative framework for the ring-fence of retail banking operations by May 2015, requiring compliance as soon as practicable thereafter and setting a final deadline for full implementation by 2019.

Additional information

Risk factors continued
The impact of any final legislation on the Group is difficult to estimate with any precision at this stage. The Statutory Instruments setting out the scope of the ring-fence required by the Banking Reform Act 2013 are currently under discussion and final versions are expected to be published at some point in the summer of 2014. The PRA will have responsibility for drawing up the ring-fencing rules which will impact on the governance and operation of the ring-fenced bank. It is understood that the first consultation on the PRA rules will commence around the summer of 2014. It is also likely that ring-fencing certain of the Group's operations would require significant restructuring with the possible transfer of large numbers of customers between legal entities. Ring-fencing is also likely to entail changes to the structure of the Group's existing pension arrangements, so as to ensure that any ring-fenced and non-ring-fenced banks that may eventually be established should not be liable for each other's pension liabilities. Any such changes could result in additional costs and increased operational risks. It is possible that such ring-fencing, by itself, or taken together with the impact of other proposals contained in this legislation and other EU legislation that will apply to the Group could have a material adverse effect on the Group's structure and on the viability of certain businesses, in addition to the Group's results of operations, financial conditions and prospects.

On 29 January 2014, the EC published proposals on structural measures to improve the resilience of EU credit institutions which included potential separation of certain trading activities from retail banking operations. The proposal currently contemplates that member states having already implemented ring-fencing legislation, such as the UK, may apply for a derogation from the separation of trading activities provisions included in the proposals if they can satisfy the EC that such local legislation meets the objectives and requirements set out in the EU proposal. The timeline envisaged under the proposals would be the effective separation of other trading activities to apply as of 1 July 2018.

Under the US Federal Reserve's new rules which change how it regulates the US operations of large foreign banking groups (the "FBO Rules"), foreign banking organisations with total global consolidated assets of $50 billion or more ("Large FBOs") and Large FBOs with total US assets of $50 billion or more (excluding assets of US branches and agencies of a Large FBO's foreign banks and certain other US subsidiaries) will have to create a separately capitalised top-tier US intermediate holding company (IHC) that would hold all US bank and non-bank subsidiaries. The IHC would be subject to US capital, liquidity and other enhanced prudential standards on a consolidated basis. Among other things, an IHC will be subject to the same US risk based and leverage capital standards that apply to a US bank holding company.

The imposition of US capital, liquidity and other enhanced prudential standards, including capital planning and stress testing requirements, on an IHC of a Large FBO such as the Group that is subject to home country capital standards on a group-wide consolidated basis would likely give rise to challenging organisational and compliance issues and could make it more difficult to manage capital and liquidity efficiently on a global, consolidated basis. The foregoing is only one example of issues that the Group may confront as a result of the application of the FBO Rules to its US operations.

As a result of the adoption of the ring-fence proposals in the UK and the potential adoption of the other proposals described above, major changes to the Group's corporate structure, its business activities conducted in the UK and the US and potentially other jurisdictions where the Group operates, as well as changes to the Group's business model, are likely to be required. The changes include ring-fencing certain core banking activities in the UK from other activities of the Group as well as restructuring other operations within the Group in order to comply with these proposed new rules and regulations. The proposals, when adopted, are expected to take an extended period of time to put into place, to be costly to implement and may lack harmonisation, all of which could have a material adverse effect on the Group's structure, reputation, results of operations, financial condition and prospects.

The Group is subject to resolution procedures under current and proposed resolution and recovery schemes which may result in various actions being taken in relation to any securities of the Group, including the write off, write-down or conversion of the Group's securities
As a result of its status as a GSIFI and in accordance with current and proposed resolution and recovery schemes and the Prudential Standards issued by the PRA on 19 December 2013 on recovery and resolution planning, the Group was required to meet certain resolution planning requirements contemplating its possible failure by the end of 2012 and 2013 and will be required to meet others in 2014. The Group made the required submissions in 2012 to the Financial Services Authority (FSA) (now the PRA) and its US business made their required submissions to the Federal Reserve and the FDIC in H1 2013 and further submissions will be required to be made in 2014. Similar to other major financial institutions, both the Group and its key subsidiaries remain engaged in a constructive dialogue on resolution and recovery planning with key national regulators and other authorities. The Prudential Standards issued by the PRA may evolve over time to ensure continued consistency with the Financial Stability Board's (FSB) recommendations and the technical standards and guidelines produced by the European Banking Authority to implement the RRD.

In addition to the powers provided by the Banking Act 2009, as amended by the Banking Reform Act 2013, that include a bail-in power which could be implemented prior to January 2015, resolution powers will also be included in the RRD. The EU Member States, the European Parliament and the EC reached a political agreement as announced on 12 December 2013 on the RRD and on 15 April 2014 the European Parliament voted to approve the RRD in plenary session (which remains subject to technical finalisation and formal approval by the co-legislators) and current expectations are that the RRD will be finalised during the second quarter of 2014. The draft RRD includes a "bail-in" tool, which would give the relevant supervisory authorities the power to write down or write off claims (including debt securities issued by the Group and its subsidiaries) of certain unsecured creditors of a failing institution and/or to convert certain debt claims to equity. Except for the general bail-in tool, which is now expected to be implemented by 1 January 2016, it is currently contemplated that the measures set out in the draft RRD (including the power of authorities to write off or convert Additional Tier 1 and Tier 2 instruments) will be implemented with effect from 1 January 2015.

Additional information

Risk factors continued

Such bail-in mechanism, which is anticipated to be consistent with the powers granted under the Banking Reform Act 2013, pursuant to which losses would be imposed on shareholders and, as appropriate, creditors (including senior creditors) of the Group (through write-down or conversion into equity of liabilities including debt securities) would be used to recapitalise and restore the Group to solvency as well as other options, including those as set forth in the Banking Act 2009, as amended by the Banking Reform Act 2013, following the recommendations of the ICB. The methods for implementation of any resolution and recovery scheme remain the subject of significant debate, particularly for GSIFIs with complex cross border activities. Such debate includes whether the bail-in tool may be exercised through a single point of entry at the holding company or at various levels of the corporate structure of a GSIFI.

The potential impacts of these resolution and recovery powers may include the total loss of value of securities issued by the Group and, in addition for debt holders, the possible conversion into equity securities, and under certain circumstances the inability of the Group to perform its obligations under its securities. As these resolution and recovery measures remain subject to further implementation both at the European and UK level, changes may be made in the course of the legislative process, which may affect their impact on the Group and securities issued by the Group.

The Group’s operations are highly dependent on its information technology systems

The Group’s operations are dependent on the ability to process a very large number of transactions efficiently and accurately while complying with applicable laws and regulations where it does business. The proper functioning of the Group’s payment systems, financial and sanctions controls, risk management, credit analysis and reporting, accounting, customer service and other information technology systems, as well as the communication networks between its branches and main data processing centres, are critical to the Group’s operations. Critical system failure, any prolonged loss of service availability or any material breach of data security, particularly involving confidential customer data, could cause serious damage to the Group’s ability to service its clients, could result in significant compensation costs, could breach regulations under which the Group operates and could cause long-term damage to the Group’s business and brand.

For example, failure to protect the Group’s operations from cyber-attacks could result in the loss of customer data or other sensitive information. During 2013, the Group experienced a number of IT failures following a series of deliberate attacks which temporarily prevented RBS, RBS Citizens and NatWest customers from accessing their accounts or making payments. The Bank of England, the FCA and HM Treasury have identified cyber security as a systemic risk to the UK financial sector and highlighted the need for financial institutions to improve resilience to cyber-attacks. In addition to meeting the requirements of the Bank of England’s programme of work to improve and test financial institutions’ resilience to cyber-attacks due to be completed during the first quarter of 2014, the Group expects greater regulatory engagement on cyber security in the future . Although the Group has been implementing remedial actions to improve its resilience to the increasing intensity and sophistication of cyber-attacks, the Group expects to be the target of continued attacks in the future and there can be no assurance that the Group will be able to prevent all threats.

In addition, in June 2012 and more recently in November 2013, computer system failures prevented NatWest, RBS and Ulster Bank customers from accessing accounts in both the UK and Ireland. Ongoing issues relating to the failure continued for several months, requiring the Group to set aside a provision for compensation to customers who suffered losses as a result of the system failure, in addition to other related costs. See page 469. The vulnerabilities of the Group’s IT systems are due to the complexity of the Group’s IT infrastructure attributable in part to overlapping multiple legacy systems acquired through the Group’s acquisitions and resulting gaps in how the IT systems operate,

and insufficient-investments in IT infrastructure in the past, creating challenges in recovering from system breakdowns.

The Group’s operations have inherent reputational risk

Reputational risk, meaning the risk of brand damage and/or financial loss due to a failure to meet stakeholders’ expectations of the Group’s conduct and performance, is inherent in the Group’s business. Stakeholders include customers, investors, rating agencies, employees, suppliers, government, politicians, regulators, special interest groups, consumer groups, media and the general public. Brand damage can be detrimental to the business of the Group in a number of ways, including its ability to build or sustain business relationships with customers, low staff morale, regulatory censure or reduced access to, or an increase in the cost of, funding. In particular, negative public opinion resulting from the actual or perceived manner in which the Group conducts its business activities, the Group’s financial performance, the level of direct and indirect government support or actual or perceived practices in the banking and financial industry may adversely affect the Group’s ability to keep and attract customers and, in particular, corporate and retail depositors. Modern technologies, in particular online social networks and other broadcast tools which facilitate communication with large audiences in short time frames and with minimal costs, may significantly enhance and accelerate the impact of damaging information and allegations. The Group cannot ensure that it will be successful in avoiding damage to its business from reputational risk, which may result in a material adverse effect on the Group’s financial condition, results of operations and prospects.

The Group may suffer losses due to employee misconduct

The Group’s businesses are exposed to risk from potential non-compliance with policies, employee misconduct or negligence and fraud, which could result in regulatory sanctions and serious reputational or financial harm to the Group. In recent years, a number of multinational financial institutions, including the Group, have suffered material losses due to the actions of employees. It is not always possible to deter employee misconduct and the precautions the Group takes to prevent and detect this activity may not always be effective.

Additional information

Risk factors continued

The Group's earnings and financial condition have been, and its future earnings and financial condition may continue to be, materially affected by depressed asset valuations resulting from poor market conditions

Severe market events have resulted in the Group recording large write-downs on its credit market exposures in recent years. Any deterioration in economic and financial market conditions or continuing weak economic growth could lead to further impairment charges and write-downs. Moreover, market volatility and illiquidity (and the assumptions, judgements and estimates in relation to such matters that may change over time and may ultimately not turn out to be accurate) make it difficult to value certain of the Group's exposures, for example, the assets included in the CRG. Valuations in future periods, reflecting, among other things, the then prevailing market conditions and changes in the credit ratings of certain of the Group's assets, may result in significant changes in the fair values of the Group's exposures, including in respect of exposures, such as credit market exposures, for which the Group has previously recorded write-downs. In addition, the value ultimately realised by the Group may be materially different from the current or estimated fair value. As part of the Group's strategy it has materially reduced the size of its balance sheet mainly through the sale and run-off of non-core assets. Certain of the Group's assets that were part of its Non-Core division together with additional assets identified as part of a HM Treasury review, form part of CRG as of 1 January 2014. In connection with the establishment of CRG, the Group has indicated its clear aspiration to remove the vast majority, if not all of these assets within three years which has led to increased impairments of £4.5 billion which were recognised in Q4 2013. Despite these impairments, these assets may be difficult to sell and could be subject to further write-downs or, when sold, realised losses. Any of these factors could require the Group to recognise further significant write-downs or realise increased impairment charges, which may have a material adverse effect on its financial condition, results of operations and capital ratios. In addition, steep falls in perceived or actual asset values have been accompanied by a severe reduction in market liquidity, as exemplified by losses in recent years arising out of asset-backed collateralised debt obligations, residential mortgage-backed securities and the leveraged loan market. In dislocated markets, hedging and other risk management strategies may not be as effective as they are in normal market conditions due in part to the decreasing credit quality of hedge counterparties.

The Group may be required to make further contributions to its pension schemes if the value of pension fund assets is not sufficient to cover potential obligations

The Group maintains a number of defined benefit pension schemes for past and a number of current employees. Pension risk is the risk that the assets of the Group's various defined benefit pension schemes which are long-term in nature do not fully match the timing and amount of the schemes' liabilities, as a result of which the Group is required or chooses to make additional contributions to the schemes. 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 applicable legislation. The schemes' assets comprise investment portfolios that are held to meet projected liabilities to the scheme members. Risk arises from the schemes because the value of these asset portfolios, returns from them and any additional future contributions to the schemes, may be less than expected and because there may be greater than expected increases in the estimated value of the schemes' liabilities.

In these circumstances, the Group could be obliged, or may choose, to make additional contributions to the schemes. Given the recent economic and financial market difficulties and the risk that such conditions may occur again over the near and medium term, the Group could experience increasing pension deficits or be required or elect to make further contributions to its pension schemes and such deficits and contributions could be significant and have an adverse impact on the Group's results of operations or financial condition. The most recent tri-annual funding valuation, at 31 March 2010 was agreed during 2011. It showed the value of liabilities exceeded the value of assets by £3.5 billion at 31 March 2010, a ratio of assets to liabilities of 84%.

In order to eliminate this deficit, the Group has been and will continue to pay additional contributions each year over the period 2011 until 2018. Contributions started at £375 million per annum in 2011, increased to £400 million per annum in 2013 and will further increase from 2016 onwards in line with price inflation. These contributions are in addition to the regular annual contributions of around £200 million for on-going accrual of benefits as well as contributions to meet the expenses of running the schemes.

The Banking Reform Act 2013 will require banks to ring-fence specific activities (principally retail and small business deposits) from certain other activities. Ring-fencing is likely to entail changes to the structure of the Group's existing defined benefit pension schemes, which could affect assessments of the schemes' deficits. Such assessments may also be affected by other measures introduced in the Banking Reform Act 2013, including the categorisation of deposits eligible for compensation under the Financial Services Compensation Scheme as preferential debts.

The financial performance of the Group has been, and continues to be, materially affected by counterparty credit quality and deteriorations could arise due to prevailing economic and market conditions and legal and regulatory developments

The Group has exposure to many different industries and counterparties, and risks arising from actual or perceived changes in credit quality and the recoverability of monies due from borrowers and counterparties are inherent in a wide range of the Group's businesses. In particular, the Group has significant exposure to certain individual counterparties in weakened business sectors and geographic markets and also has concentrated country exposure in the UK, the US and across the rest of Europe (principally Germany, The Netherlands, Ireland and France) (at 31 December 2013 credit risk assets in the UK were £320.0 billion, in North America £96.1 billion and in Western Europe (excluding the UK) £104.3 billion); and within certain business sectors, namely personal finance, financial institutions, shipping and commercial real estate (at 31 December 2013 personal finance lending amounted to £177.1 billion, lending to financial institutions was £91.0 billion, lending against ocean going vessels was £8.6 billion and commercial real estate lending was £52.6 billion). The Group expects its exposure to the UK to increase proportionately as its business becomes more concentrated in the UK, with exposures generally being reduced in other parts of its business as it continues to implement its strategy.

The credit quality of the Group's borrowers and counterparties is impacted by prevailing economic and market conditions and by the legal and regulatory landscape in their respective markets.

Additional information

Risk factors continued
A further deterioration in economic and market conditions or changes to legal or regulatory landscapes could worsen borrower and counterparty credit quality and also impact the Group's ability to enforce contractual security rights. In addition, the Group's credit risk is exacerbated when the collateral it holds cannot be realised or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due to the Group, which is most likely to occur during periods of illiquidity and depressed asset valuations, such as those experienced in recent years. This has been particularly the case with respect to large parts of the Group's commercial real estate portfolio. Any such losses could have an adverse effect on the Group's results of operations and financial condition.

Concerns about, or a default by, one financial institution could lead to significant liquidity problems and losses or defaults by other financial institutions, as the commercial and financial soundness of many financial institutions may be closely related as a result of credit, trading, clearing and other relationships. Even the perceived lack of creditworthiness of, or questions about, a counterparty may lead to market-wide liquidity problems and losses for, or defaults by, the Group. This systemic risk may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with which the Group interacts on a daily basis, all of which could have a material adverse effect on the Group's access to liquidity or could result in losses which could have a material adverse effect on the Group's financial condition, results of operations and prospects.

In certain jurisdictions in which the Group does business, particularly Ireland, additional constraints have been imposed in recent years on the ability of certain financial institutions to complete foreclosure proceedings in a timely manner (or at all), including as a result of interventions by certain states and local and national governments.

These constraints have lengthened the time to complete foreclosures, increased the backlog of repossessed properties and, in certain cases, have resulted in the invalidation of purported foreclosures.

The EU, the ECB, the International Monetary Fund and various national authorities have proposed and implemented certain measures intended to address systemic financial stresses in the Eurozone, including the creation of a European Banking Union which, through a Single Resolution Mechanism (SRM) will apply the substantive rules of bank recovery and resolution set out in the RRD. Current expectations are that the RRD, which is intended to provide supervisory authorities with common tools and powers to address banking crises pre-emptively in order to safeguard financial stability and minimise taxpayers' exposure to losses, will be finalised early in 2014. The effectiveness of these and other actions proposed and implemented at both the EU and national level to address systemic stresses in the Eurozone is not assured.

The trends and risks affecting borrower and counterparty credit quality have caused, and in the future may cause, the Group to experience further and accelerated impairment charges, increased repurchase demands, higher costs, additional write-downs and losses for the Group and an inability to engage in routine funding transactions.

Changes in interest rates, foreign exchange rates, credit spreads, bond, equity and commodity prices, basis, volatility and correlation risks and other market factors have significantly affected and will continue to affect the Group's business and results of operations
Some of the most significant market risks the Group faces are interest rate, foreign exchange, credit spread, bond, equity and commodity prices and basis, volatility and correlation risks. Changes in interest rate levels (or extended periods of low interest rates such as experienced over the past several years), yield curves (which remain depressed) and spreads may affect the interest rate margin realised between lending and borrowing costs, the effect of which may be heightened during periods of liquidity stress. Changes in currency rates, particularly in the sterling-US dollar and sterling-euro exchange rates, affect the value of assets, liabilities, income and expenses denominated in foreign

currencies and the reported earnings of the Group's non-UK subsidiaries and may affect the Group's reported consolidated financial condition or its income from foreign exchange dealing. For accounting purposes, the Group values some of its issued debt, such as debt securities, at the current market price. Factors affecting the current market price for such debt, such as the credit spreads of the Group, may result in a change to the fair value of such debt, which is recognised in the income statement as a profit or loss.

The performance of financial markets affects bond, equity and commodity prices, which has caused, and may in the future cause, changes in the value of the Group's investment and trading portfolios. As part of its on-going derivatives operations, the Group also faces significant basis, volatility and correlation risks, the occurrence of which are also impacted by the factors noted above.

While the Group has implemented risk management methods to mitigate and control these and other market risks to which it is exposed, it is difficult to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on the Group's financial performance and business operations.

The value or effectiveness of any credit protection that the Group has purchased depends on the value of the underlying assets and the financial condition of the insurers and counterparties
The Group has credit exposure arising from over-the-counter derivative contracts, mainly credit default swaps (CDSs), and other credit derivatives, each of which are carried at fair value. The fair value of these CDSs, as well as the Group's exposure to the risk of default by the underlying counterparties, depends on the valuation and the perceived credit risk of the instrument against which protection has been bought. Many market counterparties have been adversely affected by their exposure to residential mortgage linked and corporate credit products, whether synthetic or otherwise, and their actual and perceived creditworthiness may deteriorate rapidly. If the financial condition of these counterparties or their actual or perceived creditworthiness deteriorates, the Group may record further credit valuation adjustments on the credit protection bought from these counterparties under the CDSs. The Group also recognises any fluctuations in the fair value of other credit derivatives. Any such adjustments or fair value changes may have a material adverse impact on the Group's financial condition and results of operations.

Additional information

Risk factors continued

In the UK and in other jurisdictions, the Group is responsible for contributing to compensation schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers

In the UK, the Financial Services Compensation Scheme (FSCS) was established under the FSMA and is the UK's statutory fund of last resort for customers of authorised financial services firms. The FSCS can pay compensation to customers if a firm is unable or likely to be unable, to pay claims against it and may be required to make payments either in connection with the exercise of a stabilisation power or in exercise of the bank insolvency procedures under the Banking Act 2009. The FSCS is funded by levies on firms authorised by the FCA, including the Group. In the event that the FSCS raises funds from the authorised firms, raises those funds more frequently or significantly increases the levies to be paid by such firms, the associated costs to the Group may have an adverse impact on its results of operations and financial condition. In addition, the RRD will require the establishment of national resolution funds, which will require ex ante levies on banks and investment firms to ensure that the resolution tools contemplated by the RRD can be applied effectively.

To the extent that other jurisdictions where the Group operates have introduced or plan to introduce similar compensation, contributory or reimbursement schemes (such as in the US with the Federal Deposit Insurance Corporation), the Group may make further provisions and may incur additional costs and liabilities, which may have an adverse impact on its financial condition and results of operations.

The value of certain financial instruments recorded at fair value is determined using financial models incorporating assumptions, judgements and estimates that may change over time or may ultimately not turn out to be accurate

Under International Financial Reporting Standards (IFRS), the Group recognises at fair value: (i) financial instruments classified as held-for-trading or designated as at fair value through profit or loss; (ii) financial assets classified as available-for-sale; and (iii) derivatives.

Generally, to establish the fair value of these instruments, the Group relies on quoted market prices or, where the market for a financial instrument is not sufficiently active, internal valuation models that utilise observable market data.

In certain circumstances, the data for individual financial instruments or classes of financial instruments utilised by such valuation models may not be available or may become unavailable due to prevailing market conditions. In such circumstances, the Group's internal valuation models require the Group to make assumptions, judgements and estimates to establish fair value, which are complex and often relate to matters that are inherently uncertain. These assumptions, judgements and estimates will need to be updated to reflect changing facts, trends and market conditions. The resulting change in the fair values of the financial instruments has had and could continue to have a material adverse effect on the Group's earnings and financial condition.

The Group's results could be adversely affected in the event of goodwill impairment

The Group capitalises goodwill, which is calculated as the excess of the cost of an acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Acquired goodwill is recognised initially at cost and subsequently at cost less any accumulated impairment losses. As required by IFRS, the Group tests goodwill for impairment annually, or more frequently when events or circumstances indicate that it might be impaired. An impairment test involves comparing the recoverable amount (the higher of the value in use and fair value less cost to sell) of an individual cash generating unit with its carrying value. At 31 December 2013, the Group carried goodwill of £10.1 billion on its balance sheet. The value in use and fair value of the Group's cash generating units are affected by market conditions and the performance of the economies in which the Group operates. Where the Group is required

to recognise a goodwill impairment, it is recorded in the Group's income statement, although it has no effect on the Group's regulatory capital position. Any significant write-down of goodwill could have a material adverse effect on the Group's results of operations.

The recoverability of certain deferred tax assets recognised by the Group depends on the Group's ability to generate sufficient future taxable profits

In accordance with IFRS, the Group has recognised deferred tax assets on losses available to relieve future profits from tax only to the extent that it is probable that they will be recovered. The deferred tax assets are quantified on the basis of current tax legislation and accounting standards and are subject to change in respect of the future rates of tax or the rules for computing taxable profits and allowable losses. Failure to generate sufficient future taxable profits or changes in tax legislation or accounting standards may reduce the recoverable amount of the recognised deferred tax assets. In April 2011, the UK Government commenced a staged reduction in the rate of UK corporation tax from 28% to 23% over a four-year period and further rate reductions were announced in 2012 and 2013 which will lead to a corporation tax rate of 20% by April 2015. Such changes in the applicable tax rates will reduce the recoverable amount of the recognised deferred tax assets.

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Additional information

Iran sanctions and related disclosures

Disclosure pursuant to section 13(r) of the Securities Exchange Act

Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 added a new Section 13(r) to the Exchange Act, requiring an issuer to disclose in its annual or quarterly reports, as applicable, whether, during the period covered by the report, it or any of its affiliates knowingly engaged in specified activities or transactions relating to Iran or with individuals or entities designated under Executive Order 13382 or 13224. Disclosure is required of certain activities conducted outside the United States by non-U.S. entities in compliance with local law, whether or not the activities are sanctionable under U.S. law. In order to comply with this new requirement, the following activities of the Group are disclosed in response to section 13(r).

Licensed Payments

During 2013, in full compliance with applicable sanctions and under applicable licenses granted by appropriate authorities, the Group facilitated a small number of payments that were remitted by a financial institution designated under Executive Order 13382. The payments related to amounts due to a provider for the provision of medical supplies to a non-designated entity.

The Group also facilitated several payments from or to frozen accounts of Iranian government-owned financial institutions and/or financial institutions designated under Executive Order 13382 or 13224 maintained at other financial institutions. These payments related to amounts due to third parties for legal services and IT services provided to such entities, and the refund of payments made following the termination of services. All payments were made or received in full compliance with applicable sanctions and under applicable licences.

During 2013, the Group also received a number of payments related to entities identified as part of the Government of Iran and/or entities designated under Executive Order 13382 or 13324. These payments related to amounts due to providers for legal services provided to such entities. All such payments were received in compliance with applicable laws and regulations, and where appropriate, the Group made or obtained the required notification, authorisation and/or licence from the applicable regulator.

The transactions described in the above paragraphs resulted in less than the equivalent of £30 in gross revenue to the Group for each such transaction. The Group intends to continue to engage in transactions similar to those described in this paragraph as long as such transactions are licensed by the proper authorities.

Account Closure Payments

During 2013, the Group maintained a banking relationship with an entity in the UK that became designated under Executive Order 13382 in 2013. Following the designation of the entity, the Group terminated the banking relationship and paid the balance of the account to a non-Group account held by the customer. The closure and subsequent payment were made in compliance with applicable rules and regulations. The transactions described in the above resulted in less than the equivalent of £30 in gross revenue to the Group for each such transaction.

Legacy Guarantees

In 2013, in full compliance with applicable sanctions and under general license from the appropriate authorities, the Group exited two legacy guarantees (performance bonds) that were originally entered into in 2003 and 2007 in compliance with applicable law. In connection with exiting these guarantees, the Group made a payment into a frozen account of one Iranian government-owned financial institution that is designated under Executive Order 13382 maintained at another financial institution. The other guarantee was exited without any payment as the Iranian Government-owned financial institution agreed to waive an existing charge under the guarantee.

Under appropriate license from the applicable authorities, the Group holds eight additional legacy guarantees entered into between 1995 and 2005 which support arrangements entered into lawfully by the Group customers with Iranian counterparties. These performance bonds are in favour of Iranian government-owned financial institutions that are also designated under Executive Order 13382. The Group has made considerable efforts to exit and formally cancel the guarantees. It has been unable to do so to date but intends to terminate these legacy guarantees if changes to the applicable law are made to allow it to terminate them. One of these legacy guarantees was disclosed in the Group's Form 20-F for the year ended December 31, 2012. The other seven guarantees were only recently identified as part of a migration of RBS Holdings NV business to the books of another Group affiliate. The affiliate that originally held these guarantees previously sought permission from its regulator to exit these guarantees, but has not yet received a license to do so.

The Group received revenue of £3,018 in the reporting period in respect of these legacy guarantees. No other payments were made under these guarantees in 2013. If any payments are required to be made under the performance bonds while the beneficiaries remain the targets of EU sanctions, the Group intends to make the payments under applicable licence into frozen bank accounts.

Clearing System

The Group participates in local government-run clearing and settlement exchange systems in a number of countries in compliance with applicable laws and regulations. Iranian government-owned banks, including certain banks designated under Executive Order 13382 or 13224, also participate in some of these clearing systems, which creates the risk that the Group could participate in transactions in which such Iranian banks are involved. Where legally permissible, the Group has instituted procedures to screen and halt any outgoing and incoming payments to and from Iranian banks in these clearing systems prior to settlement. The Group has obtained a license from Her Majesty's Treasury to participate in local payment and settlement systems in the United Arab Emirates (UAE). The Group intends to continue to participate in the clearing and settlement exchange systems in various countries and will continue to seek to limit the risk of participating in transactions involving Iranian government-owned financial institutions in accordance with applicable laws and regulations. It intends to participate in transactions involving such entities only pursuant to licenses from the appropriate authorities.

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Shareholder information

Financial calendar		Dividends	
Annual General Meeting	25 June 2014	Payment dates	
	RBS Conference Centre	Cumulative preference shares	30 May and 31 December 2014
	RBS Gogarburn		
	Edinburgh EH12 1HQ	Non-cumulative preference shares	31 March, 30 June, 30 September and 31 December 2014
		Ex-dividend date	
Interim results	1 August 2014	Cumulative preference shares	30 April 2014
		Record date	
		Cumulative preference shares	2 May 2014

For further information on the payment of dividends, see page 534.

Shareholder enquiries
Shareholdings in the company may be checked by visiting the Shareholder centre section of our website, rbs.com. You will need the shareholder reference number printed on your share certificate or tax voucher to gain access to this information.

Listed below are the most commonly used features on the website:

- holding enquiry - view balances, values, history, payments and reinvestments;
- address change - change your registered address;
- e-Comms sign-up - choose to receive email notification when your shareholder communications become available instead of paper communications;
- outstanding payments - reissue any uncashed payments using our online replacement service; and
- downloadable forms - including stock transfer and change of address forms.

You may also check your shareholding by contacting our Registrar:

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ
Telephone: +44 (0)870 702 0135
Fax: +44 (0)870 703 6009
Website: www.investorcentre.co.uk/contactus

Braille and audio Strategic report with additional information
Shareholders requiring a Braille or audio version of the Strategic report with additional information should contact the Registrar on +44 (0)870 702 0135.

ShareGift
The company is aware that shareholders who hold a small number of shares may be retaining these shares because dealing costs make it uneconomical to dispose of them. ShareGift, the charity share donation scheme, is a free service operated by The Orr Mackintosh Foundation (registered charity 1052686) to enable shareholders to donate shares to charity.

Donating your shares in this way will not give rise to either a gain or a loss for UK capital gains tax purposes and you may be able to reclaim UK income tax on gifted shares. Further information can be obtained from HM Revenue & Customs.

Should you wish to donate your shares to charity in this way you should contact ShareGift for further information:

ShareGift, The Orr Mackintosh Foundation
17 Carlton House Terrace, London SW1Y 5AH
Telephone: +44 (0)20 7930 3737
Website:www.sharegift.org

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Shareholder information

Share fraud warning

Fraudsters use persuasive and high-pressure tactics to lure investors into scams. They may offer to sell shares that turn out to be worthless or non-existent, or to buy shares at an inflated price in return for an upfront payment. While high profits are promised, if you buy or sell shares in this way you will probably lose your money.

- Keep in mind that firms authorised by the FCA are unlikely to contact you out of the blue with an offer to buy or sell shares.
- Do not get into a conversation, note the name of the person and firm contacting you and then end the call.
- Check the Financial Services Register at www.fca.org.uk to see if the person and firm contacting you is authorised by the FCA.
- Beware of fraudsters claiming to be from an authorised firm, copying its website or giving you false contact details.
- Use the firm's contact details listed on the Register if you want to call it back.
- Call the FCA on 0800 111 6768 if the firm does not have contact details on the Register or you are told they are out of date.
- Search the list of unauthorised firms to avoid at www.fca.org.uk/scams
- Consider that if you buy or sell shares from an unauthorised firm you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme.
- Think about getting independent financial and professional advice before you hand over any money.
- Remember if it sounds too good to be true, it probably is.

Report a scam

If you are approached by fraudsters please tell the FCA using the share fraud reporting form at www.fca.gov.uk/scams, where you can find out more about investment scams. You can also call the FCA Consumer Helpline on 0800 111 6768. If you have already paid money to share fraudsters you should contact Action Fraud on 0300 123 2040.

Analyses of ordinary shareholders

At 31 December 2013	Shareholdings	Number of shares - millions	%
Individuals	200,686	123.9	2.0
Banks and nominee companies	11,988	6,013.2	96.9
Investment trusts	105	3.8	0.1
Insurance companies	111	0.4	-
Other companies	1,014	18.0	0.3
Pension trusts	25	0.9	-
Other corporate bodies	89	42.8	0.7
	214,018	6,203.0	100.0

Range of shareholdings:			
1 - 1,000	184,830	46.6	0.8
1,001 - 10,000	27,384	62.5	1.0
10,001 - 100,000	1,152	31.2	0.5
100,001 - 1,000,000	437	150.4	2.4
1,000,001 - 10,000,000	172	544.7	8.8
10,000,001 and over	43	5,367.6	86.5
	214,018	6,203.0	100.0

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Shareholder information

Trading market
Non-cumulative dollar preference shares
On 26 March 1997, 8 February 1999, 30 September 2004, 26 August 2004, 19 May 2005, 9 November 2005, 25 May 2006, 27 December 2006, 28 June 2007, 27 September 2007 and 4 October 2007, the company issued the following series of American Depository Shares (ADSs) representing non-cumulative dollar preference shares of the company, in the United States, of which the following were outstanding at 31 December 2013:

6,255,408 Series F ("Series F ADSs") representing 6,255,408 non-cumulative dollar preference shares, Series F;

9,687,654 Series H ("Series H ADSs") representing 9,687,654 non-cumulative dollar preference shares, Series H;

30,027,877 Series L ("Series L ADSs") representing 30,027,877 non-cumulative dollar preference shares, Series L;

23,125,869 Series M (“Series M ADSs”) representing 23,125,869 non-cumulative dollar preference shares, Series M;

22,113,160 Series N ("Series N ADSs") representing 22,113,160 non-cumulative dollar preference shares, Series N;

9,883,307 Series P ("Series P ADSs") representing 9,883,307 non-cumulative dollar preference shares, Series P;

20,646,938 Series Q ("Series Q ADSs") representing 20,646,938 non-cumulative dollar preference shares, Series Q;

10,163,932 Series R ("Series R ADSs") representing 10,163,932 non-cumulative dollar preference shares, Series R;

26,449,040 Series S ("Series S ADSs") representing 26,449,040 non-cumulative dollar preference shares, Series S;

51,245,839 Series T ("Series T ADSs") representing 51,245,839 non-cumulative dollar preference shares, Series T; and

10,130 Series U ("Series U ADSs") representing 10,130 non-cumulative dollar preference shares, Series U.

Each of the respective ADSs set out above represents the right to receive one corresponding preference share, and is evidenced by an American Depository Receipt (ADR) and is listed on the New York Stock Exchange, a subsidiary of NYSE Euronext (NYSE).

The ADRs evidencing the ADSs above were issued pursuant to Deposit Agreements, among the company, The Bank of New York, as depository, and all holders from time-to-time of ADRs issued thereunder. Currently, there is no non-United States trading market for any of the
non-cumulative dollar preference shares. All of the non-cumulative dollar preference shares are held by the depository, as custodian, in bearer form.

In May 2010, the Group redeemed certain subordinated debt securities and equity preference shares in exchange for cash or senior debt, resulting in the number of securities in issue reducing to the amounts shown above.

At 31 December 2013, there were 54 registered shareholders of Series F ADSs, 34 registered shareholders of Series H ADSs, 21 registered shareholders of Series L ADSs, 6 registered shareholders of Series M ADSs, 13 registered shareholders of Series N ADSs, 24 registered shareholders of Series P ADSs, 9 registered shareholders of Series Q

ADSs, 3 registered shareholders of Series R ADSs, 1 registered shareholder of Series S ADSs, 18 registered shareholders of Series T ADSs and 1 registered shareholder of Series U ADSs.

PROs

In August 2001, the company issued US$1.2 billion perpetual regulatory tier one securities (PROs) in connection with a public offering in the United States. The PROs are listed on the NYSE.

ADSs representing ordinary shares

In October 2007, the company listed ADSs, each representing one ordinary share nominal value 25p each (or a right to receive one ordinary share), and evidenced by an ADR or uncertificated securities, on the NYSE. The ADSs were issued in connection with the company's bid for the outstanding share capital of ABN AMRO Holding N.V.. With effect from 7 November 2008, the ratio of one ADS representing one ordinary share changed to one ADS representing 20 ordinary shares.

At the Annual General Meeting on 30 May 2012, shareholders approved a sub-division and consolidation of the Group’s ordinary shares which resulted in new ordinary shares of 100 pence each being admitted to trading in London and New York with effect from 6 June 2012. The ratio of one ADS representing 20 ordinary shares changed to one ADS representing two ordinary shares with effect from 6 June 2012. As at 31 December 2013, 30.6 million ADSs were outstanding.

The ADSs described above were issued pursuant to a Deposit Agreement, among the company, The Bank of New York Mellon, as depository, and all owners and holders from time to time of ADSs issued thereunder. The ordinary shares of the company are listed and traded on the London Stock Exchange. All ordinary shares are deposited with the principal London office of The Bank of New York Mellon, as custodian for the depository.

Shareholder information

Trading market continued

The following table shows, for the periods indicated, the high and low sales prices for each of the outstanding ADSs representing non-cumulative dollar preference shares and PROs, as reported on the NYSE or NASDAQ.

Figures in US$		Series F ADSs	Series H ADSs	Series L ADSs	Series M ADSs	Series N ADSs	Series P ADSs	Series Q ADSs	Series R ADSs	Series S ADSs	Series T ADSs	Series U ADSs	PROs (1)
By month													
Mar 2014	High	25.56	25.15	21.66	22.80	22.67	22.33	23.73	22.26	23.16	25.12	101.50	107.72
	Low	25.19	24.87	21.18	22.35	22.23	21.93	23.23	21.87	22.76	24.90	100.00	106.77
Feb 2014	High	25.59	25.08	21.40	22.84	22.75	22.25	23.67	22.18	23.16	25.02	100.25	106.72
	Low	25.03	24.50	20.67	22.09	21.98	21.56	22.86	21.48	22.51	24.59	98.25	105.87
Jan 2014	High	25.42	24.93	21.23	22.68	22.52	22.11	23.69	21.88	23.15	24.96	99.50	106.56
	Low	24.93	24.23	19.89	20.86	20.68	20.39	21.85	20.06	21.68	24.17	97.25	105.04
Dec 2013	High	25.24	24.74	20.24	21.59	21.45	21.19	22.70	20.85	22.46	24.68	97.50	105.16
	Low	24.81	23.83	19.22	20.52	20.30	20.05	21.46	19.70	21.33	23.83	95.50	104.30
Nov 2013	High	25.14	24.85	20.25	21.88	21.75	21.40	22.95	21.18	22.49	24.76	97.25	104.76
	Low	24.70	24.41	19.65	21.46	21.30	21.04	22.48	20.62	22.00	24.25	95.25	104.10
Oct 2013	High	24.91	24.82	20.00	21.35	21.26	20.78	22.46	20.65	22.00	24.07	96.00	104.00
	Low	24.32	24.16	19.13	20.23	20.07	19.88	21.16	19.88	20.72	23.05	92.50	102.20
By quarter													
2014: Q1	High	25.59	25.15	21.66	22.84	22.75	22.33	23.73	22.26	23.16	25.12	101.50	
	Low	24.93	24.23	19.89	20.86	20.68	20.39	21.85	20.06	21.68	24.17	97.25	
2013: Q4	High	25.24	24.85	20.25	21.88	21.75	21.40	22.95	21.18	22.49	24.76	97.50	105.16
	Low	24.32	23.83	19.13	20.23	20.07	19.88	21.16	19.70	20.72	23.05	92.50	102.20
2013: Q3	High	24.95	24.70	20.42	21.16	21.08	20.89	22.24	20.71	21.82	23.84	95.00	102.80
	Low	24.16	23.64	18.46	19.58	19.46	19.29	20.57	19.26	20.23	22.28	89.00	91.38
2013: Q2	High	25.86	25.55	23.87	24.03	23.72	23.92	24.63	23.70	24.45	25.44	98.50	106.76
	Low	24.07	23.52	18.99	20.21	20.16	20.00	21.05	19.79	20.49	21.83	84.00	90.27
2013: Q1	High	25.62	25.41	24.00	23.87	23.69	23.71	24.54	23.47	24.21	25.03	97.00	107.70
	Low	24.77	24.70	22.39	22.24	22.20	21.92	23.32	21.77	23.03	24.19	89.00	100.24
2012: Q4	High	25.20	24.92	23.57	23.09	22.98	22.83	23.40	22.96	23.31	24.50	90.00	100.59
	Low	24.33	23.99	21.32	20.73	20.71	21.15	21.16	21.26	20.89	22.78	82.50	97.92
2012: Q3	High	25.35	24.96	22.29	21.24	21.31	21.76	21.93	21.26	21.44	23.54	85.00	98.46
	Low	23.23	21.92	18.02	17.53	17.28	17.52	18.20	17.50	17.85	19.76	66.00	79.51
2012: Q2	High	23.43	22.33	19.10	17.76	17.64	18.33	18.77	17.85	18.44	20.45	71.00	86.60
	Low	20.39	19.34	17.00	15.85	15.70	15.85	16.39	15.58	16.23	18.11	62.00	73.78
2012: Q1	High	24.24	22.74	19.48	16.64	16.51	16.52	17.39	16.57	16.98	19.00	71.38	85.32
	Low	17.60	16.76	15.46	11.63	11.53	11.41	12.24	11.41	11.83	13.08	53.63	66.58
By year													
2013	High	25.86	25.55	24.00	24.03	23.72	23.92	24.63	23.70	24.45	25.44	98.50	107.70
	Low	24.07	23.52	18.46	19.58	19.46	19.29	20.57	19.26	20.23	21.83	84.00	90.27
2012	High	25.35	24.96	23.57	23.09	22.98	22.83	23.40	22.96	23.31	24.50	90.00	100.59
	Low	17.60	16.76	15.46	11.63	11.53	11.41	12.24	11.41	11.83	13.08	53.63	66.58
2011	High	25.05	23.95	19.40	18.80	18.82	18.40	19.40	18.35	18.88	20.60	84.00	96.69

	Low	16.21	15.35	13.87	10.21	10.11	9.97	10.62	9.98	10.22	11.43	46.00	63.58
2010	High	23.97	23.85	19.88	17.75	17.73	17.77	17.91	17.75	17.73	18.64	78.25	97.06
	Low	16.57	15.10	13.35	10.95	10.91	10.75	11.24	10.80	10.99	11.90	53.00	67.13
2009	High	18.30	16.46	13.65	14.07	14.11	13.91	15.15	13.63	14.45	16.48	57.50	69.25
	Low	3.00	2.77	2.21	2.63	2.55	2.43	2.64	2.37	2.58	2.78	8.98	20.00

Note:
(1) Price quoted as a % of US$1,000 nominal.

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Shareholder information

Trading market continued

Ordinary shares

The following table shows, for the periods indicated, the high and low sales prices for the company's ordinary shares, as derived from the Daily Official List of the London Stock Exchange. Following the sub-division and one-for-ten consolidation of ordinary shares, which took effect in June 2012, prices prior to that date were restated accordingly.

By month		£	By quarter		£	By year		£
March 2014	High	3.323	2014: Q1	High	3.750	2013	High	3.849
	Low	2.991		Low	2.991		Low	2.661
February 2014	High	3.624	2013: Q4	High	3.849	2012	High	3.250
	Low	3.626		Low	3.159		Low	1.966
January 2014	High	3.750	2013: Q3	High	3.727	2011	High	4.900
	Low	3.322		Low	2.700		Low	1.734
December 2013	High	3.400	2013: Q2	High	3.519	2010	High	5.804
	Low	3.159		Low	2.661		Low	3.125
November 2013	High	3.400	2013: Q1	High	3.678	2009	High	5.765
	Low	3.218		Low	2.755		Low	1.030
October 2013	High	3.849	2012: Q4	High	3.250			
	Low	3.521		Low	2.573			
			2012: Q3	High	2.790			
				Low	1.966			
			2012: Q2	High	2.775			
				Low	1.998			
			2012: Q1	High	2.917			
				Low	2.007			

On 25 April 2014, the closing price of the ordinary shares on the London Stock Exchange was £3.032, equivalent to $5.097 per share translated at the Noon Buying Rate of $1.6810 per £1.00 on 25 April 2014.

ADSs

The following table shows, for the periods indicated, the high and low sales prices for the company's ordinary ADSs, as reported on the NYSE composite tape.

By month		US$	By quarter		US$	By year		US$
March 2014	High	11.15	2014: Q1	High	12.40	2013	High	12.35
	Low	9.86		Low	9.86		Low	8.15
February 2014	High	12.11	2013: Q4	High	12.35	2012	High	10.79
	Low	10.74		Low	10.25		Low	6.09
January 2014	High	12.40	2013: Q3	High	11.97	2011	High	15.83
	Low	11.00		Low	8.23		Low	5.36
December 2013	High	11.33	2013: Q2	High	10.81	2010	High	17.30

	Low	10.35		Low	8.15		Low	9.89
November	High			High		2009	High	
2013		10.85	2013: Q1		11.84			18.95
	Low	10.25		Low	8.37		Low	3.33
October 2013	High	12.35	2012: Q4	High	10.79			
	Low	11.39		Low	8.20			
			2012: Q3	High	9.05			
				Low	6.09			
			2012: Q2	High	8.87			
				Low	6.17			
			2012: Q1	High	9.29			
				Low	6.25			

Following the ordinary share sub-division and consolidation which took effect from 6 June 2012, the ratio of one ADS representing 20 ordinary shares changed to one ADS representing two ordinary shares.

On 25 April 2014, the closing price of the ordinary ADSs on the New York Stock Exchange was $10.17.

Shareholder information

Dividend history
Preference dividends

	2013	2013	2012	2011	2010	2009
Amount per share	$	£	£	£	£	£
Non-cumulative preference shares of US$0.01						
- Series F (1)	1.91	1.16	1.21	1.19	1.06	1.22
- Series H (1)	1.81	1.10	1.14	1.13	1.03	1.15
- Series L (1)	1.44	0.87	0.91	0.90	0.86	0.92
- Series M (2)	1.60	1.03	0.75	—	0.26	1.02
- Series N (2)	1.59	1.03	0.74	—	0.26	1.01
- Series P (2)	1.56	1.01	0.73	—	0.25	0.99
- Series Q (2)	1.69	1.09	0.79	—	0.27	1.07
- Series R (2)	1.53	0.99	0.72	—	0.25	0.97
- Series S (2)	1.65	1.07	0.77	—	0.27	1.05
- Series T (2)	1.81	1.17	0.85	—	0.29	1.15
- Series U (2)	7,640	4,881	2,406	—	2,474	5,019
Non-cumulative convertible preference shares of US$0.01						
- Series 1 (1)	91.18	55.12	57.86	56.87	59.98	60.33
Non-cumulative preference shares of €0.01						
- Series 1 (2)	75.77	45.76	44.65	—	—	49.46
- Series 2 (2)	72.32	44.83	42.25	—	—	46.00
- Series 3 (2)	4,885	3,027	2,813	—	—	3,125
Non-cumulative convertible preference shares of £0.01						
- Series 1 (1)	122.20	73.87	73.87	73.87	73.87	73.87
Non-cumulative preference shares of £1						
- Series 1 (2)	47.02	28.42	89.62	—	—	81.62
- Series 2 (redeemed April 2009) (2)	—	—	—	—	—	54.71

Notes:
(1) Classified as subordinated liabilities.
(2) Classified as equity.

On 26 November 2009, RBS entered into a State Aid Commitment Deed with HM Treasury containing commitments and undertakings that were designed to ensure that HM Treasury was able to comply with the commitments to be given by it to the European Commission for the purposes of obtaining approval for the State aid provided to RBS. As part of these commitments and undertakings, RBS agreed not to pay discretionary coupons and dividends on its existing hybrid capital instruments for a period of two years. This period commenced on 30 April 2010 for RBS Group instruments and ended on 30 April 2012; the two year deferral period for RBS Holdings N.V. instruments commenced on 1 April 2011 and ended on 1 April 2013.

On 4 May 2012, RBS determined that it was in a position to recommence payments on RBS Group instruments. In June 2013 RBS Holdings N.V. resumed payments on its hybrid capital instruments. Future coupons and dividends on hybrid capital instruments will only be paid subject to, and in accordance with, the terms of the relevant instruments.

For further information, see Note 7 on the consolidated accounts.

Ordinary dividends
The company has not paid an ordinary dividend since 2007. In 2008, the company issued new ordinary shares by way of a capitalisation issue rather than paying an interim dividend.

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Shareholder information

Taxation for US Holders

The following discussion summarises certain US federal and UK tax consequences of the ownership and disposition of ordinary shares, ADSs representing ordinary shares (ordinary ADSs), ADSs representing non-cumulative dollar preference shares (preference ADSs) or PROs by a beneficial owner that is a citizen or resident of the United States or that otherwise will be subject to US federal income tax on a net income basis in respect of the ordinary shares, ordinary ADSs, preference ADSs or PROs (a "US Holder"). This summary assumes that a US Holder is holding ordinary shares, ordinary ADSs, preference ADSs or PROs, as applicable, as capital assets. This summary does not address the tax consequences to a US Holder (i) that is resident in the UK for UK tax purposes, (ii) that carries on a trade, profession or vocation through a branch, agency or permanent establishment in the UK in connection with which their ordinary shares, ordinary ADSs, preference ADSs or PROs are held, used or acquired, or (iii) generally, that is a corporation which alone or together with one or more associated companies, controls, directly or indirectly, 10% or more of the voting stock of the company, nor does this summary address all of the tax consequences to US Holders subject to special rules, such as certain financial institutions, dealers or traders in securities who use a mark-to-market method of tax accounting, persons holding ordinary shares, ordinary ADSs, preference ADSs or PROs as part of a hedging transaction, straddle, wash sale, conversion transaction or integrated transaction or persons entering into a constructive sale with respect to such securities, persons liable for the alternative minimum tax or the 'Medicare contribution tax' on 'net investment income,' persons whose functional currency for US federal income tax purposes is not the US dollar, entities classified as partnerships for US federal income tax purposes, tax-exempt entities, persons that own or are deemed to own 10% or more of the voting stock of the company.

The statements and practices set forth below regarding US and UK tax laws, including the US/UK double taxation convention relating to income and capital gains which entered into force on 31 March 2003 (the "Treaty") and the US/UK double taxation convention relating to estate and gift taxes (the "Estate Taxation Treaty"), are based on those laws and practices as in force and as applied in practice on the date of this report. This summary is not exhaustive of all possible tax considerations and holders are advised to satisfy themselves as to the overall tax consequences, including specifically the consequences under US federal, state, local and other laws, and possible changes in taxation law, of the acquisition, ownership and disposition of ordinary shares, ordinary ADSs, preference ADSs or PROs by consulting their own tax advisers.

The following discussion assumes that the company was not for the taxable year ended 31 December 2013, and will not become in the foreseeable future, a passive foreign investment company – see 'Passive Foreign Investment Company (PFIC) considerations' on page 538.

Ordinary shares, ordinary ADSs and preference ADSs

Taxation of dividends

For the purposes of the Treaty, the Estate Taxation Treaty and the US Internal Revenue Code of 1986 as amended (the "Code"), US Holders of ordinary ADSs and preference ADSs should be treated as owners of the respective ordinary shares and the non-cumulative dollar preference shares underlying such ADSs.

The US Treasury has expressed concerns that parties to whom depositary receipts are released before shares are delivered to the depositary, or intermediaries in the chain of ownership between US holders and the issuer of the security underlying the depositary receipts, may be taking actions that are inconsistent with the claiming of foreign tax credits for US holders of depositary receipts. Such actions would also be inconsistent with the claiming of the favourable US tax rates applicable to dividends received by certain non-corporate US holders (described below). Accordingly, the availability of the favourable tax rates for dividends received by certain non-corporate US holders could be affected by actions taken by such parties or intermediaries.

The company is not required to withhold UK tax at source from dividend payments it makes or from any amount (including any amounts in respect of accrued dividends) distributed by the company. US Holders who are not resident in the UK and who do not carry on a trade, profession or vocation in the UK through a branch, agency or permanent establishment in connection with which their ordinary shares, ordinary ADSs or preference ADSs are held, used or acquired will not be subject to UK tax in respect of any dividends received on the relevant shares or ADSs.

Distributions by the company (other than certain pro-rata distributions of ordinary shares or rights to receive such shares) will constitute foreign source dividend income for US federal income tax purposes to the extent paid out of the current or accumulated earnings and profits of the company, as determined for US federal income tax purposes. Because the company does not maintain calculations of its earnings and profits under US federal income tax principles, it is expected that distributions will be reported to US Holders as dividends. Payments will not be eligible for the dividends-received deduction generally allowed to corporate US holders.

Subject to applicable limitations that vary depending upon a US Holder's particular circumstances and the discussion above regarding concerns expressed by the US Treasury, dividends paid to certain non-corporate US Holders may be taxable at the favourable rates applicable to long-term capital gain. Non-corporate US Holders should consult their own tax advisers to determine whether they are subject to any special rules that limit their ability to be taxed at these favourable rates.

Shareholder information

Taxation for US Holders continued
Dividends will be included in a US Holder's income on the date of the US Holder's (or in the case of ADSs, the depositary's) receipt of the dividend. The amount of any dividend paid in pounds sterling to be included in income by a US Holder will be the US dollar amount calculated by reference to the relevant exchange rate in effect on the date of such receipt regardless of whether the payment is in fact converted into US dollars. If the dividend is converted into US dollars on the date of receipt, the US Holder generally should not be required to recognise foreign currency gain or loss in respect of the dividend income. If the amount of such dividend is converted into US dollars after the date of receipt, the US Holder may have foreign currency gain or loss.

Taxation of capital gains
A US Holder that is not resident in the UK will not normally be liable for UK tax on capital gains realised on the disposition of an ordinary share, an ordinary ADS or a preference ADS unless at the time of the disposal, in the case of a corporate US Holder, such US Holder carries on a trade in the UK through a permanent establishment or, in the case of any other US Holder, such US Holder carries on a trade, profession or vocation in the UK through a branch or agency and, in each case, such ordinary share, ordinary ADS or preference ADS is or has been used, held or acquired by or for the purposes of such trade (or profession or vocation), carried on through such permanent establishment, branch or agency. Special rules apply to individuals who are temporarily not resident in the UK.

A US Holder will, upon the sale or other disposition of an ordinary share, an ordinary ADS or a preference ADS, or upon the redemption of preference ADS, generally recognise capital gain or loss for US federal income tax purposes (assuming that in the case of a redemption of a preference ADS, such US Holder does not own, and is not deemed to own, any ordinary shares or ordinary ADSs of the company) in an amount equal to the difference between the amount realised (excluding in the case of a redemption any amount treated as a dividend for US federal income tax purposes, which will be taxed accordingly) and the US Holder's tax basis in such share or ADS. This capital gain or loss will be long-term capital gain or loss if the US Holder held the share or ADS so sold, disposed or redeemed for more than one year. The deductibility of capital losses is subject to limitations.

A US Holder who is liable for both UK and US tax on a gain recognised on the disposal of an ordinary share, an ordinary ADS or a preference ADS may be entitled, subject to certain limitations, to credit the UK tax against its US federal income tax liability in respect of such gain.

Estate and gift tax
Subject to the discussion of the Estate Tax Treaty in the following paragraph, ordinary shares, ordinary ADSs or preference ADSs beneficially owned by an individual may be subject to UK inheritance tax (subject to exemptions and reliefs) on the death of the individual or in certain circumstances, if such shares or ADSs are the subject of a gift (including a transfer at less than market value) by such individual. Inheritance tax is not generally chargeable on gifts to individuals made more than seven years before the death of the donor. Ordinary shares, ordinary ADSs or preference ADSs held by the trustees of a settlement may also be subject to UK inheritance tax. Special rules apply to such settlements.

An ordinary share, an ordinary ADS or a preference ADS beneficially owned by an individual, whose domicile is determined to be the United States for purposes of the Estate Tax Treaty and who is not a national of the UK, will not be subject to UK inheritance tax on the individual's death or on a lifetime transfer of such share or ADS, except in certain cases where the share or ADS (i) is comprised in a settlement (unless, at the time of the settlement, the settlor was domiciled in the United States and was not a national of the UK); (ii) is part of the business property of a UK permanent establishment of an enterprise; or (iii) pertains to a UK fixed base of an individual used for the performance of independent personal services. The Estate Tax Treaty generally provides a credit against US federal

estate or gift tax liability for the amount of any tax paid in the UK in a case where the ordinary share, ordinary ADS or preference ADS is subject to both UK inheritance tax and US federal estate or gift tax.

UK stamp duty and stamp duty reserve tax (SDRT)

The following is a summary of the UK stamp duty and SDRT consequences of transferring an ADS (otherwise than to the custodian on cancellation of the ADS) or of transferring an ordinary share. A transfer of an ADS executed and retained in the United States will not give rise to stamp duty and an agreement to transfer an ADS will not give rise to SDRT. Stamp duty or SDRT will normally be payable on or in respect of transfers of ordinary shares and accordingly any holder that acquires or intends to acquire ordinary shares is advised to consult its own tax adviser in relation to stamp duty and SDRT.

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Shareholder information

Taxation for US Holders continued
PROs
United States
Payments of interest on a PRO (including any UK withholding tax, as to which see below) will constitute foreign source dividend income for US federal income tax purposes to the extent paid out of the current or accumulated earnings and profits of the company, as determined for US federal income tax purposes. Because the company does not maintain calculations of its earnings and profits under US federal income tax principles, it is expected that distributions will be reported to US Holders as dividends. Payments will not be eligible for the dividends-received deduction generally allowed to corporate US holders. A US Holder who is entitled under the Treaty to a refund of UK tax, if any, withheld on a payment will not be entitled to claim a foreign tax credit with respect to the refundable tax. Subject to applicable limitations that vary depending upon a US Holder's particular circumstances and the discussion above regarding concerns expressed by the US Treasury, dividends paid to certain non-corporate US Holders may be taxable at the favourable rates applicable to long-term capital gain. Non-corporate US Holders should consult their own tax advisers to determine whether they are subject to any special rules that limit their ability to be taxed at these favourable rates.

A US Holder will, upon the sale, exchange or redemption of a PRO, generally recognise capital gain or loss for US federal income tax purposes (assuming that in the case of a redemption, such US Holder does not own, and is not deemed to own, any ordinary shares or ordinary ADSs of the company) in an amount equal to the difference between the amount realised (excluding any amount in respect of mandatory interest and any missed payments which are to be satisfied on a missed payment satisfaction date, which would be treated as ordinary income) and the US Holder's tax basis in the PRO.

A US Holder who is liable for both UK and US tax on gain recognised on the disposal of PROs may be entitled, subject to certain limitations, to credit the UK tax against all or a portion of its US federal income tax liability in respect of such gain.

United Kingdom
Taxation of payments on the PROs
Payments on the PROs will constitute interest rather than dividends for UK withholding tax purposes. However, the PROs constitute 'quoted eurobonds' within the meaning of section 987 of the Income Tax Act 2007 and therefore payments of interest will not be subject to withholding or deduction for or on account of UK tax as long as the PROs remain at all times listed on a 'recognised stock exchange' within the meaning of section 1005 of the Income Tax Act 2007, such as the main market of the New York Stock Exchange. In all other cases, an amount must be withheld on account of UK income tax at the basic rate (currently 20%) subject to any direction to the contrary by HM Revenue & Customs under the Treaty and except that the withholding obligation does not apply to payments to persons who the company reasonably believes are within the charge to corporation tax or fall within various categories enjoying a special tax status (including charities and pension funds), or are partnerships consisting of such persons (unless HM Revenue & Customs directs otherwise). Where interest has been paid under deduction of UK withholding tax, US Holders may be able to recover the tax deducted under the Treaty.

However, a US Holder who is entitled under the Treaty to a refund of UK tax, if any, withheld on a payment will not be entitled to claim a foreign tax credit with respect to the refundable tax.

Any paying agent or other person by or through whom interest is paid to, or by whom interest is received on behalf of an individual, may be required to provide information in relation to the payment and the individual concerned to HM Revenue & Customs. HM Revenue & Customs may communicate this information to the tax authorities of other

jurisdictions.

HM Revenue & Customs confirmed at around the time of the issue of the PROs that interest payments would not be treated as distributions for UK tax purposes by reason of (i) the fact that interest may be deferred under the terms of issue; or (ii) the undated nature of the PROs, provided that at the time an interest payment is made, the PROs are not held by a company which is 'associated' with the company or by a 'funded company'. A company will be associated with the company if, broadly speaking, it is part of the same group as the company. A company will be a 'funded company' for these purposes if there are arrangements involving that company being put in funds (directly or indirectly) by the company, or an entity associated with the company. In this respect, HM Revenue & Customs has confirmed that a company holding an interest in the PROs which incidentally has banking facilities with any company associated with the company will not be a 'funded company' by virtue of such facilities.

Interest on the PROs constitutes UK source income for UK tax purposes and, as such, may be subject to income tax by direct assessment even where paid without withholding. However, interest with a UK source received without deduction or withholding on account of UK tax will not be chargeable to UK tax in the hands of a US Holder unless, in the case of a corporate US Holder, such US Holder carries on a trade in the UK through a UK permanent establishment or in the case of other US Holders, such persons carry on a trade, profession or vocation in the UK through a branch or agency in each case in connection with which the interest is received or to which the PROs are attributable. There are also exemptions for interest received by certain categories of agents (such as some brokers and investment managers).

EU Directive on taxation of savings income

Under the European Union Council Directive 2003/48/EC on the taxation of savings income, member states of the European Union are required to provide to the tax authorities of other member states details of payments of interest and other similar income paid by a person to an individual or certain other persons resident in another member state, except that Luxembourg and Austria may instead impose a withholding system for a transitional period unless during such period they elect otherwise. On April 10, 2013, the Luxembourg Ministry of Finance announced that Luxembourg's transitional period will end with effect from January 1, 2015.

Disposal (including redemption)

A disposal (including redemption) of PROs by a non-corporate US Holder will not give rise to any liability to UK tax on capital gains unless the US Holder carries on a trade (which for this purpose includes a profession or a vocation) in the UK through a branch or agency and the PROs are, or have been, held or acquired for the purposes of that trade, carried on through such branch or agency.

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Shareholder information

Taxation for US Holders continued
A transfer of PROs by a US Holder will not give rise to a charge to UK tax on accrued but unpaid interest payments, unless the US Holder is an individual or other non-corporate taxpayer and at any time in the relevant year of assessment or accounting period carries on a trade, profession or vocation in the UK through a branch or agency to which the PROs are attributable.

Annual tax charges
Corporate US Holders of PROs may be subject to annual UK tax charges (or tax relief) by reference to fluctuations in exchange rates and in respect of profits, gains and losses arising from the PROs, but only if such corporate US Holders carry on a trade in the UK through a UK permanent establishment to which the PROs are attributable.

Inheritance tax
In relation to PROs held through Depository Trust Company (or any other clearing system), the UK inheritance tax position is not free from doubt in respect of a lifetime transfer, or death of, a US Holder who is not domiciled nor deemed to be domiciled in the UK for inheritance tax purposes; HM Revenue & Customs is known to consider that the situs of securities held in this manner is not necessarily determined by the place where the securities are registered. In appropriate circumstances, there may be a charge to UK inheritance tax as a result of a lifetime transfer at less than market value by, or on the death of, such US Holder. Inheritance tax is not generally chargeable on gifts to individuals made more than seven years before the death of the donor. However, exemption from, or a reduction of, any such UK tax liability may be available under the Estate Tax Treaty (see below). US Holders should consult their professional advisers in relation to such potential liability. PROs beneficially owned by an individual, whose domicile is determined to be the United States for the purposes of the Estate Tax Treaty and who is not a national of the UK, will not be subject to UK inheritance tax on the individual's death or on a lifetime transfer of the PRO, except in certain cases where the PRO (i) is comprised in a settlement (unless, at the time of the settlement, the settlor was domiciled in the United States and was not a national of the UK); (ii) is part of the business property of a UK permanent establishment of an enterprise; or (iii) pertains to a UK fixed base of an individual used for the performance of independent personal services. The Estate Tax Treaty generally provides a credit against US federal estate or gift tax liability for the amount of any tax paid in the UK in a case where the PRO is subject to both UK inheritance tax and US federal estate or gift tax.

Stamp duty and SDRT
No stamp duty, SDRT or similar tax is imposed in the UK on the issue, transfer or redemption of the PROs.

Passive Foreign Investment Company (PFIC) considerations
In general, a foreign corporation will be a PFIC for any taxable year in which, after taking into account the income and assets of the corporation and certain subsidiaries pursuant to applicable 'look-through rules', either (i) at least 75% of its gross income is 'passive income' or (ii) at least 50% of the average quarterly value of its assets is attributable to assets which produce passive income or are held for the production of passive income. The company does not believe that it was a PFIC for its 2013 taxable year. Although interest income is generally passive income, a special rule allows banks to treat their banking business income as non-passive. To qualify for this rule, a bank must satisfy certain requirements regarding its licensing and activities.

The company's possible status as a PFIC is determined annually, however, and may be subject to change if the company fails to qualify under this special rule for any year in which a US Holder owns ordinary shares, ordinary ADSs, preference ADSs or PROs. If the company were to be treated as a PFIC for any taxable year during which a US Holder owned ordinary shares, ordinary ADSs, preference ADSs or PROs, the US Holder would generally be subject to adverse US federal income tax consequences and certain reporting obligations. Holders should consult their own

tax advisers as to the potential application of the PFIC rules to the ownership and disposition of the company's ordinary shares, ordinary ADSs, preference ADSs or PROs.

Information reporting and backup withholding

Payments on, and proceeds from the sale of, ordinary shares, ordinary ADSs, preference ADSs or PROs that are made within the United States or through certain U.S-related financial intermediaries may be subject to information reporting and backup withholding unless (i) the US Holder is an exempt recipient or (ii) in the case of backup withholding, the US Holder provides a correct taxpayer identification number and certifies that it is not subject to backup withholding. The amount of any backup withholding from a payment to a US Holder will be allowed as a credit against the US Holder’s US federal income tax liability and may entitle it to a refund, provided that the required information is timely furnished to the Internal Revenue Service.

Foreign financial assets reporting

Certain US Holders who are individuals (and under proposed regulations, certain entities) may be required to report information relating to the company’s securities, subject to certain exceptions (including an exception for securities held in accounts maintained by US financial institutions). US Holders are urged to consult their tax advisers regarding the application of these rules in the US Holders’ particular circumstances.

Exchange controls

The company has been advised that there are currently no UK laws, decrees or regulations which would prevent the import or export of capital, including the availability of cash or cash equivalents for use by the Group, or the remittance of dividends, interest or other payments to non-UK resident holders of the company's securities.

There are no restrictions under the Articles of Association of the company or under UK law, as currently in effect, which limit the right of non-UK resident owners to hold or, when entitled to vote, freely to vote the company's securities.

Shareholder information

Memorandum and Articles of Association
The company's Memorandum and Articles of Association as in effect at the date of this Annual Report are registered with the Registrar of Companies of Scotland.

The following information is a summary of certain terms of the company's Memorandum of Association (the "Memorandum") and Articles of Association (the "Articles") as in effect at the date of this Annual Report and certain relevant provisions of the Companies Act 2006 (the "2006 Act") where appropriate and as relevant to the holders of any class of share. The current Articles were adopted on 28 April 2010. The Articles were updated primarily to reflect the coming into force of the remaining provisions of the 2006 Act and the implementation of the Shareholder Rights Directive in the UK. An amendment was made to the Articles at a General Meeting held on 28 April 2010 in relation to the price at which certain classes of preference shares may be purchased.

A further amendment was made to the Articles at the Annual General Meeting held on 19 April 2011 to the effect that subject to existing class rights of shareholders, new preference shares can be issued with such rights and restrictions as the directors may determine. A further amendment was made to the Articles at the Annual General Meeting held on 30 May 2012 to include a new sub-article specifying the rights attaching to the Deferred shares arising as a result of share subdivision and consolidation.

The following summary description is qualified in its entirety by reference to the terms and provisions of the Memorandum and Articles (and, in the case of the summary description of the non-cumulative preference shares, the B Shares and the Dividend Access Share, by reference to the terms of issue of those shares determined by the Directors pursuant to the Articles prior to allotment). The Memorandum and Articles are registered with the Registrar of Companies of Scotland. Holders of any class of share are encouraged to read the full Memorandum and Articles, which have been filed as an exhibit to this Annual Report on Form 20-F.

Incorporation and registration
The company was incorporated and registered in Scotland under the Companies Act 1948 as a limited company on 25 March 1968 under the name National and Commercial Banking Group Limited. On 3 September 1979 the name was changed to The Royal Bank of Scotland Group Limited and on 10 March 1982, it changed its name to its present name and was registered under the Companies Acts 1948 to 1980 as a public company with limited liability. The company is registered under Company No. SC 45551.

Purpose and objects
The 2006 Act greatly reduces the constitutional significance of a company's memorandum of association and provides that a memorandum of association will record only the names of the subscribers and the number of shares each subscriber has agreed to take in the company. The 2006 Act further states that, unless a company's articles provide otherwise, a company's objects are unrestricted and abolishes the need for companies to have objects clauses. The company removed its objects clause together with all other provisions of its memorandum of association which by virtue of the 2006 Act were treated as forming part of the company's articles. The articles of association contain an express statement regarding the limited liability of the shareholders.

Directors
At each annual general meeting of the company, any Director appointed since the last annual general meeting and any Directors who were not appointed at one of the preceding two annual general meetings shall retire from office and may offer themselves for re-election by the members. Directors may be appointed by the company by ordinary resolution or by the Board. A director appointed by the Board holds office only until the next annual general meeting, whereupon he will be eligible for re-election. Unless and until otherwise determined by ordinary resolution, the

directors (other than alternate directors) shall be not more than twenty five. There is no stipulation in the Articles regarding a minimum number of directors; under the 2006 Act, and in the absence of express provision, the minimum number is two.

Directors' interests

A director shall not vote at a meeting of the Board or a Committee of the Board on any resolution of the Board concerning a matter in which he has an interest (otherwise than by virtue of his interest in shares, debentures or other securities of, or otherwise in or through, the company) which (together with any interest of any person connected with him) is, to his knowledge, material unless his interests arises only because the resolution relates to one or more of the following matters:

(i) the giving of any security or indemnity to him pursuant to the Articles or in respect of money lent, or obligations incurred, by him at the request of, or for the benefit of, the company or any of its subsidiary undertakings;

(ii) the giving of any security or indemnity to a third party in respect of a debt or obligation of the company or any of its subsidiary undertakings for which he has assumed responsibility (in whole or in part) under a guarantee or indemnity or by the giving of security;

(iii) a proposal concerning an offer of shares, debentures or other securities of the company, or any of its subsidiary undertakings, for subscription or purchase, in which offer he is, or may be, entitled to participate as a holder of securities or in the underwriting or sub-underwriting of which he is to participate;

(iv) any proposal concerning any other body corporate in which he is interested, directly or indirectly, whether as an officer or shareholder or otherwise, provided that he is not the holder of shares representing one per cent or more of any class of the equity share capital of such body corporate;

Shareholder information

(v) any proposal concerning the adoption, modification or operation of a pension fund or retirement, death or disability benefits scheme or employees' share scheme which relates both to directors and employees of the company or a subsidiary of the company and does not provide any privilege or advantage in respect of any director which it does not accord to the employees to which the fund or scheme relates;

(vi) a contract or arrangement for the benefit of the employees of the company or any of its subsidiary undertakings which does not accord him any privilege or advantage not generally accorded to the employees to whom the contract or arrangement relates; and

(vii) a proposal concerning any insurance which the company proposes to purchase and/or maintain for the benefit of any directors or for persons who include directors of the company.

Under the 2006 Act, a director must avoid a situation where he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the company's interests. The 2006 Act allows directors of public companies, where appropriate, to authorise conflicts and potential conflicts where the articles of association contain a provision to this effect. The 2006 Act also allows the articles of association to contain other provisions for dealing with directors' conflicts of interest to avoid a breach of duty.

Clause 92 of the Articles, gives the directors authority to authorise any matter which would or might otherwise constitute or give rise to a breach of the duty of a director under the 2006 Act to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict with the company.

Authorisation of any matter pursuant to Clause 92 must be approved in accordance with normal board procedures by directors who have no interest in the matter being considered. In taking the decision, the directors must act in a way they consider, in good faith, will be most likely to promote the company's success.

Any authorisation of a matter may be given on or subject to such conditions or limitations as the directors determine, whether at the time of authorisation or subsequently, including providing for the exclusion of the interested directors from the receipt of information or participation in discussion relating to the matter authorised by the directors and providing that interested directors in receipt of confidential information from a third party are not obliged to disclose such information to the company or use the information in relation to the company's affairs. Any authorisation may be terminated by the directors at any time.

A director is not, except as otherwise agreed by him, accountable to the company for any benefit which he, or a person connected with him, derives from any matter authorised by the directors and any contract, transaction or arrangement relating to such matter is not liable to be avoided on the grounds of such benefit.

Directors' power to allot securities
In line with market practice, the Articles provide that the authority to allot shares and the disapplication of pre-emption rights will not be set out in the Articles, but subject to resolutions passed at the company's annual general meeting to obtain these authorities on an annual basis.

Borrowing powers
The directors may exercise all the powers of the company to borrow money and to mortgage or charge its undertaking, property and uncalled capital and to issue debentures and other securities, whether outright or as collateral security for any debt, guarantee, liability or obligation of the company, or of any third party.

Qualifying shareholding
Directors are not required to hold any shares of the company by way of qualification.

Classes of shares
The company has issued and outstanding the following four general classes of shares, namely ordinary shares, preference shares, B Shares and a Dividend Access Share, to which the provisions set forth below apply. In addition, the company has as part of its share capital Additional Value Shares ("AVSs"). All of the issued AVSs were converted into non-voting deferred shares in December 2003. The terms of those AVSs are set out in Schedule 3 to the Articles. The terms of the issued B Shares (designated Series 1 Class B Shares) and the Dividend Access Share (designated a Series 1 Dividend Access Share) were determined by the directors pursuant to the Articles prior to the time of allotment, and apply as if they were set out in the Articles.

Dividends
General
Subject to the provisions of the 2006 Act and Clause 123 of the Articles, the company may, by ordinary resolution, declare dividends on ordinary shares save that no dividend shall be payable except out of profits available for distribution, or in excess of the amount recommended by the Board or in contravention of the special rights attaching to any share. Any dividend which has remained unclaimed for 12 years from the date of declaration shall be forfeited and shall revert to the company.

The company may cease sending dividend warrants and cheques by post or otherwise to a member if such instruments have been returned undelivered to, or left uncashed by, that member on at least two consecutive occasions, or, following one such occasion, reasonable enquiries have failed to establish any new address or account of the registered holder. The company may resume sending warrants and cheques if the holder requests such recommencement in writing.

Shareholder information

Preference shares
Each cumulative preference share confers the right to a fixed cumulative preferential dividend payable half-yearly. Each non-cumulative preference share confers the right to a preferential dividend (not exceeding a specified amount) payable in the currency of the relevant share. The rate of such dividend and the date of payment thereof, together with the terms and conditions of the dividend, are as may be determined by the directors prior to allotment. Cumulative preference share dividends are paid in priority to any dividend on any other class of share.

The non-cumulative preference shares rank for dividend after the cumulative preference shares but rank pari passu with each other and any shares expressed to rank, in terms of participation in the profits of the company, in some or all respects pari passu therewith and otherwise in priority to dividends payable on the ordinary shares and any other share capital in the company.

The directors may resolve prior to the issue and allotment of any series of non-cumulative preference shares that full dividends in respect of a particular dividend payment date will not be declared and paid if, (i) in its sole and absolute discretion, the directors resolve prior to the relevant dividend payment date that such dividend (or part thereof) shall not be paid and/or (ii) in the opinion of the directors, payment of a dividend would cause a breach of the UK Financial Services Authority’s capital adequacy requirements applicable to the company or its subsidiaries, or subject to the next following paragraph, insufficient distributable profits of the company are available to cover the payment in full of all dividends after having paid any dividends payable on any of the cumulative preference shares.

If dividends will be paid but, in the opinion of the directors, insufficient distributable profits of the company are available to cover the payment in full of dividends after having paid any dividends payable on any of the cumulative preference shares, dividends will be declared by the directors, pro rata on the non-cumulative preference shares to the extent of the available distributable profits.

The non-cumulative preference shares will carry no further rights to participate in the profits of the company and if, and to the extent, any dividend or part of any dividend is on any occasion not paid for any of the reasons described above, holders of non-cumulative preference shares will have no claim in respect of such non-payment.

If any dividend is not payable for the reasons described in clause (ii) of the third paragraph of this subsection, the directors may pay a special dividend not exceeding US$0.01, £0.01 or €0.01 (depending on the currency of the relevant preference share) per share.

If the dividend payable on any series of non-cumulative preference shares on the most recent payment date is not paid in full, or if a sum is not set aside to provide for such payment in full, in either case for the reasons set forth in clause (ii) of the third paragraph of this subsection, no dividends may be declared on any other share capital of the company and no sum may be set aside for the payment of a dividend on any other share capital (in each case other than the cumulative preference shares), unless, on the date of declaration, an amount equal to the dividend payable in respect of the then current dividend period for such series of non-cumulative preference shares is set aside for payment in full on the next dividend payment date.

If any dividend payable on the non-cumulative preference shares is not paid in full or if a sum is not set aside to provide for such payment in full (in either case for the reasons set forth in clause (ii) of the third paragraph of this subsection), the company may not redeem or purchase or otherwise acquire any other share capital of the company and may not set aside any sum nor establish any sinking fund for its redemption, purchase or other such acquisition, until such time as dividends have been declared and paid in full in respect of successive dividend periods together aggregating not less than twelve months.

The non-payment of any dividend (in full or in part) by reason of the exercise of the directors' discretion referred to in clause (i) of the third paragraph of this subsection, shall not prevent or restrict (a) the declaration and payment of dividends on any other series of non-cumulative preference shares or on any non-cumulative preference shares expressed to rank pari passu with the non-cumulative preference shares, (b) the setting aside of sums for the payment of such dividends, (c) except as set forth in the following paragraph, the redemption, purchase or other acquisition of shares in the company by the company, or (d) except as set forth in the following paragraph, the setting aside of sums, or the establishment of sinking funds, for any such redemption, purchase or other acquisition by the company.

If dividends are not declared and paid in full on any series of non-cumulative preference shares as a result of the directors' discretion referred to in clause (i) of the third paragraph of this subsection, then the company may not redeem, purchase or otherwise acquire for any consideration any share capital ranking after such preference shares, and may not set aside any sum nor establish any sinking fund for the redemption, purchase or other acquisition thereof, until such time as the company has declared and paid in full dividends on such series of non-cumulative preference shares in respect of successive dividend periods together aggregating no less than twelve months. In addition, no dividend may be declared or paid on any of the company's share capital ranking after such preference shares until the dividend in respect of a particular dividend payment date payable on the preference shares to which the directors' discretion in clause (i) of the third paragraph of this subsection applies has been declared and paid in full.

With effect from 19 April 2011, subject to existing class rights of shareholders, new preference shares can be issued with such rights and restrictions as the directors may determine.

Non-voting deferred shares
The holders of non-voting deferred shares are not entitled to the payment of any dividend or other distribution.

Shareholder information

B Shares
Prior to the occurrence of a Trigger Event (as defined below) in respect of any Series 1 Class B Shares, those Series 1 Class B Shares rank equally with the holders of ordinary shares in respect of any cash dividends, and each Series 1 Class B Share will entitle its holder to the same cash dividend as is (or may, at the election of a holder of the ordinary share, be) payable to the holder of one ordinary share, as adjusted from time to time to reflect any consolidation, reclassification or subdivision in relation to the ordinary shares.

If a Trigger Event has occurred in respect of any Series 1 Class B Shares, the Series 1 Class B Shares in respect of which the Trigger Event has occurred will rank pari passu with the holders of the ordinary shares in respect of any dividends paid on the ordinary shares. Each Series 1 Class B Share will entitle its holder to the same dividend as is (or may, at the election of a holder of an ordinary share, be) payable to the holder of one (as adjusted from time to time) ordinary share. If a bonus issue of fully paid ordinary shares is made to holders of ordinary shares in lieu of a dividend, a holder of a Series 1 Class B Share in respect of which the Trigger Event has occurred will be entitled to receive the same number of ordinary shares as is payable to the holder of one (as adjusted from time to time) ordinary share, save that if the issue of such ordinary share(s) to such holder would result in it holding directly or indirectly more than 75% of the total issued ordinary shares, then such holder will instead receive further Series 1 Class B Shares of the same value.

A Trigger Event occurs in relation to the Series 1 Class B Shares in issue at the relevant time, if the daily volume weighted average price of the company’s ordinary shares on the London Stock Exchange equals or exceeds £0.65 per ordinary share (subject to adjustment) for 20 or more complete dealing days in any period of 30 consecutive dealing days.

Dividend Access Share
Subject to the discretions, limitations and qualifications described in this subsection, non-cumulative dividends on the Series 1 Dividend Access Share will be payable from 22 December 2009 in respect of the period up to and including the Series 1 Class B Dividend Stop Date (if any).

The company will pay dividends on the Series 1 Dividend Access Share when, as and if declared by its board of directors or a duly authorised committee of such board of directors (the ‘‘board of directors’’). Subject to the discretions, limitations and qualifications described in this section, the Series 1 Dividend Access Share will entitle the holder to receive out of the distributable profits of the company a non-cumulative dividend at the rate described below (the ‘‘Dividend Access Share Dividend’’), in priority to the payment of any dividend to the holders of any class of ordinary share or Class B Share and pari passu in such regard with the holder of any other dividend access share then in issue.

The board of directors may in its sole and absolute discretion resolve that no Dividend Access Share Dividend shall be paid on a Dividend Access Share Dividend payment date.

The board of directors will, by 31 October in each financial year of the company, decide whether or not to pay an interim dividend on the ordinary shares or make an interim Ordinary Share Bonus Issue in that financial year. If it is decided that an interim dividend on the ordinary shares or an interim Ordinary Share Bonus Issue is to be paid or made in any financial year, the corresponding semi-annual (hereinafter referred to as ‘‘first semi-annual’’) Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share in the same financial year will be paid or made at the time set out below. The record date for any first semi-annual Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share will be the same as the record date for any interim dividend on the ordinary shares or interim Ordinary Share Bonus Issue in the relevant financial year or otherwise will be three business days before 31 October in each year. If paid or made, the first semi-annual Dividend Access Share Dividend

or Bonus Issue on the Series 1 Dividend Access Share in a financial year will be paid or made on the same date that the corresponding interim dividend on the ordinary shares is paid or interim Ordinary Share Bonus Issue is made. If it is decided that no such interim dividend on the ordinary shares or interim Ordinary Share Bonus Issue will be paid or made in a financial year, the first semi-annual Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share in such financial year will, if to be paid or made, be so paid or made on 31 October in such financial year (commencing in 2010).

The Board of directors will, by 31 May in each financial year of the company, decide whether or not to recommend a dividend on the ordinary shares or make an Ordinary Share Bonus Issue which is expressed to be a final dividend for the immediately preceding financial year. If it is decided that such a dividend on the ordinary shares or Ordinary Share Bonus Issue is to be recommended and is subsequently approved by shareholders, the corresponding semi-annual (hereinafter referred to as ‘‘second semi-annual’’) Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share expressed to be for the corresponding period will be paid at the time set out below. The record date for any second semi-annual Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share will be the same as the record date for any final dividend on the ordinary shares or final Ordinary Share Bonus Issue for the relevant financial year or otherwise will be three business days before 31 May in each year. If paid or made, the second semi-annual Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share in a financial year will be paid or made on the same date that the corresponding final dividend on the ordinary shares is paid or final Ordinary Share Bonus Issue is made. If it is decided that no such final dividend on the ordinary shares or Ordinary Share Bonus Issue will be paid or made in any year (the ‘‘current year’’) for the immediately preceding financial year, any second semi-annual Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share expressed to be for the corresponding period will, if to be paid or made, be so paid or made on 31 May in the current year (commencing in 2010).

Shareholder information

Any first semi-annual Dividend Access Share Dividend or second semi-annual Dividend Access Share Dividend will only be paid if (to the extent legally required) profits are available for distribution and are permitted by law to be distributed.

If paid or made, the first semi-annual Dividend Access Share Dividend on the Series 1 Dividend Access Share will be equivalent to (A) the greater of:

(i) 7% of the Reference Amount multiplied by the actual number of days in the period from (but excluding) the immediately preceding Relevant Date (or, if none, 22 December 2009), to (and including) the current Relevant Date (or, if there has occurred prior to such current Relevant Date a Series 1 Class B Dividend Stop Date in respect of any Series 1 Class B Shares, then in respect of those Series 1 Class B Shares, to (and including) such earlier Series 1 Class B Dividend Stop Date), divided by 365 (or 366 in a leap year)

(ii) if a cash dividend or cash dividends on the ordinary shares or Ordinary Share Bonus Issue(s) is/are paid or made in the period from (but excluding) the immediately preceding Relevant Date (or, if none, 22 December 2009) to (and including) the current Relevant Date (or, if there has occurred prior to such current Relevant Date a Series 1 Class B Dividend Stop Date in respect of any Series 1 Class B Shares, then in respect of those Series 1 Class B Shares, to (and including) such earlier Series 1 Class B Dividend Stop Date), 250% (as adjusted from time to time as described in the terms of issue of the Series 1 Dividend Access Share, ‘‘Participation Rate’’) of the aggregate fair market value (as defined in the terms of issue of the Series 1 Dividend Access Share) of such cash dividend or cash dividends or Ordinary Share Bonus Issue per ordinary share multiplied by the then Reference Series 1 Class B Shares Number. Where a dividend in cash is announced which may at the election of a shareholder or shareholders be satisfied by the issue or delivery of ordinary shares in an Ordinary Share Bonus Issue, or where an Ordinary Share Bonus Issue is announced which may at the election of a shareholder or shareholders be satisfied by the payment of cash, then the fair market value of such dividend or Ordinary Share Bonus Issue will be deemed to be the amount of the dividend in cash or of the payment in cash (as the case may be) less (B) the fair market value (as defined in the terms of issue of the Series 1 Dividend Access Share) of the aggregate amount of any dividend or distribution paid or made on the Series 1 Class B Shares and/or on any ordinary shares issued on conversion of the B Shares (regardless of who holds such Series 1 Class B Shares or ordinary shares at the relevant time) in the period from (but excluding) the immediately preceding Relevant Date (or, if none, 22 December 2009) to (and including) the current Relevant Date (or, if there has occurred prior to such current Relevant Date a Series 1 Class B Dividend Stop Date in respect of any Series 1 Class B Shares, then in respect of those Series 1 Class B Shares to (and including) such earlier Series 1 Class B Dividend Stop Date), provided that the first semi-annual Dividend Access Share Dividend will never be less than zero.

If the Participation Rate is adjusted during the course of a financial year, the amount of the semi-annual Dividend Access Share Dividend in such financial year, if determined by reference to the Participation Rate, will itself be adjusted in such manner as the Independent Financial Adviser (acting as an expert) considers appropriate to take account of the date(s) on which the adjustment(s) to the Participation Rate become effective. A written opinion of the Independent Financial Adviser will be conclusive and binding on all parties, save in the case of manifest error.

In the event of a change in the frequency of dividend payments on the ordinary shares such that they are not paid semi-annually consistent with the payment of Dividend Access Share Dividends on the Series 1 Dividend Access Share, the company will make such changes to the Dividend Access Share Dividend payment arrangements described above as, following consultation with the Independent Financial Adviser (acting as an expert), it determines are fair and reasonable to take account of such changed frequency.

Non-cumulative dividends on the Series 1 Dividend Access Share will be payable in respect of the period up to and including the Series 1 Class B Dividend Stop Date (if any). After the Series 1 Class B Dividend Stop Date (if any), the right of the holder of the Series 1 Dividend Access Share to Dividend Access Share Dividends in respect of any Series 1 Class B Shares in issue during each of the 30 consecutive dealing days during which the Trigger Event occurs will cease, but this is without prejudice to the right to Dividend Access Share Dividends in respect of any Series 1 Class B Shares not in issue on each such day.

Bonus Issue of Series 1 Class B Shares on the Series 1 Dividend Access Share
If the board of directors decides to pay a Dividend Access Share Dividend and either (i) no dividend has been paid on the ordinary shares and/or distribution made thereon in respect of the corresponding period, or (ii) a dividend has been paid and/or a distribution has been made on the ordinary shares otherwise than in cash in respect of the corresponding period, the board of directors may in its discretion determine that such Dividend Access Share Dividend will be paid in whole or in part by the company issuing Series 1 Class B Shares, credited as fully paid, to the holder of the Series 1 Dividend Access Share. The number of such further Series 1 Class B Shares to be issued to the holder will be such number of Series 1 Class B Shares as is certified by an Independent Financial Adviser (acting as an expert) to be as nearly as possible equal to (but not greater than) the cash amount (disregarding any tax credit) of such semi-annual Dividend Access Share Dividend or part thereof otherwise payable to such holder of the Series 1 Dividend Access Share, based on the fair market value of a Series 1 Class B Share at the time of such determination. A written opinion of such Independent Financial Adviser will be conclusive and binding on all parties, save in the case of manifest error. The additional Series 1 Class B Shares will rank pari passu in all respects with the fully paid Series 1 Class B Shares then in issue save only as regards participation in the relevant dividend.

Shareholder information

Restrictions following non-payment of dividend

If any Dividend Access Share Dividend is not declared and paid in full in cash or otherwise, the company:

(i) may not, and will procure that no subsidiary undertaking of the company will, declare or pay dividends or other distributions on any Parity Securities (whether in cash or otherwise, and whether payable on the same date as the relevant Dividend Access Share Dividend or subsequently) or make any Ordinary Share Bonus Issue (whether to be made on the same date as the relevant Dividend Access Share Dividend or subsequently), and the company may not, and will procure that no subsidiary undertaking of the company shall, set aside any sum for the payment of these dividends or distributions; and

(ii) may not, and will procure that no subsidiary undertaking of the company will, redeem, purchase or otherwise acquire (whether on the same date as the relevant Dividend Access Share Dividend is payable or subsequently) for any consideration any of its Parity Securities or any depository or other receipts or certificates representing Parity Securities (other than any such purchases or acquisitions which are made in connection with any Employee Share Scheme (as defined in the terms of issue of the Series 1 Dividend Access Share) and (save as aforesaid) the company may not, and will procure that no subsidiary undertaking of the company shall, set aside any sum or establish any sinking fund (whether on the same date as the relevant Dividend Access Share Dividend is payable or subsequently) for the redemption, purchase or other acquisition of Parity Securities or any depositary or other receipts or certificates representing Parity Securities, in each case until such time as Dividend Access Share Dividends are no longer payable or payment of Dividend Access Share Dividends in cash or otherwise has resumed in full, as the case may be.

Definitions in relation to this Dividend Access Share subsection
“Bonus Issue” means a bonus issue of Series 1 Class B Shares to the holder of the Series 1 Dividend Access Share.

“Independent Financial Adviser” means an independent financial institution appointed by the company and approved by HM Treasury.

“Ordinary Share Bonus Issue” means a bonus issue of fully paid ordinary shares to holders of ordinary shares in lieu of a dividend.

“Parity Securities” means ordinary shares, Series 1 Class B Shares and any other securities of the company or its subsidiary undertakings which rank pari passu with the ordinary shares, and/or Series 1 Class B Shares on a return of capital on a winding up, either issued by the company or issued by a subsidiary undertaking of the company with terms attached which benefit from a guarantee or support agreement entered into by the company which ranks pari passu with the ordinary shares, and/or Series 1 Class B Shares on a return of capital on a winding up.

‘‘Reference Amount’’ means £25,500,000,000 plus the aggregate Relevant Amount of any further Series 1 Class B Shares issued by the company to HM Treasury after 22 December 2009 and before the record date for the relevant Dividend Access Share Dividend, less the aggregate Relevant Amount of any Series 1 Class B Shares which were in issue during the 30 consecutive dealing days during which a Series 1 Class B
Dividend Trigger Event occurred. “Reference Series 1 Class B Shares Number” means the Reference Amount divided by the Relevant Amount.

“Relevant Amount” means £0.50 (subject to adjustment from time to time to reflect any consolidation, redesignation or subdivision in relation to the Series 1 Class B Shares) per Series 1 Class B Share.

“Relevant Date” means in respect of any semi-annual Dividend Access Share Dividend or Bonus Issue, the date on which the company pays or makes the same or (subject to adjustment for a change to the company’s accounting reference date), if the same is not paid or made, means 31 October of the relevant year in the case of a first semi-annual Dividend Access Share Dividend or Bonus Issue, and 31 May of the relevant year in the case of a second semi-annual Dividend Access Share Dividend or Bonus Issue.

“Series 1 Class B Dividend Stop Date” means the date falling 20 days after the Series 1 Class B Dividend Trigger Event.

“Series 1 Class B Dividend Trigger Event” means, in relation to the Series 1 Class B Shares in issue at the relevant time, the daily volume weighted average price of the company’s ordinary shares on the London Stock Exchange equals or exceeds £0.65 per ordinary share (subject to adjustment) for 20 or more complete dealing days in any period of 30 consecutive dealing days.

Distribution of assets on liquidation
Cumulative preference shares
In the event of a return of capital on a winding-up or otherwise, the holders of cumulative preference shares are entitled to receive out of t he surplus assets of the company available for distribution amongst the members (i) in priority to the holders of the non-cumulative preference shares and any other shares ranking pari passu therewith, the arrears of any fixed dividends including the amount of any dividend due for a payment after the date of commencement of any winding-up or liquidation but which is payable in respect of a half-year period ending on or before such date and (ii) pari passu with the holders of the non-cumulative preference shares and any other shares ranking pari passu therewith, the amount paid up or credited as paid up on such shares together with any premium.

Non-cumulative preference shares
Each non-cumulative preference share will confer on a winding up or liquidation (except (unless otherwise provided by the terms of issue) a redemption or purchase by the company of any shares in the capital of the company), the right to receive out of surplus assets of the company available for distribution amongst the members after payment of the arrears (if any) of the cumulative dividend on the cumulative preference shares and in priority to the holders of the ordinary shares, repayment of the amount paid up or credited as paid up on the non-cumulative preference shares together with any premium paid on issue pari passu with the holders of the cumulative preference shares and together with an amount equal to accrued and unpaid dividends.

Shareholder information

Non-voting deferred shares
On a winding-up or other return of capital of the company, holders of non-voting deferred shares are entitled only to payment of the amounts paid up on the non-voting deferred shares, after repayment to the holders of ordinary shares of the nominal amount paid up on the ordinary shares held by them and payment of £100,000 on each ordinary share.

B Shares
On a winding-up, holders of the Series 1 Class B Shares will rank equally with the holders of the ordinary shares, the Series 1 Dividend Access Share and any other class of shares or securities of the company which rank equally with the Series 1 Class B Shares, the Series 1 Dividend Access Share or the ordinary shares on a winding-up or liquidation, and junior to all other shareholders and all creditors of the company. For these purposes, on a winding-up each holder of a Series 1 Class B Share will be deemed to hold one (as adjusted from time to time) ordinary share of the company for every Series 1 Class B Share held at the date of the commencement of such winding-up, and will be entitled to receive out of the surplus assets of the company remaining after payment of all prior-ranking claims, a sum equal to that payable to a holder of one (as adjusted) ordinary share in such event.

Dividend Access Share
On a winding-up, the holder of the Series 1 Dividend Access Share will rank equally with the holders of the ordinary shares, the Series 1 Class B Shares and any other class of shares or securities of the company which rank equally with the Series 1 Dividend Access Share, the Series 1 Class B Shares or the ordinary shares on a winding-up or liquidation, and junior to all other shareholders and all creditors of the company. For these purposes, on a winding-up the holder of the Series 1 Dividend Access Share will be deemed to hold one (as adjusted from time to time) ordinary share of the company, and will be entitled to receive out of the surplus assets of the company remaining after payment of all prior-ranking claims, a sum equal to that payable to a holder of one (as adjusted) ordinary share in such event.

General
On a winding-up of the company, the liquidator may, with the authority of any extraordinary resolution and any other sanction required by the Insolvency Act 1986 and subject to the rights attaching to any class of shares after payment of all liabilities, including the payment to holders of preference shares, divide amongst the members in specie or kind the whole or any part of the assets of the company or vest the whole or any part of the assets in trustees upon such trusts for the benefit of the members and may determine the scope and terms of those trusts. No member shall be compelled to accept any assets on which there is a liability.

Voting Rights
General
Subject to any rights or restrictions as to voting attaching to any shares or class of shares, on a show of hands every member who is present in person or by proxy at a general meeting shall have one vote (except that a proxy who is appointed by more than one member has one vote for and one vote against if the proxy has been instructed by one or more members to vote for the resolution and by one or more members to vote against the resolution) and on a poll every member present in person or by proxy shall have one vote for each 25 pence in nominal amount of shares held by him. No member shall, unless the directors otherwise determine, be entitled to vote at a general meeting or at a separate meeting of the holders of shares in the capital of the company, either in person or by proxy, in respect of any share held by him unless all monies presently payable by him in respect of that share have been paid. There is no obligation on the company to check and ensure that a proxy is voting at a general meeting in accordance with the voting directions provided by the appointing member. The chairman of a general meeting does not have a casting vote in the event of an equality of votes, as this is not permitted under the 2006 Act. The quorum required for a meeting of members is not less than five members present in person and entitled to vote. If a meeting is adjourned because of the lack of a quorum, the members present in person or by proxy and entitled to vote will constitute a

quorum at the adjourned meeting.

Meetings are convened upon written notice of not less than 21 days in respect of annual general meetings of members and not less than 14 days in respect of other meetings of members subject to certain conditions. An adjourned meeting may be called at shorter notice than applied to the original meeting, but where a meeting is adjourned for lack of quorum only if the adjourned meeting is held at least ten days after the original meeting and does not include any new business.

Cumulative preference shares
At a general meeting of the company, every holder of a cumulative preference share who is present in person or by proxy shall be entitled to one vote on a show of hands and, on a poll, every person who is present in person or by proxy shall have one vote for each 25 pence in nominal amount of shares held. No member shall be entitled to vote any share in person or by proxy unless all moneys owed in respect of that share have been paid.

Non-cumulative preference shares
Holders of non-cumulative preference shares are not entitled to attend or vote at any general meeting unless the business of the meeting includes the consideration of a resolution for the winding-up of the company or any resolution directly varying or abrogating the rights attached to any such shares and then in such case only to speak to and vote upon any such resolution. However, holders have the right to vote in respect of any matter when the dividend payable on their shares has not been declared in full for such number of dividend periods as the directors shall determine prior to the allotment thereof. Whenever a holder is entitled to vote at a general meeting, on a show of hands every shareholder who is present in person has one vote and, on a poll, every such holder who is present in person or by proxy shall have such number of votes as may be determined by the directors prior to allotment.

Shareholder information

Non-voting deferred shares
The holders of non-voting deferred shares are not entitled to receive notice of or to attend or vote at any general meeting of the company or otherwise receive any shareholder communication.

B Shares
Holders of the Series 1 Class B Shares are not entitled to attend or vote at any general meeting unless the business of the meeting includes the consideration of a resolution for the winding-up of the company or any resolution varying or abrogating the rights attached to any such shares and then in such case only to speak to and vote upon any such resolution. If entitled to vote, each holder is entitled on a poll to two votes for each Series 1 Class B Share held.

Dividend Access Share
The holder of the Series 1 Dividend Access Share is not entitled to attend or vote at any general meeting unless the business of the meeting includes the consideration of a resolution for the winding-up of the company or any resolution varying or abrogating the rights attached to such share and then in such case only to speak to and vote upon any such resolution. If entitled to vote, the holder is entitled on a poll to one vote.

Redemption
Except as set forth in the following paragraph, unless the directors determine, prior to allotment of any particular series of non-cumulative preference shares, that such series shall be non-redeemable, the preference shares will be redeemable at the option of the company on any date which (subject to certain exceptions described in the terms of such shares) falls no earlier than such date (if any) as may be fixed by the directors, prior to allotment of such shares. On redemption, there shall be paid on each non-cumulative preference share the aggregate of its nominal amount together with any premium paid on issue, where applicable a redemption premium and accruals of dividend.

If the company wishes to issue redeemable shares, the Directors are authorised to determine the terms and manner of redemption.

Purchase
General
Under the 2006 Act a company requires shareholder authority to purchase its own shares, consolidate and sub-divide its shares and reduce its share capital. Whenever non-cumulative preference shares are issued in the future the Articles have no restriction on the maximum purchase price payable by the company unless such restriction is expressly applied by the directors in relation to an issuance of non-cumulative preference shares.

Conversion rights
Convertible preference shares carry the right to convert into ordinary shares if they have not been the subject of a notice of redemption from the company, on or before a specified date determined by the directors. The right to convert will be exercisable by service of a conversion notice on the company within a specified period. The company will use reasonable endeavours to arrange the sale, on behalf of convertible preference shareholders who have submitted a conversion notice, of the ordinary shares which result from such conversion and to pay to them the proceeds of such sale so that they receive net proceeds equal to the nominal value of the convertible preference shares which were the subject of the conversion notice and any premium at which such shares were issued, provided that ordinary shares will not be sold at below a benchmark price (as determined prior to the issue of the relevant convertible preference shares by the directors).

B Shares

The B Shares are convertible into ordinary shares at HM Treasury's option at an initial conversion price of £0.50 per share, subject to adjustment. In December 2003, following the payment of aggregate dividends of £1 in respect of each AVS, all issued and outstanding AVSs were de-listed from the Official List and from trading on the London Stock Exchange's market for listed securities and converted into non-voting deferred shares of £0.01 each.

Changes in share capital and variation of rights

Subject to the provisions of the 2006 Act and without prejudice to any rights attached to any existing shares or class of shares, any share may be issued with such rights or restrictions as the company may by ordinary resolution determine or, subject to and in default of such determination, as the Board shall determine. Subject to the provisions of the 2006 Act, the company may issue shares which are, or at the option of the company or the holder are liable, to be redeemed. Subject to the provisions of the 2006 Act and the Articles, unissued shares are at the disposal of the Board.

The company may by ordinary resolution: increase its share capital; consolidate and divide all or any of its share capital into shares of larger amount than its existing shares; subject to the provisions of the 2006 Act, subdivide its shares, or any of them, into shares of smaller amount than is fixed by the Memorandum; or cancel any shares which have not been taken or agreed to be taken by any person and diminish the amount of its share capital by the amount of the shares so cancelled.

Shareholder information

Subject to the provisions of the 2006 Act, if at any time the capital of the company is divided into different classes of shares, the rights attached to any class of shares may (unless further conditions are provided by the terms of issue of the shares of that class) be varied or abrogated, whether or not the company is being wound up, either with the consent in writing of the holders of three-quarters in-nominal value of the issued shares of the class or with the sanction of an extraordinary resolution passed at a separate general meeting of holders of the shares of the class (but not otherwise). To any such separate general meeting the provision of the Articles relating to general meeting s will apply, save that:

(i) if at any adjourned meeting of such holders a quorum as defined above is not present, two people who hold shares of the class, or their proxies, are a quorum; and

(ii) any such holder present in person or by proxy may demand a poll

The rights attaching to any class of shares having preferential rights are not, unless otherwise expressly provided by the terms of issue thereof, deemed to be varied by the creation or issue of further shares ranking, as regards participation in t he profits or assets of the company, pari passu therewith, but in no respect in priority thereto.

Disclosure of interests in shares
The 2006 Act gives the company the power to require persons who it believes to be, or have been within the previous three years, interested in its shares, to disclose prescribed particulars of those interests. Failure to supply the information or supplying a statement which is materially false may lead to the Board imposing restrictions upon the relevant shares. The restrictions available are the suspension of voting or other rights conferred by membership in relation to meetings of the company in respect of the relevant shares and, additionally, in the case of a shareholding representing at least 0.25 per cent of the class of shares concerned, the withholding of payment of dividends on, and the restriction of transfers of, the relevant shares.

Limitations on rights to own share
There are no limitations imposed by UK law or the Memorandum and Articles on the right of non-residents or foreign persons to hold or vote the company's shares other than the limitations that would generally apply to all of the company's shareholders.
Members resident abroad
Members with registered addresses outside the United Kingdom are not entitled to receive notices from the company unless they have given the company an address within the United Kingdom at which such notices may be served.

Sending notices and other documents to shareholders
The company may communicate with members by electronic and/or website communications. A member whose registered address is not within the United Kingdom shall not be entitled to receive any notice from the Company unless he gives the Company a postal address within the United Kingdom at which notices may be given to him.

Documents on display
Documents concerning the company may be inspected at 36 St Andrew Square, Edinburgh, EH2 2YB.

Executive directors' service contracts and copies of directors' indemnities granted by the company in terms of section 236 of the Companies Act 2006 may be inspected at the company's office at Gogarburn, Edinburgh, EH12 1HQ (telephone 0131 626 4114).

In addition, we file reports and other information with the SEC. You can read and copy these reports and other information at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You can call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room or contact the offices of The New York Stock Exchange, on which certain of our securities are listed, at 20 Broad Street, New York, New York 10005. The SEC also maintains a website at www.sec.gov which contains in electronic form each of the reports and other information that we have filed electronically with the SEC.

Incorporation and registration

The company was incorporated and registered in Scotland under the Companies Act 1948 as a limited company on 25 March 1968 under the name National and Commercial Banking Group Limited, and changed its name to The Royal Bank of Scotland Group Limited on 3 September 1979. On 10 March 1982 it was re-registered under the Companies Acts 1948 to 1980 as a public company with limited liability. The company is registered under Company No. SC45551.

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Abbreviations and acronyms

ABCP	Asset Backed Commercial Paper	GRG	Global Restructuring Group
AFS	Available-for-sale	HFT	Held-for-trading
APR	All Price Risk	HMT	HM Treasury
AQ	Asset Quality	IAS	International Accounting Standards
AT1	Additional Tier 1	IASB	International Accounting Standards Board
BCBS	Basel Committee on Banking Supervision	ICAAP	Internal Capital Adequacy Assessment Process
CCR	Counterparty Credit Risk	ICB	Independent Commission on Banking
CD	Certificate of deposit	IFRS	International Financial Reporting Standards
CDO	Collateralised Debt Obligation	IMF	International Monetary Fund
CDPC	Credit Derivative Product Company	IPO	Initial Public Offering
CDS	Credit Default Swap	IPV	Independent Price Verification
CEM	Counterparty Exposure Management	IRC	Incremental Risk Charge
CET1	Common Equity Tier 1	IRRBB	Interest Rate Risk in the Banking Book
CGU	Cash Generating Unit	ISDA	International Swaps and Derivatives Association
CLO	Collateralised Loan Obligation	LAR	Loans and Receivables
CMBS	Commercial Mortgage-backed Securities	LGD	Loss Given Default
CP	Commercial Paper	LIBOR	London Interbank Offered Rate
CQA	Credit Quality Assurance	LTIP	Long Term Incentive Plan
CRA	Credit Risk Assets	LTV	Loan-to-value
CRD	Capital Requirements Directive	MBS	Mortgage-backed Securities
CRE	Commercial Real Estate	MTN	Medium-term Notes
CRG	Capital Resolution Group	NI	Northern Ireland
CRM	Credit Risk Mitigation	NYSE	New York Stock Exchange
CRO	Chief Risk Officer	OFT	Office of Fair Trading
CRR	Capital Requirements Regulation	OTC	Over-the-counter
CVA	Credit Valuation Adjustment	PD	Probability of Default
DFV	Designated as at Fair Value through profit or loss	PFE	Potential Future Exposure
DTA	Deferred Tax Asset	PPI	Payment Protection Insurance
EAD	Exposure At Default	PPL	Potential Problem Loans
EC	European Commission	PRA	Prudential Regulation Authority
ECB	European Central Bank	PVA	Prudential Valuation Adjustment
EDTF	Enhanced Disclosure Task Force	R&C	Retail & Commercial

EL	Expected Loss
EMEA	Europe, the Middle East and Africa
ERF	Executive Risk Forum
ESOP	Executive Share Option Plan
EU	European Union
FCA	Financial Conduct Authority
FI	Financial Institution
FLB3	Fully Loaded Basel III
FPC	Financial Policy Committee
FSA	Financial Services Authority
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
FVTPL	Fair Value Through Profit or Loss
GAC	Group Audit Committee
GALCO	Group Asset and Liability Management Committee
GCCO	Group Chief Credit Officer
GCoR	Global Country Risk
GCR	Group Credit Risk
GRC	Group Risk Committee
GDP	Gross Domestic Product
GPF	Group Policy Framework
RBSG	The Royal Bank of Scotland Group plc
RCR	RBS Capital Resolution
REIL	Risk Elements In Lending
RFS	RFS Holdings B.V.
RMBS	Residential Mortgage-backed Securities
RNIV	Risks Not In VaR
ROE	Return on Equity
ROI	Republic of Ireland
RoW	Rest of the World
RTS	Regulatory Technical Standards
RWA	Risk-weighted asset
SE	Structured Entity
SEC	US Securities and Exchange Commission
SFT	Securities Financing Transaction
SME	Small and Medium-sized Enterprise
SNC	Single Name Concentration
SVaR	Stressed Value-at-Risk
TSR	Total Shareholder Return
UK	United Kingdom
UKFI	UK Financial Investments Limited
US/USA	United States of America
VaR	Value-at-Risk

Glossary of terms

Arrears - the aggregate of contractual payments due on a debt that have not been met by the borrower. A loan or other financial asset is said to be 'in arrears' when payments have not been made.

Asset-backed commercial paper (ABCP) - a form of asset-backed security generally issued by a commercial paper conduit.

Asset-backed securities (ABS) - securities that represent interests in specific portfolios of assets. They are issued by a structured entity following a securitisation. The underlying portfolios commonly comprise residential or commercial mortgages but can include any class of asset that yields predictable cash flows. Payments on the securities depend primarily on the cash flows generated by the assets in the underlying pool and other rights designed to assure timely payment, such as guarantees or other credit enhancements. Collateralised debt obligations, collateralised loan obligations, commercial mortgage backed securities and residential mortgage backed securities are all types of ABS.

Asset quality (AQ) band - probability of default banding for all counterparties on a scale of 1 to 10.

Assets under management - assets managed by the Group on behalf of clients.

Back-testing - statistical techniques that assess the performance of a model, and how that model would have performed had it been applied in the past.

Basel II - the capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the ‘International Convergence of Capital Measurement and Capital Standards’.

Basel III - in December 2010, the Basel Committee on Banking Supervision issued final rules: ‘Basel III: A global regulatory framework for more resilient banks and banking systems’ and ‘Basel III: International framework for liquidity risk measurement, standards and monitoring’.

Basis point - one hundredth of a per cent i.e. 0.01 per cent. 100 basis points is 1 per cent. Used when quoting movements in interest rates or yields on securities.

Bear steepener - a steepening of the yield curve caused by long-term rates increasing faster than short term rates.

BIPRU - the prudential sourcebook for banks, building societies and investment firms. The part of the Financial Conduct Authority's (FCA) Handbook that sets out detailed prudential requirements for the banks that they regulate.

Bull flattener - a flattening of the yield curve in which long term rates are decreasing faster than short term rates.

Buy-to-let mortgages - mortgages to customers for the purchase of residential property as a rental investment.

Capital requirements regulation (CRR) - see CRD IV.

Central counterparty (CCP) - an intermediary between a buyer and a seller (generally a clearing house).

Certificates of deposit (CDs) - bearer negotiable instruments acknowledging the receipt of a fixed term deposit at a specified interest rate.

Collateralised debt obligations (CDOs) - asset-backed securities for which the underlying asset portfolios are debt obligations: either bonds (collateralised bond obligations) or loans (collateralised loan obligations) or both. The credit exposure underlying synthetic CDOs derives from credit default swaps. The CDOs issued by an individual vehicle are usually divided in different tranches: senior tranches (rated AAA), mezzanine tranches (AA to BB), and equity tranches (unrated). Losses are borne first by the equity securities, next by the junior securities, and finally by the senior securities; junior tranches offer higher coupons (interest payments) to compensate for their increased risk.

Collateralised loan obligations (CLOs) - asset-backed securities for which the underlying asset portfolios are loans, often leveraged loans.

Collectively assessed loan impairment provisions - impairment loss provisions in respect of impaired loans, such as credit cards or personal loans, that are below individual assessment thresholds. Such provisions are established on a portfolio basis, taking account of the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends.

Commercial mortgage backed securities (CMBS) - asset-backed securities for which the underlying asset portfolios are loans secured on commercial real estate.

Commercial paper (CP) - unsecured obligations issued by a corporate or a bank directly or secured obligations (asset-backed CP), often issued through a commercial paper conduit, to fund working capital. Maturities typically range from two to 270 days. However, the depth and reliability of some CP markets means that issuers can repeatedly roll over CP issuance and effectively achieve longer term funding. CP is issued in a wide range of denominations and can be either discounted or interest-bearing.

Commercial paper conduit - a structured entity that issues commercial paper and uses the proceeds to purchase or fund a pool of assets. The commercial paper is secured on the assets and is redeemed either by further commercial paper issuance, repayment of assets or liquidity drawings.

Glossary of terms

Commercial real estate - freehold and leasehold properties used for business activities. Commercial real estate includes office buildings, industrial property, medical centres, hotels, retail stores, shopping centres, agricultural land and buildings, warehouses, garages etc.

Common Equity Tier 1 capital - the highest quality form of regulatory capital under Basel III comprising common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments.

Contractual maturity - the date in the terms of a financial instrument on which the last payment or receipt under the contract is due for settlement.

Core Tier 1 capital - called-up share capital and eligible reserves plus equity non-controlling interests, less intangible assets and other regulatory deductions.

Core Tier 1 capital ratio - Core Tier 1 capital as a percentage of risk-weighted assets.

Cost:income ratio - operating expenses as a percentage of total income.

Counterparty credit risk - the risk that a counterparty defaults before the maturity of a derivative or sale and repurchase contract. In contrast to non-counterparty credit risk, the exposure to counterparty credit risk varies by reference to a market factor (e.g. interest rate, exchange rate, asset price).

Coverage ratio - impairment provisions as a percentage of impaired loans.

Covered bonds - debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds.

CRD IV - the European Union has implemented the Basel III capital proposals through the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), collectively known as CRD IV. CRD IV was implemented on 1 January 2014. The European Banking Authority’s technical standards are still to be finalised through adoption by the European Commission and implemented within the UK.

Credit default swap (CDS) - a contract where the protection seller receives premium or interest-related payments in return for contracting to make payments to the protection buyer upon a defined credit event in relation to a reference financial asset or portfolio of financial assets. Credit events usually include bankruptcy, payment default and rating downgrades.

Credit derivatives - contractual agreements that provide protection against a credit event on one or more reference entities or financial assets. The nature of a credit event is established by the protection buyer and protection seller at the inception of a transaction, and such events include bankruptcy, insolvency or failure to meet payment obligations when due. The buyer of the credit derivative pays a periodic fee in return for a payment by the protection seller upon the occurrence, if any, of a credit event. Credit derivatives include credit default swaps, total return swaps and credit swap options.

Credit derivative product company (CDPC) - a structured entity that sells credit protection under credit default swaps or certain approved forms of insurance policies. Sometimes they can also buy credit protection. CDPCs are similar to monoline insurers. However, unlike monoline insurers, they are not regulated as insurers.

Credit enhancements - techniques that improve the credit standing of financial obligations; generally those issued by a structured entity in a securitisation. External credit enhancements include financial guarantees and letters of credit from third-party providers. Internal enhancements include excess spread - the difference between the interest rate received on the underlying portfolio and the coupon on the issued securities; and over-collateralisation - on securitisation, the value of the underlying portfolio is greater than the securities issued.

Credit grade - a rating that represents an assessment of the credit worthiness of a customer. It is a point on a scale representing the probability of default of a customer.

Credit risk - the risk of financial loss due to the failure of a customer, or counterparty, to meet its obligation to settle outstanding amounts.

Credit risk mitigation - reducing the credit risk of an exposure by application of techniques such as netting, collateral, guarantees and credit derivatives.

Credit valuation adjustments (CVA) - the CVA is the difference between the risk-free value of a portfolio of trades and its market value, taking into account the counterparty’s risk of default. It represents the market value of counterparty credit risk, or an estimate of the adjustment to fair value that a market participant would make to reflect the creditworthiness of its counterparty.

Currency swap - an arrangement in which two parties exchange specific principal amounts of different currencies at inception and subsequently interest payments on the principal amounts. Often, one party will pay a fixed rate of interest, while the other will pay a floating rate (though there are also fixed-fixed and floating-floating arrangements). At the maturity of the swap, the principal amounts are usually re-exchanged.

Customer accounts - money deposited with the Group by counterparties other than banks and classified as liabilities. They include demand, savings and time deposits; securities sold under repurchase agreements; and other short term deposits. Deposits received from banks are classified as deposits by banks.

Debit valuation adjustment (DVA) - an adjustment made by an entity to the valuation of OTC derivative liabilities to reflect within fair value the entity's own credit risk.

Glossary of terms

Debt securities - transferable instruments creating or acknowledging indebtedness. They include debentures, bonds, certificates of deposit, notes and commercial paper. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue, such as the right to receive certain information. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured or unsecured.

Debt securities in issue - unsubordinated debt securities issued by the Group. They include commercial paper, certificates of deposit, bonds and medium-term notes.

Deferred tax asset - income taxes recoverable in future periods as a result of deductible temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in tax deductible amounts in future periods) and the carry-forward of tax losses and unused tax credits.

Deferred tax liability - income taxes payable in future periods as a result of taxable temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in taxable amounts in future periods).

Defined benefit obligation - the present value of expected future payments required to settle the obligations of a defined benefit plan resulting from employee service.

Defined benefit plan/scheme - pension or other post-retirement benefit plan other than a defined contribution plan.

Defined contribution plan/scheme - pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.

Deposits by banks - money deposited with the Group by banks and recorded as liabilities. They include money-market deposits, securities sold under repurchase agreements, federal funds purchased and other short term deposits. Deposits received from customers are recorded as customer accounts.

Derivative - a contract or agreement whose value changes with changes in an underlying index such as interest rates, foreign exchange rates, share prices or indices and which requires no initial investment or an initial investment that is smaller than would be required for other types of contracts with a similar response to market factors. The principal types of derivatives are: swaps, forwards, futures and options.

Discontinued operation - a component of the Group that either has been disposed of or is classified as held for sale. A discontinued operation is either: a separate major line of business or geographical area of operations or part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or a subsidiary acquired exclusively with a view to resale.

Economic capital - an internal measure of the capital required by the Group to support the risks to which it is exposed.

Economic profit - the difference between the return on shareholders funds and the cost of that capital. Economic profit is usually expressed as a percentage.

Effective interest rate method - the effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly

discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees payable or receivable that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows.

Encumbrance - an interest in an asset held by another party. Encumbrance usually impacts the transferability of the asset and can restrict its free use until the encumbrance is removed.

Equity risk - the risk of changes in the market price of the equities or equity instruments arising from positions, either long or short, in equities or equity-based financial instruments.

Eurozone - the 17 European Union countries that have adopted the euro: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, The Netherlands, Portugal, Slovakia, Slovenia and Spain.

Expected loss (EL) - expected loss represents the anticipated loss on an exposure over one year. It is determined by multiplying probability of default, loss given default and exposure at default and can be calculated at individual, credit facility, customer or portfolio level.

Exposure - a claim, contingent claim or position which carries a risk of financial loss.

Exposure at default (EAD) - an estimate of the extent to which the bank will be exposed under a specific facility, in the event of the default of a counterparty.

FICO score - a credit score calculated using proprietary software developed by the Fair Isaac Corporation in the US from a consumer's credit profile. The scores range between 300 and 850 and are used in credit decisions made by banks and other providers of credit.

Financial Conduct Authority (FCA) - the statutory body responsible for conduct of business regulation and supervision of UK authorised firms from 1 April 2013. The FCA also has responsibility for the prudential regulation of firms that do not fall within the PRA’s scope.

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Glossary of terms

Financial Services Compensation Scheme (FSCS) - the UK's statutory fund of last resort for customers of authorised financial services firms. It pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the financial services industry.

First/second lien - a lien is a charge such as a mortgage held by one party, over property owned by a second party, as security for payment of some debt, obligation, or duty owed by that second party. The holder of a first lien takes precedence over all other encumbrances on that property i.e. second and subsequent liens.

Forbearance - forbearance takes place when a concession is made on the contractual terms of a loan in response to a customer's financial difficulties.

Forward contract - a contract to buy (or sell) a specified amount of a physical or financial commodity, at an agreed price, at an agreed future date.

Fully loaded Basel III basis - capital ratios based on the rules that will apply at the end of the Basel III transition period.

Futures contract - a contract which provides for the future delivery (or acceptance of delivery) of some type of financial instrument or commodity under terms established at the outset. Futures differ from forward contracts in that they are traded on recognised exchanges and rarely result in actual delivery; most contracts are closed out prior to maturity by acquisition of an offsetting position.

G10 - the Group of Ten comprises the eleven industrial countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States) that have agreed to participate in the International Monetary Fund's (IMF's) General Arrangements to Borrow.

Government Sponsored Enterprises (GSEs) - a group of financial services corporations created by the US Congress. Their function is to improve the efficiency of capital markets and to overcome statutory and other market imperfections which otherwise prevent funds from moving easily from suppliers of funds to areas of high loan demand. They include the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association.

Gross yield - the interest rate earned on average interest-earning assets i.e. interest income divided by average interest-earning assets.

Haircut - a downward adjustment to collateral value to reflect its nature, any currency or maturity mismatches between a credit risk mitigant and the underlying exposure to which it is being applied.

Hedge funds - pooled investment vehicles that are not widely available to the public; their assets are managed by professional asset managers who participate in the performance of the fund.

Impaired loans - all loans for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans.

Impairment allowance - see Loan impairment provisions.

Impairment losses - (a) for impaired financial assets measured at amortised cost, impairment losses - the difference between carrying value and the present value of estimated future cash flows discounted at the asset's original effective interest rate - are recognised in profit or loss and the carrying amount of the financial asset reduced by establishing a provision (allowance) (b) for impaired available-for-sale financial assets, the cumulative loss that had been recognised directly in equity is removed from equity and recognised in profit or loss as an impairment loss.

Individual liquidity guidance (ILG) - guidance from the PRA on a firm's required quantity of liquidity resources and funding profile.

Individually assessed loan impairment provisions - impairment loss provisions for individually significant impaired loans assessed on a case-by-case basis, taking into account the financial condition of the counterparty and any guarantor and the realisable value of any collateral held.

Interest rate swap - a contract under which two counterparties agree to exchange periodic interest payments on a predetermined monetary principal, the notional amount.

Interest spread - the difference between the gross yield and the interest rate paid on average interest-bearing liabilities.

Internal Capital Adequacy Assessment Process (ICAAP) - the Group’s own assessment, as part of Basel II requirements, of its risks, how it intends to mitigate those risks and how much current and future capital is necessary having considered other mitigating factors.

Internal funding of trading business - the internal funding of the trading book comprises net banking book financial liabilities that fund financial assets in the Group’s trading portfolios. Interest payable on these financial liabilities is charged to the trading book.

International Accounting Standards Board (IASB) - the independent standard-setting body of the IFRS Foundation. Its members are responsible for the development and publication of International Financial Reporting Standards (IFRSs) and for approving Interpretations of IFRS as developed by the IFRS Interpretations Committee.

International Swaps and Derivatives Association (ISDA) master agreement - a standardised contract developed by ISDA for bilateral derivatives transactions. The contract grants legal rights of set-off for derivative transactions with the same counterparty.

Investment grade - generally represents a risk profile similar to a rating of BBB-/Baa3 or better, as defined by independent rating agencies.

Key management - directors of RBSG and members of the Group Management Committee.

Latent loss provisions - loan impairment provisions held against impairments in the performing loan portfolio that have been incurred as a result of events occurring before the balance sheet date but which have not been identified as impaired at the balance sheet date.

Glossary of terms

Level 1 - level 1 fair value measurements are derived from quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

Level 2 - level 2 fair value measurements use inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly.

Level 3 - level 3 fair value measurements use one or more unobservable inputs for the asset or liability.

Leverage ratio - a measure prescribed under Basel III. It is the ratio of tier 1 capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives, and generally follow the accounting measure of exposure.

Leveraged finance - funding (leveraged finance) provided to a business resulting in an overall level of debt in relation to cash flow that exceeds that which would be considered usual for the business or for the industry in which it operates. Leveraged finance is commonly employed to achieve a specific, often temporary, objective: to make an acquisition, to effect a buy-out or to repurchase shares.

Liquidity and funding risk - the risk that the Group is unable to meet its financial liabilities when they fall due.

Liquidity coverage ratio (LCR) - the ratio of the stock of high quality liquid assets to expected net cash outflows over the following 30 days. High quality liquid assets should be unencumbered, liquid in markets during a time of stress and, ideally, central bank eligible.

Loan:deposit ratio - the ratio of loans and advances to customers net of provision for impairment losses and excluding reverse repurchase agreements to customer deposits excluding repurchase agreements.

Loan impairment provisions - loan impairment provisions are established to recognise incurred impairment losses on a portfolio of loans classified as loans and receivables and carried at amortised cost. It has three components: individually assessed loan impairment provisions, collectively assessed loan impairment provisions and latent loss provisions.

Loan-to-value ratio - the amount of a secured loan as a percentage of the appraised value of the security e.g. the outstanding amount of a mortgage loan as a percentage of the property's value.

London Interbank Offered Rate (LIBOR) - the benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.

Loss given default (LGD) - an estimate of the amount that will not be recovered by the Group in the event of default, plus the cost of debt collection activities and the delay in cash recovery.

Market risk - the risk of loss arising from fluctuations in interest rates, credit spreads, foreign currency rates, equity prices, commodity prices and other risk-related factors such as market volatilities that may lead to a reduction in earnings, economic value or both.

Master netting agreement - an agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.

Medium term notes (MTNs) - debt securities usually with a maturity of five to ten years, but the term may be less than one year or as long as 50 years. They can be issued on a fixed or floating coupon basis or with an exotic coupon; with a fixed maturity date (non-callable) or with embedded call or put options or early repayment triggers. MTNs are generally issued as senior unsecured debt.

Monoline insurers (monolines) - entities that specialise in providing credit protection against the notional and interest cash flows due to the holders of debt instruments in the event of default. This protection is typically in the form of derivatives such as credit default swaps.

Mortgage-backed securities - asset-backed securities for which the underlying asset portfolios are loans secured on property. See Residential mortgage backed securities and Commercial mortgage backed securities.

Mortgage servicing rights - the rights of a mortgage servicer to collect mortgage payments and forward them, after deducting a fee, to the mortgage lender.

Negative equity mortgages - mortgages where the value of the property mortgaged is less than the outstanding balance on the loan.

Net interest income - the difference between interest receivable on financial assets classified as loans and receivables or available-for-sale and interest payable on financial liabilities carried at amortised cost.

Net interest margin - net interest income as a percentage of average interest-earning assets.

Net stable funding ratio (NSFR) - the ratio of available stable funding to required stable funding over a one year time horizon, assuming a stressed scenario. Available stable funding includes items such as equity capital, preferred stock with a maturity of over one year and liabilities with an assessed maturity of over one year.

Non-performing loans - loans classified as Risk elements in lending and Potential problem loans. They have a 100% probability of default and have been assigned an AQ10 internal credit grade.

Operational risk - the risk of loss resulting from inadequate or failed processes, people, systems or from external events.

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Glossary of terms

Option - an option is a contract that gives the holder the right but not the obligation to buy (or sell) a specified amount of the underlying physical or financial commodity, at a specific price, at an agreed date or over an agreed period. Options can be exchange-traded or traded over-the- counter.

Over-the-counter (OTC) derivatives - derivatives with tailored terms and conditions negotiated bilaterally, in contrast to exchange traded derivatives that have standardised terms and conditions.

Own credit adjustment (OCA) - the effect of the Group's own credit standing on the fair value of financial liabilities.

Past due - a financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.

Pillar 1 - the part of Basel II that sets out the process by which regulatory capital requirements should be calculated for credit, market and operational risk.

Pillar 2 - the part of Basel II that sets out the process by which a bank should review its overall capital adequacy and the processes under which the supervisors evaluate how well financial institutions are assessing their risks and take appropriate actions in response to the assessments.

Pillar 3 - the part of Basel II that sets out the information banks must disclose about their risks, the amount of capital required to absorb them, and their approach to risk management. The aim is to strengthen market discipline.

Position risk requirement - a capital requirement applied to a position treated under BIPRU 7 (Market risk) as part of the calculation of the market risk capital requirement.

Potential future exposure - is a measure of counterparty risk/credit risk. It is calculated by evaluating existing trades done against the possible market prices in future during the lifetime of the transactions.

Potential problem loans (PPL) - loans for which an impairment event has taken place but no impairment loss is expected. This category is used for advances which are not past due 90 days or revolving credit facilities where identification as 90 days overdue is not feasible.

Private equity investments - equity investments in operating companies not quoted on a public exchange. Capital for private equity investment is raised from retail or institutional investors and used to fund investment strategies such as leveraged buyouts, venture capital, growth capital, distressed investments and mezzanine capital.

Probability of default (PD) - the likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon.

Prudential Regulation Authority (PRA) - the statutory body responsible, from 1 April 2013, for the prudential supervision of banks, building societies, insurers and a small number of significant investment firms in the UK. The PRA is a subsidiary of the Bank of England.

Regular way purchase or sale - a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.

Regulatory capital - the amount of capital that the Group holds, determined in accordance with rules established by the PRA for the consolidated Group and by local regulators for individual Group companies.

Repurchase agreement (Repo) - see Sale and repurchase agreements.

Residential mortgage - a loan to purchase a residential property where the property forms collateral for the loan. The borrower gives the lender a lien against the property and the lender can foreclose on the property if the borrower does not repay the loan per the agreed terms. Also known as a home loan.

Residential mortgage backed securities (RMBS) - asset-backed securities for which the underlying asset portfolios are residential mortgages.

Retail loans - loans made to individuals rather than institutions. The loans may be for car purchases, home purchases, medical care, home repair, holidays and other consumer uses.

Return on equity - profit attributable to ordinary and B shareholders divided by average shareholders' equity as a percentage.

Reverse repurchase agreement (Reverse repo) - see Sale and repurchase agreements.

Risk appetite - an expression of the maximum level of risk that the Group is prepared to accept to deliver its business objectives.

Risk asset ratio (RAR) - total regulatory capital as a percentage of risk-weighted assets.

Risk elements in lending (REIL) - impaired loans and accruing loans which are contractually overdue 90 days or more as to principal or interest.

Glossary of terms

Risk-weighted assets (RWAs) - assets adjusted for their associated risks using weightings established in accordance with the Basel Capital Accord as implemented by the PRA. Certain assets are not weighted but deducted from capital.

Sale and repurchase agreements - in a sale and repurchase agreement one party, the seller, sells a financial asset to another party, the buyer, at the same time the seller agrees to reacquire and the buyer to resell the asset at a later date. From the seller's perspective such agreements are repurchase agreements (repos) and from the buyer's reverse repurchase agreements (reverse repos).

Securitisation - a process by which assets or cash flows are transformed into transferable securities. The underlying assets or cash flows are transferred by the originator or an intermediary, typically an investment bank, to a structured entity which issues securities to investors. Asset securitisations involve issuing debt securities (asset-backed securities) that are backed by the cash flows of income-generating assets (ranging from credit card receivables to residential mortgage loans).

Settlement balances - payables and receivables that result from purchases and sales of financial instruments recognised on trade date. Asset settlement balances are amounts owed to the Group in respect of sales and liability settlement balances are amounts owed by the Group in respect of purchases.

Sovereign exposures - exposures to governments, ministries, departments of governments and central banks.

Standardised approach - a method used to calculate credit risk capital requirements under Pillar 1 of Basel II. In this approach the risk weights used in the capital calculation are determined by regulators. For operational risk, capital requirements are determined by multiplying three years' historical gross income by a percentage determined by the regulator. The percentage ranges from 12 to 18%, depending on the type of underlying business being considered.

Standstill - is an agreement, usually for a specified period of time, not to enforce the Bank's rights as a result of a customer breaching the terms and conditions of their facilities. This is a concession to the customer. A standstill is most commonly used in a complex restructuring of a company's debts, where a group of creditors agree to delay enforcement action to give the company time to gather information and formulate a strategy with a view to establishing a formal restructuring.

Stress testing - a technique used to evaluate the potential effects on an institution's financial condition of an exceptional but plausible event and/or movement in a set of financial variables.

Stressed value-at-risk (SVaR) - a VaR measure using historical data from a one year period of stressed market conditions. For the purposes of calculating regulatory SVaR, a time horizon of ten trading days is assumed at a confidence level of 99%. (refer to Value-at-risk definition below).

Structured credit portfolio (SCP) - a portfolio of certain of the Group's illiquid assets - principally CDO super senior positions, negative basis trades and monoline exposures - held within Non-Core division.

Structured entity (SE) - an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose, they do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions.

Structured notes - securities that pay a return linked to the value or level of a specified asset or index. Structured notes can be linked to equities, interest rates, funds, commodities and foreign currency.

Subordinated liabilities - liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.

Super senior CDO - the most senior class of instrument issued by a CDO vehicle. They benefit from the subordination of all other instruments, including AAA rated securities, issued by the CDO vehicle.

Supervisory slotting approach - a method of calculating regulatory capital, specifically for lending exposures in project finance and income producing real estate, where the PD estimates do not meet the minimum IRB standards. Under this approach, the bank classifies exposures from 1 to 5, where 1 is strong and 5 is default. Specific risk-weights are assigned to each classification.

Tier 1 capital - Core Tier 1 capital plus other Tier 1 securities in issue, less material holdings in financial companies.

Tier 1 capital ratio - Tier 1 capital as a percentage of risk-weighted assets.

Tier 2 capital - qualifying subordinated debt and other Tier 2 securities in issue, eligible collective impairment allowances, unrealised available-for-sale equity gains and revaluation reserves less certain regulatory deductions.

Unaudited - financial information that has not been subjected to the audit procedures undertaken by the Group's auditors to enable them to express an opinion on the Group's financial statements.

Glossary of terms

US Federal Agencies - are independent bodies established by the US Government for specific purposes such as the management of natural resources, financial oversight or national security. A number of agencies, including, the Government National Mortgage Association, issue or guarantee publicly traded debt securities.

Value-at-risk (VaR) - a technique that produces estimates of the potential loss in the market value of a portfolio over a specified time period at a given confidence level.

Wholesale funding - wholesale funding comprises Deposits by banks, Debt securities in issue and Subordinated liabilities.

Write-down - a reduction in the carrying value of an asset to record a decline in its fair value or value in use.

Wrong-way risk - the risk of loss when the risk factors driving the exposure to a counterparty or customer are positively correlated with the creditworthiness of that counterparty i.e. the size of the exposure increases at the same time as the risk of the counterparty or customer being unable to meet that obligation, increases.

EDTF recommendations

The Enhanced Disclosure Taskforce (EDTF), established by the Financial Stability Board, published its report 'Enhancing the Risk Disclosures of Banks' in October 2012. The report suggests improvements to address the quality, comparability and transparency of risk disclosures in areas of risk governance, capital adequacy, liquidity and funding, credit risk and market risk.

The Group implemented the majority of the EDTF recommendations in its 2012 Form 20-F and Pillar 3 Report and the remainder in its 2013 reports.

The table below sets out the EDTF recommendations and the related locations in the 2013 Form 20-F and Pillar 3 Report.

			Page reference	
Risk type		Recommendation	Form 20-F	Pillar 3
General	1	Present all risk information together. Where this is not practicable, provide an index.	169-359 557	
	2	Risk terminology, risk measures and key parameter values used.	548-556	ü
	3	Top and emerging risks.	174-176	
	4	Key future regulatory ratios.	190-197, 199 206,208,210	
Risk governance and risk management strategies/business model	5	Summarise risk management organisation, processes and key functions.	171-172	
	6	Risk culture and risk appetite.	179-181	
	7	Key risks arising from business models and activities.	172-173	
	8	Stress testing.	176-177 189, 207 324	
Capital adequacy and risk-weighted assets	9	Pillar 1 minimal capital requirements.	188-189	ü
	10	Composition of capital and reconciliation between accounting and regulatory balance sheet.	192-193,200	
	11	Regulatory capital flow statement.	193-194	
	12	Capital planning and management.	188-189	
	13	Risk-weighted assets (RWAs) and business activities.	197-199	ü
	14	Capital requirements and RWAs.	190, 325	ü
	15	Credit risk in the banking book for major portfolios.	202-203	ü
	16	RWA flow statements.	197-199	
	17	Back-testing of models.	321-322	ü
Liquidity	18	Liquid assets and their management.	205-209	
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	20	Contractual maturity of assets, liabilities and off-balance sheet commitments	212, 215-217 425, 464	
	21	Funding strategy including key sources.	211-215	
Market risk	22	Linkages the balance sheet and market risk portfolios	315	
	23	Significant trading and non-trading market risk factors.	318	
	24	Model limitations, assumptions and validation procedures.	319-323	
	25	Stress testing and scenario analysis.	324	
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	27	Policies for impaired loans and forbearance.	237-246	
	28	Flow statements for impaired loans and allowance for loan losses.	294-311	

	29	Counterparty credit risk that arises from derivatives transactions.	236, 291-294 406, 418-419	ü
	30	Credit risk mitigation.	232-236, 264	ü
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	32	Discussion of publicly known risk events.	173-174 385-386 443-444 466-474	

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Exhibit Index

Exhibit Number	Description
1.1	Memorandum and Articles of Association of The Royal Bank of Scotland Group plc
2.1(1)	Form of Deposit agreement among The Royal Bank of Scotland Group plc, The Bank of New York as Depositary, and all Owners and Holders from time to time of American Depositary Receipts issued thereunder
2.2(2)	Form of American Depositary Receipt for ordinary shares of the par value of £1 each
2.3(3)	Letter dated May 12, 2008 from The Bank of New York Mellon as Depository to The Royal Bank of Scotland Group plc relating to the Prerelease of American Depository Receipts
2.4	Neither The Royal Bank of Scotland Group plc nor The Royal Bank of Scotland plc is party to any single instrument relating to long-term debt pursuant to which a total amount of securities exceeding 10% of the Group's total assets (on a consolidated basis) is authorized to be issued. Each of The Royal Bank of Scotland Group plc and The Royal Bank of Scotland plc hereby agrees to furnish to the Securities and Exchange Commission (the "Commission"), upon its request, a copy of any instrument defining the rights of holders of its long-term debt or the rights of holders of the long-term debt of any of its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed with the Commission.
4.1	Service agreement for Ross McEwan
4.2	Service agreement for Nathan Bostock
4.3	Service agreement for Ewen Stevenson
4.4(4)	Form of Deed of Indemnity for Directors
4.5(5)	Amendment Agreement dated August 2008, relating to the Consortium and Shareholders' Agreement dated 28 May 2007, among The Royal Bank of Scotland Group plc, Banco Santander, S.A., Fortis N.V., Fortis SA/NV and, by accession, Fortis Nederland (Holding) N.V., and RFS Holdings B.V. (as supplemented and amended by a Supplemental Consortium and Shareholders' Agreement dated 17 September 2007)
4.6(5)	Deed of Accession dated December 2008 among The Royal Bank of Scotland Group plc, Banco Santander, S.A., Fortis Bank Nederland (Holding) N.V., The State of the Netherlands and RFS Holdings B.V.
4.7(6)	Acquisition and contingent capital agreement dated 26 November 2009 among The Royal Bank of Scotland Group plc and The Commissioners of Her Majesty's Treasury
4.8(6,8)	State Aid Commitment Deed dated 26 November 2009 among The Commissioners of Her Majesty's Treasury and The Royal Bank of Scotland Group plc
4.9(6,8)	State Aid Cost Reimbursement Deed dated 26 November 2009 among The Commissioners of Her Majesty's Treasury and The Royal Bank of Scotland Group plc

4.10(7,8)	Agreement for the Sale and Purchase of RBS Aerospace Limited, RBS Aerospace (UK) Limited and RBS Australia Leasing Pty Limited dated January 16, 2012 among The Royal Bank of Scotland plc and Sumitomo Mitsui Banking Corporation
4.11(8)	Investment Agreement, dated September 27, 2013, among the Royal Bank of Scotland Group plc, The Royal Bank of Scotland plc, National Westminster Bank plc, Williams & Glyn's Limited, Lunar Investors LLP, Corsair IV-B FSCP AIV II Cayman, L.P., Corsair IV FSCP AIV II Cayman, L.P., Corsair Rainbow Investors L.P., Centerbridge Capital Partners SBS II (Cayman), L.P., Centerbridge Capital Partners II (Cayman), L.P.
4.12(8)	Amendment Agreement in relation to the Investment Agreement, dated October 20, 2013, among the parties to the Investment Agreement listed above at 4.11
4.13(8)	Revised State Aid Commitment Deed dated 9 April 2014 among The Commissioners of Her Majesty's Treasury and The Royal Bank of Scotland Group plc
4.14(8)	Dividend Access Share Retirement Agreement, dated 9 April 2014 among The Commissioners of Her Majesty's Treasury and The Royal Bank of Scotland Group plc
7.1	Explanation of ratio calculations
8.1	Principal subsidiaries of The Royal Bank of Scotland Group plc
12.1	CEO certification required by Rule 13a-14(a)
12.2	CFO certification required by Rule 13a-14(a)
13.1	Certification required by Rule 13a-14(b)
15.1	Consent of independent registered public accounting firm

Notes:

(1) Previously filed and incorporated by reference to Exhibit 1 to the Registration Statement on Form F-6 (Registration No. 333-144756) (filed on 20 July 2007)

(2) Previously filed and incorporated by reference to the prospectus filed pursuant to Rule 424(b)(3) (filed on 7 June 2012) relating to the Registration Statement on Form F-6 (Registration No. 333-144756) (filed on 20 July 2007)

(3) Previously filed and incorporated by reference to Exhibit 2.3 to the Group's Annual Report on Form 20-F for the fiscal year ended 31 December 2007 (File No. 1-10306)

(4) Previously filed and incorporated by reference to Exhibit 4.11 to the Group's Annual Report on Form 20-F for the fiscal year ended 31 December 2006 (file No. 1-10306) except that the sentence "PROVIDED THAT this Indemnity is given subject to the provisions of Section 309A Company Act 1985" has been replaced with "PROVIDED THAT this Indemnity is given subject to the provisions of Section 234 Company Act 2001".

(5) Previously filed and incorporated by reference to Exhibit 4.1, 4.2, 4.8 and 4.9, respectively, to the Group's Annual Report on Form 20-F for the fiscal year ended 31 December 2008 (file No. 1-10306)

(6) Previously filed and incorporated by reference to Exhibit 4.3, 4.19, 4.24 and 4.25, respectively, to the Group's Annual Report on Form 20-F for the fiscal year ended 31 December 2009 (File No. 1-10306)

(7) Previously filed and incorporated by reference to exhibit 4.32 to the Group's Annual Report on Form 20-F for the fiscal year ended 31 December 2011 (File No. 1-10306).

(8) Confidential treatment has been requested. Confidential materials have been redacted and separately filed with the SEC.

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SIGNATURE

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

The Royal Bank of Scotland Group plc
Registrant

/s/ Nathan Bostock
Nathan Bostock
Group Finance Director
April 30, 2014