

ROYAL BANK OF SCOTLAND GROUP PLC  
Form 6-K  
December 02, 2009

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# SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

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## FORM 6-K

### REPORT OF FOREIGN PRIVATE ISSUER Pursuant to Rule 13a-16 or 15d-16 of the Securities Exchange Act of 1934

For December 2, 2009  
Commission File Number: 001-10306

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## THE ROYAL BANK OF SCOTLAND GROUP PLC

**RBS, Gogarburn, PO Box 1000  
Edinburgh EH12 1HQ  
(Address of principal executive offices)**

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F  Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes  No

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-

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The following information was made available on The Royal Bank of Scotland Group plc's website and is furnished pursuant to General Instruction B to the General Instructions to Form 6-K:

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**THIS DOCUMENT AND ANY ACCOMPANYING DOCUMENTS ARE IMPORTANT AND REQUIRE YOUR IMMEDIATE ATTENTION.**

**If you are in any doubt as to the action you should take, you are recommended to seek immediately your own personal financial advice from your stockbroker, bank manager, solicitor, accountant, fund manager or other appropriate independent financial adviser, who is authorised under the Financial Services and Markets Act 2000 (the "FSMA") if you are in the United Kingdom or, if not, from another appropriately authorised independent financial adviser.**

If you sell or have sold or otherwise transferred all of your Ordinary Shares please send this document, together with any accompanying form of proxy, as soon as possible, to the purchaser or transferee or to the bank, stockbroker or other agent through whom the sale or transfer was effected for delivery to the purchaser or transferee. If you have sold or transferred, or otherwise disposed of, only part of your holding of Ordinary Shares you should retain this circular and accompanying form of proxy and consult the stockbroker, bank or other agent through whom you made the sale, transfer or disposal.

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## **The Royal Bank of Scotland Group plc**

*(incorporated under the Companies Acts 1948 to 1967 and registered with Registered No. SC045551)*

### **Proposed accession to the Asset Protection Scheme and B Share and Dividend Access Share issues**

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#### **Circular and Notice of General Meeting**

**Your attention is drawn to the letter from your Chairman which is set out in Part I of this document and which recommends you vote in favour of the Resolutions to be proposed at the General Meeting referred to below. Please read the whole of this document. You should not rely solely on any key or summarised information set out in this document.**

Notice of a General Meeting of RBS, to be held on 15 December 2009 at 10.30 a.m. at RBS Conference Centre, RBS Gogarburn, Edinburgh EH12 1HQ, is set out at the end of this document. A form of proxy for use at the General Meeting is enclosed. To be valid, forms of proxy should be completed, signed and returned in accordance with the notes to the Notice of General Meeting (at the end of this document) and the form of proxy itself.

Morgan Stanley and UBS are acting exclusively for RBS and no one else in connection with the Transaction and will not regard any other person (whether or not a recipient of this document) as a client in relation to the Transaction and will not be responsible to anyone other than RBS for providing the protections afforded to their respective clients or for providing advice in relation to the Transaction or any matters referred to in this document. In particular, the advice of Morgan Stanley and UBS referred to in Part I of this document has been delivered to the RBS Directors for the purposes of their obligations under the Listing Rules. It has not been delivered for the benefit of anyone else, including RBS Shareholders, and it is not to be relied on by anyone other than the RBS Directors for any purpose whatsoever.

Apart from the responsibilities and liabilities, if any, which may be imposed on Morgan Stanley and UBS by the Listing Rules, Morgan Stanley and UBS accept no responsibility whatsoever and make no representation or warranty, express or implied, for the contents of this document, including its accuracy, completeness or verification or for any other statement made or purported to be made by RBS, or on RBS's behalf, or by them, or on their behalf, in connection with RBS or the Transaction, and nothing in this document is or shall be relied upon as a promise or representation in this respect, whether as to the past or future. Morgan Stanley and UBS accordingly disclaim to the fullest extent permitted by law all and any responsibility and liability whether arising in tort, contract or otherwise (save as referred to above) which they might otherwise have in respect of this document and any such statement.

None of The Commissioners of Her Majesty's Treasury, the Solicitor for the Affairs of Her Majesty's Treasury, UK Financial Investments Limited, the Asset Protection Agency, or any person controlled by or controlling any such person, or any director, officer, official or employee of any such person (each such person, a "Relevant Person") accepts any responsibility for the contents of, or makes any representation or warranty as to the accuracy, completeness or fairness of, any information in this document. Each Relevant Person expressly disclaims any liability whatsoever for any loss howsoever arising from, or in reliance upon, the whole or any part of the contents of this document (or any

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supplement or amendment to this document).

The B Shares and the Dividend Access Share referred to herein are not being offered in any jurisdiction and accordingly this document does not constitute an offer to sell, or the solicitation of an offer to buy, the B Shares or the Dividend Access Share in any jurisdiction, including, without limitation, the United States. The B Shares and the Dividend Access Share have not been, and will not be, registered under the US Securities Act or under the securities laws of any state or other jurisdiction of the United States or of any other jurisdiction and may not be offered or sold in the United States. There will be no public offer of the B Shares or the Dividend Access Share in the United Kingdom, the United States or elsewhere. No application has been, or is currently expected to be, made to list the B Shares, and no application has been or will be made to list the Dividend Access Share, on any exchange or in any share dealing facility.

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**FORWARD LOOKING STATEMENTS**

This document contains or incorporates by reference "forward looking statements", within the meaning of Section 27A of the US Securities Act and Section 21E of the US Exchange Act, regarding the belief or current expectations of RBS, RBS's Directors and other members of its senior management about RBS's businesses and the transactions described in this document, including statements relating to any future write-downs or impairments. Generally, words such as "may", "could", "will", "expect", "intend", "estimate", "anticipate", "believe", "plan", "seek", "continue" or similar expressions identify forward looking statements.

These forward looking statements are not guarantees of future performance. Rather, they are based on current views and assumptions and involve known and unknown risks, uncertainties and other factors, many of which are outside the control of RBS and are difficult to predict, that may cause actual results to differ materially from any future results or developments expressed or implied from the forward looking statements. Factors that could cause actual results to differ materially from those contemplated by the forward looking statements include, among other factors:

the ability of RBS to access sufficient funding to meet its liquidity needs;

developments in the current crisis in the global financial markets, and their impact on the financial industry in general and on RBS in particular;

the full nationalisation of RBS or other resolution procedures under the Banking Act;

general economic conditions in the United Kingdom, countries in Europe and Asia in which RBS has business activities, and the United States;

the financial stability of other financial institutions, and RBS's counterparties and borrowers;

the value and effectiveness of any credit protection purchased by RBS;

the extent of future write-downs and impairment charges caused by depressed asset valuations;

RBS's ability to achieve revenue benefits and cost savings from the integration of certain of ABN AMRO's businesses and assets;

the potential exposure of RBS to various types of market risks, such as interest rate risk, foreign exchange rate risk, and commodity and equity price risk;

changes in RBS's credit ratings;

RBS's participation in the APS and the effect of such Scheme on RBS's financial and capital position;

the issuance by RBS of the B Shares and the Dividend Access Share, and the conversion of the B Shares in accordance with their terms;

the ability of RBS to access the contingent capital arrangements;

a change of UK Government or changes to UK Government policy;

the monetary and interest rate policies of central banks, in particular the Bank of England, the European Central Bank, the Dutch Central Bank, the Board of Governors of the US Federal Reserve System and other G-7 central banks;

limitations on, or additional requirements imposed on, RBS's activities as a result of HM Treasury's investment in RBS;

changes in the pricing environment;

the effects of competition and consolidation in the markets in which RBS operates;

changes in applicable laws, regulations and taxes in jurisdictions in which RBS operates;

the inability of RBS to hedge certain risks economically;

the final impact of the State aid approval;

the ability of RBS to complete its restructurings on a timely basis, or at all, including the disposal of certain non-core assets and assets and businesses required as part of the State aid approval; and

the success of RBS in managing the risks involved in the foregoing.

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These statements are further qualified by the risk factors disclosed in this document that could cause actual results to differ materially from those in the forward looking statements. See Part I, Appendix 1 of this document.

These forward looking statements speak only as at the date of this document. Except as required by the FSA, the London Stock Exchange, the Listing Rules, the Disclosure and Transparency Rules or applicable law, RBS does not have any obligation to update or revise publicly any forward looking statement, whether as a result of new information, further events or otherwise. Except as required by the FSA, the London Stock Exchange, the Listing Rules, the Disclosure and Transparency Rules or applicable law, RBS expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statement contained herein to reflect any change in RBS's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Capitalised terms have the meanings ascribed to them in Part VI of this document.

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**FINANCIAL INFORMATION**

Unless otherwise stated, the financial information relating to the Group contained herein has been extracted without material adjustment from the Interim Management Statement.



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**EXPECTED TIMETABLE OF PRINCIPAL EVENTS**

Each of the times and dates in the table below is indicative only and may be subject to change.

	<b>2009</b>
Latest time and date for receipt of General Meeting forms of proxy	10.30 a.m. on 11 December
General Meeting	10.30 a.m. on 15 December
Implementation of APS and issue of Initial B Shares and the Dividend Access Share to HM Treasury	22 December

**General notes:**

- (a) The times and dates set out in the expected timetable of principal events above and mentioned throughout this document may be adjusted by RBS, in which event details of the new times and dates will be notified, where appropriate, to Shareholders.
- (b) References to times in this document are to London times unless otherwise stated.

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**DIRECTORS, COMPANY SECRETARY, REGISTERED OFFICE AND ADVISERS**

**Directors**

Philip Hampton	Chairman
Stephen Hester	Group Chief Executive
Gordon Pell	Deputy Chief Executive
Bruce Van Saun	Group Finance Director
Colin Buchan <sup>(1)</sup>	Non-Executive Director
Sir Sandy Crombie <sup>(1)</sup>	Non-Executive Director
Archie Hunter <sup>(1)</sup>	Non-Executive Director
Joe MacHale <sup>(1)</sup>	Non-Executive Director
John McFarlane <sup>(1)</sup>	Non-Executive Director
Arthur "Art" Ryan <sup>(1)</sup>	Non-Executive Director
Philip Scott <sup>(1)</sup>	Non-Executive Director

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Note:

- (1)  
Denotes Independent Non-Executive Director.

Penny Hughes has been appointed, subject to regulatory approval, as an Independent Non-Executive Director with effect from 1 January 2010.

Each of the Directors' business address is the Company's registered address at 36 St Andrew Square, Edinburgh EH2 2YB.

**Group General Counsel and Group Secretary**

Miller McLean

**Registered office**

36 St Andrew Square  
Edinburgh EH2 2YB

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Registered in Scotland No. SC045551

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Edinburgh EH1 2DB

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London EC2Y 8HQ

Linklaters LLP  
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The Pavilions  
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Bristol BS99 6ZZ

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**PART I**

**LETTER FROM THE CHAIRMAN OF RBS**

Gogarburn  
PO Box 1000  
Edinburgh EH12 1HQ

27 November 2009

Dear Shareholder,

On 3 November 2009 we announced the key terms of our participation in the Asset Protection Scheme (the "APS") set up by HM Treasury as one of a series of measures aimed at helping to restore confidence in the UK banking system and, in conjunction with that proposed participation, our agreement to issue new capital to HM Treasury. At the same time, we announced that we had reached an agreement in principle with the EC Competition Commissioner (the "Commissioner") on a series of restructuring measures to comply with EC State aid requirements. These announcements marked a crucial milestone in RBS's recovery. While the terms agreed do not represent everything we might have hoped for, they provide us with the tools to get on with the job of restoring RBS to standalone strength and rebuilding attractive, sustainable shareholder value.

Since February 2009, when we first announced our intention to take part in the APS, the financial and economic environment has become less harsh. We still see real risks in the global economy but the probability of the downturn continuing much longer now appears less likely than it seemed nine months ago. That changed environment has made it possible to redesign the APS and proposed capital issuance, and the Transaction we have now agreed with HM Treasury is narrower in scope, more affordable and more flexible than the original plan. The proposed capital issuance and redesigned APS have the Board's full support, and I am writing to you today to provide you with further information on their terms and to seek your support for the Board's decision to proceed with the capital issuance and to participate in the APS.

Our revised plans comprise three main elements:

**B Share Issuance**

While we now believe credit impairments may be plateauing at around the levels we experienced in the first half of 2009, we have already made it clear that we expect our overall results in 2010 and 2011 to continue to be affected by high credit losses as we manage down the exposures in our Non-Core Division and continue to experience high levels of impairments in the Core Bank. At the same time, as the effects of the severe downturn experienced in 2008 and 2009 work through the economy, the risk weightings applied to our assets, and so the capital required to support them, may continue to rise. We know, too, that a number of regulatory pressures may further raise the levels of capital we, along with other banks, will be required to hold. We still need, therefore, to strengthen our capital base materially and have accordingly agreed to issue £25.5 billion of new capital to HM Treasury. This new capital will take the form of B Shares, which will not generally carry voting rights at meetings of Ordinary Shareholders but which are convertible into Ordinary Shares and will count as Core Tier 1 Capital. While the B Shares themselves will be entitled to the same dividends as Ordinary Shares, a Dividend Access Share will be issued in conjunction with them. The combined effect will be that HM Treasury will enjoy preferential but non-transferable dividend rights on the new capital it provides.

**Contingent Subscription**

Although the proposed capital issuance of £25.5 billion is expected to be sufficient to provide RBS with robust capital ratios according to the Group's current base case forecasts, the FSA also requires banks to have enough capital to maintain a minimum Core Tier 1 Ratio of at least 4 per cent. even in a severely stressed scenario in which economic conditions deteriorate well beyond consensus forecasts. To enable RBS to meet this test, HM Treasury will subscribe for up to an additional £8 billion of capital (in the form of additional B Shares) if RBS's Core Tier 1

Ratio falls below 5 per cent. (the "Contingent

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Subscription"). This Contingent Subscription will enable us to maintain our capital resilience even if such a severely stressed scenario were to occur.

## **APS**

There have been signs of improvement in the economic environment in some of RBS's key markets and many observers now believe that the worst of the crisis that has afflicted financial markets over the last two years has passed. Nevertheless, the range of forecasts for the major economies in which RBS operates remains wide. We have therefore agreed to take part in a redesigned APS in which, once losses on a £282 billion pool of specified assets exceed £60 billion, HM Treasury would bear 90 per cent. of further losses. In the event of a further severe or prolonged economic downturn, which could result in extreme credit losses on RBS's portfolio, the APS provides additional protection to our capital ratios and financial position.

Either a failure to meet the FSA's capital assessment framework or a failure to withstand any further deterioration in the economy could lead to the full nationalisation or other resolution procedures under the Banking Act in respect of RBS. Bluntly, the combination of the £25.5 billion B Share issuance, the Contingent Subscription and the APS which the proposed arrangements entail is the only protection currently available to our Group to avoid the risk of full nationalisation or other resolution procedures under the Banking Act. In the event of full nationalisation or other resolution procedures under the Banking Act in respect of RBS, the likelihood is that Shareholders would lose most or all of the value in their Shares. HM Treasury is required to put in place certain compensation arrangements under the Banking Act, but there can be no assurance that holders of Ordinary Shares would recover compensation promptly and/or equal to any loss incurred. In view of this, the Board, having full regard to the Directors' duty to promote the success of RBS to the benefit of Shareholders as a whole, believes that acceding to the APS is the only prudent option open to our Group.

RBS's agreement to issue the B Shares and the associated Dividend Access Share and to participate in the APS (together, "the Transaction") is classified under the Listing Rules as a related party transaction because HM Treasury, with which the Accession Agreement and the Acquisition and Contingent Capital Agreement have been reached, is also our largest shareholder, controlling approximately 70 per cent. of our Ordinary Shares. The Transaction, therefore, cannot take effect without the approval of Independent Shareholders.

In addition, we are seeking Shareholder approval to adopt a new deferral plan, which will enable RBS to defer incentive awards into Shares and/or subordinated debt.

## **1. Issuance of B Shares and the Dividend Access Share**

### **1.1 Initial capital issuance**

On implementation of the APS (the "Issue Date") and subject to certain terms and conditions, HM Treasury has agreed to acquire 51,000,000,000 B Shares (the "Initial B Shares") and the Dividend Access Share for an aggregate amount of £25.5 billion. This capital injection will be satisfied partly in cash and partly through the issue of bills issued by HM Treasury on which interest will accrue. The B Shares will constitute Core Tier 1 Capital.

We will pay a fee for the B Share issuance and the Contingent Subscription, payable annually over a five year period.

### **1.2 The Contingent Subscription**

RBS has received a commitment from HM Treasury that, for a period of five years from the Issue Date or, if earlier, until the occurrence of a Termination Event or until RBS (with FSA consent) decides to terminate the Contingent Subscription, it will subscribe for up to an additional £8 billion in aggregate amount of B Shares. The Contingent Subscription will take effect if RBS's Core Tier 1 Ratio falls below 5 per cent. and certain other conditions are met.

### **1.3 Fee**

The annual fee for the Initial B Shares and the Contingent Subscription will be £320 million less 4 per cent. of the value of any B Shares subscribed for under the Contingent Subscription. This annual fee will be paid over a five year period and will be payable in cash or, subject to the consent of HM Treasury, either by the waiver of certain UK tax reliefs that are treated as deferred tax assets (pursuant to the Tax





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Loss Waiver) or through the issuance of additional B Shares to HM Treasury (on the same terms as the Initial B Shares). The annual fee ceases to be payable on termination of the Contingent Subscription and if RBS terminates the Contingent Subscription in part, the fee will reduce proportionately.

**1.4 Key terms of the B Shares and the Dividend Access Share**

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. The initial agreement reached with HM Treasury in February 2009 envisaged that the B Shares would be mandatorily converted if the price of RBS's Ordinary Shares exceeded £0.65 for a specified period but this mandatory conversion right no longer applies to the B Shares. HM Treasury has maintained its agreement not to convert its B Shares into Ordinary Shares to the extent that its holding of Ordinary Shares following conversion would represent more than 75 per cent. of RBS's issued Ordinary Share capital.

The B Shares will rank *pari passu* with the Ordinary Shares on a winding up or liquidation and carry the same cash dividend rights (and, in certain circumstances, the same dividend rights generally) as Ordinary Shares. However, a Dividend Access Share carrying enhanced dividend rights will also be issued to HM Treasury on the Issue Date. The Dividend Access Share will rank equally with RBS's Ordinary Shares in the event of a winding-up or liquidation of the Company and the enhanced dividend rights embedded in the Dividend Access Share will be linked to the total number of B Shares issued to HM Treasury from time to time. In combination, the Dividend Access Share and the B Shares will entitle HM Treasury to dividends calculated, broadly, as the greater of 7 per cent. of the B Share issue amount and 250 per cent. of dividends paid on one Ordinary Share multiplied by the number of B Shares issued to HM Treasury.

These enhanced dividend rights are described more fully in Appendix 3 to this letter and will fall away in respect of B Shares in issue at the relevant time when the RBS share price 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. Dividends on the B Shares and the Dividend Access Share will be covered by the two-year prohibition on the payment of dividends agreed in principle with the Commissioner. For as long as no dividend is paid on the Dividend Access Share, no dividend may be paid on the Ordinary Shares or B Shares and no Ordinary Shares may be bought back by RBS.

The voting rights attached to the B Shares and the Dividend Access Share are limited, as described more fully in Appendix 3 to this letter.

The Dividend Access Share will only be transferable to an entity which is wholly-owned, directly or indirectly, by HM Treasury. The B Shares will be freely transferable.

Please refer to Appendix 3 to this letter for a more detailed description of the terms of the B Shares and the Dividend Access Share.

**2. The Asset Protection Scheme**

As originally conceived in February 2009, the APS offered, in our view, strong but costly cover against losses including those within our base case forecasts. We have now agreed with HM Treasury that the APS should be restructured. The restructuring is designed so that losses within our base case forecasts no longer result in a payout under the APS.

The pool of assets covered by the new Scheme has been reduced from the £325 billion announced in February 2009 to £282 billion, both amounts as at 31 December 2008, while the First Loss amount to be absorbed by RBS, originally £42.2 billion, will be much higher at £60 billion. Historic accounting impairments and write-downs on the revised pool of assets now amount to £21.3 billion compared with £22.7 billion when originally announced.

The £282 billion pool of assets included in the Scheme includes £3 billion of derivatives and structured finance assets which for technical reasons do not currently, or which it is anticipated will not in the future, satisfy the eligibility requirements of the Scheme. HM Treasury and RBS have agreed to enter into good faith negotiations to establish as soon as possible whether (and if so, to what extent) APS coverage should extend to these assets. In addition, RBS has agreed that on or prior to its accession to the APS it will issue a withdrawal notice in respect of £1.2 billion of Covered Assets across a broad range of asset classes.

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As originally envisaged in February 2009, RBS would have paid a single fee to HM Treasury for the APS of £6.5 billion, payable in B Shares, and would have agreed to give up the benefit of certain current and future tax losses. These losses were valued at £9 billion to £11 billion at 30 June 2009.

Under the terms now agreed with HM Treasury, RBS will instead pay an annual fee at a rate of £700 million per annum for three years (2009-2011) and £500 million per annum thereafter until the earlier of (i) termination of the APS and (ii) 31 December 2009. The fee is payable in cash or, subject to HM Treasury consent, either by the waiver of certain UK tax reliefs that are treated as deferred tax assets (pursuant to the Tax Loss Waiver) or, through the issuance of additional B Shares to HM Treasury (on the same terms as the Initial B Shares).

In the event that the First Loss is not exceeded, RBS will have the option to exit the APS, subject to FSA approval and subject to an exit fee equal to the shortfall (if any) between (i) aggregate annual fees paid to the date of exit and (ii) the higher of (a) £2.5 billion and (b) 10 per cent. of the aggregate annual reduction in Pillar 1 capital requirements in respect of the assets covered by the APS up to the time of exit (see Appendix 2 to this letter for more details). Except in a scenario where losses are significantly higher than in the base case, we would not expect the exit fee to exceed the £2.5 billion minimum. These commercial terms relating to exit agreed with HM Treasury are an important and, in the base case, a beneficial change to the APS and we will be working resolutely to bring forward the point at which exit becomes possible.

The exit fee is payable in cash or, subject to HM Treasury consent, by the waiver of certain UK tax reliefs that are treated as deferred tax assets (pursuant to the Tax Loss Waiver).

If the First Loss is exceeded, subject to FSA approval, RBS may exit the APS by repaying any net payments made by HM Treasury under the terms of the APS (or as otherwise agreed with HM Treasury) together with the exit fee referred to above. Given these exit terms, in a severe stressed scenario in which the First Loss may have been exceeded, the advantage of the protection afforded by the APS may outweigh the £700 million (or £500 million as the case may be) annual cost and other disadvantages of continuing to participate in the APS and the Group may choose not to exit and continue in the APS indefinitely. Self evidently this would be a serious consequence for the Group. The manner in which the APS protection will be treated for accounting purposes and the value attributed to such protection is set out more fully on page 66.

Many of the Scheme rules, including the extensive reporting requirements, remain onerous. For example, in certain circumstances HM Treasury may appoint a step-in manager who would have certain oversight, investigation, approval and other rights over the management of assets covered by the APS. Moreover, although we do not currently expect to have to make any claim under the APS, in the severe scenario in which we had to do so, the Scheme's provisions mean that there would be a time lag of at least two years for payments made by HM Treasury. I would direct your attention to Appendix 2 to this letter, in which you will find a more detailed discussion of these rules.

In addition to the reporting requirements, the terms of accession to the APS are in several respects very restrictive. HM Treasury has required that, as a condition of accessing the APS, RBS grants to HM Treasury the right to consent to the quantum and shape of the 2009 bonus pool, such right to be exercised by UK Financial Investments Limited ("UKFI"). The Board has agreed to this requirement solely on the basis that it is an essential part of the overall agreements for the refinancing of the Group and accession to the APS, which the Board believes are in the interests of all shareholders. Depending on UKFI's approach to recommendations made by the Board in respect of that bonus pool, this requirement may adversely impact RBS's ability to attract and retain senior managers and other key employees and thereby place RBS at a significant competitive disadvantage against its competitors as well as increasing the risks facing RBS and weakening management's ability to deal with them.

On our base case forecasts, the substantial First Loss amount borne by RBS will not be exceeded and HM Treasury will make no payment under the APS. On this base case analysis, we expect HM Treasury, therefore, to make a sizeable profit from RBS under the APS through the fees we will pay.

However, the Board considers this to be a reasonable price for RBS to pay for the cover received from HM Treasury for the very stressed scenarios in which claims might be made on HM Treasury under the APS. To be clear, RBS must meet the capital assessment requirements for both base case and stressed case scenarios laid down by the FSA in order to ensure that each of its licensed entities is permitted to carry on as a licensed bank. The Board believes that acceding to the APS, which together with the B Share issuance and Contingent Subscription form part of an overall transaction with HM Treasury,

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remains an essential safeguard in the event of an economic outcome more severe than we currently anticipate. Additionally, the APS provides capital relief to RBS which reduces the amount of new capital that would otherwise be required to be issued.

**3. State aid measures**

HM Treasury had detailed negotiations with the Commissioner in order to reach agreement in principle on the State aid and the restructuring package announced on 3 November 2009 on which negotiations have continued. The ultimate decision to approve these proposals still rests with the EC's College of Commissioners (the "College"). RBS believes that these proposed measures are consistent with well-publicised State aid guidelines. State aid received by RBS and covered by the State aid approval and restructuring package includes the recapitalisation of RBS announced in October 2008 and RBS's planned accession to, and participation in, the APS, together with the B Share capital issuance, including the Contingent Subscription.

**3.1 Business Divestments**

Based on discussions with the Commissioner, RBS believes that, the State aid and State aid restructuring package, as submitted to the European Commission (the "Commission"), demonstrates a viable plan for RBS to return to long-term standalone strength without the support of the UK Government. The approval will be subject to RBS taking a number of measures in the shape of business divestments in accordance with the State aid process.

The Commissioner and HM Treasury have agreed in principle that RBS will be required to reduce its presence in the UK banking sector. The divestment associated with this will encompass the disposal of the RBS branch-based business in England and Wales, the NatWest branches in Scotland, along with direct SME customers across the UK. This will result in the disposal of 318 branches UK-wide (14 per cent. of the Group's UK retail network) and the appropriate infrastructure to support this business.

RBS has committed that the SME and mid-corporate customers that form part of the UK banking divestment will amount to 5 per cent. of all SME and mid-corporate customers in the UK respectively. This divestment is expected to reduce RBS's UK market share by approximately 2 percentage points in Retail banking.

This network, combining RBS branches in England and Wales (for the most part, originally Williams & Glyn's) and NatWest in Scotland, is expected to constitute a viable, standalone, nationwide business.

In addition, between now and the end of 2013, and subject to potentially retaining a minority interest until the end of 2014, RBS will divest RBS Insurance, which has a market-leading position in the UK. RBS will also divest by the end of 2013 Global Merchant Services, its card payment acquiring business which has a top five global market share, (subject to RBS retaining up to 20 per cent. of each business within Global Merchant Services if required by the purchaser). RBS's interest in RBS Sempra Commodities, a leading global commodities trader, will also be divested.

The Board will seek to time these disposals to maximise value and they may be effected through an initial public offering, sales or a combination of these. RBS will now develop a process and timetable for carrying out these disposals by the end of 2013. One of our principal areas of focus as part of this process will be to minimise disruption and uncertainty for our customers and staff.

In the event that the Group is unable to achieve these disposals or to implement other restructuring measures in the agreed timescales, the conditions of the State aid approvals will not be met and the Group may be compelled to take further action in a manner that could materially reduce the value achieved by the Group for disposals, if any, or otherwise negatively affect the Group's business, operations and financial conditions.

In the event that the RBS Core Tier 1 Ratio (calculated by reference to the regulatory rules in force as at 31 December 2009) declines to below 5 per cent. at any time before 31 December 2014, or should RBS fail to implement its funded balance sheet target level (after certain adjustments) by 31 December 2013 by £30 billion or more, RBS has further agreed in principle with the Commissioner that it will reduce RWAs by £60 billion through further disposals of identifiable businesses and associated assets.

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**3.2 Behavioural Measures**

RBS has also agreed to a number of behavioural commitments, including the requirement for the ranking of our Global Banking & Markets division to be no higher than fifth in the combined global all debt league table for three years. This includes all bonds globally and all syndicated loans globally measured in US dollars. It excludes self-led, self-funded, money market, short term deals and certain other debt. RBS is currently ranked sixth globally for all debt and at the same time last year held the fifth ranking.

RBS will enter into a commitment that, from 1 January 2010 until 31 December 2013, it will be at the leading edge of implementing the G-20 principles, the FSA Remuneration Code and any remuneration proposals from the Walker Review that are implemented in regulations.

RBS has undertaken that, unless otherwise agreed with the Commission, neither RBS nor any of its direct or indirect subsidiaries (excluding any companies in the ABN AMRO Group) will pay investors any dividends or coupons on existing hybrid capital instruments (including preference shares, B shares and upper and lower tier 2 instruments) from a date starting not later than 30 April 2010 and for a period of two years thereafter (the "Deferral Period") or exercise any call rights in relation to the same between 24 November 2009 and the end of the Deferral Period, unless there is a legal obligation to do so. Hybrid capital instruments issued after 24 November 2009 will generally not be subject to the restriction on dividend or coupon payments or call options.

Unless the Commission agrees otherwise, the hybrid capital instruments existing on 24 November 2009 which are retained in the ABN AMRO Group after Separation is complete will be subject to a restriction on the payment of dividends and coupons and on the exercise of any call rights, unless in any such case there is a legal obligation to do so, for an effective period of two years after the proposed capital restructuring of RFS Holdings B.V. (which is intended to take place soon after Separation) and following the expiry of any "pusher" periods following Separation and such capital restructuring.

Further details on the restructuring and behavioural commitments can be found in Appendix 4 to this letter.

**3.3 Other agreements with HM Treasury and its degree of influence over the Group**

In addition to the substantial fees associated with the APS, HM Treasury has required RBS, as a pre-condition to its participation in the APS, to enter into a number of additional commitments. The principal elements of these additional commitments are:

RBS has agreed to a revised approach to pay and reward for its staff for 2009, including a comprehensive plan to defer a large part of any bonuses paid, with the potential for clawback if part of the profits to which any bonus originally related turns out in later years to result in a loss for the Group.

RBS has also agreed with HM Treasury that it will continue to meet its lending commitments, which include lending an additional £25 billion to creditworthy customers on commercial terms subject to market demand. A similar lending commitment will be agreed for next year, which will reflect the economic circumstances at the time.

At HM Treasury's request, RBS has agreed to contribute up to £100 million as a cornerstone investor to funds managed by a national investment corporation established by the UK Government. This new fund is intended to improve the availability of growth capital for small and medium-sized enterprises.

RBS has agreed to implement its plans to introduce a customer charter for its small and medium-sized clients by 27 November 2009, and to play a constructive role in discussions between the banking industry and the Office of Fair Trading in relation to current account fees and charges.

Furthermore, HM Treasury has stated that it intends to respect the commercial decisions of the Group and 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 majority shareholder means that it may be able to exercise a significant degree of influence over (among other things) the election of directors, the appointment of senior management, remuneration policy and governance. Notwithstanding this, the Board has a duty to promote the success of RBS for the benefit of



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its members as a whole and, in discharging this duty, will have to take into account the implications of such influence as may be exerted on RBS from time to time.

#### **4. Financial effects of the Transaction**

The £25.5 billion capital issue and the APS will materially strengthen RBS's capital ratios, augmenting the impact of our own restructuring measures. The subscription for £25.5 billion of B Shares will qualify as Core Tier 1 Capital. Whilst the APS has at accession no impact on the Pillar 1 regulatory capital requirement in respect of the assets in the pool, it will improve the reported overall capital, and the Core Tier 1, ratios of the Group, and is expected to assist RBS in meeting the forward looking stress testing framework applied by the FSA.

At 30 September 2009 the Group's Core Tier 1 Ratio stood at 5.5 per cent. and its Tier 1 Capital ratio at 8.0 per cent. Taken together, but without taking account of the £8 billion Contingent Subscription, the Transaction would have strengthened these capital ratios to 11.7 per cent. and 15.1 per cent. respectively, on a pro-forma basis.<sup>(1)</sup>

The payment of annual fees under the APS and in respect of the Initial B Shares and the Contingent Subscription will negatively affect RBS's retained earnings while it continues to participate in the APS. As discussed above, in the event that the First Loss is not exceeded, RBS will have the option to exit the APS, subject to FSA approval and subject to an exit fee equal to the higher of £2.5 billion or 10 per cent. of the aggregate annual reduction in Pillar 1 capital requirements in respect of the assets covered by the APS up to the time of exit (see Appendix 2 to this letter for more details), less, in each case, the aggregate annual fees already paid. The dividends payable on the B Shares and Dividend Access Share will also, if paid, negatively affect retained earnings attributable to RBS's Ordinary Shareholders.

While the Board has increased its 2013 target for the Group's Core Tier 1 Ratio to over 8 per cent., reflecting the expectation of both regulators and investors that banks should in future hold significantly more capital than was the norm in recent years, the capital ratios resulting from the £25.5 billion capital issuance will, on our base case forecasts, exceed this target. Consequently, HM Treasury's economic interest in RBS will increase by more than would otherwise be the case, and earnings per share for other Shareholders will be further diluted.

However, the extent of prospective regulatory change that may impact this ratio adversely is not yet known. Additionally, in a significantly worse economic environment than envisaged in those base case forecasts, such as the severe and prolonged recessionary scenarios used by the FSA for its capital assessment, then this additional £25.5 billion capital cushion, together with the Contingent Subscription and the APS, would be essential in order to maintain the Group's Core Tier 1 Ratio above the FSA stressed minimum of 4 per cent.

While the costs of the B Share issuance, the Dividend Access Share and the APS will adversely affect RBS's profitability over the next few years, the strengthening of our capital ratios will provide our Group with increased confidence that it can withstand the credit losses that could conceivably occur in a severe or prolonged economic downturn.

Following the issuance of B Shares and the Dividend Access Share, the HM Treasury holding of Ordinary Shares in RBS will remain at 70.3 per cent., though this holding could rise to 75 per cent. if B Shares are converted to Ordinary Shares. As a result of the issuance of the £25.5 billion of B Shares and the Dividend Access Share, HM Treasury's economic interest will rise to 84.4 per cent.

#### **5. Trading performance and outlook**

RBS's Interim Management Statement on results for the three months ended 30 September 2009 were published on 6 November 2009. The data set out below have been extracted without material adjustment from the Interim Management Statement.

##### **5.1 Current trading**

The Group reported an operating loss of £1,525 million in the third quarter, compared with £3,533 million in the second quarter. Adjusting for movements in the fair value of own debt, pre-impairment operating profit improved to £2,237 million, compared with £2,090 million in the previous quarter. Global

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(1) These figures have been extracted without material adjustment from the unaudited pro forma financial information set out in Part III of this document.



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Banking & Markets revenues, as we signalled in August, have returned to more normalised levels from the exceptionally strong conditions seen in the first and, to a lesser extent, second quarters. UK Corporate and GTS results are solid, but profitability in the UK, Ireland and US retail divisions remains subdued. The Non-Core Division is now operational and is thus far meeting its run-off forecasts. The Non-Core operating loss decreased to £2,718 million from £4,975 million in the second quarter.

Group net interest margin ("NIM") beat our forecasts in the quarter at 1.75 per cent., compared with 1.70 per cent. in the second quarter and 2.05 per cent. in the third quarter of 2008. All divisions have made good progress in improving asset margins to reflect the increased cost of funding, risk and additional capital requirements, and there has been some improvement in wholesale funding markets. Deposit margins remain under pressure, however.

Funding and liquidity positions have continued to improve, and the loan:deposit ratio, gross of provisions, declined to 142.3 per cent., compared with 144.5 per cent. at the end of the second quarter. Our liquidity pool, at £140 billion, is now close to our 2013 target of £150 billion, though its make-up will become more costly as government bonds are required to increase sharply as part of the total. Reliance on central bank funding is now down 69 per cent. from its peak, reflecting the marked improvement in short term money markets.

Net tangible equity per share increased to £0.594p at 30 September 2009, from £0.580p at 30 June 2009, with positive movements in available for sale reserves and currency translation outweighing the attributable loss of £1.8 billion.

## **5.2 Efficiency**

RBS's cost:income ratio improved to 59.1 per cent. in the third quarter from 66.4 per cent. in the second quarter. Adjusted for insurance claims, the cost:income ratio improved from 78.3 per cent. to 70.5 per cent. Our efficiency programme is progressing well though this will, regrettably but inevitably, mean further job losses as we continue our restructuring to meet the changed market realities.

We are actively re-tooling our businesses for future success as part of our five year strategic plan. These actions will require some reinvestment of cost savings into increased information technology and marketing spending, but they also involve making each of our businesses better and more efficient at serving their customers.

## **5.3 Impairments**

Although impairments remained high at £3,279 million in the quarter, third quarter trends are encouraging, notwithstanding a modest increase in default rates. Impairments and credit market write-downs remain concentrated in the Non-Core Division, though Ulster Bank particularly and Citizens are still experiencing increased impairment losses, reflecting the difficult economic environments they operate in.

## **5.4 Capital**

Our Core Tier 1 Capital Ratio declined to 5.5 per cent. at 30 September 2009, reflecting in part the loss recorded in the third quarter, which reduces our capital base, but just as importantly an increase of £47.4 billion in risk-weighted assets to £594.7 billion. This increase in RWAs was driven primarily by the fall in credit ratings for monolines, the effect of procyclicality in Basel II models and by foreign exchange movements. The majority of these effects occurred in the Non-Core Division, which in time will be run down. Nominal assets were broadly stable at constant exchange rates.

As indicated above, the proposed issuance of B Shares and the APS, taken together, would have increased the Group's pro forma Core Tier 1 Ratio at 30 September 2009 to 11.7 per cent. The significant strengthening of our capital base will enable the Group to maintain robust capital ratios in the face of continuing high impairment levels, rising RWAs from the impact of procyclicality and increasing regulatory capital demands.

## **5.5 Serving our customers**

Our core customer franchises have demonstrated remarkable resilience in the face of very difficult economic conditions. Except for those activities earmarked for run-off or exit, RBS has sustained its market positions and customer service measures. Customer numbers are growing or stable in all major



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businesses. UK Retail added 139,000 current account customers and 25,000 mortgage customers during the third quarter, while Ulster Bank and Citizens have held their customer bases steady. The stability of our retail franchises helped RBS to increase customer deposits by £8.5 billion during the quarter.

In business markets, RBS lent £15.2 billion to UK SMEs and corporates in the third quarter, taking total lending to £45.5 billion in the first nine months of the year. Lending to SMEs increased to £9.7 billion in the third quarter, up 5 per cent. from the previous quarter. Demand for lending remains muted, and overdraft utilisation rates across the SME and mid-corporate segments have remained low at 44 per cent. SME and mid-corporate customers still have access to undrawn committed facilities of more than £27 billion. The average interest rate on new lending to SMEs fell to 3.4 per cent., compared with 7.0 per cent. in the third quarter of 2008.

## 5.6 Outlook

While the third quarter has shown a number of encouraging trends, we remain cautious about economic prospects as the recovery seems likely to be slow and unemployment continues to rise. NIM is stabilising, but we expect competition for retail deposits to remain intense and overall NIM is expected to remain broadly stable in the next few quarters. Impairments appear to be plateauing in line with first half levels, although there may be volatility around that trend in coming quarters.

While the APS and capital issuance plans we have agreed with the Government will take our Core Tier 1 Capital Ratio to well above our target of 8 per cent., it is clear that the next two years will bring a number of further pressures, including the impact of procyclicality and increasing regulatory demands. Core business profits will take time to recover and build, especially as GBM results normalise.

Shareholders are urged to read the whole of this document and not to rely solely on the summarised financial information set out in this section of the document.

## 6. Importance of the Resolutions

As mentioned earlier, RBS's agreement to participate in the APS and to issue the B Shares and the Dividend Access Share (including pursuant to the Contingent Subscription) is classified as a related party transaction because HM Treasury, with which the Accession Agreement and the Acquisition and Contingent Capital Agreement have been concluded, is also our largest shareholder, controlling approximately 70 per cent. of our Ordinary Shares. It is, therefore, important that Independent Shareholders should be given the opportunity to review this large and complex transaction and to satisfy themselves of its merits. RBS's participation in the APS, the B Share issuance and the Dividend Access Share issue cannot take effect without Independent Shareholder approval and you will, therefore, be invited to vote on the Transaction at a General Meeting to be held at RBS Conference Centre, RBS Gogarburn, Edinburgh EH12 1HQ on 15 December 2009. Notice of this meeting and the Resolutions to be proposed are included at the end of this document.

Resolution 1 is an ordinary resolution to approve the accession to and participation in the APS and the issue of B Shares and the Dividend Access Share to HM Treasury as a related party transaction, as required under the Listing Rules; HM Treasury will not vote on this resolution. The issue of B Shares to HM Treasury includes the issue of £25.5 billion of B Shares, the Contingent Subscription and the possible issue of B Shares in connection with (a) the fees for the APS and the B Share Issue, (b) the payment in B Shares of certain dividends in respect of the Dividend Access Share and the B Shares and (c) any Bonus Issue made in connection with the conversion of the B Shares to Ordinary Shares.

Resolution 2 is an ordinary resolution granting the Directors authority to allot B Shares, the Dividend Access Share and Ordinary Shares in certain circumstances, in each case as required under the Companies Act.

Resolution 3 is an ordinary resolution, as required under the Companies Act and the Articles of Association, to grant the Directors authority to capitalise certain amounts of the Company's reserves and to apply these amounts in paying up B Shares and to consolidate and sub-divide share capital and/or sub-divide shares, in each case in connection with any conversion of B Shares into Ordinary Shares or the payment in B Shares of certain dividends on the Dividend Access Share and the B Shares.

Resolution 4 is an ordinary resolution, as required under Listing Rules, to adopt the RBS 2010 Deferral Plan. Under the new plan, incentives will be deferred into awards that will be settled in shares and/or

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subordinated debt. In order to ensure that performance-related pay awards take future risk from current business into account, thereby aligning employee, customer and shareholder interest more fully, the RBS Remuneration Committee can determine that awards should be reduced and/or forfeited, after reviewing (amongst other things) the performance of the employing company, any member of the Group, any business area or team or the relevant individual. Further plans may be adopted based on the RBS 2010 Deferral Plan to allow it to be operated in other countries or for relevant employees in the ABN AMRO Group or it may be modified to take account of local tax, exchange control or securities laws in such countries and, where feasible, to mitigate any unfavourable tax treatment.

Resolution 5 is a special resolution, as required under the Companies Act, to approve (a) the deletion of the references in the Articles of Association to the Company's authorised share capital now that the 2006 Act has abolished the requirement for a company to have an authorised share capital and (b) other amendments to the Articles of Association required in connection with the B Share Issue, the issue of the Dividend Access Share, the Non-Voting Deferred Shares Series B and the conversion of RBS's convertible preference shares.

Resolution 6 is a special resolution which will authorise the Directors to disapply pre-emption rights, to the extent applicable under the Companies Act, in respect of the allotment of the B Shares, the Dividend Access Share and the Ordinary Shares referred to in Resolution 2. This power will expire simultaneously with the authority to allot given pursuant to Resolution 2. All Ordinary Shareholders (including HM Treasury) have statutory pre-emption rights and are entitled to vote on resolutions to disapply such rights. Therefore pre-emption rights cannot be disapplied, to the extent applicable, unless a resolution to disapply such rights has been put to the vote of all Ordinary Shareholders (including HM Treasury) and passed by the requisite majority.

Resolutions 2, 3, 5 and 6 must be passed by Shareholders and Resolution 1 must be passed by Independent Shareholders at the General Meeting in order for the Transaction to proceed. If any of Resolutions 2, 3, 5 and 6 is not approved by Shareholders or Resolution 1 is not approved by Independent Shareholders, then the Group will not participate in the APS or issue the B Shares or the Dividend Access Share. If this were to be the case, the Directors do not believe that any alternative methods of obtaining protection for stressed losses through the economic cycle and improving capital ratios are available to the Group, with the result that the Group could face increased risk of full nationalisation or other resolution procedures under the Banking Act in respect of RBS and Shareholders could lose most or all of the value of their Shares (which risk remains despite the compensation arrangements HM Treasury is required to put in place in accordance with that Act) (for further information, see Appendix 1 to this letter).

As the accession to and participation in the APS, the B Share Issue and the issue of the Dividend Access Share is a related party transaction for the purposes of the Listing Rules, in accordance with the Listing Rules, HM Treasury will not vote on Resolution 1 (being the resolution to approve the accession to and participation in the APS, the B Share Issue and the issue of the Dividend Access Share as a related party transaction), and HM Treasury has undertaken to take all reasonable steps to ensure that its associates, if any, will not vote on Resolution 1. This reflects HM Treasury's role as provider of credit risk protection under the APS, as well as its potentially conflicting role as our major shareholder and the collector of taxes in the United Kingdom.

## **7. Directors' assessment**

Since we first announced our intention to participate in the APS in February 2009, the apparent improvement in the economic environment has contributed to a strong rally in the financial markets and we, for our part, have set out a strong and coherent restructuring plan that we believe can rebuild RBS to standalone strength. We have taken the first steps towards that goal by embarking on the implementation of our strategic plan and through the creation of our Non-Core Division. In the light of all that has changed in the economic environment since February, the B Shares and related Dividend Access Share may appear to be a relatively expensive form of capital, and besides the financial cost of the APS, there is a very significant management and reporting burden that will result from our accession to and participation in the APS. There will be some who may argue that, given the improvement in market conditions since we first announced our plans, the price is, in aggregate, too high for the protection our

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Group will receive. The Board's view is, nevertheless, that the rationale for the Transaction remains valid for the reasons set out below:

RBS must meet the capital assessment requirements for both normal and stressed case scenarios laid down by the FSA in order to ensure that each of its licensed entities is permitted to carry on as a licensed bank. Without the £25.5 billion capital issuance, the additional £8 billion of Contingent Subscription and the APS we would not satisfy this framework.

We do not believe that any alternative source of additional capital or protection is currently available to the Group that would provide us with the resilience we need and that would avoid the risk of Independent Shareholders losing most or all of the value in their Shares if RBS were to be nationalised or be subject to other resolution procedures under the Banking Act.

The range of forecasts for the major economies in which RBS operates remains wide. In the event of a severe or prolonged economic downturn, which could result in more extreme credit losses on RBS's portfolio, the Contingent Subscription and the APS will provide important protection to its capital position beyond that provided by the initial B Share issuance.

It is possible that we may look back in years to come and, if the severe outcomes against which we have obtained protection have not come to pass, feel that the price was too great. Today, however, it is the Board's view that the costs of the Transaction are commensurate with the substantial risk protection provided to our Group.

Since our original announcement in February 2009, material changes have been made during negotiations with HM Treasury to certain of the terms of the Transaction. Although we have had to accept terms which are, in a number of respects, not as we would have wished, the redesigned APS is more affordable and flexible and has our support. Likewise, the agreement in principle reached with the Commissioner is clearly more material to the structure of the Group than we had hoped, and this will require us to revise our strategic plan and so will increase the risks in its execution. However, the Group's inherent strengths remain intact and the divestment proceeds will help our capital position, bringing forward the prospect of exit from the APS. The Directors believe that they have negotiated the most favourable terms available to RBS in all the circumstances and, given the risk of nationalisation and other resolution procedures under the Banking Act in respect of RBS for Independent Shareholders if the Transaction is not implemented, have recommended they vote in favour of the Transaction as described below.

## **8. Recommendation**

The Board, which has been so advised by Morgan Stanley and UBS, considers that the Transaction is fair and reasonable so far as Independent Shareholders are concerned. In providing their advice, Morgan Stanley and UBS have taken into account the Board's commercial assessments of the Transaction.

**Further, the Board considers that the Transaction and the Resolutions are in the best interests of Shareholders taken as a whole. Accordingly, the Board unanimously recommends that Shareholders vote in favour of the Resolutions to be put to the General Meeting as they intend to do, or procure, in respect of their own beneficial shareholdings held at the time of the General Meeting.** Please note that HM Treasury will not vote on Resolution 1, and HM Treasury has undertaken to take all reasonable steps to ensure that its associates, if any, will not vote on Resolution 1.

Yours sincerely,

Philip Hampton  
Chairman

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**APPENDIX 1 TO THE LETTER FROM THE CHAIRMAN OF RBS RISK FACTORS**

*The following risks should be considered carefully by Shareholders before making any decision whether or not to vote in favour of the Resolutions.*

*This section addresses the existing and future material risks to RBS's business. The risks below are not the only ones that RBS will face. Some risks are not yet known and some that are not currently deemed material could later turn out to be material. All of these risks could materially affect RBS, its income, operating profits, earnings, net assets, liquidity and capital resources. In such a case, the market price of Ordinary Shares may decline and Shareholders could lose all or part of their investment.*

**RISKS RELATING TO RBS**

***RBS and its UK bank subsidiaries may face the risk of full nationalisation or other resolution procedures under the Banking Act.***

Under the provisions of the Banking Act, substantial powers have been granted to the Authorities as part of the Special Resolution Regime to stabilise banks that are in financial difficulties (the "SRR"). The SRR confers powers on the Bank of England: (i) to transfer to the private sector all or part of the business of a UK incorporated institution with permission to accept deposits pursuant to Part IV of the FSMA (a "relevant entity"); (ii) to transfer all or part of the business of the relevant entity to a "bridge bank" established by the Bank of England; and also confers a power on HM Treasury to transfer into temporary public ownership (nationalisation) the relevant entity or its UK-incorporated holding company. The Banking Act also provides for two new insolvency and administration procedures for relevant entities.

The purpose of the stabilisation options is to address the situation where all or part of the business of a relevant entity has encountered, or is likely to encounter, financial difficulties. Accordingly, the stabilisation options may only be exercised if the FSA is satisfied that (i) a relevant entity such as RBS's UK banking subsidiaries, including RBS plc and NatWest, is failing, or is likely to fail, to satisfy the threshold conditions set out in Schedule 6 to the FSMA, and (ii) having regard to timing and other relevant circumstances, it is not reasonably likely that (ignoring the stabilisation options) action will be taken that will enable the relevant entity to satisfy those threshold conditions. The threshold conditions are conditions which an FSA-authorized institution must satisfy in order to retain its FSA authorisation. They are relatively wide-ranging and deal with most aspects of a relevant entity's business, including, but not limited to, minimum capital resource requirements. It is therefore possible that the FSA may trigger one of the stabilisation options before an application for an insolvency or administration order could be made.

The stabilisation options may be exercised by means of powers to transfer property, rights or liabilities of a relevant entity and shares and other securities issued by a relevant entity. HM Treasury may also take the parent company of a relevant entity (such as RBS) into temporary public ownership provided that certain conditions set out in Section 82 of the Banking Act are met. Temporary public ownership is effected by way of a share transfer order and can be actioned irrespective of the financial condition of the parent company.

If HM Treasury makes the decision to take RBS into temporary public ownership, it may take various actions in relation to Ordinary Shares without the consent of holders of the Ordinary Shares, including (among other things):

- (i) transferring the Ordinary Shares free from any contractual or legislative restrictions on transfer;
- (ii) transferring the Ordinary Shares free from any trust, liability or encumbrance;
- (iii) extinguishing any rights to acquire Ordinary Shares;
- (iv) delisting the Ordinary Shares;
- (v) converting the Ordinary Shares into another form or class of securities; or
- (vi)

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disapplying any termination or acceleration rights or events of default under the terms of the Ordinary Shares which would be triggered by the transfer.

Where HM Treasury has made a share transfer order in respect of securities issued by the holding company of a relevant entity, HM Treasury may make an order providing for the property, rights or

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liabilities of the holding company or of any relevant entity in the holding company group to be transferred and where such property is held on trust, removing or altering the terms of such trust.

Accordingly, there can be no assurance that the taking of any such actions would not adversely affect the rights of holders of Ordinary Shares and/or adversely affect the price or value of their investment or that the ability of RBS to satisfy its obligations under contracts related to Ordinary Shares would be unaffected. In such circumstances, such holders may have a claim for compensation under one of the compensation schemes currently existing under, or contemplated by, the Banking Act if any action is taken in respect of Ordinary Shares (for the purposes of determining an amount of compensation, an independent valuer must disregard actual or potential financial assistance provided by the Bank of England or HM Treasury). There can be no assurance that holders of Ordinary Shares would thereby recover compensation promptly and/or equal to any loss actually incurred.

If RBS was taken into temporary public ownership and a partial transfer of its or any relevant entity's business was effected, or if a relevant entity were made subject to the SRR and a partial transfer of its business to another entity was effected, the transfer may directly affect RBS and/or its Group companies by creating, modifying or cancelling their contractual arrangements with a view to ensuring the provision of such services and facilities as are required to enable the bridge bank or private sector purchaser to operate the transferred business (or any part of it) effectively. For example, the transfer may (amongst other things) (i) require RBS or Group companies to support and cooperate with the bridge bank or private sector purchaser, (ii) cancel or modify contracts or arrangements between RBS or the transferred business and a Group company, or (iii) impose additional obligations on RBS under new or existing contracts. There can be no assurance that the taking of any such actions would not adversely affect the ability of RBS to satisfy its obligations under related contracts.

If RBS was taken into temporary public ownership and a partial transfer of its or any relevant entity's business was effected, or if a relevant entity were made subject to the SRR and a partial transfer of its business to another entity was effected, the nature and mix of the assets and liabilities not transferred may adversely affect RBS's financial condition and increase the risk that RBS may eventually become subject to administration or insolvency proceedings pursuant to the Banking Act.

While it was in force, the UK Government took action under the Banking (Special Provisions) Act 2008 in respect of a number of UK financial institutions, including, in extreme circumstances, full and part nationalisation. There have been concerns in the market in the past year regarding the risks of such nationalisation in relation to RBS and other UK banks. If economic conditions in the United Kingdom or globally continue to deteriorate, or the events described in the following risk factors occur to such an extent that they have a materially adverse impact on the financial condition, perceived or actual credit quality, results of operations or business of any of the relevant entities in the Group, the UK Government may decide to take similar action in relation to RBS under the Banking Act. Given the extent of the Authorities' powers under the Banking Act, it is difficult to predict what effect such actions might have on the Group and any Securities issued by RBS or Group companies. However, potential impacts may include full nationalisation of RBS and the total loss of value in the Shares.

If a partial transfer of RBS's business were effected under the Banking Act by the Bank of England, under the terms of which the liabilities under Ordinary Shares were not transferred, HM Treasury is required to make a compensation scheme order or a resolution fund order (depending on the stabilisation power adopted) and must make a third party compensation scheme order including pursuant to the Banking Act (Third Party Compensation Arrangements for Partial Property Transfers) Regulations 2009. However, there can be no assurance that compensation would be assessed to be payable or that holders of Ordinary Shares would recover any compensation promptly and/or equal to any loss actually incurred.

***The Group's businesses, earnings and financial condition have been and will continue to be affected by the global economy and instability in the global financial markets.***

The performance of the Group has been and will continue to be influenced by the economic conditions of the countries in which it operates, particularly the United Kingdom, the United States and other countries throughout Europe and Asia. The outlook for the global economy over the near to medium term remains challenging, particularly in the United Kingdom, the United States and other European economies. In addition, the global financial system has yet fully to overcome the difficulties which first manifested themselves in August 2007 and financial markets conditions have not yet fully normalised. These conditions led to severe dislocation of financial markets around the world and unprecedented levels of illiquidity in 2008 and 2009, resulting in the development of significant problems at a number of

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the world's largest corporate institutions operating across a wide range of industry sectors, many of whom are the Group's customers and counterparties in the ordinary course of its business. In response to this economic instability and illiquidity in the market, a number of governments, including the UK Government, the governments of the other EU member states and the US Government, have intervened in order to inject liquidity and capital into the financial system, and, in some cases, to prevent the failure of these institutions.

Despite such measures, the volatility and disruption of the capital and credit markets have continued, and global economic conditions are expected to remain challenging in the near to medium term, with many forecasts predicting negative GDP growth in the United Kingdom for the remainder of 2009, and only modest levels of GDP growth over the course of 2010. Similar conditions are likely to exist in a number of the Group's key markets, including those in the United States and Europe, particularly Ireland. These conditions have exerted, and may continue to exert, downward pressure on asset prices and on availability and cost of credit for financial institutions, including RBS, and will continue to impact the credit quality of the Group's customers and counterparties. Such conditions, alone or in combination with regulatory changes or actions of other market participants, may cause the Group to incur losses or to experience further reductions in business activity, increased funding costs and funding pressures, lower share prices, decreased asset values, additional write-downs and impairment charges and lower profitability.

In addition, the Group will continue to be exposed to the risk of loss if major corporate borrowers or counterparty financial institutions fail or are otherwise unable to meet their obligations. The Group currently experiences certain business sector and country concentration risk, primarily focused in the United Kingdom and the rest of Europe and relating to personal and banking and financial institution exposures. The Group's performance may also be affected by future recovery rates on assets and the historical assumptions underlying asset recovery rates, which (as has already occurred in certain instances) may no longer be accurate given the unprecedented market disruption and general economic instability. The precise nature of all the risks and uncertainties the Group faces as a result of current economic conditions cannot be predicted and many of these risks are outside the control of the Group.

***The aid given to the Group by HM Treasury is subject to State aid review by the Commission. The outcome of this review is uncertain and may involve the imposition of conditions on the Group that may be materially adverse to its interests, the prohibition of some elements of the aid or the requirement for the Group to repay the aid. It is expected that there will be a prohibition on the making of discretionary dividend or coupon payments on existing hybrid capital instruments (including preference shares and B Shares) for a two-year period, which may impair the Group's ability to raise new Tier 1 Capital through the issuance of Ordinary Shares and other Securities.***

The aid given to the Group by HM Treasury as part of the First Placing and Open Offer, the issuance of up to £25.5 billion of B Shares to HM Treasury, a commitment by HM Treasury to acquire up to an additional £8 billion of B Shares if certain conditions are met and the Group's participation in the APS (the "State aid"), is subject to clearance under the European State aid rules.

As a result of the First Placing and Open Offer, the Group was required to cooperate with HM Treasury to submit a forward plan to the Commission. This plan was submitted and there have been detailed discussions between HM Treasury, the Group and the Commission. The plan submitted not only had regard to the First Placing and Open Offer, but also the B Share Issue (including the Contingent Subscription) and the Group's participation in the APS. As part of its review, the Commission is required to assess the State aid and to consider whether the Group's long-term viability will be assured, that the Group makes a sufficient contribution to the costs of its restructuring and that measures are taken to limit distortions of competition arising from the aid provided to the Group by the UK Government. In advance of the announcement of the restructuring package on 3 November 2009, the Group, together with HM Treasury, agreed in principle with the Commissioner the terms of the State aid and the terms of a restructuring plan (the "State aid restructuring plan"). Since 3 November 2009, discussions have continued with regard to the State aid and the State aid restructuring plan. Based on these negotiations, the Group anticipates that the final State aid restructuring plan will consist of the principal elements set out in Part I, Appendix 4 of this document (although it remains possible that further measures will be required), which the Group is confident will address any competition distortions from the State aid that the Group has received. The expected prohibition on the making of discretionary dividend (including preference shares and B Shares) or coupon payments on existing hybrid capital instruments for a

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two-year period will prevent RBS from paying dividends on its Ordinary Shares and preference shares and coupons on other Tier 1 Capital securities for the same duration, and it may impair the Group's ability to raise new Tier 1 Capital through the issuance of Ordinary Shares and other Securities.

As the ultimate State aid decision, including the terms of the State aid and the State aid restructuring plan, will be taken by the College, at this stage there can be no certainty as to the outcome of the State aid proceedings and the content of the final State aid restructuring plan.

If the College does not approve the State aid and the State aid restructuring plan in substantially the form described in Part I, Appendix 4 of this document, then the Commission would be likely instead to open a formal investigation into State aid given to the Group. At the conclusion of this investigation, the Commission could prohibit some or all, or require amendments to the terms, of the B Share Issue, the Contingent Subscription or the APS, including the pricing of the APS, but still require some or all elements of the proposed State aid restructuring plan, the result of which could be more disadvantageous to the Group. The Commission could also impose conditions that are more disadvantageous, potentially materially so, to the Group than those in the proposed State aid restructuring plan. In particular, the Group could be required to dispose of a significantly larger proportion of its assets and/or agree to a more stringent divestment timetable or more onerous behavioural restrictions than those contemplated in the State aid restructuring plan. Any more extensive remedies could have a materially more negative impact on the Group than would be the case if the Group implemented the proposed State aid restructuring plan. In addition, such divestments could be complicated by relevant assets and/or exposures that are covered by the APS ceasing to be covered, upon divestment.

In addition, the Commission may, instead of imposing more disadvantageous conditions as described above, refuse to permit the B Share Issue (including access by the Group to the Contingent Subscription) or the Group's participation in the APS or require HM Treasury to recover the State aid from the Group, all of which could have a materially adverse impact on the Group. For further detail, please read the risk factor entitled *If the Group is unable to participate in the APS and/or the Company is unable to issue £25.5 billion of B Shares, the Dividend Access Share and, if required, the £8 billion Contingent B Shares (including as a result of the Resolutions not being approved), the Group may be unable to find alternative methods of obtaining protection for stressed losses against severe or prolonged recessionary periods in the economic cycle and improving its capital ratios, with the result that the Group may face increased risk of full nationalisation or other resolution procedures under the Banking Act below.*

It is possible that, even if the College does approve the State aid and the State aid restructuring plan in substantially the form described in Part I, Appendix 4 of this document, there could be changes to either or both which are, in each case, disadvantageous to the Group.

Further, it is possible that, even if the College does approve the State aid and the State aid restructuring plan in substantially the form described in Part I, Appendix 4 of this document, a third party could challenge that decision in the European Courts. The Group does not believe that any such challenge would be likely to succeed but, if it were to succeed, the Commission would need to reconsider its decision, which may result in any of the adverse outcomes described above.

The Group will also be subject to a variety of risks as a result of implementing the State aid restructuring plan in the form submitted by HM Treasury. There is no assurance that the price that the Group receives for any assets sold pursuant to the State aid restructuring plan will be 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 (including in relation to potential purchasers of the UK branch divestment) contained in the terms thereof. Further, should the Group fail to complete any of the required disposals within the agreed timeframes for such disposals, under the proposed terms of the State aid clearance a divestiture trustee can 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 Commission doubts that the Group is complying with the terms of the State aid approval, it may open a formal investigation. At the conclusion of this investigation, if the Commission decides that there has been misuse of aid, it can issue a decision requiring HM Treasury to recover the misused aid which could have a material adverse impact on the Group.



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In implementing the State aid restructuring plan, the Group will lose existing customers, deposits and other assets (both directly through the 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. Further, the loss of such revenues and related income may extend the time period over which the Group may pay any amounts owed to HM Treasury under the APS or otherwise. 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 giving rise to separation costs which could be substantial.

The implementation of the State aid restructuring plan agreed in principle with the Commissioner may result in the emergence of one or more new viable competitors or a material strengthening of one or more of the Group's 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. If any or all of the risks described above, or any other currently unforeseen risks, materialise, there could be a materially negative impact on the Group's business, operations, financial condition, capital position and competitive position.

For further details on the State aid restructuring plan, including a description of the Group's undertakings and the restrictions imposed, see Part I, Appendix 4 of this document.

***Lack of liquidity is a risk to the Group's business and its ability to access sources of liquidity has been, and will continue to be, constrained.***

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 enterprise specific factors, including an over-reliance on a particular source of funding (including, for example, short-term and overnight funding), changes in credit ratings or market-wide phenomena such as market dislocation and major disasters. Since the second half of 2008, credit markets worldwide have experienced a severe reduction in liquidity and term-funding. During this time, perception of counterparty risk between banks also increased significantly. This increase in perceived counterparty risk also led to reductions in inter-bank lending, and hence, in common with many other banking groups, the Group's access to traditional sources of liquidity has been, and may continue to be, restricted.

The Group's liquidity management focuses on maintaining a diverse and appropriate funding strategy for its assets, controlling the mismatch of maturities and carefully monitoring its undrawn commitments and contingent liabilities. However, the Group's ability to access sources of liquidity (for example, through the issue or sale of financial and other instruments or through the use of term loans) during the recent period of liquidity stress has been constrained to the point where it, like other banks, has had 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. While in the first half of 2009 money market conditions have improved, with the Group seeing a material reduction of funding from central banks and the issuance of £9 billion of non-government guaranteed term debt, further tightening of credit markets could have a negative impact on the Group.

In addition, there is also a risk that corporate and institutional counterparties with credit exposures may look to reduce all credit exposures to banks, given current risk aversion trends. It is possible that credit market dislocation becomes so severe that overnight funding from non-government sources ceases to be available.

Like many banking groups, the Group relies on customer deposits to meet a considerable portion of its funding. Furthermore, as part of its ongoing strategy to improve its liquidity position, the Group is actively seeking to increase the proportion of its funding represented by customer deposits. However, such deposits are subject to fluctuation due to certain factors outside the Group's control, such as a loss of confidence, increasing competitive pressures 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. There is currently heavy competition among UK banks for retail customer deposits, which has increased the cost of procuring new deposits and impacted the Group's ability to grow its deposit base. 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 negative impact on the Group's ability to satisfy its liquidity needs unless corresponding actions were taken to improve the liquidity profile of other deposits or to reduce assets. In particular, the liquidity position of the Group may

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be negatively impacted if it is unable to achieve the run-off and sale of non-core and other assets as expected. Any significant delay in those plans may require the Group to consider disposal of other assets not previously identified for disposal to achieve its funded balance sheet target level.

The governments of some of the countries in which the Group operates have taken steps to guarantee the liabilities of the banks and branches operating in their respective jurisdiction. Whilst in some instances the operations of the Group are covered by government guarantees alongside other local banks, in other countries this may not necessarily always be the case. This may place the Group's subsidiaries operating in those countries, such as Ulster Bank Ireland Ltd, which did not participate in such government guarantee schemes, at a competitive disadvantage to the other local banks and therefore may require the Group to provide additional funding and liquidity support to these operations.

There can be no assurance that these measures, alongside other available measures, will succeed in improving the funding and liquidity in the markets in which the Group operates, or that these measures, combined with any increased cost of any funding currently available in the market, will not lead to a further increase in the Group's overall cost of funding, which could have an adverse impact on the Group's financial condition and results of operations or result in a loss of value in the Shares.

***Governmental support schemes may be subject to cancellation, change or withdrawal or may fail to be renewed, which may have a negative impact on the availability of funding in the markets in which the Group operates.***

Governmental support schemes may be subject to cancellation, change or withdrawal (on a general or individual basis, subject to relevant contracts) or may fail to be renewed, based on changing economic and political conditions in the jurisdiction of the relevant scheme. Furthermore, certain schemes which have been announced, may not yet have been fully implemented, or their terms have not yet been finalised. To the extent government support schemes are cancelled, changed or withdrawn in a manner which diminishes their effectiveness, or to the extent such schemes fail to generate additional liquidity or other support in the relevant markets in which such schemes operate, the Group, in common with other banking groups, may continue to face limited access to, have insufficient access to, or incur higher costs associated with, funding alternatives, which could have a material adverse impact on the Group's business, financial condition, results of operations and prospects or result in a loss of value in the Shares.

***The financial performance of the Group has been and will be affected by borrower credit quality.***

Risks arising from changes in credit quality and the recoverability of loans and amounts due from counterparties are inherent in a wide range of the Group's businesses. Whilst some economies have stabilised over the course of 2009, the Group may continue to see adverse changes in the credit quality of its borrowers and counterparties, for example, as a result of their inability to refinance their indebtedness, with increasing delinquencies, defaults and insolvencies across a range of sectors (such as the personal and banking and financial institution sectors) and in a number of geographies (such as the United Kingdom, the United States, the Middle East and the rest of Europe, particularly Ireland). This trend has led and may lead to further and accelerated impairment charges, higher costs, additional write-downs and losses for the Group or result in a loss of value in the Shares.

***The actual or perceived failure or worsening credit of the Group's counterparties has adversely affected and could continue to adversely affect the Group.***

The Group's ability to engage in routine funding transactions has been and will continue to be adversely affected by the actual or perceived failure or worsening credit of its counterparties, including other financial institutions and corporate borrowers. The Group has exposure to many different industries and counterparties and routinely executes transactions with counterparties in the financial industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds and other institutional clients. As a result, defaults by, or even the perceived creditworthiness of or concerns about, one or more corporate borrowers, financial services institutions or the financial services industry generally, have led to market-wide liquidity problems, losses and defaults and could lead to further losses or defaults by the Group or by other institutions. Many of these transactions expose the Group to credit risk in the event of default of the Group's counterparty or client and the Group does have significant exposures to certain individual counterparties (including counterparties in certain weakened sectors and markets). In addition, the Group's credit risk is exacerbated when the collateral it holds

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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 recently experienced. Any such losses could have a material adverse effect on the Group's results of operations and financial condition or result in a loss of value in the Shares.

***The Group's earnings and financial condition have been, and its future earnings and financial condition may continue to be, affected by depressed asset valuations resulting from poor market conditions.***

Financial markets continue to be subject to significant stress conditions, where steep falls in perceived or actual asset values have been accompanied by a severe reduction in market liquidity, as exemplified by recent events affecting asset-backed collateralised debt obligations, residential mortgage-backed securities and the leveraged loan market. In dislocated markets, hedging and other risk management strategies have proven not to be as effective as they are in normal market conditions due in part to the decreasing credit quality of hedge counterparties, including monoline and other insurance companies and credit derivative product companies. Severe market events have resulted in the Group recording large write-downs on its credit market exposures in 2007, 2008 and during the first nine months of 2009. Any further deterioration in economic and financial market conditions could lead to further impairment charges and write-downs. Moreover, market volatility and illiquidity make it difficult to value certain of the Group's exposures. Valuations in future periods, reflecting, among other things, 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, even 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. Any of these factors could require the Group to recognise further significant write-downs or realise increased impairment charges, any of which may adversely affect its capital position, its financial condition and its results of operations or result in a loss of value in the Shares.

Further information about the write-downs which the Group has incurred and the assets it has reclassified (a) during the year ended 31 December 2008 is set out on pages 122 to 143 of the Annual Report and Accounts of RBS, (b) during the six months ended 30 June 2009 is set out in the Interim Results and (c) during the nine months ended 30 September 2009 is set out in the Interim Management Statement.

***The value or effectiveness of any credit protection that the Group has purchased from monoline and other insurers and other market counterparties (including credit derivative product companies) depends on the value of the underlying assets and the financial condition of the insurers and such counterparties.***

The Group has credit exposure arising from over-the-counter derivative contracts, mainly credit default swaps ("CDSs"), 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. Since 2007, monoline and other insurers and other market counterparties (including credit derivative product companies) 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 has deteriorated rapidly, which may continue. If the financial condition of these counterparties or their actual or perceived creditworthiness deteriorates further, the Group may record further credit valuation adjustments on the credit protection bought from these counterparties under the CDSs in addition to those already recorded and such adjustments may have a material adverse impact on the Group's financial condition and results of operations.

***Changes in interest rates, foreign exchange rates, credit spreads, bond, equity and commodity prices and other market factors have significantly affected and will continue to affect the Group's business.***

Some of the most significant market risks the Group faces are interest rate, foreign exchange, credit spread, bond, equity and commodity price risks. Changes in interest rate levels, yield curves 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, such as those experienced in the past year.

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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 RBS's non-UK subsidiaries (principally Citizens and RBS Securities Inc.) and may affect income from foreign exchange dealing. The performance of financial markets may affect bond, equity and commodity prices and, therefore, cause changes in the value of the Group's investment and trading portfolios. This has been the case during the period since August 2007, with market disruptions and volatility resulting in significant reductions in the value of such portfolios. 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, particularly in the current environment, 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 Group's borrowing costs and its access to the debt capital markets depend significantly on its and the UK Government's credit ratings.***

RBS and other Group members have been subject to a number of downgrades in the recent past. Any future reductions in the long-term or short-term credit ratings of RBS or one of its principal subsidiaries (particularly RBS plc) would further 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. Furthermore, given the extent of UK Government ownership and support provided to the Group through the Credit Guarantee Scheme, any downgrade in the UK Government's credit ratings could adversely affect the Group's own credit ratings and may have the effects noted above. All credit rating agencies have reaffirmed the UK Government's AAA rating, although S&P changed its outlook to "negative" on 21 May 2009. Fitch reaffirmed the UK Government's stable outlook on 31 July 2009 and Moody's reiterated the UK Government's stable outlook on 26 October 2009. Credit ratings of RBS, RBS plc, ABN AMRO, Ulster Bank and 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 RBS's long-term or short-term credit ratings or those of its principal subsidiaries could adversely affect the Group's access to liquidity and competitive position, increase its funding costs and have a negative impact on the Group's earnings and financial condition or result in a loss of value in the Shares.

***The Group's business performance could be adversely affected if its capital is not managed effectively.***

Effective management of the Group's capital is critical to its ability to operate its businesses, to grow organically and to pursue its strategy of returning to standalone strength. The Group is required by regulators in the United Kingdom, the United States and in other jurisdictions in which it undertakes regulated activities, to maintain adequate capital. 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. Accordingly, the purpose of the B Share Issue and the previous placing and open offers was to allow RBS to strengthen its capital position. Recently, the FSA has indicated that it is considering raising capital adequacy standards generally and may require banks operating in the United Kingdom to increase the proportion of their capital held in the form of government securities, to ensure that these institutions have adequate liquidity in times of financial stress.

These and other future changes to capital adequacy and liquidity requirements in the jurisdictions in which it operates may require the Group to raise additional Tier 1 Capital and Core Tier 1 Capital by way of further issuances of securities, including in the form of Ordinary Shares or B Shares. The requirement to raise additional Core Tier 1 Capital could have a number of negative consequences for RBS and its Shareholders, including impairing RBS's ability to pay dividends or make other distributions in respect of the Ordinary Shares and diluting the ownership of existing Shareholders. If the Group is unable to raise the requisite capital, it may be required to further reduce the amount of its risk weighted assets and engage in the disposition 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. In addition, pursuant to the agreement in principle reached with the Commissioner, should the Group's Core Tier 1 Capital ratio decline to below 5 per cent. at any time before 31 December 2014, or should the Group fall short of its funded balance sheet target level (after adjustments) for 31 December 2013 by £30 billion or more, the

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Group will be required to reduce its risk weighted assets by a further £60 billion in excess of its plan through further disposals of identifiable businesses and their associated assets.

As at 31 December 2008, the Group's Tier 1 Capital and Core Tier 1 Capital ratios were 9.9 per cent. and 5.9 per cent.<sup>(2)</sup>, respectively (and 8.0 per cent. and 5.5 per cent., respectively, as at 30 September 2009), calculated in accordance with FSA definitions. 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, delays in the disposal of certain assets or the inability to syndicate loans as a result of market conditions, a growth in unfunded pension exposures or otherwise) or to access funding sources, could have a material adverse impact on its financial condition and regulatory capital position or result in a loss of value in the Shares.

***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 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, each as further described in "Accounting Policies" on page 182 of the Annual Report and Accounts of RBS. 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 changes in market conditions, as has been the case during the current financial crisis. In such circumstances, the Group's internal valuation models require the Group to make assumptions, judgements and estimates to establish fair value. In common with other financial institutions, these internal valuation models are complex, and the assumptions, judgements and estimates the Group is required to make often relate to matters that are inherently uncertain, such as expected cash flows, the ability of borrowers to service debt, residential and commercial property price appreciation and depreciation, and relative levels of defaults and deficiencies. Such assumptions, judgements and estimates may 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. Also, recent market volatility and illiquidity have challenged the factual bases of certain underlying assumptions and have made it difficult to value certain of the Group's financial instruments. Valuations in future periods, reflecting prevailing market conditions, may result in further significant changes in the fair values of these instruments, which could have a negative effect on the Group's results of operations and financial condition or result in a loss of value in the Shares.

***The Group's ability to implement its strategic plan depends on the success of the Group's refocus on its core strengths and the balance sheet reduction programme arising out of its previously announced non-core restructuring plan and the State aid restructuring plan.***

In light of the changed global economic outlook, the Group has embarked on a financial and core business restructuring which is 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 this restructuring is the programme to run down and sell the Group's non-core assets announced in February 2009, which targets a gross reduction in funded assets of £251 billion, and the continued review of the Group's portfolio to identify further disposals of certain non-core assets. This balance sheet reduction programme will continue alongside the disposals proposed under the State aid restructuring plan agreed in principle with the Commissioner (but still subject to final approval by the College).

Because the ability to dispose of assets and the price achieved for such disposals will be dependent on prevailing economic and market conditions, which may remain challenging, there is no assurance that the Group will be able to sell or run down (as applicable) those businesses it is seeking to exit either on favourable economic terms to the Group or at all. Furthermore, where transactions are entered into for the purpose of selling non-core assets and businesses, they may be subject to conditions precedent,

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(2)  
These figures have been extracted without material adjustment from the Annual Report and Accounts.

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including government and regulatory approvals and completion mechanics that in certain cases may entail consent from customers. There is no assurance that such conditions precedent will be satisfied, or consents and approvals obtained, in a timely manner or at all. There is consequently a risk that the Group may fail to complete such disposals by any agreed longstop date. Furthermore, in the context of implementing any agreed State aid restructuring plan, the Group is expected to be subject to certain timing and other restrictions which may result in the sale of assets at prices below those which the Group would have otherwise agreed had the Group not been required to sell such assets as part of the State aid restructuring plan or if such sale were not subject to the restrictions contained in the terms of the State aid conditions. For further details of the State aid restrictions and conditions, see Part I, Appendix 4 of this document.

In addition, the Group may be liable for any deterioration in businesses being sold between the announcement of the disposal and its completion. In certain cases, the period between the announcement of a transaction and its completion may be lengthy and may span many months. Other risks that may arise out of the disposal of the Group's assets include ongoing liabilities up to completion of the relevant transaction in respect of the assets and businesses disposed of, commercial and other risks associated with meeting covenants to the buyer during the period up to completion, the risk of employee and customer attrition in the period up to completion, substantive indemnity obligations in favour of the buyer, the risk of liability for breach of warranty, the need to continue to provide transitional service arrangements for potentially lengthy periods following completion of the relevant transaction to the businesses being transferred and redundancy and other transaction costs. Further, the Group may be required to enter into covenants agreeing not to compete in certain markets for specific periods of time. In addition, as a result of the disposals, the Group will lose existing customers, deposits and other assets (both directly through the sale and potentially through the impact on the rest of the Group's business arising from implementing the restructuring plans) and the potential for realising additional associated revenues and margins that it otherwise might have achieved in the absence of such disposals.

Any of the above factors, either in the context of State aid-related or non-core or other asset disposals, could affect the Group's ability to implement its strategic plan and have a material adverse effect on the Group's business, results of operations, financial condition, capital ratios, liquidity and Share price.

***The extensive organisational restructuring may adversely affect the Group's business, results of operations and financial condition.***

As part of its refocus on core strengths and its disposal programme, RBS has undertaken and continues to undertake extensive organisational restructuring involving the allocation of assets identified as non-core assets to a separate Non-Core Division, and the run-down and sale of those assets over a period of time. In addition, to comply with State aid clearance, RBS has agreed in principle to undertake a series of measures to be implemented over a four-year period, which include disposing of RBS Insurance (subject to potentially maintaining a minority interest until the end of 2014). RBS will also divest by the end of 2013 Global Merchant Services, subject to RBS retaining up to 20 per cent. of each business within Global Merchant Services if required by the purchaser, and its interest in RBS Sempra Commodities, as well as divesting the RBS branch-based business in England and Wales and the NatWest branches in Scotland, along with the direct SME customers across the United Kingdom. In order to implement these restructurings, various businesses and divisions within the Group will be re-organised, transferred or sold, or potentially merged with other businesses and divisions within the Group. As part of this process, personnel may be reallocated, where permissible, across the Group, new technology may be implemented, and new policies and procedures may be established in order to accommodate the new shape of the Group. As a result, the Group may experience a high degree of business interruption, significant restructuring charges, delays in implementation, and significant strain on management, employee, operational and financial resources. Any of the above factors could affect the Group's ability to achieve its strategic objectives and have a material adverse effect on its business, results of operations and financial condition or could result in a loss of value in the Shares.

***The Group operates in markets that are highly competitive and consolidating. If the Group is unable to perform effectively, its business and results of operations will be adversely affected.***

Recent consolidation among banking institutions in the United Kingdom, the United States and throughout Europe is changing the competitive landscape for banks and other financial institutions. If financial markets continue to be volatile, more banks may be forced to consolidate. This consolidation, in combination with the introduction of new entrants into the US and UK markets from other European and Asian countries, could increase competitive pressures on the Group.

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In addition, certain competitors may have access to lower cost funding and be able to offer retail deposits on more favourable terms than the Group and may have stronger multi-channel and more efficient operations as a result of greater historical investments. Furthermore, the Group's competitors may be better able to attract and retain clients and talent, which may have a negative impact on the Group's relative performance and future prospects.

Furthermore, increased government ownership of, and involvement in, banks generally may have an impact on the competitive landscape in the major markets in which the Group operates. Although, at present, it is difficult to predict what the effects of this increased government ownership and involvement will be or how they will differ from jurisdiction to jurisdiction, such involvement may cause the Group to experience stronger competition for corporate, institutional and retail clients and greater pressure on profit margins. 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. Since the markets in which the Group operates are expected to remain highly competitive in all areas, these and other changes to the competitive landscape could adversely affect the Group's business, margins, profitability and financial condition or result in a loss of value in the Shares.

***As a condition to HM Treasury support, RBS has agreed (or in certain cases, agreed in principle) to certain undertakings which may serve to limit the Group's operations and it may be required to agree further restrictions in the future.***

Under the terms of the First Placing and Open Offer, RBS provided certain undertakings aimed at ensuring that the subscription by HM Treasury of the relevant RBS Ordinary Shares and preference shares and the Group's participation in the Credit Guarantee Scheme offered by HM Treasury as part of its support for the UK banking industry are compatible with the common market under EU law. These undertakings include (i) supporting certain initiatives in relation to mortgage lending and lending to SMEs until 2011, (ii) regulating management remuneration and (iii) regulating the rate of growth of the Group's balance sheet. Under the terms of the Second Placing and Open Offer, the Group's undertakings in relation to mortgage lending and lending to SMEs were extended to larger commercial and industrial companies in the United Kingdom. These undertakings may serve to limit the Group's operations. In addition, pursuant to certain arrangements entered into between RBS and certain UK Government departments, RBS is subject to further undertakings, which supersede the lending commitments made to HM Treasury in October 2008 and January 2009 by agreeing to lend to creditworthy borrowers on commercial terms, £16 billion above the amount RBS had budgeted to lend to UK businesses and £9 billion above the amount RBS had budgeted to lend to UK homeowners in the year commencing 1 March 2009. There is also a commitment to lend at similar levels in the year commencing 1 March 2010, although this is subject to adjustment of the commitments by agreement with the UK Government to reflect circumstances at the start of the 2010 commitment period. Notwithstanding the Group's willingness to lend to creditworthy customers and its clarity that the requisite funds are available, thereby fulfilling its commitments, indications remain that it is unlikely that RBS's net business lending will increase by the £16 billion that it is making available, in the light of the subdued demand that the Group is currently experiencing. Failure to comply with these lending commitments may result in the withdrawal or restriction of the Group's eligibility to extend its participation in the Credit Guarantee Scheme from three to five years, which could have a material adverse impact on the Group's business, financial condition, results of operations and prospects. For a description of these undertakings, see paragraph 9 of Part IV of this document.

The Group has also agreed in principle to certain other commitments, which are material for the structure of the Group and its operations, under the State aid restructuring plan agreed in principle with the Commissioner in relation to State aid, as set out in Part I, Appendix 4 of this document.

In addition, the Group, together with HM Treasury, has now agreed in principle with the Commissioner a prohibition on the making of discretionary dividends (including on preference shares and B Shares) or coupon payments on existing hybrid capital instruments for a two-year period. It is possible that the Group may, in future, be subject to further restrictions on payments on such hybrid capital instruments, whether as a result of undertakings given to regulatory bodies or otherwise.

The Group has also agreed to certain other undertakings in the Acquisition and Contingent Capital Agreement, as described in Part I, Appendix 3 of this document.

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***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 depends on the ability and experience of its senior management, which may include Directors, and other key employees. The loss of the services of certain key employees, particularly to competitors, could have a negative impact on the Group's business. The Group's future success will also depend on its ability to attract, retain and remunerate highly skilled and qualified personnel 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 compensation arrangements, in particular those in receipt of government funding (such as RBS). The Group has made a commitment to comply with the FSA Remuneration Code. These rules come into force on 1 January 2010 and are in line with the agreement reached by the G-20, setting global standards for the implementation of the Financial Stability Board's remuneration principles. The Group agreed that it will be at the leading edge of implementing the G-20 principles and has granted UKFI consent rights over the shape and size of its aggregate bonus pool for the 2009 performance year. Depending on UKFI's approach to the recommendations made by the Board regarding the bonus pool, this may impair the ability of the Group to attract and retain suitably qualified personnel in various parts of the Group's businesses.

The Group is also consulting on proposals to alter certain of the pension benefits it offers to staff. 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 becoming 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 or result in a loss of value in the Shares.

In addition, certain of the Group's employees in the United Kingdom, 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. As the Group implements cost-saving initiatives and disposes of, or runs-down, certain assets or businesses (including as part of its expected restructuring plans), it faces increased risk in this regard and there can be no assurance that the Group will be able to maintain good relations with its employees or employee representative bodies in respect of all matters. As a result, the Group may experience strikes or other industrial action from time to time, which could have a material adverse effect on its business and results of operations and could cause damage to its reputation.

***Each of the Group's businesses is subject to substantial regulation and oversight. Any significant regulatory developments could have an effect on how the Group conducts its business and on its results of operations and financial condition.***

The Group is subject to financial services laws, regulations, corporate governance requirements, administrative actions and policies in each location in which it operates. All of these are subject to change, particularly in the current market environment, where there have been unprecedented levels of government intervention and changes to the regulations governing financial institutions, including recent nationalisations in the United Kingdom, the United States and other European countries. As a result of these and other ongoing and possible future changes in the financial services regulatory landscape (including requirements imposed by virtue of the Group's participation in the APS and any other government or regulator-led initiatives), the Group expects to face greater regulation in the United Kingdom, the United States and other countries in which it operates, including throughout the rest of Europe. Compliance with such regulations may increase the Group's capital requirements and costs and have an adverse impact on how the Group conducts its business, on the products and services it offers, on the value of its assets and on its results of operations and financial condition or result in a loss of value in the Shares.

Other areas where governmental policies and regulatory changes could have an adverse impact include, but are not limited to:

the monetary, interest rate, capital adequacy, liquidity, balance sheet leverage and other policies of central banks and regulatory authorities;



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general changes in government or regulatory policy or changes in regulatory regimes that may significantly influence investor decisions in particular markets in which the Group operates or may increase the costs of doing business in those markets;

changes to financial reporting standards;

changes in regulatory requirements relating to capital, such as limitations on the use of deferred tax assets in calculating Core Tier 1 and/or Tier 1 Capital, or prudential rules relating to the capital adequacy framework;

other general changes in the regulatory requirements, such as the imposition of onerous compliance obligations, restrictions on business growth or pricing and requirements to operate in a way that prioritises objectives other than Shareholder value creation;

changes in competition and pricing environments;

further developments in financial reporting, corporate governance, conduct of business and employee compensation;

differentiation amongst financial institutions by governments with respect to the extension of guarantees to bank customer deposits and the terms attaching to such guarantees, including requirements for the entire Group to accept exposure to the risk of any individual member of the Group, or even third party participants in guarantee schemes, failing;

implementation of, or costs related to, local customer or depositor compensation or reimbursement schemes;

transferability and convertibility of currency risk;

expropriation, nationalisation and confiscation of assets;

changes in legislation relating to foreign ownership; and

other unfavourable political, military or diplomatic developments producing social instability or legal uncertainty which, in turn, may affect demand for the Group's products and services.

***The Group's results have been and could be further 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, at external reporting dates, when events or circumstances indicate that it might be impaired. An impairment test involves comparing the recoverable amount (the higher of value in use and fair value less cost to sell) of an individual cash generating unit with its carrying value. 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. For the year ended 31 December 2008, the Group recorded a £32.6 billion<sup>(3)</sup> accounting write down of goodwill and other intangibles relating to prior year acquisitions (see page 71 of the Annual Report and Accounts) and for the nine months ended 30 September 2009, the Group recorded a £311 million accounting write down of goodwill and other intangible assets (see page 102 of the Interim Management Statement).

*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. Pensions risk is the risk that the liabilities of the Group's various defined benefit pension schemes which are long term in nature will exceed the schemes' assets, as a result of which the Group is required or chooses to make additional contributions to the schemes. 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 and returns from them may be less than

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(3) This figure has been extracted without material adjustment from the Annual Report and Accounts.

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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, and during recent periods, the Group has voluntarily made such contributions. Given the current economic and financial market difficulties and the prospects that they may continue over the near and medium term, the Group may 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 a negative impact on the Group's capital position, results of operations or financial condition or result in a loss of value in the Shares. The next funding valuation of the Group's major defined benefit pension plan, The Royal Bank of Scotland Group Pension Fund, will take place with an effective date of 31 March 2010.

***The Group is and may be subject to litigation and regulatory investigations that may impact its business.***

The Group's operations are diverse and complex, and it operates in legal and regulatory environments that expose it to potentially significant litigation, regulatory investigation and other regulatory risk. As a result, the Group is, and may in the future be, involved in various disputes, legal proceedings and regulatory investigations in the United Kingdom, the EU, the United States and other jurisdictions, including class action litigation and review by the European Commission under State aid rules. Furthermore, the Group, like many other financial institutions, has come under greater regulatory scrutiny over the last year and expects that environment to continue for the foreseeable future, particularly as it relates to compliance with 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. Disputes, legal proceedings and regulatory investigations are subject to many uncertainties, and their outcomes are often difficult to predict, particularly in the earlier stages of a case or investigation. Adverse regulatory action or adverse judgments in litigation could result in restrictions or limitations on the Group's operations or result in a material adverse effect on the Group's reputation or results of operations or result in a loss of value in the Shares. For details about certain litigation and regulatory investigations in which the Group is involved, see paragraphs 7 and 8 of Part IV of this document.

***Operational risks are inherent in the Group's operations.***

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 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-money laundering and anti-terrorism legislation, as well as the provisions of applicable sanctions programmes), equipment 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. Any weakness in these systems or controls, or any breaches or alleged breaches of applicable laws or regulations, could have a materially negative impact on the Group's business, reputation and results of operations and share price. Notwithstanding anything contained in this risk factor, it should not be taken as implying that RBS will be unable to comply with its obligations as a company with securities admitted to the Official List of the UKLA or as a supervised firm regulated by the FSA.

***The Group is exposed to the risk of changes in tax legislation and its interpretation and to increases in the rate of corporate and other taxes in the jurisdictions in which it operates.***

The Group's activities are subject to tax at various rates around the world computed in accordance with local legislation and practice. Action by governments to increase tax rates or to impose additional taxes or to restrict the tax reliefs currently available to the Group would reduce the Group's profitability. Revisions to tax legislation or to its interpretation might also affect the Group's results in the future.

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***HM Treasury (or UKFI on its behalf) may be able to exercise a significant degree of influence over the Group.***

UKFI manages HM Treasury's shareholder relationship with RBS. 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 the appointment of senior management. In addition, as the provider of the APS, HM Treasury has a range of rights that other shareholders do not have. These include rights under the terms of the APS over the Group's remuneration policy and practice, including the right (through UKFI) to consent to the shape and quantum of the bank's aggregate variable bonus pool for the 2009 performance year. The manner in which HM Treasury or UKFI exercises HM Treasury's rights as majority shareholder or in which HM Treasury exercises its rights under the APS 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 RBS for the benefit of its members as a whole.

***The Group's insurance businesses are subject to inherent risks involving claims.***

Future claims in the Group's general and life assurance business may be higher than expected as a result of changing trends in claims experience resulting from catastrophic weather conditions, demographic developments, changes in the nature and seriousness of claims made, changes in mortality, changes in the legal and compensatory landscape and other causes outside the Group's control. These trends could affect the profitability of current and future insurance products and services. The Group reinsures some of the risks it has assumed and is accordingly exposed to the risk of loss should its reinsurers become unable or unwilling to pay claims made by the Group against them.

***The Group's operations have inherent reputational risk.***

Reputational risk, meaning the risk to earnings and capital from negative public opinion, is inherent in the Group's business. Negative public opinion can result from the actual or perceived manner in which the Group conducts its business activities, from the Group's financial performance, from the level of direct and indirect government support or from actual or perceived practices in the banking and financial industry. Negative public opinion may adversely affect the Group's ability to keep and attract customers and, in particular, corporate and retail depositors. The Group cannot ensure that it will be successful in avoiding damage to its business from reputational risk.

***In the United Kingdom 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 United Kingdom, the Financial Services Compensation Scheme (the "Compensation Scheme") was established under the FSMA and is the United Kingdom's statutory fund of last resort for customers of authorised financial services firms. The Compensation Scheme 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. The Compensation Scheme is funded by levies on firms authorised by the FSA, including the Group. In the event that the Compensation Scheme 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 a material impact on its results of operations and financial condition. During the financial year ended 31 December 2008, the Group made a provision of £150 million<sup>(4)</sup> related to a levy by the Compensation Scheme for the 2008/09 and 2009/10 Compensation Scheme years. An additional accrual of £113 million in respect of the Compensation Scheme levy was made in the nine months ended 30 September 2009.

In addition, 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 United States with the Federal Deposit Insurance Corporation), the Group may make further provisions and may incur

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(4) This figure has been extracted without material adjustment from the Annual Report and Accounts.

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additional costs and liabilities, which may negatively impact its financial condition and results of operations or result in a loss of value in the Shares.

***The Group's business and earnings may be affected by geopolitical conditions.***

The performance of the Group is significantly influenced by the geopolitical and economic conditions prevailing at any given time in the countries in which it operates, particularly the United Kingdom, the United States and other countries in Europe and Asia. For example, the Group has a presence in countries where businesses could be exposed to the risk of business interruption and economic slowdown following the outbreak of a pandemic, or the risk of sovereign default following the assumption by governments of the obligations of private sector institutions. Similarly, the Group faces the heightened risk of trade barriers, exchange controls and other measures taken by sovereign governments which may impact a borrower's ability to repay. Terrorist acts and threats and the response to them of governments in any of these countries could also adversely affect levels of economic activity and have an adverse effect upon the Group's business.

***The restructuring proposals for ABN AMRO are complex and may not realise the anticipated benefits for the Group.***

The restructuring plan in place for the integration and separation of ABN AMRO into and among the businesses and operations of the Consortium Members is complex, involving substantial reorganisation of ABN AMRO's operations and legal structure. The restructuring plan is being implemented and significant elements have been completed within the planned timescales and the integration of the Group's businesses continues. The Group may not realise the benefits of the acquisition or the restructuring when expected or to the extent projected. The occurrence of any of these events, including as a result of staff losses or performance issues, or as a result of further disposals or restructurings by the Group, may have a negative impact on the Group's financial condition and results of operations. It is not expected that the Dutch State's acquisition of Fortis Bank Nederland's shares in RFS Holdings, will materially affect the integration benefits envisaged by the Group.

***The recoverability and regulatory capital treatment of certain deferred tax assets recognised by the Group depends on the Group's ability to generate sufficient future taxable profits and there being no adverse changes to tax legislation, regulatory requirements or accounting standards.***

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.

There is currently no restriction in respect of deferred tax assets recognised by the Group for regulatory purposes. Changes in regulatory rules may restrict the amount of deferred tax assets that can be recognised and such changes could lead to a reduction in the Group's Core Tier 1 capital ratio.

**RISKS RELATING TO THE TRANSACTION**

***If the Group is unable to participate in the APS and/or the Company is unable to issue £25.5 billion of B Shares, the Dividend Access Share and, if required, the £8 billion Contingent B Shares (including as a result of the Resolutions not being approved), the Group may be unable to find alternative methods of obtaining protection for stressed losses against severe or prolonged recessionary periods in the economic cycle and improving its capital ratios, with the result that the Group may face increased risk of full nationalisation or other resolution procedures under the Banking Act.***

The Group expects its participation in the APS, together with the issue of £25.5 billion of B Shares and, if required, the £8 billion Contingent B Shares, to protect a proportion of the Group's stressed losses against severe or prolonged recessionary periods in the economic cycle and improve its capital ratios. The Group's ability to participate in the APS and issue £25.5 billion of B Shares and, if required, the £8 billion Contingent B Shares is subject to the satisfaction of a number of conditions, including Independent Shareholder approval, State aid approval and certain regulatory approvals. The Group's ability to issue the Initial B Shares is also subject to a number of conditions within the discretion of

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HM Treasury, including that HM Treasury is satisfied that the issue of the Initial B Shares and the Dividend Access Share continues to be proportionate and appropriate for the maintenance of the financial stability of the Group. If Resolution 1 is not approved by the Independent Shareholders and/or the Group is unable to participate in the APS and the Company is unable to issue the £25.5 billion of B Shares and the Dividend Access Share and, if required, the £8 billion Contingent B Shares, the Group will need to assess its strategic and operational position and will be required to find alternative methods for achieving the requisite capital ratios. Such methods could include an accelerated reduction in risk-weighted assets, disposals of certain businesses, increased issuance of Tier 1 Capital securities, increased reliance on alternative government-supported liquidity schemes and other forms of government assistance. There can be no assurance that any of these alternative methods will be available or would be successful in increasing the Group's capital ratios to the desired or requisite levels. If the Group is unable to participate in the APS and to obtain protection for stressed losses and the Company is unable to issue the £25.5 billion of B Shares and the Dividend Access Share and, if required, the £8 billion Contingent B Shares, the Group's business, results of operations, financial condition and capital position and ratios will suffer, its credit ratings may drop, its ability to lend and access funding will be further limited and its cost of funding may increase. The occurrence of any or all of such events may cause RBS's share price to decline substantially and may result in intervention by the Authorities or other regulatory bodies in the other jurisdictions in which RBS and its subsidiaries operate, which could include full nationalisation, other resolution procedures under the Banking Act or revocation of permits and licences necessary to conduct the Group's businesses. Any compensation payable to Shareholders would be subject to the provisions of the Banking Act, and Shareholders may receive no value for their Shares (see the risk factor entitled *RBS and its UK bank subsidiaries may face the risk of full nationalisation or other resolution procedures under the Banking Act* above).

***Owing to the complexity, scale and unique nature of the APS and the uncertainty surrounding the duration and severity of the current economic recession, there may be unforeseen issues and risks that are relevant in the context of the Group's participation in the APS and in the impact of the APS on the Group's business, operations and financial condition. In addition, the assets or exposures to be covered by the APS may not be those with the greatest future losses or with the greatest need for protection.***

Since the APS is a unique form of credit protection over a complex range of diversified Covered Assets in a number of jurisdictions and there is significant uncertainty about the duration and severity of the current economic recession, there may be unforeseen issues and risks that may arise as a result of the Group's participation in the APS and the impact of the APS on the Group's business, operations and financial condition cannot be predicted with certainty. Such issues or risks may have a material adverse effect on the Group. Moreover, the Group's choice of assets or exposures to be covered by the APS is based on current predictions regarding the performance of counterparties and assumptions about market dynamics and asset and liability pricing, all or some of which may prove to be inaccurate. There is, therefore, a risk that the Covered Assets will not be those with the greatest future losses or with the greatest need for protection and, as a result, the Group's financial condition, income from operations and Share price may still suffer due to further impairments and credit write-downs.

***There is no assurance that the Group's participation in the APS and the issue of £25.5 billion of B Shares and, if required, the £8 billion Contingent B Shares will achieve the Group's goals of improving and maintaining the Group's capital ratios in the event of further losses. Accordingly, the Group's participation in the APS and the issue of £25.5 billion of B Shares and, if required, the £8 billion Contingent B Shares may not improve market confidence in the Group and the Group may still face the risk of full nationalisation or other resolution procedures under the Banking Act.***

The Group expects that its participation in the APS, together with the issue of £25.5 billion of B Shares and, if required, the £8 billion Contingent B Shares, will improve its consolidated capital ratios. However, even if the Group is able to participate in the APS and the proposed £25.5 billion of B Shares and, if required, the £8 billion Contingent B Shares are issued, the Group remains exposed to a substantial first loss amount of £60 billion in respect of the Covered Assets and for 10 per cent. of Covered Assets losses after the first loss amount (see *First loss and the 90 per cent./10 per cent. split* in Part I, Appendix 2 of this document). In addition, as mentioned in the previous risk factor, the assets or exposures to be covered by the APS may not be those with the greatest future losses or with the greatest need for protection. Moreover, the Group continues to carry the risk of losses, impairments and write-downs with respect to assets not covered by the APS. Therefore, there can be no assurance that any regulatory capital benefits

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and the additional Core Tier 1 Capital will be sufficient to maintain the Group's capital ratios at the requisite levels in the event of further losses (even with the £8 billion Contingent B Shares). If the Group is unable to improve its capital ratios sufficiently or to maintain its capital ratios in the event of further losses, its business, results of operations and financial condition will suffer, its credit ratings may fall, its ability to lend and access funding will be further limited and its cost of funding may increase. The occurrence of any or all of such events may cause RBS's share price to decline substantially and may result in intervention by the Authorities, which could include full nationalisation or other resolution procedures under the Banking Act. Any compensation payable to Shareholders would be subject to the provisions of the Banking Act, and Shareholders may receive no value for their Shares.

***The Group may have included Covered Assets that are ineligible (or that later become ineligible) for protection under the APS. Protection under the APS may be limited or may cease to be available where Covered Assets are not correctly or sufficiently logged or described, where a Covered Asset is disposed of (in whole or in part) prior to a Trigger, where the terms of the APS do not apply or are uncertain in their application, where the terms of the protection itself potentially give rise to legal uncertainty, where certain criminal conduct has or may have occurred or where a breach of bank secrecy, confidentiality, data protection or similar laws may occur. In addition, certain assets included in the APS do not satisfy the eligibility requirements of the Scheme Documents. In each case this would reduce the anticipated benefits to the Group of the APS.***

The Covered Assets comprise a wide variety and a very large number of complex assets and exposures. As a result of the significant volume, variety and complexity of assets and exposures and the resulting complexity of the Scheme Documents, there is a risk that the Group may have included assets or exposures within the Covered Assets that are not eligible for protection under the APS, with the result that such assets or exposures may not be protected by the APS. Furthermore, if Covered Assets are not correctly or sufficiently logged or described for the purposes of the APS, protection under the APS may, in certain circumstances and subject to certain conditions, not be available or may be limited, including by potentially being limited to the terms of the assets "as logged". If a Covered Asset is disposed of prior to the occurrence of a Trigger in respect of that Covered Asset, the Group will also lose protection under the APS in respect of that disposed asset or, if the Covered Asset is disposed of in part, in respect of that disposed part of the Covered Asset or in some circumstances all of the Covered Asset, in each case with no rebate of the fee payable to HM Treasury, unless an agreement otherwise is reached with HM Treasury at the relevant time. Moreover, since the terms of the credit protection available under the APS are broad and general (given the scale and purpose of the APS and the wide variety and very large number of complex assets and exposures intended to be included as Covered Assets) and also very complex and in some instances operationally restrictive, certain Scheme Conditions may not apply to particular assets, exposures or operational scenarios or their applicability may be uncertain (for example, in respect of overdrafts). In addition, many of these provisions apply from 31 December 2008 and therefore may not have been complied with between this date and the date of RBS's accession to the APS. In each case this may result in a loss or reduction of protection. There are certain limited terms and conditions of the Scheme Conditions which are framed in such a way that may give rise to lack of legal certainty. Furthermore, if a member of the Group becomes aware after due and reasonable enquiry that there has been any material or systemic criminal conduct on the part of the Group (including its directors, officers and employees) relating to or affecting any of the Covered Assets, some or all of those assets may cease to be protected by the APS. HM Treasury may also require the withdrawal or RBS may itself consider it necessary to withdraw Covered Assets held in certain jurisdictions where disclosure of certain information to HM Treasury may result in a breach of banking secrecy, confidentiality, data protection or similar laws. In addition, £3 billion of derivative and structured finance assets have been included in the APS which, for technical reasons, do not currently, or are anticipated at some stage not to, satisfy the eligibility requirements specified in the Scheme Documents. HM Treasury and RBS plc have agreed to negotiate in good faith to establish as soon as practicable whether (and if so, to what extent) coverage should extend to these assets. In addition, RBS has agreed that, on or prior to its accession to the APS, it will issue a withdrawal notice in respect of £1.2 billion of Covered Assets across a broad range of asset classes in order to take them out of the APS. The effect of (i) failures to be eligible and/or to log or correctly describe Covered Assets, (ii) disposals of Covered Assets prior to a Trigger, (iii) the uncertainty of certain Scheme Conditions and the exclusion of certain assets and exposures from the APS and potential lack of legal certainty, (iv) the occurrence of material or systemic criminal conduct on the part of RBS or its representatives relating to or affecting Covered Assets or breach of banking secrecy, confidentiality, data protection or similar laws and (v) failure or potential failure of HM Treasury

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and RBS plc to reach agreement in respect of whether (and if so, to what extent) cover should extend to certain ineligible assets, may (or, in respect of assets which HM Treasury and RBS have agreed are ineligible, will) impact the enforceability and/or level of protection available to the Group and may materially reduce the protection anticipated by the Group for its stressed losses. Further, there is no ability to nominate additional or alternative assets or exposures in place of those which turn out not to be covered under the APS. If the Group is then unable to find alternative methods for improving and maintaining its capital ratios, its business, results of operations and financial condition will suffer, its credit ratings may drop, its ability to lend and access funding will be further limited and its cost of funding may increase. The occurrence of any or all of such events may cause the Company's share price to decline substantially and may result in intervention by the Authorities, which could include full nationalisation or other resolution procedures under the Banking Act. Any compensation payable to Shareholders would be subject to the provisions of the Banking Act, and Shareholders may receive no value for their Ordinary Shares.

***During the life of the APS, certain or all of the Covered Assets may cease to be protected due to a failure to comply with continuing obligations under the APS, reducing the benefit of the APS to the Group.***

If the Group participates in the APS, the Group will be subject to limitations on actions it can take in respect of the Covered Assets and certain related assets and to extensive continuing obligations under the Scheme Conditions relating to governance, asset management, audit and reporting. The Group's compliance with the Scheme Conditions will be dependent on its ability to (i) implement efficiently and accurately new approval processes and reporting, governance and management systems in accordance with the Scheme Conditions and (ii) comply with applicable laws and regulations where it does business. The Group has complex and geographically diverse operations, and operational risk in the context of the APS may result from errors by employees or third-parties, failure to document transactions or procedures properly or to obtain proper authorisations in accordance with the Scheme Conditions, equipment failures or the inadequacy or failure of systems and controls. Although the Group has devoted substantial financial and operational resources, and intends to devote further substantial resources, to developing efficient procedures to deal with the requirements of the APS and to training staff, it is not possible to be certain that such actions will be effective to control each of the operational risks faced by the Group or to provide the necessary information in the necessary time periods in the context of the APS. Since the Group's operational systems were not originally designed to facilitate compliance with these extensive continuing obligations, there is a risk that the Group will fail to comply with a number of these obligations. This risk is particularly acute in the period immediately following the APS becoming effective. Certain of the reporting requirements, in particular, are broad in their required scope and challenging in their required timing. There is, as a result, a real possibility that RBS, at least initially, will not be able to achieve full compliance. Where the Group is in breach of its continuing obligations under the Scheme Conditions in respect of any of the Covered Assets, related assets or other obligations, or otherwise unable to provide or verify information required under the APS within the requisite time periods, recovery of losses under the APS may be adversely impacted, may lead to an indemnity claim and HM Treasury may in addition have the right to exercise certain step-in rights, including the right to require RBS to appoint a step-in manager who may exercise oversight, direct management rights and certain other rights including the right to modify certain of the Group's strategies, policies or systems. Therefore, there is a risk that Covered Assets in relation to which the Group has failed to comply with its continuing obligations under the Scheme Conditions, will not be protected or fully protected by the APS. As there is no ability to nominate additional or alternative assets or exposures for cover under the APS, the effect of such failures will impact the level of protection available to the Group and may reduce or eliminate in its entirety the protection anticipated by the Group for its stressed losses, in which case its business, results of operations and financial condition will suffer, its credit ratings may drop, its ability to lend and access funding will be further limited and its cost of funding may increase. The occurrence of any or all of such events may cause the Company's share price to decline substantially and may result in intervention by the Authorities, which could include full nationalisation or other resolution procedures under the Banking Act. Any compensation payable to Shareholders would be subject to the provisions of the Banking Act, and Shareholders may receive no value for their Shares.



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***The Scheme Conditions may be modified by HM Treasury in certain prescribed circumstances, which could result in a loss or reduction in the protection provided under the APS in relation to certain Covered Assets, increased costs to the Group in respect of the APS or limitations on the Group's operations.***

HM Treasury may, following consultation with the Company, modify or replace certain of the Scheme Conditions in such a manner as it considers necessary (acting reasonably) to:

remove or reduce (or remedy the effects of) any conflict between: (i) the operation, interpretation or application of certain Scheme Conditions (see *Modifications to the Scheme Conditions* in Part I, Appendix 2 of this document); and (ii) any of the overarching principles governing the APS as set out in Annex 3 of this document (the "Scheme Principles");

correct any manifest error contained in certain Scheme Conditions; or

take account of any change in law.

HM Treasury can only effect a modification or replacement of a Scheme Condition if (i) it is consistent with each of the Scheme Principles, (ii) there has been no formal notification from the FSA that such modification would result in any protection provided to RBS plc under the APS ceasing to satisfy certain requirements for eligible credit risk mitigation and (iii) HM Treasury has considered in good faith and had regard to any submissions, communications or representations of or made by RBS plc regarding the anticipated impact of the proposed modification under any non-UK capital adequacy regime which is binding on RBS plc or a Covered Entity.

Such modifications or replacements may be retrospective and may result in a loss of or reduction in the protection expected by the Group under the APS in relation to certain Covered Assets, an increase in the risk weightings of the Covered Assets (either in the UK or overseas), a material increase in the continuing reporting obligations or asset management conditions applicable to the Group under the Scheme Conditions or a material increase in the expenses incurred or costs payable by RBS plc under the APS. Modifications by HM Treasury of the Scheme Conditions could result in restrictions or limitations on the Group's operations. The consequences of any such modifications by HM Treasury are impossible to quantify and are difficult to predict and may have a material adverse effect on the Group's financial condition and results of operations.

***Owing to the complexity of the APS and possible regulatory capital developments, the operation of the APS and the issue of £25.5 billion of B Shares and, if required, the £8 billion Contingent B Shares may fail to achieve the desired effect on the Group's regulatory capital position. This may mean the Group's participation in the APS and the issuance of £25.5 billion of B Shares and, if required, the £8 billion Contingent B Shares does not improve market confidence in the Group sufficiently or at all. This may result in the Group facing the risk of full nationalisation or other resolution procedures under the Banking Act.***

One of the key objectives of the APS and the issuance of £25.5 billion of B Shares and, if required, the £8 billion Contingent B Shares is to improve capital ratios at a consolidated level for the Group and at an individual level for certain relevant Group members. RBS plc will or may in the future enter into certain back-to-back arrangements with Group members holding assets or exposures to be covered by the APS in order to ensure the capital ratios of these entities are also improved by virtue of the APS. As the APS and certain of the associated back-to-back arrangements are a unique form of credit protection over a complex range of diversified Covered Assets in a number of jurisdictions, there is a risk that the interpretation of the relevant regulatory capital requirements by one or more of the relevant regulatory authorities may differ from that assumed by the Group, with the result that the anticipated improvement to the Group's capital ratios will not be fully achieved. There is a further risk that, given that the current regulatory capital requirements and the regulatory bodies governing these requirements are subject to unprecedented levels of review and scrutiny both globally and locally, regulatory capital treatment that differs from that assumed by the Group in respect of the APS, the treatment of any B Share issuance or the back-to-back arrangement may also occur because of changes in law or regulation, regulatory bodies or interpretation of the regulatory capital regimes applicable to the Group and/or the APS and/or the B Shares and/or the back-to-back arrangements described above. If participation in the APS and the issuance of £25.5 billion of B Shares and, if required, the £8 billion Contingent B Shares are not sufficient to maintain the Group's capital ratios, this could cause the Group's business, results of operations and financial condition to suffer, its credit rating to drop, its ability to lend and access to funding to be further

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limited and its cost of funding to increase. The occurrence of any or all of such events may cause RBS's share price to decline substantially and may result in intervention by the Authorities, which could include full nationalisation or other resolution procedures under the Banking Act. Any compensation payable to Shareholders would be subject to the provisions of the Banking Act and Shareholders may receive no value for their Shares.

***The costs of the Group's participation in the APS may be greater than the amounts received thereunder.***

The costs of participating in the APS incurred by the Group to HM Treasury include a fee of £700 million, payable in advance for the first three years of the APS and £500 million per annum thereafter until the earlier of (i) the date of termination of the APS and (ii) 31 December 2099. The fee may be paid in cash or, subject to HM Treasury consent, by the waiver of certain UK tax reliefs that are treated as deferred tax assets (pursuant to the Tax Loss Waiver) or be funded by a further issue of B Shares to HM Treasury. On exit the fees described in the risk factor below entitled *RBS may have to repay any net pay-outs made by HM Treasury under the APS in order to terminate its participation in the APS* will apply. Furthermore, the Group may be subject to additional liabilities in connection with the associated intra group arrangements. Significant costs will also be incurred in (i) establishing the APS (including a portion of HM Treasury's costs attributed to RBS plc by HM Treasury), (ii) implementing the APS, including RBS's internal systems building and as a consequence of its on-going management and administration obligations under the Scheme Conditions, such as complying with (a) the extensive governance, reporting, auditing and other continuing obligations of the APS and (b) the asset management objective which is generally applied at all times to the Covered Assets and will require increased lending in certain circumstances and (iii) paying the five-year annual fee for the Initial B Shares and the Contingent Subscription of £320 million less 4 per cent. of: (a) the value of any B Shares subscribed for under the Contingent Subscription; and (b) the amount by which the Contingent Subscription has been reduced pursuant to any exercise by the Company of a partial termination of the Contingent Subscription (payable in cash or, with HM Treasury's consent, by waiving certain UK tax reliefs that are treated as deferred tax assets (pursuant to the Tax Loss Waiver), or funded by a further issue of B Shares to HM Treasury). In addition, there will be ongoing expenses associated with compliance with the Scheme Conditions, including RBS plc's and HM Treasury's professional advisers' costs and expenses. These expenses are expected to be significant due to the complexity of the APS, the need to enhance the Group's existing systems in order to comply with reporting obligations required by the APS and RBS plc's obligations under the Scheme Conditions to pay HM Treasury's and its advisers' costs in relation to the APS. In addition, the Group has certain other financial exposures in connection with the APS including (i) an obligation to indemnify HM Treasury, any governmental entity or their representatives and (ii) for the minimum two-year period from a Trigger until payment is made by HM Treasury under the APS, exposure to the funding costs of retaining assets and exposures on its balance sheet whilst receiving interest based on the "Sterling General Collateral Repo Rate" as displayed on the Bloomberg service, or such other rate as may be notified by HM Treasury from time to time as reflecting its costs of funds. The aggregate effect of the joining, establishment and operational costs of the APS and the on-going costs and expenses, including professional advisers' costs, may significantly reduce or even eliminate the anticipated amounts to be received by the Group under the APS.

The amounts received under the APS (which amounts are difficult to quantify precisely (see *Principal terms and conditions of the APS* in particular *Recoveries* and *Calculation of payment from HM Treasury* in Part I, Appendix 2 of this document)) may be less than the costs of participation, as described above. There are other, non-cash, anticipated benefits of the Group's participation, which include the regulatory capital benefits referred to above and the potential protection from future losses, which are themselves also difficult to quantify.

***RBS may have to repay any net pay-outs made by HM Treasury under the APS in order to terminate its participation in the APS.***

During its participation in the APS, RBS plc will pay an annual participation fee to HM Treasury. The annual fee, which is payable in advance, will be £700 million per annum for the first three years of RBS's participation in the APS and £500 million per annum thereafter until the earlier of (i) the date of termination of the APS and (ii) 31 December 2099. Pursuant to the Accession Agreement and the Tax Loss Waiver, subject to HM Treasury consent, all or part of the exit fee (but not the refund of the net

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payments RBS plc has received from HM Treasury under the APS) may be paid by the waiver of certain UK tax reliefs that are treated as deferred tax assets (pursuant to the Tax Loss Waiver). The Directors may, in the future, conclude that the cost of this annual fee, in combination with the other costs of the Group's participation in the APS, outweighs the benefits of the Group's continued participation and therefore that the Group's participation in the APS should be terminated. However, in order to terminate the Group's participation in the APS, the Group must have FSA approval and pay an exit fee which is an amount equal to (a) the larger of (i) the cumulative aggregate fee of £2.5 billion and (ii) 10 per cent. of the annual aggregate reduction in Pillar I capital requirements in respect of the assets covered by the APS up to the time of exit (see Part I, Appendix 2 of this document for further details) less (b) the aggregate of the annual fees paid up to the date of exit. In the event that the Group has received payments from HM Treasury under the APS in respect of losses on any Triggered Assets, it must either negotiate a satisfactory exit payment to exit the APS, or absent such agreement, refund to HM Treasury any net payments made by HM Treasury under the APS in respect of losses on the Triggered Assets.

The effect of the payment of the exit fee and potentially the refund of the net pay-outs it has received from HM Treasury under the APS may significantly reduce or even eliminate the anticipated further regulatory capital benefits to the Group of its participation in the APS or if FSA approval for the proposed termination is not obtained and could have an adverse impact on the Group's financial condition and results of operation or result in a loss of value in the Shares. Alternatively, if the Group is unable to repay to HM Treasury in full the exit fee and potentially the net pay-outs it has received under the APS and, therefore, unable to terminate its participation in the APS, the Group will be required under the Scheme Conditions to continue to pay the annual fee to HM Treasury until 31 December 2099, which could have an adverse impact on the Group's financial condition and results of operation or result in a loss of value in the Shares.

***Under certain circumstances, RBS cannot be assured that assets of ABN AMRO (and certain other entities) will continue to be covered under the APS, either as a result of a withdrawal of such assets or as a result of a breach of the relevant obligations.***

If HM Treasury seeks to exercise its right to appoint one or more step-in managers in relation to the management and administration of Covered Assets held by ABN AMRO or its wholly owned subsidiaries, ABN AMRO will, in certain circumstances, need to seek consent from the Dutch Central Bank to allow it to comply with such step-in. If this consent is not obtained by the date (which will fall no less than 10 Business Days after the notice from HM Treasury) on which the step-in rights must be effective, and other options to effect compliance are not possible (at all or because the costs involved prove prohibitive), those assets would need to be withdrawn by RBS plc from the APS where permissible under the Scheme Conditions or, otherwise, with HM Treasury consent. If RBS plc cannot withdraw such Covered Assets from the APS, it would be likely to lose protection in respect of these assets under the APS and/or may be liable under its indemnity to HM Treasury. If RBS plc loses cover under the APS in respect of any Covered Asset held by ABN AMRO or its wholly owned subsidiaries, any losses incurred on such asset will continue to be borne fully by RBS and may have a material adverse impact on its financial condition, profitability and capital ratios. Similar issues apply in certain other jurisdictions but the relevant Covered Assets are of a lower quantum.

***The extensive governance, asset management and information requirements under the Scheme Conditions and HM Treasury's step-in rights may serve to limit materially the Group's operations. In addition, the market's reaction to such controls and limitations may have an adverse impact on the price of the Ordinary Shares.***

Under the Scheme Conditions, the Group has extensive governance, asset management, audit and information obligations aimed at ensuring (amongst other things) that (i) there is no prejudice to, discrimination against, or disproportionate adverse effect on the management and administration of Covered Assets when compared with the management and administration of other assets of the Group that are outside of the APS and (ii) HM Treasury is able to manage and assess its exposure under the APS, perform any other functions within HM Treasury's responsibilities or protect or enhance the stability of the UK financial system. Any information obtained by HM Treasury through its information rights under the APS may be further disclosed by HM Treasury to other government agencies, the UK Parliament, the European Commission, and more widely if HM Treasury determines that doing so is required, for example, to protect the stability of the UK financial system. For further information on these obligations, see *Management and governance of Covered Assets* in Part I, Appendix 2 of this document.

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Moreover, HM Treasury has the right under the Scheme Conditions to appoint one or more step-in managers (identified or agreed to by HM Treasury) to exercise certain step-in rights upon the occurrence of certain specified events. The step-in rights are extensive and include certain oversight, investigation, approval and other rights, the right to require the modification or replacement of any of the systems, controls, processes and practices of the Group and extensive rights in relation to the direct management and administration of the Covered Assets. For further information on these rights, see *Step-in rights* and *Additional Step-in Rights* in Part I, Appendix 2 of this document. If RBS plc does not comply with the instructions of the step-in manager, once appointed, RBS plc may lose protection under the APS in respect of all or some of the Covered Assets. The step-in manager may be a person identified by HM Treasury and not by RBS.

The payment obligations of HM Treasury under the Scheme Documents are capable of being transferred to any third party (provided the transfer does not affect the risk weightings RBS is entitled to apply to its exposures to Covered Assets). The step-in rights, together with all other monitoring, administration and enforcement rights, powers and discretions of HM Treasury under the Scheme Documents, are capable of being transferred to any government entity (see *HM Treasury transfer rights* in Part I, Appendix 2 of this document).

The obligations of the Group and the rights of HM Treasury may, individually or in the aggregate, impact the way the Group runs its business and may serve to limit the Group's operations with the result that the Group's business, results of operations and financial condition will suffer.

***Any conversion of the B Shares, in combination with any future purchase by HM Treasury of Ordinary Shares, would increase HM Treasury's ownership interest in RBS, and could result in the delisting of RBS's Securities.***

If Resolutions 2, 3, 5 and 6 are passed by Shareholders and Resolution 1 is passed by Independent Shareholders, RBS expects to issue to HM Treasury up to £25.5 billion of B Shares at the time of entering into the APS. The B Shares would be convertible, at the option of the holder at any time, into Ordinary Shares at an initial conversion price of £0.50 per Ordinary Share. Although HM Treasury has agreed not to convert any B Shares it holds if, as a result of such conversion, it would hold more than 75 per cent. of the Ordinary Shares, if HM Treasury were to acquire additional ordinary shares otherwise than through the conversion of the B Shares, such additional acquisitions could significantly increase HM Treasury's ownership interest in RBS to above 75 per cent. of RBS's ordinary issued share capital, which would put RBS in breach of the Listing Rules requirement that at least 25 per cent. of its issued ordinary share capital must be in public hands. Although RBS may apply to the UKLA for a waiver in such circumstances, there is no guarantee that such a waiver would be granted, the result of which could be the delisting of RBS from the Official List and potentially other exchanges where its Securities are currently listed and traded. In addition, HM Treasury will not be entitled to vote in respect of the B Shares or in respect of the Dividend Access Share to the extent, but only to the extent, that votes cast on such B Shares and/or on such Dividend Access Share, together with any other votes which HM Treasury is entitled to cast in respect of any other 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 presented at a general meeting of RBS.

***Any purchase of B Shares by HM Treasury will, when taken together with its existing holding of Ordinary Shares, increase its economic interest in RBS and will have a corresponding dilutive effect on other RBS Shareholders in respect of a winding up and the payment of dividends.***

If Resolutions 2, 3, 5 and 6 are passed by Shareholders and Resolution 1 is passed by Independent Shareholders, RBS expects to issue to HM Treasury up to £25.5 billion of B Shares at the time of entering into the APS. This issuance would increase HM Treasury's economic interest in RBS to 84.4 per cent. In addition, HM Treasury has committed to subscribe for up to an additional £8 billion in aggregate amount of Contingent B Shares for the Contingent Period, if certain conditions are met (see Part I, Appendix 3 for further details). Following such additional issuance, and assuming no other dilutive issuances, HM Treasury's economic interest in RBS would increase further to 86.4 per cent. In addition, HM Treasury's economic interest in RBS would also increase if RBS elects to issue B Shares to HM Treasury as a means of paying the annual fee due under the APS or the Contingent Subscription (both of which would require the consent of HM Treasury), or to fund dividend payments under the terms of the Dividend Access Share. As the B Shares, if issued, will rank *pari passu* with the Ordinary Shares on a winding-up and the Dividend Access Share entitles HM Treasury to an enhanced dividend calculated

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on the basis of the number of B Shares issued, any increase in HM Treasury's economic interest in RBS will have a corresponding dilutive effect on other Shareholders in the event of a winding-up and in respect of the payment of dividends.

***A significant proportion of senior management's time and resources will have to be committed to the APS, which may have a material adverse effect on the rest of the Group's business.***

The Group expects that significant senior management and key employee time and resources will have to be committed to the ongoing operation of the APS, including governance, asset management and reporting and generally to ensure compliance with the Scheme Conditions. The time and resources required to be committed to the APS by the Group's senior management and other key employees is likely to place significant additional demands on senior management in addition to the time and resources required to be dedicated to the rest of the Group's business. In addition, and separately from the Group's participation in the APS, significant headcount reductions are being introduced at all levels of management in the context of a restructuring of the Group. The Group's ability to implement its overall strategy depends on the availability of its senior management and other key employees. If the Group is unable to dedicate sufficient senior management resources to the Group's business outside the APS, its business, results of operations and financial condition will suffer.

***The cost of the Tax Loss Waiver and related undertakings is uncertain and the Group may be subject to additional tax liabilities in connection with the APS.***

It is difficult to value accurately the cost to the Group if RBS opts, subject to HM Treasury consent, to satisfy the annual fee in respect of both the APS and the Contingent Subscription and any exit fee (payable to terminate the Group's participation in the APS) by waiving certain UK tax reliefs that are treated as deferred tax assets pursuant to the Tax Loss Waiver. The cost will depend on unascertainable factors including the extent of future losses, the extent to which the Group regains profitability and any changes in tax law. In addition to suffering greater tax liabilities in future years as a result of the Tax Loss Waiver, the Group may also be subject to further tax liabilities in the UK and overseas in connection with the APS and the associated intra-group arrangements which would not otherwise have arisen. The Tax Loss Waiver will provide that the Group will not be permitted to enter into arrangements which have a main purpose of reducing the net cost of the Tax Loss Waiver. It is unclear precisely how these restrictions will apply, but it is possible that they may limit the operations and future post-tax profitability of the Group.

***In order to fulfil its disclosure obligations under the APS, the Group may incur the risk of civil suits, criminal liability or regulatory actions.***

The Scheme Conditions require that certain information in relation to the Covered Assets be disclosed to HM Treasury to enable HM Treasury to quantify, manage and assess its exposure under the APS. The FSA has issued notices to RBS plc requiring the information that HM Treasury requires under the Scheme Documents prior to the Group's accession to and participation in the APS (and certain other information which HM Treasury requires under the Scheme Documents following the Group's accession), be provided to it through its powers under the FSMA and the Banking Act. To the extent regulated by the FSA, the Group has a legal obligation to comply with these disclosure requests from the FSA. However, in complying with these disclosure obligations and providing such information to the FSA, the Group may, in certain jurisdictions, incur the risk of civil suits or regulatory action (which could include fines) to the extent that disclosing information related to the Covered Assets results in the Group breaching common law or statutory confidentiality laws, contractual undertakings, data protection laws, banking secrecy and other laws restricting disclosure. There can be no guarantee that future requests for information will be made by the FSA in the same manner. Requests made directly by HM Treasury pursuant to the terms of the APS are likely to expose the Group to a greater risk of such suits or regulatory action. Adverse regulatory action or adverse judgments in litigation could result in a material adverse effect on the Group's reputation or results of operations or result in a loss of value in the Shares. Alternatively, in order to avoid the risk of such civil suits or regulatory actions or to avoid the risk of criminal liability, the Group may choose to or (in the case of criminal liability) be required to remove Covered Assets from the APS so as not to be required to disclose to HM Treasury, such information, with the result that such assets will not be protected by the APS. The effect of the removal of such Covered Assets will impact the level of protection available to the Group and may materially reduce the protection

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anticipated by the Group for its stressed losses, in which case its business, results of operations and financial condition will suffer.

Where the Group discloses information to HM Treasury as set out above, HM Treasury may disclose that information to a number of third parties for certain specified purposes (for further information, see *Management and governance of Covered Assets* in Part I, Appendix 2 of this document). Such disclosures by HM Treasury may put the Group in breach of common law or statutory confidentiality laws, contractual undertakings, data protection laws, banking secrecy or other laws restricting disclosure.

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**APPENDIX 2 TO THE LETTER FROM THE CHAIRMAN OF RBS PRINCIPAL TERMS AND CONDITIONS OF THE APS**

**PART A PRINCIPAL TERMS AND CONDITIONS OF THE APS**

On 26 February 2009, RBS confirmed its intended participation in the APS through RBS plc. Following RBS plc's accession to and participation in the APS, HM Treasury will provide RBS plc with protection against certain credit losses in relation to certain assets of RBS plc and certain members of the Group in return for an annual fee (see *Fees and costs* below).

The global and UK economic conditions which first manifested themselves in August 2007 and which have brought volatility and disruption to the capital and credit markets, have led both to the UK Government taking unprecedented action to support the stability of the financial system and to a unique level of exposure experienced by the Group. It is against this background that HM Treasury offered protection under the APS to certain authorised deposit-taking institutions including RBS plc. Consequently, the terms and conditions of the APS, as well as its size and structure and the allocation of risks and burdens, are in many respects not comparable with other forms of protection customarily available in the wholesale credit markets.

Set out below is a summary of the principal terms and conditions of the Scheme Documents.

**Legal and accounting structure of the APS**

The Scheme Conditions set out the terms under which protection will be provided in respect of the Covered Assets. The protection provided by the APS does not fall into traditional legal classifications, but it has a number of material aspects akin to those under a guarantee. It is intended, however, to be accounted for as a credit derivative for all of the Covered Assets irrespective of the individual accounting treatment of those Covered Assets.

The Accession Agreement contains provisions specific to RBS plc and the Covered Assets.

**APS amount**

Protection under the APS will, subject to the various requirements specified below, be provided in respect of the Covered Assets on RBS's consolidated balance sheet as at 31 December 2008 with an aggregate covered amount of £282.0 billion comprising on balance sheet carrying value of £198.8 billion; provisions and write downs of £21.3 billion; and undrawn commitments and other adjustments of £61.9 billion (see *Covered Assets as at 30 September 2009 and 31 December 2008*).

This protection is subject to a "first loss" amount to be borne by RBS plc (see *First loss and the 90 per cent./10 per cent. split* below) and thereafter a further 10 per cent. of losses will also continue to be borne by RBS plc.

**Covered Assets**

The Covered Assets include assets which fall into the following asset classes (the "Covered Asset Classes"):

- (i) Residential Mortgage;
- (ii) Consumer Finance;
- (iii) Bond;
- (iv) Loan;
- (v)

Lease Finance;

(vi)

Project Finance;

(vii)

Leveraged Finance;

(viii)

Commercial Real Estate Finance;

(ix)

Structured Finance; and

(x)

Derivative (including contracts documented under, or deemed to be subject to, ISDA or other master agreements or single or multiple derivative transaction agreements).



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**Overview of Scheme Rules**

**Scheme Principles**

The Scheme Conditions contain a set of overriding general principles (the "Scheme Principles") which overlay the detailed terms and conditions of the Scheme Conditions. The Scheme Principles are set out in Annex 3 to this document.

**Eligibility of Covered Assets**

In order for the Covered Assets specified above to be covered and to continue to be covered by the APS, a Covered Asset must at all times satisfy, prior to any Trigger (see *Triggers* below), the following asset eligibility criteria:

- (i) the Covered Asset was and continues to be economically owned by one or more Covered Entities (see *Scope Covered Entities* below) from and including 31 December 2008 until a Trigger occurs. "Economically owned" means that either (a) broadly, the Covered Entity legally and beneficially owns the Covered Asset; or (b) the Covered Asset is subject to certain permitted arrangements where the Covered Entity continues to retain all or substantially all of the economic exposure to that Covered Asset and, in each case, the Covered Entity is able to control, directly or indirectly, the management and administration of the Covered Asset save to the extent that rights, responsibilities, duties or obligations in connection with the management and administration of the Covered Asset are or have been (and continue to be) transferred in accordance with the Scheme Conditions. Permitted arrangements include certain security interests, repurchase agreements, stock loans, assets swaps and certain securitisations and conduit arrangements. Generally, where a Covered Asset is subject to a permitted arrangement, the Covered Asset must (at RBS plc's cost) be released and discharged from such arrangements and any security interest released within a specified time after the occurrence of a Trigger in respect of that Covered Asset (subject to certain limited exceptions). Failure to do so may result in a Covered Asset ceasing to be covered by the APS; and
- (ii) the Covered Asset was and continues to be included in RBS's audited consolidated balance sheet (including, in the case of contingent liabilities, where appearing as a note to RBS's financial statements) from and including 31 December 2008 until a Trigger occurs.

£3 billion of assets in the Derivative and Structured Assets Covered Asset Classes included in the APS do not, for technical reasons, currently satisfy, or are anticipated at some stage not to satisfy, the eligibility requirements of the Scheme Documents. HM Treasury and RBS plc have agreed to negotiate in good faith to establish as soon as practicable whether (and if so to what extent) coverage should extend to these assets. If no agreement is reached these assets will not be covered by the APS. In addition, RBS has agreed that, on or prior to its accession to the APS, it will issue a withdrawal notice in respect of £1.2 billion of Covered Assets across a broad range of Covered Asset Classes.

In addition, it has been agreed between HM Treasury and RBS plc that the submission of some Covered Assets under the APS be changed no later than 31 March 2010, by the removal from the APS of certain credit derivative transactions and the inclusion in their place of bonds which are the subject of those credit derivative transactions. These changes may result in a technical change to the aggregate covered amount (see *Loss* below) of assets included in the APS.

**Permitted amendments and refinancing**

The APS generally permits any agreement or instrument relating to an asset or exposure comprising a Covered Asset to be amended, and (except in the case of Derivatives), novated or replaced. However, a Covered Asset will cease to be covered (and, therefore, no losses or recoveries will be recognised under the APS) where, on or after 31 December 2008 any amendment or replacement on or before a Trigger occurs or has occurred in respect of that Covered Asset which breaches certain asset continuity requirements designed to ensure that the original asset is not effectively substituted for another asset or changed so as effectively to become a new asset. These requirements include certain obligor continuity requirements (with limited exceptions in relation to, for example, obligors within the same group provided that there is no increase in the expected loss) and are also designed to ensure the preservation of potential recoveries under certain specified closely related hedges identified as such by RBS in the initial data which the Scheme Conditions provide should be hedging arrangements in respect of Covered Assets in existence as at 31 December 2008 which are recorded in the credit risk management,

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credit line, trading line or equivalent system of any member of the Group as a reduction in the credit risk or increase in the credit line to any obligor with respect to that Covered Asset ("Closely Related Hedges"). It should also be noted that:

- (i) the cover under the APS for a Covered Asset whose maturity has been extended is limited (see *Rollovers* below);
- (ii) (a) the disposal of part of a Covered Asset before a Trigger is subject to certain limitations breach of which may result in the whole of the Covered Asset ceasing to be covered by the APS (see *Circumstances in which a Covered Asset will cease to be covered by the APS or payments will be suspended by HM Treasury under the APS* below) and (b) certain conduct, such as a partial or complete disposal of a Covered Asset following the occurrence of a Trigger is subject to certain approval requirements (see *Asset management conditions* below); and
- (iii) the protection provided by the APS is generally capped by the lower of (a) the amount specified for each Covered Asset in the agreed initial data and (b) the maximum exposure a Covered Entity has to that Covered Asset based on the terms and conditions of that Covered Asset as at 31 December 2008 (see *Loss* below).

In addition, the APS does not expressly provide for novations of transactions forming all or part of a Derivative Covered Asset Class and protection may therefore be lost or reduced where derivative transactions are novated from one Covered Entity to another or in connection with a restructuring (other than a restructuring which constitutes a Trigger).

**Scope-Covered Entities**

Protection under the APS will be provided to RBS plc directly, although it will extend to Covered Assets held by Covered Entities other than RBS plc. These Covered Entities include a number of wholly owned subsidiaries of RBS, the most significant of which are NatWest and the Ulster Bank group, as well as assets held by RBS Group plc's interests in ABN AMRO. RBS plc will, in respect of ABN AMRO, enter into an agreement (to which HM Treasury is not a party) to ensure that ABN AMRO receives the desired regulatory treatment and to obtain comfort from ABN AMRO that it will facilitate RBS plc complying with certain of its obligations to HM Treasury as regards the Covered Assets of approximately £48 billion at 31 December 2008 held by ABN AMRO and its wholly owned subsidiaries.

However, ABN AMRO has not obtained regulatory pre-approval from the Dutch Central Bank for ABN AMRO to permit HM Treasury to appoint one or more step-in managers (see *Step-in rights* below) in relation to the management and administration of Covered Assets held by ABN AMRO or its wholly owned subsidiaries. Accordingly, if HM Treasury seeks to exercise such step-in rights in respect of Covered Assets held by ABN AMRO or its wholly owned subsidiaries, ABN AMRO will in certain circumstances need to seek consent from the Dutch Central Bank to allow it to comply with such step-in. If this consent is not obtained by the date (which will fall no earlier than 10 Business Days after the notice from HM Treasury) on which the step-in rights must be effective, RBS plc will need to consider whether other options are open to it to effect compliance with the step-in notice. If this does not prove possible (at all, or because the costs involved prove prohibitive), the affected Covered Assets would need to be withdrawn from the APS where permissible under the Scheme Conditions (see *Asset withdrawal rights and termination rights* below) or otherwise with HM Treasury consent. If RBS plc cannot withdraw such Covered Assets from the APS, it would be likely to lose protection in respect of these assets under the APS (see *Circumstances in which a Covered Asset will cease to be covered by the APS or payments will be suspended by HM Treasury under the APS* below), and/or RBS plc may be liable under its indemnity to HM Treasury.

Similar issues apply in certain other jurisdictions but the relevant Covered Assets are of a lower quantum.

**Duration of the APS for each Covered Asset**

The duration of the cover under the APS for each Covered Asset is generally expected to be for the remaining maturity of that Covered Asset.

**Triggers**

Under the Scheme Conditions, HM Treasury will be liable (subject to the terms and conditions of the Scheme Conditions and, in particular, as described further below with respect to Covered Assets in the



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Derivatives, Consumer Finance and Residential Mortgages Covered Asset Classes) to make payments in respect of Covered Assets in respect of which a trigger occurs (which assets will, following a trigger, become "Triggered Assets"), such trigger being a failure to pay, a bankruptcy or a restructuring as described in the Scheme Conditions (a "Trigger"). The date of the first Trigger to occur will be the "Trigger Date".

- (i) A failure to pay Trigger:
  - (a) is defined as a failure (or, in the case of certain structured Covered Assets, an implied failure) by an obligor to make payments when due under the terms of the relevant Covered Asset; and
  - (b) will only occur at the end of an applicable grace period specified in the Scheme Conditions. The grace periods differ for each asset class: 30 days in the case of, for example, Bonds and 270 days in the case of, for example, Loans.
- (ii) A bankruptcy Trigger will occur:
  - (a) where one of certain specified bankruptcy, insolvency or similar events or proceedings occurs in respect of all obligors who are liable for all of the payment obligations under a Covered Asset; or
  - (b) upon a secured party in respect of an obligor taking possession of or legal process against any of the obligor's assets in connection with the enforcement of security relating to the relevant Covered Asset.
- (iii) A restructuring Trigger is defined as including a reduction in or deferral of principal or interest, a change in priority, ranking or a release or discharge of security, provided that an individual asset level accounting impairment has been or is, at the time or as a result of the applicable restructuring event, recorded against the value of the relevant Covered Asset in the consolidated accounting balance sheet of RBS (a "Specific Impairment"). Periodic individual impairment assessments and calculations are expressly required by the Scheme Documents in respect of all Covered Assets with a covered amount (see *Loss* below) of over £1 million (or its equivalent) other than (i) assets within the Consumer Finance Covered Asset Class which are managed on a "blind basis" (see *Asset management conditions*). For these assets periodic individual impairment assessments and calculations are required where the assets have a covered amount (see *Loss* below) of £10 million; and (ii) assets within the Residential mortgage Covered Asset Class.

Neither (i) a failure to pay or bankruptcy which was remedied or waived on or before 31 December 2008, nor (ii) a restructuring which occurred on or before 31 December 2008, will be Triggers under the APS.

The three Triggers set out above apply to all Covered Assets other than:

- (i) Derivatives. The only Triggers applicable to Derivatives under the Scheme Conditions are:
  - (a) a failure to pay when due an amount payable to the Covered Entity in respect of an early termination date reflecting the value of the transaction(s) terminated and other unpaid amounts, subject to a grace period of 30 days; and
  - (b) a restructuring Trigger, however, the applicable restructuring events for Derivatives include a reduction in the early termination amount, termination (in whole or in part) to one or more transactions where the amount payable in respect of such termination is less than the amount that would otherwise have been the early termination amount if the transactions had terminated on an early termination date, amendment to one or more transactions where scheduled payments are reduced and there is a related forgiveness of value, a postponement or deferral of any scheduled payment or the early termination amount or a change in the priority, ranking or a release or discharge of security, provided that in each case an individual asset level accounting impairment (as described in sub-paragraph (iii) above for a general restructuring Trigger) has been or is, at the

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time or as a result of the applicable restructuring event, recorded against the value of the relevant Covered Asset in the consolidated accounting balance sheet of RBS and provided that the amount of loss in respect of that Covered Asset which arises as a result of such a Trigger would not exceed £10 million. If it would exceed £10 million, a restructuring Trigger will only occur if HM Treasury in its sole discretion agrees to specify such Trigger.

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- (ii) Consumer Finance and Residential Mortgages. The failure to pay Trigger will apply to these assets. However, (a) the restructuring Trigger only applies (as explained above) where specific asset impairments are made, and, in practice, this will generally not occur in respect of these assets and (b) subparagraph (a) of the bankruptcy Trigger is replaced for these Covered Assets with a bankruptcy Trigger which will occur when such Covered Asset is recorded as written off in the systems of the Covered Entity in accordance with its ordinary business practices and the accounts closed.

**First loss and the 90 per cent./10 per cent. split**

RBS plc will bear a "first loss" amount in respect of the Covered Assets. The first loss amount will be an aggregate amount of £60 billion.

When the aggregate of all losses (see *Loss* below) in respect of the pool of Covered Assets exceeds the aggregate of all recoveries (see *Recoveries* below) in respect of the Covered Assets, by an amount greater than the first loss amount, HM Treasury will bear 90 per cent. of that excess. The remaining 10 per cent. of that excess is for the account of RBS plc.

Where the first loss amount has been exceeded in this manner, this position may later be reversed (i.e. where at any time the first loss amount is greater than the excess of aggregate losses over aggregate recoveries) and at any time this occurs, RBS plc will bear all losses until such first loss amount has again been exceeded.

**Loss**

The losses in respect of a Covered Asset protected by the APS are capped at the lesser of the outstanding amount and the covered amount for that Covered Asset, each as determined either on the Trigger Date (see subparagraph (i) below in respect of calculating the covered amount this may in some circumstances refer back to an earlier date, such as the first failure to pay under the agreement) or thereafter (see subparagraph (ii) below).

- (i) Trigger Date losses

The outstanding amount for each Covered Asset (except Derivatives) will be an amount equal to the aggregate outstanding principal amount (if any) of that Covered Asset on the Trigger Date (after taking into account any reduction on that date). It excludes interest, fees, premium or any other non-principal sum which has accrued or is payable in respect of that Covered Asset save to the extent it was capitalised on or before 31 December 2008 or, capitalised in respect of an overdraft. Where a Covered Asset is an exposure such as a committed undrawn facility, undrawn overdraft facility, letter of credit or guarantee (a "Covered Liability"), the outstanding amount will be broadly the amount paid or amounts drawn in respect of that liability by the relevant Covered Entity and not reimbursed at the time of the Trigger.

In respect of Derivatives, the outstanding amount is the lower of (i) the relevant amount (if any) payable to the relevant Covered Entity in respect of an early termination date reflecting the value of the transaction(s) which was terminated and other unpaid amounts and (ii) such amount recalculated disregarding any transactions entered into after 31 December 2008. The outstanding amount of a Derivative is reduced to take account of collateral, by subtracting an amount reflecting a proportion of the cash recoveries under the Derivative (see *Recoveries* below).

The covered amount for all Covered Assets other than Derivatives, Consumer Finance Assets, Extended Protection Assets (as defined in subparagraph (ii)(b) below) and certain assets which have become subject to a rollover (see *Rollovers* below) is the lesser of (i) the maximum exposure a Covered Entity is committed to have (i.e. including contingent exposures) on any day in respect of that Covered Asset based on its terms as at 31 December 2008 and subject to any actual reduction in that maximum exposure at any time up until a Trigger occurs (so that the covered amount will not go back up again should a reduced exposure be subsequently reinstated or increased); if, following the notification to HM Treasury of a loss in respect of a Covered Asset there is no reasonable evidence to establish this exposure, the covered amount will be zero; and (ii) the amount specified by RBS in the agreed initial data for that Covered Asset (see *Monitoring and reporting conditions* below).

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In addition in respect of Derivatives, the covered amount is, subject to the Data Field Rules, based on the mark to market value of such Derivative as at 31 December 2008 plus, in respect of certain specified Derivatives only, an additional buffer amount.

(ii) Post Trigger Date losses

Further losses may arise after the Trigger Date in respect of:

- (a) amounts paid (and not reimbursed) by a Covered Entity in respect of Covered Liabilities. Such loss is also capped at the lesser of the relevant outstanding amount and the covered amount. The covered amount concept is adjusted for these assets or exposures for technical reasons but in particular to ensure any loss already claimed on the Trigger Date is taken into account and also to take account of principal amounts repaid which are capable of being redrawn; and
- (b) certain assets which HM Treasury have elected will be protected by the APS (which otherwise would not have been so protected) ("Extended Protection Assets").

For the position in respect of Consumer Finance Assets more generally, see *Consumer Finance Assets* below. For the position in respect of Covered Assets eligible for rollovers, see *Rollovers* below.

**Recoveries**

90 per cent. of the recoveries on a Triggered Asset are to be applied to reduce the loss payable by HM Treasury on all Triggered Assets. Recoveries are to be applied at a portfolio level rather than in respect of the loss for the specific Triggered Asset for which the relevant recovery has been received. This will have the effect that, amongst other things, if recoveries received in respect of a Triggered Asset exceed the loss payable by HM Treasury on that Triggered Asset, the excess recoveries will be applied to reduce the losses on other Triggered Assets. The remaining 10 per cent. of recoveries is for the account of RBS plc.

The concept of recoveries is different from the concept of losses covered by the APS. Whereas losses are effectively limited to principal, recoveries include any of the amounts set out in sub-paragraphs (i) to (vii) below. In addition, any such recoveries are not capped by losses covered by the APS in respect of a Covered Asset, they may also extend to recoveries on certain assets not covered by the APS, namely (a) any Closely Related Hedge, and (b) any share, equity security or equity interest or any asset or exposure that ranks junior to the relevant Triggered Asset in respect of which one or more of the counterparties (or its group members) is also an obligor in respect of that Triggered Asset (a "Related Junior Asset") (excluding any publicly traded securities managed and administered by a market-making desk of a RBS Group member which is unaware that the asset is related to a Covered Asset and where there is an information barrier (which is required by applicable law) in place between that desk and the personnel who manage and administer the Covered Asset or any Non-Cash Realisation in respect of that asset). Recoveries include:

- (i) any payment received whether in respect of interest, principal, dividends or other amounts;
- (ii) any reduction in or discharge of obligations as a result of set off, netting or other substantially similar arrangements;
- (iii) any non-cash asset received and all recoveries with respect to each non-cash asset;
- (iv) the proceeds of: any sale, assignment, transfer or other disposal of any interest in a Covered Asset, any Non-Cash Realisation, any Related Junior Asset; any undertaking which holds or economically owns a Triggered Asset, Non-Cash Realisation or Related Junior Asset (or has a right, interest or benefit, whether direct or indirect in or with respect thereto) ceasing to be a consolidated entity; any insurance claim; any recovery under a protection scheme; any claim against any person including for negligence or breach of warranty; an indemnity claim; in respect of an asset within the Consumer Finance or Residential Mortgage Covered Asset Classes any related loan or mortgage payment protection insurance policy or rebate which must be accounted for to any obligor in connection with any such insurance if all outstanding amounts had been repaid ("Relevant Protection Policy") or rebates in connection with any payment protection insurance policy; and any refunds or payments received in respect of tax credits or VAT, etc.;





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- (v) any amount received following the enforcement of any security or other benefit arising from security;
- (vi) any reduction (including expected further reduction) in any amount that would otherwise have been payable by any applicable entity in respect of a Closely Related Hedge which is a credit-linked note; and
- (vii) any fee received acting as agent, security trustee, servicer, manager or administrator.

Non-cash recoveries will generally only be applied to reduce the loss payable by HM Treasury on Triggered Assets after they have been converted into cash receipts. However, there are exceptions to this such as the deemed cash recoveries in respect of sub-paragraph (vi) above. In addition, if RBS plc fails to deliver a conflicts certificate pursuant to the requirements of the Scheme Conditions with respect to a Covered Asset (see *Monitoring and reporting conditions* below), HM Treasury will be entitled to determine that a recovery has been made in respect of that Covered Asset with an amount corresponding to the excess benefits (as determined by HM Treasury) received by the RBS Group with respect to any arrangement not being commercially fair, reasonable and on arm's length terms. Recoveries include recoveries received by an "applicable entity" which includes a member of the Group and any entity with whom a Covered Entity has entered into a permitted arrangement and which owns the relevant Covered Asset. RBS takes the risk of such entity failing to pass on any such recoveries.

Certain limited third party recovery expenses paid by a member of the Group or another applicable entity in respect of recoveries will be deducted from the recoveries for which such expenses are incurred, if:

- (i) they are, amongst other requirements set out in the Scheme Conditions, proportionate, properly and reasonably incurred in good faith and directly associated with the corresponding recoveries and not a consequence of outsourcing arrangements which was or could otherwise have been performed by the RBS Group as at 31 December 2008; or
- (ii) approved by HM Treasury in writing.

As the concept of recoveries is linked to the Covered Assets and not the loss suffered on them, this may mean that the amounts included as recoveries have been received either in respect of a loss not covered by the APS or in respect of other obligations, for example, payments of fees to a member of the Group in its capacity as facility agent. This possibility is increased where the recoveries to be applied include recoveries received prior to the Trigger Date). This includes the following situations:

- (i) cash amounts recovered in respect of a restructuring Trigger whether before or after the restructuring, will be applied as recoveries;
- (ii) cash amounts received on or after a potential breach which leads to a Trigger in respect of any Related Junior Asset in respect of that Triggered Asset; and
- (iii) all cash amounts received (whether before or after a Trigger) in respect of: Closely Related Hedges; any assets transferred to a Covered Entity under any credit support annex or similar title transfer arrangement in respect of Derivatives; any insurance claim; any claim under another protection scheme; any claim against any person including a claim for negligence or breach of warranty; an indemnity claim; or any Relevant Protection Policy proceeds or rebates in connection with any payment protection insurance policy, etc.

In respect of Derivatives, only a specified proportion of receipts in respect of the relevant asset are treated as recoveries. The specified proportion is the lower of 100 per cent. and a fraction equal to the early termination amount under the relevant derivative agreement (calculated ignoring any transaction entered into after 31 December 2008) divided by the early termination amount (calculated taking into account any such transaction(s)). Where a cash recovery in respect of a Derivative arises before the Trigger Date, the specified proportion of the cash recovery is applied to reduce the outstanding amount (and therefore the loss) of the relevant Derivative. Where a cash recovery arises on or after the Trigger Date, the specified proportion of the cash recovery is applied in the usual way through the Pending Account as described below (see *Recoveries and Calculation of payment from HM Treasury* below). If the Trigger in respect of a Derivative was a restructuring Trigger which does not result in the termination of all transactions under the relevant derivative agreement, the mid-market value of any transaction which remains outstanding after the restructuring Trigger is deemed to be a cash recovery.



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**Calculation of payment from HM Treasury**

The Scheme Conditions provide for the preparation of various accounts to determine amounts paid or payable under the APS.

At the end of each calendar quarter, a single net amount will be added to the balance of an account established by HM Treasury (the "Pending Account"). This net amount will broadly be equal to (i) 90 per cent. of cumulative losses in that quarter in excess of the first loss amount less (ii) 90 per cent. of cumulative recoveries received on the Triggered Assets in that quarter (such net amount being the "Quarterly Payable"). Interest will accrue on the balance of the Pending Account at the "Sterling General Collateral Repo Rate", as displayed on the Bloomberg service, or such rate as may be notified by HM Treasury from time to time. If the balance of the Pending Account as of the first day of a quarter is greater than zero (the "Positive Balance") and the balance of the Pending Account has been greater than zero throughout the immediately preceding eight quarters, HM Treasury shall pay to RBS plc an amount equal to the lesser of (i) any positive excess of the Positive Balance over the sum of the Quarterly Payables for the eight preceding quarters and (ii) the Positive Balance, plus accrued interest.

The rules for the operation of these accounts have the effect (amongst other things) that:

- (i) there is at least a two year delay between RBS suffering a loss in respect of a Covered Asset and RBS receiving a loss compensation payment from HM Treasury;
- (ii) the pending payment from HM Treasury will be subject to (a) reduction by an amount (if any) by which 90 per cent. of recoveries received on all Triggered Assets exceed 90 per cent. of losses in the intervening eight quarters from the occurrence of a loss under the APS and (b) a requirement that 90 per cent. of total applicable recoveries to date do not exceed 90 per cent. of total applicable losses to date; and
- (iii) if the Pending Account is negative at any time, RBS plc will be required to make an immediate payment to HM Treasury (subject to a cap equal to (a) the aggregate amounts paid or payable by HM Treasury from the date of RBS plc's accession to and participation in the APS until the relevant quarter minus (b) the amount payable by RBS plc in that quarter).

If a Quarterly Statement (as described in *Monitoring and reporting conditions* below) notifies (i) a correction or adjustment which increases the amount of the losses or reduces the amount of the recoveries for a quarter which ended more than one year before the date of that Quarterly Statement, or (ii) an adjustment relating to an amount which becomes repayable as a result of applicable law, and such adjustment relates to a quarter and the applicable repayment was made in a quarter which ended more than one year before the date of that Quarterly Statement, or (iii) in the case of an adjustment arising as a result of the retrospective effect of an Extended Protection Notice, and such adjustment relates to a quarter and the Extended Protection Notice became effective in a quarter which ended more than one year before the date of that Quarterly Statement, in each case, such correction or adjustment will be disregarded for the purpose of calculating any payment due from HM Treasury.

It is possible that, in particular where a Triggered Asset rehabilitates (that is, either all or substantially all of the amounts payable in respect of that Triggered Asset are paid to the relevant Covered Entity by the obligor), the relevant Covered Entity may have recovered a higher amount in respect of that Triggered Asset were it not included in the APS, because of (amongst other things) the requirement to account to HM Treasury for 90 per cent. of Recoveries after the occurrence of a Trigger. This outcome may be avoided, however: (i) in respect of a failure to pay Trigger, if the initial failure to pay is remedied within the applicable grace period; and (ii) in respect of a restructuring or bankruptcy Trigger, by the exercise of the withdrawal rights set out in *Asset withdrawal rights and termination rights* below.

**Hedging**

Subject to certain exceptions, RBS plc is able to hedge the exposure to the remaining 10 per cent. of risk provided that, once the first loss amount has been exceeded and following the occurrence of a Trigger, RBS plc will retain a fully unhedged exposure to its right to 10 per cent. of recoveries in respect of such risk.

**Valuations of non-sterling losses and recoveries**

Each Covered Asset is protected under the APS until the Trigger Date (or such other date on which the loss is calculated) in the currency specified by RBS plc in the initial data (see *Monitoring and reporting conditions* below), usually the base repayment currency under the terms of that Covered Asset in effect as at 31 December 2008.



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Following a Trigger Date (or any subsequent date on which a loss amount may be claimed under the APS), the loss in respect of a Covered Asset is converted to sterling in accordance with the Scheme Conditions. Any recovery in respect of a loss is also converted into sterling on the date of its recovery under the Scheme Conditions.

These conversion mechanics give rise to the possibility of some currency mismatches in respect of the protection provided by the APS and RBS's exposure to the underlying asset. This may occur in particular as a consequence of errors in specifying the correct currency in the initial data, or where RBS has an exposures to any currencies other than the specified base currency at any time during the life of the underlying asset.

**Circumstances in which a Covered Asset will cease to be covered by the APS or payments will be suspended by HM Treasury under the APS**

A Covered Asset will cease to be covered by the APS if:

- (i) a Covered Asset which satisfied the asset eligibility criteria (see *Eligibility of Covered Assets* above) at the outset of the APS subsequently fails to satisfy those criteria at any time prior to a Trigger;
- (ii) an amendment or replacement of any agreement or instrument relating to an asset or exposure comprising a Covered Asset breaches certain asset continuity requirements (see *Permitted amendments and refinancing* above);
- (iii) there are errors in the initial data and, as a result of corrections proposed by RBS plc to be made to such initial data, it is no longer possible to identify the asset or exposure RBS plc intended to be included in the APS;
- (iv) there is a notification in a Quarterly Statement (see *Monitoring and reporting conditions* below) of a Trigger Date, relating to a quarter which ended more than one year before the date of that Quarterly Statement;
- (v) there is a relevant event of default. An event of default may occur if RBS plc breaches any of a number of specified obligations under the Scheme Conditions. These obligations mostly relate to RBS plc's compliance with the asset management, information and reporting conditions, including: not to modify the asset management framework, the conflicts management policy or the credit aggregation policy (see *Asset management conditions* below) without HM Treasury's approval; not to transfer responsibilities, rights, duties or obligations, create security or undertake other specified prohibited conduct (see *Asset management conditions* below) in connection with any Covered Asset without certain internal or HM Treasury's approval; to comply with various aspects of the remuneration conditions; to produce and deliver Quarterly Statements in accordance with the Scheme Conditions; to notify, subject to certain conditions, HM Treasury of proposed corrections to information provided by RBS plc in any initial data in respect of a Covered Asset; to deliver to HM Treasury accurate data in respect of Covered Assets post-accession at pre agreed date(s); and to comply with the instructions of a step-in manager (see *Step-in rights* below). These obligations also include RBS plc's obligations to make the payment described in paragraph (iii) in *Recoveries* and *Calculation of payment from HM Treasury* above and to pay any indemnity amounts due to HM Treasury or any of its representatives (see *Indemnities* below). If RBS plc fails to comply with any specified obligation, HM Treasury has the right, subject to certain conditions, to suspend the payment of an amount due from HM Treasury (all payments still being due from RBS), in respect of relevant Covered Assets (or, if the specified obligation relates to all Covered Assets, all Covered Assets), provided that if the relevant breach is specified to be remediable, such suspension will cease if remedied within 60 Business Days (or 120 Business Days, in the case of data submitted in respect of Covered Assets post-accession in accordance with pre-agreed timing and frequency requirements (see *Monitoring and reporting conditions* below) but which were not accurate. If such breach has not been remedied by RBS plc or waived by HM Treasury within 60 Business Days (or 120 Business Days as applicable HM Treasury shall remove such Covered Assets from the APS (or if the specified obligation relates to all Covered Assets, all Covered Assets);
- (vi) any material or systematic criminal conduct on the part of RBS or any of its representatives occurs which affects or relates to a Covered Asset; or



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(vii)

certain of the jurisdictions where Covered Assets are held impose criminal penalties for breach of banking secrecy or data protection laws. Various defences and exceptions are available under the relevant laws. In relation to up to approximately £5 billion of the Covered Assets held in certain of these jurisdictions if certain information is disclosed to HM Treasury or any of its representatives pursuant to the APS these laws may be breached and RBS has not yet agreed with HM Treasury satisfactory mechanisms for ensuring that it can make disclosure of information to HM Treasury and its representatives in all circumstances in which disclosure may be required under the APS. HM Treasury and RBS have agreed that they will work together in good faith in respect of any information requests HM Treasury or its representative considers necessary or desirable in respect of any such Covered Asset, to ensure that such information can be provided without any breach of such laws. However, if no such agreement can be reached, HM Treasury may require the withdrawal of any such Covered Asset or RBS itself may consider it necessary to withdraw any such Covered Asset. If this occurs, the Covered Asset would cease to be covered by the APS and retrospective adjustments may be made for the repayment of any losses reimbursed by HM Treasury or the repayment of any recoveries paid by RBS plc.

In addition, if a Covered Asset is disposed of in whole or in part prior to a Trigger, the disposed part of that Covered Asset (or where a partial disposal does not meet certain criteria, the whole of the Covered Asset including that part which has not been disposed) will cease to be covered by the APS and no protection will extend to any loss associated with that part of the Covered Asset.

If RBS has included Covered Assets comprising the same asset or exposure in the APS, the duplicated part of the Covered Assets shall be eliminated from the APS on terms to be agreed between RBS plc and HM Treasury. In the absence of agreement, HM Treasury shall determine the terms of changes which may have a retrospective effect and result in adjustments to the payments made as described in *Calculation of payment from HM Treasury* above.

If a Covered Asset (including a Triggered Asset) ceases to be covered by the APS as a result of the circumstances described above, HM Treasury is no longer obliged to reimburse RBS plc for any (past or future) losses in respect of that Covered Asset. In the case of a Triggered Asset ceasing to be covered by the APS, retrospective adjustments will be made for the repayment of any losses reimbursed by HM Treasury or the repayment of any recoveries paid by RBS plc.

**Fees and costs**

During the life of the APS, RBS plc will pay a non-refundable annual fee (payable in advance) of £700 million per annum for the first three years of the APS and £500 million per annum until the earlier of (i) the date of termination of the APS and (ii) 31 December 2099 (see *Asset withdrawal rights and termination rights* below). The annual fee can, subject to HM Treasury consent, be paid wholly or partly by means of the waiver of certain UK tax reliefs that are treated as deferred tax assets (pursuant to the Tax Loss Waiver) or funded by the issuance of additional B Shares to HM Treasury.

There will be no rebate of any part of any annual fee regardless of any withdrawal of Covered Assets or termination of the APS unless agreed by HM Treasury at the time of the withdrawal or termination. RBS will bear its own costs in connection with its accession to, and participation in, the APS. It will also bear HM Treasury's costs (including employment costs) in relation to the establishment and ongoing management and administration of the APS. This includes £45 million of costs which have been incurred or are expected to be incurred up to 31 December 2009. It also includes any costs associated with HM Treasury carrying out its duties and obligations or exercising its rights and powers in connection with the State Aid Commitment Deed.

**Tax Loss Waiver**

Under the Tax Loss Waiver, subject to HM Treasury consent, RBS has the option to pay the annual fee in respect of both the APS and the Contingent Subscription, and the exit fee payable in connection with any termination of the Group's participation in the APS (but not the refund of the net payments it has received from HM Treasury under the APS), in whole or in part, by waiving the entitlement of members of the RBS Group to certain UK tax reliefs. The tax reliefs in question are, broadly, those which are taken into account as deferred tax assets in the Annual Report and Accounts and future tax reliefs which would so qualify to be taken into account in future financial statements of the RBS Group before the relevant fee is payable. In addition to requiring HM Treasury consent, the use of tax reliefs to pay the above fees is subject to certain conditions including verification of the tax reliefs by HMRC.

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The Tax Loss Waiver contains provisions designed approximately to value the tax reliefs which are being waived. In calculating the value of those tax reliefs, the Tax Loss Waiver requires the tax reliefs being waived to be subject to a discounting factor to reflect their present value (with a minimum rate of 20 per cent.) and takes into account any difference in the tax treatments of the waiver and the fee which would otherwise have been payable in cash.

The Tax Loss Waiver contains undertakings designed to prevent the RBS Group from engaging in arrangements which have a main purpose of reducing the net cost to the RBS Group of any waiver of tax reliefs pursuant to the Tax Loss Waiver.

**Asset withdrawal rights and termination rights**

RBS plc has the right to withdraw from the APS permanently all or a consistent proportion of all the constituent parts of a non-Triggered Asset (failure to dispose of such a consistent portion will result in the whole of the Covered Asset ceasing to be covered by the APS). In respect of a Triggered Asset where the relevant Trigger is a restructuring or bankruptcy Trigger, RBS plc also has the right to withdraw permanently all of that Triggered Asset within one year after the date of the occurrence of that Trigger. If RBS plc were to exercise this right (including where that leads to the withdrawal of all or the bulk of the Covered Assets from the APS), the remaining provisions of the Scheme Documents (including the information, audit and control rights (including those relating to remuneration) exercisable by HM Treasury) would nevertheless continue in full force and effect.

In addition, RBS plc contractually has a right to terminate the APS exercisable at any time provided that the FSA has confirmed in writing to HM Treasury that it has no objection to the proposed termination. On such termination, RBS plc must pay an exit fee which is an amount equal to the shortfall (if any) between (i) the aggregate annual fees paid by RBS plc and (ii) the greater of (a) £2.5 billion and (b) 10 per cent. of the annual aggregate reduction in Pillar I capital requirement in respect of the assets covered by the APS up to the time of exit. The exit fee is payable in cash or, subject to HM Treasury consent, by the waiver of certain UK tax reliefs that are treated as deferred tax assets (pursuant to the Tax Loss Waiver). RBS plc would also potentially be required to refund (in the absence of agreement to the contrary) to HM Treasury any net payments made by it under the APS in respect of losses on all Triggered Assets, such refund only being payable in cash.

**Rollovers**

The APS provides limited rights for the protection provided in respect of some Covered Assets which fall within the "Loans" or "Commercial Real Estate Finance" Covered Asset Classes where the covered amount currency specified in the initial data (generally the base currency amount of a Covered Asset) is sterling and have a final maturity date (and a cover termination date as specified in the initial data) no later than 31 December 2010 to be extended where the maturity date of that Covered Asset is extended (whether such extension takes the form of an amendment or a refinancing). Where this is the case, the cover under the APS after the original final maturity date will be limited to 49.5 per cent. of the principal amount of such Covered Asset and will only be provided for the period to no later than 31 December 2013.

**Consumer Finance Assets**

The protection provided by the APS in respect of Consumer Finance Assets is slightly more flexible than for other Covered Assets in that:

- (i) amendments, novations and replacements can generally be made to these Covered Assets provided that, broadly, the obligor remains the same person or is a connected person;
- (ii) in respect of overdrafts (including Consumer Finance overdrafts), the covered amount will be the lesser of (a) the amount specified by RBS plc in the agreed initial data for that Covered Asset; and (b) an imputed amortisation profile which will broadly be the covered amount as at 31 December 2008 for two years and will then amortise down over the next two years on a monthly basis; and
- (iii) in respect of Consumer Finance Assets other than overdrafts, the covered amount will be the higher of (a) the amount set out in the fourth paragraph of *Loss* above and (b) the amount set out in sub-paragraph (ii) above.



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**Management and governance of Covered Assets**

The management and administration of the Covered Assets, Non-Cash Realisations and Closely Related Hedges (collectively the "Protected Assets") must be carried out in accordance with:

- (i) the asset management conditions;
- (ii) the monitoring and reporting conditions; and
- (iii) the governance and oversight conditions,

each as described in *Asset management conditions*, *Monitoring and reporting conditions* and *Governance and oversight conditions* below.

**Asset management conditions**

Under the Scheme Conditions, RBS plc is obliged to ensure that the management and administration of the Protected Assets is undertaken, subject to certain exceptions, in a manner consistent with the following requirements (the "Asset Management Conditions"):

- (i) applicable law;
- (ii) the asset management objective (see below);
- (iii) so as to ensure that there is no prejudice to, discrimination against or disproportionate and adverse effect on the Protected Assets when compared with the Group's other assets and exposures (including the Related Party Assets);
- (iv) in accordance with any provisions of the asset management framework and the conflicts management policy (see below);
- (v) in a manner which will facilitate compliance with the monitoring and reporting conditions and the governance and oversight conditions (see below); and
- (vi) in accordance with the ordinary course business and banking policies, practices and procedures of the Group, to the extent consistent with (a) the business and banking policies, practices and procedures of a reasonable and prudent banking organisation and (b) good industry practice.

**Asset management objective**

The asset management objective, as set out in the Scheme Conditions, is to maximise the expected net present value of the Protected Assets (calculated, on a risk-adjusted basis, using a discount rate equal to the fixed loan rates of the Public Works Loan Board published on the website of the Debt Management Office of HM Government (or a similar government rate)), including by minimising losses and potential losses and maximising recoveries and potential recoveries. "Related Party Assets" (which broadly include assets or exposures in respect of which the credit limit, credit line or trading line of the obligor is or would be aggregated with the credit limit, credit line or trading line of an obligor in respect of a Protected Asset pursuant to the credit aggregation policy of the RBS Group and assets in respect of which a conflict under the APS has arisen (see *Asset management framework conflicts management policy* below)) must also be managed and administered in a manner consistent with the Asset Management Conditions.

RBS plc is not required to comply with the asset management objective (i) in respect of Protected Assets or Related Party Assets which are managed on a "blind" basis (i.e. certain specified classes of assets where the relevant bank personnel managing and administering the assets are unaware, and are not authorised to know, whether those assets are included in the APS), (ii) where doing so would terminate or reduce, or entitle

HM Treasury to terminate or reduce, cover under the APS, (iii) where doing so would require, preclude or prohibit any withdrawal of a Covered Asset under specified APS terms, the full or partial termination of the APS or any sale or disposal of a Covered Asset which is not Triggered or (iv) where RBS plc would be required to make additional loans which are not protected under the APS.

**Asset management framework and conflicts management policy**

The Protected Assets must also be managed and administered in compliance with the asset management framework implemented by RBS plc. The asset management framework includes internal governance arrangements for the management and administration of Protected Assets and Related

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Party Assets (including in particular a conduct approval hierarchy), procedures for regular review of such assets and remedial management steps where losses on the Covered Assets or the likelihood of any or further losses, increase.

The management and administration of the Protected Assets must also comply with the conflicts management policy. This is a written statement setting out the proposed policy for the avoidance (where possible), identification, monitoring, management and mitigation of conflicts between the interests of any member of the Group and HM Treasury or between Protected Assets and assets of the Group which do not comprise Protected Assets.

Any modification to the asset management framework, the conflicts management policy or the credit aggregation policy must be approved by HM Treasury.

**Additional lending**

In order to comply with the asset management conditions as outlined above, a member of the Group may be required to provide additional or to extend existing financing to an obligor in relation to a Covered Asset, a group member of the obligor or another relevant person, subject to any loss incurred by the relevant member of the Group in respect of such additional or extended financing being covered under the APS. Losses incurred by the Group in respect of such additional or extended financing may, at the option of HM Treasury form part of a Triggered Asset and be protected by the APS (see the Extended Protection Assets requirements set out in *Loss* above). However, even if such protection is extended, such additional or extended financing may, at the option of HM Treasury, cease to be covered by the APS if certain circumstances as described in *Circumstances in which a Covered Asset will cease to be covered by the APS or payments will be suspended by HM Treasury under the APS* above occurs in respect of that Triggered Asset.

In addition, the Scheme Conditions include a list of actions which constitute "Prohibited Conduct" in relation to the Covered Assets, Closely Related Hedges or Related Party Assets. The Covered Entities are not permitted to carry out any Prohibited Conduct if it exceeds certain thresholds, unless approved in accordance with a specified "Conduct Approvals Hierarchy" included in RBS plc's asset management framework. Under the terms of the Conduct Approvals Hierarchy, decisions require, in increasing order, the approval of specified categories of Group APS personnel, a member of the Scheme Executive Team, the Scheme Head, the Senior Oversight Committee (each as defined in *Governance and oversight conditions* below) and, for the most significant decisions, HM Treasury (which consent may be assumed if not given within five business days). The following activities will constitute "Prohibited Conduct":

- (i) sales, transfers or other disposals of any Triggered Assets and/or Non-Cash Realisations (other than intra-Group sales, transfers or disposals);
- (ii) any release of security in respect of Covered Assets which are not "blind assets" (see above);
- (iii) any return of value on equity (whether by way of payments of dividends, distributions or otherwise) to any applicable entity by an obligor of a Covered Asset to the extent it does not give rise to a recovery under the APS; and
- (iv) amendments, replacements or termination of any Closely Related Hedge.

**Monitoring and reporting conditions**

The general principle underlying the monitoring and reporting conditions is to provide transparency in respect of the Covered Assets to enable HM Treasury to manage and assess its exposure under the APS, subject to certain contractual and legal limitations on disclosure. There are detailed requirements relating to the provision of information in relation to each Covered Asset which are intended to ensure that:

- (i) HM Treasury can verify that the assets or exposures forming part of a Covered Asset meet the asset eligibility criteria as set out in *Eligibility of Covered Assets* above and the asset continuity requirements as set out in *Permitted amendments and refinancing* above;
- (ii)

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the arrangements for calculation of payments to be made pursuant to the Scheme Documents can operate effectively and the quantum of such payments can be accurately verified;

(iii)

the performance and expected performance of the Covered Assets can be monitored and assessed;

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(iv) HM Treasury can monitor and assess compliance of each member of the Group with the Scheme Documents; and

(v) HM Treasury can (a) comply with its responsibilities and obligations, and exercise its rights, powers and discretions in connection with the APS or the Scheme Documents, (b) provide or enable the provision of financial support to RBS plc or protect or enhance the stability of the financial system of the UK, (c) report on the establishment, performance or operation of, or compliance with the APS and (d) discharge its responsibilities and functions.

RBS plc will identify the Covered Assets by the completion of agreed data fields in relation to each Covered Asset in the Accession Agreement. There are a limited number of agreed initial data fields in relation to each Covered Asset to be completed prior to the Accession Agreement being signed. Information provided by RBS plc in respect of such data may be corrected in limited circumstances. The consequences of incorrect data potentially include a lower level of protection or, in some very limited cases, loss of protection in respect of the affected Covered Asset. Other consequences of data errors include, subject to certain conditions, HM Treasury's exercise of step-in rights (see *Step-in rights* below).

Post-accession, RBS plc is also obliged to provide further data in respect of the Covered Assets (for example, data regarding guarantees, collateral, rollovers, etc.), some of which will need to be updated on an ongoing basis at pre-agreed time intervals. The consequences of a failure to update or correct such further data, or the quarterly statement data, in respect of a Covered Asset include suspension of payments by HM Treasury or removal of cover in respect of that Covered Asset subject to lengthy grace periods (see *Circumstances in which a Covered Asset will cease to be covered by the APS or payments will be suspended by HM Treasury under the APS* above).

Under the Scheme Documents, RBS plc has the obligation to provide the following statements, certificates and reports to HM Treasury:

- (i) "Quarterly Statements": these are statements to be provided on a quarterly basis which set out, for example, details of Triggers, losses and recoveries on the Triggered Assets during the relevant quarter, and include certain quarterly statement data fields which set out this information for each relevant Covered Asset;
- (ii) "Conflicts Certificates": these are certificates to be delivered to HM Treasury with each Quarterly Statement with respect to aggregate losses exceeding £10 million in respect of a Covered Asset, which confirm that (a) all agreements, transactions or arrangements which have been entered into either in connection with that Covered Asset or any Related Party Asset or which give rise to a conflict (as described in *Asset management conditions* above), in each case in the period from the initial breach to the Trigger Date, were commercially fair and reasonable and on arm's length terms, and (b) RBS plc has complied with the asset management objective and the other asset management requirements (see *Asset management conditions* above) at all times during the relevant period, and is signed and certified by the Scheme Head (see *Governance and oversight conditions* below).
- (iii) "Requested Reports": these are reports which may be requested by HM Treasury from time to time in relation to a variety of specified matters, for example, satisfaction of the asset eligibility criteria and the asset continuity requirements with respect to any Covered Asset, events or circumstances that have materially affected the level of losses and recoveries in respect of Triggered Assets or the impact of any material modifications that have been made to the asset management framework and/or the conflicts management policy (each as described in *Asset management conditions* above);
- (iv) "Notification Reports": these are reports which relate to adverse events in relation to the Group and its ability to comply with the APS requirements (such as the occurrence of an event of default in respect of RBS plc and its obligations under the APS or a proposed material reorganisation of the Group) and are to be notified to HM Treasury by RBS plc upon the occurrence of the relevant events; and
- (v) "Reconciliation Statements": these are statements to be delivered to HM Treasury, monthly listing the Covered Assets which have permanently ceased to be Covered Assets since the delivery of the previous monthly report.

RBS plc is under an obligation to prepare an assurance plan, which will set out the scope of an annual review of the systems architecture in place for compliance with the APS. The assurance plan will address



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the adequacy of controls, practices and processes for ensuring compliance with the APS, the accuracy of Quarterly Statements, the accuracy and completeness of data and a review of any failure to comply with the APS. The results of the review conducted in accordance with the assurance plan are to be set out in an annual assurance report to HM Treasury. In addition, the assurance plan shall provide a reconciliation between the aggregate outstanding amounts of all Covered Assets then included in the APS and the total assets of the Group, as soon as reasonably practicable following the finalisation of the audited consolidated balance sheet of the Group for any financial year.

HM Treasury has the right, at any time, to conduct an audit, investigation and review of the Group and certain other matters in connection with the APS. For example, an HM Treasury audit may focus on general compliance with the APS, specific reports provided to HM Treasury or reports on the performance of any Covered Assets. The scope and duration of any such audit is largely at the discretion of HM Treasury. HM Treasury may also appoint any Asset Protection Agency personnel or HM Treasury employee or officials to attend meetings of any credit or risk committee (or equivalent) of the Group, from time to time, for the purpose of monitoring RBS's compliance with the asset management conditions (see *Asset management conditions* above).

**Governance and oversight conditions**

The governance and oversight conditions involve the establishment of the following governance structure for the purposes of the APS:

- (i) the "Senior Oversight Committee" which consists of senior management personnel of the Group charged with, for example, developing strategy for, and providing oversight and supervision of, compliance with the APS and reviewing, approving and periodically reassessing the business strategies and governance arrangements of the Group in connection with the APS. The Senior Oversight Committee must include a least one non-executive director of RBS. HM Treasury is entitled to appoint one or more non-voting observers to this committee;
- (ii) the "Scheme Head" who reports to the Senior Oversight Committee and is the primary senior point of contact for HM Treasury with respect to the APS. The Scheme Head is one of RBS plc's executive directors or a member of its senior management team appointed to be dedicated to the APS and his/her appointment is subject to the prior approval of HM Treasury. The Scheme Head is responsible for leading, overseeing and ensuring the performance by the Scheme Executive Team of their respective functions under the APS; and
- (iii) the "Scheme Executive Team" which will include the deputy to the Scheme Head, and which is charged with the day-to-day oversight of compliance with the APS, for example, ensuring compliance with the monitoring and reporting conditions and the asset management conditions.

For the purpose of compliance with the Scheme Conditions, RBS plc's obligations under the governance and oversight conditions also include:

- (i) retaining or recruiting sufficient and appropriately trained staff and having available to them such resources as may be necessary and appropriate, and ensuring that, amongst other obligations, there is no prejudice to, discrimination against, or disproportionate adverse effect on the management and administration of the Covered Assets when compared with the other assets and exposures of the members of the Group;
- (ii) ensuring the provision of the same shared services in relation to the Covered Assets as are provided from time to time by the Group on a centralised basis in respect of assets and exposures which are not Covered Assets, and the other businesses, operations and activities of the members of the Group; and
- (iii) ensuring that each member of the Group shall maintain and operate and implement all systems, controls and processes that are necessary.

**Remuneration**

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The Scheme Conditions and the Accession Agreement contain requirements for the development of a remuneration policy for both RBS plc and the wider Group. This policy must comply with the FSA Remuneration Code, as well as be on the leading edge of implementing the G-20 principles and proposals from the Walker Review that are implemented in regulations. RBS plc is required to provide a copy of this remuneration policy to HM Treasury.



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Remuneration for members of the Scheme Oversight Committee, the Scheme Head and members of the Scheme Executive Team must be at least equivalent to that of non-APS personnel. In addition, (i) a substantial majority of the incentive and bonus components of the remuneration of APS personnel and (ii) an appropriate proportion of the incentive and bonus component of the remuneration of certain specified senior executives of the Group, must be linked to performance targets and measures of compliance with the APS. The "appropriate proportion" for such linkage for senior executives is, in the case of senior executives who have RBS plc-wide responsibilities, a proportion which is not less than the proportion of the total risk adjusted value of all risk weighted assets of the Group which is represented by the Covered Assets and, in the case of senior executives who have responsibility for certain business units or divisions of RBS plc, the proportion of the total risk adjusted value of all risk weighted assets in that division or business unit which is represented by the Covered Assets in that division or business unit (in each case, ignoring for the purposes of this calculation any impact of the APS and attributing an appropriate proportion and risk weighting to be agreed to defaulted assets). The compensation targets and measures referred to above and the level of the appropriate proportion must be approved by HM Treasury.

RBS plc is required to provide information with respect to remuneration of particular categories of personnel to HM Treasury on request. In addition, RBS plc has agreed with HM Treasury the structure and clawback principles applicable to the pool of bonuses for the 2009 performance year. RBS plc has further undertaken to provide to UK Financial Investments Limited ("UKFI") proposals regarding the total quantum of individual variable remuneration proposals for all main board directors, and aggregate discretionary bonus proposals for other employees, for the 2009 performance year. This is with a view to discussing such proposals with UKFI, and RBS plc is not to announce or implement such proposals for the 2009 performance year without having obtained UKFI's consent. UKFI has agreed to take into account RBS plc's pre-existing binding and irrevocable commitments regarding 2009 bonuses.

**Asset purchase requests**

HM Treasury has the right under the Scheme Conditions to deliver asset purchase requests from time to time in respect of one or more Covered Assets and/or Non-Cash Realisations stating that it wishes to acquire, or enter into total return swaps (or the economic equivalent) with respect to the relevant Covered Assets and/or Non-Cash Realisations specified in such request. Following the provision of an asset purchase request, RBS plc and HM Treasury are required to negotiate in good faith to attempt to agree the terms upon which HM Treasury may acquire the relevant Covered Assets and/or Non-Cash Realisations (including pricing (taking into account the value, of any credit protection provided by the APS which would be lost by RBS plc) and the date upon which such transaction is to occur).

**Step-in rights**

HM Treasury has the right under the Scheme Documents to appoint one or more step-in managers to exercise extensive step-in rights in relation to all or some of the Covered Assets upon the occurrence of the following specified trigger events: (i) the provision of incorrect or incomplete information, or the failure to manage the Protected Assets in accordance with APS requirements, in each case where HM Treasury determines that such information deficiency or failure is persistent or material or evidences a systemic problem which prejudices compliance with any asset management conditions monitoring and reporting conditions or governance and oversight conditions, (ii) where aggregate losses in respect of the Covered Assets net of recoveries (incurred or received, as the case may be, in the most recent quarter) exceed a specified threshold amount equal to 125 per cent. of the First Loss for Covered Assets in the aggregate (provided that this right may only be exercised two years after RBS's accession to the APS except in respect of Non-Performing Assets (as defined below) (the "Two Year Standstill Period")) or a (broadly proportionate) specified amount for each Covered Asset Class, or (iii) as a result of RBS plc's default under or breach of specified provisions of the Scheme Documents. In respect of the trigger event referred to in (ii) above, it should be noted that, as recoveries are generally not received in the same quarter as the loss (for example, recoveries from enforcement of security or a liquidator process will generally take some time to be received), this threshold may be reached even though ultimately it is anticipated that, when those recoveries are received, the net amount will be within the threshold.

Once appointed, a step-in manager would have certain oversight, investigation, approval and other step-in rights. For example, the step-in manager may determine that certain decisions may not be taken in relation to the Covered Assets without the step-in manager's approval. The step-in manager could

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also require the modification or replacement of any of the systems, controls, processes and practices of the Group. In addition, the step-in manager would have extensive rights in relation to the direct management and administration of the Covered Assets, which may be exercised without regard to whether or not an asset is a "blind asset". In other words, the step-in manager would have the ability to exercise all or any of the rights and decision-making powers of the Group in respect of the relevant Covered Assets, with the authority to sell Covered Assets (subject to RBS plc's consent not to be unreasonably withheld) or otherwise to effect investment transactions involving such Covered Assets.

Under the step-in provisions, step-in rights are to be carried out in good faith and with a view solely to the achievement of certain step-in objectives:

- (i) to gather information for reporting to HM Treasury in relation to the management and administration of the Covered Assets and Related Party Assets and compliance with the Scheme Documents;
- (ii) to remedy the effects of any default trigger where step-in has been exercised as a result of any default under or breach of the Scheme Documents;
- (iii) to meet the asset management objective and certain other asset management conditions; and
- (iv) to ensure compliance by RBS plc (and other members of the Group) with the Scheme Documents.

RBS plc will be required to appoint the step-in manager as its agent. The step-in manager will either be a representative appointed by HM Treasury or a person otherwise identified by, or agreed with, HM Treasury. Consequently, RBS plc has limited influence over the identity of the step-in manager.

The appointment of a step-in manager may be terminated under the following circumstances:

- (i) at HM Treasury's election; or
- (ii) where the relevant step-in trigger has been remedied, provided that HM Treasury is satisfied that the step-in objectives have been achieved; or
- (iii) where the relevant step-in trigger is a default based trigger, HM Treasury has exercised its right to terminate protection in relation to the particular Covered Asset(s) or the APS as a whole.

HM Treasury may, by notice to the Participant also require the appointment of a special adviser to the Senior Oversight Committee (the "SOC Special Adviser") to carry out all or any of oversight functions which a step-in manager would have in accordance with the Scheme Conditions, in relation to:

- (i) any Covered Assets which are subject to Specific Impairments and/or Triggered Assets ("Non-Performing Assets"); and/or
- (ii) any of the Covered Assets in the "Leveraged Finance", "Commercial Real Estate" or "Structured Finance" Covered Asset Classes and assets in the "Derivatives" Covered Asset Class which are managed by RBS plc's Strategic Asset Unit, in respect of which, in each case, the covered amount is £25,000,000 or more.

The SOC Special Adviser shall be a person identified by RBS plc and approved by HM Treasury or, if none of the persons identified by RBS plc has been approved by HM Treasury, a person identified by HM Treasury.

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If HM Treasury exercises its rights to require the appointment of a SOC Special Adviser in respect of any Non-Performing Assets on the terms set out above, it shall not exercise any right to require RBS plc to appoint or procure the appointment of a step-in manager (on the terms set out above) to carry out any direct management functions in respect of such Non-Performing Assets within 6 months of the appointment of that SOC Special Adviser. At the expiry of that period, a step-in trigger shall be deemed to have occurred in respect of the relevant Covered Assets, whereupon HM Treasury will have the rights set out under *Step-In rights* above.

HM Treasury's rights in respect of the appointment of a SOC Special Adviser and the rights flowing from this as set out above, apply notwithstanding the Two Year Standstill Period.

As noted above (see *Scope-Covered Entities*), the step-in rights may conflict with certain regulatory obligations or company law requirements applicable to certain Covered Entities. However, other than in

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respect of ABN AMRO, RBS understands that these issues will be limited to jurisdictions in which the quantum of Covered Assets is small relative to the size of the Covered Asset pool.

**Indemnities**

The Scheme Conditions contain indemnity obligations from RBS plc in favour of HM Treasury, any other government entity, HM Treasury's solicitor, and any representatives of the same. Under the indemnities, RBS plc is obliged to indemnify HM Treasury (in its capacity as provider of credit risk under the APS) and the other indemnified parties against all losses or damages suffered by such persons in relation to either the Covered Assets (other than a loss covered by the APS) or any other assets, exposures, liabilities and obligations of any member of the Group (as well as any losses or damages in relation to other matters including any event of default), without the need for any default or culpable action by the Group. The indemnities also extend to certain tax liabilities (including UK tax liabilities) which may arise in connection with the APS. The indemnities do not contain an exclusion for loss arising from the negligence of the indemnified persons themselves. RBS plc has no right of control in respect of proceedings in which the indemnified persons may be involved, the costs of which (whether successful or otherwise) RBS plc is also required to indemnify.

**HM Treasury transfer rights**

HM Treasury has the right to transfer (i) any of its payment obligations under the Scheme Documents at any time to any person (including a Government entity) and (ii) any of its monitoring, administration or enforcement rights, powers or discretions under the Scheme Documents at any time to a government entity, in each case provided that the regulatory capital risk weightings in respect of the Covered Assets will (overall) be no worse following any such transfer. Any such transfer does not require RBS plc's consent and HM Treasury is not obliged to consult with RBS plc in relation to the transfer. Following notification of such a proposed transfer from HM Treasury, RBS plc is required to enter into any such further agreements as may be required to give effect to such a transfer, including consequential amendments and modifications to the Scheme Documents. RBS plc is also required to bear its own costs in respect of the transfer.

**Modifications to the Scheme Conditions**

Certain Scheme Conditions are subject to modification at any time with retrospective effect at the discretion of HM Treasury as described in the next paragraph. The exercise of such modification rights by HM Treasury does not require the consent of RBS plc, although HM Treasury will consult RBS plc by serving a notice on it. Such notice will specify the nature and details of the proposed modification, the date on which the modification is proposed to become effective and the reasons for such modification. HM Treasury will consult with RBS plc (and any other participants who may accede to the APS) in good faith in relation to the proposed modification with a view to agreeing the proposed modification, the modification effective date, and determining and identifying any consequential matters arising from the proposed modification. RBS plc is entitled to object to any part of the proposed modification and any consequential matters arising from the proposed modification, including to propose an alternative modification. HM Treasury is obliged to consider any such objection or alternative suggestions from RBS plc (or any other participants in the APS), although it is not obliged to take them into account.

The modification rights arise where (i) the operation, interpretation or application of such Scheme Conditions conflicts with any of the overriding Scheme Principles (as set out in Annex 3 of this document), (ii) the Scheme Conditions contain a manifest error or (iii) it is necessary to modify such Scheme Conditions to take account of any change in applicable law. HM Treasury's modification rights are not permitted to be exercised if (a) the proposed modification is inconsistent with any of the Scheme Principles, or (b) following HM Treasury's consultation with the FSA, the FSA has formally notified HM Treasury that the proposed modification would be expected to result in any protection provided to the Group under the APS ceasing to satisfy the BIPRU eligible risk mitigation techniques requirements, or (c) HM Treasury has not considered in good faith or had regard to any submissions, communications or representations of or made by RBS plc regarding the anticipated impact of the proposed modification under any non-UK capital adequacy regime, which is binding on RBS plc or a Covered Entity. The Scheme Conditions can therefore be modified where the modification results in the regulatory capital risk weightings in respect of the Covered Assets being greater post-modification.

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The Scheme Conditions to which the modification rights apply in the context described in clause (i) above are limited to:

- (i) the asset eligibility criteria and the operative Trigger, loss, recovery and payment mechanics;
- (ii) the asset management conditions (except the asset management objective and the Restricted Conduct provisions); and
- (iii) the step-in conditions.

The Scheme Conditions to which the modification rights in clauses (ii) and (iii) apply include all provisions other than the overriding Scheme Principles themselves and HM Treasury's transfer rights (see *HM Treasury transfer rights* above).

**Dispute resolution procedures**

If a dispute arises, RBS plc or HM Treasury may instigate arbitration proceedings. The Scheme Conditions set out the requirements for notices, the composition of the arbitration panel (generally to be agreed between the parties) and the length of time for awards. A decision of the arbitration panel will be final and binding.

**Announcements**

There are material restrictions on the form and substance of announcements or public statements (including any required by law or the rules of any securities exchange) made by RBS plc and the Group in relation to the APS or to HM Treasury in connection with the APS ("APS Statements") without HM Treasury's consent.

Generally, prior to making any APS Statements which are required by law or regulation, RBS plc or the relevant Group member must notify HM Treasury and allow HM Treasury sufficient time to review and comment. RBS plc or the relevant Group member is then required to reflect any such comments except where to do so would not be permitted by law, would conflict with directors' fiduciary duties, would be inaccurate or misleading or the comments reflects a disagreement between the Participant and HM Treasury. As an exception to this regime, post-notification of such statements is permitted if the relevant statement must be made urgently such that prior notification to HM Treasury is not reasonably practicable.

Where APS Statements are not required by law or regulation, HM Treasury retains an absolute veto on such statements with the exception of unscripted oral statements (which are required to be consistent with other APS Statements).

RBS plc must also provide to HM Treasury an advanced draft of any material financial announcement in relation to the Group.

**Confidentiality obligations**

Under the Scheme Conditions, RBS plc and HM Treasury are obliged to keep confidential information which they or their representatives receive from the other under the Scheme Documents or in connection with the APS (or any information relating to negotiations, discussions or correspondence regarding the APS) confidential, subject to certain exceptions. The exceptions which apply to HM Treasury allow it to disclose such confidential information, to its representatives, the FSA, the Bank of England, the National Audit Office, the National Archive, the Cabinet Office, HMRC and any other government entity (or any of their successors), or to Parliament, any Parliamentary Committee, or otherwise, or any third party where it is necessary or HM Treasury considers it necessary to enable it to fulfil certain purposes as set out in sub-paragraph (v) of *Monitoring and reporting conditions* above. In the case of any disclosure to another government entity (or any of its successors), these may also be made for that entity's purposes rather than those of HM Treasury. In addition to such exceptions, HM Treasury may also disclose such confidential information (i) where required by applicable law, the rules of the Bank of England or any authority to which HM Treasury is subject, or (ii) to step-in managers (or proposed step-in managers) or the European Commission (where HM Treasury considers it necessary in connection with the application of the State aid rules or an EC decision relating to those rules for State aid purposes). Although HM Treasury has a duty to notify or consult with RBS plc in certain limited situations (i.e. disclosures to Parliament, a Parliamentary Committee or the European Commission) prior to disclosure, RBS plc has no powers to prevent such disclosure.

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Any information received by HMRC from HM Treasury as set out above may be held, retained or disclosed by HMRC as if it had been obtained by HMRC in accordance with applicable law. Pursuant to the Tax Loss Waiver, RBS has consented to the disclosure of information concerning RBS or its subsidiaries held by or on behalf of HMRC to HM Treasury, which information is subject to the confidentiality obligations under the Scheme Conditions described above.

Under the Scheme Documents, RBS plc is obliged to provide certain information to foreign regulators outside of the UK. However, in some of these cases RBS plc's confidentiality obligations restrict the transfer of HM Treasury confidential information outside of the UK by RBS plc without HM Treasury's permission (except where required to comply with any opinions or other confirmations considered desirable by HM Treasury in relation to the regulatory capital treatment of the APS in respect of RBS plc or a Covered Entity).

HM Treasury may publish RBS plc confidential information pursuant to its publication scheme (which allows it to publish information on its website), whether or not it receives a request for that information under the Freedom of Information Act 2000, but in deciding whether to publish RBS plc confidential information in this way HM Treasury must have due regard, in its sole opinion, as to whether such information would be exempt from disclosures under that Act. Such publication would not be in breach of HM Treasury's duty of confidence.

The Scheme Conditions contain other additional provisions which seek to ensure the correct treatment of inside information pursuant to FSMA and the Criminal Justice Act 1993.

RBS plc is permitted to use and transfer HM Treasury confidential information to its representatives and other members of the Group for the purpose of complying with its responsibilities and obligations and exercising its rights, powers and discretions under the APS. RBS plc may also disclose such information where required to by applicable law, the rules of the Bank of England or any authority, clearing system or securities exchange to which RBS plc is subject. RBS plc is obliged to consult with HM Treasury prior to any such disclosure and to limit that disclosure to the portion of the HM Treasury confidential information required to be disclosed.

Confidentiality provisions under the Scheme Conditions remain in force even when RBS plc ceases to be a participant in the APS. Unless required by applicable law, RBS plc must ensure that none of its Group or representatives will allow an obligor or counterparty to discover whether its asset is part of the APS or not.

**Behavioural Measures**

In connection with its participation in the APS, RBS has agreed to a number of behavioural commitments under the Accession Agreement.

RBS has undertaken to implement and maintain compliance with (until the earlier of 31 March 2011 and agreement with HM Treasury) the customer charter for lending to businesses in the UK in the form agreed with HM Treasury.

In addition, RBS has undertaken in relation to personal current accounts provided by it or any member of the Group to (i) implement in full (a) any agreements that the OFT has made with RBS as detailed in the OFT's report "Personal current accounts in the UK A follow up report, October 2009", relating to the transparency of costs to consumers and the process of switching accounts to another bank and (b) any agreements that the OFT may make with the banking industry relating to fees and charges, and the terms and conditions of personal current accounts and (ii) play a constructive role in any discussions between the banking industry and the OFT about fees and charges, and the terms and conditions of personal current accounts.

In addition to the behavioural commitments set out in the Accession Agreement, RBS has also separately undertaken to HM Treasury, subject to market conditions, statutory duties of directors and requisite approvals, to develop and implement a capital optimisation exercise designed to increase the Group's Core Tier 1 Capital.

**State Aid Commitment Deed**

At the same time as RBS's entry into the Accession Agreement, RBS has also entered into a State Aid Commitment Deed with HM Treasury which provides that RBS will comply or procure compliance with the measures and behavioural commitments as described in Part I, Appendix 4 of this document and any

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other commitments to be given to HM Treasury for the purpose of obtaining State aid approval. Further details of State Aid Deed are set out in paragraph 9.16 of Part IV of this document.

**Accounting**

Once the Group becomes party to the contractual arrangements, it will recognise a credit derivative at fair value. It will be measured subsequently at fair value with changes in fair value being recorded in profit or loss.

The existence of the APS will not affect the accounting treatment of the Covered Assets. These comprise assets classified as loans and receivables, held-for-trading, designated as at fair value through profit or loss and available-for-sale. The Group's accounting policy for such financial assets is summarised below.

Financial assets classified as loans and receivables are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost, using the effective interest method, less any impairment losses. Assets held-for-trading or designated as at fair value through profit or loss are measured at fair value with changes in fair value reflected in profit or loss. Financial assets classified as available-for-sale are measured at fair value. Impairment losses and exchange differences resulting from retranslating the amortised cost of non-Sterling currency monetary available-for-sale financial assets are recognised in profit or loss together with interest calculated using the effective interest method. Other changes in the fair value of available-for-sale financial assets are reported in a separate component of Shareholders' equity until disposal, when the cumulative gain or loss is recognised in profit or loss.

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**PART B COVERED ASSETS**

**Basis of asset selection**

The selection has been carried out primarily between February and April 2009 and was driven by three principal criteria:

- (1) Risk and degree of impairment in base case and stressed scenarios;
- (2) Liquidity of exposure; and
- (3) Capital intensity under procyclicality.

The approach for high volume commercial and retail exposures was on a portfolio basis. Selection for large corporates and GBM was at the counterparty/asset level. Set out below are the selection criteria for the affected divisions.

**Global Banking and Markets\***

Banking book: selection by individual asset pool (e.g., Corporate loans, Real estate finance, Leveraged finance), Global Restructuring Group (GRG) work-out unit counterparties/assets and high risk counterparties/assets. Additional counterparties/assets were selected through an individual risk review of the total portfolio.

**UK Corporate\***

Trading book: selection by individual assets (e.g., Monolines, Derivatives, Mortgage trading).  
Commercial & Corporate real estate: all defaulted assets in the work-out/restructuring unit or in high risk bands.

Corporate: all defaulted assets in the work-out/restructuring unit. Corporate banking clients in high risk sectors or with high concentration risk.

**UK Retail\***

Business Banking: portfolios in the work out/restructuring unit or in high risk bands.  
Mortgages: assets with higher Loan to Values ('LTV') and in higher risk segments (e.g. LTVs >97 per cent. on general book, LTVs >85 per cent. on buy-to-let book), and those assets in arrears (at 31 December 2008).

**Ulster Bank\*  
(Corporate & Retail)**

Loans and overdrafts: higher risk customers based on internal bandings, and those assets in arrears (as at 31 December 2008).

Mortgages: assets with greater than 85 per cent. LTV, broker mortgages and interest only with a higher probability of default.

Retail: portfolios of accounts in default, >1 month arrears, <2 years old and a higher probability of default.

Corporate: counterparties/assets in work-out/restructuring groups or in high risk bands, and other assets identified as part of an individual review of cases.

\*

including assets transferred to Non-Core Division





Table of Contents**Covered Assets by division**

The Covered Assets are allocated to the following Covered Asset Classes, as defined by Scheme Conditions, by division at 31 December 2008:

<b>Asset Class</b>	<b>UK Retail</b>	<b>UK Corporate</b>	<b>Global Banking &amp; Markets</b>	<b>Ulster Bank</b>	<b>Non-Core</b>	<b>Covered amount<sup>(1)</sup></b>
	<i>(£m)</i>	<i>(£m)</i>	<i>(£m)</i>	<i>(£m)</i>	<i>(£m)</i>	<i>(£m)</i>
Residential mortgage	10,280		128	2,837	2,182	15,427
Consumer finance	11,609	24,582		5,776	12,576	54,543
Bond			455		1,108	1,563
Loan		9,097	42,010	2,663	26,207	79,977
Lease finance		594			1,844	2,438
Project finance			425		1,818	2,243
Leveraged finance		4,978		329	22,427	27,734
Commercial real estate finance		12,436		1,268	26,146	39,850
Structured finance			10,497		8,694	19,191
Derivative			16,349	229	22,415	38,993
<b>Total</b>	<b>21,889</b>	<b>51,687</b>	<b>69,864</b>	<b>13,102</b>	<b>125,417</b>	<b>281,959</b>

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Note:

(1)

The covered amount specified above includes £3 billion of assets in the Derivative and Structured Finance Covered Asset Classes which, for technical reasons, do not currently satisfy, or are anticipated at some stage not to satisfy, the eligibility requirements of the Scheme Documents. HM Treasury and RBS plc have agreed to negotiate in good faith to establish as soon as practicable whether (and, if so, to what extent) coverage should extend to these assets. In addition, RBS has agreed that, on or prior to its accession to the APS, it will issue a withdrawal notice in respect of £1.2 billion of Covered Assets across a broad range of Covered Asset Classes in order to take them out of the APS. (See note (1) to the table in 2(a)).

Table of Contents**2. Asset coverage*****Basis of preparation***

Disclosures in this section are unaudited and have been extracted without material adjustment from the Group's management information systems that support reporting on Covered Assets to HM Treasury (the "APS system").

***(a) Roll forward of Covered Assets to 30 September 2009***

The table below provides an analysis of amount of covered assets at 31 December 2008 and the factors contributing to the decrease in covered amount at 30 September 2009.

	<b>£bn</b>
Covered Assets at 31 December 2008 as announced on 26 February 2009	325.0
asset pool refinements	(9.2)
Covered Assets at 31 December 2008 as published on 7 August 2009	315.8
Refinements and exclusions	
asset pool refinements	(1.1)
credit derivative product companies	(7.2)
derivatives buffer	(4.8)
conduits	(6.3)
reverse repurchase agreements	(5.2)
assets potentially eligible for other sovereign schemes	(6.9)
other asset removals	(2.3)
Covered Assets at 31 December 2008 as announced on 3 November 2009	282.0 <sup>(1)</sup>
Disposals, rollovers and repayments	(14.8)
Effect of foreign currency movements	(9.1)
Amortisations and other movements	(16.0)
Covered Assets at 30 September 2009	242.1 <sup>(1)</sup>

Note:

(1)

The covered amount specified above includes £3 billion (30 September 2009: £2.7 billion) of assets in the Derivative and Structured Finance Covered Asset Classes which, for technical reasons, do not currently satisfy, or are anticipated at some stage not to satisfy, the eligibility requirements of the Scheme Documents. HM Treasury and RBS plc have agreed to negotiate in good faith to establish as soon as practicable whether (and, if so, to what extent) coverage should extend to these assets. In addition, RBS has agreed that, on or prior to its accession to the APS, it will issue a withdrawal notice in respect of £1.2 billion (30 September 2009: £0.6 billion) of Covered Assets across a broad range of Covered Asset Classes in order to take them out of the APS.

Removals are a function of ineligibility in line with the Scheme rules, operational complexity, eligibility for other sovereign schemes and more economic forms of covering risk.



Table of Contents**(b) Covered Assets at 30 September 2009 and 31 December 2008**

The tables below show balances by asset classes<sup>(1)</sup>, as defined by the Scheme, with underlying product categories, at 30 September 2009 and 31 December 2008.

	30 September 2009				
	Carrying value <sup>(2)</sup> (a)	Provisions and adjustments to par value <sup>(3)</sup> (b)	Par value <sup>(4)</sup> (c)=(a)+(b) (£m)	Undrawn commitments and other adjustments <sup>(5)</sup> (d)	Covered amount <sup>(6)</sup> (e)=(c)+(d)
Residential mortgages	14,478	233	14,711		14,711
Consumer finance	38,221	4,185	42,406	8,510	50,916
Personal loans	7,586	2,320	9,906	1,372	11,278
Business and commercial loans	30,635	1,865	32,500	7,138	39,638
Commercial real estate finance	30,070	1,272	31,342	1,095	32,437
Leveraged finance	16,821	4,045	20,866	3,214	24,080
Lease finance	1,831	253	2,084	220	2,304
Project finance	1,689	44	1,733	285	2,018
Structured finance	7,721	7,345	15,066	1,665	16,731
Structured loans	1,702	359	2,061	423	2,484
Residential mortgage-backed securities	928	1,590	2,518	167	2,685
Commercial mortgage-backed securities	1,315	259	1,574	253	1,827
Collateralised debt and loan obligations	1,666	4,608	6,274	495	6,769
Other asset-backed securities	2,110	529	2,639	327	2,966
Loans	40,083	2,536	42,619	21,342	63,961
Bonds <sup>(7)</sup>	649	102	751	8	759
Derivatives	13,349	6,633	19,982	14,156	34,138
Monoline insurers	3,457	6,300	9,757	10,323	20,080
Other counterparties	9,892	333	10,225	3,833	14,058
<b>Total</b>	<b>164,912</b>	<b>26,648</b>	<b>191,560</b>	<b>50,495</b>	<b>242,055</b>
Loans and advances	144,895	12,927	157,822	35,089	192,911
Debt securities	6,668	7,088	13,756	1,250	15,006
Derivatives	13,349	6,633	19,982	14,156	34,138
<b>Total</b>	<b>164,912</b>	<b>26,648</b>	<b>191,560</b>	<b>50,495</b>	<b>242,055</b>
UK Retail	16,338	2,121	18,459	1,339	19,798
UK Corporate	37,133	773	37,906	10,258	48,164
Global Banking & Markets	33,349	1,507	34,856	20,566	55,422

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Ulster Bank	10,356	441	10,797	768	11,565
Non-Core	67,736	21,806	89,542	17,564	107,106
Total	164,912	26,648	191,560	50,495	242,055

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Table of Contents*Covered Assets at 30 September 2009 and 31 December 2008 (continued)*

	31 December 2008				
	Carrying value <sup>(2)</sup> (a)	Provisions and adjustments to par value <sup>(3)</sup> (b)	Par value <sup>(4)</sup> (c)=(a)+(b) (£m)	Undrawn commitments and other adjustments <sup>(5)</sup> (d)	Covered amount <sup>(6)</sup> (e)=(c)+(d)
Residential mortgages	15,283	144	15,427		15,427
Consumer finance	45,617	2,420	48,037	6,506	54,543
Personal loans	10,267	1,687	11,954	1,440	13,394
Business and commercial loans	35,350	733	36,083	5,066	41,149
Commercial real estate finance	32,131	847	32,978	6,872	39,850
Leveraged finance	19,792	2,875	22,667	5,067	27,734
Lease finance	2,012	138	2,150	288	2,438
Project finance	1,761	58	1,819	424	2,243
Structured finance	9,325	6,885	16,210	2,981	19,191
Structured loans	2,761	155	2,916	597	3,513
Residential mortgage-backed securities	1,165	1,471	2,636	143	2,779
Commercial mortgage-backed securities	1,357	238	1,595	257	1,852
Collateralised debt and loan obligations	1,825	4,565	6,390	1,380	7,770
Other asset-backed securities	2,217	456	2,673	604	3,277
Loans	50,285	1,420	51,705	28,272	79,977
Bonds <sup>(7)</sup>	1,467	(103)	1,364	199	1,563
Derivatives	21,093	6,575	27,668	11,325	38,993
Monoline insurers	5,620	5,892	11,512	10,758	22,270
Other counterparties	15,473	683	16,156	567	16,723
<b>Total</b>	<b>198,766</b>	<b>21,259</b>	<b>220,025</b>	<b>61,934</b>	<b>281,959</b>
Loans and advances	169,642	8,057	177,699	48,026	225,725
Debt securities	8,031	6,627	14,658	2,583	17,241
Derivatives	21,093	6,575	27,668	11,325	38,993
<b>Total</b>	<b>198,766</b>	<b>21,259</b>	<b>220,025</b>	<b>61,934</b>	<b>281,959</b>
UK Retail	18,909	1,565	20,474	1,415	21,889
UK Corporate	39,107	337	39,444	12,243	51,687
Global Banking & Markets	46,241	1,757	47,998	21,866	69,864
Ulster Bank	11,772	167	11,939	1,163	13,102
Non-Core	82,737	17,433	100,170	25,247	125,417
<b>Total</b>	<b>198,766</b>	<b>21,259</b>	<b>220,025</b>	<b>61,934</b>	<b>281,959</b>

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Notes:

- (1) The balances at 30 September 2009 (on page 70) within specific asset classes reflect the Group's application of the asset class definitions in the Scheme Conditions, particularly in relation to Consumer finance, Commercial real estate finance and Loans.
- (2) Carrying value represents the amounts recorded on the balance sheet and includes assets classified as loans and receivables ('LAR'), fair valued through profit or loss ('FVTPL') and available-for-sale ('AFS').
- (3) Provisions and adjustments to par value comprises:
- impairments on LAR and AFS debt securities
  - credit valuation adjustments relating to derivatives
  - adjustment to par value on other FVTPL assets
  - add-back of write-offs of £1,792 million in relation to LAR and FVTPL assets, as these are covered by the Scheme rules

Adjustments to par on AFS debt securities are included within column (d).



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- (4) Par value excludes adjustments relating to available-for-sale reserves on debt securities; these are included within column (d).
- (5) Undrawn commitments and other adjustments include:
- undrawn commitments and other contingent liabilities
  - potential future exposures and other adjustments to covered amount relating to derivative contracts
  - available-for sale reserves on AFS debt securities
  - adjustments relating to rollovers and refinancings that are specific to the Scheme rules (30 September 2009 only).
- (6) See note (1) to the table at 2(a) above in respect of assets included in the covered amount which do not satisfy the eligibility requirements of the Scheme Conditions or which it has been agreed will be withdrawn.
- (7) Comprises non asset-backed securities.

*(c) Credit impairments and write downs*

Cumulative credit impairment losses and adjustments to par value relating to Covered Assets are set out below:

	Closing balance	
	30 September 2009	31 December 2008
	(£m)	
Loans and advances	12,927	8,057
Debt securities	7,088	6,627
Derivatives	6,633	6,575
<b>Total</b>	<b>26,648</b>	<b>21,259</b>
UK Retail	2,121	1,565
UK Corporate	773	337
Global Banking & Markets	1,507	1,757
Ulster Bank	441	167
Non-Core	21,806	17,433
	26,648	21,259

In the nine months ended 30 September 2009, the Group recorded impairment losses of £10.8 billion and credit and other market losses of £5.1 billion of which £5.9 billion and £2.1 billion respectively related to assets covered by the Scheme.

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The amounts above include credit impairments and losses relating to Covered Assets referred to in Note (1) to the table at 2(a).

***(d) Risk elements in lending and potential problem loans***

Risk elements in lending (REILs) and potential problem loans (PPLs) for the Group and the amount relating to assets in the Scheme are set out below.

	<b>30 September 2009</b>		<b>31 December 2008</b>	
	<b>Group</b>	<b>APS</b>	<b>Group</b>	<b>APS</b>
	<i>(£m)</i>			
Non-performing loans	31,802	23,430	17,082	12,679
Other REIL	3,206	2,550	1,709	1,498
<b>Total REIL</b>	<b>35,008</b>	<b>25,980</b>	<b>18,791</b>	<b>14,177</b>
PPLs	619	558	226	187
<b>REIL and PPLs</b>	<b>35,627</b>	<b>26,538</b>	<b>19,017</b>	<b>14,364</b>
Core	11,881	7,658		
Non-Core	23,746	18,880		
	35,627	26,538		

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The internal reporting and oversight of risk assets principles are set out in the Group 2008 Report and Accounts credit risk section on page 90. The table below shows the credit quality of the Group's credit risk assets by risk bands and the proportion relating to assets in the Scheme.

Asset quality band	Probability of default		30 September 2009		31 December 2008	
			Group (£bn)	% relating to assets in the Scheme	Group (£bn)	% relating to assets in the Scheme
AQ1	0%	0.034%	106	2%	127	3%
AQ2	0.034%	0.048%	17	5%	26	16%
AQ3	0.048%	0.095%	27	7%	38	17%
AQ4	0.095%	0.381%	107	13%	150	15%
AQ5	0.381%	1.076%	135	22%	148	28%
AQ6	1.076%	2.153%	99	29%	103	36%
AQ7	2.153%	6.089%	48	39%	46	52%
AQ8	6.089%	17.222%	27	41%	26	46%
AQ9	17.222%	100%	18	66%	12	69%
AQ10	100%		38	79%	18	72%
Other <sup>(1)</sup>			44	5%	41	8%
			666	23%	735	24%

Note:

(1)

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

Reverse repurchase agreements, carrying value relating to net derivative positions and issuer risk relating to debt securities are excluded from both Group numbers and APS Covered Assets above.

*(f) Risk-weighted assets*

Risk-weighted assets (RWAs) were as follows:

	30 September 2009		31 December 2008	
	(£bn)	(%)	(£bn)	(%)
APS	165.5	28	158.7	27
Non APS	429.2	72	419.1	73
Group	594.7	100	577.8	100

30 September 2009		
APS	Non APS	Total
(£bn)		

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<b>Risk-weighted assets by division:</b>			
UK Retail	17.0	34.6	51.6
UK Corporate	32.8	58.2	91.0
Global Banking & Markets	26.9	105.0	131.9
Ulster	9.1	19.4	28.5
Other divisions	n/a	101.4	101.4
Core	85.8	318.6	404.4
Non-Core	79.7	110.6	190.3
Group	165.5	429.2	594.7

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**PART C REGULATORY CAPITAL IMPACT OF B SHARES AND APS**

**Regulatory capital impact of B Share issuance**

The subscription for £25.5 billion of B Shares will enhance RBS's Core Tier 1 Capital. RBS's Core Tier 1 Capital would be further enhanced if the additional £8 billion of B Shares are subscribed under the contingent capital arrangements.

***Regulatory capital impact of the APS***

*Methodology*

RBS will apply the FSA's securitisation framework to calculate the regulatory capital requirements associated with the Scheme. Broadly, the method for calculating the capital requirements impact of the Scheme (before the application of the cap described below the "Uncapped Basis") will be as follows:

RBS will deduct from capital resources the First Loss position after subtracting impairments to date (the "First Loss Deduction Amount"). The First Loss Deduction Amount will be split equally between Core Tier 1 and Tier 2 Capital.

RBS will risk weight at 0 per cent. its exposure to HM Treasury on 90 per cent. of (i) the portfolio of assets in the APS less (ii) an amount thereof equal to the First Loss.

RBS will risk weight in the normal way the remaining 10 per cent. of (i) the portfolio of assets in the APS, less (ii) an amount thereof equal to the First Loss.

In accordance with the applicable FSA rules, the total capital requirement for the assets covered by the Scheme (taking account of required deductions from capital resources), may be capped. This cap applies where the capital requirement (taking account of required deductions from capital resources), which would be applicable had the Scheme not been entered into (the "Non-APS Requirement") is lower than the capital requirement under the Uncapped Basis. For the purposes of determining the Non-APS Requirement, the capital requirement is calculated using an 8 per cent. ratio.

Where the cap applies, RBS will (i) exclude from calculations of its overall capital requirements an amount equal to the RWAs and deductions in relation to the assets covered by the APS; and (ii) deduct an amount equal to the Non-APS Requirement from its capital resources up to the First Loss Deduction Amount, with this deduction being split equally between Core Tier 1 and Tier 2 Capital; and (iii) take RWAs for any Non-APS Requirement in excess of the First Loss Deduction Amount (the "Capped Basis").

In accordance with regulatory rules and guidance as applicable to it, RBS will adjust the regulatory capital benefit of the protection where there is either a currency or maturity mismatch.

Maturity mismatches could occur if RBS decides to extend the maturity of any asset covered by the Scheme; and

Currency mismatches could occur if, for instance, RBS extends loans under multi-currency facilities that are not in the base currency of that facility.

These mismatches will have an impact upon the timing of the removal of the cap and level of regulatory capital benefit on the Uncapped Basis, but this effect is not expected to be material.

*Impact at Accession*

After accession, RBS expects initially to calculate its capital requirements in accordance with the Capped Basis. On this basis, the APS itself (viewed separately from the B Share issuance) will at accession have no impact on the Pillar 1 regulatory capital requirement in respect of the assets covered by the APS. (For the avoidance of doubt, as it is 10 per cent. of any such aggregate impact that is taken into account for the

purposes of the fees required to be paid by RBS on exit from the APS as described under *Asset withdrawal rights and termination rights* in Part I, Appendix 2 of this document, no such fee would arise unless and until there is such impact, as described in the following paragraph.) It will, however, improve the total capital ratios, and the Core Tier 1 Ratios, of the Group as a whole. It is also expected that the protection afforded by the APS will assist RBS in satisfying the forward looking stress testing framework applied by the FSA.

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*Future Regulatory Capital Effects*

As impairments on the pool of assets arise, these will be required to be deducted in full from Core Tier 1 Capital in the normal way. RBS will be entitled to apply these impairments to reduce the First Loss deduction for the Scheme, potentially leading to a position where the capital requirement on the Uncapped Basis would no longer for the assets covered by the APS exceed the Non-APS Requirement and, as a result, RBS would expect to start reporting the regulatory capital treatment on the Uncapped Basis.

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**APPENDIX 3 TO THE LETTER FROM THE CHAIRMAN OF RBS PRINCIPAL TERMS OF ISSUE OF THE B SHARES AND THE DIVIDEND ACCESS SHARE**

If Resolutions 2, 3, 5 and 6 are passed by Shareholders and Resolution 1 is passed by Independent Shareholders at the General Meeting, RBS expects to issue to HM Treasury (i) £25.5 billion of B Shares (the "Initial B Shares") and (ii) the Dividend Access Share at the time of entering into the APS. Terms used but not defined in this Appendix 3 are as defined in Annex 1 and, in the event of any inconsistency with the definitions in Part VI of this document, the definitions in Annex 1 shall prevail.

For technical reasons, RBS will issue the Initial B Shares and Dividend Access Share in consideration for the transfer to it by HM Treasury of certain issued ordinary and the entire issued redeemable preference share capital of an English incorporated subsidiary of RBS ("Cash Box Co"), which will result in RBS owning the entire issued share capital of Cash Box Co, the only assets of which will be cash resources. These resources will represent the net proceeds of the issue of the Initial B Shares and Dividend Access Share. This structure is expected to have the effect of creating distributable reserves to the extent that realised profits are generated on the redemption of the redeemable preference shares. Any issue of the Contingent B Shares may also be structured in this way.

**Acquisition and Contingent Capital Agreement**

On 26 November 2009, RBS and HM Treasury entered into the Acquisition and Contingent Capital Agreement pursuant to which HM Treasury has agreed to subscribe for the Initial B Shares and the Dividend Access Share (the "Acquisitions") and has agreed the terms of HM Treasury's subscription for an additional £8 billion in aggregate in the form of further B Shares (the "Contingent B Shares"), which will be issued on the same terms as the Initial B Shares.

*Initial subscription of £25.5 billion B Shares and the Dividend Access Share*

The Acquisitions are subject to the satisfaction of certain conditions ("Conditions Precedent") (unless waived by HM Treasury in its sole discretion), including: (i) the satisfaction or waiver of all conditions to RBS plc's participation in the APS; (ii) the European Commission having decided that all State aid received by RBS to date, and any State aid that may be provided to RBS under the APS and as a consequence of the Acquisitions and the purchase of any Contingent B Shares, is aid compatible with article 87 of the consolidated version of the Treaty establishing the European Community (subject to the commitments given in respect thereof by HM Treasury); (iii) HM Treasury and RBS having obtained such approvals (including parliamentary approvals), authorisations, permits and consents as may be required by any governmental, state or other regulatory body in any part of the world, and all necessary filings having been made, as a result of the Acquisitions; (iv) RBS having obtained the approval of its shareholders in relation to the Acquisition; (v) there being, in the opinion of HM Treasury (acting in good faith), no material adverse change in the position of the Group between the date of the Acquisition and Contingent Capital Agreement and the date of satisfaction of all other Conditions Precedent; and (vi) HM Treasury being satisfied that the Acquisitions continue to be proportionate and appropriate for the maintenance of the financial stability of RBS, each in the context of the general economic and market conditions then prevailing. HM Treasury will be able to terminate the Acquisitions either on the grounds specified in (vi) above, or if any other Condition Precedent is not satisfied and HM Treasury does not consider the Acquisitions to be necessary in order to maintain the financial stability of the United Kingdom.

*Contingent Subscription*

RBS and HM Treasury further agreed the terms of the £8 billion Contingent Subscription in the Acquisition and Contingent Capital Agreement. For a period of five years from the Issue Date or, if earlier, until the occurrence of a Termination Event or until RBS decides (with FSA consent) to terminate such Contingent Subscription (the "Contingent Period"), if the Core Tier 1 Ratio of RBS falls below five per cent. (and if certain other conditions are met, including that the European Commission's decision that the aid is compatible with article 87 of the consolidated version of the Treaty establishing the European Community continues to be in force, that the European Commission has not opened a formal investigation under article 88(2) of such treaty in relation to the possible misuse of aid, that there has been no breach by RBS of the State Aid Commitment Deed and that no Termination Event has occurred) HM Treasury has committed to subscribe for the Contingent B Shares in no fewer than two



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tranches of £6 billion and £2 billion (or such smaller amounts as RBS and HM Treasury may agree). Any unused portion of the £8 billion may be subscribed in one or more further tranches.

*Fee*

RBS may, subject to certain conditions, at any time terminate the Contingent Subscription in whole or in part, with the consent of the FSA. RBS is required to pay an annual fee, for the Contingent Period, in relation to the Acquisitions and the Contingent Subscription of £320 million less four per cent. per annum of the value of any B Shares subscribed for under the Contingent Subscription. Such fee is payable in cash or, with HM Treasury's consent, by waiving certain UK tax reliefs that are treated as deferred tax assets (pursuant to the Tax Loss Waiver) or through a further issue of B Shares to HM Treasury. The annual fee ceases to be payable on termination of the Contingent Subscription and if RBS terminates the Contingent Subscription in part, the fee will reduce proportionately.

*Warranties*

On the date of the Acquisition and Contingent Capital Agreement, on the date the Circular is posted to Shareholders, on the first date on which all of the Conditions Precedent are satisfied, or waived, on the date of the Acquisition(s), on each date (if any) a Contingent Subscription is triggered and on each date (if any) on which B Shares are issued pursuant to a Contingent Subscription, RBS will give certain representations and warranties to HM Treasury.

*Expenses*

RBS has agreed to reimburse HM Treasury for its expenses incurred in connection with the Acquisitions and, if the Contingent Subscription is exercised, the Contingent B Shares.

*Undertakings*

The Company has agreed to a number of undertakings under the Acquisition and Contingent Capital Agreement, including those summarised below.

RBS has undertaken that it will not, and will procure that no B Share Group company will, at any time before the expiry of the Contingent Period: (i) pay or make any dividends or other distributions or make any interest or coupon payment or payment of a similar nature (in each case whether in cash or otherwise) on any shares, Innovative Tier 1 Instruments or Upper Tier 2 Instruments issued by RBS or by any B Share Group company (other than Mandatory Securities) and that it will not, and will procure that no B Share Group company will, set aside any sum for the payment of any such dividends or amounts; and (ii) redeem, purchase or otherwise acquire for any consideration any shares, Innovative Tier 1 Instruments or Upper Tier 2 Instruments issued by RBS or by any B Share Group company or any depository or other receipts or certificates representing such securities or instruments, or set aside any sum, or establish any sinking fund for the redemption, purchase or other acquisition of such securities or instruments or any depository or other receipts or certificates representing such securities or instruments, in each case the result or consequence of which would be that following such occurrence the Core Tier 1 Ratio of RBS would remain or fall below 6 per cent.

The undertakings set out in the immediately preceding paragraph will not apply to: (i) the payment or making of any dividends or other distributions or the setting aside of any sum for the payment of such dividends or distributions (a) by any wholly owned Group Company to any other wholly owned Group Company and (b) by any non-wholly owned B Share Group Company to any person which is not a wholly owned B Share Group Company to the extent the payment or making of such dividends or other distributions or the setting aside of any sum for the payment of such dividends or distributions is required by the terms of any legally binding obligation in existence at the date of the Acquisition and Contingent Capital Agreement; (ii) the redemption, purchase or acquisition for consideration by any wholly owned B Share Group Company of any securities or instruments issued by any other wholly owned B Share Group Company or of any depository or other receipts or certificates representing such securities or instruments, or the setting aside of any sum, or the establishment of any sinking fund for the redemption, purchase or other acquisition of such securities or instruments or any depository or other receipts or certificates representing such securities or instruments; (iii) the redemption or purchase or acquisition for consideration by any B Share Group Company of any securities or instruments issued by any non-wholly owned B Share Group Company or of any depository or other receipts or certificates representing such securities or instruments, or the setting aside of any sum, or the establishment of any

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sinking fund for the redemption, purchase or other acquisition of such securities or instruments or any depository or other receipts or certificates representing such securities or instruments where such redemption, purchase or acquisition is required to be made by the terms of any legally binding obligation in existence at the date of the Acquisition and Contingent Capital Agreement; (iv) the payment of coupons on the ABN Securities for so long as permitted under the State Aid Commitment Deed; (v) the payment of dividends or other distributions (whether in cash or in kind) or return of capital in any other form (a) by subsidiaries and/or subsidiary undertakings of RFS Holdings BV to their shareholders and ultimately to RFS Holdings BV and (b) by RFS Holdings BV to shareholders of RFS Holdings BV, in each case to the extent required (in the reasonable opinion of RBS) to achieve segregation, Separation and the capital restructuring of RFS Holdings BV; (vi) the purchase of Ordinary Shares in connection with any employee share scheme of the Company or any member of the B Share Group; (vii) any action taken by the Company or any member of the B Share Group pursuant to any liability management exercise, which exercise has been approved in advance by HM Treasury; (viii) any action taken in accordance with the B Share Terms or the terms of the Convertible Preference Shares in respect of their conversion to Ordinary Shares; (ix) any action which has no effect on, or has the effect of increasing, the Core Tier 1 Ratio; or (x) any other action taken by the Company or any member of the B Share Group with the prior approval of HM Treasury.

HM Treasury and the Company have acknowledged in the Acquisition and Contingent Capital Agreement that it is their current expectation that in relevant circumstances, and acknowledging the conversion feature applicable to the B Shares set out in the B Share terms, the Company will repurchase the B Shares if it is prudent and practicable. Such repurchase would be subject to FSA approval and take account of the Regulatory Group's capital position at the time of the proposed repurchase and prevailing market conditions.

The Company has been informed by HM Treasury that HM Treasury has agreed the matters set out below with the European Commission. The Company is not a party to this agreement.

- (i) That without the prior approval of the European Commission, it will not agree to sell to the Company any B Shares issued to and held by HM Treasury below the following minimum purchase prices: (a) for purchases before 31 December 2012, 50p; (b) for purchases between 31 December 2012 and 30 December 2013, 55p; (c) for purchases between 31 December 2013 and 30 December 2014, 60p; and (d) for purchases from 31 December 2014, 65p.

In each of these cases, if the price of the Ordinary Shares is higher than the above agreed price when the sale is agreed, the price of the Ordinary Shares will be the minimum price. Each minimum purchase price would be adjusted in line with adjustments under paragraph 4(l) of the B Share terms.

- (ii) That without the prior approval of the European Commission, it will not convert any B Shares issued to and held by it into Ordinary Shares unless the market price of Ordinary Shares is at least 50p on the date on which HM Treasury delivers its Conversion Notice. This price is subject to adjustment in line with adjustments to the Conversion Price.

- (iii) If the capital position of the Company allows this and subject to any consent required from the FSA, it will request the Company to purchase from it an appropriate number of B Shares (within the above-mentioned price parameters) or to retire an appropriate amount of the Contingent Subscription.

HM Treasury and RBS have agreed in the Acquisition and Contingent Capital Agreement that they will negotiate in good faith with a view to agreeing any necessary amendments to the terms of the Contingent Subscription which may be necessary as a result of future legislative or regulatory changes so as to preserve the effect of the Contingent Subscription as at the date of the Acquisition and Contingent Capital Agreement.

In the event that the B Shares or Dividend Access Share cease to be eligible as Core Tier 1 Capital then, if and to the extent that B Shares or the Dividend Access Share are held by or on behalf of HM Treasury and/or the Contingent Subscription remains capable of exercise in respect of any Contingent B Shares at such time, HM Treasury and RBS have agreed to negotiate in good faith with a view to agreeing such amendments to the B Share terms and/or the Dividend Access Share terms as may be necessary, after consultation with the FSA, to enable the B Shares and the Dividend Access Share to be eligible as Core Tier 1 Capital. Until the later of the end of the Contingent Period and HM Treasury ceasing to hold any B Shares, RBS has undertaken that, notwithstanding the terms of the B Shares, it will not amend or seek

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to amend the terms of the B Shares or the Dividend Access Share without the prior written consent of HM Treasury.

All of the B Shares and the Dividend Access Share will constitute Core Tier 1 Capital. The B Shares will all be issued on the same terms.

RBS has also agreed to certain restrictions with respect to its share premium account, including an undertaking that it shall not, without the prior written consent of HM Treasury, issue any convertible securities, the conversion of which would require the capitalisation of any amount standing to the credit of RBS's share premium account or which would otherwise prejudice or adversely affect any conversion of the B Shares. RBS has also undertaken that, except as required by law and otherwise in connection with (a) the conversion of the B Shares and the Convertible Preference Shares in accordance with their terms of issue and/or the Articles and (b) subject to the provisions of the Companies Act, any write-offs of commission against share premium generated through future share issues, it shall not, directly or indirectly take or omit to take any action designed to or which results in or which might reasonably be expected to cause or result in, the amount standing to the credit of its share premium account being reduced. RBS has also undertaken to not, directly or indirectly: (a) take or omit to take any action designed to or which results in or which might reasonably be expected to cause or result in any increase in the nominal value of the Ordinary Shares; or (b) permit any circumstances to arise which might, directly or indirectly, lead to any increase in the nominal value of the Ordinary Shares, without the prior written consent of HM Treasury. If at any time HM Treasury reasonably believes that RBS will have insufficient reserves to permit the conversion of B Shares into Ordinary Shares, HM Treasury may require RBS (at RBS's option) to either capitalise reserves so as to increase the nominal value of the B Shares to at least the nominal value of the Ordinary Shares or to sub-divide the Ordinary Shares into ordinary shares with a nominal value equal to or less than the nominal value of the B Shares.

*Use of Proceeds*

RBS has agreed in the Acquisition and Contingent Capital Agreement to use the proceeds of any redemption by Cash Box Co of the redeemable preference shares transferred to RBS by HM Treasury in connection with the Acquisition and the proceeds of any issue of Contingent B Shares in such manner, in such form and for such purposes as may be agreed with HM Treasury, the FSA and the Bank of England.

*Waiver of statutory pre-emption rights*

HM Treasury has agreed in the Acquisition and Contingent Capital Agreement 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 RBS other than B Shares and has agreed to vote its B Shares and the Dividend Access Share, 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. The pre-emption rights arising out of the B Shares and the Dividend Access Share will also be disapplied in the Articles of Association.

*Limitations on conversion of the B Shares*

HM Treasury has agreed in the Acquisition and Contingent Capital Agreement 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 RBS 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 RBS.

*Voting rights of the B Shares*

HM Treasury has agreed in the Acquisition and Contingent Capital Agreement 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 other 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 RBS.

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*Related party transactions*

For as long as it is a substantial shareholder of RBS (within the meaning of the Listing Rules), HM Treasury has undertaken in the Acquisition and Contingent Capital Agreement not to vote on related party transaction resolutions at general meetings and to direct that its affiliates do not so vote.

***Description of the B Shares and the Dividend Access Share***

The terms of the B Shares and the Dividend Access Share include the following and the full terms of issue of the B Shares are set out in Annex 1, Part A and the full terms of issue of the Dividend Access Share are set out in Annex 1, Part B. The summary below is qualified in its entirety by Annex 1 and, in the event of any inconsistency, Annex 1 shall prevail:

*Nominal value of the B Shares and the Dividend Access Share*

£0.01 per B Share and £0.01 in relation to the Dividend Access Share. The B Shares and the Dividend Access Share will be fully paid up at issue.

*Ranking of the B Shares and the Dividend Access Share*

On a winding-up, holders of the B Shares and the Dividend Access Share will rank equally with the holders of the Ordinary Shares and any other class of shares or securities of the Company in issue or which may be issued by the Company which rank or are expressed to rank equally with the B Shares, the 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 B Share and the holder of the Dividend Access Share will be deemed to hold one (as adjusted from time to time, the "Winding Up Ratio") Ordinary Share of RBS for every B Share or, as the case may be, the Dividend Access Share held at the date of the commencement of such winding-up and will be entitled to receive out of the surplus assets of RBS 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 entitlement of the B Shares*

Prior to the occurrence of a Trigger Event in respect of any B Shares, such B Shares shall rank equally with the holders of Ordinary Shares in respect of any cash dividends and each B Share shall 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 B Shares, the B Shares in respect of which the Trigger Event has occurred shall rank *pari passu* with the holders of the Ordinary Shares in respect of any dividends paid on the Ordinary Shares. Each B Share shall 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 an Ordinary Share Bonus Issue is made, a holder of a B Share in respect of which the Trigger Event has occurred shall 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 per cent. of the total issued Ordinary Shares then such holder shall instead receive further B Shares of the same value.

*Dividend entitlement of the Dividend Access Share*

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. Subject to the discretions, limitations and qualifications described in this section "Description of the B Shares and the Dividend Access Share" and in the terms of the Dividend Access Share, non-cumulative dividends on the Dividend Access Share will be payable from the date RBS issues the Dividend Access Share in respect of the period up to and including the Class B Dividend Stop Date (if any). RBS will pay dividends on the Dividend Access Share when, as and if declared by the 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 "Description of the B Shares and the Dividend Access Share" and in the terms of the Dividend Access Share, the Dividend Access Share shall entitle the holder

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thereof to receive out of the distributable profits of RBS 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 B Share and *pari passu* in such regard with the holder of any other dividend access share then in issue.

The Board of Directors shall, by 31 October in each financial year of RBS, 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 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 Dividend Access Share shall 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 shall 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 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 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). Any first 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.

The Board of Directors shall, by 31 May in each financial year of RBS, 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 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 Dividend Access Share shall 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 shall 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 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 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). Any 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 Dividend Access Share shall be equivalent to (A) the greater of:

- (i) 7 per cent. 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, the Issue Date, to (and including) the current Relevant Date or, if there has occurred prior to such current Relevant Date a Class B Dividend Stop Date in respect of any B Shares, then in respect of those B Shares, to (and including) such earlier Class B Dividend Stop Date, divided by 365 (or 366 in a leap year) and
- (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, the Issue Date to (and including) the current Relevant Date or, if there has occurred prior to such current Relevant Date a Class B Dividend Stop Date in respect of any B Shares, then in respect of those B Shares, to (and including) such earlier Class B Dividend Stop Date, 250 per cent. (as adjusted from time to time as described in Annex I, Part B, the "Participation Rate") of the aggregate Fair Market Value of such cash dividend or cash dividends or Ordinary Share

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Bonus Issue per Ordinary Share multiplied by the then Reference 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 shall 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 of the aggregate amount of any dividend or distribution paid or made on the B Shares and/or on any Ordinary Shares issued on conversion of the B Shares (regardless of who holds such B Shares or Ordinary Shares at the relevant time) in the period from (but excluding) the immediately preceding Relevant Date or, if none, the Issue Date to (and including) the current Relevant Date (or, if there has occurred prior to such current Relevant Date a Class B Dividend Stop Date in respect of any B Shares, then in respect of those B Shares to (and including) such earlier Class B Dividend Stop Date), provided that the first semi-annual Dividend Access Share Dividend shall never be less than zero.

If paid or made, the second semi-annual Dividend Access Share Dividend on the Dividend Access Share shall be equivalent to (A) the greater of:

- (i) 7 per cent. of the Reference Amount multiplied by the actual number of days in the period from (but excluding) the Relevant Date falling on (or nearest to) one year prior to the current Relevant Date or, if none, the Issue Date to (and including) the current Relevant Date or, if there has occurred prior to such current Relevant Date a Class B Dividend Stop Date in respect of any B Shares, then in respect of those B Shares, to (and including) such earlier Class B Dividend Stop Date divided by 365 (or 366 in a leap year) and
- (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 Relevant Date falling on (or nearest to) one year prior to the current Relevant Date or, if none, the Issue Date to (and including) the current Relevant Date or, if there has occurred prior to such current Relevant Date a Class B Dividend Stop Date in respect of any B Shares, then in respect of those B Shares, to (and including) such earlier Class B Dividend Stop Date the Participation Rate of the aggregate Fair Market Value of such cash dividend(s) or Ordinary Share Bonus Issue(s) per Ordinary Share multiplied by the then Reference 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 shall 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 of the aggregate amount of any dividend or distribution paid or made on the B Shares and/or on any Ordinary Shares issued on conversion of the B Shares (regardless of who holds such B Shares or Ordinary Shares at the relevant time) in the period from (but excluding) the Relevant Date falling on (or nearest to) one year prior to the current Relevant Date or, if none, the Issue Date to (and including) the current Relevant Date (or, if there has occurred prior to such current Relevant Date a Class B Dividend Stop Date in respect of any B Shares, then in respect of those B Shares to (and including) such earlier Class B Dividend Stop Date) and less the Fair Market Value of the immediately preceding first semi-annual Dividend Access Share Dividend or Bonus Issue paid or made (if any), provided that the second semi-annual Dividend Access Share Dividend shall 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, shall 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 in respect thereof shall 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 Dividend Access Share, the Company shall make such changes to the Dividend Access Share Dividend payment

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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 Dividend Access Share will be payable in respect of the period up to and including the Class B Dividend Stop Date (if any). After the Class B Dividend Stop Date (if any), the right of the holder of the Dividend Access Share to Dividend Access Share Dividends in respect of any B Shares in issue during each of the 30 consecutive dealing days during which the Trigger Event occurs shall cease, but this is without prejudice to the right to Dividend Access Share Dividends in respect of any B Shares not in issue on each such day.

"Class B Dividend Stop Date" means the date falling 20 days after the Trigger Event.

"Reference Amount" means £25,500,000,000 plus the aggregate Relevant Amount of any further B Shares issued by the Company to HM Treasury after the Issue Date and before the record date for the relevant Dividend Access Share Dividend, less the aggregate Relevant Amount of any B Shares which were in issue during the 30 consecutive dealing days during which a Trigger Event occurred.

"Reference Class B Shares Number" means the Reference Amount divided by the Relevant Amount.

*Bonus Issue on the 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 shall be paid in whole or in part by the Company issuing B Shares, credited as fully paid, to the holder of the Dividend Access Share. The number of such further B Shares to be issued to the holder shall be such number of B Shares as shall be 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 Dividend Access Share, based on the Fair Market Value of a B Share at the time of such determination. A written opinion of such Independent Financial Adviser in respect thereof shall be conclusive and binding on all parties, save in the case of manifest error. The additional B Shares so allotted shall rank *pari passu* in all respects with the fully paid B Shares then in issue save only as regards participation in the relevant dividend.

*Restrictions following non-payment of dividend on the Dividend Access Share*

If any Dividend Access Share Dividend is not declared and paid in full in cash or otherwise, RBS:

- (i) may not, and shall procure that no member of the B Share Group shall, declare or pay dividends or other distributions upon 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 RBS may not, and shall procure that no member of the B Share Group shall, set aside any sum for the payment of these dividends or distributions; and
- (ii) may not, and shall procure that no member of the B Share Group shall, 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 Annex 1, Part A of this document)), and (save as aforesaid) RBS may not, and shall procure that no member of the B Share Group 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 depository 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.

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*Redemption rights of the B Shares and the Dividend Access Share*

There are no redemption rights in the B Shares (save in conjunction with conversion) and the Dividend Access Share, but RBS may purchase the B Shares at any time and/or the Dividend Access Share at any time, subject to applicable laws and FSA consent.

*Optional conversion rights under the B Shares*

At any time from the date on which the B Shares are issued, a holder of a B Share may deliver a notice to RBS requesting conversion of B Shares into Ordinary Shares of RBS. The number of Ordinary Shares to be issued upon conversion will be determined by dividing the aggregate Relevant Amount (£0.50 per B Share on issue) of the B Shares being converted by the conversion price (as adjusted from time to time, the "Conversion Price"). The initial Conversion Price of the B Shares will be £0.50.

*Transferability of the B Shares and the Dividend Access Share*

The Dividend Access Share shall not be transferable save to any entity which is wholly owned, directly or indirectly, by HM Treasury. The B Shares will be freely transferable.

*Voting rights under the B Shares before conversion and under the Dividend Access Share*

Holders of the B Shares and the Dividend Access Share will only have voting rights in limited circumstances (resolutions varying/abrogating class rights and resolutions proposing the winding-up of RBS). If entitled to vote, on a poll holders of B Shares will have two votes for each B Share held and the holder of the Dividend Access Share will have one vote. In the Acquisition and Contingent Capital Agreement HM Treasury has agreed that it shall not be so entitled to vote the B Shares or the Dividend Access Share to the extent the votes cast on such B Shares and/or 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 RBS.

*Ordinary Share buy-back*

Until HM Treasury or its nominee(s) cease to hold any interest in the B Shares, RBS may not purchase any of its Ordinary Shares, other than purchases which are made in connection with any Employee Share Scheme or purchases from HM Treasury or its nominee(s).

*Listing*

The B Shares will not initially be listed on any stock exchange. HM Treasury is entitled to require RBS to seek a listing of the B Shares. The Dividend Access Share will not be listed on any stock exchange.

*Adjustment events*

The Winding Up Ratio, Relevant Amount, Participation Rate and Conversion Price shall be adjusted in accordance with standard Euro-market anti-dilution adjustments for events affecting the Ordinary Shares other than customary change of control adjustments or dividend adjustments, as described more fully in the full terms of issue of the B Shares set out in Annex 1, Part A and the full terms of issue of the Dividend Access Share are set out in Annex 1, Part B, as applicable. The Relevant Amount shall also be adjusted in the event of a consolidation, reclassification or subdivision in relation to the B Shares.

*Regulatory approvals*

The issuance of any B Shares in satisfaction of the Acquisitions and the Contingent Subscription and the issuance of any B Shares which may be applied in satisfaction of the annual fee for the APS and the annual fee for the Contingent Subscription are subject to regulatory approvals in a number of jurisdictions including, Australia, Canada, Chile, Ireland, the Netherlands, New Zealand and Thailand.



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**APPENDIX 4 TO THE LETTER FROM THE CHAIRMAN OF RBS KEY TERMS OF THE STATE AID RESTRUCTURING PLAN**

As a result of the State aid granted to RBS through the First Placing and Open Offer, the issuance of £25.5 billion of B Shares to HM Treasury, a commitment by HM Treasury to subscribe up to an additional £8 billion of B Shares and the Group's participation in the APS, RBS has been required to work with HM Treasury to submit a State aid restructuring plan to the Commission for approval under the State aid rules. These State aid rules require that the aid is limited to the minimum necessary, that the aided firm can return to viability without state support and that efforts have been made to minimise distortions to competition.

To meet these requirements, RBS has agreed, in principle and subject to approval by the College, a series of measures to be implemented over a four year period, which supplement the measures in the strategic plan already announced by RBS.

To minimise distortions to competition caused by rescue and restructuring support for RBS, the Commissioner and HM Treasury have agreed in principle that RBS will reduce its presence in the UK banking sector. The divestment associated with this will encompass the disposal of the RBS branch-based business in England and Wales, the NatWest branches in Scotland, along with Direct SME customers across the UK. This will result in the disposal of 318 branches UK-wide (14 per cent. of the Group's UK retail network) and the appropriate infrastructure to support this business.

RBS has committed that the SME and mid-corporate customers that form part of the UK banking divestment will amount to 5 per cent. of all SME and mid-corporate customers in the UK respectively. This divestment represents a reduction in RBS's UK market share by approximately two percentage points in Retail banking.

In addition, between now and the end of 2013, RBS will divest RBS Insurance (subject to potentially maintaining a minority interest until the end of 2014) which has a market-leading position in the UK, RBS's interest in RBS Sempra Commodities, a leading global commodities trader, and Global Merchant Services, RBS's card payment acquiring business, which has a top five global market share, subject to RBS retaining an ownership interest of up to 20 per cent. of each business within Global Merchant Services, if required by the purchaser.

The Board will seek to time these disposals to maximise value and they may be effected through initial public offerings, agreed sales or a combination of these and accordingly timetable and process will vary.

RBS has also agreed with the Commissioner in principle that if either:

- (i) the RBS Core Tier 1 Capital Ratio (calculated by reference to the regulatory rules in force as at 31 December 2009) declines to below 5 per cent. at any time before 31 December 2014, or
- (ii) RBS falls short of its funded balance sheet target level (after certain adjustments) by 31 December 2013 by £30 billion or more,

RBS will reduce RWAs by a further £60 billion through further disposals of identifiable businesses and associated assets.

RBS has committed to appoint a hold separate manager to manage the UK banking business to be divested, within six months of final State aid approval. The hold separate manager will oversee the management of the business, in its best interests, in consultation with RBS and consistent with the Board of RBS's fiduciary duties to RBS's Shareholders. The appointment of the hold separate manager will not prevent the business from having access to infrastructure and personnel of RBS, where appropriate for the efficient conduct of the business, nor will it prevent the transfer of information between the business and the remainder of RBS.

Set out below is a description of the businesses impacted by these measures:

**UK branch divestment.** This includes a combination of a branch network, customers, staff and supporting infrastructure. It consists of the RBS branch-based business in England and Wales, the NatWest branches in Scotland and the Direct SME customer base. Banking infrastructure will also include 40 business and commercial banking centres, four corporate banking centres, two direct business banking centres, three personal relationship manager centres and three operational centres. The Williams & Glyn's brand name will also be available to an acquirer. The UK branch divestment includes 318 branches, 1.7 million retail customers and 230,000 SME customers.



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

**Global Merchant Services** enables clients to accept card payments either at point of sale or over the Internet. It is the fourth largest provider of global card payment services, enabling over 5 billion card transactions to be made each year. It meets the rapidly changing and increasingly sophisticated needs of clients to accept card payments on a global, efficient and secure basis.

**RBS Sempra Commodities** is a leading global commodities trader. It provides liquidity and is a partner for several of the world's largest producers and consumers of energy, metals and other commodities. RBS Sempra Commodities offers trading, market making and risk management solutions to its extensive customer network. It is the fifth largest energy trading company in North America.

RBS has also agreed to a number of behavioural commitments including the requirement for GBM's ranking to be no higher than number five in the combined global all debt league tables for three years. This includes all bonds globally and all syndicated loans globally measured in US dollars. It excludes self-led, self-funded, money market, short term deals and other debt not eligible for inclusion under Dealogic standard industry criteria for published league tables. RBS has also agreed not to restart or set up, or acquire or re-acquire any ownership interest in, a business that competes with any of RBS Insurance, Global Merchant Services or RBS Sempra Commodities until the end of 2014.

RBS will enter into a commitment that, from 1 January 2010 until 31 December 2013, it will be at the leading edge of implementing the G-20 principles, the FSA Remuneration Code and any remuneration proposals accepted by the UK Government from the Walker Review that are implemented in regulations.

In addition, RBS has undertaken that, unless otherwise agreed with the Commission, neither RBS nor any of its direct or indirect subsidiaries (excluding any companies in the ABN AMRO Group) will pay investors any dividends or coupons on existing hybrid capital instruments (including preference shares, B shares and upper and lower tier-2 instruments) from a date starting not later than 30 April 2010 and for a period of two years thereafter (the "Deferral Period") or exercise any call rights in relation to the same between 24 November 2009 and the end of the Deferral Period, unless there is a legal obligation to do so. Hybrid capital instruments issued after 24 November 2009 will generally not be subject to the restriction on dividend or coupon payments or call options.

Unless the Commission agrees otherwise, the hybrid capital instruments existing on 24 November 2009 which are retained in the ABN AMRO Group after Separation is complete will be subject to a restriction on the payment of dividends and coupons and on the exercise of any call rights, unless in any such case there is a legal obligation to do so, for an effective period of two years after the proposed capital restructuring of RFS Holdings B.V. (which is intended to take place soon after Separation) and following the expiry of any "pusher" periods following Separation and such capital restructuring.

RBS has agreed not to acquire any financial institutions and not to make any other acquisitions the purpose of which is to expand RBS's activities outside of its business model, until the later of 31 December 2012 and the date on which the last of the agreed divestments has been divested (save that RBS shall be permitted to make such acquisitions if the cumulative purchase price excluding the assumption of debt paid by RBS for all such acquisitions in this period is less than £500 million).

RBS has agreed that for a period of five years it will not restart (including by acquisition) any activity that it only carries on by virtue of the Non-Core Activities (which means those activities forming part of the Non-Core Division of RBS as referred to in RBS's Interim Results for the half year ending 30 June 2009).

The Company has agreed in principle with the Commission to use reasonable endeavours to develop and, subject to market conditions and requisite approvals, implement a plan to continue the improvement and optimisation of its capital base in a manner which is consistent with the principles of burden sharing.

Whilst the restructuring measures set out above follow substantial discussions with the Commission and HM Treasury, RBS notes that the State aid restructuring plan is subject to a decision by the College on the compatibility of the overall RBS aid package with the State aid rules and, therefore, at this stage there can be no certainty as to the outcome of the State aid proceedings and the content of the final State aid restructuring plan.

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**APPENDIX 5 TO THE LETTER FROM THE CHAIRMAN OF RBS GENERAL MEETING AND ACTION TO BE TAKEN BY SHAREHOLDERS**

**General Meeting**

The accession to and participation in the APS, the B Share Issue and any other issue of B Shares to HM Treasury pursuant to the Accession Agreement and the Acquisition and Contingent Capital Agreement and the issue of the Dividend Access Share to HM Treasury constitute a related party transaction for the purposes of the Listing Rules. In addition, certain other shareholder approvals are required to implement the Transaction. Accordingly, the Transaction is conditional, amongst other things, upon the approval of Shareholders (including HM Treasury to the extent it is permitted to do so under the Listing Rules and applicable law) in general meeting.

A notice convening a General Meeting of the Company to be held on 15 December 2009 at RBS Conference Centre, RBS Gogarburn, Edinburgh EH12 1HQ at 10.30 a.m. is set out at the end of this document and the Resolutions to be proposed at the General Meeting are set out in the notice. The General Meeting is being held for the purpose of considering and, if thought fit, passing six resolutions.

Resolution 1 is an ordinary resolution to approve, as a related party transaction, the accession to and participation in the APS, the entry into of any agreements and transactions contemplated by the Scheme Documents, the B Share Issue and any other issue of B Shares to HM Treasury pursuant to the Accession Agreement and the Acquisition and Contingent Capital Agreement and the issue of the Dividend Access Share.

Resolution 2 is an ordinary resolution granting the Directors authority to allot B Shares, the Dividend Access Share and Ordinary Shares, in each case as required under the Companies Act. The B Shares and the Dividend Access Share will be issued on the terms set out in Annex 1. The Directors' authority to allot such shares will expire five years from the date of the General Meeting. As at the date of this document, RBS holds no treasury shares.

Resolution 3 is an ordinary resolution to grant the Directors authority to capitalise certain amounts of the Company's reserves and to apply these amounts in paying up new B Shares and to consolidate and sub-divide share capital and/or sub-divide shares (including the consolidation and sub-division of Ordinary Shares into ordinary shares of a lower nominal value), in each case in connection with any conversion of B Shares into Ordinary Shares and, as applicable, the payment in B Shares of certain dividends in respect of the Dividend Access Share and the B Shares.

Resolution 4 is an ordinary resolution to adopt the RBS 2010 Deferral Plan. Under the new plan, incentives will be deferred into awards which will be settled in shares and/or subordinated debt. In order to ensure that performance-related pay awards take future risk from current business into account, thereby aligning employee, customer and shareholder interests more fully, the Remuneration Committee can determine that awards should be reduced and/or forfeited, after reviewing (amongst other things) the performance of the employing company, any member of the Group, any business area or team or the relevant individual. Further plans may be adopted based on the RBS 2010 Deferral Plan to allow it to be operated in other countries or for relevant employees in the ABN AMRO Group or it may be modified to take account of local tax, exchange control or securities laws in such countries and, where feasible, to mitigate any unfavourable tax treatment.

Resolution 5 is a special resolution to approve (a) the deletion of the references in the Articles of Association to the Company's authorised share capital now that the 2006 Act has abolished the requirement for a company to have an authorised share capital and (b) other amendments to the Articles of Association required in connection with the B Share Issue, the issue of the Dividend Access Share and the creation of Non-Voting Deferred Shares Series B as well as the conversion of RBS's convertible preference shares. The amendments to the Articles of Association are required in order to (i) create the three new classes of shares (namely the B Shares, the Dividend Access Share and the Non-Voting Deferred Shares Series B), where relevant, on the terms set out in Annex 1 to this document, (ii) provide for the disapplication of pre-emption rights in respect of the B Shares and the Dividend Access Share, (iii) provide for the payment of scrip dividends on the B Shares and (iv) set the quorum for class meetings of holders of B Shares or the Dividend Access Share. For further details on the amendments to the Articles of Association, please see Annex 2 to this document.



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Resolution 6 is a special resolution to empower the Directors to allot the B Shares, the Dividend Access Share and the Ordinary Shares referred to in Resolution 2, on a non-preemptive basis. This will enable the Directors to allot these shares to HM Treasury as described further in this document, without shareholder preemption rights applying (to the extent relevant). This power will expire simultaneously with the authority to allot given pursuant to Resolution 2.

As the accession to and participation in the APS, the B Share Issue and any other issue of B Shares to HM Treasury pursuant to the Accession Agreement and the Acquisition and Contingent Capital Agreement and the issue of the Dividend Access Share constitute a related party transaction for the purposes of the Listing Rules, HM Treasury will not vote on Resolution 1 described above and HM Treasury has undertaken to take all reasonable steps to ensure that its associates, if any, will not vote on Resolution 1.

A Form of Proxy is enclosed. To be effective, Forms of Proxy must be completed by Shareholders and received at the Company's transfer office at Computershare Investor Services PLC, The Pavilions, Bridgwater Road, Bristol BS99 6ZY by 10.30 a.m. on 11 December 2009.

**Action to be taken by Shareholders**

A Form of Proxy is enclosed which covers the Resolutions to be proposed at the General Meeting and which is for use by the holders of Ordinary Shares and Cumulative Preference Shares. If you are a person nominated under section 146 of the 2006 Act to enjoy information rights, please read Note 3 to the General Meeting Notice.

Completed Forms of Proxy should be returned in the pre-paid envelope as soon as possible, but in any event no later than 10.30 a.m. on 11 December 2009. In addition, it is possible to appoint and instruct your proxy electronically by following the instructions on the enclosed Form of Proxy. Completion of a Form of Proxy will not prevent you from attending and voting at the General Meeting if you so wish. To appoint more than one proxy (each of whom must be appointed to exercise rights attached to the different shares held by you), see Note 2 on the reverse of the Form of Proxy.

At the General Meeting the Company will disclose, for each resolution, the total of the proxy votes received and any votes cast at the meeting, the proportion for and against each resolution, and the number of votes withheld. Votes withheld will not be counted in the calculation of the proportion of votes 'for' and 'against' a resolution.

Voting at the General Meeting in respect of each resolution, will be conducted by way of a poll. The Directors believe it is important that the intentions of all members who register a vote are fully taken into account. Voting on a poll is more transparent and equitable, since it allows the votes of all shareholders who wish to vote to be taken into account, and it reflects evolving best practice. Shareholders who attend the meeting will still be able to ask questions relevant to the business of the meeting prior to voting on the Resolutions.

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**PART II**

**CAPITAL RESOURCES AND LIQUIDITY MANAGEMENT**

**1. Capital resources**

The Group effected two capital raisings during 2008, featuring a £12 billion rights issue in June 2008 and a further £20 billion capital raising completed in December 2008. The latter included £5 billion of Preference Shares acquired entirely by HM Treasury and £15 billion of Ordinary Shares issued under the First Placing and Open Offer, which were principally subscribed for by HM Treasury under the UK Government's bank recapitalisation scheme.

The £5 billion of Preference Shares were subsequently redeemed, and effectively replaced by Ordinary Shares, using the proceeds of the Second Placing and Open Offer in April 2009. This directly strengthened the Group's Core Tier 1 Capital giving the Group enhanced financial capability to protect and deliver the value of its established and strong customer franchises during continued difficult economic and market conditions. The enhancement to the Group's financial strength supported lending commitments given to the UK Government, also benefiting customers, counterparties and investors.

Financial market and economic conditions deteriorated throughout 2008 with significant credit impairment losses and credit market write-downs booked by the Group. 2009 has seen a continuation of the challenging background to financial markets and, although some signs of improvement have started to emerge, key economies remain uncertain. The Group has continued to experience material impairment losses and credit market write-downs, including further write-downs in respect of monoline exposures, in 2009.

The major franchise of RBS is in the UK economy, and this economy has been subject to significant recessionary effects in 2009, which are expected to continue for a more protracted period. This could result in a continued erosion of RBS's capital base as losses are incurred, and further increases in risk weighted assets are experienced due to adverse risk migration. RBS's reported performance for 2009 and its underlying capital position benefited from the redemption of a number of outstanding debt securities, which contributed a gain of approximately £3.8 billion before tax, partially mitigating the scope of capital erosion attributable to underlying losses and risk impacts witnessed in 2009.

The effective management of the Group's capital is key to sustaining its ability to operate its businesses, develop organically and pursue its strategy. The maintenance of adequate capital is also necessary to enhance the Group's financial flexibility in the face of continuing turbulence and uncertainty in global and national economies.

On 26 February 2009, RBS set out its intended participation in the UK Government's APS and further confirmed its commitment to the APS in the Interim Results for the half year ended 30 June 2009. The key commercial terms relevant to APS entry have now been agreed and were set out in RBS's announcement of 3 November 2009, and in RBS's Interim Management Statement for the third quarter of 2009. Under the proposed terms of the APS, HM Treasury will provide loss protection against potential stressed case losses arising in a pool of assets with an expected gross value of around £282 billion, as at 31 December 2008. On accession to the APS, HM Treasury will subscribe for £25.5 billion of capital in the form of B Shares and a Dividend Access Share with a further £8 billion of capital in the form of B Shares potentially available as contingent capital. RBS will pay annual fees in respect of base protection and the contingent capital. RBS will not surrender any deferred tax assets as originally envisaged (although, as explained above, RBS will have the option, subject to HM Treasury consent, to pay the annual fee in respect of the APS, the Initial B Shares and the Contingent Subscription and the exit fee payable in connection with any termination of the Group's participation in the APS (but not the refund of the net payments it has received from HM Treasury under the APS), in whole or in part, by waiving the entitlements of members of the RBS Group to certain UK tax reliefs treated as deferred tax assets (under the Tax Loss Waiver)).

It is the intention that, on accession to and participation in the APS, arrangements will be constructed within the Group that will extend effective APS protection to all other regulated entities holding assets covered by the APS. The APS Covered Assets disclosures set out in Part I, Appendix 2 of this document provide disclosure on all assets which have been identified for inclusion in the Scheme.

RBS's policy will continue to be to maintain a strong capital base, to develop this base as appropriate and to utilise it efficiently throughout RBS's activities in order to optimise shareholder returns while

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maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, RBS follows the supervisory requirements of the FSA. The FSA 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 being "weighted" to reflect the inherent credit and other risks). The FSA has also set out their expectation in relation to the respective levels of Core Tier 1 Capital and Tier 1 Capital that banks participating in the current UK Government's recapitalisation scheme should maintain.

On 19 January 2009, the FSA announced that it expects each bank participating in the UK Government's recapitalisation scheme to have a minimum Core Tier 1 Ratio of 4 per cent. on a stressed basis. As at 30 September 2009, the Group's total RAR was 10.4 per cent. and its Tier 1 and Core Tier 1 Capital ratios were 8.0 per cent. and 5.5 per cent. respectively, on a proportional consolidated basis, calculated in accordance with FSA definitions. While the APS and capital issuance plans we have agreed on with the Government will take our Core Tier 1 Capital ratio to well above our target of 8 per cent., it is clear that the next two years will bring a number of further pressures, including the impact of procyclicality and increasing regulatory demands. Core business profits will take time to recover and build, especially as GBM results normalise.

The Board has increased its target for the Group's Core Tier 1 Ratio to in excess of 8 per cent. This reflects the expectation of both regulators and investors that banks should hold significant capital buffers, with appropriate loss absorption characteristics, to adequately protect against the impacts of stress volatilities and unexpected losses.

Accession to and participation in the APS, and the associated issue of B Shares, is essential to provide the necessary capital resilience and stability to allow the Group to rebuild and restore standalone strength. Without the protection afforded by the APS, the Group would be unable to satisfy extant FSA stress criteria and would ultimately be at significant risk of regulatory capital breaches. The combination of asset protection and capital issuance associated with the APS, including the Contingent Subscription, is of a scale that ensures base case capital forecasts for Core Tier 1 Capital at all material times track above the updated target criteria. The Group's bolstered capital base provides a capital cushion to satisfy the impact of FSA stress tests, with Core Tier 1 Capital remaining above the 4 per cent. stressed minimum, assuming a severe and prolonged recessionary scenario.

Had accession to the APS and the associated issue of Initial B Shares completed on 30 September 2009, the Group's reported 30 September 2009 Core Tier 1 Ratio would have increased to 11.7 per cent., on a proportional consolidated basis; the Group's total RAR and Tier 1 Capital ratio would have increased to 17.0 per cent. and 15.1 per cent. respectively.

Total capital resources principally comprise shareholders' equity, minority interests and subordinated liabilities less goodwill and other intangible assets and other supervisory deductions, such as the Group's investment in insurance companies. The Group has redeemed one subordinated note of \$1.0 billion between 30 September 2009 and the date of this document; this note was a dated note and was fully amortised in capital resources reported as at 30 September 2009. Changes in shareholders' equity since 30 September 2009 reflect trading results, changes in the fair values of available-for-sale investments and cash flow hedges, and exchange differences on translation of foreign operations.

As a key element of its strategic review, the Group has allocated assets and activities to the Non-Core Division totalling £220 billion at 30 September 2009, of which approximately 30 per cent. are expected to be subject to APS cover. Most assets within the Non-Core Division are expected to be run-off or disposed of over the strategic horizon. These measures will significantly lower the size of the Group's balance sheet and, particularly to the extent that assets are held outside of the APS protection, will materially reduce the associated capital requirements.

To comply with European Commission State Aid requirements, and as set out in RBS's announcement of 3 November 2009, RBS has agreed in principle to a series of restructuring measures to be implemented over a four year period. The proposals focus on a number of divestments including elements of the branch network and operating businesses. These measures will supplement strategic initiatives already announced by RBS and potentially accelerate ultimate exit from the APS scheme.

Generally, in connection with its ongoing capital management efforts, RBS from time to time considers market based and/or internal capital management opportunities to generate and further strengthen its Core Tier 1 Capital. In particular, RBS and its subsidiaries have engaged and may engage in transactions involving the sale, issuance, purchase, redemption, pledge, hypothecation or other acquisition or



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transfer of assets, liabilities or securities, any of which may result in changes to the Group's assets, liabilities, capital structure and capital ratios.

## 2. Liquidity Management

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

Important developments in central bank liquidity programmes since February 2009 include:

In the UK, the Bank of England reduced interest rates to 0.5 per cent. in March, and later the same month the Bank of England initiated "quantitative easing" through its Asset Purchase Facility. Gilt purchases dominate activity to date, while direct purchases of commercial paper and corporate bonds have been relatively small. More recently the Bank of England has increased the amount of quantitative easing programme by another £25 billion to £200 billion.

In the US, the Federal Reserve has maintained its target for the funds rate at 0-0.25 per cent, while supplementing its credit-easing programmes with a new Term Asset-Backed Securities Loan Facility ("TALF") although initial take up of the TALF has been slow.

In the Euro Area, the European Central Bank ("ECB") decided in early May to hold three 1-year repo operations against its general collateral list. These were received enthusiastically in June and September, resulting in significant supply of ECB liquidity to the banking system and bringing downward pressure on short term rates.

Following the economic and financial crisis, regulators across the world have continued to review their respective liquidity regulation. In particular the FSA published its new policy statement (PS09/16) at the beginning of October 2009. The new regulation will be phased in over a number of years with the first element covering systems and controls, effective 1 December 2009 and new reporting requirements being introduced during 2010. In addition, the requirements for liquidity buffers will be introduced over a number of years recognising the position of the economic cycle and the potential for increased liquidity buffers, above the "back-stop" levels to impact the availability of credit. The Group has a programme in place to address the new FSA requirements, with the Group to continue building its liquidity reserves together with reducing the customer funding gap.

Liquidity management within RBS focuses on managing short-term and long term liquidity risk including control and monitoring, within prudent limits, of risks arising from the mismatch of maturities of assets and liabilities across the balance sheet, and risks arising from undrawn commitments and other contingent obligations. RBS manages the structure of its balance sheet with the aim of maintaining funding diversification, minimising concentration across its various deposit sources and restricting the level of reliance on total short-term wholesale sources of funds. As part of its planning process, RBS reviews regularly the forecasted structure of its balance sheet over the planning period.

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	30 September 2009		30 June 2009		31 December 2008	
	(£m)	(%)	(£m)	(%)	(£m)	(%)
Deposits by banks <sup>(1)</sup>	<b>138,584</b>	<b>16.1</b>	135,601	16.3	178,943	18.8
Debt securities in issue:						
Commercial paper	<b>45,508</b>	<b>5.3</b>	49,270	5.9	69,891	7.3
Certificates of deposits	<b>79,305</b>	<b>9.2</b>	76,095	9.2	73,925	7.8
MTNs	<b>112,091</b>	<b>13.0</b>	104,190	12.5	94,298	9.9
Other (bonds)	<b>12,440</b>	<b>1.4</b>	4,394	0.5	14,231	1.5
Securitisations	<b>16,869</b>	<b>2.0</b>	14,761	1.8	17,113	1.8
	<b>266,213</b>	<b>30.9</b>	248,710	29.9	269,458	28.3
Subordinated debt	<b>33,085</b>	<b>3.8</b>	32,106	3.9	43,678	4.6
Total wholesale funding	<b>437,882</b>	<b>50.8</b>	416,417	50.1	492,079	51.7
Customer deposits <sup>(1)</sup>	<b>423,769</b>	<b>49.2</b>	415,267	49.9	460,318	48.3
Total	<b>861,651</b>	<b>100.0</b>	831,684	100.0	952,397	100.0

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Note:

- (1) Excluding repurchase agreements and stock lending.

The funding profile shows that the funding mix has been relatively stable over the course of 2009.

The most important source of funding is customer deposits that are diversified across a large client base and geographical distribution. The risk is that confidence in RBS or competitive pressures may make it more difficult for RBS to retain customer deposits at an economic price. Customer deposits have reduced from £460,318 million at December 2008 to £423,769 million at September 2009. This reduction of £36,549 million is more than offset by a reduction in loans and advances giving rise to an overall improvement in the customer funding gap which was £231,658 million at December 2008 and £164,227 million at September 2009. RBS also uses secured funding markets to fund its balance sheet and at 30 September 2009 had £69,465 million of customer secured funding and £39,816 million of bank secured funding. Funding from banks of £138,584 million<sup>(1)</sup> and debt securities in issue of £266,213 million<sup>(2)</sup> at 30 September 2009 are the major sources of wholesale funding. Total wholesale funding of £437,882 million at 30 September 2009 is predominantly unguaranteed and as the wholesale funding markets have improved over the course of 2009 the Group is better able to manage both its short and longer term term funding requirements. The Group issued £9.2 billion of unguaranteed debt securities with a maturity greater than one year in the period from 1 January 2009 to 30 September 2009.

An important source of funding for RBS is customer deposits that are diversified across its retail, wealth and SME customer base. The Group maintains customer depositor taking activities across the geographies in which it operates to maintain access to this funding source. It is therefore critical that confidence in RBS's franchise does not deteriorate substantially for any reason. There is currently increased competition among UK banks for retail customer deposits; this has raised the cost of procuring new deposits and made it more challenging for RBS to grow its deposit base.

#### Debt securities in issue and subordinated liabilities

Debt issues and subordinated debt maturing less than one year is £162,427 million. RBS has well established capability in the short term debt issuance markets and is proactive in managing investors and clients to ensure that it is able to roll over its funding requirements in the next 12 months at reasonable cost and maturity.

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(1)

Group before RFS Holdings minority interest.

(2)

Group before RFS Holdings minority interest.

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The amount of funding with a maturity greater than 12 months has increased from £131,551 million at 30 June 2009 to £136,871 million at 30 September 2009 reflecting the increased term funding issuances over the period.

	30 September 2009				30 June 2009		31 December 2008	
	Debt securities in issue (£m)	Sub-ordinated debt (£m)	Total (£m)	(%)	(£m)	(%)	(£m)	(%)
Less than one year	159,296	3,131	162,427	54.3	149,265	53.2	172,234	55.0
1 - 5 years	70,458	4,769	75,227	25.1	67,390	24.0	61,842	19.8
More than 5 years	36,459	25,185	61,644	20.6	64,161	22.8	79,060	25.2
<b>Total</b>	<b>266,213</b>	<b>33,085</b>	<b>299,298</b>	<b>100.0</b>	280,816	100.0	313,136	100.0

Additional measures to improve the structural balance sheet have focused on reducing the size of the multi-seller conduit business, down by £19.4 billion from £49.9 billion at 31 December 2008 to £30.5 billion at 30 September 2009, which relies upon funding assets through the issuance of short term asset-backed commercial paper.

As mentioned above, wholesale debt markets have been heavily impacted by the global financial crisis. However since March 2009 access to wholesale funding has been improving with RBS issuing unguaranteed term funding of £9.2 billion during the nine months ending 30 September 2009. This included 10 year issuances of £2.7 billion and for five years of £2.5 billion.

Governments and central banks have taken various actions to improve funding and liquidity within their respective banking systems through the course of the financial crisis. These include liquidity and funding support to banks, including, for example, the raising of liabilities that are guaranteed by HM Treasury, which RBS has taken advantage of. Whilst there has been improvement in financial markets in 2009 there is no certainty that this trend will continue or that these global measures will succeed in continuing to improve the funding and liquidity of the markets in which the major banks, including RBS, operate.

RBS has made use of a number of central bank schemes to assist with its funding and liquidity management. Following the collapse of Lehman Brothers in September 2008 and the severe market dislocation which followed, the Group accessed Bank of England Emergency Liquidity Assistance ("ELA") from 7 October 2008 to 16 December 2008, with peak usage of £36.6 billion on 17 October 2008. The Group repaid the ELA by 16 December 2008. Additional schemes used include the Special Liquidity Scheme ("SLS") operated by the Bank of England and selective use of ECB and US Federal Reserve schemes. The general purpose of such schemes is to allow a bank to pledge or enter into a repurchase agreement in respect of collateral for varying periods of time in exchange for funding. Whilst RBS continues to be reliant on certain government funding schemes, through 2009 with improving financial markets and initiatives to improve RBS's balance sheet, it has reduced its reliance thereon and has also seen a significant improvement in its liquidity ratios. The Group has addressed the planned phasing out of various government schemes through the five year strategic plan by targeting increased customer deposits and the reduction of assets in the Non-Core Division thus reducing reliance on wholesale markets. The Group is increasing the use of non guaranteed term issuance and in conjunction with the strategic funding plan enables the phasing out of government schemes to be effectively managed. Whilst the strategic funding plan of the Group explicitly assumes that government funding schemes close at the publicly stated dates the Group continues to access certain of these schemes. A number of the schemes to which RBS has access, assuming they are not extended, will expire over the next 53 months, including the SLS which expires in January 2012 and the Credit Guarantee Scheme which expires in April 2014. The funding plan has targets for increased customer deposits and reduced assets in Non-Core Division, which, if successful, would reduce overall reliance on wholesale funding markets.

Apart from the ability to issue liabilities directly guaranteed by government, there are other government and central bank schemes that RBS is eligible to participate in within the United Kingdom, Europe and the United States alone, in addition to similar schemes that are operated by other central banks and governments in jurisdictions in which RBS operates. The general purpose of such schemes is to allow a bank to pledge or enter into a repurchase agreement in respect of collateral for varying periods of time in

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exchange for funding. RBS makes use of a number of central bank schemes to assist with its funding and liquidity management. Throughout 2009 with improving financial markets and initiatives to improve RBS's balance sheet, RBS has significantly reduced its reliance on central bank funding.

RBS believes that its access to a range of governmental and non-governmental sources of liquidity, in combination with its increased capital ratios following the completion of the APS, should allow it to better absorb further write downs and unexpected changes in market conditions and will help the Group to maintain customer support and confidence, while providing the resources to support its future development.

As outlined in the Liquidity Management section of Part II of this document, there is a risk that these various support schemes may be cancelled, changed or withdrawn resulting in an adverse impact on the availability of funding. The Group has addressed the planned phasing out of various government schemes through the five year strategic plan by targeting increased customer deposits and the reduction of assets in the Non-Core Division thus reducing reliance on wholesale markets.

Further RBS has recently confirmed an agreement in principle with the European Commission regarding a State aid restructuring plan for the Bank. The in-principle agreement envisages, among other things, the sale of some of RBS's UK branches and other business units which also may impact the funding profile of the Bank.

Further disclosures about the Group's management of capital resources and liquidity are set out on pages 73 and 78-144 of the Annual Report and Accounts and pages 83 to 86 of the Interim Management Statement for the nine months ending 30 September 2009.

As discussed above, the global markets for short and medium term sources of funding on which banks rely to support their business activities remain constrained as a result of which support by HM Treasury and the Bank of England to directly supplement existing sources of funding and create the environment for an improvement in the availability of other traditional sources of funding remains necessary. Due to dislocation and the uncertainty surrounding the implementation of new government schemes, the UK Listing Authority has agreed that a statement regarding the adequacy of working capital for at least the next 12 months should not be required in this document. There is, therefore, no working capital statement in this document.

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**PART III**

**UNAUDITED PRO FORMA FINANCIAL INFORMATION**

**PART A UNAUDITED PRO FORMA FINANCIAL INFORMATION**

**Basis of preparation**

The unaudited pro forma condensed consolidated financial information (the "pro forma financial information") comprises the unaudited pro forma condensed consolidated income statement for the year ended 31 December 2008 and the six months ended 30 June 2009 (the "pro forma income statements"), the unaudited pro forma condensed consolidated balance sheet as at 30 June 2009 (the "pro forma balance sheet") and the unaudited pro forma proportional regulatory capital ratios on a proportional consolidated basis (the "pro forma regulatory capital ratios") as at 30 June 2009 and 30 September 2009. The pro forma financial information is being provided to give a better understanding of how the results of operations and financial position of RBS might have been affected had the Scheme come into effect and the issue of B shares occurred, on:

1 January 2008 in respect of the pro forma income statement for the year ended 31 December 2008

1 January 2009 in respect of the pro forma income statement for the six months ended 30 June 2009

30 June 2009 in respect of the pro forma balance sheet and pro forma regulatory capital ratios at 30 June 2009

30 September 2009 in respect of the pro forma regulatory capital ratios at 30 September 2009

The pro forma financial information has been prepared solely for illustrative purposes. Because of its nature, the pro forma financial information addresses a hypothetical situation and, therefore, does not represent the actual results of operations or financial position of RBS nor is it necessarily indicative of the results of operations or financial position that may or may be expected to be achieved in the future.

A key feature of the Scheme is that it mitigates credit losses on Covered Assets that exceed the first loss threshold, as defined in the Scheme terms and conditions. The effect of this mitigation is not illustrated in the pro forma financial information as credit losses in the periods covered by the pro forma financial information did not exceed the first loss threshold.

The Covered Assets will be protected by a credit derivative. The fair value of the credit derivative is expected to be equal to its transaction value on execution and no profit or loss will be recorded on initial recognition; subsequent changes in the fair value of the credit derivative will be recorded in profit or loss. For the purposes of the pro forma income statements for the year ended 31 December 2008 and six months ended 30 June 2009 it has been assumed that the fair value of the credit derivative is equal to the fair value of the consideration given.

Table of Contents**Pro forma income statement for the year ended 31 December 2008**

	<b>RBS<sup>(1)</sup></b> <b>(£m)</b>	<b>B share</b> <b>issuance<sup>(2)</sup></b> <b>(£m)</b>	<b>Discount</b> <b>unwind on</b> <b>B Share issue</b> <b>and contingent</b> <b>subscription</b> <b>fees<sup>(3)</sup></b> <b>(£m)</b>	<b>Pro forma</b> <b>RBS</b> <b>(£m)</b>
<b>Net interest income</b>	18,675	1,137	(58)	19,754
Net fee and commission income	7,445			7,445
Loss from trading activities	(8,477)			(8,477)
Other operating income	8,225			8,225
<b>Non-interest income</b>	7,193			7,193
<b>Total income</b>	25,868	1,137	(58)	26,947
<b>Operating expenses</b>	(54,202)			(54,202)
<b>(Loss)/profit before other operating charges and impairment losses</b>	(28,334)	1,137	(58)	(27,255)
Insurance net claims	(4,430)			(4,430)
Impairment losses	(8,072)			(8,072)
<b>Operating loss before tax</b>	(40,836)	1,137	(58)	(39,757)
Tax	2,323	(324)	17	(2,016)
<b>Loss from continuing operations</b>	(38,513)	813	(41)	(37,741)
Profit from discontinued operations, net of tax	3,971			3,971
<b>(Loss)/profit for the year</b>	(34,542)	813	(41)	(33,770)
<b>(Loss)/profit attributable to:</b>				
Minority interests	(10,832)			(10,832)
Other owners	596			596
Ordinary shareholders	(24,306)	813	(41)	(23,534)
	(34,542)	813	(41)	(33,770)
<b>Per 25p ordinary share:</b>				
<b>Basic loss from continuing operations</b>	(146.2p)			(141.6p)
<b>Diluted loss from continuing operations</b>	(146.2p)			(141.6p)
<b>Basic loss from discontinued operations</b>	(0.5p)			(0.5p)
<b>Diluted loss from discontinued operations</b>	(0.5p)			(0.5p)

Notes:

(1)

The financial information for RBS for the year ended 31 December 2008 includes the results of operations of the Group to that date only. This information has been extracted from RBS's 2008 Annual Report and Accounts, as updated by the unaudited Interim Results relating to the implementation of *Vesting Conditions and Cancellation* amendments to IFRS 2 'Share-based payments', as required by IFRS, without adjustment.

(2)

The pro forma effect of £25.5 billion of B share issuance comprises interest accrued of:

(a)

£682 million on cash component of £15.5 billion, at an interest rate of 4.4%, being the 5 year gilt rate in January 2008

(b)

£152 million on 1 month LIBOR Treasury bills of £3.5 billion at an interest rate of 5.31%, changing to 5 year gilt rate of 4.24% after one month

(c)

£150 million on 3 month LIBOR Treasury bills of £3.5 billion at an interest rate of 5.17%, changing to 5 year gilt rate of 4.01% after three months

(d)

£153 million on 6 month LIBOR Treasury bills of £3.0 billion at an interest rate of 5.02%, changing to 5 year gilt rate of 5.16% after six months

The total effect of the above has been tax effected at a rate of 28.5%, the effective UK corporation tax rate in 2008.

(3)

The liability to pay the annual fees in consideration for the issue of B shares and the contingent subscription (as described on page 77) is recorded at the present value of all future cash flows discounted at a discount rate of 5.1%. The unwind of the discount is recognised in the income statement.

(4)

The Covered Assets will be protected by a credit derivative. The fair value of the credit derivative is expected to be equal to its transaction value on execution and no profit or loss will be recorded on initial recognition. For the purposes of the pro forma income statement for the year ended 31 December 2008 it has been assumed that the fair value of the credit derivative is equal to the fair value of the consideration given.

(5)

Dividends are payable on the B Shares at the discretion of the Directors of RBS and will be recognised when declared. Dividends are not reflected in the pro forma income statement above.



Table of Contents**Pro forma income statement for the six months ended 30 June 2009**

	<b>RBS<sup>(1)</sup></b>	<b>B share</b>	<b>Discount</b>	<b>Pro forma</b>
	<b>(£m)</b>	<b>issuance<sup>(2)</sup></b>	<b>unwind on</b>	<b>RBS</b>
		<b>(£m)</b>	<b>B Share</b>	<b>(£m)</b>
			<b>issue and</b>	
			<b>contingent</b>	
			<b>subscription</b>	
			<b>fees<sup>(3)</sup></b>	
			<b>(£m)</b>	
<b>Net interest income</b>	8,374	278	(19)	8,633
Net fee and commission income	3,648			3,648
Income from trading activities	1,994			1,994
Gain on redemption of own debt	3,790			3,790
Other operating income	4,035			4,035
<b>Non-interest income</b>	13,467			13,467
<b>Total income</b>	21,841	278	(19)	22,100
<b>Operating expenses</b>				