

Dated 10 June 2010

# **THE ROYAL BANK OF SCOTLAND GROUP PLC**

## **REGISTRATION DOCUMENT**

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## INTRODUCTION

This document constitutes a registration document ("**Registration Document**") for the purposes of Article 5.3 of Directive 2003/71/EC (the "**Prospectus Directive**") and has been prepared for the purpose of giving information with respect to The Royal Bank of Scotland Group plc (the "**Issuer**" or "**RBSG**"), whose registered office address appears on the last page of this Registration Document, and its subsidiaries (RBSG, together with its subsidiaries, the "**Group**") which, according to the particular nature of the Issuer and the securities which it may offer to the public or apply to have admitted to trading on a regulated market, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses and prospects of the Issuer.

The Issuer accepts responsibility for the information contained in this Registration Document. To the best of the knowledge of the Issuer (which has taken all reasonable care to ensure that such is the case), the information contained in this Registration Document is in accordance with the facts and does not omit anything likely to affect the import of such information.

This Registration Document has been filed with, and approved by, the Financial Services Authority (the "**FSA**") in its capacity as competent authority (the "**UK Listing Authority**") under the Financial Services and Markets Act 2000 (the "**FSMA**").

Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("**Standard & Poor's**") is expected to rate: senior notes issued by RBSG with a maturity of one year or more "A"; senior notes issued by RBSG with a maturity of less than one year "A-1"; dated subordinated notes issued by RBSG "BBB-"; undated tier 2 notes issued by RBSG "BB-"; and tier 1 notes issued by RBSG will be rated on a case-by-case basis. Fitch Ratings Limited ("**Fitch**") is expected to rate: senior notes issued by RBSG with a maturity of one year or more "AA-"; senior notes issued by RBSG with a maturity of less than one year "F1+"; and dated subordinated notes, undated tier 2 notes and tier 1 notes issued by RBSG will be rated on a case-by-case basis. Moody's Investors Service Limited ("**Moody's**") is expected to rate: senior notes issued by RBSG with a maturity of one year or more "A1"; and dated subordinated notes, undated tier 2 notes and tier 1 notes issued by RBSG will be rated on a case-by-case basis; and senior notes issued by RBSG with a maturity of less than one year "P-1".

As defined by Standard & Poor's, an "A" rating means that the ability of the Issuer to meet its financial commitment on the relevant notes issued by it is strong and an "A-1" rating means that the ability of the Issuer to meet its financial commitment on the relevant notes issued by it is extremely strong. A "BB" rating means that the ability of the Issuer to meet its financial commitment on the relevant notes issued by it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the Issuer's inadequate capacity to meet its financial commitment on the relevant notes. As defined by Standard & Poor's, an addition of a plus (+) or minus (-) sign shows relative standing within the major rating categories.

As defined by Fitch, an "AA" rating indicates that the Issuer has a very strong capacity for payment of its financial commitments on the relevant notes issued by it and that this capacity is not significantly vulnerable to foreseeable events. As defined by Fitch, an addition of a plus (+) or minus (-) sign denotes relative status within the major rating categories. As defined by Fitch, an "F1" rating indicates that the Issuer has the strongest capacity for timely payment of its financial commitments on the relevant notes issued by it. As defined by Fitch, an addition of a plus (+) to an "F1" rating denotes an exceptionally strong credit feature.

As defined by Moody's, an "A" rating means the capacity of the Issuer to meet its obligations on the relevant notes issued by it is considered upper-medium grade and subject to low credit risk. As defined by Moody's the addition of a "1" indicates that the obligation ranks in the higher end of its rating category. As defined by Moody's, a "P-1" rating means that the Issuer has a superior ability to repay its short term debt obligations on the relevant notes issued by it.

A rating is not a recommendation to buy, sell or hold securities and may be subject to change, suspension or withdrawal at any time by the assigning rating agency.

The Commissioners of Her Majesty's Treasury ("**HM Treasury**") have neither reviewed this Registration Document nor verified the information contained in it, and HM Treasury makes no representation with respect to, and does not accept any responsibility for, the contents of this Registration Document or any other statement made or purported to be made on its behalf in connection with the Issuer or the issue and offering of securities by the Issuer. HM Treasury accordingly disclaims all and any liability, whether arising in tort or contract or otherwise, which it might otherwise have in respect of this Registration Document or any such statement.

## RISK FACTORS

*Prospective investors should consider carefully the risks set forth below and the other information set out elsewhere in this Registration Document (including any documents incorporated by reference herein) and reach their own views prior to making any investment decision with respect to any securities of the Issuer.*

*Set out below are certain risk factors which could have a material adverse effect on the business, operations, financial condition or prospects of the Group and cause the Group's future results to be materially different from expected results. The Group's results could also be affected by competition and other factors. The factors discussed below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties the Group businesses face. The Issuer has described only those risks relating to its operations that it considers to be material. There may be additional risks that the Issuer currently considers not to be material or of which it is not currently aware, and any of these risks could have the effects set forth above. All of these factors are contingencies which may or may not occur and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring. Investors should note that they bear the Issuer's solvency risk. Each of the risks highlighted below could have a material adverse effect on the amount of principal and interest which investors will receive in respect of securities issued by the Issuer. In addition, each of the risks highlighted below could adversely affect the trading price of such securities or the rights of investors under such securities and, as a result, investors could lose some or all of their investment.*

### RISKS RELATING TO THE GROUP

#### **RBSG and its United Kingdom bank subsidiaries may face the risk of full nationalisation or other resolution procedures under the Banking Act 2009**

Under the Banking Act 2009 (the “**Banking Act**”), substantial powers have been granted to HM Treasury, the Bank of England and the FSA (together, the “**Authorities**”) as part of a special resolution regime (the “**SRR**”). These powers enable the Authorities to deal with United Kingdom banks, building societies and other institutions with permission to accept deposits pursuant to Part IV of the FSMA (each, a “**relevant entity**”) where the conditions set out in the next paragraph are met. The SRR consists of three stabilisation options and two insolvency and administration procedures applicable to United Kingdom banks which may be commenced by the Authorities. The stabilisation options provide for: (i) transfer of all or part of the business of the relevant entity to a private sector purchaser; (ii) transfer of all or part of the business of the relevant entity to a “bridge bank” established by the Bank of England; and (iii) temporary public ownership (nationalisation) of the relevant entity or its United Kingdom-incorporated holding company. In each case, the Authorities have been granted wide powers under the Banking Act including powers to modify contractual arrangements in certain circumstances and powers for HM Treasury to disapply or modify laws (with possible retrospective effect) to enable the powers under the Banking Act to be used effectively. The following paragraphs set out some of the possible consequences of the exercise of those powers under the SRR.

#### ***The SRR may be triggered prior to the insolvency of RBSG or its United Kingdom bank subsidiaries***

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 (a) the FSA is satisfied that (i) a relevant entity such as RBSG's United Kingdom banking subsidiaries, including The Royal Bank of Scotland plc (“**RBS**”) and National Westminster Bank Plc (“**NatWest**”), are failing, or are likely to fail, to satisfy

the threshold conditions within the meaning of section 41(1) of the FSMA (which are the conditions that a relevant entity must satisfy in order to retain its authorisation to accept deposits), (b) following consultation with the other Authorities, the FSA determines that 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, and (c) the Authorities consider the exercise of the stabilisation options to be necessary, having regard to certain public interest considerations (such as the stability of the United Kingdom financial systems, public confidence in the United Kingdom banking systems and the protection of depositors). It is therefore possible that one of the stabilisation options could be exercised prior to the point at which any insolvency proceedings with respect to the relevant entity (such as RBS or NatWest) or RBSG could be initiated.

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 RBSG) 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.

***Various actions may be taken in relation to any securities issued by RBSG without the consent of the holders thereof.***

If HM Treasury makes the decision to take RBSG into temporary public ownership, it may take various actions in relation to any securities issued by RBSG (the “**Securities**”) without the consent of holders of the Securities, including (among other things):

- (i) transferring the Securities free from any contractual or legislative restrictions on transfer;
- (ii) transferring the Securities free from any trust, liability or other encumbrance;
- (iii) extinguishing any rights to acquire Securities;
- (iv) delisting the Securities;
- (v) converting the Securities into another form or class (the scope of which power is unclear, although may include, for example, conversion of the Securities into equity securities);
- (vi) disapplying any termination or acceleration rights or events of default under the terms of the Securities which would be triggered by the transfer or certain related events; or
- (vii) where property is held on trust, removing or altering the terms of such trust.

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 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.

There can be no assurance that the taking of any such actions would not adversely affect the rights of holders of the Securities, the price or value of their investment in the Securities and/or the ability of RBSG to satisfy its obligations under the Securities and/or contracts related to the Securities. Where the transfer powers are effected, HM Treasury are required to make certain compensation or resolution fund orders and holders of Securities 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 the Securities (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). However, there can be no

assurance that holders of the Securities would thereby recover compensation promptly and/or equal to any loss actually incurred.

***Contractual arrangements between RBSG, other Group companies and/or the bridge bank or private sector purchaser may be created, modified or cancelled***

If RBSG 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 was made subject to the SRR and a partial transfer of its business to another entity was effected, the transfer may directly affect RBSG 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 (among other things) (i) require RBSG or Group companies to support and co-operate with the bridge bank or private sector purchaser; (ii) cancel or modify contracts or arrangements between RBSG or the transferred business and a Group company; or (iii) impose additional obligations on RBSG under new or existing contracts. There can be no assurance that the taking of any such actions would not adversely affect the ability of RBSG to satisfy its obligations under the issued Securities or related contracts.

***A partial transfer of RBSG's business may result in a deterioration of its creditworthiness***

If RBSG 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 RBSG's financial condition and increase the risk that RBSG may eventually become subject to administration or insolvency proceedings pursuant to the Banking Act. In such circumstances, holders of Securities may have a claim for compensation under one of the compensation schemes existing under, or contemplated by, the Banking Act, but there can be no assurance that such holders would thereby recover compensation promptly or equal to any loss actually incurred.

While the main provisions of the Banking (Special Provisions) Act 2008 were in force, which conferred certain transfer powers on HM Treasury, the United Kingdom Government took action under that Act in respect of a number of United Kingdom financial institutions, including, in extreme circumstances, full and part nationalisation. There have been concerns in the market in recent years regarding the risks of such nationalisation in relation to RBSG and other United Kingdom banks. If economic conditions in the United Kingdom or globally were 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 United Kingdom Government may decide to take similar action in relation to RBSG 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 RBSG or Group companies. However, potential impacts may include full nationalisation of RBSG, the total loss of value in Securities issued by RBSG and the inability of RBSG to perform its obligations under the Securities.

If the relevant stabilisation option was effected in respect of RBSG or the stabilisation options were effected in respect of a relevant entity or its business within the Group, HM Treasury would be required to make certain compensation or resolution fund orders, which will depend on the stabilisation power adopted. For example, in the event that the Bank of England were to transfer some of the business of a relevant entity to a bridge bank, HM Treasury would have to make a resolution fund order including a third party compensation order 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 the Securities 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, the Middle East 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 to fully 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 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 United Kingdom Government, the governments of the other EU member states and the United States 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, with many forecasts predicting 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 RBSG and 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.

The performance of the Group may be affected by economic conditions impacting euro-zone member states. For example, the financial problems experienced by the government of Greece may lead to Greece issuing significant volumes of debt, which may in turn reduce demand for debt issued by financial institutions and corporate borrowers. This could adversely affect the Group's access to the debt capital markets and may increase the Group's funding costs, having a negative impact on the Group's earnings and financial condition. In addition, euro-zone countries in which the Group operates will be required to provide financial assistance to Greece, which may in turn have a negative impact on the financial condition of those EU member states. Should the economic conditions facing Greece be replicated in other euro-zone member states, the risks above would be exacerbated.

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 States, 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 Group was required to obtain State Aid approval, for the aid given to the Group by HM Treasury and for the Group's State Aid restructuring plan, from the European Commission. The Group is subject to a variety of risks as a result of implementing the State Aid restructuring plan. The State Aid restructuring plan includes 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 commencing no later than 30 April 2010, which may impair the Group's ability to raise new Tier 1 capital through the issuance of Ordinary Shares and other Securities**

The Group was required to obtain State Aid approval for the aid given to the Group by HM Treasury as part of the placing and open offer undertaken by RBSG in December 2008 (the **"First Placing and Open Offer"**), the issuance of £25.5 billion of B shares in the capital of RBSG (the **"B Shares"**) which are, subject to certain terms and conditions, convertible into ordinary shares in the share capital of RBSG (**"Ordinary Shares"**) to HM Treasury, a contingent commitment by HM Treasury to subscribe for up to an additional £8 billion of B Shares if certain conditions are met and the Group's participation in the Asset Protection Scheme (the **"APS"**) (the **"State Aid"**).

As a result of the First Placing and Open Offer (approved as part of the European Commission's approval of a package of measures to the banking industry in the United Kingdom in October 2008), the Group was required to cooperate with HM Treasury to submit a forward plan to the European Commission. This plan was submitted and detailed discussions took place between HM Treasury, the Group and the European Commission. The plan submitted not only had regard to the First Placing and Open Offer, but also the issuance of B Shares to HM Treasury, the commitment by HM Treasury to subscribe for additional B Shares if certain conditions were met and the Group's participation in the APS. As part of its review, the European Commission was required to assess the State Aid and to consider whether the Group's long-term viability would be assured, that the Group makes a sufficient contribution to the costs of its restructuring and that measures are taken to limit any distortions of competition arising from the State Aid provided to the Group by the United Kingdom Government. The Group, together with HM Treasury, agreed in principle with the European Competition Commissioner the terms of the State Aid and the terms of a restructuring plan (the **"State Aid restructuring plan"**). On 14 December 2009, the European Commission formally approved the Group's participation in the APS, the issuance of £25.5 billion of B Shares to HM Treasury, a contingent commitment by HM Treasury to subscribe for up to an additional £8 billion of B Shares and the State Aid restructuring plan. The State Aid restructuring plan consists of the principal elements set out in Part I, Appendix 4 of the Shareholder Circular, which is incorporated by reference herein. The prohibition on the making of discretionary dividend (including preference shares and B Shares) or coupon payments on existing hybrid capital instruments for a two-year period commencing no later than 30 April 2010 (which RBSG has subsequently announced is 30 April 2010) will prevent RBSG, RBS and other Group companies from paying dividends on their preference shares and coupons on other Tier 1 securities, and RBSG from paying dividends on its Ordinary Shares, 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.

It is possible a third party could challenge the approval decision in the European Courts (within specified time limits). The Group does not believe that any such challenge would be likely to succeed but, if it were to succeed, the European Commission would need to reconsider its decision, which might result in an adverse outcome for the Group, including a prohibition or

amendment to some or all of the terms of the State Aid. The European Commission could also impose conditions that are more disadvantageous, potentially materially so, to the Group than those in the State Aid restructuring plan.

The Group is subject to a variety of risks as a result of implementing the State Aid restructuring plan. 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 United Kingdom 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 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 European 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 European 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.

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 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 the Shareholder Circular, which is incorporated by reference herein.

**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 announced in February 2009 to run-down and sell the Group's non-core assets and the continued review of the Group's portfolio to identify further disposals of certain non-core assets. Assets identified for this purpose and allocated to the Group's Non-Core division totalled £252 billion, excluding derivatives, as at 31 December 2008. At 31 March 2010, this total had reduced to £194 billion, including £14 billion relating to the Group's interest in RBS Semptra Commodities LLP ("**RBS Semptra Commodities**"), which was transferred to the Non-Core division during 2009. This balance sheet reduction programme will continue alongside the disposals under the State Aid restructuring plan approved by the European Commission.

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, 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 the State Aid restructuring plan, the Group is 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 the Shareholder Circular, which is incorporated by reference herein.

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 and liquidity and could result in a loss of value in the Securities.

**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, the Group 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, the Group agreed to undertake a series of measures to be implemented over a four-year period from December 2009, which include disposing of RBS Insurance, the Group's insurance division (subject to potentially maintaining a minority interest until the end of 2014). RBSG will also divest its global card payment services business, Global Merchant Services, by the end of 2013, subject to RBSG 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, a leading global commodities trader, as well as divesting the RBS branch-based business in England and Wales and the NatWest branches in Scotland, along with the direct small and medium-sized enterprise ("SME") customers and certain mid-corporate customers across the United Kingdom. On 16 February 2010, RBSG announced that RBS Sempra Commodities had agreed to sell its Metals, Oil and European Energy business lines, subject to certain conditions including regulatory approvals. The Group and its joint venture partner, Sempra Energy, are continuing to consider ownership alternatives for the remaining North American Power and Gas businesses of RBS Sempra Commodities.

In order to implement the restructurings referred to above, 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 Securities.

**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. During the course of 2008, 2009 and 2010, credit markets worldwide 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 during the course of 2009 money market conditions improved, with the Group seeing a material reduction of funding from central banks and the issuance of non-government guaranteed term debt, further tightening of credit markets could have a negative impact on the Group. The Group, in line with other financial institutions, may need to seek funds from alternative sources, potentially at higher costs of funding than has previously been the case.

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 United Kingdom 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 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 Securities.

**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. 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 Securities.

**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 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 Securities.

**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 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 Securities.

**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 2009. Any deterioration in economic and financial market conditions could lead to further impairment charges and write-downs. Moreover, market volatility and illiquidity (and the assumptions, judgements and estimates in relation to such matters that may change over time and may ultimately not turn out to be accurate) make it difficult to value certain of the Group's exposures. 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 in addition to those already recorded or realised 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 Securities.

Further information about the write-downs which the Group has incurred and the assets it has reclassified during the year ended 31 December 2009 is set out in the audited consolidated financial statements of RBSG for the year ended 31 December 2009, which are incorporated by reference herein.

**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 recent years. 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 RBSG's non-United Kingdom subsidiaries (principally Citizens Financial Group, Inc. ("Citizens"), The Royal Bank of Scotland N.V. 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 United Kingdom Government's credit ratings**

RBSG, 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 RBSG or one of its principal subsidiaries (particularly RBS) 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 the United Kingdom Government ownership and support provided to the Group through HM Treasury's guarantee scheme (announced by the United Kingdom Government on 8 October 2008) (the "**Credit Guarantee Scheme**"), any downgrade in the United Kingdom Government's credit ratings could adversely affect the credit ratings of Group companies and may have the effects noted above. Standard & Poor's and Moody's reaffirmed the United Kingdom Government's AAA rating on 7 May 2010, although Standard & Poor's changed its outlook to "negative" on 21 May 2009. Fitch reaffirmed the United Kingdom Government's stable outlook on 31 July 2009 and Moody's reiterated the United Kingdom Government's stable outlook on 26 October 2009. Credit ratings of RBSG, RBS, ABN AMRO Holding N.V. (which was renamed "RBS Holdings N.V." on 1 April 2010) ("**RBS Holdings N.V.**"), The Royal Bank of Scotland N.V. (which was renamed from "ABN AMRO Bank N.V." on 6 February 2010), 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 RBSG's long-term or short-term credit ratings or those of its principal subsidiaries could adversely affect the Group's access to liquidity and 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 Securities.

**The Group's business performance could be adversely affected if its capital is not managed effectively or if there are changes to capital adequacy and liquidity requirements**

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 resources. The maintenance of adequate capital is also necessary for the Group's financial flexibility in the face of continuing turbulence and uncertainty in the global economy. Accordingly, the purpose of the issuance of the £25.5 billion of B Shares, the grant of the Contingent Subscription (as defined below) and the previous placing and open offers was to allow the Group to strengthen its capital position. The FSA's liquidity policy statement issued in October 2009 states that firms must hold sufficient eligible securities to survive a liquidity stress and this will result in banks holding a greater amount of government securities, to ensure that these institutions have adequate liquidity in times of financial stress.

In addition, on 17 December 2009, the Basel Committee on Banking Supervision (the "**Basel Committee**") proposed a number of fundamental reforms to the regulatory capital framework in its consultative document entitled "Strengthening the resilience of the banking sector". If the



proposals made by the Basel Committee are implemented, this could result in the Group being subject to significantly higher capital requirements. The proposals include: (a) the build-up of a counter-cyclical capital buffer in excess of the regulatory minimum capital requirement, which is large enough to enable the Group to remain above the minimum capital requirement in the face of losses expected to be incurred in a feasibly severe downturn; (b) an increase in the capital requirements for counterparty risk exposures arising from derivatives, repo-style transactions and securities financing transactions; (c) the imposition of a leverage ratio as a supplementary measure to the existing Basel II risk-based measure; (d) the phasing out of hybrid capital instruments as Tier 1 capital and the requirement that the predominant form of Tier 1 capital must be common shares and retained earnings; and (e) the imposition of global minimum liquidity standards that include a requirement to hold a stock of unencumbered high quality liquid assets sufficient to cover cumulative net cash outflows over a 30-day period under a prescribed stress scenario. The proposed reforms are subject to a consultative process and an impact assessment and are not likely to be implemented before the end of 2012. The Basel Committee will also consider appropriate transition and grandfathering arrangements.

These and other future changes to capital adequacy and liquidity requirements in the jurisdictions in which it operates, including the European Commission's public consultation on further possible changes to the Capital Requirements Directive launched in February 2010, may require the Group to raise additional Tier 1, Core Tier 1 and Tier 2 capital by way of further issuances of securities, including in the form of Ordinary Shares or B Shares and could result in existing Tier 1 and Tier 2 securities issued by the Group ceasing to count towards the Group's regulatory capital, either at the same level as present or at all. The requirement to raise additional Core Tier 1 capital could have a number of negative consequences for RBSG and its shareholders, including impairing RBSG's ability to pay dividends on or make other distributions in respect of Ordinary Shares and diluting the ownership of existing shareholders of RBSG. If the Group is unable to raise the requisite Tier 1 and Tier 2 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 State Aid approval, 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 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 provided in the Acquisition and Contingent Capital Agreement (as defined below), the Group would also be subject to restrictions on payments on its hybrid capital instruments should its Core Tier 1 ratio fall below 6 per cent. or if it would fall below 6 per cent. as a result of such payment. For further details of these restrictions, see "Appendix 3 to the Letter From the Chairman of RBS – Principal Terms of Issue of the B Shares and the Dividend Access Share – Undertakings" on pages 77 to 79 of the Shareholder Circular, which is incorporated by reference herein.

As at 31 December 2009, the Group's Tier 1 and Core Tier 1 capital ratios were 14.1 per cent. and 11.0 per cent., respectively, calculated in accordance with FSA definitions (as set out in the audited consolidated financial statements of RBSG for the year ended 31 December 2009, which are incorporated by reference herein). 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 Securities.

**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. 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 recent 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 Securities.

**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 United States and United Kingdom markets from other European and Asian countries, could increase competitive pressures on the Group.

In addition, certain competitors may have access to lower cost funding and/or 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 Securities.

**As a condition to HM Treasury support, RBSG has agreed to certain undertakings which may serve to limit the Group's operations**

Under the terms of the First Placing and Open Offer, RBSG provided certain undertakings aimed at ensuring that the subscription by HM Treasury of the relevant 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 United Kingdom 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 placing and open offer undertaken by RBSG in April 2009 (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. Pursuant to these arrangements, RBS agreed to make available to creditworthy borrowers on commercial terms, £16 billion above the amount RBSG had budgeted to lend to United Kingdom businesses and £9 billion above the amount RBSG had budgeted to lend to United Kingdom homeowners in the year commencing 1 March 2009. For a description of these undertakings, see paragraph 9 of Part IV of the Shareholder Circular, which is incorporated by reference herein.

In relation to the 2009 commitment period, which ended on 28 February 2010, the Group's net mortgage lending to UK homeowners was £12.7 billion above the amount it had originally budgeted to lend. In relation to its business lending commitment, the Group achieved £60 billion of gross new lending to businesses, including £39 billion to SMEs but, in the economic environment prevailing at the time, many customers were strongly focused on reducing their borrowings and repayments consequently increased. Moreover, the withdrawal of foreign lenders was less pronounced than anticipated, there was a sharp increase in capital market issuance and demand continued to be weak. As a result, the Group's net lending did not reach the £16 billion targeted.

In March 2010, RBS agreed with the United Kingdom Government certain adjustments to the lending commitments for the 2010 commitment period (the 12 month period commencing 1 March 2010), to reflect expected economic circumstances over the period. As part of the amended lending commitments, RBS has committed, among other things, to make available gross new facilities, drawn or undrawn, of £50 billion to UK businesses in the period 1 March 2010 to 28 February 2011. In addition, RBS has agreed with the United Kingdom government to make available £8 billion of net mortgage lending in the 2010 commitment period. This is a decrease of £1 billion on the net mortgage lending target that previously applied to the 2010 commitment period which ends on 28 February 2011, to reflect that the mortgage lending commitment for the 2009 commitment period was increased from £9 billion to £10 billion.

The Group has also agreed to certain other commitments, which are material for the structure of the Group and its operations, under the State Aid restructuring plan approved by the European Commission in relation to State Aid, as set out in Part I, Appendix 4 of the Shareholder Circular, which is incorporated by reference herein.

In addition, the Group, together with HM Treasury, has agreed with the European Commission 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 from a date commencing no later than 30 April 2010 (which RBSG has subsequently announced is 30 April 2010). 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, changes to capital requirements such as the proposals published by the Basel Committee on 17 December 2009 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 the Shareholder Circular, which is incorporated by reference herein (the “**Acquisition and Contingent Capital Agreement**”).

The undertakings described above may serve to limit the Group’s operations. See also “HM Treasury (or UKFI on its behalf) may be able to exercise a significant degree of influence over the Group.”

**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 RBSG). The Group has made a commitment to comply with the FSA Remuneration Code. These rules came 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 granted UK Financial Investments Limited (“**UKFI**”) consent rights over the shape and size of its aggregate bonus pool for the 2009 performance year. The deferral and claw-back provisions implemented by the Group may impair the ability of the Group to attract and retain suitably qualified personnel in various parts of the Group’s businesses.

The Group has altered certain of the pension benefits it offers to staff. Some employees continue to participate in defined benefit arrangements. The following two changes have been made to the main defined benefit pension plans: (i) a yearly limit on the amount of any salary increase that will count for pension purposes; and (ii) a reduction in the severance lump sum for those who take an immediate undiscounted pension for redundancy. 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 Securities.

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 States, the United Kingdom 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 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 Securities.

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

- the introduction of a banking levy;
- employee remuneration;
- government-imposed requirements with respect to lending to the United Kingdom SME market;
- a separation of retail banking from investment banking and restrictions on proprietary trading and similar activities within a commercial bank and/or a group which contains a commercial bank;
- the monetary, interest rate, capital adequacy, liquidity, balance sheet leverage and other policies of central banks and regulatory authorities;
- 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, increase the costs of doing business in those markets or result in a reduction in the credit ratings of RBSG or one of its subsidiaries;
- changes to financial reporting standards;
- changes in regulatory requirements relating to capital and liquidity, 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, new levies or fees, requirements in relation to the structure and organisation of the Group 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, corporate structure, conduct of business and employee compensation;
- differentiation among 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 the 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 accounting write-down of goodwill and other intangibles relating to prior year acquisitions (see the 2008 annual report and accounts of RBSG, which is incorporated by reference herein). For the year ended 31 December 2009, the Group recorded a £363 million accounting write-down of goodwill and other intangible assets principally relating to RBS Holdings N.V. (formerly ABN AMRO Holding N.V.) and NatWest goodwill allocated to Non-Core businesses (as set out in the audited consolidated financial statements of RBSG for the year ended 31 December 2009, which are incorporated by reference herein).

**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 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 prospect 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 Securities. 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, anti-money laundering investigations 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 Securities. For details about certain litigation and regulatory investigations in which the Group is involved, see the sections of this document entitled "Description of The Royal Bank of Scotland Group plc - Litigation" and "Description of The Royal Bank of Scotland Group plc – Investigations".

**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 the price of any Securities. Notwithstanding anything contained in this risk factor, it should not be taken as implying that RBSG will be unable to comply with its obligations as a company with securities admitted to the Official List of the United Kingdom Listing Authority (the "**Official List**")

nor that it, or its relevant subsidiaries, will be unable to comply with its or their obligations as supervised firms 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.

**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 RBSG. 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. 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 RBSG for the benefit of its members as a whole.

**The offer or sale by the United Kingdom Government of all or a portion of its stake in RBSG could affect the market price of the Securities and related securities**

The United Kingdom Government currently holds 68.4 per cent. of the issued ordinary share capital of RBSG. On 22 December 2009, RBSG issued £25.5 billion of B Shares to the United Kingdom Government. The B Shares are convertible, at the option of the holder at any time, into Ordinary Shares. The United Kingdom Government has agreed that it shall not exercise rights of conversion in respect of the B Shares if and to the extent that following any such conversion it would hold more than 75 per cent. of the total issued shares in RBSG. The United Kingdom Government may sell all or a part of the Ordinary Shares that it owns at any time. Offers or sales by the United Kingdom Government of a substantial number of Ordinary Shares or securities convertible or exchangeable into Ordinary Shares, or an expectation that it may undertake such an offer or sale, could affect prevailing market prices for the Securities and related securities.

**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. As at 31 December 2009, the Group had accrued £135 million for its share of Compensation Scheme management expenses levies for the 2009/10 and 2010/2011 Compensation Scheme years (as set out in the audited consolidated financial statements of RBSG for the year ended 31 December 2009, which are incorporated by reference herein).

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

### **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 plan for RBS Holdings N.V. is complex and may not realise the anticipated benefits for the Group**

The restructuring plan in place for the integration and separation of ABN AMRO Holding N.V. (which was renamed “RBS Holdings N.V.” on 1 April 2010) into and among the businesses and operations of the Consortium Members (as defined in “Description of The Royal Bank of Scotland

Group plc – The Group” below) is complex, involving substantial reorganisation of RBS Holdings N.V.’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. As part of this reorganisation, on 6 February 2010, the majority of the businesses of RBS Holdings N.V. acquired by the Dutch State were legally demerged from the RBS Holdings N.V. businesses acquired by the Group and were transferred into a newly established company, ABN AMRO Bank N.V. (formerly named ABN AMRO II N.V.). This company was transferred to ABN AMRO Group N.V., a company wholly owned by the Dutch State, on 1 April 2010. Certain assets and liabilities of RBS Holdings N.V. acquired by the Dutch State were not part of the transfer which occurred on 1 April 2010 and remain within ABN AMRO Bank N.V. (now The Royal Bank of Scotland N.V.). These will be transferred to the Dutch State as soon as possible. In addition, certain assets within The Royal Bank of Scotland N.V. continue to be under shared ownership by the Consortium Members.

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.

**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. In particular, on 17 December 2009, the Basel Committee published a consultative document setting out certain proposed changes to capital requirements (see risk factor above headed “The Group’s business performance could be adversely affected if its capital is not managed effectively or if there are changes to capital adequacy and liquidity requirements”). Those proposals included a requirement that deferred tax assets which rely on future profitability of the Group to be realised should be deducted from the common equity component of Tier 1 and therefore not count towards Tier 1 capital.

## **RISKS RELATING TO THE GROUP'S PARTICIPATION IN THE ASSET PROTECTION SCHEME, THE B SHARES, THE CONTINGENT B SHARES AND THE DIVIDEND ACCESS SHARE**

Owing to the complexity, scale and unique nature of the APS and the uncertainty surrounding the duration and severity of the recent 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 assets and exposures (the **"Covered Assets"**) in a number of jurisdictions and there is significant uncertainty about the duration and severity of the recent 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 was based on predictions at the time of its accession to the APS 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 the value of any Securities 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's participation in the APS, together with the issue of £25.5 billion of B Shares in December 2009 and, if required, the £8 billion Contingent B Shares (as defined below), has improved its consolidated capital ratios. In the event that the Group's Core Tier 1 capital ratio declines to below 5 per cent., and if certain conditions are met, HM Treasury is committed to subscribe (the **"Contingent Subscription"**) for up to an additional £8 billion of B Shares (the **"Contingent B Shares"**) and, in connection with such subscription, would receive further enhanced dividend rights under the associated series 1 dividend access share in the capital of RBSG (the **"Dividend Access Share"**). However, notwithstanding the Group's participation in the APS and the issue of the £25.5 billion of B Shares and, if required, the issue of the £8 billion Contingent B Shares, 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 the Shareholder Circular, which is incorporated by reference herein). In addition, as mentioned in the previous risk factor, the assets or exposures 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 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 the price of the Securities to decline substantially and may result in intervention by the Authorities, which could include full nationalisation or other resolution procedures under the Banking Act. In that case, any compensation payable to holders of the Securities would be subject to the provisions of the Banking Act, and investors may receive no value for their Securities.

**In the event that the Group's Core Tier 1 capital ratio declines to below 5 per cent., HM Treasury is committed to subscribe for up to an additional £8 billion of Contingent B Shares if certain conditions are met. If such conditions are not met, and RBSG is unable to issue the £8 billion Contingent B Shares, 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**

In the event that the Group's Core Tier 1 capital ratio declines to below 5 per cent., HM Treasury is committed to subscribe for up to an additional £8 billion of Contingent B Shares if certain conditions are met. Such conditions include that the European Commission's decision that the State Aid is compatible with article 107 of the consolidated version of the Treaty on the Functioning of the European Union (the "TFEU") (ex-article 87 of the Treaty establishing the European Community) continues to be in force, that the European Commission has not opened a formal investigation under article 108(2) of the TFEU (ex-article 88(2) of the Treaty establishing the European Community) in relation to the possible misuse of State Aid, that there has been no breach by RBSG of the State Aid Commitment Deed and that no Termination Event has occurred (as defined in Part VI of the Shareholder Circular, which is incorporated by reference herein).

If such conditions are not met, and RBSG is unable to issue the £8 billion Contingent B Shares, 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.

In these circumstances, if RBSG is unable to issue 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 RBSG is unable to issue 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 the price of the Securities to decline substantially and may result in intervention by the Authorities or other regulatory bodies in the other jurisdictions in which RBSG 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 holders of Securities would be subject to the provisions of the Banking Act, and investors may receive no value for their Securities (see the risk factor headed "RBSG and its United Kingdom

bank subsidiaries may face the risk of full nationalisation or other resolution procedures under the Banking Act 2009" above).

**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 (as defined in Part VI of the Shareholder Circular, which is incorporated by reference herein), 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 failure to pay, a bankruptcy or a restructuring, as described in the UK Asset Protection Scheme Terms and Conditions (the "**Scheme Conditions**") in respect of that Covered Asset (a "**Trigger**"), 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 applied from 31 December 2008 and therefore may not have been complied with between this date and the date of the Group's accession to the APS on 22 December 2009. 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, as at 31 March 2010, approximately £2 billion of derivative and structured finance assets were included in the APS which, for technical reasons, do not currently satisfy, or are anticipated at some stage not to satisfy, the eligibility requirements specified in the Scheme Documents. HM Treasury and RBS continue to negotiate in good faith to establish whether (and if so, to what extent) coverage should extend to these assets. In addition,

RBS and HM Treasury have a difference of opinion as to the status of certain structured credit assets for the purposes of the Scheme. Discussions on the relevant areas of interpretation are ongoing and the determination of the status of those assets is dependent on how the matters under discussion are resolved.

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, (v) failure or potential failure of HM Treasury and RBS to reach agreement in respect of whether (and if so, to what extent) cover should extend to certain ineligible assets and (vi) failure or potential failure of HM Treasury and RBS to reach agreement on the classifications of some structured credit assets included in the APS, 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 price of the Securities 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 holders of Securities would be subject to the provisions of the Banking Act, and investors may receive no value for their Securities.

**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**

The Group is 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 is 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 the Group, 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 the Group 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 price of the Securities 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 holders of Securities would be subject to the provisions of the Banking Act, and investors may receive no value for their Securities.

**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 Group, 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 the Shareholder Circular, which is incorporated by reference herein); and (ii) any of the overarching principles governing the APS as set out in Annex 3 of the Shareholder Circular, which is incorporated by reference herein (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 the Group 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 the Group regarding the anticipated impact of the proposed modification under any non-United Kingdom capital adequacy regime which is binding on RBSG or a Covered Entity (as defined in the accession agreement between HM Treasury and RBSG which incorporates the Scheme Conditions and sets out certain other terms and conditions applicable to RBSG's participation in the APS (the "**Accession Agreement**")).

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 United Kingdom 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 the Group 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 in December 2009 and, if required, the £8 billion Contingent B Shares was to improve capital ratios at a consolidated level for the Group and at an individual level for certain relevant Group members. The Group has entered and may in the future enter into further 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 the 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 limited and its cost of funding to increase. The occurrence of any or all of such events may cause the price of the Securities 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 holders of Securities would be subject to the provisions of the Banking Act and investors may receive no value for their Securities.

**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 per annum, 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 United Kingdom tax reliefs that are treated as deferred tax assets (pursuant to three agreements which provide the right, at RBSG's option, subject to HM Treasury consent, to satisfy all or part of the annual fee in respect of the APS and £8 billion of Contingent B Shares, and the exit fee



payable in connection with any termination of the Group's participation in the APS, by waiving the right to certain United Kingdom tax reliefs that are treated as deferred tax assets ("**Tax Loss Waiver**") or be funded by a further issue of B Shares to HM Treasury. The Group has paid in cash the fee of £1.4 billion in respect of 2009 and 2010. On termination of the Group's participation in the APS, the fees described in the risk factor below headed "The Group 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 either have been or will also be incurred in (i) establishing the APS (including a portion of HM Treasury's costs attributed to the Group by HM Treasury), (ii) implementing the APS, including the Group'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 £8 billion of Contingent B Shares 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 RBSG of a partial termination of the Contingent Subscription (payable in cash or, with HM Treasury's consent, by waiving certain United Kingdom 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 RBSG'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 the Group'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 the Shareholder Circular, which is incorporated by reference herein)) 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.

**The Group 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 will pay an annual participation fee to HM Treasury. The annual fee, which is payable in advance, is £700 million per annum for the first three years of the Group'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 2009. The Group has paid in cash the fee of £1.4 billion in respect of 2009 and 2010. 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 payments the Group has received from HM Treasury under the APS) may be paid by the waiver of certain United Kingdom tax reliefs that are treated as deferred tax assets (pursuant to the Tax Loss Waiver). The directors of RBSG 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 the Shareholder Circular, which is incorporated by reference herein, 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 Covered Assets in respect of which a Trigger occurs ("**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 Securities. 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 Securities.

**Under certain circumstances, the Group cannot be assured that assets of RBS Holdings N.V. (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 RBS Holdings N.V. or its wholly-owned subsidiaries, RBS Holdings N.V. 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 the Group from the APS where permissible under the Scheme Conditions or, otherwise, with HM Treasury consent. If the Group 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 the Group loses cover under the APS in respect of any Covered Asset held by RBS Holdings N.V. or its wholly-owned subsidiaries, any losses incurred on such asset will continue to be borne fully by the Group 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 Securities**

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 United Kingdom 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 United Kingdom Parliament, the European Commission, and more widely if HM Treasury determines that doing so is required, for example, to protect the stability of the United Kingdom financial system. For further information on these obligations, see "Management and governance of Covered Assets" in Part I, Appendix 2 of the Shareholder Circular, which is incorporated by reference herein.

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 the Shareholder Circular, which is incorporated by reference herein. If the Group does not comply with the instructions of the step-in manager, once appointed, the Group 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 the Group.

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 the Group 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 the Shareholder Circular, which is incorporated by reference herein).

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 RBSG, and could result in the delisting of RBSG's Securities**

On 22 December 2009, RBSG issued £25.5 billion of B Shares to HM Treasury. The B Shares are 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 RBSG to above 75 per cent. of RBSG's ordinary issued share capital, which would put RBSG in breach of the FSA's Listing Rules requirement that at least 25 per cent. of its issued ordinary share capital must be in public hands. Although RBSG may apply to the FSA in its capacity as the competent authority under the FSMA 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 RBSG 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 RBSG. In addition, holders of the B Shares will only be entitled to receive notice of and to attend any general meeting of RBSG and to speak to or vote upon any resolution proposed at such meeting if a resolution is proposed which either varies or abrogates any of the rights and restrictions attached to the B Shares or proposes the winding up of RBSG (and then in each such case only to speak and vote upon any such resolution).

**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**

Significant senior management and key employee time and resources 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 places 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 RBSG 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 United Kingdom 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 United Kingdom and overseas in connection with the APS and the associated intra-group arrangements which would not otherwise have arisen. The Tax Loss Waiver provides 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 the Group requiring the information that HM Treasury required 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 not 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 Securities. 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 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 the Shareholder Circular, which is incorporated by reference herein). 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.

***Investors should be aware that the materialisation of any of the above risks may adversely affect the value of any Securities.***

## DESCRIPTION OF THE ROYAL BANK OF SCOTLAND GROUP PLC

### The Group

RBSG is a public limited company incorporated in Scotland with registration number SC045551. RBSG was incorporated under Scots law on 25 March 1968. RBSG is the holding company of a large global banking and financial services group. Headquartered in Edinburgh, the Group operates in the United Kingdom, the United States and internationally through its two principal subsidiaries, RBS and NatWest. Both RBS and NatWest are major United Kingdom clearing banks whose origins go back over 275 years. In the United States, the Group's subsidiary Citizens is a large commercial banking organisation. The Group has a large and diversified customer base and provides a wide range of products and services to personal, commercial and large corporate and institutional customers in over 50 countries.

The United Kingdom Government currently holds 68.4 per cent. of the issued ordinary share capital of RBSG. This was reduced from 70.3 per cent following completion of a conversion of certain preference shares into Ordinary Shares on 31 March 2010. On 22 December 2009, RBSG issued £25.5 billion of B Shares to HM Treasury. The B Shares are convertible, at the option of the holder at any time, into Ordinary Shares. HM Treasury has agreed that it shall not exercise rights of conversion in respect of the B Shares if and to the extent that following any such conversion it would hold more than 75 per cent. of the total issued shares in RBSG. Furthermore, HM Treasury has agreed that it shall not be entitled to vote in respect of the B Shares or the Dividend Access Share held by it to the extent that votes cast on such shares, together with any other votes which HM Treasury is entitled to cast in respect of any other 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 RBSG.

The issue of the £25.5 billion of B Shares to HM Treasury on 22 December 2009 increased HM Treasury's economic interest in RBSG to 84.4 per cent. but this was reduced to 83.2 per cent following completion of a conversion of certain preference shares into Ordinary Shares on 31 March 2010. If the £8 billion Contingent B Shares were issued to HM Treasury (which is subject to certain conditions being met), assuming no other dilutive issuances, HM Treasury's economic interest in RBSG would increase further to 85.3 per cent. In addition, HM Treasury's economic interest in RBSG would also increase if RBSG 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 or the B Shares.

The Group had total assets of £1,696.5 billion and owners' equity of £77.7 billion as at 31 December 2009. The Group's capital ratios at that date, which included the equity minority interest of the State of the Netherlands and Banco Santander S.A. ("**Santander**") in RBS Holdings N.V., were a total capital ratio of 16.1 per cent., a Core Tier 1 capital ratio of 11.0 per cent. and a Tier 1 capital ratio of 14.1 per cent.

On 17 October 2007, RFS Holdings B.V. ("**RFS Holdings**"), which at the time was owned by RBSG, Fortis N.V., Fortis S.A./N.V., Fortis Bank Nederland (Holding) N.V. and Banco Santander, S.A. ("**Santander**"), completed the acquisition of ABN AMRO Holding N.V. (which was renamed RBS Holdings N.V. on 1 April 2010). RFS Holdings, which is now jointly owned by RBSG, the Dutch State and Santander (the "**Consortium Members**"), has substantially completed an orderly separation of the business units of RBS Holdings N.V. As part of this reorganisation, on 6 February 2010, the businesses of RBS Holdings N.V. acquired by the Dutch State were legally demerged from the RBS Holdings N.V. businesses acquired by the Group and were transferred into a newly established holding company, ABN AMRO Bank N.V. (save for certain assets and liabilities

acquired by the Dutch State that were not part of the legal separation and which will be transferred to the Dutch State as soon as possible). Legal separation of ABN AMRO Bank N.V. occurred on 1 April 2010, with the shares in that entity being transferred by RBS Holdings N.V. to a holding company called ABN AMRO Group N.V., which is owned by the Dutch State. Certain assets within RBS Holdings N.V. continue to be shared by the Consortium Members. Following the legal separation, RBS Holdings N.V. has one direct subsidiary, The Royal Bank of Scotland N.V., a fully operational bank within the Group. The Royal Bank of Scotland N.V. is independently rated and regulated by the Dutch Central Bank.

#### **Accession to the Asset Protection Scheme and issuance of £25.5 billion of B Shares and Dividend Access Share to HM Treasury**

On 22 December 2009, the Group entered into the APS and RBSG issued to HM Treasury £25.5 billion of B Shares and the Dividend Access Share. For further details of the APS, the issuance of the £25.5 billion of B Shares, the Dividend Access Share and the £8 billion Contingent B Shares, see the sections of the Shareholder Circular that are incorporated by reference herein.

#### **State Aid**

On 14 December 2009, the European Commission announced that the College of Commissioners had given final approval under the State Aid rules to the APS and to the State Aid restructuring plan of RBSG. Having assessed the State Aid and RBS's State Aid restructuring plan, the European Commission was satisfied that the aid measures and the restructuring plan are in line with the European Commission's communications on State Aid to the financial sector and, as such, are compatible with EU rules on State Aid.

To comply with State Aid clearance, RBSG has agreed to undertake a series of measures to be implemented over a four-year period from December 2009, which include disposing of RBS Insurance, the Group's insurance division (subject to potentially maintaining a minority interest until the end of 2014). RBSG will also divest by the end of 2013 Global Merchant Services, subject to RBSG 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 and certain mid-corporate 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.

On 16 February 2010, RBSG announced that RBS Sempra Commodities had agreed to sell its Metals, Oil and European Energy business lines to J.P. Morgan for a consideration of US\$1.7 billion, representing a premium of US\$468 million to tangible net assets, subject to certain conditions including regulatory approvals. After goodwill and reserves, RBSG expects to report a small gain on the transaction, with a slightly positive impact on core tier 1 capital. The Group and its joint venture partner, Sempra Energy, are continuing to consider ownership alternatives for the remaining North American Power and Gas businesses of RBS Sempra Commodities.

#### **The Group's businesses**

Following a comprehensive strategic review, changes were made to the Group's operating segments in 2009. A Non-Core division was created comprising those lines of business, portfolios and individual assets that the Group intends to run off or sell. Furthermore, Business Services (formerly Group Manufacturing) is no longer reported as a separate division and its costs are now allocated to the customer-facing divisions along with certain central costs. UK Retail & Commercial Banking has been split into three segments (UK Retail, UK Corporate and Wealth). Ulster Bank

has become a specific segment. The remaining elements of Europe & Middle East Retail & Commercial Banking, Asia Retail & Commercial Banking and the Group's share of shared RBS Holdings N.V. assets form part of the Non-Core division. The Group's organisational structure comprises the following divisions:

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

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

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

**Global Banking & Markets ("GBM")** is a leading banking partner to major corporations and financial institutions around the world, providing an extensive range of debt and equity financing, risk management and investment services to its customers. The division is organised along five principal business lines: money markets; rates flow trading; currencies and commodities; equities; credit markets and portfolio management and origination.

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

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

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

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

**Business Services** (formerly Group Manufacturing) supports the customer-facing businesses and provides operational technology, customer support in telephony, account management, lending and money transmission, global purchasing, property and other services. Business Services drives efficiencies and supports income growth across multiple brands and channels by using a single, scalable platform and common processes wherever possible. It also leverages the Group's



purchasing power and is the Group's centre of excellence for managing large-scale and complex change.

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

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

### **The Placing and Open Offers**

Following the First Placing and Open Offer in December 2008, HM Treasury owned approximately 58 per cent. of the enlarged ordinary share capital of RBSG and £5 billion of non-cumulative sterling preference shares. In April 2009, RBSG issued new Ordinary Shares by way of the Second Placing and Open Offer, the proceeds from which were used in full to fund the redemption of the preference shares held by HM Treasury at 101 per cent. of their issue price together with the accrued dividend and the commissions payable to HM Treasury under the Second Placing and Open Offer Agreement. The Second Placing and Open Offer was underwritten by HM Treasury and as a result, HM Treasury currently holds 68.4 per cent. of the issued ordinary share capital of RBSG.

### **Liability Management Transactions**

In April 2010, the Group announced (i) an invitation to holders of certain existing Upper Tier 2 debt securities of the Group to offer to exchange any or all of such securities for new senior unsecured notes of RBS and (ii) invitations to holders of certain existing preference shares, trust preferred securities and other Tier 1 securities of the Group to tender such securities for purchase by RBSG and NatWest for cash (together the "**Liability Management Transactions**"). Settlement of the Liability Management Transactions occurred in May 2010 and generated an after-tax gain of approximately £1.25 billion, which increased the Group's Core Tier 1 capital by approximately 0.3 per cent. and resulted in a reduction in the Group's Total Tier 1 capital of approximately 0.5 per cent. As part of the Liability Management Transactions, RBS issued the equivalent of £1.75 billion of senior unsecured notes under its Euro Medium Term Note programme.

### **Relationship with RBSG's major shareholder**

The United Kingdom Government currently owns 68.4 per cent. of the issued ordinary share capital of RBSG. The United Kingdom Government's shareholding in RBSG is currently held by the Solicitor for the Affairs of HM Treasury as nominee for HM Treasury and managed by UKFI, a company wholly owned by HM Treasury. The relationship between HM Treasury and UKFI, and between UKFI and Government investee banks is set out in the UKFI Framework Document and Investment Mandate, agreed between HM Treasury and UKFI.

The Framework Document sets out UKFI's overarching objective, to "develop and execute an investment strategy for disposing of the investments in an orderly and active way through sale, redemption, buy-back or other means within the context of an overarching objective of protecting and creating value for the taxpayer as shareholder, paying due regard to the maintenance of financial stability and to acting in a way that promotes competition."

It states that UKFI will operate “on a commercial basis and at arm’s length from Government” and will manage the UK financial institutions in which HM Treasury holds an interest “on a commercial basis and will not intervene in day-to-day management decisions of the Investee Companies.” HM Treasury expects UKFI to act in the same way as any other engaged institutional shareholder would. The UKFI Investment Mandate states that it will “follow best institutional shareholder practice. This includes compliance with the Institutional Shareholders’ Committee’s Statement of Principles together with any developments to best institutional shareholder practice arising from recommendations or guidance contained in the Walker Review or elsewhere.”

For example, RBSG announced on 17 February 2009 that it had reached an agreement with UKFI in respect of certain changes to its remuneration policy. RBSG also undertook to conduct a review of its strategy and UKFI was actively engaged in reviewing the output of this review, as any other engaged shareholder would be expected to be. RBSG has made a commitment to comply with the FSA Remuneration Code. These rules came 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. UKFI was granted consent rights over the shape and size of the RBS aggregate bonus pool for the 2009 performance year. Separate to the shareholding relationship, RBSG has a number of relationships with the United Kingdom Government arising out of the Government’s provision of support.

As a result of the Government’s recapitalisation of RBSG, an undertaking was given to UKFI in 2008 to appoint a new Chairman and three new non-executive directors to the Group Board. This undertaking has been completed by the following appointments: Philip Hampton as Chairman, Sandy Crombie as Senior Independent Director and Philip Scott and Penny Hughes as non-executive directors. In addition, Brendan Nelson was appointed as a non-executive director with effect from 1 April 2010. Subsequently, UKFI were consulted as majority shareholder on proposed non-executive director appointments but in all cases the usual process for appointments was followed i.e. candidates were considered by the Nominations Committee and then recommended to the Group Board for approval. For the avoidance of doubt, no member of the Board represents or acts on the instructions of UKFI or HMT. There is no further arrangement with UKFI in this regard, beyond usual shareholder rights, and no such arrangements with any other shareholder.

In connection with the Group’s accession to the APS (further details of which are set out above), RBSG has undertaken to provide lending to creditworthy UK homeowners and businesses in a commercial manner. RBSG’s compliance with this commitment is subject to a monthly reporting process to the United Kingdom Government. The lending commitment does not require RBSG to engage in uncommercial practices. For further details, see the risk factor headed “As a condition to HM Treasury support, RBSG has agreed to certain undertakings which may serve to limit the Group’s operations and it may be required to agree to further restrictions in the future”.

Certain other considerations relating to RBSG’s relationship with HM Treasury and UKFI are set out in the risk factors headed “HM Treasury (or UKFI on its behalf) may be able to exercise a significant degree of influence over the Group” and “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”.

Other than in relation to these areas, however, UKFI’s governance documents state that the United Kingdom Government’s intention is to allow the financial institutions in which it holds an interest to operate their business independently.

As a result of the United Kingdom Government’s holding, the United Kingdom Government and United Kingdom Government-controlled bodies became related parties of the Group.

In the normal course of business the Group enters into transactions with many of these bodies on an arms' length basis.

The Group is not a party to any transaction with the United Kingdom Government or any United Kingdom Government-controlled body involving goods or services which is material to the Group, or any such transaction that is unusual in its nature or conditions. To the Group's knowledge, the Group is not a party to any transaction with the United Kingdom Government or any United Kingdom Government-controlled body involving goods or services which is material to the United Kingdom Government or any United Kingdom Government-controlled body. However, given the nature and extent of the United Kingdom Government-controlled bodies, the Group may not know whether a transaction is material for such a party.

Any outstanding loans made by the Group to or for the benefit of the United Kingdom Government or any United Kingdom Government-controlled body, were made on an arm's length basis and (A) such loans were made in the ordinary course of business, (B) were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons, and (C) did not involve more than the normal risk of collectability or present other unfavourable features. The Group notes, however, that with respect to outstanding loans made by the Group to or for the benefit of the United Kingdom Government or any United Kingdom Government-controlled body, there may not exist any comparable transactions with other persons.

### **Principal subsidiary undertakings**

RBSG's directly owned principal operating subsidiaries are RBS and RBS Insurance Group Limited. In addition, RFS Holdings is controlled by RBSG. Each of these companies is included in the consolidated financial statements of RBSG and has an accounting reference date of 31 December.

RBS is wholly-owned by RBSG and supervised by the Financial Services Authority as a bank.

The principal subsidiary undertakings of RBS are shown below. Their capital consists of ordinary and preference shares, which are unlisted with the exception of certain preference shares issued by NatWest.

All of the subsidiary undertakings are owned directly or indirectly through intermediate holding companies and are wholly-owned. All of these subsidiaries are included in the consolidated financial statements of RBSG and have an accounting reference date of 31 December.

- Citizens Financial Group, Inc.
- Coutts & Co
- RBS Securities Inc.
- National Westminster Bank Plc
- Ulster Bank Limited

### **Litigation**

As a participant in the financial services industry, the Group operates in a legal and regulatory environment that exposes it to potentially significant litigation risks. As a result, RBSG and other members of the Group are involved in various disputes and legal proceedings in the United Kingdom, the United States and other jurisdictions, including litigation. Such cases are subject to

many uncertainties, and their outcome is often difficult to predict, particularly in the earlier stages of a case.

Other than as set out in this section entitled “Litigation” on pages 41 to 43 (excluding the sub-headings “World Online International N.V.” and “Summary of other disputes, legal proceedings and litigation”), neither RBSG nor any of its subsidiaries is or has been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which RBSG is aware) during the 12 months prior to the date of this Registration Document, which may have, or have had in the recent past, a significant effect on RBSG and its subsidiaries taken as a whole.

In relation to the subject matter of this section, RBSG will comply with its obligations as a company with securities admitted to the Official List of the United Kingdom Listing Authority or as a supervised firm regulated by the FSA.

#### *Unarranged overdraft charges*

In common with other banks in the United Kingdom, RBS and NatWest have received claims and complaints from a large number of customers in the United Kingdom seeking refunds of unarranged overdraft charges (the “**Charges**”). The vast majority of these claims and complaints have challenged the Charges on the basis that they contravene the Unfair Terms in Consumer Contracts Regulations 1999 (the “**Regulations**”) or are unenforceable under the common law penalty doctrine (or both).

In July 2007, the Office of Fair Trading (“**OFT**”) issued proceedings in a test case in the English High Court against the banks which was intended to determine certain issues concerning the legal status and enforceability of contractual terms relating to the Charges. The test case concluded in November 2009 with a judgment of the Supreme Court in favour of the banks. As a result of the court rulings made in the test case, the Group expects substantially all of the customer claims and complaints it has received relating to the Charges to fail. The Group cannot at this stage predict with any certainty the final outcome of all customer claims and complaints. It is unable reliably to estimate any liability that may arise as a result of or in connection with these matters or its effect on the Group’s consolidated net assets, operating results or cash flows in any particular period.

#### *Shareholder litigation*

RBSG and a number of its subsidiaries and certain individual officers and directors have been named as defendants in a class action filed in the United States District Court for the Southern District of New York. The consolidated amended complaint alleges certain false and misleading statements and omissions in public filings and other communications during the period 1 March 2007 to 19 January 2009, and variously asserts claims under Sections 11, 12 and 15 of the Securities Act 1933, Sections 10 and 20 of the Securities Exchange Act 1934 and Rule 10b-5 thereunder.

The putative class is composed of (1) all persons who purchased or otherwise acquired Group securities between 1 March 2007 and 19 January 2009; and/or (2) all persons who purchased or otherwise acquired RBSG Series Q, R, S, T and/or U non-cumulative dollar preference shares issued pursuant or traceable to the 8 April 2005 SEC registration statement and were damaged thereby. Plaintiffs seek unquantified damages on behalf of the putative class.

The Group has also received notification of similar potential claims in the United Kingdom and elsewhere but no court proceedings have been commenced in relation to these claims.

The Group considers that it has substantial and credible legal and factual defences to these claims and will defend them vigorously. The Group is unable reliably to estimate the liability, if any, that

might arise or its effect on the Group's consolidated net assets, operating results or cash flows in any particular period.

#### *Other securitisation and securities related litigation in the United States*

Group companies have been named as defendants in a number of purported class action and other lawsuits in the United States that relate to the securitisation and securities underwriting businesses. In general, the cases involve the issuance of mortgage-backed securities, collateralised debt obligations, or public debt or equity where the plaintiffs have brought actions against the issuers and underwriters of such securities (including Group companies) claiming that certain disclosures made in connection with the relevant offerings of such securities were false or misleading with respect to alleged "sub-prime" mortgage exposure. The Group considers that it has substantial and credible legal and factual defences to these claims and will continue to defend them vigorously. The Group cannot at this stage reliably estimate the liability, if any, that may arise as a result of or in connection with these lawsuits, individually or in the aggregate, or their effect on the Group's consolidated net assets, operating results or cash flows in any particular period.

#### *World Online International N.V.*

In November 2009, the Supreme Court in the Netherlands gave a declaratory judgment against World Online International N.V., Goldmans Sachs International and ABN AMRO Bank N.V. (now known as The Royal Bank of Scotland N.V.) in relation to claims arising out of the World Online initial public offering of 2000. It held that these defendants had committed certain wrongful acts in connection with the initial public offering. The judgment does not establish liability or the amount of any loss. The Group does not believe that any final liability or loss will have a significant effect on the Group's financial position or profitability.

#### *Summary of other disputes, legal proceedings and litigation*

Members of the Group are engaged in other litigation in the United Kingdom and a number of overseas jurisdictions, including the United States, involving claims by and against them arising in the ordinary course of business. The Group has reviewed these other actual, threatened and known potential claims and proceedings and, after consulting with its legal advisers, does not expect that the outcome of these other claims and proceedings will have a material adverse effect on the Group's financial position or profitability in any particular period.

### **Investigations**

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

In particular there is continuing political and regulatory scrutiny of the operation of the retail banking and consumer credit industries in the United Kingdom and elsewhere. The nature and impact of future changes in policies and regulatory action are not predictable and are beyond the Group's control but could have an adverse impact on the Group's businesses and earnings.

### *Retail banking*

In the European Union, regulatory actions included an inquiry into retail banking initiated on 13 June 2005 in all of the then 25 member states by the European Commission's Directorate General for Competition. The inquiry examined retail banking in Europe generally. On 31 January 2007, the European Commission announced that barriers to competition in certain areas of retail banking, payment cards and payment systems in the European Union had been identified. The European Commission indicated that it will consider using its powers to address these barriers and will encourage national competition authorities to enforce European and national competition laws where appropriate.

### *Multilateral interchange fees*

In 2007, the European Commission issued a decision that while interchange is not illegal per se, MasterCard's current multilateral interchange fee ("**MIF**") arrangement for cross-border payment card transactions with MasterCard and Maestro branded consumer credit and debit cards in the European Union are in breach of competition law. MasterCard was required by the decision to withdraw the relevant cross-border MIFs (i.e. set these fees to zero) by 21 June 2008.

MasterCard appealed against the decision to the European Court of First Instance on 1 March 2008, and the Group has intervened in the appeal proceedings. In addition, in Summer 2008, MasterCard announced various changes to its scheme arrangements. The European Commission was concerned that these changes might be used as a means of circumventing the requirements of the infringement decision. In April 2009 MasterCard agreed an interim settlement on the level of cross-border MIF with the European Commission pending the outcome of the appeal process and, as a result, the European Commission has advised it will no longer investigate the non-compliance issue (although MasterCard is continuing with its appeal).

Visa's cross-border MIFs were exempted in 2002 by the European Commission for a period of five years up to 31 December 2007 subject to certain conditions. On 26 March 2008, the European Commission opened a formal inquiry into Visa's current MIF arrangements for cross-border payment card transactions with Visa branded debit and consumer credit cards in the European Union and on 6 April 2009 the European Commission announced that it had issued Visa with a formal Statement of Objections. At the same time Visa announced changes to its interchange levels and introduced some changes to enhance transparency. There is no deadline for the closure of the inquiry. However on 26 April 2010 Visa announced it had reached an agreement with the EC as regards immediate cross border debit card MIF rates only.

In the United Kingdom, the OFT has carried out investigations into Visa and MasterCard domestic credit card interchange rates. The decision by the OFT in the MasterCard interchange case was set aside by the Competition Appeal Tribunal (the "**CAT**") in June 2006. The OFT's investigations in the Visa interchange case and a second MasterCard interchange case are ongoing. On 9 February 2007, the OFT announced that it was expanding its investigation into domestic interchange rates to include debit cards. In January 2010 the OFT advised that it did not anticipate issuing a Statement of Objections prior to the European Court's judgment, although it has reserved the right to do so if it considers it appropriate.

The outcome of these investigations is not known, but they may have an impact on the consumer credit industry in general and, therefore, on the Group's business in this sector.

### *Payment Protection Insurance*

Having conducted a market study relating to Payment Protection Insurance ("**PPI**"), on 7 February 2007 the OFT referred the PPI market to the Competition Commission ("**CC**") for an in-depth inquiry. The CC published its final report on 29 January 2009 and announced its intention to order

a range of remedies, including a prohibition on actively selling PPI at point of sale of the credit product (and for 7 days thereafter), a ban on single premium policies and other measures to increase transparency (in order to improve customers' ability to search and improve price competition). Barclays Bank PLC subsequently appealed certain CC findings to the CAT. On 16 October 2009, the CAT handed down a judgment quashing the ban on selling PPI at the point of sale of credit products and remitted the matter back to the CC for review. The CC's current Administrative Timetable is to publish a supplementary report by Summer 2010 and give further consideration to its full range of recommended remedies and a draft order to implement them during Autumn 2010.

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

Following unsuccessful negotiations with the industry, the FSA issued consultation papers on PPI complaint handling and redress in Q3 2009 and again in March 2010. The FSA's final policy statement is expected in June/July 2010 with new rules coming into force in August 2010. Separately, discussions continue between the FSA and the Group in respect of concerns expressed by the FSA over certain categories of historical PPI sales.

#### *Personal current accounts*

On 16 July 2008, the OFT published the results of its market study into personal current accounts in the United Kingdom. The OFT found evidence of competition and several positive features in the personal current account market but believes that the market as a whole is not working well for consumers and that the ability of the market to function well has become distorted.

On 7 October 2009, the OFT published a follow-up report summarising the initiatives agreed between the OFT and personal current account providers to address the OFT's concerns about transparency and switching, following its market study. Personal current account providers will take a number of steps to improve transparency, including providing customers with an annual summary of the cost of their account and making charges prominent on monthly statements. To improve the switching process, a number of steps are being introduced following work with BACS, the payment processor, including measures to reduce the impact on consumers of any problems with transferring direct debits.

On 22 December 2009, the OFT published a further report in which it stated that it continued to have significant concerns about the operation of the personal current account market in the United Kingdom, in particular in relation to unarranged overdrafts, and that it believed that fundamental changes are required for the market to work in the best interests of bank customers. The OFT stated that it would discuss these issues intensively with banks, consumer groups and other organisations, with the aim of reporting on progress by the end of March 2010. On 16 March 2010 the OFT announced that it had secured agreement from the banks on four industry-wide initiatives, namely (i) minimum standards on the operation of opt-outs from unarranged overdrafts, (ii) new working groups on information sharing with customers, (iii) best practice for PCA customers in financial difficulties and incurring charges, and (iv) PCA providers to publish their policies on dealing with PCA customers in financial difficulties. The OFT plan to conduct six monthly ongoing reviews, to fully review the market again in 2012 and to undertake a short piece of work on barriers to entry now.

### *US dollar clearing activities*

The Group announced on 11 May 2010 that the United States Department of Justice and the Consortium that acquired the ABN AMRO Holding N.V. group in 2007 have agreed to a Deferred Prosecution Agreement relating to the previously disclosed criminal investigation into ABN AMRO Bank N.V.'s US dollar clearing activities, OFAC compliance procedures, and Bank Secrecy Act compliance matters during the period from 1995 to the end of 2007.

ABN AMRO Bank N.V. announced in April 2007, six months before it was acquired by the Consortium, that it had reached an agreement in principle with the Department of Justice to resolve the investigation and made a provision of US\$500 million to cover the costs of resolving the investigation. The final amount agreed with the Department of Justice is covered by this provision.

The Deferred Prosecution Agreement deferral period is 12 months and the signatory to the Deferred Prosecution Agreement is The Royal Bank of Scotland N.V., which is the legal entity that was known as ABN AMRO Bank N.V. until February 2010.

### *Securitisation and collateralised debt obligation business*

The New York State Attorney General has issued subpoenas to a wide array of participants in the securitisation and securities industry, focusing on the information underwriters obtained as part of the due diligence process from the independent due diligence firms. RBS Securities Inc. has produced documents requested by the New York State Attorney General, principally related to loans that were pooled into one securitisation transaction and will continue to cooperate with the investigation. More recently, the Massachusetts Attorney General has issued a subpoena to RBS Securities Inc. seeking information related to residential mortgage lending practices and sales and securitisation of residential mortgage loans. These respective investigations are in the early stages and therefore it is difficult to predict the potential exposure from any such investigation. RBSG and its subsidiaries are co-operating with these various investigations and requests.

### *Other investigations*

In the UK, the OFT has been investigating the Group for alleged conduct in breach of Article 101 of the Treaty on the Functioning of the European Union and/or the Chapter 1 prohibition of the Competition Act 1998 relating to the provision of loan products to professional services firms. The Group co-operated fully with the OFT's investigation and on 30 March 2010 the OFT announced that it had arrived at an early resolution agreement with the Group by which the Group will pay a (discounted) fine of £28.59m and admit a breach in competition law relating to the provision of loan products to professional services firms.

In April 2009, the FSA notified the Group that it was commencing a supervisory review of the acquisition of the ABN AMRO Holding N.V. group in 2007 and the 2008 capital raisings and an investigation into conduct, systems and controls within the Global Banking & Markets division of the Group. RBSG and its subsidiaries are cooperating fully with this review and investigation.

In November 2009, the FSA informed the Group that it was commencing an investigation into certain aspects of the policies of, and training and controls within, certain of the Group's United Kingdom subsidiaries relating to compliance with United Kingdom money laundering regulations during the period from December 2007 to December 2008. RBSG and its subsidiaries are cooperating fully with this investigation.

In January 2010, the FSA informed the Group that it intended to commence an investigation into certain aspects of the handling of customer complaints. On 25 March 2010, the FSA formally notified the Group of the appointment of investigators in respect of aspects of complaint handling



relating to RBS and NatWest retail bank products and services. RBSG and its subsidiaries are co-operating fully with this investigation.

In the United States, RBSG and certain subsidiaries have received requests for information from various governmental agencies, self-regulatory organisations, and state governmental agencies including in connection with sub-prime mortgages and securitisations, collateralised debt obligations and synthetic products related to sub-prime mortgages. In particular, during March 2008, the Group was advised by the US Securities and Exchange Commission that it had commenced a non-public, formal investigation relating to the Group's United States sub-prime securities exposures and United States residential mortgage exposures. RBSG and its subsidiaries are co-operating with these various requests for information and investigations.

## DIRECTORS AND CORPORATE GOVERNANCE

The directors and the secretary of RBSG, their functions within the Group and their principal outside activities (if any) of significance are:

<i>Name</i>	<i>Functions within the Group</i>	<i>Principal outside activity (if any) of significance to the Group</i>
<b>Chairman</b>		
Philip Hampton	Chairman	Formerly group finance director of Lloyds TSB Group plc, BT Group plc, BG Group plc, British Gas and British Steel plc, an executive director of Lazards and a non-executive director of RMC Group plc. He is the former chairman of UK Financial Investments Limited. Currently a non-executive director of Belgacom SA and Anglo American plc.
<b>Executive Directors</b>		
Stephen Hester	Group Chief Executive	Formerly chief executive of The British Land Company PLC. He was previously chief operating officer of Abbey National plc and prior to that he held positions with Credit Suisse First Boston. He was appointed non-executive deputy chairman of Northern Rock plc in February 2008, a position he relinquished in October 2008.
Bruce Van Saun	Group Finance Director	Formerly vice chairman and chief financial officer of Bank of New York Mellon. Since 2008 he worked as an advisor to US private equity companies. He previously held senior positions with Deutsche Bank, Wasserstein Perella Group and Kidder Peabody & Co.
<b>Non-Executive Directors</b>		
Colin Buchan	—	Formerly member of the group management board of UBS AG and Head of Equities, UBS Warburg and chairman of UBS Securities Canada Inc. Currently

		chairman of Standard Life Investments Limited, a director of Standard Life plc and BlackRock World Mining Trust Plc.
Sir Sandy Crombie	Senior Independent Director	Former director of the Association of British Insurers. Formerly group chief executive of Standard Life plc, chief executive of Standard Life Investments and deputy chief executive of Standard Life plc.
Penny Hughes	—	Currently a non-executive director of Home Retail Group plc and Cable & Wireless plc and formerly a non-executive director of Gap Inc, Vodafone PLC and Reuters PLC. Currently chairperson of the Remuneration Committee of Home Retail Group. Former director and chairman of the Remuneration Committee of Skandinaviska Enskilda Banken AB. Former President, Coca-Cola Great Britain and Ireland. Currently a director of Wm Morrisons Supermarkets PLC.
Joe MacHale	—	Currently a non-executive director and chairman of the remuneration committee of Brit Insurance Holdings plc. Formerly chief executive of JP Morgan Europe, Middle East and Africa Region.
John McFarlane	—	Formerly chief executive officer of Australia and New Zealand Banking Group Limited, group executive director of Standard Chartered and head of Citicorp/Citibank in the United Kingdom and Ireland. He is currently a non-executive director of Westfield Holdings Limited and a director of Old Oak Holdings Limited.
Brendan Nelson	—	Formerly held various positions within KPMG and was previously a director of the Financial

		Services Skills Council and was the chairman of the Audit Committee of the Institute of Chartered Accountants of Scotland.
Arthur “Art” Ryan	—	Former chairman, chief executive officer and president of Prudential Financial Inc. Previously held senior positions with Prudential Insurance and the former Chase Manhattan Bank NA. Currently a non-executive director of Regeneron Pharmaceuticals Inc.
Philip Scott	—	Formerly chief financial officer of Aviva plc and executive director of Aviva International and previously held a number of senior positions with Aviva. Currently a non-executive director of Diageo plc.

#### **Company Secretary**

Aileen Taylor	Group Secretary	—
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There are no potential conflicts of interest between the duties to the Issuer of the directors of RBSG and their other principal activities as listed above or any of their private interests.

The business address for all the directors and the secretary of RBSG is:

The Royal Bank of Scotland Group plc  
RBS Gogarburn  
PO Box 1000  
Edinburgh  
EH12 1HQ  
United Kingdom

## **Audit Committee and Corporate Governance**

The current members of the Group Audit Committee are Brendan Nelson (Chairman), Colin Buchan and Philip Scott. All served throughout 2009 with the exception of Philip Scott who became a member of the Committee with effect from 19 January 2010 and Brendan Nelson who became a member of the Committee with effect from 28 April 2010. All members of the Group Audit Committee are independent non-executive directors. Art Ryan has been a regular attendee with effect from August 2009 and has fully participated in the activity of the Committee. The Group Audit Committee holds at least six scheduled meetings each year. A meeting is held immediately prior to submission of the interim and annual financial statements to the Board and the quarterly interim management statements. This core programme is supplemented by additional meetings as required. A total of ten meetings were held in 2009. Group Audit Committee meetings are attended by relevant executive directors, the internal and external auditors and finance and risk management executives. At least twice per annum the Group Audit Committee meets privately with the external auditors. Since 2000, the Group Audit Committee has undertaken an annual programme of visits to the Group's business divisions and control functions. The object of the programme is to allow the Group Audit Committee to gain a better understanding of the Group and an invitation to attend is extended to all non-executive directors. The programme of future visits is considered annually and the norm is for two to three visits to be undertaken each year. The Group Audit Committee undertook three visits in 2009.

The Board is satisfied that all the Group Audit Committee members have recent and relevant financial experience. Although the Board has determined that each member of the Group Audit Committee is an 'Audit Committee Financial Expert' and is independent, each as defined in the SEC rules under the US Securities Exchange Act of 1934 and related guidance, the members of the Group Audit Committee are selected with a view to the expertise and experience of the Group Audit Committee as a whole, and the Group Audit Committee reports to the Board as a single entity. The designation of a director or directors as an 'Audit Committee Financial Expert' does not impose on any such director, any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such director as a member of the Group Audit Committee and Board in the absence of such a designation. Nor does the designation of a director as an 'Audit Committee Financial Expert' affect the duties, obligations or liability of any other member of the Board.

The Group Audit Committee is responsible for:

- assisting the Board in discharging its responsibilities and in making all relevant disclosures in relation to the financial affairs of the Group;
- reviewing accounting and financial reporting and regulatory compliance;
- reviewing the Group's systems of internal control; and
- monitoring the Group's processes for internal audit and external audit.

In addition the Group Audit Committee had responsibility for the consideration of risk issues throughout 2009.

Following publication of the Walker Review initial recommendations in July 2009, on 4 August 2009 the Board approved the creation of a Board Risk Committee. The Group Audit Committee will be informed of risk issues through appropriate representation at the Board Risk Committee. Revised terms of reference for the Group Audit Committee and terms of reference for the Board Risk Committee were approved by the Board on 28 October 2009.

The terms of reference of the Group Audit Committee are considered annually by the Group Audit Committee and approved by the Board.

The Group Audit Committee has adopted a policy on the engagement of the external auditors to supply audit and non-audit services, which takes into account relevant legislation regarding the provision of such services by an external audit firm. The Group Audit Committee reviews the policy annually and prospectively approves the provision of audit services and certain non-audit services by the external auditors.

Annual audit services include all services detailed in the annual engagement letter including the annual audit and interim reviews (including United States reporting requirements), periodic profit verifications and reports to regulators including skilled persons reports commissioned by the FSA (e.g. Reporting Accountants Reports).

Annual audit services also include statutory or non-statutory audits required by any Group companies that are not incorporated in the United Kingdom. Terms of engagement for these audits are agreed separately with management, and are consistent with those set out in the audit engagement letter insofar as local regulations permit.

The prospectively approved non-audit services include the following classes of service:

- capital raising, including consents, comfort letters and relevant reviews of registration statements;
- provision of accounting opinions relating to the financial statements of the Group;
- provision of reports that, according to law or regulation, must be rendered by the external auditors;
- tax compliance services;
- corporate finance services relative to companies that will remain outside the Group;
- restructuring services relating to the Group's customers; and
- reports providing assurance to third parties over certain of the Group's internal controls prepared under US Statement of Auditing Standards 70 or similar auditing standards in other jurisdictions.

For all other permitted non-audit services, Group Audit Committee approval must be sought, on a case-by-case basis, before the provision of the service commences. In addition, the Group Audit Committee reviews and monitors the independence and objectivity of the external auditors when it approves non-audit work to be carried out by them, taking into consideration relevant legislation, ethical guidance and the level of non-audit services relative to audit services. The approval process is rigorously applied to prevent the auditors from functioning in the role of management, auditing their own work, or serving in an advocacy role.

The Group Audit Committee was pleased to note progress towards meeting the Group's strategic plan in 2009. However, ongoing economic uncertainty continued to affect the Group throughout the period and it has recorded significant asset write-downs in its 2009 financial statements.

In these circumstances, particular attention of the Group Audit Committee was focused on a number of salient judgments involved in the preparation of the accounts, including:

- valuation methodologies and assumptions for financial instruments carried at fair value including the Group's credit market exposures and the disclosures provided;
- claims reserves in the Group's general insurance business

- the accounting treatment of bonus tax;
- accounting issues relating to the Asset Protection Scheme;
- actuarial assumptions for the Group Pension Fund;
- impairment losses in the Group's portfolio of loans and advances and available- for –sale securities;
- carrying value of the deferred tax asset; and
- impairment of goodwill and other purchased intangible assets.

In its consideration of each of these issues, the aims of the Group Audit Committee have been to:

- understand and challenge the valuation and other accounting judgments made by management;
- review the conclusions of the external auditors and, where applicable, other experts and to understand how they came to their conclusions; and
- satisfy itself that the disclosures in the financial statements about these estimates and valuations are transparent and appropriate.

Also addressed by the Group Audit Committee, given the current economic environment, was management's going concern assessment. In particular, the Committee reviewed the evidence to demonstrate that the Group had access to sufficient funding and capital over the next 12 months. The Group Audit Committee reviewed and challenged the assumptions underlying the analysis and discussed with the external auditors its review of management's analysis and conclusions.

The Group Audit Committee also dedicated a significant proportion of time and attention during 2009 to the consideration and approval of the Group's accession to the Asset Protection Scheme. A specific meeting, which was attended by the majority of the Board, was held to consider the Asset Protection Scheme and its impact on the Group.

In response to the economic crisis the Group Audit Committee formally commissioned an independent report on risk reporting within the organisation. As a result, the format and content of risk reporting has undergone significant development during 2009.

As far as it can determine, the Group Audit Committee received all the information and material it required to allow it to meet its obligations in respect of the 2008 financial statements of RBSG.

During 2009, the Group Audit Committee regularly reviewed the work of the Group's risk management and internal audit functions. Additional sessions of the Committee were held in 2009 that focused solely on risk and audit issues.

The Group Audit Committee undertakes an annual evaluation to assess the independence and objectivity of the external auditors and the effectiveness of the audit process, taking into consideration relevant professional and regulatory requirements. The outcomes of this evaluation are considered by the Board together with the Group Audit Committee's recommendation on the re-appointment of the external auditors or whether to commence an audit tender process. The annual evaluation is carried out following completion of the annual accounts and audit.

Deloitte LLP have been the RBSG's auditors since March 2000. The external auditors are required to rotate the lead audit partner responsible for the audit every five years. A new audit partner has been appointed to lead the audits for the year ending 31 December 2010, the previous incumbent having completed his fifth year as audit partner. There are no contractual obligations restricting the RBSG's choice of external auditor.

The Group Audit Committee is responsible for making recommendations to the Board, for it to submit the Group Audit Committee's recommendations to shareholders for their approval at the Annual General Meeting in relation to the appointment, reappointment and removal of the external auditors. The Board endorsed the Group Audit Committee's recommendation that shareholders be requested to approve the reappointment of Deloitte LLP as external auditors at the Group's Annual General Meeting in April 2010. Shareholders approved such reappointment at the Group's Annual General Meeting on 28 April 2010.

The Group Audit Committee also fixes the remuneration of the external auditors as authorised by shareholders at the Annual General Meeting.

The Group Audit Committee approves the terms of engagement of the external auditors.

Group Internal Audit supports the Group Audit Committee in providing an independent assessment of the design, adequacy and effectiveness of internal controls relating to risk management.

It is intended that there will be an external review of the effectiveness of Group Internal Audit every three to five years, in line with best practice, with internal reviews continuing in the intervening years. Ernst and Young will conduct an external review of the 2009 performance of Group Internal Audit in 2010. Internal reviews were undertaken of 2008 and 2009 performance, both of which concluded that the function operated effectively and the Board agreed with the Group Audit Committee findings.

It is also intended that there will be an external review of the effectiveness of the Group Audit Committee every three to five years, with internal reviews by the Board continuing in the intervening years. PricewaterhouseCoopers conducted an external review of the effectiveness of the Group Audit Committee in 2005. In 2009, the Group Audit Committee performance evaluation was conducted externally by Spencer Stuart as part of the Board and Senior Committee evaluation process. The evaluation used detailed questionnaires and individual meetings were held with each member. Amongst the areas reviewed were the role of the Board and Committees, composition, meetings and processes, performance and reporting, and external relationships. The Board has considered and discussed reports on the outcomes of the evaluations and is satisfied with the way in which the evaluations have been conducted, the conclusions and the actions being progressed.

Since 2005, divisional audit committees have been responsible for reviewing each division's business. During 2009, the divisional audit committee structure was revised to reflect organisational changes including the creation of the Non-Core Division. The divisional audit committees report to the Group Audit Committee and the Group Audit Committee is satisfied that these committees continue to discharge their terms of reference.

RBSG complies with the laws and regulations of the United Kingdom regarding corporate governance.



## **Board Risk Committee**

Following publication of the Walker Review's initial recommendations in July 2009, the Board approved the creation of a Board Risk Committee on 4 August 2009. Terms of reference for the Board Risk Committee, which are compliant with the final Walker Review recommendations published on 26 November 2009, were approved by the Board on 28 October 2009. The terms of reference will be considered annually by the Board Risk Committee and approved by the Board.

The current members of the Board Risk Committee are Philip Scott (Chairman), Colin Buchan, Sandy Crombie, Joe MacHale and Brendan Nelson. All members of the Board Risk Committee are independent non-executive directors.

The Board Risk Committee will hold at least six scheduled meetings each year. The Board Risk Committee held its first meeting on 19 January 2010. Meetings are held as soon as practicable prior to Group Audit Committee meetings to ensure that the work of the two Committees is coordinated and consistent. Meetings will be held immediately prior to submission of the interim and annual financial statements to the Board and the quarterly interim management statements. This core programme is supplemented by additional meetings as required. Board Risk Committee meetings are attended by relevant executive directors, risk management, finance executives and the internal auditors. External advice may be sought by the Board Risk Committee where considered appropriate. The Board Risk Committee has not sought external advice to date.

The Board Risk Committee is responsible for:

- providing oversight and advice to the Board in relation to current and potential future risk exposures of the Group and risk strategy, including determination of risk appetite and tolerance;
- assisting the Board on such other matters as may be referred to it by the Board;
- promoting a risk awareness culture within the Group; and
- reporting to the Board, identifying any matters within its remit in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.

The Board Risk Committee plays a key role in the review, design and implementation of risk management and measurement strategies and risk management policy across the Group.

The Board Risk Committee considers the Group's risk profile relative to current and future Group strategy. The Committee reports to the Board following each meeting on its consideration of the risk profile of the Group and any longer term macro or perceived strategic threats to the Group and makes recommendations as appropriate.

The Group risk appetite framework remains under development and work continues on enhancing risk limits and key risk measures. Risk appetite is regularly reviewed by the Committee and the Committee makes recommendations to the Board as to risk appetite and tolerance as part of this ongoing process.

The Board Risk Committee also considers the Group's exposure to country, single name and sector concentration risk and will ensure rigorous stress and scenario testing of the Group's business is undertaken. The output of this testing will be reviewed by the Committee with a view to ensuring appropriate actions are taken where necessary. It can also make recommendations to the Board regarding related authorities, limits and mandates.

As required under the Walker Review, the Board Risk Committee meets as required to review the due diligence of any proposed strategic transaction (involving a merger, acquisition or disposal) prior to the Board approval of the transaction.

The Board Risk Committee will approve the operational plan for RBS Risk Management. It will consider the adequacy and effectiveness of resource and the scope and nature of the work undertaken by the function.

The Board Risk Committee will consider the adequacy and effectiveness of the technology infrastructure supporting the finance and risk management framework.

The Board Risk Committee reviews the risk input to divisional bonus pools and provides advice to the Remuneration Committee on risk weightings to be applied to performance objectives which are incorporated within the incentive structure for the Group's senior executives.

The Board Risk Committee ensures that it has substantial oversight of the work being undertaken within the divisions of the Group through the existing Divisional Audit Committee structure, in conjunction with the Group Audit Committee.

## SUMMARY CONSOLIDATED FINANCIAL INFORMATION RELATING TO THE ROYAL BANK OF SCOTLAND GROUP PLC

### Financial information prepared in accordance with IFRS

The following tables summarise certain financial information of RBSG for its financial years ended 31 December 2009 and 31 December 2008 and have been extracted without material adjustment from the audited consolidated financial statements of RBSG for the financial year ended 31 December 2009, which were prepared in accordance with IFRS. As set out in the audited consolidated financial statements of RBSG for the financial year ended 31 December 2009, the audited consolidated financial statements of RBSG for the financial year ended 31 December 2008, which were prepared in accordance with IFRS, have been restated for the amendment to IFRS 2 'Share-based Payment'.

### RBSG Share Capital

The amount of RBSG's issued share capital as at 31 December 2009 was £14,632 million, as derived from the audited consolidated financial statements of RBSG for the financial year ended 31 December 2009.

	<i>Allotted, called up and fully paid</i>		
	<i>1 January 2009 £m (audited)</i>	<i>Issued/ (redeemed) during the year £m (audited)</i>	<i>31 December 2009 £m (audited)</i>
Ordinary shares of £0.25 .....	9,864	4,227	14,091
B shares of £0.01 .....	—	510	510
Dividend access share of £0.01 .....	—	—	—
Non-voting deferred shares of £0.01 .....	27	—	27
Additional value shares of £0.01 .....	—	—	—
Non-cumulative preference shares of US\$0.01.....	2	—	2
Non-cumulative convertible preference shares of US\$0.01 .....	—	—	—
Non-cumulative preference shares of €0.01 .....	—	—	—
Non-cumulative convertible preference shares of €0.01 .....	—	—	—
Non-cumulative convertible preference shares of £0.25 .....	—	—	—
Non-cumulative convertible preference shares of £0.01 .....	—	—	—
Cumulative preference shares of £1 .....	1	—	1
Non-cumulative preference shares of £1 .....	6	(5)	1
Total share capital.....	9,900	4,732	14,632

*Allotted, called up and fully paid*

*31 December 2009  
(audited)*

**Numbers of shares - thousands**

Ordinary shares of £0.25.....	56,365,721
B shares of £0.01 .....	51,000,000
Dividend access share of £0.01 .....	—
Non-voting deferred shares of £0.01 .....	2,660,556
Additional value shares of £0.01 .....	—
Non-cumulative preference shares of US\$0.01.....	308,015
Non-cumulative convertible preference shares of US\$0.01 .....	1,000
Non-cumulative preference shares of €0.01 .....	2,526
Non-cumulative convertible preference shares of €0.01 .....	—
Non-cumulative convertible preference shares of £0.25 .....	—
Non-cumulative convertible preference shares of £0.01 .....	200
Cumulative preference shares of £1 .....	900
Non-cumulative preference shares of £1 .....	750

Under IFRS, certain preference shares included in the tables above are classified as debt and are included in subordinated liabilities in the balance sheet.

In March 2010, RBSG converted 935,228 non-cumulative convertible dollar preference shares of US\$0.01 in RBSG into Ordinary Shares resulting in approximately 1.6 billion Ordinary Shares being issued.

In May 2010, the Group concluded a series of exchange and tender offers with the holders of a number of Tier 1 and upper Tier 2 securities. The tender offer resulted in the redemption of:

- (i) 98.4 million non-cumulative preference shares of US\$0.01;
- (ii) 0.5 million non-cumulative preference shares of €0.01; and
- (iii) 0.7 million non-cumulative preference shares of £1.00.

Save as disclosed above, the information contained in the tables above has not changed materially since 31 December 2009.

**Selected financial information of RBSG for the years ended 31 December 2009 and 2008**

	Year ended 31 December 2009 £m (audited)	Year ended 31 December 2008 £m (audited and restated <sup>(1)</sup> )
Operating loss before tax .....	(2,595)	(40,836)
Tax credit .....	371	2,323
Loss from continuing operations .....	(2,224)	(38,513)
(Loss)/profit from discontinued operations, net of tax .....	(99)	3,971
Loss for the year .....	(2,323)	(34,542)

Note:

<sup>(1)</sup> Restated for the amendment to IFRS 2 "Share-based Payment".

	31 December 2009 £m (audited)	31 December 2008 £m (audited)
Called-up share capital .....	14,630	9,898
Reserves .....	63,106	48,981
Owners' equity .....	77,736	58,879
Minority interests .....	16,895	21,619
Subordinated liabilities .....	37,652	49,154
Capital resources .....	132,283	129,652

	31 December 2009 £m (audited)	31 December 2008 £m (audited)
Deposits by customers and banks .....	756,346	897,556
Loans and advances to customers and banks .....	820,146	1,012,919
Total assets .....	1,696,486	2,401,652

	31 December 2009 per cent. (unaudited)	31 December 2008 per cent. (unaudited)
Core Tier 1 ratio .....	11.0	6.6
Tier 1 ratio .....	14.1	10.0
Total capital ratio .....	16.1	14.1

## **GENERAL INFORMATION**

### **RBSG's Objects and Purposes**

Article 161 of RBSG's articles of association, adopted by RBSG on 28 April 2010, provides that nothing in the RBSG articles of association shall constitute a restriction on the objects of RBSG to do (or omit to do) any act and, in accordance with Section 31(1) of the Companies Act 2006, RBSG's objects are unrestricted.

### **Documents Available for Inspection**

From the date hereof and throughout the life of the Registration Document, copies of the following documents will, when available, be available during usual business hours on a weekday (Saturdays, Sundays and public holidays excepted) for inspection at the registered office of RBSG:

- (i) the constitutional documents of the Issuer;
- (ii) all future consolidated financial statements of the Issuer;
- (iii) this Registration Document; and
- (iv) the documents incorporated by reference herein.

### **No Significant Change and No Material Adverse Change**

There has been no significant change in the trading or financial position of the Group taken as a whole since 31 December 2009 (the end of the last financial period for which either audited financial information or interim financial information has been published).

There has been no material adverse change in the prospects of the Group taken as a whole since 31 December 2009 (the last date to which the latest audited published financial information of the Group was prepared).

### **Auditors**

The consolidated financial statements of RBSG for the years ended 31 December 2009 and 2008 have been audited by Deloitte LLP (name changed from Deloitte & Touche LLP on 1 December 2008), Chartered Accountants (authorised and regulated by the Financial Services Authority for designated investment business), whose address is 2 New Street Square, London EC4A 3BZ.

The financial information contained in this Registration Document in relation to the Issuer does not constitute the Issuer's statutory accounts within the meaning of section 434 of the Companies Act 2006. Statutory accounts for the years ended 31 December 2009 and 31 December 2008 to which the financial information in this Registration Document relates have been delivered to the Registrar of Companies in Scotland.

Deloitte LLP has reported on such statutory accounts and such reports were unqualified and did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

### **Material Contracts**

RBSG and its subsidiaries are party to various contracts in the ordinary course of business. In addition to material contracts set on pages 363 to 369 of the 2009 annual report and accounts of RBSG, the Consortium and Shareholders Agreement (the "**CSA**"), restated on 1 April 2010, is also a material contract.

The CSA governs the relationships amongst the parties thereto in relation to the acquisition by RFS Holdings of the ABN AMRO Holding N.V. group. The CSA as restated details, inter alia, the

equity interests in RFS Holdings, the governance of RFS Holdings, the arrangements for the transfer of certain ABN AMRO Holding N.V. businesses, assets and liabilities to the Dutch State (previously Fortis Bank Nederland), RBSG and Santander, further funding obligations of the Dutch State, RBSG and Santander where funding is required by regulatory authorities in connection with the ABN AMRO Holding N.V. businesses, the allocation of Core Tier 1 capital, the allocation of taxes and conduct of tax affairs and the steps that the Dutch State, RBSG and Santander expect to take to enable RBSG to become the sole shareholder of RBS Holdings N.V.

## FORWARD-LOOKING STATEMENTS

Certain sections in, or incorporated by reference in, this document contain 'forward-looking statements', such as statements that include the words 'expect', 'estimate', 'project', 'anticipate', 'believes', 'should', 'intend', 'plan', 'probability', 'risk', 'Value-at-Risk (VaR)', 'target', 'goal', 'objective', 'will', 'endeavour', 'outlook', 'optimistic', 'prospects' and similar expressions or variations on such expressions.

In particular, this document includes forward-looking statements relating, but not limited to: the Group's restructuring plans, capitalisation, portfolios, capital ratios, liquidity, risk weighted assets, return on equity, cost : income ratios, leverage and loan : deposit ratios, funding and risk profile, the Group's future financial performance, the level and extent of future impairments and write-downs, the protection provided by the APS, and the Group's potential exposures to various types of market risks, such as interest rate risk, foreign exchange rate risk and commodity and equity price risk. These statements are based on current plans, estimates and projections, and are subject to inherent risks, uncertainties and other factors which could cause actual results to differ materially from the future results expressed or implied by such forward-looking statements. For example, certain of the market risk disclosures are dependent on choices about key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market risk disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated.

Other factors that could cause actual results to differ materially from those estimated by the forward-looking statements contained in, or incorporated by reference in, this document include, but are not limited to: the full nationalisation of the Group or other resolution procedures under the Banking Act 2009; the global economy and instability in the global financial markets, and their impact on the financial industry in general and on the Group in particular; the financial stability of other financial institutions, and the Group's counterparties and borrowers; the ability to complete 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 EC State Aid restructuring plan; organisational restructuring; the ability to access sufficient funding to meet liquidity needs; cancellation or failure to renew governmental support schemes; the extent of future write-downs and impairment charges caused by depressed asset valuations; the inability to hedge certain risks economically; the value and effectiveness of any credit protection purchased by the Group; unanticipated turbulence in interest rates, foreign currency exchange rates, credit spreads, bond prices, commodity prices and equity prices; changes in the credit ratings of the Group; ineffective management of capital or changes to capital adequacy or liquidity requirements; changes to the valuation of financial instruments recorded at fair value; competition and consolidation in the banking sector; HM Treasury exercising influence over the operations of the Group; the ability of the Group to attract or retain senior management or other key employees; regulatory change or a change in United Kingdom Government policy; changes to the monetary and interest rate policies of the Bank of England, the Board of Governors of the Federal Reserve System and other G7 central banks; impairments of goodwill; pension fund shortfalls; litigation and regulatory investigations; general operational risks; insurance claims; reputational risk; general geopolitical and economic conditions in the UK and in other countries in which the Group has significant business activities or investments, including the United States; the ability to achieve revenue benefits and cost savings from the integration of certain of RBS Holdings N.V.'s (formerly ABN AMRO Holding N.V.) businesses and assets; changes in UK and foreign laws, regulations, accounting standards and taxes, including changes in regulatory capital regulations and liquidity requirements; the participation of the Group in the APS and the effect of the APS on the Group's financial and capital position; the ability to access the contingent capital arrangements with HM Treasury; the



conversion of the B Shares in accordance with their terms; limitations on, or additional requirements imposed on, the Group's activities as a result of HM Treasury's investment in the Group; and the success of the Group in managing the risks involved in the foregoing.

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

For a further discussion of certain risks faced by the Group, see "Risk Factors" on pages 3 to 35.

## DOCUMENTS INCORPORATED BY REFERENCE

The following documents, which have been (1) previously published and (2) approved by the FSA or filed with it shall be deemed to be incorporated in, and form part of, this Registration Document:

- (a) the following sections of the 2009 annual report and accounts of RBSG, which were published via the Regulatory News Service of the London Stock Exchange plc (the “**RNS**”) on 18 March 2010:
  - (i) Independent auditors’ report on page 240;
  - (ii) Consolidated income statement on page 241;
  - (iii) Consolidated statement of comprehensive income on page 242;
  - (iv) Balance sheets as at 31 December 2009 on page 243;
  - (v) Statements of changes in equity on pages 244 to 246;
  - (vi) Cash flow statements on page 247;
  - (vii) Accounting policies on pages 248 to 258;
  - (viii) Notes on the accounts on pages 259 to 348;
  - (ix) What we have achieved on page 1;
  - (x) Chairman’s statement on pages 2 to 3;
  - (xi) Group Chief Executive’s review on pages 4 to 6;
  - (xii) Our strategic plan and progress on pages 12 to 19;
  - (xiii) Divisional review on pages 20 to 41;
  - (xiv) Business review on pages 49 to 206;
  - (xv) Report of the Directors on pages 208 to 213;
  - (xvi) Corporate governance on pages 214 to 222;
  - (xvii) Letter from the Chairman of the Remuneration Committee on pages 223 to 224;
  - (xviii) Directors’ remuneration report on pages 225 to 236;
  - (xix) Directors’ interests in shares on page 237;
  - (xx) Impairment review on pages 302 to 303;
  - (xxi) Financial Summary on pages 350 to 359;
  - (xxii) Exchange rates on page 359;
  - (xxiii) Economic and monetary environment on page 360;
  - (xxiv) Supervision on page 361;
  - (xxv) Regulatory developments and reviews on pages 361 to 362;
  - (xxvi) Description of property and equipment on pages 362 to 363;
  - (xxvii) Major shareholders on page 363;
  - (xxviii) Material contracts on pages 363 to 369; and

- (xxix) Glossary of terms on pages 383 to 387;
- (b) the following sections of the 2008 annual report and accounts of RBSG, which were published via the RNS on 9 March 2009:
- (i) Independent auditors' report for the year ended 31 December 2008 on pages 172 to 173;
  - (ii) Consolidated income statement for the year ended 31 December 2008 on page 174;
  - (iii) Balance sheets as at 31 December 2008 on page 175;
  - (iv) Statement of recognised income and expense for the year ended 31 December 2008 on page 176;
  - (v) Cash flow statement for the year ended 31 December 2008 on page 177;
  - (vi) Accounting policies on pages 178 to 188;
  - (vii) Notes on the accounts for the year ended 31 December 2008 on pages 189 to 266;
  - (viii) Business review on pages 23 to 144;
  - (ix) Report of the Directors on pages 148 to 152;
  - (x) Corporate governance on pages 153 to 158;
  - (xi) Letter from the Chairman of the Remuneration Committee on page 159;
  - (xii) Directors' remuneration report on pages 160 to 168;
  - (xiii) Directors' interests in shares on page 169;
  - (xiv) Amounts in accordance with IFRS on pages 268 to 277;
  - (xv) Exchange rates on page 277;
  - (xvi) Economic and monetary environment on page 278;
  - (xvii) Supervision on page 279;
  - (xviii) Regulatory reviews and developments on pages 280 to 281;
  - (xix) Description of property and equipment on page 281;
  - (xx) Major shareholders on page 281; and
  - (xxi) Material contracts on pages 281 to 284;
- (c) the RBSG Interim Management Statement Q1 2010 published via the RNS on 7 May 2010;
- (d) the following sections of the Shareholder Circular published by RBSG on 27 November 2009 (the "**Shareholder Circular**"):
- (i) "Financial Information" on page 5;
  - (ii) "Part I – Letter From the Chairman of RBS" on pages 10 to 20;
  - (iii) "Appendix 2 to the Letter From the Chairman of RBS – Principal Terms and Conditions of the APS" on pages 46 to 75;
  - (iv) "Appendix 3 to the Letter From the Chairman of RBS – Principal Terms of Issue of the B Shares and the Dividend Access Share" on pages 76 to 84;

- (v) "Appendix 4 to the Letter From the Chairman of RBS – Key Terms of the State Aid Restructuring Plan" on pages 85 to 86;
  - (vi) "Part II – Capital Resources and Liquidity Management" on pages 89 to 94;
  - (vii) "Part VI – Definitions" on pages 121 to 133;
  - (viii) "Annex 1 – Terms of Issue of the B Shares and the Dividend Access Share" on pages 134 to 170; and
  - (ix) "Annex 3 – Scheme Principles" on pages 177 to 181; and
- (e) the press release headed "The Royal Bank of Scotland Group plc, The Royal Bank of Scotland plc and National Westminster Bank Plc – Clarification of Contractual Position Relating to Payments Under Preference Shares and Subordinated Securities" published via the RNS on 20 October 2009.

Any information or other documents themselves incorporated by reference, either expressly or implicitly, in the documents incorporated by reference in this Registration Document shall not form part of this Registration Document, except where such information or other documents are specifically incorporated by reference into this Registration Document.

It should be noted that, except as set forth above, no other portion of the above documents is incorporated by reference into this Registration Document. In addition, where sections of any of the above documents which are incorporated by reference into this Registration Document cross-reference other sections of the same document, such cross-referenced information shall not form part of this Registration Document, unless otherwise incorporated by reference herein.

The Issuer will provide, without charge, to each person to whom a copy of this Registration Document has been delivered, upon the oral or written request of such person, a copy of any or all of the information which is incorporated herein by reference. Written or oral requests for such information should be directed to the Issuer at its principal office set out on the last page of this Registration Document.

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## INDEPENDENT PUBLIC ACCOUNTANTS

*To the Issuer*

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Chartered Accountants

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