

The Royal Bank of Scotland plc
Results for the half year ended 30 June 2014

The Royal Bank of Scotland plc ('RBS plc') is a wholly-owned subsidiary of The Royal Bank of Scotland Group plc (the 'holding company' or 'RBSG'). The 'Group' comprises RBS plc and its subsidiary and associated undertakings. 'RBS Group' or 'RBS' comprises the holding company and its subsidiary and associated undertakings.

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Financial review

Operating profit

Operating profit before tax was £2,170 million compared with £1,411 million in the first half of 2013. The increase was due to a significant reduction in impairment losses which was partially offset by a decline in non-interest income.

Net interest income

Net interest income was up 1%, £48 million to £5,288 million, with the increase consistent across all businesses. The increase was driven by deposit repricing initiatives across a number of businesses. The benefit of reduced funding costs outweighed lower yields on assets.

Non-interest income

Non-interest income decreased by £1,419 million, 25% to £4,339 million compared with £5,758 million in the first half of 2013. This was primarily due to a decline in income from trading activities (£683 million) in line with Corporate & Institutional Banking's (CIB) smaller balance sheet and reduced risk profile. There were also reductions within other operating income (£444 million) and gain on redemption of own debt (£185 million). Other operating income included a net gain of £170 million (\$283 million) on Citizens Financial Group's sale of its Illinois branch network.

Operating expenses

Operating expenses decreased by £296 million, 4% to £7,175 million compared with £7,471 million in the first half of 2013. Much of the decrease was achieved in CIB through headcount reductions and tight control of discretionary expenditure.

Litigation and conducts costs totalled £250 million compared with £620 million in H1 2013, with an additional provision of £150 million (H1 2013 - £185 million) for Payment Protection Insurance redress recorded in Personal & Business Banking and a further £100 million (H1 2013 - £50 million) relating to interest rate hedging product redress booked within Commercial Banking and CIB. H1 2013 included provisions for other regulatory and legal actions of £385 million in CIB. Restructuring costs increased by £243 million to £514 million, including significant charges in relation to Williams & Glyn and to the restructuring of the property portfolio. H1 2014 also included a write-down of goodwill of £130 million.

Impairment losses

Impairment losses decreased by £1,834 million to £282 million compared with £2,116 million in the first half of 2013, due to improvements in bad debt flows, primarily reflecting improving credit conditions, as well as latent provision releases across all businesses.

Capital ratios

Capital ratios at 30 June 2014 were 9.0% (CET1), 10.1% (Tier 1) and 15.9% (Total) compared with 9.8% (CT1), 11.4% (Tier 1) and 17.4% (Total) at the year end on a Basel 2.5 basis. Risk-weighted assets calculated in accordance with Prudential Regulation Authority definitions are set out below:

	30 June 2014 £bn	31 December 2013 (1) £bn
Risk-weighted assets by risk		
Credit risk		
- non-counterparty	270.8	277.7
- counterparty	38.3	22.5
Market risk	32.1	28.8
Operational risk	35.3	37.5
	376.5	366.5

Note:

(1) Risk-weighted assets at 31 December 2013 are on a Basel 2.5 basis.

**Condensed consolidated income statement
for the half year ended 30 June 2014**

	Half year ended	
	30 June 2014 £m	30 June 2013 £m
Interest receivable	7,496	8,372
Interest payable	(2,208)	(3,132)
Net interest income	5,288	5,240
Fees and commissions receivable	2,563	2,647
Fees and commissions payable	(481)	(458)
Income from trading activities	1,477	2,160
Gain on redemption of own debt	6	191
Other operating income	774	1,218
Non-interest income	4,339	5,758
Total income	9,627	10,998
Operating expenses	(7,175)	(7,471)
Profit before impairment losses	2,452	3,527
Impairment losses	(282)	(2,116)
Operating profit before tax	2,170	1,411
Tax charge	(672)	(771)
Profit for the period	1,498	640
Non-controlling interests	(5)	15
Preference shareholders	(36)	(39)
Profit attributable to ordinary shareholders	1,457	616

**Condensed consolidated statement of comprehensive income
for the half year ended 30 June 2014**

	Half year ended	
	30 June 2014 £m	30 June 2013 £m
Profit for the period	1,498	640
Items that qualify for reclassification		
Available-for-sale financial assets	128	(1,223)
Cash flow hedges	244	(1,595)
Currency translation	(620)	1,270
Tax	(133)	708
Other comprehensive loss after tax	(381)	(840)
Total comprehensive income/(loss) for the period	1,117	(200)
Total comprehensive income/(loss) is attributable to:		
Non-controlling interests	-	(13)
Preference shareholders	36	39
Ordinary shareholders	1,081	(226)
	1,117	(200)

**Condensed consolidated balance sheet
at 30 June 2014**

	30 June 2014 £m	31 December 2013 £m
Assets		
Cash and balances at central banks	66,609	79,993
Amounts due from fellow subsidiaries	12,423	15,058
Other loans and advances to banks	55,369	51,425
Loans and advances to banks	67,792	66,483
Amounts due from holding company and fellow subsidiaries	1,657	1,620
Other loans and advances to customers	436,140	437,480
Loans and advances to customers	437,797	439,100
Debt securities	101,918	100,696
Equity shares	7,404	8,278
Settlement balances	19,724	5,634
Amounts due from holding company and fellow subsidiaries	3,482	3,413
Other derivatives	272,970	285,990
Derivatives	276,452	289,403
Intangible assets	12,156	12,352
Property, plant and equipment	7,073	7,866
Deferred tax	3,076	3,435
Prepayments, accrued income and other assets	5,598	5,904
Assets of disposal groups	52	790
Total assets	1,005,651	1,019,934
Liabilities		
Amounts due to fellow subsidiaries	2,034	2,463
Other deposits by banks	69,821	62,700
Deposits by banks	71,855	65,163
Amounts due to holding company and fellow subsidiaries	10,010	5,207
Other customers accounts	450,238	467,097
Customer accounts	460,248	472,304
Debt securities in issue	50,471	59,746
Settlement balances	15,125	5,245
Short positions	39,019	28,004
Amounts due to holding company and fellow subsidiaries	2,378	2,586
Other derivatives	268,468	283,547
Derivatives	270,846	286,133
Accruals, deferred income and other liabilities	13,509	14,753
Retirement benefit liabilities	2,719	3,188
Deferred tax	305	189
Amounts due to holding company	18,984	19,825
Other subordinated liabilities	12,644	13,309
Subordinated liabilities	31,628	33,134
Liabilities of disposal groups	14	3,210
Total liabilities	955,739	971,069
Equity		
Non-controlling interests	79	79
Owners' equity		
Called up share capital	6,609	6,609
Reserves	43,224	42,177
Total equity	49,912	48,865
Total liabilities and equity	1,005,651	1,019,934

**Condensed consolidated balance sheet
at 30 June 2014**

Key points

- Total assets decreased by £14.3 billion to £1,005.7 billion due to a reduction in the mark-to-market value of derivatives plus reduced cash and balances at central banks, partially offset by increased settlement balances from seasonal year-end lows.
- Net loans and advances to customers decreased by £1.3 billion, due to disposals and run-off in RCR partly offset by growth in mortgage lending in Personal & Business Banking.
- Deposits by banks were up £6.7 billion, with increases in short-term borrowing in Citizens Financial Group and Corporate & Institutional Banking.
- Customer deposits decreased by £12.1 billion to £460.2 billion mainly in Commercial & Private Banking, Ulster Bank and Corporate & Institutional Banking due to the impact of deposit repricing.
- Assets and liabilities of disposal groups decreased by £0.7 billion and £3.2 billion respectively following the sale of retail branches in Illinois by Citizens Financial Group.

**Condensed consolidated statement of changes in equity
for the half year ended 30 June 2014**

	Half year ended	
	30 June 2014 £m	30 June 2013 £m
Called-up share capital		
At beginning and end of period	6,609	6,609
Share premium account		
At beginning of period	26,290	26,081
Redemption of preference shares classified as debt (1)	517	-
At end of period	26,807	26,081
Merger reserve		
At beginning and end of period	10,800	10,881
Available-for-sale reserve		
At beginning of period	359	1,750
Unrealised gains/(losses)	445	(631)
Realised gains	(317)	(592)
Tax	(58)	328
At end of period	429	855
Cash flow hedging reserve		
At beginning of period	(86)	1,815
Amount recognised in equity	963	(936)
Amount transferred from equity to earnings	(719)	(659)
Tax	(69)	373
At end of period	89	593
Foreign exchange reserve		
At beginning of period	1,842	2,041
Retranslation of net assets	(726)	1,362
Foreign currency gains/(losses) on hedges of net assets	111	(94)
Tax	(6)	7
At end of period	1,221	3,316
Retained earnings		
At beginning of period	2,972	10,111
Profit attributable to ordinary and equity preference shareholders	1,493	655
Equity preference dividends paid	(36)	(39)
Redemption of preference shares classified as debt (1)	(517)	-
Shares in holding company released under employee share schemes	(41)	-
Share-based payments		
- gross	8	(4)
- tax	(1)	(3)
At end of period	3,878	10,720
Owners' equity at end of period	49,833	59,055
Non-controlling interests		
At beginning of period	79	137
Currency translation adjustments and other movements	(5)	2
Profit/(loss) attributable to non-controlling interests	5	(15)
Equity withdrawn and disposals	-	(43)
At end of period	79	81
Total equity at end of period	49,912	59,136

Note:

(1) Issued by RBS plc to the holding company which was redeemed in June 2014.

**Condensed consolidated cash flow statement
for the half year ended 30 June 2014**

	Half year ended	
	30 June 2014 £m	30 June 2013 £m
Operating activities		
Operating profit before tax	2,170	1,411
Adjustments for non-cash items	(517)	(6,453)
Net cash inflow/(outflow) from trading activities	1,653	(5,042)
Changes in operating assets and liabilities	(2,323)	(285)
Net cash flows from operating activities before tax	(670)	(5,327)
Income taxes paid	(40)	(265)
Net cash flows from operating activities	(710)	(5,592)
Net cash flows from investing activities	(4,021)	14,127
Net cash flows from financing activities	(1,569)	(2,302)
Effects of exchange rate changes on cash and cash equivalents	(2,628)	4,976
Net (decrease)/increase in cash and cash equivalents	(8,928)	11,209
Cash and cash equivalents at beginning of period	127,956	133,101
Cash and cash equivalents at end of period	119,028	144,310

1. Basis of preparation

The Group's condensed consolidated financial statements have been prepared in accordance with the Disclosure Rules and Transparency Rules of the Financial Conduct Authority and IAS 34 'Interim Financial Reporting'. They should be read in conjunction with the 2013 Annual Report and Accounts which were prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the IFRS Interpretations Committee of the IASB as adopted by the European Union (EU) (together IFRS).

Going concern

The Group's business activities and financial position, and the factors likely to affect its future development and performance are discussed on pages 2 to 49. A summary of the risk factors which could materially affect the Group's future results are described on pages 52 to 54.

Having reviewed the Group's forecasts, projections and other relevant evidence and considered the interim financial statements of The Royal Bank of Scotland Group plc for the six months ended 30 June 2014 which were prepared on a going concern, the directors have a reasonable expectation that the Group will continue in operational existence for the foreseeable future. Accordingly, the results for the half year ended 30 June 2014 have been prepared on a going concern basis.

2. Accounting policies

There have been no significant changes to the Group's principal accounting policies as set out on pages 208 to 219 of the 2013 Annual Report and Accounts apart from the adoption of new and revised IFRSs that are effective from 1 January 2014:

'Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)' adds application guidance to IAS 32 to address inconsistencies identified in the application of the standard's criteria for offsetting financial assets and financial liabilities.

'Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)' applies to investment entities; such entities should account for their subsidiaries (other than those that provide services related to the entity's investment activities) at fair value through profit or loss.

IFRIC 21 'Levies' provides guidance on accounting for levies payable to public authorities if certain conditions are met on a particular date.

IAS 36 'Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)' aligns IAS 36's disclosure requirements about recoverable amounts with IASB's original intentions.

IAS 39 'Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)' provides relief from discontinuing hedge accounting on novation of a derivative designated as a hedging instrument.

The implementation of these requirements has not had a material effect on the Group's financial statements.

2. Accounting policies (continued)

Critical accounting policies and key sources of estimation uncertainty

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. The judgements and assumptions that are considered to be the most important to the portrayal of the Group's financial condition are those relating to pensions; goodwill; provisions for liabilities; deferred tax; loan impairment provisions and fair value of financial instruments. These critical accounting policies and judgments are described on pages 216 to 219 of the 2013 Annual Report and Accounts.

Recent developments in IFRS

In July 2014 the IASB published IFRS 9 'Financial Instruments'. IFRS 9 replaces the current financial instruments standard IAS 39, setting out new accounting requirements in a number of areas. First, there are revisions to the classification and measurement of financial instruments. There are new restrictions on the ability to account for financial assets at amortised cost and a prohibition on the bifurcation of embedded derivatives from financial assets. Accounting for financial liabilities is largely unchanged except for the treatment of changes in the fair value of liabilities designated as at fair value through profit or loss attributable to own credit risk; these are recognised in other comprehensive income. Secondly, there are amended requirements for hedge accounting designed to align the accounting more closely to the risk management framework and remove or simplify some of the rule-based requirements of IAS 39. The basic mechanics of hedge accounting: fair value, cash flow and net investment hedges are retained. Finally, there is a new approach to credit impairment provisions moving from IAS 39's incurred loss model to an expected loss model. An expected loss model will result in the recognition of credit impairment losses earlier than an incurred loss model. IFRS 9 is effective for periods beginning on or after 1 January 2018.

IFRS 9 makes major and fundamental changes to accounting for financial instruments. The Group is continuing its assessment of its effect on the Group's financial statements.

The IASB also published:

- in January 2014 IFRS 14 'Regulatory Deferral Accounts' which permits costs that can be deferred in the presentation of regulatory accounts to be deferred also in accordance with IFRS.
- in May 2014 IFRS 15 'Revenue from Contracts with Customers' effective from 1 January 2017 replacing IAS 11 'Construction Contracts', IAS 18 'Revenue' and several Interpretations. Contracts are bundled or unbundled into distinct performance obligations with revenue recognised as the obligations are met.
- in May 2014 'Accounting for Acquisitions of interests in Joint Operations', an amendment to IFRS 11 'Joint Arrangements' to clarify that the donor of assets and liabilities to a joint operation should hold its continuing interest in them at the lower of cost and recoverable amount.
- in May 2014 'Clarification of Acceptable Methods of Depreciation and Amortisation' amending IAS 16 'Property, Plant and Equipment and IAS 38 'Intangible Assets' to require any policy less prudent than straight line to be justified.
- in August 2014 'Equity Method in Separate Financial Statements' amending IAS 27 'Separate Financial Statements' to permit investments in subsidiaries and associates to be measured at cost plus subsequent changes in net asset value.

The Group is reviewing these requirements to determine their effect, if any, on its financial reporting.

Notes

3. Operating expenses

Payment Protection Insurance (PPI)

An additional charge of £150 million has been recognised for PPI in H1 2014 (H1 2013 - £185 million) as a result of higher customer response rates and higher average redress costs. The cumulative charge in respect of PPI is £3.2 billion, of which £2.6 billion (82%) in redress and expenses had been utilised by 30 June 2014. Of the £3.2 billion cumulative charge, £2.9 billion relates to redress and £0.3 billion to administrative expenses.

	Half year ended	
	30 June 2014 £m	30 June 2013 £m
At beginning of period	926	895
Charge to income statement	150	185
Utilisations	(490)	(376)
At end of period	586	704

The remaining provision provides coverage for approximately seven months for redress and administrative expenses, based on the current average monthly utilisation.

The table below shows the sensitivity of the provision to changes in the principal assumptions (all other assumptions remaining the same).

Assumption	Actual to date	Current assumption	Sensitivity	
			Change in assumption %	Consequential change in provision £m
Past business review take up rate	47%	52%	+/-5	+/-56
Uphold rate (1)	89%	88%	+/-5	+/-17
Average redress	£1,741	£1,722	+/-5	+/-15

Note:

(1) Uphold rate excludes claims where no PPI policy was held.

Interest that will be payable on successful complaints has been included in the provision as has the estimated cost to the Group of administering the redress process. The Group expects the majority of the cash outflows associated with this provision to have occurred by the end of 2014. There are uncertainties as to the eventual cost of redress which will depend on actual complaint volumes, take up and uphold rates and average redress costs. Assumptions relating to these are inherently uncertain and the ultimate financial impact may be different than the amount provided. The Group will continue to monitor the position closely and refresh its assumptions.

3. Operating expenses (continued)

Interest Rate Hedging Products (IRHP) redress and related costs

Following an industry-wide review conducted in conjunction with the Financial Services Authority (now being dealt with by the Financial Conduct Authority (FCA)), the Group agreed to provide redress to customers in relation to certain interest rate hedging products sold to small and medium-sized businesses classified as retail clients under FSA rules. An additional charge of £100 million has been recognised in H1 2014 (H1 2013 - £50 million), principally reflecting the marginal increase in our redress experience compared to expectations. We have now agreed outcomes with the independent reviewer relating to over 95% of cases. A cumulative charge of £1.4 billion has been recognised, of which £1.1 billion relates to redress and £0.3 billion relates to administrative expenses.

	Half year ended	
	30 June 2014 £m	30 June 2013 £m
At beginning of period	1,077	676
Charge to income statement	100	50
Utilisations	(417)	(56)
At end of period	760	670

The Group is progressing with its review of sales of IRHP and providing basic redress to all customers who are entitled to it. Customers may also be entitled to be compensated for any consequential losses they may have suffered. The Group is not able to measure reliably any liability it may have and has accordingly not made any provision. Customers will receive redress monies without having to wait for the assessment of any additional consequential loss claims which are outside the allowance for such claims included in the 8% interest on redress due.

The Group continues to monitor the level of provision given the uncertainties over the number of transactions that will qualify for redress and the nature and cost of that redress.

Regulatory and legal actions

The Group is party to certain legal proceedings and regulatory investigations and continues to co-operate with a number of regulators. All such matters are periodically reassessed with the assistance of external professional advisers, where appropriate, to determine the likelihood of the Group incurring a liability and to evaluate the extent to which a reliable estimate of any liability can be made. No additional charge has been booked in 2014 (H1 2013 - £385 million). Charges totalling £2,394 million were booked in 2013, primarily in respect of matters related to mortgage-backed securities and securities related litigation following recent third party litigation settlements and regulatory decisions.

4. Pensions

In May 2014, the triennial funding valuation of The Royal Bank of Scotland Group Pension Fund was agreed which showed that the value of the liabilities exceeded the value of assets by £5.6 billion at 31 March 2013, a ratio of 82%. To eliminate this deficit, RBS will pay annual contributions of £650 million from 2014 to 2016 and £450 million (indexed in line with inflation) from 2017 to 2023. These contributions are in addition to regular annual contributions of approximately £270 million in respect of the ongoing accrual of benefits as well as contributions to meet the expenses of running the scheme.

Notes

5. Loan impairment provisions and REIL

Loan impairments

Operating profit is stated after charging loan impairment losses of £292 million (H1 2013 - £2,177 million). The balance sheet loan impairment provisions decreased in the half year ended 30 June 2014 from £25,045 million to £22,324 million and the movements thereon were:

	Half year ended	
	30 June 2014 £m	30 June 2013 £m
At beginning of period	25,045	20,807
Currency translation and other adjustments	(501)	530
Transfers from fellow subsidiaries	-	22
Amounts written-off	(2,471)	(2,104)
Recoveries of amounts previously written-off	98	118
Charge to income statement	292	2,177
Unwind of discount (recognised in interest income)	(139)	(204)
At end of period	22,324	21,346

Provisions at 30 June 2014 include £50 million in respect of loans and advances to banks (30 June 2013 - £82 million).

Risk elements in lending

Risk elements in lending (REIL) comprises impaired loans and accruing loans past due 90 days or more as to principal or interest. Impaired loans are all loans (including loans subject to forbearance) for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans. Accruing loans past due 90 days or more comprise loans past due 90 days where no impairment loss is expected and those awaiting individual assessment. A latent provision is established for the latter.

REIL decreased from £39,126 million to £33,892 million in the half year ended 30 June 2014 and the movements thereon were:

	Half year ended	
	30 June 2014 £m	30 June 2013 £m
At beginning of period	39,126	40,524
Currency translation and other adjustments	(809)	1,122
Transfers from fellow subsidiaries	-	39
Additions	4,032	6,812
Transfers (1)	(69)	288
Transfers to performing book	(185)	(77)
Repayments and disposals	(5,732)	(4,952)
Amounts written-off	(2,471)	(2,104)
At end of period	33,892	41,652

Note:

(1) Transfers between REIL and potential problem loans.

Provision coverage of REIL was 66% at 30 June 2014 (30 June 2013 - 51%).

Notes

6. Tax

The actual tax charge differs from the expected tax charge computed by applying the standard rate of UK corporation tax of 21.5% (2013 - 23.25%) as follows:

	Half year ended	
	30 June 2014 £m	30 June 2013 £m
Profit before tax	2,170	1,411
Expected tax charge	(467)	(328)
Losses in period where no deferred tax asset recognised	(13)	(55)
Foreign profits taxed at other rates	(85)	(129)
Unrecognised timing differences	13	(12)
Non-deductible goodwill impairment	(28)	-
Items not allowed for tax		
- losses on disposals and write-downs	(5)	-
- UK bank levy	(30)	(29)
- regulatory and legal actions	-	(90)
- employee share schemes	(5)	(14)
- other disallowable items	(53)	(69)
Non-taxable items	2	27
Taxable foreign exchange movements	10	(21)
Losses brought forward and utilised	17	4
Reduction in carrying value of deferred tax asset in respect of losses in US	(76)	-
Adjustments in respect of prior periods	48	(55)
Actual tax charge	(672)	(771)

At 30 June 2014, the Group has recognised a deferred tax asset of £3,076 million (31 December 2013 - £3,435 million) and a deferred tax liability of £305 million (31 December 2013 - £189 million). These include amounts recognised in respect of UK trading losses of £2,135 million (31 December 2013 - £2,411 million). Under UK tax legislation, these UK losses can be carried forward indefinitely to be utilised against profits arising in the future. The Group has considered the carrying value of this asset as at 30 June 2014 and concluded that it is recoverable based on future profit projections.

7. Segmental analysis

On 27 February 2014, RBS announced the reorganisation of the previously reported operating divisions into three franchises:

- Personal & Business Banking (PBB), comprising two reportable segments, UK Personal & Business Banking, including Williams & Glyn, (UK PBB) and Ulster Bank.
- Commercial & Private Banking (CPB), comprising two reportable segments, Commercial Banking and Private Banking.
- Corporate & Institutional Banking (CIB); a single reportable segment.

RBS Capital Resolution (RCR) was established with effect from 1 January 2014 by the transfer of capital intensive and higher risk assets from existing divisions. Non-Core was dissolved on 31 December 2013. No business lines moved to RCR and so comparative data has not been restated.

RBS will continue to manage and report Citizens Financial Group (CFG) and RCR separately until disposal or wind-down. Residual unallocated costs will continue to be reported within central items.

As part of its internal reorganisation, RBS has also centralised all services and functions and the related costs are now reallocated to businesses using appropriate drivers.

In addition, a number of previously reported reconciling items (Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs, regulatory and legal actions, restructuring costs, amortisation of purchased intangible assets and bank levy) have now been allocated to the reportable segments.

Comparatives have been restated accordingly.

Notes

7. Segmental analysis (continued)

Analysis of operating profit/(loss)

	Half year ended	
	30 June 2014 £m	30 June 2013* £m
UK Personal & Business Banking	1,234	979
Ulster Bank	83	(354)
Personal & Business Banking	1,317	625
Commercial Banking	849	604
Private Banking	222	167
Commercial & Private Banking	1,071	771
Corporate & Institutional Banking	767	446
Central items	(1,405)	(1,094)
Citizens Financial Group	421	375
RCR	172	n/a
Non-Core	n/a	(293)
Non-statutory basis	2,343	830
Reconciling items:		
Own credit adjustments	(50)	390
Gain on redemption of own debt	6	191
Write-down of goodwill	(130)	-
Strategic disposals	1	-
Statutory basis	2,170	1,411

*Restated

Impairment losses/(recoveries)

	Half year ended	
	30 June 2014 £m	30 June 2013* £m
UK Personal & Business Banking	148	256
Ulster Bank	57	503
Personal & Business Banking	205	759
Commercial Banking	31	281
Private Banking	-	6
Commercial & Private Banking	31	287
Corporate & Institutional Banking	(33)	165
Central items	(12)	(2)
Citizens Financial Group	104	51
RCR	(13)	n/a
Non-Core	n/a	856
Total	282	2,116

*Restated

Notes

7. Segmental analysis (continued)

Total revenue

	Half year ended					
	30 June 2014			30 June 2013*		
	External £m	Inter segment £m	Total £m	External £m	Inter segment £m	Total £m
UK Personal & Business Banking	3,558	6	3,564	3,589	6	3,595
Ulster Bank	408	40	448	549	36	585
Personal & Business Banking	3,966	46	4,012	4,138	42	4,180
Commercial Banking	1,729	13	1,742	1,778	16	1,794
Private Banking	470	258	728	503	340	843
Commercial & Private Banking	2,199	271	2,470	2,281	356	2,637
Corporate & Institutional Banking	2,902	1,876	4,778	3,250	2,480	5,730
Central items	1,108	1,630	2,738	1,622	3,995	5,617
Citizens Financial Group	1,724	5	1,729	1,644	50	1,694
RCR	460	82	542	n/a	n/a	n/a
Non-Core	n/a	n/a	n/a	1,072	132	1,204
Non-statutory basis	12,359	3,910	16,269	14,007	7,055	21,062
Reconciling items:						
Own credit adjustments	(50)	-	(50)	390	-	390
Gain on redemption of own debt	6	-	6	191	-	191
Strategic disposals	1	-	1	-	-	-
Elimination of intra-group transactions	-	(3,910)	(3,910)	-	(7,055)	(7,055)
Statutory basis	12,316	-	12,316	14,588	-	14,588

*Restated

Total assets and liabilities

	30 June 2014		31 December 2013*	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
UK Personal & Business Banking	133,485	147,623	132,024	146,233
Ulster Bank	26,734	24,718	28,206	27,047
Personal & Business Banking	160,219	172,341	160,230	173,280
Commercial Banking	88,577	90,293	87,889	93,206
Private Banking	21,133	36,232	21,518	37,356
Commercial & Private Banking	109,710	126,525	109,407	130,562
Corporate & Institutional Banking	543,053	501,667	556,934	515,680
Central items	84,171	78,390	92,746	84,877
Citizens Financial Group	75,843	64,251	71,489	61,695
RCR	32,655	12,565	n/a	n/a
Non-Core	n/a	n/a	29,128	4,975
Total	1,005,651	955,739	1,019,934	971,069

*Restated

Notes

8. Financial instruments

Classification

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

30 June 2014	Financial instruments						Finance leases £m	Non financial assets £m	Total £m
	HFT (1) £m	DFV (2) £m	HD (3) £m	AFS (4) £m	LAR (5) £m	HTM (6) £m			
Assets									
Cash and balances at central banks	-	-	-	-	66,609	-	-	-	66,609
Loans and advances to banks									
- amounts due from fellow subsidiaries	3,069	-	-	-	9,354	-	-	-	12,423
- reverse repos	25,137	-	-	-	2,984	-	-	-	28,121
- other	9,204	-	-	-	18,044	-	-	-	27,248
Loans and advances to customers									
- amounts due from holding company and fellow subsidiaries	41	-	-	-	1,616	-	-	-	1,657
- reverse repos	53,141	-	-	-	400	-	-	-	53,541
- other	17,932	50	-	-	358,078	-	6,539	-	382,599
Debt securities	55,606	15	-	38,250	3,491	4,556	-	-	101,918
Equity shares	6,314	276	-	814	-	-	-	-	7,404
Settlement balances	-	-	-	-	19,724	-	-	-	19,724
Derivatives									
- amounts due from holding company and fellow subsidiaries	3,482	-	-	-	-	-	-	-	3,482
- other	269,066	-	3,904	-	-	-	-	-	272,970
Intangible assets								12,156	12,156
Property, plant and equipment								7,073	7,073
Deferred tax								3,076	3,076
Prepayments, accrued income and other assets								5,598	5,598
Assets of disposal groups								52	52
	442,992	341	3,904	39,064	480,300	4,556	6,539	27,955	1,005,651

For the notes to this table refer to page 21.

Notes

8. Financial instruments (continued)

30 June 2014	Financial instruments				Finance leases £m	Non financial liabilities £m	Total £m
	HFT (1) £m	DFV (2) £m	HD (3) £m	Amortised cost £m			
Liabilities							
Deposits by banks							
- amounts due to fellow subsidiaries	491	-		1,543			2,034
- repos	28,931	-		2,762			31,693
- other	21,238	-		16,890			38,128
Customer accounts							
- amounts due to holding company and fellow subsidiaries	366	-		9,644			10,010
- repos	46,862	-		4,679			51,541
- other	8,897	5,248		384,552			398,697
Debt securities in issue	7,346	12,269		30,856			50,471
Settlement balances	-	-		15,125			15,125
Short positions	39,019	-					39,019
Derivatives							
- amounts due to holding company and fellow subsidiaries	2,378	-					2,378
- other	265,978		2,490				268,468
Accruals, deferred income and other liabilities	-	-		1,744	15	11,750	13,509
Retirement benefit liabilities	-	-		-	-	2,719	2,719
Deferred tax	-	-		-	-	305	305
Subordinated liabilities							
- amounts due to holding company	-	-		18,984	-	-	18,984
- other	-	351		12,293	-	-	12,644
Liabilities of disposal groups						14	14
	421,506	17,868	2,490	499,072	15	14,788	955,739
Equity							49,912
							1,005,651

For the notes to this table refer to page 21.

Notes

8. Financial instruments (continued)

31 December 2013	Financial instruments					Finance leases £m	Non financial assets £m	Total £m
	HFT (1) £m	DFV (2) £m	HD (3) £m	AFS (4) £m	LAR (5) £m			
Assets								
Cash and balances at central banks	-	-	-	-	79,993	-	-	79,993
Loans and advances to banks								
- amounts due from fellow subsidiaries	3,773	-	-	-	11,285	-	-	15,058
- reverse repos	25,781	-	-	-	658	-	-	26,439
- other	9,279	-	-	-	15,707	-	-	24,986
Loans and advances to customers								
- amounts due from holding company and fellow subsidiaries	-	-	-	-	1,620	-	-	1,620
- reverse repos	49,897	-	-	-	-	-	-	49,897
- other	18,849	49	-	-	361,935	6,750	-	387,583
Debt securities	56,258	14	-	40,682	3,742	-	-	100,696
Equity shares	6,983	313	-	982	-	-	-	8,278
Settlement balances	-	-	-	-	5,634	-	-	5,634
Derivatives								
- amounts due from holding companies and fellow subsidiaries	3,413	-	-	-	-	-	-	3,413
- other	281,655	-	4,335	-	-	-	-	285,990
Intangible assets							12,352	12,352
Property, plant and equipment							7,866	7,866
Deferred tax							3,435	3,435
Prepayments, accrued income and other assets							5,904	5,904
Assets of disposal groups							790	790
	455,888	376	4,335	41,664	480,574	6,750	30,347	1,019,934

For the notes to this table refer to page 21.

Notes

8. Financial instruments (continued)

31 December 2013	Financial instruments				Finance leases £m	Non financial liabilities £m	Total £m
	HFT (1) £m	DFV (2) £m	HD (3) £m	Amortised cost £m			
Liabilities							
Deposits by banks							
- amounts due to fellow subsidiaries	435	10		2,018			2,463
- repos	23,121	-		5,491			28,612
- other	18,909	-		15,179			34,088
Customer accounts							
- amounts due to holding company and fellow subsidiary	46	-		5,161			5,207
- repos	52,300	-		4,157			56,457
- other	9,636	5,862		395,142			410,640
Debt securities in issue	8,570	14,998		36,178			59,746
Settlement balances	-	-		5,245			5,245
Short positions	28,004	-					28,004
Derivatives							
- amounts due to holding company and fellow subsidiaries	2,586		-				2,586
- other	280,428		3,119				283,547
Accruals, deferred income and other liabilities	-	-		1,759	19	12,975	14,753
Retirement benefit liabilities				-	-	3,188	3,188
Deferred tax				-	-	189	189
Subordinated liabilities							
- amounts due to holding company	-	-		19,825	-	-	19,825
- other	-	358		12,951	-	-	13,309
Liabilities of disposal groups						3,210	3,210
	424,035	21,228	3,119	503,106	19	19,562	971,069
Equity							48,865
							<u>1,019,934</u>

Notes:

- (1) Held-for-trading.
- (2) Designated as at fair value.
- (3) Hedging derivatives.
- (4) Available-for-sale.
- (5) Loans and receivables.
- (6) Held to maturity.

Apart from the reclassification of £3.6 billion of Treasury debt securities from AFS to HTM in Q1 2014, there were no other reclassifications in the first half of 2014.

Notes

8. Financial instruments: Financial instruments carried at fair value - valuation hierarchy

Commentary on the control environment, valuation techniques and related aspects pertaining to financial instruments measured at fair value are included in the Group's 2013 Annual Report and Accounts. There have been no material changes to valuation or levelling approaches in the half year to 30 June 2014.

The tables below show financial instruments carried at fair value on the Group's balance sheet by valuation hierarchy – level 1, level 2 and level 3 and valuation sensitivities for level 3 balances.

30 June 2014	Level 1 £bn	Level 2 £bn	Level 3 £bn	Total £bn	Level 3 sensitivity	
					Favourable £m	Unfavourable £m
Assets						
Loans and advances to banks	-	37.1	0.3	37.4	20	(10)
Loans and advances to customers	-	71.0	0.2	71.2	20	(30)
Debt securities	55.5	36.6	1.8	93.9	130	(60)
Equity shares	6.1	0.9	0.4	7.4	60	(60)
Derivatives	0.1	273.2	3.1	276.4	340	(180)
	61.7	418.8	5.8	486.3	570	(340)
Proportion	12.7%	86.1%	1.2%	100%		
Liabilities						
Deposits by banks and customers	-	111.9	0.2	112.1	-	(10)
Debt securities in issue	-	18.4	1.2	19.6	30	(40)
Short positions	34.3	4.7	-	39.0	-	-
Derivatives	0.1	268.2	2.5	270.8	120	(120)
Subordinated liabilities	-	0.4	-	0.4	-	-
	34.4	403.5	4.0	441.9	150	(170)
Proportion	7.8%	91.3%	0.9%	100%		

31 December 2013

Assets						
Loans and advances to banks	-	38.5	0.3	38.8	30	(10)
Loans and advances to customers	-	68.6	0.2	68.8	20	(30)
Debt securities	56.1	38.8	2.1	97.0	150	(110)
Equity shares	6.9	1.0	0.4	8.3	70	(60)
Derivatives	0.1	285.7	3.6	289.4	380	(260)
	63.1	432.6	6.6	502.3	650	(470)
Proportion	12.6%	86.1%	1.3%	100%		
Liabilities						
Deposits by banks and customers	-	110.1	0.2	110.3	-	(10)
Debt securities in issue	-	22.3	1.3	23.6	40	(60)
Short positions	23.9	4.1	-	28.0	-	-
Derivatives	0.1	282.9	3.1	286.1	130	(120)
Subordinated liabilities	-	0.4	-	0.4	-	-
	24.0	419.8	4.6	448.4	170	(190)
Proportion	5.4%	93.6%	1.0%	100%		

Notes

8. Financial instruments (continued)

The table below shows a breakdown of valuation techniques and the ranges for those unobservable inputs used in valuation models and techniques that have a material impact on the valuation of Level 3 financial instruments. The table excludes unobservable inputs where the impact on valuation is less significant. Movements in the underlying input may have a favourable or unfavourable impact on the valuation depending on the particular terms of the contract and the exposure. For example an increase in the credit spread of a bond would be favourable for the issuer and unfavourable for the note holder. Whilst we indicate where we consider that there are significant relationships between the inputs, these inter-relationships will be affected by macro economic factors including interest rates, foreign exchange rates or equity index levels.

Financial instruments	Level 3 (£bn)		Valuation technique	Unobservable inputs	Range	
	Assets	Liabilities			Low	High
Loans	0.3		Discounted cash flow (DCF)	Credit spreads (2)	285bps	1211bps
Deposits	0.2	0.2	Option pricing	Volatility (3)	27%	30%
			DCF	Credit spreads (2)	0bps	25bps
				Recovery rates (4)	0%	71%
			Price based	Price (5)	80%	100%
Debt securities						
RMBS	0.2		Price based	Price (5)	0%	99%
			DCF	Probability of default (6)	3%	12%
				Yield (5)	10%	40%
				Conditional prepayment rates (CPR) (7)	0%	10%
CDO and CLO	0.8		Price based	Price (5)	0%	100%
			DCF	Yield (5)	0%	40%
				Probability of default (6)	2%	10%
Other ABS	0.4		Price based	Price (5)	0%	100%
Other debt securities	0.4		DCF	Credit spreads (2)	100bps	109bps
			Price based	Price (5)	0%	100%
Equity securities						
	0.4		Price based	Price (5)	0%	100%
			EBITDA multiple	EBITDA multiple (8)	12x	40x
			DCF	Yield (5)	10%	30%
				Recovery rates (4)	0%	30%
Derivatives						
Foreign exchange	1.0	0.6	Option pricing model	Correlation (9)	(41%)	100%
				Volatility (3)	6%	23%
Interest rate	1.2	0.4	Option pricing model	Correlation (9)	(40%)	100%
			DCF	CPR (7)	2%	20%
Equities and commodities	0.1	0.7	Option pricing model	Volatility (3)	27%	30%
Credit	0.8	0.8	Price based	Price (5)	0%	100%
			DCF based on defaults and recoveries	Recovery rates (4)	0%	100%
				Credit spreads (2)	25bps	410bps

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

8. Financial instruments (continued)

Notes:

- (1) Level 3 structured issued debt securities of £1.2 billion are not included in the table above as valuation is consistent with the valuation of the embedded derivative component.
- (2) Credit spreads and discount margins: Credit spreads and margins express the return required over a benchmark rate or index to compensate for the credit risk associated with a cash instrument. A higher credit spread would indicate that the underlying instrument has more credit risk associated with it. Consequently, investors require a higher yield to compensate for the higher risk. The discount rate comprises credit spread or margin plus the benchmark rate; it is used to value future cash flows.
- (3) Volatility: A measure of the tendency of a price to change with time.
- (4) Recovery rate: Reflects market expectations about the return of principal for a debt instrument or other obligations after a credit event or on liquidation. Recovery rates tend to move conversely to credit spreads.
- (5) Price and yield: There may be a range of price based information used for evaluating the value of an instrument. This may be a direct comparison of one instrument or portfolio with another or movements in a more liquid instrument may be used to indicate the movement in the value of less liquid instrument. The comparison may also be indirect in that adjustments are made to the price to reflect differences between the pricing source and the instrument being valued, for example different maturity, credit quality, seniority or expected payouts. Similarly to price, an instrument's yield may be compared to other instruments either directly or indirectly. Prices move inversely to yields.
- (6) Probability of default: This is a measure of the expected rate of losses in an underlying portfolio of mortgages or other receivables. The higher the probability of default the lower the value of the underlying portfolio. The cumulative losses tend to move conversely to prepayment rates and in line with constant default rates. The higher the rate, the higher the expected number of defaults and therefore the expected losses. An increase in the default rate is likely to reduce the value of an asset.
- (7) Conditional prepayment rate: The measure of the rate at which underlying mortgages or loans are prepaid. An increase in prepayment rates in a portfolio may increase or decrease its value depending upon the credit quality and payment terms of the underlying loans. For example an increase in prepayment rate of a portfolio of high credit quality underlying assets may reduce the value and size of the portfolio whereas for lower credit quality underlyings it may increase the value.
- (8) EBITDA (earnings before interest, tax, depreciation and amortisation) multiple: This is a commonly used valuation technique for equity holdings. The EBITDA of a company is used as a proxy for the future cash flows and when multiplied by an appropriate factor gives an estimate for the value of the company.
- (9) Correlation: Measures the degree by which two prices or other variables are observed to move together. If they move in the same direction there is positive correlation; if they move in opposite directions there is negative correlation. Correlations typically include relationships between: default probabilities of assets in a basket (a group of separate assets), exchange rates, interest rates and other financial variables.
- (10) Group does not have any material liabilities measured at fair value that are issued with an inseparable third party credit enhancement.
- (11) Improvements in price discovery resulted in transfers of £0.1 billion each of asset and liabilities from level 3 to level 2. Transfers from level 2 to level 3 mainly comprised debt securities in issue of £0.2 billion, derivative assets and liabilities of £0.1 billion each and debt securities of £0.1 billion due to increased unobservability of inputs used in the valuation of these instruments. There were no significant transfers between level 1 and level 2.

Notes

8. Financial instruments (continued)

											Amounts recorded in the		
	At	Amounts recorded in the			Level 3 transfers		Purchases	Settlements	Sales	Foreign exchange and other	At	income statement in respect	
	1 January	Income	SOCI (2)	In	Out	and	30 June				of balances at period end	Unrealised	Realised
2014	statement (1)	(2)	£m	£m	£m	issuances (3)	£m	£m	£m	2014	£m	£m	
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	
Assets													
FVTPL (3)													
Loans and advances													
- banks	310	(12)	-	-	-	-	-	(5)	-	293	16	-	
- customers	172	(1)	-	13	(3)	48	(14)	(10)	(3)	202	(13)	8	
Debt securities	905	70	-	134	(52)	238	(41)	(225)	(5)	1,024	48	10	
Equity shares	230	64	-	-	(37)	40	(31)	(46)	(1)	219	(42)	2	
Derivatives	3,566	(273)	-	56	(54)	82	(232)	(65)	(14)	3,066	(299)	(81)	
FVTPL assets	5,183	(152)	-	203	(146)	408	(318)	(351)	(23)	4,804	(290)	(61)	
Available-for-sale (AFS)													
Debt securities	1,173	8	(11)	3	-	-	(297)	(53)	1	824	(3)	11	
Equity shares	207	-	18	-	-	4	(24)	(5)	(7)	193	(1)	1	
AFS assets	1,380	8	7	3	-	4	(321)	(58)	(6)	1,017	(4)	12	
	6,563	(144)	7	206	(146)	412	(639)	(409)	(29)	5,821	(294)	(49)	
Of which ABS:													
- FVTPL (3)	591	84	-	24	(29)	181	(17)	(222)	(3)	609	59	7	
- AFS	1,108	8	(9)	3	-	-	(195)	(111)	1	805	(3)	11	
Liabilities													
Deposits	213	14	-	10	-	-	(2)	-	1	236	14	-	
Debt securities in issue	1,292	(60)	-	227	(32)	36	(230)	-	-	1,233	(7)	-	
Short positions	17	(1)	-	-	(11)	7	-	(4)	-	8	(4)	-	
Derivatives	3,053	(121)	-	57	(96)	74	(374)	(69)	(11)	2,513	(97)	(44)	
	4,575	(168)	-	294	(139)	117	(606)	(73)	(10)	3,990	(94)	(44)	
Net gains/(losses)		24	7								(200)	(5)	

Notes:

- (1) Net losses on HFT instruments of £90 million (31 December 2013 - £543 million) were recorded in income from trading activities. Net gains on other instruments of £114 million (31 December 2013 - £11 million) were recorded in other operating income and interest income as appropriate.
- (2) Consolidated statement of comprehensive income.
- (3) Includes £36 million of debt securities in issue and £7 million derivative liabilities relating to issuances.
- (4) Fair value through profit or loss comprises held-for-trading predominantly and designated at fair value through profit and loss.

Notes

8. Financial instruments (continued)

Fair value of financial instruments not carried at fair value

The following table shows the carrying value and fair value of financial instruments carried at amortised cost on the balance sheet.

	30 June 2014		31 December 2013	
	Carrying value £bn	Fair value £bn	Carrying value £bn	Fair value £bn
Financial assets				
Loans and advances to banks	28.9	28.9	26.2	26.2
Loans and advances to customers	366.6	357.1	370.3	358.9
Debt securities	8.0	7.8	3.7	3.1
Financial liabilities				
Deposits by banks	20.7	20.7	21.9	21.9
Customer accounts	149.3	149.4	137.6	137.7
Debt securities in issue	30.9	32.3	36.2	37.4
Subordinated liabilities	31.3	32.8	32.8	33.2

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

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

Notes

9. Contingent liabilities and commitments

	30 June 2014 £m	31 December 2013 £m
Contingent liabilities		
Guarantees and assets pledged as collateral security	15,164	16,709
Other	5,944	5,584
	21,108	22,293
Commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend	208,510	212,353
Other	1,923	2,442
	210,433	214,795
Contingent liabilities and commitments	231,541	237,088

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

10. Litigation, investigations and reviews

Arising out of their normal business operations, RBS plc and other members of the RBS Group are party to legal proceedings and the subject of investigation and other regulatory and governmental action in the United Kingdom, the European Union, the United States and other jurisdictions.

The RBS Group recognises a provision for a liability in relation to these matters when it is probable that an outflow of economic benefits will be required to settle an obligation resulting from past events, and a reliable estimate can be made of the amount of the obligation. While the outcome of the legal proceedings, investigations and regulatory and governmental matters in which the RBS Group is involved is inherently uncertain, the directors believe that, based on the information available to them, appropriate provisions have been made in respect of legal proceedings, investigations and regulatory and governmental matters as at 30 June 2014 (see Note 3). The future outflow of resources in respect of any matter may ultimately prove to be substantially greater than or less than the aggregate provision that the RBS Group has recognised.

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

10. Litigation, investigations and reviews (continued)

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

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

Litigation

Shareholder litigation

RBSG and certain of its subsidiaries, together with certain current and former officers and directors were named as defendants in a purported class action filed in the United States District Court for the Southern District of New York involving holders of American Depositary Receipts (the ADR claims).

A consolidated amended complaint asserting claims under Sections 10 and 20 of the US Securities Exchange Act of 1934 and Sections 11, 12 and 15 of the Securities Act was filed in November 2011 on behalf of all persons who purchased or otherwise acquired RBSG's American Depositary Receipts (ADRs) from issuance through 20 January 2009. In September 2012, the Court dismissed the ADR claims with prejudice. On 5 August 2013, the Court denied the plaintiffs' motions for reconsideration and for leave to re-plead their case. The plaintiffs appealed the dismissal of this case to the Second Circuit Court of Appeals and that appeal was heard on 19 June 2014. A decision in respect of the appeal is awaited.

Additionally, between March and July 2013, claims were issued in the High Court of Justice of England and Wales by sets of current and former shareholders, against the RBS Group (and in one of those claims, also against certain former individual officers and directors) alleging that untrue and misleading statements and/or improper omissions were made in connection with the rights issue announced by the RBS Group on 22 April 2008 in breach of the Financial Services and Markets Act 2000. On 30 July 2013 these and other similar threatened claims were consolidated by the Court via a Group Litigation Order. The RBS Group's defence to the claims was filed on 13 December 2013. Since then, further High Court claims have been issued against the RBS Group under the Group Litigation Order. There are likely to be further case management conferences which, in due course, will lead to a trial date being set.

10. Litigation, investigations and reviews (continued)

Other securitisation and securities related litigation in the United States

RBS Group companies have been named as defendants in their various roles as issuer, depositor and/or underwriter in a number of claims in the United States that relate to the securitisation and securities underwriting businesses. These cases include actions by individual purchasers of securities and purported class action suits. Together, the pending individual and class action cases involve the issuance of more than US\$64 billion of mortgage-backed securities (MBS) issued primarily from 2005 to 2007. Although the allegations vary by claim, in general, plaintiffs in these actions claim that certain disclosures made in connection with the relevant offerings contained materially false or misleading statements and/or omissions regarding the underwriting standards pursuant to which the mortgage loans underlying the securities were issued. RBS Group companies remain as defendants in more than 40 lawsuits and arbitrations brought by purchasers of MBS, including the purported class actions identified below.

Among these MBS lawsuits are two cases filed on 2 September 2011 by the US Federal Housing Finance Agency (FHFA) as conservator for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). The primary FHFA lawsuit remains pending in the United States District Court for the District of Connecticut, and it relates to approximately US\$32 billion of MBS for which RBS Group entities acted as sponsor/depositor and/or lead underwriter or co-lead underwriter. Of these approximately US\$10 billion were outstanding at 30 June 2014 with cumulative losses of approximately US\$1.03 billion (being the loss of principal value suffered by security holders). On 30 September 2013, the Court denied the defendants' motion to dismiss FHFA's amended complaint in this case. Discovery is ongoing.

The other remaining FHFA lawsuit that involves the RBS Group (in which the primary defendant is Nomura) names RBS Securities Inc. as a defendant by virtue of the fact that it was an underwriter of some of the securities at issue. This case is part of a coordinated proceeding in the United States District Court for the Southern District of New York in which discovery is underway. Three other FHFA lawsuits (against JP Morgan, Morgan Stanley and Countrywide) in which RBS Securities Inc. was an underwriter defendant were settled without any contribution from RBS Securities Inc. On 19 June 2014, another FHFA lawsuit in which RBS Securities Inc. was an underwriter defendant (against Ally Financial Group) was settled by RBS Securities Inc. for US\$99.5 million. This amount is fully provided for.

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

10. Litigation, investigations and reviews (continued)

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

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

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

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

London Interbank Offered Rate (LIBOR)

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

10. Litigation, investigations and reviews (continued)

Most of the USD LIBOR-related actions in which RBS Group companies are defendants, including all purported class actions relating to USD LIBOR, have been transferred to a coordinated proceeding in the United States District Court for the Southern District of New York. In the coordinated proceeding, consolidated class action complaints were filed on behalf of (1) exchange-based purchaser plaintiffs, (2) over-the-counter purchaser plaintiffs, and (3) corporate debt purchaser plaintiffs. In orders dated 29 March 2013 and 23 June 2014, the Court dismissed plaintiffs' antitrust claims and claims under RICO (Racketeer Influenced and Corrupt Organizations Act), but declined to dismiss (a) certain Commodities Exchange Act claims on behalf of persons who transacted in Eurodollar futures contracts and options on futures contracts on the Chicago Mercantile Exchange (on the theory that defendants' alleged persistent suppression of USD LIBOR caused loss to plaintiffs), and (b) certain contract and unjust enrichment claims on behalf of over-the-counter purchaser plaintiffs who transacted directly with a defendant. Discovery is stayed. Over 35 other USD LIBOR-related actions involving the RBS Group have been stayed pending further order from the Court. On 30 June 2014, the U.S. Supreme Court announced that it would consider an appeal by plaintiffs whose claims have been dismissed in their entirety to decide whether those plaintiffs have the procedural right to appeal the dismissals to the U.S. Court of Appeals for the Second Circuit on an interlocutory basis instead of waiting until there is a final judgment in the coordinated proceeding.

Certain members of the RBS Group have also been named as defendants in class actions relating to (i) JPY LIBOR and Euroyen TIBOR (the "Yen action") and (ii) Euribor (the "Euribor action"), both of which are pending in the United States District Court for the Southern District of New York. On 28 March 2014, the Court in the Yen action dismissed the plaintiffs' antitrust claims, but refused to dismiss their claims under the Commodity Exchange Act for price manipulation.

Details of LIBOR investigations and their outcomes affecting the RBS Group are set out under 'Investigations and reviews' on page 32.

Credit default swap antitrust litigation

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

FX antitrust litigation

Certain members of the RBS Group, as well as a number of other financial institutions, are defendants in a consolidated antitrust class action on behalf of U.S.-based plaintiffs and two similar complaints on behalf of non-U.S. plaintiffs in Norway and South Korea. The three cases are all pending in the United States District Court for the Southern District of New York. The plaintiffs generally allege that the defendants violated the U.S. antitrust laws, state statutes, and the common law by conspiring to manipulate the foreign exchange market by manipulating benchmark foreign exchange rates. On 30 May 2014, the defendants filed motions to dismiss the complaints in these actions.

10. Litigation, investigations and reviews (continued)

Thornburg adversary proceeding

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

Investigations and reviews

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

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

LIBOR, other trading rates and foreign exchange trading

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

10. Litigation, investigations and reviews (continued)

In June 2013, RBS plc was listed amongst the 20 banks found by the Monetary Authority of Singapore (MAS) to have deficiencies in the governance, risk management, internal controls and surveillance systems relating to benchmark submissions following a finding by the MAS that certain traders made inappropriate attempts to influence benchmarks in the period 2007 - 2011. RBS plc was ordered at that time to set aside additional statutory reserves with MAS of SGD1-1.2 billion and to comply with certain directives set by MAS with oversight by an independent reviewer, including instituting proper benchmark rate governance, providing training and ensuring robust surveillance systems and proper management of conflicts of interest. RBS plc complied with all directives to the satisfaction of MAS and the statutory reserves amount has been repaid by MAS.

In February 2014, the RBS Group paid settlement penalties of approximately EUR 260 million and EUR 131 million to resolve investigations by the European Commission into Yen LIBOR competition infringements and EURIBOR competition infringements respectively.

In July 2014, RBS plc and RBS N.V. entered into an Enforceable Undertaking (EU) with the Australian Securities and Investments Commission (ASIC) in relation to potential misconduct involving the Australian Bank Bill Swap Rate. RBS plc and RBS N.V. undertake in the EU to (a) comply with existing undertakings arising out of the February 2013 settlement with the United States Commodity Futures Trading Commission as they relate to Australian Benchmark Interest Rates, (b) implement remedial measures with respect to its trading in Australian reference bank bills and (c) appoint an independent compliance expert to review and report on RBS plc's and RBS N.V.'s implementation of such remedial measures. The remediation measures include ensuring appropriate records retention, training, communications surveillance and trading reviews are in place. As part of the EU, RBS plc and RBS N.V. also agreed to make a voluntary contribution of A\$1.6 million to fund independent financial literacy projects in Australia.

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

In addition, various governmental and regulatory authorities have commenced investigations into foreign exchange trading and sales activities apparently involving multiple financial institutions. The RBS Group has received enquiries from certain of these authorities including the FCA. The RBS Group is reviewing communications and procedures relating to certain currency exchange benchmark rates as well as foreign exchange trading and sales activity. It is not possible to estimate reliably what effect the outcome of these investigations, any regulatory findings and any related developments may have on the RBS Group, including the timing and amount of fines or settlements, which may be material.

On 21 July 2014, the Serious Fraud Office announced that it was launching a criminal investigation into allegations of fraudulent conduct in the foreign exchange market, apparently involving multiple financial institutions.

10. Litigation, investigations and reviews (continued)

Technology incident in June 2012

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

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

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

Interest rate hedging products

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

As part of the redress exercise, the RBS Group undertook to provide fair and reasonable redress to non-sophisticated customers classified as retail clients or private customers, who were mis-sold interest rate hedging products. In relation to non-sophisticated customers classified as retail clients or private customers who were sold interest rate products other than interest rate caps on or after 1 December 2001 up to 29 June 2012, the RBS Group was required to (i) make redress to customers sold structured collars; and (ii) write to customers sold other interest rate hedging products offering a review of their sale and, if it is appropriate in the individual circumstances, propose fair and reasonable redress on a case by case basis. Furthermore, non-sophisticated customers classified as retail clients or private customers who purchased interest rate caps during the period on or after 1 December 2001 to 29 June 2012 are entitled to approach the RBS Group and request a review. The RBS Group has reached agreement with the independent reviewer in relation to redress outcomes for almost all in scope customers. The RBS Group and the independent reviewer are now focused on completing the few remaining review outcomes, as well as assessing ancillary issues such as consequential loss claims.

10. Litigation, investigations and reviews (continued)

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

The Group is voluntarily undertaking a similar exercise and past business review in relation to the sale of interest rate hedging products to retail designated small and medium sized businesses in the Republic of Ireland and to relevant customers of RBS International. Current expectations are that these will be completed by 31 December 2014.

The Group has made provisions in relation to all of the above totalling £1.4 billion to date for this matter, including £100 million in the six months ended 30 June 2014, of which £0.6 billion had been utilised at 30 June 2014.

FSA mystery shopping review

On 13 February 2013, the FSA announced the results of a mystery shopping review it undertook into the investment advice offered by banks and building societies to retail clients. As a result of that review the FSA announced that firms involved were cooperative and agreed to take immediate action. The RBS Group was one of the firms involved.

The action required included a review of the training provided to advisers, considering whether changes are necessary to advice processes and controls for new business, and undertaking a past business review to identify any historic poor advice (and where breaches of regulatory requirements are identified, to put this right for customers).

Subsequent to the FSA announcing the results of its mystery shopping review, the FCA has required the RBS Group to carry out a past business review and customer contact exercise on a sample of historic customers that received investment advice on certain lump sum products through the Financial Planning channel of the Personal and Business Banking division of the RBS Group, which includes RBS plc and National Westminster Bank Plc, during the period from March 2012 until December 2012. This review is being conducted under section 166 of the Financial Services and Markets Act, under which a skilled person has been appointed to monitor such exercise. Alongside this review, the Personal and Business Banking business of the RBS Group is also carrying out self-initiated reviews of certain parts of its advice back book and discussions are taking place with the FCA in relation to a remediation exercise for a specific customer segment who may have been mis-sold a structured product.

Card Protection Plan Limited

On 22 August 2013, the FCA announced that Card Protection Plan Limited (CPP) and 13 banks and credit card issuers, including the RBS Group, had agreed to a compensation scheme in relation to the sale of card and/or identity protection insurance to certain retail customers. The compensation scheme has now been approved by the requisite number of customers and by the High Court of England and Wales. CPP has written to affected policyholders to ask those who believe they have been mis-sold to submit their claims. Claims that have been submitted to date are currently being processed and payments are now being made. Save for exceptional cases, all claims must be submitted before 31 August 2014. The RBS Group has made appropriate levels of provision based on its estimate of ultimate exposure.

10. Litigation, investigations and reviews (continued)

Tomlinson Report

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

Separately, in November 2013 the RBS Group instructed the law firm Clifford Chance to conduct an independent review of the principal allegation made in the Tomlinson Report: the RBS Group's Global Restructuring Group was alleged to be culpable of systematic and institutional behaviour in artificially distressing otherwise viable businesses and through that putting businesses into insolvency. Clifford Chance published its report on 17 April 2014 and concluded that there was no evidence to support the principal allegation.

A separate independent review of the principal allegation, led by Mason Hayes & Curran, Solicitors, has been commenced in the Republic of Ireland. The RBS Group's current expectation is that this review will be completed by 30 September 2014.

Multilateral interchange fees

In 2007, the EC issued a decision that, while interchange is not illegal per se, MasterCard's multilateral interchange fee (MIF) arrangements for cross border payment card transactions with MasterCard and Maestro branded consumer credit and debit cards in the EEA were in breach of competition law. MasterCard was required to withdraw (i.e. set to zero) the relevant cross-border MIF by 21 June 2008. MasterCard appealed against the decision to the General Court in March 2008, with the RBS Group intervening in the appeal proceedings. The General Court heard MasterCard's appeal in July 2011 and issued its judgment in May 2012, upholding the EC's original decision. MasterCard has appealed further to the Court of Justice and the RBS Group has intervened in these appeal proceedings. The appeal hearing took place on 4 July 2013 and the Advocate General's (AG) opinion (which is a non binding opinion and provided to the Court in advance of its final decision) was published on 30 January 2014. The AG opinion proposes that the Court should dismiss MasterCard's appeal. The Court's decision is currently expected on 11 September 2014. MasterCard negotiated interim cross border MIF levels to apply for the duration of the General Court proceedings. These MIF levels remain in place during the appeal before the Court of Justice.

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

10. Litigation, investigations and reviews (continued)

In March 2008, the EC opened a formal inquiry into Visa's MIF arrangements for cross border payment card transactions with Visa branded debit and consumer credit cards in the EEA. In April 2009 the EC announced that it had issued Visa with a formal Statement of Objections. In April 2010 Visa announced it had reached an agreement with the EC as regards immediate cross border debit card MIF rates only and in December 2010 the commitments were finalised for a four year period commencing December 2010 under Article 9 of Regulation 1/2003. In July 2012 Visa made a request to re-open the settlement in order to modify the fee. The EC rejected the request and in October 2012 Visa filed an appeal to the General Court seeking to have that decision annulled. That appeal is ongoing. The EC is continuing its investigations into Visa's cross border MIF arrangements for deferred debit and credit transactions. On 31 July 2012 the EC announced that it had issued Visa with a supplementary Statement of Objections regarding consumer credit cards in the EEA. On 14 May 2013, the EC announced it had reached an agreement with Visa regarding immediate cross border credit card MIF rates. This agreement has now been market tested and was made legally binding on 26 February 2014. The agreement is to last for four years.

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

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

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

Payment Protection Insurance

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

10. Litigation, investigations and reviews (continued)

The FSA published a final policy statement in August 2010 imposing significant changes with respect to the handling of complaints about the mis-selling of PPI. In October 2010, the British Bankers' Association (BBA) filed an application for judicial review of the FSA's policy statement and of related guidance issued by the FOS. In April 2011 the High Court issued judgment in favour of the FSA and the FOS and in May 2011 the BBA announced that it would not appeal that judgment. The RBS Group then reached agreement with the FSA on a process for implementation of its policy statement and for the future handling of PPI complaints. Implementation of the agreed processes has been under way since 2011. The Group has made provisions totalling £3.2 billion to date for this matter, including £150 million in the six months ended 30 June 2014, of which £2.6 billion had been utilised at 30 June 2014.

Retail banking – EC

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

UK personal current accounts / retail banking

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

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

10. Litigation, investigations and reviews (continued)

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

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

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

On 11 March 2014, the successor body to the OFT and CC, the Competition & Markets Authority (CMA), announced that in addition to its pending SME review (see below), it would be undertaking an update of the OFT's 2013 PCA review. On 18 July 2014 the CMA published its preliminary findings in respect of both the PCA and SME market studies. The CMA provisionally decided to make a market investigation reference (MIR) for both the PCA and SME market studies. The provisional decision on both PCAs and SMEs is now subject to a consultation period which runs until 17 September 2014. Following this period of consultation the CMA will make its final decision on a MIR in late autumn 2014. Should the CMA decide to proceed with a MIR this would result in a wide-ranging 18-24 month Phase 2 inquiry. At this stage it is not possible to estimate potential impacts on the Group.

SME banking market study

The OFT announced its market study on competition in banking for SMEs in England and Wales, Scotland and Northern Ireland on 19 June 2013. Following a consultation on the scope of the market study, the OFT published an update paper on 27 September 2013 setting out its proposed scope. On 11 March 2014, the OFT set out some competition concerns on SME banking and also announced that its successor body, the CMA, would continue the review. As discussed above, the CMA has provisionally decided to make a MIR for the SME market study in addition to the PCA study. As regards SMEs, the CMA is consulting on both the provisional decision and its provisional conclusion that it would be more appropriate to make a MIR than accept a set of undertakings in lieu put forward by the RBS Group, Barclays, HSBC and Lloyds. The CMA is also consulting on whether a review is required of the previous undertakings given following the CC's investigation into SME banking in 2002 and has asked for comments on whether these undertakings need to be varied. At this stage it is not possible to estimate potential impacts on the Group.

10. Litigation, investigations and reviews (continued)

FCA Wholesale Sector Competition Review

On 9 July 2014, the FCA launched a review of competition in the wholesale sector to identify any areas which may merit further investigation through an in-depth market study.

The initial review is an exploratory exercise and will focus primarily on competition in wholesale securities and investment markets, and related activities such as corporate banking. It will commence with a three month consultation exercise, including a call for inputs from stakeholders. Following this consultation period, the FCA intends to publish a feedback statement later in 2014 and any market study is expected to be launched in early 2015.

Credit default swaps (CDS) investigation

The RBS Group is a party to the EC's antitrust investigation into the CDS information market. The RBS Group has received and responded to a Statement of Objections from the EC and continues to co-operate fully with the EC's ongoing investigation. In general terms, the EC has raised concerns that a number of banks, Markit and ISDA may have jointly prevented exchanges from entering the CDS market. At this stage, the RBS Group cannot estimate reliably what effect the outcome of the investigation may have on the Group, which may be material.

Securitisation and collateralised debt obligation business

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

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

10. Litigation, investigations and reviews (continued)

In 2007, the New York State Attorney General issued subpoenas to a wide array of participants in the securitisation and securities industry, focusing on the information underwriters obtained from the independent firms hired to perform due diligence on mortgages. The RBS Group completed its production of documents requested by the New York State Attorney General in 2008, principally producing documents related to loans that were pooled into one securitisation transaction. In May 2011, the New York State Attorney General requested additional information about the RBS Group's mortgage securitisation business and, following the formation of the RMBS Working Group, has focused on the same or similar issues as the other state and federal RMBS Working Group investigations described above. The investigation is ongoing and the RBS Group continues to respond to requests for information.

US mortgages - loan repurchase matters

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

In issuing RMBS, CIB generally assigned certain representations and warranties regarding the characteristics of the underlying loans made by the originator of the residential mortgages; however, in some circumstances, CIB made such representations and warranties itself. Where CIB has given those or other representations and warranties (whether relating to underlying loans or otherwise), CIB may be contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of such representations and warranties. In certain instances where it is required to repurchase loans or related securities, CIB may be able to assert claims against third parties who provided representations or warranties to CIB when selling loans to it, although the ability to recover against such parties is uncertain. Between the start of 2009 and 30 June 2014, CIB received approximately US\$741 million in repurchase demands in respect of loans made primarily from 2005 to 2008 and related securities sold where obligations in respect of contractual representations or warranties were undertaken by CIB. However, repurchase demands presented to CIB are subject to challenge and rebuttal by CIB.

Citizens Financial Group, Inc (Citizens) has not been an issuer or underwriter of non-agency RMBS. However, Citizens is an originator and servicer of residential mortgages, and it routinely sells such mortgage loans in the secondary market and to GSEs. In the context of such sales, Citizens makes certain representations and warranties regarding the characteristics of the underlying loans and, as a result, may be contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of the representations and warranties concerning the underlying loans. Between the start of 2009 and 30 June 2014, RBS Citizens received US\$243 million in repurchase demands in respect of loans originated primarily since 2003. However, repurchase demands presented to Citizens are subject to challenge and rebuttal by Citizens.

10. Litigation, investigations and reviews (continued)

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

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

Citizens consent orders

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

In connection with the Consent Orders, the bank subsidiaries paid a total of US\$10 million in civil monetary penalties. The Consent Orders also require the bank subsidiaries to develop plans to provide restitution to affected customers (the amount of which is anticipated to be approximately US\$8 million), to cease and desist any operations in violation of Section 5 of the Federal Trade Commission Act, and to submit to the regulators periodic written progress reports regarding compliance with the Consent Orders.

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

10. Litigation, investigations and reviews (continued)

Governance and risk management consent order

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

- a plan to strengthen board and senior management oversight of the corporate governance, management, risk management, and operations of the RBS Group's U.S. operations on an enterprise-wide and business line basis,
- an enterprise-wide risk management programme for the RBS Group's U.S. operations,
- a plan to oversee compliance by the RBS Group's U.S. operations with all applicable U.S. laws, rules, regulations, and supervisory guidance,
- a Bank Secrecy Act/anti-money laundering compliance programme for the RBS plc and RBS N.V. branches in the U.S. (the U.S. Branches) on a consolidated basis,
- a plan to improve the U.S. Branches' compliance with all applicable provisions of the Bank Secrecy Act and its rules and regulations as well as the requirements of Regulation K of the Federal Reserve,
- a customer due diligence programme designed to reasonably ensure the identification and timely, accurate, and complete reporting by the U.S. Branches of all known or suspected violations of law or suspicious transactions to law enforcement and supervisory authorities, as required by applicable suspicious activity reporting laws and regulations, and
- a plan designed to enhance the U.S. Branches' compliance with OFAC requirements.

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

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

10. Litigation, investigations and reviews (continued)

US dollar processing consent order

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

As part of the settlement, RBSG and RBS plc entered into a consent Cease and Desist Order with the Fed (the Order) indicating, among other things, that: (a) RBSG and RBS plc lacked adequate risk management and legal review policies and procedures to ensure that activities conducted outside the United States comply with applicable OFAC regulations; (b) from at least 2005 to 2008, certain business lines within RBS plc developed and implemented policies and procedures for processing U.S. dollar-denominated funds transfers through unaffiliated U.S. financial institutions involving parties subject to OFAC Regulations that omitted relevant information from payment messages necessary for the U.S. financial institutions to determine whether these transactions were carried out in a manner consistent with U.S. law; and (c) the RBS Group continues to implement improvements in its oversight and compliance programme for activities involving offices outside the United States that impact the ability of U.S. financial institutions to comply with applicable OFAC sanctions. In the Order (which is publicly available), the RBS Group agreed to create an OFAC compliance programme to ensure compliance with OFAC regulations by the RBS Group's global business lines outside of the United States, and to adopt, implement, and comply with the programme. The programme has now been submitted to the Federal Reserve Bank of Boston (Reserve Bank) for approval.

Sixty days after the programme submitted to the Federal Reserve Bank of Boston (Reserve Bank) is approved, the RBS Group is to complete a global OFAC risk assessment and submit it to the Reserve Bank and the FCA. The RBS Group also agreed in the Order to hire an independent consultant (subject to approval by the Reserve Bank and the FCA) to conduct an annual OFAC compliance review involving a review of compliance policies and their implementation and an appropriate risk-focused sampling of U.S. dollar payments. The Order further requires the RBS Group to submit quarterly written progress reports to the Reserve Bank detailing the form and manner of all actions taken to secure compliance with the Order. It was also announced that the US Department of Justice and the New York County District Attorney's Office had concluded their parallel criminal investigations and do not intend to take any action against RBS plc.

US/Swiss tax programme

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

10. Litigation, investigations and reviews (continued)

Coutts & Co Ltd, a member of the RBS Group incorporated in Switzerland, notified the DOJ that it intended to participate in the Programme based on the possibility that some of its clients may not have declared their assets in compliance with US tax laws. The Programme required a detailed review of all US related accounts. The results of Coutts & Co Ltd's review were presented to the DOJ in June 2014. The DOJ has extended, until 31 July 2014, the deadline for Programme participants to complete the collection of evidence of the tax status of their US related account holders. The DOJ has also extended, until 15 September 2014, the deadline to collect evidence of those US related account holders also participating in an offshore voluntary disclosure programme.

Review of suitability of advice provided by Coutts & Co

In 2013 the FCA conducted a thematic review of the advice processes across the UK wealth management industry. As a result of this review, Coutts & Co, a member of the RBS Group incorporated in England and Wales, decided to undertake a past business review into the suitability of investment advice provided to its clients. This review is ongoing. Coutts & Co is in the process of contacting clients and redress will be offered in appropriate cases. A provision has been taken to cover any potential liability arising from this review.

Other regulatory investigations

On 27 August 2014 the FCA announced that it had fined the RBS Group £14.47 million in relation to an investigation into advised mortgage sales made by RBS plc and National Westminster Bank Plc in the period June 2011 to March 2013 inclusive.

11. Other developments

Dividend Access Share and revised State Aid terms

RBS announced on 9 April 2014 that it had entered into an agreement ('DAS Retirement Agreement') with Her Majesty's Treasury ('HMT') to provide for the future retirement of the Dividend Access Share ('DAS') subject to approval by the Company's independent shareholders, which was received at a General Meeting of the Company on 25 June 2014. The DAS Retirement Agreement sets out the process for removal of the DAS - a key element of the Government's 2009 capital injection into RBS and the associated European Commission ("EC") approval of the state aid package for the bank. Among other benefits, the retirement of the DAS will in future allow the Board to state more clearly a dividend policy to existing and potential investors.

The DAS was an important factor in the EC's assessment of the state aid RBS received and was part of the basis for its approval of that support in 2009. It was therefore necessary for the proposal for the eventual retirement of the DAS to be notified to the EC by HMT and this was done by HMT.

11. Other developments (continued)

The EC concluded that the new arrangements for the eventual retirement of the DAS did not constitute new state aid and approved the changes to RBS's restructuring plan in its State Aid Amendment Decision of 9 April 2014. In addition, this decision included two further key commitments made by HMT to the EC as follows:

- The deadline for RBS's divestment of the Williams & Glyn business (by Initial Public Offering (IPO), whole business sale or tendering procedure for its entire interest) has been extended. In the expected event of divestment by IPO, RBS must carry out this IPO before 31 December 2016 and complete the disposal of its entire interest in the Williams & Glyn business by 31 December 2017.
- Citizens Financial Group, Inc. ('Citizens') will be disposed of by 31 December 2016, with an automatic 12 month extension if market metrics indicate that an IPO or subsequent tranches of disposal cannot be completed in an orderly fashion or at a fair value. On 1 November 2013, RBS announced that it would accelerate the divestment of Citizens with a partial IPO and that it planned to fully divest the business by the end of 2016. The obligation under the State Aid Amendment Decision to dispose of Citizens is therefore in line with RBS's planned and publicly stated divestment timetable and already reflected in its capital and strategic planning.

RBS has entered into a Revised State Aid Commitment Deed under which it undertakes to do all acts and things necessary to ensure that HMT is able to comply with the revised state aid commitments made by HMT to the EC.

Board changes

On 27 February 2014, RBS announced that Philip Scott, a non-executive director, will step down from the Board by 31 October 2014.

Morten Friis was appointed as a non-executive director with effect from 10 April 2014.

Anthony Di Iorio, a non-executive director, stepped down from the Board on 26 March 2014.

Nathan Bostock ceased to be Group Finance Director on 19 May 2014 and stepped down from the Board on 28 May 2014.

Ewen Stevenson was appointed as an executive director and RBS Chief Financial Officer with effect from 19 May 2014.

Cap on variable remuneration

The fourth EU Capital Requirements Directive (CRD IV), implemented for banks in the UK by the Prudential Regulation Authority, imposes a 1:1 cap on the ratio of variable remuneration to fixed remuneration; however, with shareholder approval it is possible to award variable remuneration up to 200% of fixed remuneration (a 2:1 ratio).

11. Other developments (continued)

On 25 April 2014, the Board announced it was not seeking approval from shareholders at the 2014 Annual General Meeting for the 2:1 ratio. Instead, the Company has taken steps to work within the constraints of the 1:1 ratio (of variable to fixed remuneration) for employees subject to the Prudential Regulation Authority's Remuneration Code to deliver a remuneration structure that is aligned with shareholders' interests and compliant with the requirements of CRD IV.

EU financial transaction tax

On 30 April 2014, the European Court rejected a challenge from the UK Government of the initial proposal for the EU financial transaction tax on procedural grounds. A further challenge on substantive grounds may follow, depending on the nature of any subsequent Directive enacted in the future. RBS continues to monitor developments.

Citizens Financial Group (CFG)

On 13 May 2014, CFG filed an S-1 registration statement with the Securities and Exchange Commission in the United States to undertake an initial public offering. An amended S-1 was filed on 15 August 2014. The intention to fully divest CFG was announced in November 2013.

The filing of an S-1 Registration Statement is a regulatory requirement in the United States as part of the IPO process. The draft S-1 registration statement remains under review by the SEC, approximately a 12-14 week process from the initial filing. A formal prospectus will then be published which will include a price range and offering size range.

The submission of this statement is in line with the stated plan to launch an IPO of CFG by Q4 2014 - and complete RBS's sell-down of CFG in 2016 - as part of the RBS Capital Plan.

Rating agencies

Moody's Investors Service

On 13 March 2014, Moody's Investors Service ('Moody's') lowered its credit ratings of RBSG and certain subsidiaries by one notch. The long term ratings of RBSG were lowered to 'Baa2' from 'Baa1' whilst the long term ratings of RBS plc and National Westminster Bank Plc were lowered to 'Baa1' from 'A3'. Short term ratings were affirmed as unchanged. Post the review, a negative ratings outlook was assigned.

The ratings of Ulster Bank Ltd and Ulster Bank Ireland Ltd were also impacted by the rating action on the RBSG. The long term and short term ratings of these entities were lowered by one notch to 'Baa3' (long term)/'P-3' (short term) from 'Baa2'/'P-2'. A negative outlook was assigned to ratings, in line with the ratings outlook on the RBSG.

Notes

11. Other developments (continued)

Rating agencies (continued)

Moody's rating actions were prompted by its concerns over the execution risks relating to the effective roll-out of the RBS Group's strategic plans, its concerns over the impact of restructuring costs on profitability and its concern that the RBS Group's capitalisation is vulnerable to short-term shocks. Despite these short to medium term concerns, Moody's expects RBS Group's capitalisation to improve in the medium to long term as the recovery plan is progressed. The agency also considers that, if executed according to plan, the intended restructuring will ultimately be positive for creditors as it will deliver a more efficient UK-focused bank with lower risk operations.

The long-term ratings of subsidiaries, Citizens Bank NA and Citizens Bank of Pennsylvania were not impacted by the rating action on RBSG and the long-term ratings of these entities were affirmed as unchanged by Moody's. Ratings are on a negative outlook.

Fitch Ratings

On 24 July 2014 Fitch Ratings ('Fitch') affirmed as unchanged the long term ratings of RBSG and subsidiaries, RBS plc and National Westminster Bank Plc, retaining the rating outlooks of these entities at negative.

On 25 July 2014 Fitch affirmed the ratings of Ulster Bank Ltd. At the same time, the long-term rating of Ulster Bank Ireland Ltd was revised down one notch to 'BBB+' from 'A-' and the short-term rating was revised to 'F2' from 'F1'. The outlooks on the ratings of both Ulster Bank Ltd and Ulster Bank Ireland Ltd remain negative.

The decision to downgrade the rating of Ulster Bank Ireland Ltd was based on the view that this entity's role within RBS Group may become less important over the next three to five years. Fitch also believe that the potential for disposal of Ulster Bank Ireland Ltd is higher than that of Ulster Bank Ltd, a Northern Irish business. These opinions caused Fitch to reduce the amount of support uplift in the ratings of Ulster Bank Ireland Ltd by one notch.

Standard & Poor's

During the quarter, Standard & Poor's affirmed as unchanged its ratings on RBSG and notable subsidiaries. Negative rating outlooks were maintained.

Current RBSG and subsidiary ratings are shown in the table below:

	Moody's		S&P		Fitch	
	Long term	Short term	Long term	Short term	Long term	Short term
RBSG	Baa2	P-2	BBB+	A-2	A	F1
The Royal Bank of Scotland plc	Baa1	P-2	A-	A-2	A	F1
National Westminster Bank Plc	Baa1	P-2	A-	A-2	A	F1
RBS N.V.	Baa1	P-2	A-	A-2	A	F1
Citizens Bank, NA/ Citizens Bank of Pennsylvania	A3	P-2	A-	A-2	BBB+	F2
Ulster Bank Ireland Ltd	Baa3	P-3	BBB+	A-2	BBB+	F2
Ulster Bank Ltd	Baa3	P-3	BBB+	A-2	A-	F1

12. Related party transactions

UK Government

The UK Government and bodies controlled or jointly controlled by the UK Government and bodies over which it has significant influence are related parties of the Group. The Group enters into transactions with many of these bodies on an arm's length basis.

Bank of England facilities

In the ordinary course of business, the Group may from time to time access market-wide facilities provided by the Bank of England.

The Group's other transactions with the UK Government include the payment of taxes, principally UK corporation tax and value added tax; national insurance contributions; local authority rates; and regulatory fees and levies (including the bank levy and FSCS levies).

Other related parties

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

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

Full details of the Group's related party transactions for the year ended 31 December 2013 are included in the 2013 Annual Report and Accounts.

13. Date of approval

The interim results for the half year ended 30 June 2014 were approved by the Board of directors on 28 August 2014.

14. Post balance sheet events

There have been no significant events between 30 June 2014 and the date of approval of this announcement which would require a change to or additional disclosure in the announcement.

Independent review report to The Royal Bank of Scotland plc

We have been engaged by The Royal Bank of Scotland plc (“the Company”) to review the condensed consolidated financial statements in the half-yearly financial report for the six months ended 30 June 2014 which comprise the condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed consolidated balance sheet, the condensed consolidated statement of changes in equity, the condensed consolidated cash flow statement and related Notes 1 to 14 (together “the condensed consolidated financial statements”). We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed financial statements.

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

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom’s Financial Conduct Authority.

As disclosed in Note 1, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed consolidated financial statements included in this half-yearly financial report have been prepared in accordance with International Accounting Standard 34, ‘Interim Financial Reporting’, as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed consolidated financial statements in the half-yearly financial report based on our review.

Scope of review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed consolidated financial statements in the half-yearly financial report for the six months ended 30 June 2014 are not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Deloitte LLP

Chartered Accountants and Statutory Auditor

London, United Kingdom

28 August 2014

Risk factors

Summary of our Principal Risks and Uncertainties

RBS plc is a principal operating subsidiary of RBSG and accounts for a substantial proportion of the consolidated assets, liabilities and operating profits of the RBS Group. Accordingly, risk factors below which relate to RBSG and the RBS Group will also be of relevance to RBS plc and the Group.

Set out below is a summary of the principal risks which could adversely affect the Group; it should be read in conjunction with the Risk and Balance Sheet management section on pages 28 to 195 of the 2013 Annual Report and Accounts (2013 R&A). This summary should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. A fuller description of these and other risk factors is included in the 2013 R&A on pages 331 to 346.

- The RBS Group is implementing a new strategic plan and direction which will result in a significant downsizing of the RBS Group, including simplifying the RBS Group by replacing the previous divisional structure with three customer franchises. The RBS Group is also taking steps to strengthen its capital position and has established medium term goals.
- The RBS Group's ability to implement its new strategic plan and achieve its capital goals depends on the success of its efforts to refocus on its core strengths and the timely divestment of Citizens Financial Group (CFG). Since 2009, the RBS Group has undertaken an extensive restructuring, including the disposal of non-core assets and businesses, such as the full divestment of Direct Line Group in March 2014, as part of the State Aid restructuring plan approved by the EC and supplemented by the agreements with HM Treasury and the EC on 9 April 2014. The RBS Group created RBS Capital Resolution in the fourth quarter of 2013 to manage the run-down of problem assets with the clear aspiration of removing such assets from the balance sheet by the end of 2016.
- The level of structural change required to implement the RBS Group's strategic and capital goals together with other regulatory requirements such as ring fencing are likely to be disruptive and increase operational and people risks for the RBS Group. There is no assurance that the RBS Group will be able to successfully implement its new strategy on which its capital plan depends or achieve its goals within the time frames contemplated or at all.
- Operational and reputational risks are inherent in the RBS Group's businesses, and heightened as a result of the implementation of the new strategic plan.
- The Scottish government is holding a referendum on 18 September 2014 on the question of Scottish independence from the UK. Although the outcome of the referendum is uncertain, subject to any mitigating factors, uncertainties resulting from an affirmative vote in favour of independence would be likely to significantly impact the RBS Group's credit ratings and could also impact the fiscal, monetary, legal and regulatory landscape to which the RBS Group is subject. Were Scotland to become independent, it may also affect Scotland's status in the EU. The occurrence of any of the impacts above could significantly impact the RBS Group's costs and would have a material adverse effect on the RBS Group's business, financial condition, results of operations and prospects.
- Despite the improved outlook for the global and UK economy over the near to medium-term, actual or perceived difficult global economic conditions, potential volatility in the UK housing market and restrictions on mortgage lending as well as increased competition, particularly in the UK, create challenging economic and market conditions and a difficult operating environment for the RBS Group's businesses. These factors, together with additional uncertainty relating to the recovery of the Eurozone economy where the RBS Group has significant exposure and the risk of a return of volatile financial markets, in part due to the monetary policies and measures carried out by central banks, have adversely affected and will continue to adversely affect the RBS Group's businesses, earnings, financial condition and prospects.

Risk factors

- The RBS Group is subject to substantial regulation and oversight, and any further significant regulatory developments such as those which have occurred over the past several years could have an adverse effect on how the RBS Group conducts its business and on its results of operations and financial condition. Certain regulatory measures introduced in the UK and in Europe relating to ring-fencing of certain bank activities could result in additional costs and increased operational risks which may impact the viability of certain business models and require significant restructuring with the possible transfer of a large number of customers between legal entities.
- The RBS Group's ability to implement its strategy and its future success depends on its ability to attract and retain qualified personnel. The RBS Group could fail to attract or retain senior management, which may include members of the RBS Group Board, or other key employees, and it may suffer if it does not maintain good employee relations. The RBS Group's changing strategy has led to the departure of many talented staff. Following the implementation of CRD IV and the Government's views on variable compensation, there is now a restriction on the RBS Group's ability to pay individual bonuses greater than salary, which may put the RBS Group at a competitive disadvantage. An inability to attract and retain qualified personnel could have an adverse impact on the implementation of the RBS Group's strategy and regulatory commitments.
- The RBS Group is subject to a number of regulatory initiatives which may adversely affect its business, including the UK Government's adoption of the Financial Services (Banking Reform) Act 2013, the US Federal Reserve's new rules for applying US capital, liquidity and enhanced prudential standards to certain of the RBS Group's US operations and ongoing reforms in the European Union with respect to capital requirements, stability and resolution of financial institutions, including CRD IV and the Resolution and Recovery Directive.
- The RBS Group's ability to meet its obligations including its funding commitments depends on the RBS Group's ability to access sources of liquidity and funding. The inability to access liquidity and funding due to market conditions or otherwise or to do so at a reasonable cost, could adversely affect the RBS Group's financial condition and results of operations. Furthermore, the RBS Group's borrowing costs and its access to the debt capital markets and other sources of liquidity depend significantly on its and the UK Government's credit ratings. The RBS Group's credit ratings would be likely to be negatively impacted by political events, such as an affirmative vote in favour of Scottish independence.
- The RBS Group's business performance, financial condition and capital and liquidity ratios could be adversely affected if its capital is not managed effectively or as a result of changes to capital adequacy and liquidity requirements, including those arising out of Basel III implementation (globally or by European, UK or US authorities) as well as structural changes that may result from the implementation of ring-fencing under the Financial Services (Banking Reform) Act 2013 or changes of the US Federal Reserve with respect to the RBS Group's US operations. The RBS Group's ability to reach its target capital ratios in the medium term will turn on a number of factors including a significant downsizing of the RBS Group in part through the sale of CFG.
- The RBS Group is, and may be, subject to litigation and regulatory and governmental investigations that may impact its business, reputation, results of operations and financial condition. Although the RBS Group settled a number of legal proceedings and regulatory investigations during 2013 and 2014, the RBS Group is expected to continue to have material exposure to legacy litigation and regulatory proceedings in the medium term. The RBS Group also expects greater regulatory and governmental scrutiny for the foreseeable future particularly as it relates to compliance with historical, new and existing laws and regulations such as anti-money laundering and anti-terrorism laws.

Risk factors

- The RBS Group is highly dependent on its information technology systems, which are currently subject to significant investment and rationalisation as part of the RBS Group's new strategic plan and associated transformation programme. The RBS Group has been and expects to continue to be subject to cyber attacks which expose the RBS Group to loss of customer data or other sensitive information and which, combined with other failures of the RBS Group's information technology systems, may hinder its ability to service its clients which could result in long-term damage to the RBS Group's businesses and brands.
- The RBS Group or any of its UK bank subsidiaries may face the risk of full nationalisation or other resolution procedures, including recapitalisation of the RBS Group or any of its UK bank subsidiaries, through bail-in which has been introduced by the Financial Services (Banking Reform) Act 2013 and will come into force on a date stipulated by HM Treasury. Various actions could be taken by or on behalf of the UK Government, including actions in relation to any securities issued, new or existing contractual arrangements and transfers of part or all of the RBS Group's businesses.
- As a result of the UK Government's majority shareholding in the RBS Group it is able to exercise a significant degree of influence over the RBS Group including on dividend policy, the election of directors or appointment of senior management, remuneration policy and/or limiting the RBS Group's operations. The offer or sale by the UK Government of all or a portion of its shareholding in the Company could affect the market price of the equity shares and other securities and acquisitions of ordinary shares by the UK Government (including through conversions of other securities or further purchases of shares) may result in the delisting of the RBS Group from the Official List.
- The actual or perceived failure or worsening credit of the RBS Group's counterparties or borrowers, including sovereigns in the Eurozone, and depressed asset valuations resulting from poor market conditions have led the RBS Group to realise and recognise significant impairment charges and write-downs which have adversely affected the RBS Group and could continue to adversely affect the RBS Group if, due to a deterioration in economic and financial market conditions or continuing weak economic growth, it were to recognise or realise further write-downs or impairment charges.
- 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.
- Recent developments in regulatory or tax legislation and any further significant developments could have an effect on how the RBS Group conducts its business and on its results of operations and financial condition, and the recoverability of certain deferred tax assets recognised by the RBS Group is subject to uncertainty.
- The RBS Group is required to make planned contributions to its pension schemes and to compensation schemes in respect of certain financial institutions (such as the UK Financial Services Compensation Scheme). Additional or increased contributions may have an adverse impact on the RBS Group's results of operations, cash flow and financial condition.

Statement of directors' responsibilities

We, the directors listed below, confirm that to the best of our knowledge:

- the condensed financial statements have been prepared in accordance with IAS 34 'Interim Financial Reporting';
- the interim management report includes a fair review of the information required by DTR 4.2.7R (indication of important events during the first six months and description of principal risks and uncertainties for the remaining six months of the year); and
- the interim management report includes a fair review of the information required by DTR 4.2.8R (disclosure of related parties' transactions and changes therein).

By order of the Board

Philip Hampton
Chairman

Ross McEwan
Chief Executive

Ewen Stevenson
Chief Financial Officer

28 August 2014

Board of directors

Chairman

Philip Hampton

Executive directors

Ross McEwan
Ewen Stevenson

Non-executive directors

Sandy Crombie
Alison Davis
Morten Friis
Robert Gillespie
Penny Hughes
Brendan Nelson
Baroness Noakes
Philip Scott

Forward looking statements

Certain sections in this document contain 'forward-looking statements' as that term is defined in the United States Private Securities Litigation Reform Act of 1995, such as statements that include the words 'expect', 'estimate', 'project', 'anticipate', 'believe', 'should', 'intend', 'plan', 'could', '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 RBS Group's and the Group's restructuring and strategic plans, divestments, capitalisation, portfolios, net interest margin, capital and leverage ratios, liquidity, risk-weighted assets (RWAs), RWA equivalents (RWAE), return on equity (ROE), profitability, cost:income ratios, loan:deposit ratios, funding and risk profile; discretionary coupon and dividend payments; implementation of legislation of ring-fencing and bail-in measures; sustainability targets; litigation, regulatory and governmental investigations; the Group's future financial performance; the level and extent of future impairments and write-downs; and the Group's exposure to political risks, including the referendum on Scottish independence, credit rating risk and 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 market risk disclosures are dependent on choices about key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market risk disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated.

Other factors that could cause actual results to differ materially from those estimated by the forward-looking statements contained in this document include, but are not limited to: global and UK economic and financial market conditions and other geopolitical risks, and their impact on the financial industry in general and on the Group in particular; the ability to implement strategic plans on a timely basis, or at all, including the simplification of the RBS Group's structure, rationalisation of and investment in its IT systems, the divestment of Citizens Financial Group and the exiting of assets in RBS Capital Resolution as well as the disposal of certain other assets and businesses as announced or required as part of the State Aid restructuring plan; the achievement of capital and costs reduction targets; ineffective management of capital or changes to capital adequacy or liquidity requirements; organisational restructuring in response to legislation and regulation in the United Kingdom (UK), the European Union (EU) and the United States (US); the implementation of key legislation and regulation including the UK Financial Services (Banking Reform Act) 2013 and the EU Recovery and Resolution Directive; the ability to access sufficient sources of capital, liquidity and funding when required; deteriorations in borrower and counterparty credit quality; litigation, government and regulatory investigations including investigations relating to the setting of interest rates and foreign exchange trading and rate setting activities; costs or exposures borne by the RBS Group arising out of the origination or sale of mortgages or mortgage-backed securities in the US; the reliability and resilience of its IT system, the extent of future write-downs and impairment charges caused by depressed asset valuations; the value and effectiveness of any credit protection purchased by the Group; unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices and basis, volatility and correlation risks; changes in the credit ratings of the Group; changes to the valuation of financial instruments recorded at fair value; competition and consolidation in the banking sector; the ability of the Group to attract or retain senior management or other key employees; regulatory or legal changes (including those requiring any restructuring of the Group's operations) in the UK, the US and other countries in which the Group operates or a change in UK Government policy; changes to regulatory requirements relating to capital and liquidity; changes to the monetary and interest rate policies of central banks and other governmental and regulatory bodies; changes in UK and foreign laws, regulations, accounting standards and taxes, including changes in regulatory capital regulations and liquidity requirements; impairments of goodwill; pension fund shortfalls; general operational risks; HM Treasury exercising influence over the operations of the RBS Group; reputational risk; the conversion of the B Shares issued by RBS Group 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 RBS Group; and the success of the Group in managing the risks involved in the foregoing.

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

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

Additional information

Statutory results

Financial information contained in this document does not constitute statutory accounts within the meaning of section 434 of the Companies Act 2006 (“the Act”). The statutory accounts for the year ended 31 December 2013 have been filed with the Registrar of Companies. The report of the auditor on those statutory accounts were unqualified, did not draw attention to any matters by way of emphasis and did not contain a statement under section 498(2) or (3) of the Act.

Contact

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