DISCLOSURES UNDER THE NEW CAPITAL ADEQUACY FRAMEWORK (BASEL II GUIDELINES) FOR THE YEAR ENDED 31 MARCH 2009

I. SCOPE OF APPLICATION

RBS India is operating in India as Indian Branches of The Royal Bank of Scotland N.V., Netherlands. The Royal Bank of Scotland N.V. is incorporated in the Netherlands and is regulated by the Dutch central bank, De Nederlandse Bank (DNB).

As of October 2007, The Royal Bank of Scotland N.V. is a wholly owned subsidiary of RFS Holdings, a holding company jointly owned by Royal Bank of Scotland, Dutch Govt. and Banco Santander. Subsequent to completion of the de-merger of RBS, legal ownership of the RBS Indian branches will transfer to Royal Bank of Scotland.

II. CAPITAL STRUCTURE

The following amounts are borrowed from Head Office during the year ended 31 March 2009:-

Type of borrowing	Amount raised during the year (in INR crores)	Eligibility
IPDI (Innovative Perpetual Debt Instrument)	Nil	Tier I
Subordinated Debt	Nil	Tier II
Hybrid capital	Nil	Upper Tier II

Capital Funds

(Rs. in crores)

		Amount
A	**Tier I Capital**	**2,230.45**
	Of which	
	- Paid-up Share Capital	169.02
	- Reserves and surplus	2,196.19
	- Innovative Perpetual Debt Instrument (IPDI)	312.58
	- Amount deducted from Tier 1 capital	
	- Deferred Tax Assets	(437.10)
	- Intangible assets	(10.23)
B	**Tier 2 Capital (net of deductions) (B.1+B.2+B.3-B.4)**	**1,568.21**
	Of which	
B.1	Debt Capital Instruments eligible for inclusion as Upper Tier 2 Capital (Hybrid Capital)	
	- Total amount outstanding	715.70
	- Of which amount raised during the current year	Nil
	- Amount eligible as capital funds	630.09

B.2	Subordinated debt eligible for inclusion in Tier 2 capital	
	- Total amount outstanding	1,661.44
	- Of which amount raised during the current year	Nil
	- Amount eligible as capital funds	758.57
B.3	Other Tier 2 Capital - Provision for Standard Assets	179.55

B.4	Deductions from Tier 2 Capital	-
C	**Total Eligible Capital**	**3,798.66**

III. CAPITAL ADEQUACY

An assessment of the capital requirement of the Bank is carried out through a comprehensive projection of future businesses that takes cognizance of the strategic intent of the Bank, profitability of particular businesses and opportunities for growth. The proper mapping of credit, operational and market risks to this projected business growth enables assignment of capital that not only adequately covers the minimum regulatory capital requirement but also provides headroom for growth. The calibration of risk to business is enabled by a strong risk culture in the Bank aided by effective, technology based risk management systems.

A summary of the Bank's capital requirement for credit, market and operational risk and the capital adequacy ratio as on 31st March 2009 is presented below.

(Rs. in crores)

		Amount
A	Capital requirements for Credit Risk	2,159.88
	- Portfolios subject to standardized approach	2,140.54
	- Securitisation exposures	19.34
B	Capital requirements for Market Risk	266.97
	- Standardized duration approach	
	- Interest rate risk	230.97
	- Foreign exchange risk	36.00
	- Equity risk	-
C	Capital requirements for Operational risk	
	- Basic indicator approach	274.35
D	Capital Adequacy Ratio of the Bank (%)	12.66%
E	Tier 1 CRAR (%)	7.43%

RISK MANAGEMENT: OBJECTIVES AND ORGANIZATION STRUCTURE

The Bank undertakes a wide variety of businesses and hence is required to be able to identify measure, control, monitor and manage as well as report risks in a clear manner. The important aspects of the Bank's risk management are a robust risk approval mechanism, well defined processes and guidelines and a elaborate internal control mechanism. The risk approval mechanism covers all the key areas of risk such as credit, market and operational risk and is involved in quantification of these risks wherever possible for effective and continuous monitoring.

Objectives and Policies

The Bank's risk management processes are guided by well-defined global as well as local policies appropriate for various risk categories. There is an independent risk team that oversees this function and oversight is by the regional as well as the global risk offices and also by periodic independent risk reviews / internal audit or reviews.

The risk appetite for the Bank in India is determined by the global risk committees based on inputs from the country management.

Besides the risk management and compliance departments of the Bank in India, there are several committees such as Asset-Liability Committee (ALCO), Operational Risk Management Committee, etc. that are involved in managing the concerned risks within the bank's guidelines as well as regulatory requirements.

The Bank has global policies for Stress Testing to measure impact of adverse stress scenarios on the adequacy of capital.

Structure and Organization

The Risk Management function reports to the Country Executive in India and has functional reporting to the Regional Head of Risk who is based in Hong Kong. Risk has three distinct teams - Credit Risk, Market Risk and Operational Risk and each of these teams are headed by experienced risk professionals. For credit risk, there is a Risk Management Committee which meets regularly to consider credit proposals for approval.

IV. CREDIT RISK

Credit Risk Management Policy

Credit risk considers the ability of a borrower or counter-party to honor commitments under an agreement as any such failure has an adverse impact on the banks' financial performance. The Bank is exposed to credit risk through its various lending activities such as funded facilities, non-funded facilities as well as hedging facilities.

The Bank's credit risk management process is quite independent of the business so as to protect integrity of the risk assessment process and decision making. The global as well as local policies guide the credit risk team to make informed decisions.

Credit risk in respect of exposures on corporate as well as micro, small and medium enterprises (MSME) is measured and managed at both individual counterparty level as well as at a portfolio level. Some of the products extended by the bank are managed at the portfolio level, as the individual loans under product programs are guided by the product program norms with built in triggers. Credit rating tools are an integral part of risk-assessment of the corporate borrowers and different rating models are used for each segment that has distinct risk characteristics such as Large Corporates, Small and Medium Corporates, financial companies, project finance etc.

The credit rating tools use a combination of quantitative inputs and qualitative inputs to arrive at a 'point-in-time' view of the rating of counterparty. Each internal rating grade corresponds to a distinct probability of default. Model validation is carried out periodically at a global level by objectively assessing the accuracy and stability of ratings.

All credit exposures, once approved, are monitored and reviewed periodically against the approved limits. Borrowers with lower credit rating are subject to more frequent reviews. Besides this there are weekly risk migration analysis and monthly watch list meetings.

The Bank’s retail asset portfolio is managed to ensure stable risk adjusted earnings stream by maintaining customer defaults within acceptable levels. The Bank periodically carries out a comprehensive portfolio level analysis of retail asset portfolio with a risk-return perspective. Risk measurement for the retail exposures is done on basis of comprehensive credit assessment parameters.

Risk Review involves independent review of credit risk assessment, compliance with internal policies of the Bank and with the regulatory framework, compliance of sanction terms and conditions and effectiveness of loan administration.

Customers with emerging credit problems are identified early and classified accordingly. Remedial action is initiated promptly to minimize the potential loss to the Bank.

The Bank controls and limits concentration risk by means of appropriate structural limits and borrower limits based on creditworthiness. The exposures to individual clients or group are based on the internal rating of the borrower as well as group-wise borrowing limits and capped by the regulatory ceiling.

Industry analysis plays an important part in assessing the concentration risk within the loan portfolio. Particular attention is given to industry sectors where the Bank believes there is a high degree of risk or potential for volatility in the future. The Bank has fixed internal limits for aggregate commitments to different sectors so that the exposures are evenly spread over various sectors.

Definitions of Non-Performing Assets

Advances are classified into performing and non-performing advances (NPAs) as per RBI guidelines. NPAs are further classified into sub-standard, doubtful and loss assets based on the criteria stipulated by RBI. An asset, including a leased asset, becomes non-performing when it ceases to generate income for the Bank.

An NPA is a loan or an advance where:

1. 1. Interest and/or installment of principal remains overdue for a period of more than 90 days in respect of a term loan;
2. 2. The account remains "out-of-order" in respect of an Overdraft or Cash Credit (OD/CC);
3. 3. The bill remains overdue for a period of more than 90 days in case of bills purchased and discounted;
4. 4. A loan granted for short duration crops will be treated as an NPA if the installments of principal or interest thereon remain overdue for two crop seasons; and
5. 5. A loan granted for long duration crops will be treated as an NPA if the installments of principal or interest thereon remain overdue for one crop season.

The Bank classifies an account as an NPA only if the interest imposed during any quarter is not fully repaid within 90 days from the end of the relevant quarter.

CREDIT RISK EXPOSURES Total Gross Credit Risk Exposure Including Geographic

Distribution of Exposure

(Rs. in crores)

	Domestic	Overseas #	Total
Fund Based	18,281.85	Nil	18,281.85
Non Fund Based *	5,716.81	Nil	5,716.81
Total	**23,998.66**	**Nil**	**23,998.66**

Being a foreign bank operating in India, overseas exposure is Nil.

Distribution of advances by industry sector

(Rs. in crores)

S.No.	Industry Classification	Funded	Non Funded
1.	Mining	45.21	0.86
2.	Iron and Steel	41.34	101.86
3.	Other Metal and Metal Products	88.99	895.04
4.	All Engineering	302.80	190.22
5.	Electricity	100.18	24.77
6.	Cotton Textiles	217.53	24.69
7.	Food Processing	443.01	169.31
8.	Paper and Paper Products	4.69	6.08
9.	Rubber and Rubber Products	191.74	7.98
10.	Chemicals, Dyes, Paints etc	519.94	2,191.51
11.	Leather and Leather Products	31.49	0.05
12.	Gems and Jewellery	2,615.40	416.42

13.	Construction	366.94	422.15
14.	Petroleum	6.67	439.87
15.	Automobiles including trucks	824.30	423.82
16.	Computer Software	621.10	587.64
17.	Infrastructure	91.27	803.27
18.	Banking	-	39,708.71
19.	Other Industries	5,095.64	6,469.00
20.	Residual exposures	5,051.50	2,000.77
	Total	**16,659.74**	**54,884.02**

Residual Contractual Maturity breakdown of Assets:

(Rs. in crores)

	Loans and Advances	**Investments**
1-14 Days	2,558.18	435.66
15-28 Days	843.34	544.19
29 Days and upto 3 Months	2,788.71	1,585.34
Over 3 Months upto 6 Months	2,596.47	136.60
Over 6 Months upto 1 Year	1,027.46	1,598.32
Over 1 Year upto 3 Years	5,510.89	2,875.71
Over 3 Years upto 5 Years	357.45	2,118.64
Over 5 Years	977.25	1,516.23
Total	**16,659.75**	**10,810.69**

Movement of NPAs and Provision for NPAs

(Rs. in crores)

		Amount
A	Amount of NPAs (Gross)	844.08
B	Net NPAs	366.41
C	NPA Ratios	
	- Gross NPAs to gross advances (%)	4.93
	- Net NPAs to net advances (%)	2.20
D	Movement of NPAs (Gross)	
	- Opening balance as on 1.4.2007	294.09
	- Additions	1246.97
	- Reductions	(696.98)
	- Closing balance as on 31.3.2008	844.08

E	Movement of Provision for NPAs	
	- Opening balance as on 1.4.2007	120.21
	- Provision made in 2007-08	372.92
	- Write – offs / Write – back of excess provision	(15.46)
	- Closing balance as on 31.3.2008	477.67

Non-Performing Investments (NPIs) and Provision for depreciation on NPIs - NIL

V. Credit Risk: Use of Rating Agency under the Standardized Approach

The bank uses short-term and long-term instrument/bank facilities' ratings from CARE, CRISIL, ICRA and Fitch to assign Risk weights in terms of RBI guidelines. In respect of claims on nonresident corporates and foreign banks, ratings assigned by international rating agencies i.e. Standard & Poor's, Moody's and Fitch are used. The bank uses credit ratings that are publicly available for assigning risk weights.
The Bank assigns Long term credit ratings accorded by the chosen credit rating agencies for assets which have a contractual maturity of more than one year. However, in accordance with the guidelines of RBI the bank classifies all cash credit exposures as long term exposures and accordingly the long term ratings accorded by the chosen credit rating agencies are assigned.

The bank uses issuer and issue ratings for both fund as well as non fund based exposures.

In case the Bank does not have exposure in a rated issue, the Bank would use the issue rating for its comparable unrated exposures to the same borrower, provided that the Bank's exposures are pari-passu or senior and of similar or lesser maturity as compared to the rated issue. If either the issuer or single issue has been assigned a rating which maps into a risk weight equal to or higher than that which applies to unrated claims, a claim on the same counterparty, which is unrated by any chosen credit rating agency, will be assigned the same risk weight as is applicable to the rated exposure, if this claim ranks pari passu or junior to the rated exposure in all respects.

Details of Gross Credit Risk Exposure (Fund based and Non-fund based) based on Risk-Weight

(Rs. in crores)

	Amount
Below 100% risk weight	3,502.47
100% risk weight	15,273.23
More than 100% risk weight	5,222.86
Deductions	
- Investments in subsidiaries	Nil

VI. CREDIT RISK MITIGATION

The Bank uses various collaterals both financial as well as non-financial, guarantees and credit insurance as credit risk mitigants. The main financial collaterals include bank deposits, NSC/KVP/LIP, while main non-financial collaterals include land and building, plant and machinery, residential and commercial mortgages. The guarantees include guarantees given by corporate, bank and personal guarantees. This also includes loan and advances guaranteed by Export Credit & Guarantee Corporation Limited (ECGC).

The Bank reduces its credit exposure to counterparty with the value of eligible financial collateral to take account of the risk mitigating effect of the collateral. To account for the volatility in the value of collateral, haircut is applied based on the type, issuer, maturity, rating and remargining/revaluation frequency of the collateral.

For disclosed credit risk portfolio under the standardised approach, the total exposure Which is covered by Eligible Financial Collateral after the application of haircuts is Rs. 874.10 crores as on 31st March 2009.

VII. SECURITISATION

The primary objectives for undertaking securitisation activity by the Bank are enhancing liquidity, optimization of usage of capital and churning of the assets as part of risk management strategy.
The securitisation of assets generally being undertaken by the Bank is on the basis of "True Sale", which provides 100% protection to the Bank from default.

The Bank enters into purchase/sale of corporate through direct assignment/SPV.

Gain on securitisation is recognized over the period of the underlying securities issued by the SPV. Loss on securitisation is immediately debited to profit and loss account. In respect of credit enhancements provided or recourse obligations (projected delinquencies, future servicing etc.) accepted by the Bank, appropriate provision/disclosure is made at the time of sale in accordance with AS 29 'Provisions, contingent liabilities and contingent assets'.

The bank uses the rating agencies as prescribed by Reserve Bank Of India for rating PTCs

As on 31st March 2009, the Bank has retained exposure of Rs. 214.93 crores on securitisation transactions originated by it in a form of outstanding credit enhancement as on 31st March 2009. In the financial year ended 31st March 2009, the Bank has securitized Rs.1,125 crores as an originator.

Comparative position of two years of the portfolio securitized by the Bank is given below

(Rs. in crores)

S.No.	Type of Securitisation	31 March 2009	31 March 2008
1.	Total number of loan assets securitised		
	- Corporate Loans	6	6
2.	Total book value of loan assets securitised		
	- Corporate Loans	1,125.00	1,025.00

3.	Sale consideration received for securitised assets	1,128.43	1,031.23
4.	Gain / loss on sale on account of securitisation	2.28	5.84
5.	Form and quantum (outstanding value) of service Provided		
	- Credit enhancement	214.93	350.69
	- Outstanding servicing liability	Nil	Nil
	- Liquidity support	Nil	Nil

VIII. MARKET RISK IN TRADING BOOK

Market risk is the risk to the Bank's earnings and capital due to changes in the market level of interest rates or prices of securities and foreign exchange, as well as the volatilities of those changes. The Bank is exposed to market risk through its trading activities, which are carried out both for customers and on a proprietary basis. The Bank adopts a comprehensive approach to market risk management for its trading, investment and asset/liability portfolios. The Bank uses various risk metrics, both statistical and non-statistical, including:

- Non-statistical measures like position, gaps and sensitivities (duration, PVBP, option greeks)
- Value at risk (VaR)

The Bank has set in place Value at Risk (VaR) limits, which are based on the Historical Simulation Method to control and monitor market risk. The Bank has also in place PV01 limits (impact of 1 basis point shift in the yield curve) and basis limits to control the exposures. Daily reports are made available through the risk management systems for monitoring these exposures. In addition to these limits, stress and scenario analysis are undertaken to evaluate shock impacts.

Capital Requirement for Market Risk

(Rs. in crores)

	Amount of Capital Required
- Interest rate risk	230.96
- Foreign exchange risk (including gold)	36.00
- Equity position risk	-

IX. OPERATIONAL RISK

Structure and Organization

The bank has an Operational Risk Management (ORM) Committee which is responsible for oversight of operational risk and implementation of new products. Under oversight / direction and delegation from the ORM Committee an independent ORM function exists in the bank to execute ORM programs and monitor and analyze Operational Risks on an ongoing basis.

The different activities related to the ORM process and the framework components supporting them form part of the Operational risk management process which are broadly classified into:

.a. Operational risk planning and scope where several tasks are performed aimed at organizing the execution of operational risk including preparation of Operational risk heat map, basically defining of High-level assessment of risks, preparation of yearly plans that sequence the ORM activities and programmes.
.b. Operational risk execution - This cycle concentrates on the effective management of risks. The operational risk execution cycle is a continuous process and the outcomes of all iterations have to be followed by a new cycle that ensures that the previously identified risks have been properly addressed and/or remain acceptable (while new risks always emerge). Key components are Risk Event Management, Risk Assessment, Issue Management and Action Tracking etc.
.c. Operational risk control - where several activities are performed including

i) Verify that the activities intended at Group and BU level in the Operational risk planning and scope phase were effectively carried-out in the Operational risk execution phase

ii) Ensure that the ORM framework is properly embedded in RBS Group and is used by the BUs in their daily management of operational risks

iii) Check that RBS Group and BU operational risk exposures remain in line with the risk profile objectives initially set

Monthly ORM reports are regularly sent to the region and the same is being copied to the Country Executive also. The loss events greater than EUR 5000 also undergo a quarterly sign-off process from the Country Executive. Besides, policy support & reporting unit in the region also undertake a review of the timeliness of loss entries. All risk issues/actionable arising out of the Operational Risk Management Process are tracked through a system called FORTE (Firm Wide Operational Risk Technology Environment) which is an intranet-based system. The reviews of the entries in the system are additionally carried out at Regional / Global Level.

Approach for Operational Risk Capital Assessment

As per the RBI guidelines, the Bank has followed the Basic Indicator Approach for the year ending 31st March 2009.

X. INTEREST RATE RISK IN THE BANKING BOOK

Interest rate risk in the banking book (IRRBB) is monitored through the impact of interest rate on the economic value of equity. INR interest rates published by FIMMDA on its website are applied on the INR balance sheet to calculate the economic value of equity. Cash flows are assumed to occur at the middle of the regulatory buckets for the interest rate sensitive gap statements. Basis risk is presently ignored. An upward interest rate shock of 100bps would result in a decrease in economic value of equity by 0.37 % and a downward interest rate shock of 100bps would result in an increase in economic value of equity by 0.37 %.

Details of increase (decline) in economic value for upward and downward rate shocks for domestic balance sheet are given below:

Economic Value Perspective

Particulars	Rs. in Crores	
Interest Rate Movement	100 bps	(100bps)
Economic Value of Equity	(16.62)	16.62

Earnings perspective is currently computed for consumer portfolio and is presented before the ALCO. The Earnings at Risk is computed for four scenarios of interest rate movements