

WEX Inc.
Form 10-K
February 26, 2016
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the fiscal year ended December 31, 2015

OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the transition period from _____ to _____
Commission file number 001-32426

WEX INC.
(Exact name of registrant as specified in its charter)
Delaware 01-0526993
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

97 Darling Avenue 04106
South Portland, Maine
(Address of principal executive offices) (Zip Code)
(207) 773-8171

(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock, \$0.01 par value | New York Stock Exchange |
| Securities registered pursuant to Section 12(g) of the Act: | |
| None | |
| (Title of class) | |

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
 Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
 Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to

submit and post such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant (assuming for the purpose of this calculation, but without conceding, that all directors, officers and any 10 percent or greater stockholders are affiliates of the registrant) as of June 30, 2015, the last business day of the registrant's most recently completed second fiscal quarter, was \$4,347,908 (based on the closing price of the registrant's common stock on that date as reported on the New York Stock Exchange).

There were 38,644,041 shares of the registrant's common stock outstanding as of February 24, 2016.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Proxy Statement for the 2016 Annual Meeting of Stockholders are incorporated by reference in Part III. With the exception of the sections of the 2016 Proxy Statement specifically incorporated herein by reference, the 2016 Proxy Statement is not deemed to be filed as part of the 10-K.

Table of Contents

TABLE OF CONTENTS

| | Page |
|---|------------|
| <u>Forward-Looking Statements</u> | <u>1</u> |
| <u>Part I</u> | |
| Item 1. <u>Business</u> | <u>1</u> |
| Item 1A. <u>Risk Factors</u> | <u>14</u> |
| Item 1B. <u>Unresolved Staff Comments</u> | <u>26</u> |
| Item 2. <u>Properties</u> | <u>27</u> |
| Item 3. <u>Legal Proceedings</u> | <u>27</u> |
| Item 4. <u>Mine Safety Disclosures</u> | <u>28</u> |
| <u>Part II</u> | |
| Item 5. <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | <u>29</u> |
| Item 6. <u>Selected Financial Data</u> | <u>29</u> |
| Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>31</u> |
| Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | <u>57</u> |
| Item 8. <u>Financial Statements and Supplementary Data</u> | <u>59</u> |
| Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u> | <u>111</u> |
| Item 9A. <u>Controls and Procedures</u> | <u>111</u> |
| Item 9B. <u>Other Information</u> | <u>113</u> |
| <u>Part III</u> | |
| Item 10. <u>Directors, Executive Officers and Corporate Governance</u> | <u>113</u> |
| Item 11. <u>Executive Compensation</u> | <u>113</u> |
| Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | <u>113</u> |
| Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u> | <u>113</u> |
| Item 14. <u>Principal Accounting Fees and Services</u> | <u>113</u> |
| <u>Part IV</u> | |
| Item 15. <u>Exhibits and Financial Statement Schedules</u> | <u>114</u> |
| <u>Signatures</u> | <u>115</u> |

Table of Contents

Unless otherwise indicated or required by the context, the terms “we,” “us,” “our,” “WEX,” or the “Company,” in this Annual Report on Form 10-K mean WEX Inc. and all of its subsidiaries that are consolidated under Generally Accepted Accounting Principles.

FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for statements that are forward-looking and are not statements of historical facts. This Annual Report includes forward-looking statements including, but not limited to, statements about management’s plan and goals, and the “Strategy” section of this Annual Report in Item 1. Any statements in this Annual Report that are not statements of historical facts are forward-looking statements. When used in this Annual Report, the words “may,” “could,” “anticipate,” “plan,” “continue,” “project,” “intend,” “estimate,” “believe” and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain such words. Forward-looking statements relate to our future plans, objectives, expectations and intentions and are not historical facts and accordingly involve known and unknown risks and uncertainties and other factors that may cause the actual results or performance to be materially different from future results or performance expressed or implied by these forward-looking statements. The following factors, among others, could cause actual results to differ materially from those contained in forward-looking statements made in this Annual Report and in oral statements made by our authorized officers: the effects of general economic conditions on fueling patterns as well as payment and transaction processing activity; the impact of foreign currency exchange rates on the Company’s operations, revenue and income; changes in interest rates; the impact of fluctuations in fuel prices; the effects of the Company’s business expansion and acquisition efforts; the Company’s failure to successfully integrate the businesses it has acquired or plans to acquire; the Company’s failure to successfully operate and expand ExxonMobil’s European commercial fuel card program, or Esso Card; the failure of corporate investments to result in anticipated strategic value; the impact and size of credit losses; the impact of changes to the Company’s credit standards; breaches of the Company’s technology systems and any resulting negative impact on our reputation, liabilities or relationships with customers or merchants; the Company’s failure to maintain or renew key agreements; failure to expand the Company’s technological capabilities and service offerings as rapidly as the Company’s competitors; the actions of regulatory bodies, including banking and securities regulators, or possible changes in banking or financial regulations impacting the Company’s industrial bank, the Company as the corporate parent or other subsidiaries or affiliates; the impact of the Company’s outstanding notes on its operations; the impact of increased leverage on the Company’s operations, results or capacity generally, and as a result of potential acquisitions specifically; financial loss if the Company determines it necessary to unwind its derivative instrument position prior to the expiration of a contract; the incurrence of impairment charges if our assessment of the fair value of certain of our reporting units changes; the uncertainties of litigation; as well as other risks and uncertainties identified in Item 1A of this Annual Report and in connection with such forward-looking statements. Our forward-looking statements and these factors do not reflect the potential future impact of any alliance, merger, acquisition, disposition or stock repurchases. The forward-looking statements speak only as of the date of the initial filing of this Annual Report and undue reliance should not be placed on these statements. We disclaim any obligation to update any forward-looking statements as a result of new information, future events or otherwise.

PART I

ITEM 1. BUSINESS

Our Company

WEX Inc. is a leading provider of corporate payment solutions. WEX Inc. began operations in 1983 as a Maine corporation and was acquired in February 1996 by an entity that subsequently merged with HFS Incorporated to form Cendant Corporation in December 1997. In June 1999, our predecessor, Wright Express, was sold to Avis Group Holdings, Inc., which was acquired by Cendant Corporation in March 2001. In anticipation of our initial public offering, the Company’s operations were transferred to a Delaware LLC, which was converted into a Delaware corporation in 2005 in conjunction with our initial public offering. Over the past 30 years, we have expanded the scope of our business from a fleet payment provider into a multi-channel provider of corporate payment solutions. WEX Inc. has been publicly traded since February 16, 2005 (NYSE:WEX) and beginning in the fourth quarter of 2015, operates in three business segments: Fleet Solutions, Travel and Corporate Solutions and Health and Employee

Benefit Solutions. Previously, the Company had reported two business segments, Fleet Payment Solutions and Other Payment Solutions. Fleet Solutions remains on the same basis as the historical Fleet Payment Solutions business segment. Travel and Corporate Solutions includes the Travel business as well as other verticals. Health and Employee Benefit Solutions includes the Healthcare and Employee related businesses. This change will enhance the Company's transparency and align our reporting with how we now operate our business. Financial reporting under this new structure is included within this report on Form 10-K and historical financial segment information has been recast to conform to this new presentation.

Table of Contents

Our business model enables us to provide exceptional payment security and control across a wide spectrum of payment sectors. The Fleet Solutions segment provides customers with fleet vehicle payment processing services specifically designed for the needs of commercial and government fleets. During the year ended December 31, 2015, Fleet Solutions revenue represented approximately 63 percent of our total revenue. As of December 31, 2015, the Fleet Solutions segment services over 9.4 million vehicles. Management estimates that WEX fleet cards are accepted at over 90 percent of fuel locations in each of the United States and Australia. With the acquisition of ExxonMobil's European commercial fleet card portfolio ("Esso portfolio in Europe") in December 2014, WEX fleet cards are now accepted at all ExxonMobil stations throughout Europe. The Travel and Corporate Solutions segment focuses on the complex payment environment of business-to-business payments, providing customers with payment processing solutions for their corporate payment and transaction monitoring needs. Travel and Corporate Solutions revenue, which represented approximately 23 percent of our total revenue during the year ended December 31, 2015, is generated primarily in the online travel market. The Travel and Corporate Solutions segment has operations in North America, Europe, South America and Asia-Pacific. The Health and Employee Benefit Solutions segment, which represented approximately 14 percent of our total revenue during the year ended December 31, 2015, is generated primarily from the healthcare payment products and our software as a service ("SaaS") consumer directed platform. The Health and Employee Benefit Solutions segment also provides payroll related benefits to customers in Brazil. The Company's U.S. operations include WEX Inc. and our wholly-owned subsidiaries WEX Bank, WEX FleetOne, Evolution1 and Benaissance. Our international operations include our wholly-owned subsidiaries, WEX Fuel Cards Australia, WEX Prepaid Cards Australia, WEX New Zealand, WEX Europe Limited, formerly CorporatePay Limited, UNIK S.A., a Brazil-based company, and a majority equity position in WEX Europe Services Limited and its subsidiaries.

Prior to our initial public offering in 2005, the Company's growth had primarily been organic. Our growth in the past several years has been supplemented by acquisitions. Our acquisitions over the last few years include:

On November 18, 2015, our wholly-owned subsidiary Evolution1 acquired Benaissance, a leading provider of integrated SaaS technologies and services for healthcare premium billing, payment and workflow management, to complement our healthcare payments products and services.

On August 31, 2015, we acquired the remaining 49 percent ownership in UNIK S.A., a majority-owned subsidiary prior to this transaction.

- On December 1, 2014, our majority owned subsidiary, WEX Europe Services Limited, acquired the assets of ExxonMobil's European commercial fuel card program, which includes operations, funding, pricing, sales and marketing in nine countries in Europe.

On July 16, 2014, we acquired Evolution1, a leading provider of payment solutions within the healthcare industry.

On October 15, 2013, our subsidiary UNIK S.A. acquired FastCred, a provider of fleet cards to the heavy truck or over-the-road segment of the fleet market in Brazil.

On October 4, 2012, we acquired FleetOne, a provider of fleet cards and fleet-related payment solutions to the over-the-road segment of the fleet market.

On August 30, 2012, we acquired a 51 percent controlling interest in UNIK S.A., a provider of payroll cards, private label and processing services in Brazil, specializing in the retail, government and transportation sectors.

On May 11, 2012, we acquired CorporatePay Limited, located in London, England, a provider of corporate prepaid solutions to the travel industry in the United Kingdom. CorporatePay offers direct, co-branded and private label solutions including virtual cards, currency cards and expense management solutions.

In addition to the transactions described above, on October 18, 2015, we entered into a purchase agreement to acquire Electronic Funds Source LLC ("EFS"), a provider of customized corporate payment solutions for fleet and corporate customers with a focus on the large and mid-sized fleet segments. Pursuant to the purchase agreement, and subject to the terms and conditions contained therein, at the closing of this acquisition, the Company will acquire all of the outstanding membership interests of WP Mustang Topco LLC, the indirect parent of EFS, and Warburg Pincus Private Equity XI (Lexington), LLC, an affiliated entity, from investment funds affiliated with Warburg Pincus LLC (the "EFS Sellers") for an aggregate purchase price comprised of \$1.1 billion in cash and 4,011,672 shares of the

Company's common stock, subject to certain working capital and other adjustments as described in the purchase agreement. The parties' obligations to consummate the acquisition are subject to customary closing conditions, including the expiration or termination of the applicable antitrust waiting period under the Hart-Scott Rodino Antitrust Improvements Act of 1976, as amended.

On July 29, 2014, we sold our Pacific Pride subsidiary for \$49.7 million, which resulted in a pre-tax book gain of \$27.5 million. The Company decided to sell the operations of Pacific Pride as it did not align with the long-term strategy of the core

Table of Contents

fleet business. The Company has entered into a multi-year agreement with the buyer that will continue to allow WEX branded card acceptance at Pacific Pride locations.

On January 7, 2015, we sold the operations of rapid! PayCard for \$20.0 million, which resulted in a pre-tax book gain of \$1.2 million. Our primary focus in the U.S. continues to be in the fleet, travel, and healthcare industries. As such, we divested the operations of rapid! PayCard, which were not material to our annual revenue, net income or earnings per share.

WEX Bank, a Utah industrial bank incorporated in 1998, is a Federal Deposit Insurance Corporation (“FDIC”) insured depository institution. The functions performed at WEX Bank contribute to the operations of the Fleet Solutions and Travel and Corporate Solutions segments by providing a funding mechanism, among other services. With our ownership of WEX Bank, we have access to low-cost sources of capital. WEX Bank raises capital primarily through the issuance of brokered deposit accounts and provides the financing and makes credit decisions that enable the Fleet Solutions and Travel and Corporate Solutions segments to extend credit to customers. WEX Bank approves customer applications, maintains appropriate credit lines for each customer, is the account issuer, and is the counterparty for the customer relationships for most of our programs. Operations such as sales, marketing, merchant relations, customer service, software development and IT are performed as a service within our organization but outside of WEX Bank. WEX Bank’s primary regulators are the Utah Department of Financial Institutions and the FDIC. WEX Bank is required to maintain elements of independence from the rest of our business to comply with its charter and applicable banking regulations, and is required to file separate financial statements with the FDIC. The activities performed by WEX Bank are integrated into the operations of our Fleet Solutions and Travel and Corporate Solutions segments.

Competitive Strengths

We believe the following strengths distinguish us from our competitors:

Our closed-loop fuel networks in the U.S. and Australia are among the largest in each country. We describe our fleet payment processing networks as “closed-loop” as we have a direct contractual relationship with both the merchant and the fleet, and only WEX transactions can be processed on these networks. We have built networks that management estimates to provide coverage to over 90 percent of fuel locations in the U.S. and Australia, as well as wide acceptance in Canada and Brazil. This provides our customers with the convenience of broad acceptance.

Our proprietary closed-loop fuel networks provide us with access to a higher level of fleet-specific information and control as compared to what is typically available on an open-loop network. This allows us to improve purchase controls at the point of sale and to refine the information reporting we provide to our fleet customers and customers of our strategic relationships.

Our proprietary closed-loop network is a competitive strength because it enables us to establish a direct relationship with each of the merchants that comprise our network.

We offer a differentiated set of products and services, including security and purchase controls, to allow our customers and the customers of our strategic relationships to better manage their vehicle fleets. We provide customized analysis and reporting on the efficiency of fleet vehicles and the purchasing behavior of fleet vehicle drivers. We make this data available to fleet customers through both traditional reporting services and sophisticated web-based data analysis tools.

Our proprietary software facilitates the collection of information and provides us with a high level of control and flexibility in allowing fleets to restrict purchases and receive automated alerts.

Our long-standing strategic relationships, multi-year contracts and high contract renewal rates have contributed to the stability and recurring nature of our revenue base. We believe that we offer a compelling value to our customers relative to our competitors given the breadth and quality of our products and services and our deep understanding of our customers’ operational needs. We have a large installed customer base, with more than 9.4 million vehicles serviced as of December 31, 2015 and co-branded strategic relationships with six of the largest U.S. fleet management providers and with numerous oil companies that use our private label solutions. Our wide site acceptance, together with our private-label portfolios and value-added product and service offerings, drive high customer satisfaction levels, with a U.S. fleet retention rate in excess of 97 percent (based on the 2015 rate of voluntary customer attrition).

Our capabilities in the over-the-road segment of the market enhance our ability to serve fleet customers who operate both heavy duty trucks and cars or light duty vehicles in the U.S. and Canada as well as to blend the small fleet and private label businesses for greater scale.

3

Table of Contents

- Our purchase of ExxonMobil's commercial fuel card program which uses a closed-loop network in Europe, combined with the long term supply agreement to serve the current and future Esso portfolio in Europe, provides us with a strong foundation in the large European fleet market.

Our travel and corporate payment products offer corporate customers enhanced security and control for complex payment needs. Our strategic relationships include three of the largest U.S. based online travel agencies, and our operations in the United Kingdom provide corporate payment solutions to the travel and healthcare industries. We continue to expand our online travel payment solution capabilities and geographies, which currently include North America, Europe, South America and Asia-Pacific. As of December 31, 2015, we settle transactions in 21 different currencies.

The demand for our payment processing, account servicing and transaction processing services combined with significant operating scale has historically driven strong revenue growth and earnings potential. We have an extensive history of organic revenue growth driven by our various marketing channels, our extensive network of fuel and service providers, and our growth in transaction volume. Further, we have completed a number of strategic acquisitions to expand our product and service offerings, which have contributed to our revenue growth and diversification.

We have an enterprise-wide risk management program that helps us to effectively address inherent risks related to funding and liquidity, our extension of credit and interest rates. Our ownership of WEX Bank provides us with access to low cost sources of capital, which provide liquidity to fund our short-term card receivables. We have maintained a long record of low credit losses due to the short-term, non-revolving credit issued to our customer base. Our credit risk management program is enhanced by our proprietary scoring models, managing credit lines and early suspension policy. Interest rate risk is managed through diversified funding sources at WEX Bank with significant non-interest bearing liabilities and merchant contracts that include some ability to raise rates if interest rates rise.

We have become a leading provider of cloud-based healthcare payments technology through the acquisitions of Evolution1 in 2014 and Benaissance in 2015. Our large partner network expands our opportunities in a growing healthcare payments market.

We have an experienced and committed management team that has substantial industry knowledge and a proven track record of financial success. The team has been successful in driving strong growth with consistent operating performance. We believe that our management team positions us well to continue successfully implementing our growth strategy and capture operating efficiencies.

Strategy

Our Company's path forward will be shaped by the following three strategic priorities:

Accelerating growth in our core verticals. We have built a robust set of products and services within our Fleet, Travel, and Health verticals. We will continue to grow our business organically in these core verticals through excellence in our marketing and sales force as well a focus on our revenue management practices. Our acquisition strategy will complement our organic growth by both enhancing scale and adding differentiation to our current offerings.

Capturing efficiencies and new scaling opportunities across the organization. We will build new product functionality while rationalizing our technology platforms to enable us to deliver greater customer value and enhanced margins. We are also focused on streamlining our delivery model to ensure we have the flexibility to meet a diversity of customer needs as well as efficiently integrate our acquisitions.

Develop and drive market leading offerings globally. Within our Fleet, Travel, and Health verticals, we are focusing on rapidly growing our presence in attractive geographies and enhancing our product suite. Revenue originated from non-US markets increased to 19% of 2015 total revenue, driven largely by our successful entry into Europe and Brazil. We will continue to target new regions such as Asia, where we see the potential for long-term growth. We are also focused on innovating with new products such as data analytics, which harness the power of our proprietary closed loop data network in our Fleet vertical.

Table of Contents

FLEET SOLUTIONS SEGMENT

Overview

The Fleet Solutions segment provides customers with fleet vehicle payment processing services specifically designed for the needs of commercial and government fleets. We are a leading provider of fleet vehicle payment processing services with over 9.4 million vehicles at year end using our fleet payment solutions to purchase fuel and maintenance services. Our competitive advantages in the fleet market include brand strength and product offerings, commitment to customer satisfaction and a unique financing model with attractive credit terms. Our fleet products are based upon proprietary technology with closed-loop networks in the U.S., Australia and Europe, and wide site acceptance domestically and abroad.

As part of our value proposition, we deliver security through individualized driver identification and real-time transaction updates, purchase controls and sophisticated reporting tools. We collect a broad array of information at the point of sale, including the amount of the expenditure, the identity of the driver and vehicle, the odometer reading, the identity of the fuel or vehicle maintenance provider and the items purchased. We use this information to provide customers with analytical tools to help them effectively manage their vehicle fleets and control costs. We deliver value to our customers by providing customized offerings for accepting merchants, processing payments and providing information management products and services to fleets.

Our proprietary closed-loop networks allow us to provide our customers with highly detailed, fleet-specific information and customized controls that are not typically available on open-loop networks, such as limiting purchases to fuel only and restricting the time of day and day of the week when fuel is purchased. Our network also enables us to avoid dependence on third-party processors. In addition, our relationships with both fleets and merchants enable us to provide security and controls and provide customizable reporting.

The following illustrates our proprietary closed-loop network:

Payment processing transactions represent a majority of the revenue stream in the Fleet Solutions segment. In a payment processing transaction, we extend short-term credit to the fleet customer and pay the purchase price for the fleet customer's transaction, less the payment processing fees we retain, to the merchant. Revenue from our WEX Europe Services operations is primarily generated by transactions where our revenue is derived from the difference between the negotiated price of the fuel from the supplier and the price charged to the fleet customer. We collect the total purchase price from the fleet customer, normally within 30 days from the billing date.

Table of Contents

The following illustration depicts our business process for a typical domestic fuel payment processing transaction:

Products and Services

Payment processing fees are based on a percentage of the aggregate dollar amount of the customer's purchase, a fixed amount per transaction or a combination of both. Additionally, payment processing revenue related to our WEX Europe Services operations is specifically derived from the difference between the negotiated price of the fuel from the supplier and the agreed upon price paid by the fleets. In 2015, we processed approximately 343 million payment processing transactions, compared to 311 million payment processing transactions in 2014. Additionally, we receive revenue from account servicing fees, factoring receivables and finance fees.

We offer the following services:

Customer service, account activation and account retention: We offer customer service, account activation and account retention services to fleets and fleet management companies and the fuel and vehicle maintenance providers on our network. Our services include promoting the adoption and use of our products and programs and account retention programs on behalf of our customers and partners.

Authorization and billing inquiries and account maintenance: We handle authorization and billing questions, account changes and other issues for fleets through our dedicated customer contact centers, which are available 24 hours a day, seven days a week. Fleet customers also have self-service options available to them through our websites.

Premium fleet services: We assign designated account managers to businesses and government agencies with large fleets. These representatives have in-depth knowledge of both our programs and the operations and objectives of the fleets they service.

Credit and collections services: We have developed proprietary account approval, credit management and fraud detection programs. Our underwriting model produces a proprietary score, which we use to predict the likelihood of an account becoming delinquent within 12 months of activation. We also use a credit maintenance model to manage ongoing accounts, which helps us to predict the likelihood of account delinquency over an ongoing 18-month time horizon. We have developed a collections scoring model that we use to rank and prioritize past due accounts for collection activities. We also employ fraud specialists who monitor accounts, alert customers and provide case management expertise to minimize losses and reduce program abuse.

Table of Contents

Merchant services: Our representatives work with fuel and vehicle maintenance providers to enroll these providers in our network, test all network and terminal software and hardware, and to provide training on our sale, transaction authorization and settlement processes.

Information Management

We provide standard and customized information to customers through monthly vehicle analysis reports, custom reports and our websites. We also alert customers of unusual transactions or transactions that fall outside of pre-established parameters. Customers, through our website, can access their account information, including account history and recent transactions, and download the related details. In addition, fleet managers can elect to be notified by email when limits are exceeded in specified purchase categories, including limits on transactions within a time range and gallons per day.

Marketing Channels

We market our fleet products and services directly to commercial and government vehicle fleet customers with small, medium and large fleets, and over-the-road, long haul fleets. Our product suite includes payment processing and transaction processing services, WEX branded fleet cards in North America and Motorpass/Motorcharge-branded fleet cards in Australia. Our direct line of business services approximately 3.8 million vehicles.

We also market our products and services indirectly through co-branded and private label relationships. With a co-branded relationship product, we market our products and services for, and in collaboration with, both fuel providers and fleet management companies using their brand names and our logo on a co-branded fleet card. These companies seek to offer our payment processing and information management services as a component of their total offering to their fleet customers. Our co-branded marketing channel services approximately 1.8 million vehicles. Our private label programs market our product and services for, and in collaboration with, fuel retailers, using only their brand names. The fuel retailers with which we have formed strategic relationships offer our payment processing and information management products and services to their fleet customers in order to establish and enhance customer loyalty. These fleets use these products and services to purchase fuel at locations of the fuel retailer with whom we have the private label relationship. Our private label marketing channel services approximately 3.8 million vehicles.

Fuel Price Derivatives

Management estimates that approximately 25 percent of our company-wide revenue in 2015 resulted from fees paid to us by fuel providers based on a negotiated percentage of the purchase price of fuel purchased by our customers. Accordingly, this revenue is impacted by fuel prices. To address fluctuations in fuel prices, we have previously hedged a portion of our U.S. fuel-price related earnings exposure to improve the management of potential cash flow volatility created by changes in U.S. fuel prices and to enhance the visibility and predictability of our anticipated future cash flows.

During the fourth quarter of 2014 we suspended purchases under our fuel derivatives program due to unusually low prices in the commodities market. We continue to hold fuel price derivative instruments for the first quarter of 2016 that were executed in the third quarter of 2014 for approximately 20 percent of the anticipated quarterly exposure to domestic earnings based on assumptions at time of purchase. After the first quarter of 2016, we will no longer be hedged for changes in fuel prices. Management will continue to monitor the fuel price market and evaluate our alternatives as it relates to this hedging program.

Our fuel price derivative instruments are in the form of put and call option contracts with monthly settlement provisions that create a “costless collar” based upon both the U.S. Department of Energy’s weekly diesel fuel price index and the NYMEX unleaded gasoline contracts. When entering into these options, our intent was to effectively lock in a range of prices during any given quarter on a portion of our U.S. forecasted earnings that are subject to fuel price variations. Differences between the indices underlying the options and actual retail prices could create a disparity between the effects of price changes on the actual revenues we earn and the gains or losses realized on the options. Our derivative instruments do not qualify for hedge accounting under accounting guidance. Accordingly, gains and losses on our fuel price-sensitive derivative instruments, whether they are realized or unrealized, affect our current period earnings.

Table of Contents

The options are intended to limit the impact fuel price fluctuations have on our cash flows. The options that we have entered into:

Create a floor price. When the current month put option contract settles, we receive cash payments from the counterparties if the average price for the current month (as defined by the option contract) is below the strike price of the put option.

Create a ceiling price. When the current month call option contract settles, we make cash payments to the counterparties if the average price for the current month (as defined by the option contract) is above the strike price of the call option.

When the current month put and call option contracts settle and the average price for the current month (as defined by the option contract) is between the strike price of the put option contract and the strike price of the call option contract, no cash is exchanged between the counterparties and us.

The following table presents information about the options as of December 31, 2015. The approximate percentage of hedged fuel price-sensitive earnings exposure is based on assumptions at time of purchase and includes the earnings from our U.S. operations only.

| | |
|--|--------|
| | Q1 |
| | 2016 |
| Average low end of range of fuel prices per gallon | \$3.28 |
| Average top end of range of fuel prices per gallon | \$3.34 |
| Approximate % of exposure locked in | 20% |

TRAVEL AND CORPORATE SOLUTIONS SEGMENT

Overview

Our Travel and Corporate Solutions segment is comprised of our virtual and prepaid products with which we provide innovative corporate purchasing and payment capabilities that can be integrated with our customers' internal systems to streamline their corporate payments, accounts payable and reconciliation processes.

Products and Services

The Travel and Corporate Solutions segment allows businesses to centralize purchasing, simplify complex supply chain processes and eliminate the paper check writing associated with traditional purchase order programs. Our product suite includes virtual and prepaid products.

Our virtual card is used for transactions where no card is presented, including, for example, transactions conducted over the telephone, by mail, by fax or on the Internet. Our virtual card also can be used for transactions that require pre-authorization, such as hotel reservations. Under our virtual card programs, each transaction is assigned a unique account number with a customized credit limit and expiration date. These controls are in place to limit fraud and unauthorized spending. The unique account number limits purchase amounts and tracks, settles and reconciles purchases more easily, creating efficiencies and cost savings for our customers. The virtual card products offer both credit and debit options.

Our prepaid and gift card products are offered through WEX Prepaid Card Australia and WEX Europe Services to companies throughout Australia and Europe. These products provide secure payment and financial management solutions with single card options, access to open or closed loop redemption, load limits and variable expirations.

Table of Contents

The following illustration depicts our business process for a typical travel virtual card product transaction:

Other equity owners

4,744

7,846

75,132

77,736

RBS Group – Annual Results 2010

Commentary on condensed consolidated balance sheet

Total assets of £1,453.6 billion at 31 December 2010 were down £242.9 billion, 14%, compared with 31 December 2009. This principally reflects the disposal of the RFS minority interest, the continuing planned disposal of Non-Core assets, together with a reduction in the level of debt securities and the mark-to-market value of derivatives.

Cash and balances at central banks were up £4.8 billion, 9%, to £57.0 billion principally due to an improvement in the Group's structural liquidity position during 2010.

Loans and advances to banks increased by £8.8 billion, 10%, to £100.5 billion. Adjusting for the disposal of the RFS minority interest, the increase was £16.6 billion, 20%. Reverse repurchase agreements and stock borrowing ('reverse repos') were up £7.5 billion, 21% to £42.6 billion and bank placings rose £9.1 billion, 19%, to £57.9 billion, primarily as a result of the investment of surplus liquidity in short-term assets.

Loans and advances to customers decreased £173.1 billion, 24%, to £555.3 billion. Excluding the disposal of the RFS minority interest, lending to customers was down £40.4 billion, 7%. Within this, reverse repurchase agreements were up £11.5 billion, 28%, to £52.5 billion. Customer lending decreased by £51.9 billion to £502.7 billion or £48.9 billion before impairment provisions. This reflected planned reductions in Non-Core of £39.7 billion along with declines in Global Banking & Markets, £16.7 billion, US Retail & Commercial, £2.6 billion and Ulster Bank, £2.0 billion. These were partially offset by growth in UK Retail, £5.4 billion, Wealth, £2.4 billion and Global Transaction Services, £1.7 billion, together with the effect of exchange rate and other movements, £2.6 billion.

Debt securities were down £49.8 billion, 19%, to £217.5 billion, or £31.6 billion, 13%, adjusting for the disposal of the RFS minority interest, driven mainly by reductions in Global Banking & Markets.

The value of derivative assets were down £14.4 billion, 3%, to £427.1 billion, primarily reflecting a decrease in interest contracts, movements in five to ten year interest yields, and the combined effect of currency movements, with Sterling weakening against the dollar but strengthening against the Euro.

The reduction in assets and liabilities of disposal groups resulted from the completion of disposals of certain of the Group's Asian and Latin American businesses, and substantially all of the RBS Sempra Commodities JV business.

Deposits by banks declined £43.4 billion, 31%, to £98.8 billion or £55.0 billion, 36% following the disposal of the RFS minority interest, with reduced inter-bank deposits, down £49.7 billion, 43%, to £65.9 billion and lower repurchase agreements and stock lending ('repos'), down £5.3 billion, 14%, to £32.7 billion.

Commentary on condensed consolidated balance sheet

Customer accounts decreased £103.5 billion, 17%, to £510.7 billion but were up £28.1 billion, 6%, excluding the disposal of the RFS minority interest. Within this, repos increased £13.7 billion, 20%, to £82.1 billion. Excluding repos, customer deposits were up £14.3 billion, 3%, to £428.6 billion, reflecting growth in UK Corporate, £12.2 billion, Global Transaction Services, £7.8 billion, UK Retail, £7.0 billion, Ulster Bank, £1.7 billion and Wealth, £0.8 billion, together with exchange rate and other movements of £3.0 billion. This was partially offset by decreases in Global Banking & Markets, £8.3 billion, US Retail & Commercial, £4.0 billion and Non-Core, £5.9 billion.

Debt securities in issue were down £49.2 billion, 18%, to £218.4 billion. Excluding the RFS minority interest disposal, they declined £28.0 billion, 11%, to £218.4 billion. Reductions in the level of certificates of deposit and commercial paper in Global Banking & Markets were partially offset by a programme of new term issuances totalling £38.4 billion.

Subordinated liabilities decreased by £10.6 billion, 28% to £27.1 billion or £4.5 billion, 14% excluding the disposal of the RFS minority interest. This reflected the redemption of £2.6 billion undated loan capital, debt preference shares and trust preferred securities under the liability management exercise completed in May, together with the conversion of £0.8 billion US dollar and Sterling preference shares and the redemption of £1.6 billion of other dated and undated loan capital, which were partially offset by the effect of exchange rate movements and other adjustments of £0.5 billion.

The Group's non-controlling interests decreased by £15.2 billion, primarily reflecting the disposal of the RFS minority interest, £14.4 billion, the majority of the RBS Sempra Commodities JV business, £0.6 billion, and the life assurance business, £0.2 billion.

Owner's equity decreased by £2.6 billion, 3%, to £75.1 billion. This was driven by the partial redemption of preference shares and paid in equity, £3.1 billion less related gains of £0.6 billion, the attributable loss for the period, £1.1 billion, together with an increase in own shares held of £0.7 billion and higher losses in available-for-sale reserves, £0.3 billion. Offsetting these reductions were the issue of £0.8 billion ordinary shares on conversion of the US dollar and Sterling non-cumulative preference shares classified as debt and exchange rate and other movements, £1.2 billion.

Condensed consolidated statement of changes in equity
for the year ended 31 December 2010

| | 2010 | 2009 |
|--|----------|---------|
| | £m | £m |
| Called-up share capital | | |
| At beginning of year | 14,630 | 9,898 |
| Ordinary shares issued | 523 | - |
| Ordinary shares issued in respect of placing and open offers | - | 4,227 |
| B shares issued | - | 510 |
| Preference shares redeemed | (1) | (5) |
| Cancellation of non-voting deferred shares | (27) | - |
| At end of year | 15,125 | 14,630 |
| Paid-in equity | | |
| At beginning of year | 565 | 1,073 |
| Securities redeemed | (132) | (308) |
| Transfer to retained earnings | (2) | (200) |
| At end of year | 431 | 565 |
| Share premium account | | |
| At beginning of year | 23,523 | 27,471 |
| Ordinary shares issued | 281 | - |
| Ordinary shares issued in respect of placing and open offer, net of £95 million expenses | - | 1,047 |
| Redemption of preference shares classified as debt | 118 | - |
| Preference shares redeemed | - | (4,995) |
| At end of year | 23,922 | 23,523 |
| Merger reserve | | |
| At beginning of year | 25,522 | 10,881 |
| Issue of B shares, net of £399 million expenses | - | 24,591 |
| Transfer to retained earnings | (12,250) | (9,950) |
| At end of year | 13,272 | 25,522 |
| Available-for-sale reserve | | |
| At beginning of year | (1,755) | (3,561) |
| Unrealised gains | 179 | 1,202 |
| Realised (gains)/losses | (519) | 981 |
| Tax | 74 | (377) |
| Recycled to profit or loss on disposal of businesses, net of £5 million tax | (16) | - |
| At end of year | (2,037) | (1,755) |

| | | |
|--|-------|-------|
| Cash flow hedging reserve | | |
| At beginning of year | (252) | (876) |
| Amount recognised in equity | 180 | 380 |
| Amount transferred from equity to earnings | (59) | 513 |
| Tax | (67) | (269) |
| Recycled to profit or loss on disposal of businesses, net of £19 million tax | 58 | - |
| At end of year | (140) | (252) |

RBS Group – Annual Results 2010

Condensed consolidated statement of changes in equity
for the year ended 31 December 2010 (continued)

| | 2010 | 2009 |
|--|---------|---------|
| | £m | £m |
| Foreign exchange reserve | | |
| At beginning of year | 4,528 | 6,385 |
| Retranslation of net assets | 997 | (2,322) |
| Foreign currency (losses)/gains on hedges of net assets | (458) | 456 |
| Tax | 63 | 9 |
| Recycled to profit or loss on disposal of businesses | 8 | - |
| At end of year | 5,138 | 4,528 |
| Capital redemption reserve | | |
| At beginning of year | 170 | 170 |
| Preference shares redeemed | 1 | - |
| Cancellation of non-voting deferred shares | 27 | - |
| At end of year | 198 | 170 |
| Contingent capital reserve | | |
| At beginning of year | (1,208) | - |
| Contingent capital agreement - consideration payable | - | (1,208) |
| At end of year | (1,208) | (1,208) |
| Retained earnings | | |
| At beginning of year | 12,134 | 7,542 |
| Loss attributable to ordinary and B shareholders and other equity owners | | |
| - continuing operations | (973) | (2,600) |
| - discontinued operations | (28) | (72) |
| Equity preference dividends paid | (105) | (878) |
| Paid-in equity dividends paid, net of tax | (19) | (57) |
| Transfer from paid-in equity | | |
| - gross | 2 | 200 |
| - tax | (1) | - |
| Equity owners gain on withdrawal of non-controlling interests | | |
| - gross | 40 | 629 |
| - tax | (11) | (176) |
| Redemption of equity preference shares | (2,968) | - |
| Gain on redemption of equity preference shares | 609 | - |
| Redemption of preference shares classified as debt | (118) | - |
| Transfer from merger reserve | 12,250 | 9,950 |
| Actuarial gains/(losses) recognised in retirement benefit schemes | | |
| - gross | 158 | (3,756) |
| - tax | (71) | 1,043 |

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| | | |
|--|--------|--------|
| Purchase of non-controlling interests | (38) | - |
| Net cost of shares bought and used to satisfy share-based payments | (13) | (16) |
| Share-based payments | | |
| - gross | 385 | 325 |
| - tax | 6 | - |
| At end of year | 21,239 | 12,134 |
| Own shares held | | |
| At beginning of year | (121) | (104) |
| Shares purchased | (700) | (33) |
| Shares issued under employee share schemes | 13 | 16 |
| At end of year | (808) | (121) |
| Equity owners at end of year | 75,132 | 77,736 |

RBS Group – Annual Results 2010

Condensed consolidated statement of changes in equity
for the year ended 31 December 2010 (continued)

| | 2010 £m | 2009 £m |
|---|------------|------------|
| Non-controlling interests | | |
| At beginning of year | 16,895 | 21,619 |
| Currency translation adjustments and other movements | (466) | (1,434) |
| (Loss)/profit attributable to non-controlling interests | | |
| - continuing operations | (60) | 382 |
| - discontinued operations | (605) | (33) |
| Dividends paid | (4,200) | (313) |
| Movements in available-for-sale securities | | |
| - unrealised (losses)/gains | (56) | 299 |
| - realised losses/(gains) | 37 | (466) |
| - tax | 5 | (36) |
| - recycled to profit or loss on disposal of discontinued operations, net of £2 million tax | (7) | - |
| Movements in cash flow hedging reserves | | |
| - amount recognised in equity | (120) | (209) |
| - tax | 39 | 59 |
| - recycled to profit or loss on disposal of discontinued operations, net of £340 million tax | 1,036 | - |
| Actuarial gains recognised in retirement benefit schemes | | |
| - gross | - | 91 |
| - tax | - | 1 |
| Equity raised | 559 | 9 |
| Equity withdrawn and disposals | (11,298) | (2,445) |
| Transfer to retained earnings | (40) | (629) |
| At end of year | 1,719 | 16,895 |
| Total equity at end of year | 76,851 | 94,631 |
| Total comprehensive loss recognised in the statement of changes in equity is | | |
| attributable as follows: | | |
| Non-controlling interests | (197) | (1,346) |
| Preference shareholders | 105 | 878 |
| Paid-in equity holders | 19 | 57 |
| Ordinary and B shareholders | (598) | (5,747) |
| | (671) | (6,158) |

Condensed consolidated cash flow statement
for the year ended 31 December 2010

| | 2010 | 2009 |
|---|----------|----------|
| | £m | £m |
| Operating activities | | |
| Operating loss before tax | (399) | (2,647) |
| Operating loss before tax on discontinued operations | (541) | (49) |
| Adjustments for non-cash items | 2,571 | 18,387 |
| Net cash inflow from trading activities | 1,631 | 15,691 |
| Changes in operating assets and liabilities | 17,095 | (15,964) |
| Net cash flows from operating activities before tax | 18,726 | (273) |
| Income taxes received/(paid) | 565 | (719) |
| Net cash flows from operating activities | 19,291 | (992) |
| Net cash flows from investing activities | 3,351 | 54 |
| Net cash flows from financing activities | (14,380) | 18,791 |
| Effects of exchange rate changes on cash and cash equivalents | 82 | (8,592) |
| Net increase in cash and cash equivalents | 8,344 | 9,261 |
| Cash and cash equivalents at beginning of year | 144,186 | 134,925 |
| Cash and cash equivalents at end of year | 152,530 | 144,186 |

RBS Group – Annual Results 2010

Notes on statutory results

1. Basis of preparation

Having reviewed the Group's forecasts, projections and other relevant evidence, the directors have a reasonable expectation that the Group will continue in operational existence for the foreseeable future. Accordingly, the results for the year ended 31 December 2010 have been prepared on a going concern basis.

2. Accounting policies

The annual accounts are prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) of the IASB as adopted by the European Union (EU) (together IFRS). The EU has not adopted the complete text of IAS 39 'Financial Instruments: Recognition and Measurement'; it has relaxed some of the standard's hedging requirements. The Group has not taken advantage of this relaxation and has adopted IAS 39 as issued by the IASB: the Group's Financial Statements are prepared in accordance with IFRS as issued by the IASB.

The Group has adopted the revised IFRS 3 'Business Combinations' and related revisions to IAS 27 'Consolidated and Separate Financial Statements' issued in January 2008 and also IFRIC 17 'Distributions of Non-cash Assets to Owners' and the IASB's consequential amendments to IFRS 5 'Non-Current Assets Held for Sale and Discontinued Operations' issued in December 2008. They apply to transactions on or after 1 January 2010 and have not resulted in the restatement of previously published financial information. There have been no material acquisitions in the year. In accordance with IFRS 5, before and after the amendment, the Dutch retail and other banking businesses that were transferred to the Dutch State on 1 April 2010 have been recognised as discontinued operations with consequent changes to the presentation of comparative financial information.

There are a number of other changes to IFRS that were effective from 1 January 2010. They have had no material effect on the Group's financial statements: April 2009 Annual Improvements to IFRS - making non-urgent but necessary amendments to standards, primarily to remove inconsistencies and to clarify wording; and IAS 39 'Financial Instruments: Recognition and Measurement - limited changes to IAS 39' issued in July 2008 clarified that (a) a one-sided risk can be designated as a hedged risk i.e. an option can be used to hedge a risk above or below a specified threshold and (b) inflation can be a hedged risk but only if the cash flows include a specified inflation portion.

Notes on statutory results (continued)

3. Analysis of income, expenses and impairment losses

| | 2010 | 2009 |
|--|---------|---------|
| | £m | £m |
| Loans and advances to customers | 18,889 | 21,356 |
| Loans and advances to banks | 591 | 830 |
| Debt securities | 3,296 | 4,125 |
| Interest receivable | 22,776 | 26,311 |
| Customer accounts | 3,721 | 4,761 |
| Deposits by banks | 1,333 | 2,898 |
| Debt securities in issue | 3,277 | 4,482 |
| Subordinated liabilities | 417 | 1,291 |
| Internal funding of trading businesses | (181) | (509) |
| Interest payable | 8,567 | 12,923 |
| Net interest income | 14,209 | 13,388 |
| Fees and commissions receivable | 8,193 | 8,738 |
| Fees and commissions payable | | |
| - banking | (1,892) | (2,351) |
| - insurance related | (319) | (439) |
| Net fees and commissions | 5,982 | 5,948 |
| Foreign exchange | 1,491 | 2,340 |
| Interest rate | 1,862 | 3,883 |
| Credit | 41 | (4,147) |
| Other | 1,123 | 1,685 |
| Income from trading activities | 4,517 | 3,761 |
| Gain on redemption of own debt (1) | 553 | 3,790 |
| Operating lease and other rental income | 1,394 | 1,323 |
| Changes in the fair value of own debt | 249 | 51 |
| Changes in the fair value of securities and other financial assets and liabilities | (180) | 42 |
| Changes in the fair value of investment properties | (405) | (117) |
| Profit on sale of securities | 496 | 162 |
| Profit on sale of property, plant and equipment | 50 | 40 |
| Profit/(loss) on sale of subsidiaries and associates | (107) | (144) |
| Life business profits | 90 | 156 |
| Dividend income | 69 | 78 |

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| | | |
|--|--------|--------|
| Share of profits less losses of associated entities | 70 | (268) |
| Other income | (247) | (450) |
| Other operating income | 1,479 | 873 |
| Non-interest income (excluding insurance net premium income) | 12,531 | 14,372 |
| Insurance net premium income | 5,128 | 5,266 |
| Total non-interest income | 17,659 | 19,638 |
| Total income | 31,868 | 33,026 |

Note:

- (1) In May 2010, the Group redeemed certain subordinated debt securities and equity preference shares in exchange for cash or senior debt. The exchanges involving instruments classified as liabilities all met the criteria in IFRS for treatment as the extinguishment of the original liability and the recognition of a new financial liability. Gains on these exchanges and on the redemption of securities classified as liabilities for cash, totalling £553 million were credited to profit or loss. No amounts have been recognised in profit or loss in relation to the redemption of securities classified as equity in the Group financial statements. The difference between the consideration and the carrying value for these securities amounting to £651 million has been recorded in equity. A similar series of exchange and tender offers concluded in April 2009 resulting in a gain of £3,790 million and £829 million being recorded in equity.

Notes on statutory results (continued)

3. Analysis of income, expenses and impairment losses (continued)

| | 2010 | 2009 |
|--|--------|---------|
| | £m | £m |
| Staff costs | | |
| - wages, salaries and other staff costs | 8,332 | 8,368 |
| - bonus tax | 99 | 208 |
| - social security costs | 671 | 675 |
| - pension costs - gains on pensions curtailment | (78) | (2,148) |
| - pension costs - other | 647 | 742 |
| | 9,671 | 7,845 |
| Premises and equipment | 2,402 | 2,594 |
| Other | 3,995 | 4,449 |
| Administrative expenses | 16,068 | 14,888 |
| Depreciation and amortisation | 2,150 | 2,166 |
| Write-down of goodwill and other intangible assets | 10 | 363 |
| Operating expenses* | 18,228 | 17,417 |
| General insurance | 4,698 | 4,223 |
| Bancassurance | 85 | 134 |
| Insurance net claims | 4,783 | 4,357 |
| Loan impairment losses | 9,144 | 13,090 |
| Securities impairment losses | 112 | 809 |
| Impairment losses | 9,256 | 13,899 |
| *Operating expenses include | | |
| Integration and restructuring costs | | |
| - administrative expenses | 1,012 | 1,268 |
| - depreciation and amortisation | 20 | 18 |
| | 1,032 | 1,286 |
| Amortisation of purchased intangible assets | 369 | 272 |
| | 1,401 | 1,558 |

Notes on statutory results (continued)

4. Pensions

| | 2010 | 2009 |
|---|------|------|
| | £m | £m |
| Pension costs (excluding curtailment gains) | | |
| Defined benefit schemes | 462 | 638 |
| Defined contribution schemes | 107 | 104 |
| | 569 | 742 |

Pension costs for the year ended 31 December 2010 amounted to £569 million (2009 - £742 million excluding curtailment gains), net of a £78 million gain in US Retail & Commercial associated with changes to its defined benefit pension plan. Defined benefit schemes charges are based on the actuarially determined pension cost rates at 31 December 2009.

Curtailment gains of £2,148 million were recognised in 2009 arising from changes to pension benefits in the main UK scheme and certain other subsidiaries schemes due to the capping of future salary increases that will count for pension purposes to the lower of 2% or the rate of inflation in any year.

| | 2010 | 2009 |
|--|-------|---------|
| | £m | £m |
| Net pension deficit/(surplus) | | |
| At 1 January | 2,905 | 1,996 |
| Currency translation and other adjustments | - | (114) |
| Income statement | | |
| - Pension cost: continuing operations | 519 | 638 |
| discontinued operations | 21 | 21 |
| - Curtailment gains: continuing operations | (78) | (2,148) |
| Net actuarial (gains)/losses | (158) | 3,665 |
| Contributions by employer | (832) | (1,153) |
| Disposal of RFS minority interest | (194) | - |
| At 31 December | 2,183 | 2,905 |
| Net assets of schemes in surplus | (105) | (58) |
| Net liabilities of schemes in deficit | 2,288 | 2,963 |

The most recent funding valuation of the main UK scheme was 31 March 2007. A funding valuation of the Main UK scheme at 31 March 2010 is currently in progress. The scheme trustees and the Group are in discussion on this valuation and the level of contributions to be paid by the Group and expect to reach agreement by 30 June 2011. The Group expects that in addition to estimated contributions of £300 - £350 million for future accrual of benefits, it will make additional contributions, as yet unquantified, in 2011 and subsequent years to improve the funding position of the scheme.

Notes on statutory results (continued)

5. Loan impairment provisions

Operating profit/(loss) is stated after charging loan impairment losses of £9,144 million (2009 - £13,090 million). The balance sheet loan impairment provisions increased in the year ended 31 December 2010 from £17,283 million to £18,182 million and the movements thereon were:

| | 2010 | 2009 |
|--|---------|---------|
| | £m | £m |
| At beginning of year | 17,283 | 11,016 |
| Transfers to disposal groups | (72) | (324) |
| Currency translation and other adjustments | 43 | (530) |
| Disposals | (2,172) | (65) |
| Amounts written-off | (6,042) | (6,939) |
| Recoveries of amounts previously written-off | 411 | 399 |
| Charge to income statement | | |
| - continuing operations | 9,144 | 13,090 |
| - discontinued operations | 42 | 1,044 |
| Unwind of discount | (455) | (408) |
| At end of year | 18,182 | 17,283 |

The provision at 31 December 2010 includes £127 million (2009 - £157 million) in respect of loans and advances to banks. The charge to the income statement in the table above excludes £112 million (2009 - £809 million) relating to securities.

6. Tax

The (charge)/credit for tax differs from the tax credit computed by applying the standard UK corporation tax rate of 28% as follows:

| | 2010 | 2009 |
|---|-------|---------|
| | £m | £m |
| Loss before tax from continuing operations | (399) | (2,647) |
| Expected tax credit | 112 | 741 |
| Non-deductible goodwill impairment | (3) | (102) |
| Unrecognised timing differences | 11 | 274 |
| Items not allowed for tax | | |
| - losses on strategic disposals and write-downs | (311) | (152) |
| - other | (328) | (356) |
| Non-taxable items | | |
| - gain on sale of Global Merchant Services | 221 | - |
| - gain on redemption of own debt | 11 | 693 |
| - other | 341 | 410 |
| Taxable foreign exchange movements | 4 | 1 |

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| | | |
|---|-------|-------|
| Foreign profits taxed at other rates | (517) | (276) |
| UK tax rate change – deferred tax impact | (82) | - |
| Losses in year where no deferred tax asset recognised | (450) | (780) |
| Losses brought forward and utilised | 2 | 94 |
| Adjustments in respect of prior years | 355 | (118) |
| Actual tax (charge)/credit | (634) | 429 |

RBS Group – Annual Results 2010

Notes on statutory results (continued)

7. (Loss)/profit attributable to non-controlling interests

| | 2010 | 2009 |
|---|-------|-------|
| | £m | £m |
| Trust preferred securities | 10 | 39 |
| Investment in Bank of China | - | 359 |
| RBS Sempra Commodities JV | 35 | 234 |
| ABN AMRO | | |
| - RFS minority interest | (726) | (299) |
| - Other | (2) | 4 |
| RBS Life Holdings Ltd | 26 | 26 |
| Other | (8) | (14) |
| (Loss)/profit attributable to non-controlling interests | (665) | 349 |

8. Profit attributable to preference shareholders and paid-in equity holders

| | 2010 | 2009 |
|---|------|------|
| | £m | £m |
| Preference shareholders | | |
| Non-cumulative preference shares of US\$0.01 | 105 | 342 |
| Non-cumulative preference shares of €0.01 | - | 201 |
| Non-cumulative preference shares of £1 | | |
| - issued to UK Financial Investments Limited (1) | - | 274 |
| - other | - | 61 |
| Paid-in equity holders | | |
| Interest on securities classified as equity, net of tax | 19 | 57 |
| | 124 | 935 |

Note:

(1) Includes £50 million redemption premium on repayment of preference shares.

9. Dividends

The Group has undertaken that, unless otherwise agreed with the European Commission, neither the company nor any of its direct or indirect subsidiaries (other than companies in the RBS Holdings N.V. group, which are subject to different restrictions) will pay external investors any dividends or coupons on existing hybrid capital instruments (including preference shares, B shares and upper and lower tier 2 instruments) from 30 April 2010 for a period of two years thereafter ("the Deferral Period"), or exercise any call rights in relation to these capital instruments between 24 November 2009 and the end of the Deferral Period, unless there is a legal obligation to do so.

Notes on statutory results (continued)

10. Earnings per ordinary and B share

Earnings per ordinary and B share have been calculated based on the following:

| | 2010 | 2009 |
|--|---------|---------|
| | £m | £m |
| Earnings | | |
| Loss from continuing operations attributable to ordinary and B shareholders | (1,097) | (3,535) |
| Gain on redemption of preference shares and paid-in equity | 610 | 200 |
| Adjusted loss from continuing operations attributable to ordinary and B shareholders | (487) | (3,335) |
| Loss from discontinued operations attributable to ordinary and B shareholders | (28) | (72) |
| Number of shares (millions) | | |
| Ordinary shares in issue during the year | 56,245 | 51,494 |
| B shares in issue during the year | 51,000 | 1,397 |
| Weighted average number of ordinary and B shares in issue during the year | 107,245 | 52,891 |
| Basic loss per ordinary and B share from continuing operations | (0.5p) | (6.3p) |
| Diluted loss per ordinary and B share from continuing operations | (0.5p) | (6.3p) |
| Basic loss per ordinary and B share from discontinued operations | - | (0.1p) |
| Diluted loss per ordinary and B share from discontinued operations | - | (0.1p) |

Following reconsideration of the terms of the B share subscription agreement with HM Treasury, it is no longer treated as dilutive. The comparative amount for the year ended 31 December 2009 has been restated.

11. Segmental analysis

There have been no significant changes in the Group's divisions during the year. Total revenue, operating profit/(loss) before tax and total assets by division are shown in the tables below.

| | 2010 | | | 2009 | | |
|---------------|----------|---------------|-------|----------|---------------|-------|
| | External | Inter segment | Total | External | Inter segment | Total |
| | £m | £m | £m | £m | £m | £m |
| Total revenue | | | | | | |
| UK Retail | 6,998 | 401 | 7,399 | 7,156 | 599 | 7,755 |
| UK Corporate | 4,347 | 132 | 4,479 | 4,563 | 118 | 4,681 |
| Wealth | 957 | 617 | 1,574 | 813 | 820 | 1,633 |

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| | | | | | | |
|--------------------------------|---------|----------|----------|--------|----------|----------|
| Global Transaction | | | | | | |
| Services | 2,850 | 85 | 2,935 | 2,923 | 60 | 2,983 |
| Ulster Bank | 1,386 | 134 | 1,520 | 1,604 | 104 | 1,708 |
| US Retail & Commercial | 3,660 | 286 | 3,946 | 4,080 | 378 | 4,458 |
| Global Banking & Markets | 9,999 | 7,195 | 17,194 | 13,805 | 9,142 | 22,947 |
| RBS Insurance | 4,918 | 10 | 4,928 | 5,018 | 19 | 5,037 |
| Central items | 2,953 | 8,549 | 11,502 | 2,057 | 10,825 | 12,882 |
| Core | 38,068 | 17,409 | 55,477 | 42,019 | 22,065 | 64,084 |
| Non-Core | 5,622 | 1,051 | 6,673 | 3,358 | 1,292 | 4,650 |
| | 43,690 | 18,460 | 62,150 | 45,377 | 23,357 | 68,734 |
| Reconciling items | | | | | | |
| RFS Holdings minority interest | (141) | - | (141) | (155) | - | (155) |
| Fair value of own debt | 174 | - | 174 | (142) | - | (142) |
| Gain on redemption of own debt | 553 | - | 553 | 3,790 | - | 3,790 |
| Strategic disposals | 171 | - | 171 | 132 | - | 132 |
| Asset Protection Scheme | (1,550) | - | (1,550) | - | - | - |
| Eliminations | - | (18,460) | (18,460) | - | (23,357) | (23,357) |
| | 42,897 | - | 42,897 | 49,002 | - | 49,002 |

Notes on statutory results (continued)

11. Segmental analysis (continued)

| | 2010 | 2009 |
|---|---------|----------|
| | £m | £m |
| Operating profit/(loss) before tax | | |
| UK Retail | 1,372 | 229 |
| UK Corporate | 1,463 | 1,125 |
| Wealth | 304 | 420 |
| Global Transaction Services | 1,088 | 973 |
| Ulster Bank | (761) | (368) |
| US Retail & Commercial | 306 | (113) |
| Global Banking & Markets | 3,364 | 5,758 |
| RBS Insurance | (295) | 58 |
| Central items | 577 | 385 |
| Core | 7,418 | 8,467 |
| Non-Core | (5,505) | (14,557) |
| | 1,913 | (6,090) |
| Reconciling items | | |
| RFS Holdings minority interest | (150) | (356) |
| Fair value of own debt | 174 | (142) |
| Amortisation of purchased intangible assets | (369) | (272) |

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| | | |
|--|-----------|-----------|
| Integration and restructuring costs | (1,032) | (1,286) |
| Gain on redemption of own debt | 553 | 3,790 |
| Strategic disposals | 171 | 132 |
| Bonus tax | (99) | (208) |
| Asset Protection Scheme credit default swap - fair value changes | (1,550) | - |
| Gains on pensions curtailment | - | 2,148 |
| Write-down of goodwill and other intangible assets | (10) | (363) |
| | (399) | (2,647) |
| | 2010 | 2009 |
| | £m | £m |
| Total assets | | |
| UK Retail | 111,793 | 110,987 |
| UK Corporate | 114,550 | 114,854 |
| Wealth | 21,073 | 17,952 |
| Global Transaction Services | 25,221 | 18,380 |
| Ulster Bank | 40,081 | 44,021 |
| US Retail & Commercial | 71,173 | 75,369 |
| Global Banking & Markets | 802,578 | 826,054 |
| RBS Insurance | 12,555 | 11,973 |
| Central items | 99,728 | 82,041 |
| Core | 1,298,752 | 1,301,631 |
| Non-Core | 153,882 | 220,850 |
| | 1,452,634 | 1,522,481 |
| Reconciling item | | |
| RFS Holdings minority interest | 942 | 174,005 |
| | 1,453,576 | 1,696,486 |

RBS Group – Annual Results 2010

Notes on statutory results (continued)

12. Discontinued operations and assets and liabilities of disposal groups

| Profit/(loss) from discontinued operations, net of tax | 2010 | 2009 |
|---|---------|---------|
| | £m | £m |
| Discontinued operations | | |
| Total income | 1,433 | 5,664 |
| Operating expenses | (803) | (4,061) |
| Insurance net claims | (161) | (500) |
| Impairment losses | (42) | (1,051) |
| Profit before tax | 427 | 52 |
| Gain on disposal before recycling of reserves | 113 | - |
| Recycled reserves | (1,076) | - |
| Operating (loss)/profit before tax | (536) | 52 |
| Tax on profit | (92) | (58) |
| Loss after tax | (628) | (6) |
| Businesses acquired exclusively with a view to disposal | | |
| Loss after tax | (5) | (99) |
| Loss from discontinued operations, net of tax | (633) | (105) |

Discontinued operations reflect the results of the State of the Netherlands and Santander in RFS Holdings B.V. following the legal separation of ABN AMRO Bank N.V. on 1 April 2010. Consortium Members' results are classified as discontinued operations and 2009 has been presented accordingly.

RBS Group – Annual Results 2010

Notes on statutory results (continued)

12. Discontinued operations and assets and liabilities of disposal groups (continued)

| | 2010 | | Total £m | 2009 £m |
|--|--------------|-------------|-------------|------------|
| | Sempra £m | Other £m | | |
| Assets of disposal groups | | | | |
| Cash and balances at central banks | - | 184 | 184 | 129 |
| Loans and advances to banks | 629 | 22 | 651 | 388 |
| Loans and advances to customers | 440 | 4,573 | 5,013 | 3,216 |
| Debt securities and equity shares | 17 | 3 | 20 | 904 |
| Derivatives | 4,768 | 380 | 5,148 | 6,361 |
| Intangible assets | - | - | - | 238 |
| Settlement balances | 555 | - | 555 | 1,579 |
| Property, plant and equipment | 18 | - | 18 | 136 |
| Other assets | 260 | 444 | 704 | 5,417 |
| Discontinued operations and other disposal groups | | | | |
| Assets acquired exclusively with a view to disposal | 6,687 | 5,606 | 12,293 | 18,368 |
| | - | 191 | 191 | 174 |
| | 6,687 | 5,797 | 12,484 | 18,542 |
| Liabilities of disposal groups | | | | |
| Deposits by banks | 266 | - | 266 | 618 |
| Customer accounts | 352 | 1,915 | 2,267 | 8,907 |
| Derivatives | 5,021 | 21 | 5,042 | 6,683 |
| Settlement balances | 907 | - | 907 | 950 |
| Subordinated liabilities | - | - | - | 6 |
| Other liabilities | 393 | 532 | 925 | 1,675 |
| Discontinued operations and other disposal groups | | | | |
| Liabilities acquired exclusively with a view to disposal | 6,939 | 2,468 | 9,407 | 18,839 |
| | - | 21 | 21 | 51 |
| | 6,939 | 2,489 | 9,428 | 18,890 |

To comply with EC State Aid requirements, the Group has agreed to make a series of divestments within four years from December 2009. During 2010, the Group successfully completed the disposal of 80.01% of the GMS business and substantially all of the RBS Sempra Commodities JV. Certain contracts of the RBS Sempra Commodities JV business were sold in risk transfer transactions prior to being novated to the purchaser and they comprise substantially all of its residual assets and liabilities. RBS Sempra Commodities JV was the only significant such divestment that met the criteria for classification as a disposal group at 31 December 2010.

The other assets and liabilities classified as disposal groups include the project finance assets to be sold to The Bank of Tokyo-Mitsubishi UFJ, Ltd, and certain non-core interests in Latin America, Europe and the Middle East.

RBS Group – Annual Results 2010

Notes on statutory results (continued)

13. 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: held-for-trading (HFT), designated as at fair value (DFV), available-for-sale (AFS), loans and receivables (LAR) and other financial instruments. Assets and liabilities outside the scope of IAS 39 are shown separately.

| | HFT | DFV | Hedging derivatives | AFS | LAR | Finance leases | Non financial assets/ liabilities | Group before RFS MI | RFS MI | Total |
|--|---------|-------|------------------------|---------|---------|-------------------|--|---------------------------|-----------|---------|
| 31 December 2010 | £m | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| Assets | | | | | | | | | | |
| Cash and balances at central banks | - | - | | - | 57,014 | | | 57,014 | - | 57,014 |
| Loans and advances to banks | | | | | | | | | | |
| - reverse repos | 38,215 | - | | - | 4,392 | | | 42,607 | - | 42,607 |
| - other | 26,082 | - | | - | 31,827 | | | 57,909 | 2 | 57,911 |
| Loans and advances to customers | | | | | | | | | | |
| - reverse repos | 41,110 | - | | - | 11,402 | | | 52,512 | - | 52,512 |
| - other | 19,903 | 1,100 | | - | 471,308 | 10,437 | | 502,748 | - | 502,748 |
| Debt securities | 98,869 | 402 | | 111,130 | 7,079 | | | 217,480 | - | 217,480 |
| Equity shares | 19,186 | 1,013 | | 1,999 | - | | | 22,198 | - | 22,198 |
| Settlement balances | - | - | | - | 11,605 | | | 11,605 | - | 11,605 |
| Derivatives (1) | 421,648 | - | 5,429 | - | - | | | 427,077 | - | 427,077 |
| Intangible assets | | | | | | | 14,448 | 14,448 | - | 14,448 |
| Property, plant and equipment | | | | | | | 16,543 | 16,543 | - | 16,543 |
| Deferred tax | | | | | | | 6,373 | 6,373 | - | 6,373 |
| Prepayments, accrued income and other assets | - | - | | - | 1,306 | - | 11,262 | 12,568 | 8 | 12,576 |
| Assets of disposal | | | | | | | 11,552 | 11,552 | 932 | 12,484 |

groups

Group before

| | | | | | | | | | |
|------------|---------|-------|-------|---------|---------|--------|--------|-----------|-----------|
| RFS MI | 665,013 | 2,515 | 5,429 | 113,129 | 595,933 | 10,437 | 60,178 | 1,452,634 | |
| RFS MI (2) | - | - | - | - | 2 | - | 940 | | 942 |
| | 665,013 | 2,515 | 5,429 | 113,129 | 595,935 | 10,437 | 61,118 | | 1,453,576 |

For notes to this table refer to page 166.

RBS Group – Annual Results 2010

Notes on statutory results (continued)

13. Financial instruments (continued)

Classification (continued)

| | HFT | DFV | Hedging derivatives | Other financial instruments (amortised cost) | Finance leases | Non financial assets/ liabilities | Group before RFS MI | RFS MI | Total |
|---|----------------|---------------|------------------------|--|-------------------|--|---------------------------|-----------|---------|
| 31 December 2010 | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| Liabilities | | | | | | | | | |
| Deposits by banks | | | | | | | | | |
| - repos | 20,585 | - | | 12,154 | | | 32,739 | - | 32,739 |
| - other | 28,216 | - | | 37,721 | | | 65,937 | 114 | 66,051 |
| Customer accounts | | | | | | | | | |
| - repos | 53,031 | - | | 29,063 | | | 82,094 | - | 82,094 |
| - other | 14,357 | 4,824 | | 409,418 | | | 428,599 | - | 428,599 |
| Debt securities in issue | 7,730 | 43,488 | | 167,154 | | | 218,372 | - | 218,372 |
| Settlement balances | - | - | | 10,991 | | | 10,991 | - | 10,991 |
| Short positions | 43,118 | - | | - | | | 43,118 | - | 43,118 |
| Derivatives (1) | 419,103 | - | 4,864 | - | | | 423,967 | - | 423,967 |
| Accruals, deferred income and other liabilities | - | - | | 1,793 | 458 | 20,824 | 23,075 | 14 | 23,089 |
| Retirement benefit liabilities | | | | - | | 2,288 | 2,288 | | 2,288 |
| Deferred tax | | | | - | | 2,111 | 2,111 | 31 | 2,142 |
| Insurance liabilities | | | | - | | 6,794 | 6,794 | - | 6,794 |
| Subordinated liabilities | | 1,129 | | 25,924 | | - | 27,053 | - | 27,053 |
| Liabilities of disposal groups | | | | - | | 8,940 | 8,940 | 488 | 9,428 |
| Group before RFS MI | 586,140 | 49,441 | 4,864 | 694,218 | 458 | 40,957 | 1,376,078 | | |

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| | | | | | | | |
|-------------------|---------|--------|-------|---------|-----|--------|-----------|
| RFS MI (2) | - | - | - | 114 | - | 533 | 647 |
| Total liabilities | 586,140 | 49,441 | 4,864 | 694,332 | 458 | 41,490 | 1,376,725 |
| Equity | | | | | | | 76,851 |
| | | | | | | | 1,453,576 |

For notes to this table refer to page 166.

RBS Group – Annual Results 2010

Notes to statutory results (continued)

13. Financial instruments (continued)

Classification (continued)

| | HFT | DFV | AFS | LAR | Finance leases | Non Financial assets/ liabilities | Group before | | Group |
|---|---------|-------|---------|---------|-------------------|--|-----------------|---------|---------|
| | £m | £m | £m | £m | £m | £m | RFS | MI | £m |
| 31 December 2009 | | | | | | | | | |
| Assets | | | | | | | | | |
| Cash and balances | | | | | | | | | |
| at central banks | - | - | - | 51,548 | | | 51,548 | 713 | 52,261 |
| Loans and advances | | | | | | | | | |
| to banks | | | | | | | | | |
| - reverse repos | 26,886 | - | - | 8,211 | | | 35,097 | - | 35,097 |
| - other | 18,563 | - | - | 30,214 | | | 48,777 | 7,879 | 56,656 |
| Loans and advances | | | | | | | | | |
| to customers | | | | | | | | | |
| - reverse repos | 26,313 | - | - | 14,727 | | | 41,040 | - | 41,040 |
| - other | 15,371 | 1,981 | - | 524,204 | 13,098 | | 554,654 | 132,699 | 687,353 |
| Debt securities | 111,413 | 2,429 | 125,382 | 9,871 | | | 249,095 | 18,159 | 267,254 |
| Equity shares | 11,318 | 2,083 | 2,559 | - | | | 15,960 | 3,568 | 19,528 |
| Settlement balances | | | | | | | | | |
| | - | - | - | 12,024 | | | 12,024 | 9 | 12,033 |
| Derivatives (1) | 438,199 | - | - | - | | | 438,199 | 3,255 | 441,454 |
| Intangible assets | | | | | | | | | |
| Property, plant and equipment | | | | | | | | | |
| | | | | | | 17,773 | 17,773 | 1,624 | 19,397 |
| Deferred tax | | | | | | | | | |
| | | | | | | 6,492 | 6,492 | 547 | 7,039 |
| Prepayments, accrued income and other assets | | | | | | | | | |
| | - | - | - | 1,421 | | 17,183 | 18,604 | 2,381 | 20,985 |
| Assets of disposal groups | | | | | | | | | |
| | | | | - | | 18,432 | 18,432 | 110 | 18,542 |
| Group before | | | | | | | | | |
| RFS MI | 648,063 | 6,493 | 127,941 | 652,220 | 13,098 | 74,666 | 1,522,481 | | |
| RFS MI (2) | 7,042 | 283 | 18,250 | 140,707 | - | 7,723 | | 174,005 | |

655,105 6,776 146,191 792,927 13,098 82,389 1,696,486

For notes to this table refer to page 166.

RBS Group – Annual Results 2010

Notes to statutory results (continued)

13. Financial instruments (continued)

Classification (continued)

| 31 December 2009 | HFT £m | DFV £m | Other financial instruments £m | Finance leases £m | Non financial assets/ liabilities £m | Group before RFS £m | MI RFS £m | MI RFS £m | Group £m |
|--|-----------|-----------|---|-------------------------|--|------------------------------|-----------------|-----------------|-------------|
| Liabilities | | | | | | | | | |
| Deposits by banks | | | | | | | | | |
| - other | 32,647 | - | 82,995 | | | 115,642 | (11,504) | | 104,138 |
| - repos | 20,962 | - | 17,044 | | | 38,006 | - | | 38,006 |
| Customer accounts | | | | | | | | | |
| - other | 11,217 | 5,256 | 397,778 | | | 414,251 | 131,598 | | 545,849 |
| - repos | 41,520 | - | 26,833 | | | 68,353 | - | | 68,353 |
| Debt securities in issue | | | | | | | | | |
| | 3,925 | 41,444 | 200,960 | | | 246,329 | 21,239 | | 267,568 |
| Settlement balances | | | | | | | | | |
| | - | - | 10,412 | | | 10,412 | 1 | | 10,413 |
| Short positions | | | | | | | | | |
| | 40,463 | - | - | | | 40,463 | - | | 40,463 |
| Derivatives (1) | | | | | | | | | |
| | 421,534 | - | - | | | 421,534 | 2,607 | | 424,141 |
| Accruals, deferred income and other liabilities | | | | | | | | | |
| | - | - | 1,889 | 466 | 22,269 | 24,624 | 5,703 | | 30,327 |
| Retirement benefit liabilities | | | | | | | | | |
| | | | - | | 2,715 | 2,715 | 248 | | 2,963 |
| Deferred tax | | | | | | | | | |
| | | | - | | 2,161 | 2,161 | 650 | | 2,811 |
| Insurance liabilities | | | | | | | | | |
| | | | - | | 7,633 | 7,633 | 2,648 | | 10,281 |
| Subordinated liabilities | | | | | | | | | |
| | | 1,277 | 30,261 | | - | 31,538 | 6,114 | | 37,652 |
| Liabilities of disposal groups | | | | | | | | | |
| | | | - | | 18,857 | 18,857 | 33 | | 18,890 |
| Group before RFS | | | | | | | | | |
| MI | 572,268 | 47,977 | 768,172 | 466 | 53,635 | 1,442,518 | | | |
| RFS MI (2) | 2,738 | 3,417 | 143,901 | - | 9,281 | | 159,337 | | |
| | 575,006 | 51,394 | 912,072 | 466 | 62,916 | | | | 1,601,855 |
| Equity | | | | | | | | | |
| | | | | | | | | | 94,631 |
| | | | | | | | | | 1,696,486 |

Notes:

(1) HFT derivatives include hedging derivatives.

(2) RFS MI comprises the following financial instruments at 31 December 2010:

- (a) There were no HFT assets or liabilities at 31 December 2010 (31 December 2009 - HFT assets of £7,042 million comprised loans to customers - £593 million, debt securities - £69 million, equity shares - £3,125 million and derivatives - £3,255 million; HFT liabilities of £2,738 million comprised customer accounts - £131 million, and derivatives - £2,607 million);
- (b) There were no DFV assets or liabilities at 31 December 2010 (31 December 2009 - DFV assets of £283 million comprised; debt securities of £174 million, equity shares - £109 million; DFV liabilities of £3,417 million comprised customer accounts - £3,324 million, debt securities in issue - £93 million);
- (c) There were no AFS assets at 31 December 2010 (31 December 2009 - AFS assets of £18,250 million comprised debt securities - £17,916 million and equity shares - £334 million);
- (d) Loans and receivables of £2 million all within the loans and advances to banks category at 31 December 2010 (31 December 2009 - £140,969 million comprised cash and balances at central banks - £713 million; loans and advances to banks - £7,879 million, loans and advances to customers - £132,106 million; settlement balances - £9 million); and
- (e) Amortised cost liabilities of £114 million all within the deposits by banks category at 31 December 2010 (31 December 2009 - £143,901 million comprised deposits by banks - £(11,504) million, customer accounts - £128,143 million, debt securities in issue - £21,146 million, settlement balances - £1 million, accruals, deferred income and other liabilities - £1 million, subordinated liabilities - £6,114 million).

Notes to statutory results (continued)

13. Financial instruments (continued)

Reclassification

As permitted by IAS 39 as amended, the Group reclassified certain financial assets from the HFT and AFS categories into the LAR category and from the HFT category into the AFS category in 2008 and 2009. There were no reclassifications in the year ended 31 December 2010. The following tables detail the effect of the reclassifications and the balance sheet values of the assets.

| | Year ended 31 December 2010 |
|--|--------------------------------|
| Reduction in profit as a result of reclassifications | £m |
| From HFT to: | |
| AFS | 280 |
| LAR | 796 |
| | 1,076 |

| | 31 December 2010 | | 31 December 2009 | |
|--------------|-------------------|------------|-------------------|------------|
| | Carrying value | Fair value | Carrying value | Fair value |
| | £m | £m | £m | £m |
| From HFT to: | | | | |
| AFS | 6,447 | 6,447 | 7,629 | 7,629 |
| LAR | 8,908 | 7,549 | 12,933 | 10,644 |
| | 15,355 | 13,996 | 20,562 | 18,273 |
| From AFS to: | | | | |
| LAR | 422 | 380 | 869 | 745 |
| | 15,777 | 14,376 | 21,431 | 19,018 |

During the year ended 31 December 2010, the balance sheet value of reclassified assets decreased by £5.7 billion, primarily due to disposals and repayments across a range of securities and loans.

For assets reclassified from HFT to AFS, net unrealised losses recorded in equity at 31 December 2010 were £0.3 billion (31 December 2009 - £0.6 billion).

RBS Group – Annual Results 2010

Notes to statutory results (continued)

13. Financial instruments (continued)

Financial instruments carried at fair value

Detailed explanations of the valuation techniques are set out in the Group's 2010 Annual Report and Accounts. There has been no change to the Group's valuation techniques except for:

Derivative discounting

The market convention for some derivative products has moved to pricing collateralised derivatives using the overnight indexed swap (OIS) curve, which reflects the interest rate typically paid on cash collateral. In order to reflect observed market practice the Group's valuation approach for the substantial portion of its collateralised derivatives was amended to use OIS. Previously the Group had discounted these collateralised derivatives at LIBOR. The rate for discounting of uncollateralised derivatives was also changed in line with observable market pricing. This change resulted in a net increase in income from trading activities of £127 million for 2010.

Certain aspects relating to the valuation of financial instruments carried at fair value are discussed below.

Valuation reserves

When valuing financial instruments in the trading book, adjustments are made to mid-market valuations to cover bid-offer spread, liquidity and credit risk.

The table below shows the valuation reserves and adjustments.

| | 31 December 2010 £m | 31 December 2009 £m |
|-------------------------------------|------------------------------|------------------------------|
| Credit valuation adjustments | | |
| Monoline insurers | 2,443 | 3,796 |
| Credit derivative product companies | 490 | 499 |
| Other counterparties | 1,714 | 1,588 |
| | 4,647 | 5,883 |
| Bid-offer and liquidity reserves | 2,797 | 2,814 |
| | 7,444 | 8,697 |

Credit valuation adjustments (CVA) represent an estimate of the adjustment to fair value that a market participant would make to incorporate the credit risk inherent in counterparty derivative exposures. CVA is discussed in Other risk exposures included within Appendix 3.

Notes to statutory results (continued)

13. Financial instruments (continued)

Financial instruments carried at fair value (continued)

Bid-offer and liquidity reserves

Fair value positions are adjusted to bid or offer levels, by marking individual cash based positions directly to bid or offer or by taking bid-offer reserves calculated on a portfolio basis for derivatives exposures.

The bid-offer approach is based on current market spreads and standard market bucketing of risk. Risk data are used as the primary sources of information within bid-offer calculations and are aggregated when they are more granular than market standard buckets.

Bid-offer adjustments for each risk factor are determined by aggregating similar risk exposures arising on different products. Additional basis bid-offer reserves are taken where these are charged in the market. Risk associated with non identical underlying exposures is not netted down unless there is evidence that the cost of closing the combined risk exposure is less than the cost of closing on an individual basis.

Bid-offer spreads vary by maturity and risk type to reflect different spreads in the market. For positions where there is no observable quote, the bid-offer spreads are widened in comparison to proxies to reflect reduced liquidity or observability. Bid-offer methodologies also incorporate liquidity triggers whereby wider spreads are applied to risks above pre-defined thresholds.

Netting is applied across risk buckets where there is market evidence to support this. For example calendar netting and cross strike netting effects are taken into account where such trades occur regularly within the market. Netting will also apply where long and short risk in two different risk buckets can be closed out in a single market transaction at less cost than by way of two separate transactions (closing out the individual bucketed risk in isolation).

Vanilla risk on exotic products is typically reserved as part of the overall portfolio based calculation e.g. delta and vega risk is included within the delta and vega bid-offer calculations. Aggregation of risk arising from different models is in line with the Group's risk management practices; the model review control process considers the appropriateness of model selection in this respect.

Product related risks such as correlation risk attract specific bid-offer reserves. Additional reserves are provided for exotic products to ensure overall reserves match market close-out costs. These market close-out costs inherently incorporate risk decay and cross-effects which are unlikely to be adequately reflected in the static hedge based on vanilla instruments.

Where there is limited bid-offer information for a product a conservative approach is taken, taking into account pricing approach and risk management strategy.

Notes to statutory results (continued)

13. Financial instruments (continued)

Financial instruments carried at fair value (continued)

Own credit

The Group takes into account the effect of its own credit standing when valuing financial liabilities recorded at fair value, in accordance with IFRS. The categories of financial liabilities on which own credit spread adjustments are made are issued debt, including issued structured notes, and derivatives. An own credit adjustment is applied to positions where it is believed that counterparties would consider the Group's creditworthiness when pricing trades.

For issued debt and structured notes, this adjustment is based on independent quotes from market participants for the debt issuance spreads above average inter-bank rates, (at a range of tenors) which the market would demand when purchasing new senior or subordinated debt issuances from the Group. Where necessary, these quotes are interpolated using a curve shape derived from credit default swap prices.

The fair value of the Group's derivative financial liabilities has also been adjusted to reflect the Group's own credit risk. The adjustment takes into account collateral posted by the Group and the effects of master netting agreements.

The own credit adjustment does not alter cash flows, is not used for performance management, is disregarded for regulatory capital reporting processes and will reverse over time as the liabilities mature.

The reserve movement between periods will not equate to the reported profit or loss for own credit. The balance sheet reserves are stated by the conversion of underlying currency balances at spot rates for each period, however the income statement includes intra-period foreign exchange sell-offs.

The effect of change in credit spreads could reverse in future periods provided the liability is not repaid at a premium or a discount.

| Cumulative own credit adjustment | Debt | | Total | Derivatives | Total |
|---|---------------------|--------------------------|-------|-------------|-------|
| | securities in issue | Subordinated liabilities | | | |
| | £m | £m | £m | £m | £m |
| 31 December 2010 | 2,091 | 325 | 2,416 | 534 | 2,950 |
| 31 December 2009 | 1,857 | 474 | 2,331 | 467 | 2,798 |
| Carrying values of underlying liabilities | £bn | £bn | £bn | | |
| 31 December 2010 | 51.2 | 1.1 | 52.3 | | |
| 31 December 2009 | 45.5 | 1.3 | 46.8 | | |

Notes to statutory results (continued)

13. Financial instruments (continued)

Valuation hierarchy

| Assets | 31 December 2010 | | | | 31 December 2009 | | | |
|---------------------------------|------------------|---------|---------|-------|------------------|---------|---------|-------|
| | Level | | | Total | Level | | | Total |
| | 1 | Level 2 | Level 3 | | 1 | Level 2 | Level 3 | |
| £bn | £bn | £bn | £bn | £bn | £bn | £bn | £bn | |
| Loans and advances to banks | | | | | | | | |
| - reverse repos | - | 38.2 | - | 38.2 | - | 26.9 | - | 26.9 |
| - collateral | - | 25.1 | - | 25.1 | - | 18.4 | - | 18.4 |
| - other | - | 0.6 | 0.4 | 1.0 | - | 0.1 | - | 0.1 |
| | - | 63.9 | 0.4 | 64.3 | - | 45.4 | - | 45.4 |
| Loans and advances to customers | | | | | | | | |
| - reverse repos | - | 41.1 | - | 41.1 | - | 26.3 | - | 26.3 |
| - collateral | - | 14.4 | - | 14.4 | - | 9.6 | - | 9.6 |
| - other | - | 6.2 | 0.4 | 6.6 | - | 6.7 | 1.1 | 7.8 |
| | - | 61.7 | 0.4 | 62.1 | - | 42.6 | 1.1 | 43.7 |
| Debt securities | | | | | | | | |
| - government | 110.2 | 13.7 | - | 123.9 | 118.2 | 15.9 | - | 134.1 |
| - MBS (1) | - | 49.5 | 0.7 | 50.2 | - | 60.6 | 0.6 | 61.2 |
| - CDOs (2) | - | 1.0 | 2.4 | 3.4 | - | 2.6 | 1.0 | 3.6 |
| - CLOs (3) | - | 3.6 | 2.1 | 5.7 | - | 8.0 | 0.8 | 8.8 |
| - other ABS (4) | - | 4.0 | 1.4 | 5.4 | - | 5.2 | 0.9 | 6.1 |
| - corporate | - | 7.7 | 0.9 | 8.6 | - | 9.9 | 0.6 | 10.5 |
| - banks and building societies | 0.1 | 12.2 | 0.7 | 13.0 | - | 13.8 | 0.2 | 14.0 |
| - other | - | 0.2 | - | 0.2 | - | 0.9 | - | 0.9 |
| | 110.3 | 91.9 | 8.2 | 210.4 | 118.2 | 116.9 | 4.1 | 239.2 |
| Equity shares | 18.4 | 2.8 | 1.0 | 22.2 | 12.2 | 2.5 | 1.3 | 16.0 |
| Derivatives | | | | | | | | |
| - foreign exchange | - | 83.2 | 0.1 | 83.3 | - | 68.1 | 0.2 | 68.3 |
| - interest rate | 1.7 | 308.3 | 1.7 | 311.7 | 0.3 | 319.7 | 1.5 | 321.5 |
| - credit - APS (5) | - | - | 0.6 | 0.6 | - | - | 1.4 | 1.4 |
| - credit - other | - | 23.2 | 3.1 | 26.3 | 0.1 | 37.2 | 3.0 | 40.3 |
| | 0.1 | 4.9 | 0.2 | 5.2 | 0.3 | 6.1 | 0.3 | 6.7 |

- equities and
commodities

| | | | | | | | | |
|---------------------|-------|-------|------|-------|-------|-------|------|-------|
| | 1.8 | 419.6 | 5.7 | 427.1 | 0.7 | 431.1 | 6.4 | 438.2 |
| Group before RFS MI | 130.5 | 639.9 | 15.7 | 786.1 | 131.1 | 638.5 | 12.9 | 782.5 |
| RFS MI (6) | - | - | - | - | 15.4 | 10.0 | 0.2 | 25.6 |
| Group | 130.5 | 639.9 | 15.7 | 786.1 | 146.5 | 648.5 | 13.1 | 808.1 |
| Of which | | | | | | | | |
| Core | 129.4 | 617.6 | 7.2 | 754.2 | | | | |
| Non-Core | 1.1 | 22.3 | 8.5 | 31.9 | | | | |
| | 130.5 | 639.9 | 15.7 | 786.1 | | | | |

For notes to this table refer to page 175.

RBS Group – Annual Results 2010

Notes to statutory results (continued)

13. Financial instruments (continued)

Valuation hierarchy (continued)

The following table details AFS assets included in total assets on page 171.

| Assets | 31 December 2010 | | | | 31 December 2009 | | | |
|-----------------------------------|------------------|----------------|----------------|--------------|------------------|----------------|----------------|--------------|
| | Level 1 £bn | Level 2 £bn | Level 3 £bn | Total £bn | Level 1 £bn | Level 2 £bn | Level 3 £bn | Total £bn |
| Debt securities | | | | | | | | |
| - government | 53.0 | 6.4 | - | 59.4 | 58.3 | 6.6 | - | 64.9 |
| - MBS (1) | - | 31.1 | 0.4 | 31.5 | - | 38.6 | 0.2 | 38.8 |
| - CDOs (2) | - | 0.6 | 1.4 | 2.0 | - | 1.2 | 0.4 | 1.6 |
| - CLOs (3) | - | 3.5 | 1.5 | 5.0 | - | 5.4 | 0.1 | 5.5 |
| - other ABS (4) | - | 2.9 | 1.1 | 4.0 | - | 4.0 | 0.6 | 4.6 |
| - corporate | - | 2.0 | - | 2.0 | - | 2.5 | - | 2.5 |
| - banks and building societies | 0.1 | 7.1 | - | 7.2 | - | 7.4 | - | 7.4 |
| - other | - | - | - | - | - | 0.1 | - | 0.1 |
| | 53.1 | 53.6 | 4.4 | 111.1 | 58.3 | 65.8 | 1.3 | 125.4 |
| Equity shares | 0.3 | 1.4 | 0.3 | 2.0 | 0.3 | 1.6 | 0.7 | 2.6 |
| Group before RFS | | | | | | | | |
| MI | 53.4 | 55.0 | 4.7 | 113.1 | 58.6 | 67.4 | 2.0 | 128.0 |
| RFS MI (6) | - | - | - | - | 12.2 | 6.0 | - | 18.2 |
| Group | 53.4 | 55.0 | 4.7 | 113.1 | 70.8 | 73.4 | 2.0 | 146.2 |
| Of which | | | | | | | | |
| Core | 52.8 | 49.2 | 1.0 | 103.0 | | | | |
| Non-Core | 0.6 | 5.8 | 3.7 | 10.1 | | | | |
| | 53.4 | 55.0 | 4.7 | 113.1 | | | | |

For notes to this table refer to page 175.

RBS Group – Annual Results 2010

Notes to statutory results (continued)

13. Financial instruments (continued)

Valuation hierarchy (continued)

| Liabilities | 31 December 2010 | | | | 31 December 2009 | | | |
|----------------------------|------------------|----------------|----------------|--------------|------------------|----------------|----------------|--------------|
| | Level 1 £bn | Level 2 £bn | Level 3 £bn | Total £bn | Level 1 £bn | Level 2 £bn | Level 3 £bn | Total £bn |
| Deposits by banks | | | | | | | | |
| - repos | - | 20.6 | - | 20.6 | - | 21.0 | - | 21.0 |
| - collateral | - | 26.6 | - | 26.6 | - | 28.2 | - | 28.2 |
| - other | - | 1.6 | - | 1.6 | - | 4.4 | - | 4.4 |
| | - | 48.8 | - | 48.8 | - | 53.6 | - | 53.6 |
| Customer accounts | | | | | | | | |
| - repos | - | 53.0 | - | 53.0 | - | 41.5 | - | 41.5 |
| - collateral | - | 10.4 | - | 10.4 | - | 8.0 | - | 8.0 |
| - other | - | 8.7 | 0.1 | 8.8 | - | 8.4 | 0.1 | 8.5 |
| | - | 72.1 | 0.1 | 72.2 | - | 57.9 | 0.1 | 58.0 |
| Debt securities in issue | - | 49.0 | 2.2 | 51.2 | - | 43.1 | 2.3 | 45.4 |
| Short positions | 35.0 | 7.3 | 0.8 | 43.1 | 27.1 | 13.2 | 0.2 | 40.5 |
| Derivatives | | | | | | | | |
| - foreign exchange | 0.1 | 89.3 | - | 89.4 | - | 63.6 | - | 63.6 |
| - interest rate | 0.2 | 298.0 | 1.0 | 299.2 | 0.1 | 308.4 | 0.8 | 309.3 |
| - equities and commodities | 0.1 | 9.6 | 0.4 | 10.1 | 0.8 | 8.5 | 0.2 | 9.5 |
| - credit - other | - | 25.0 | 0.3 | 25.3 | - | 38.2 | 0.9 | 39.1 |
| | 0.4 | 421.9 | 1.7 | 424.0 | 0.9 | 418.7 | 1.9 | 421.5 |
| Other (7) | - | 1.1 | - | 1.1 | - | 1.3 | - | 1.3 |
| Group before RFS | | | | | | | | |
| MI | 35.4 | 600.2 | 4.8 | 640.4 | 28.0 | 587.8 | 4.5 | 620.3 |
| RFS MI (6) | - | - | - | - | 0.2 | 5.8 | 0.1 | 6.1 |
| Group | 35.4 | 600.2 | 4.8 | 640.4 | 28.2 | 593.6 | 4.6 | 626.4 |
| Of which | | | | | | | | |
| Core | 35.4 | 586.9 | 3.8 | 626.1 | | | | |
| Non-Core | - | 13.3 | 1.0 | 14.3 | | | | |

35.4 600.2 4.8 640.4

For notes to this table refer to page 175.

RBS Group – Annual Results 2010

Notes to statutory results (continued)

13. Financial instruments (continued)

Valuation hierarchy (continued)

| | 31 December 2010 | | | 31 December 2009 | | |
|--------------------------------|------------------|------------------|-----------------------|------------------|------------------|-----------------------|
| | Balance | Sensitivity | | Balance | Sensitivity | |
| | £bn | Favourable £m | Unfavourable(8) £m | £bn | Favourable £m | Unfavourable(8) £m |
| Assets | | | | | | |
| Loans and advances | 0.8 | 70 | (60) | 1.1 | 80 | (40) |
| Debt securities | | | | | | |
| - MBS (1) | 0.7 | 120 | (80) | 0.6 | 60 | (10) |
| - CDOs (2) | 2.4 | 180 | (20) | 1.0 | 130 | (80) |
| - CLOs (3) | 2.1 | 180 | (50) | 0.8 | 80 | (50) |
| - other ABS (4) | 1.4 | 150 | (80) | 0.9 | 120 | (40) |
| - corporate | 0.9 | 60 | (60) | 0.6 | 70 | (20) |
| - banks and building societies | 0.7 | 60 | (60) | 0.2 | 10 | (30) |
| | 8.2 | 750 | (350) | 4.1 | 470 | (230) |
| Equity shares | 1.0 | 160 | (160) | 1.3 | 260 | (200) |
| Derivatives | | | | | | |
| - foreign exchange | 0.1 | - | - | 0.2 | 10 | - |
| - interest rate | 1.7 | 150 | (140) | 1.5 | 80 | (100) |
| - equities and commodities | 0.2 | - | - | 0.3 | 20 | (20) |
| - credit - APS (5) | 0.6 | 860 | (940) | 1.4 | 1,370 | (1,540) |
| - credit - other | 3.1 | 320 | (170) | 3.0 | 420 | (360) |
| | 5.7 | 1,330 | (1,250) | 6.4 | 1,900 | (2,020) |
| Group before RFS MI | 15.7 | 2,310 | (1,820) | 12.9 | 2,710 | (2,490) |
| RFS MI (6) | - | - | - | 0.2 | 20 | (20) |
| Group | 15.7 | 2,310 | (1,820) | 13.1 | 2,730 | (2,510) |

Amounts classified as available-for-sale included above comprise:

| | 31 December 2010 | | | 31 December 2009 | | |
|------------|------------------|------------------|-----------------------|------------------|------------------|-----------------------|
| | Balance | Sensitivity | | Balance | Sensitivity | |
| | £bn | Favourable £m | Unfavourable(8) £m | £bn | Favourable £m | Unfavourable(8) £m |
| - MBS (1) | 0.4 | 10 | - | 0.2 | - | - |
| - CDOs (2) | 1.4 | 100 | (10) | 0.4 | 40 | (20) |
| - CLOs (3) | 1.5 | 110 | (10) | 0.1 | 10 | (10) |

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| | | | | | | |
|-----------------|-----|-----|-------|-----|-----|-------|
| - other ABS (4) | 1.1 | 80 | (40) | 0.6 | 40 | (20) |
| | 4.4 | 300 | (60) | 1.3 | 90 | (50) |
| Equity shares | 0.3 | 60 | (60) | 0.7 | 100 | (90) |
| Group | 4.7 | 360 | (120) | 2.0 | 190 | (140) |

For notes to this table refer to page 175.

RBS Group – Annual Results 2010

Notes on statutory results (continued)

13. Financial instruments (continued)

Valuation hierarchy (continued)

| | 31 December 2010 | | | 31 December 2009 | | |
|----------------------------|------------------|------------------|-----------------------|------------------|------------------|-----------------------|
| | Balance £bn | Favourable £m | Unfavourable(8) £m | Balance £bn | Favourable £m | Unfavourable(8) £m |
| Liabilities | | | | | | |
| Deposits | 0.1 | 60 | (60) | 0.1 | - | (10) |
| Debt securities in issue | 2.2 | 90 | (110) | 2.3 | 50 | (10) |
| Short positions | 0.8 | 20 | (50) | 0.2 | 10 | (20) |
| Derivatives | | | | | | |
| - foreign exchange | - | - | (10) | - | - | - |
| - interest rate | 1.0 | 70 | (90) | 0.8 | 40 | (60) |
| - equities and commodities | 0.4 | 10 | - | 0.2 | 20 | (70) |
| - credit | 0.3 | 40 | (40) | 0.9 | 80 | (100) |
| | 1.7 | 120 | (140) | 1.9 | 140 | (230) |
| Group before RFS MI | | | | | | |
| MI | 4.8 | 290 | (360) | 4.5 | 200 | (270) |
| RFS MI | - | - | - | 0.1 | - | - |
| Group | 4.8 | 290 | (360) | 4.6 | 200 | (270) |

Notes:

- (1) Mortgage-backed securities.
- (2) Collateralised debt obligations.
- (3) Collateralised loan obligation.
- (4) Asset-backed securities.
- (5) Asset Protection Scheme.
- (6) There were no RFS MI financial instruments carried at fair value at 31 December 2010. The RFS MI at 31 December 2009 comprised:
 - (a) Loans and advances of £0.6 billion in level 2;
 - (b) Debt securities of £18.2 billion of which £12.1 billion is in level 1 and £6.1 billion is in level 2;
 - (c) Equity shares of £3.5 billion of which £3.2 billion is in level 1, £0.1 billion in level 2 and £0.2 billion in level 3;
 - (d) Derivative assets of £3.3 billion of which £0.1 billion is in level 1 and £3.2 billion in level 2;
 - (e) Deposits of £3.4 billion in level 2;
 - (f) Debt securities in issue of £0.1 billion in level 1; and
 - (g)

Derivative liabilities of £2.6 billion of which £0.2 billion is in level 1, £2.3 billion in level 2 and £0.1 billion in level 3.

- (7) Comprises subordinated liabilities.
- (8) Sensitivity represents the reasonably possible favourable and unfavourable effect respectively on the income statement or the statement of comprehensive income due to reasonably possible changes to valuations using reasonably possible alternative inputs to the Group's valuation techniques or models.

The level 3 sensitivities above are calculated at a trade or low level portfolio basis. They are not calculated on an overall portfolio basis and therefore do not reflect a likely overall potential uncertainty on the whole portfolio. The figures are aggregated and do not reflect the correlated nature of some of the sensitivities. In particular for some of the portfolios the sensitivities may be negatively correlated where a downward movement in one asset would produce an upward move in another, but due to the additive presentation of the above disclosures this correlation can not be observed. For example, with assets in the APS scheme, the downwards sensitivity on the underlying asset would be materially offset by the consequent upward movement of the APS derivative, so whilst the net sensitivity of the two positions may be lower, it would be shown with the gross upside and downside sensitivity of the two assets inflating the overall sensitivity figures in the above table. The actual potential downside sensitivity of the total portfolio may be less than the non correlated sum of the additive figures as shown in the above table.

Notes on statutory results (continued)

13. Financial instruments (continued)

Valuation hierarchy (continued)

Key points (1)

- Total assets carried at fair value increased by £3.6 billion in the year to £786.1 billion at 31 December 2010, principally reflecting increases in reverse repos of £26.1 billion and collateral of £11.5 billion, offset by decreases in debt securities of £28.8 billion and derivatives of £11.1 billion.
- Total liabilities carried at fair value increased by £20.1 billion, with increases in repos of £11.1 billion, collateral of £0.8 billion, debt securities in issue of £5.8 billion and derivatives of £2.5 billion.
- Level 3 assets of £15.7 billion represented 2.0% (31 December 2009 - £12.9 billion and 1.6%) of total assets carried at fair value an increase of £2.8 billion, reflecting the movement of some lower quality AFS CDOs and CLOs in Non-Core in Q1 2010, where price discovery indicated uncertainty in observability. In addition, the use of more conservative internal recovery rates for the calculation of CVA for certain monolines resulted in these credit derivatives moving to level 3. This was partially offset by disposals in the third quarter of 2010 and tighter credit spreads. The fair value of APS credit derivative decreased from £1,400 million to £550 million primarily due to the reduction in overall assets covered by the scheme.
- Level 3 liabilities increased to £4.8 billion from £4.5 billion at 31 December 2009, mainly reflecting the impact of wider credit spreads on short positions.
- The favourable and unfavourable effects of reasonably possible alternative assumptions on financial instruments carried at fair value were £2,310 million and £(1,820) million respectively of which £860 million and £(940) million related to the APS credit derivative. The reduction in the APS sensitivity corresponds with a decrease in the overall value of the protection that the scheme provides.
- There were no significant transfers between level 1 and level 2.

Notes:

- (1) Key points are based on numbers before RFS MI.

Notes on statutory results (continued)

13. Financial instruments (continued)

Level 3 movement table

| 2010 | At 1 January 2010 | | Gains/(losses) recognised in the Income Statement (2) | | Transfers in/(out) of Level 3 | | Issuances | Purchases | Settlements | Sales | Foreign exchange | December 2010 | Gains/(losses) relating to instruments held at year end |
|-----------------------------|-------------------|--------------|---|--------------|-------------------------------|--------------|----------------|----------------|-------------|---------------|------------------|---------------|---|
| | £m | £m | £m | £m | £m | £m | | | | | | | |
| Assets | | | | | | | | | | | | | |
| FVTPL (1) | | | | | | | | | | | | | |
| Loans and advances | 1,059 | 169 | - | 10 | - | 169 | (451) | (165) | 52 | 843 | 38 | | |
| Debt securities | 2,782 | 294 | - | 1,770 | - | 1,973 | (386) | (2,682) | 33 | 3,784 | 154 | | |
| Equity shares | 711 | 414 | - | (26) | - | 654 | - | (1,027) | (10) | 716 | 54 | | |
| Derivatives | 6,429 | (1,561) | - | 1,728 | - | 948 | (299) | (1,534) | 26 | 5,737 | (1,556) | | |
| FVTPL assets | 10,981 | (684) | - | 3,482 | - | 3,744 | (1,136) | (5,408) | 101 | 11,080 | (1,310) | | |
| AFS | | | | | | | | | | | | | |
| Debt securities | 1,325 | 26 | 511 | 2,909 | - | 306 | (458) | (274) | 34 | 4,379 | 10 | | |
| Equity shares | 749 | (4) | (39) | (118) | - | 22 | (2) | (343) | 14 | 279 | (4) | | |
| AFS assets | 2,074 | 22 | 472 | 2,791 | - | 328 | (460) | (617) | 48 | 4,658 | 6 | | |
| | 13,055 | (662) | 472 | 6,273 | - | 4,072 | (1,596) | (6,025) | 149 | 15,738 | (1,304) | | |
| Liabilities | | | | | | | | | | | | | |
| Deposits | 103 | - | - | 11 | - | - | (32) | - | 2 | 84 | - | | |
| Debt securities in issue | 2,345 | 336 | - | (212) | 413 | - | (695) | - | 16 | 2,203 | 309 | | |
| Short positions | 184 | (187) | - | 792 | 6 | - | (2) | (16) | (1) | 776 | (179) | | |
| Derivatives | 1,987 | (258) | - | (152) | - | 318 | (175) | (27) | 47 | 1,740 | (187) | | |
| Other financial liabilities | 1 | - | - | - | - | - | - | - | - | 1 | - | | |
| | 4,620 | (109) | - | 439 | 419 | 318 | (904) | (43) | 64 | 4,804 | (57) | | |

For the notes to this table refer to page 178.

RBS Group – Annual Results 2010

Notes on statutory results (continued)

13. Financial instruments (continued)

Level 3 movement table (continued)

| 2009 | Gains/(losses) | | | | | | | | At 31 December 2009 £m | Gains/(losses) relating to instruments held at year end £m |
|-----------------------------------|----------------------------------|---|-------------------|--|------------------------|-------------------------------------|--------------------------------|---------------------------|------------------------------------|---|
| | At 1 January 2009 £m | recognised in the Income statement £m | SOCI (2) £m | Transfers in/(out) of Level 3 £m | Reclassification £m | Purchases and issuances £m | Sales and settlements £m | Foreign exchange £m | | |
| Assets | | | | | | | | | | |
| FVTPL (1) | | | | | | | | | | |
| Loans and advances | 3,148 | 130 | - | 330 | (1,537) | 22 | (898) | (136) | 1,059 | 11 |
| Debt securities | 3,846 | (49) | - | 104 | (157) | 378 | (1,207) | (133) | 2,782 | (165) |
| Equity shares | 793 | (49) | - | 133 | - | 22 | (151) | (37) | 711 | (48) |
| Derivatives | 10,265 | (3,672) | - | (211) | - | 1,811 | (1,301) | (463) | 6,429 | (1,079) |
| FVTPL assets | 18,052 | (3,640) | - | 356 | (1,694) | 2,233 | (3,557) | (769) | 10,981 | (1,281) |
| AFS | | | | | | | | | | |
| Debt securities | 3,102 | (329) | (47) | (929) | - | 128 | (491) | (109) | 1,325 | (9) |
| Equity shares | 325 | (128) | (13) | 632 | - | 53 | (75) | (45) | 749 | (51) |
| AFS assets | 3,427 | (457) | (60) | (297) | - | 181 | (566) | (154) | 2,074 | (60) |
| | 21,479 | (4,097) | (60) | 59 | (1,694) | 2,414 | (4,123) | (923) | 13,055 | (1,341) |
| Liabilities | | | | | | | | | | |
| Deposits | 290 | 43 | - | (217) | - | 15 | (23) | (5) | 103 | - |
| Debt securities in issue | 4,362 | 57 | - | (1,682) | - | 493 | (638) | (247) | 2,345 | (41) |
| Short positions | 41 | (45) | - | 188 | - | 4 | (4) | - | 184 | 12 |
| Derivatives | 4,035 | (215) | - | (978) | - | 76 | (744) | (187) | 1,987 | (244) |
| Other financial liabilities | 257 | - | - | - | - | - | (242) | (14) | 1 | - |
| | 8,985 | (160) | - | (2,689) | - | 588 | (1,651) | (453) | 4,620 | (273) |

Notes:

- (1) Fair value through profit or loss.
- (2) Statement of comprehensive income.

RBS Group – Annual Results 2010

Notes on statutory results (continued)

14. Debt securities

The following table analyses debt securities by measurement classification.

| Measurement classification | Central and local government | | | Banks and building societies | ABS | (1) Corporate | Other | Group before | RFS | MI | Group |
|----------------------------|------------------------------|----------|-------------|------------------------------|--------|---------------|-------|--------------|----------|----------|---------|
| | UK £m | US £m | Other £m | £m | £m | £m | £m | RFS £m | MI £m | MI £m | £m |
| 31 December 2010 | | | | | | | | | | | |
| HFT | 5,097 | 15,956 | 43,224 | 5,778 | 21,988 | 6,590 | 236 | 98,869 | - | - | 98,869 |
| DFV (2) | 1 | - | 262 | 3 | 119 | 16 | 1 | 402 | - | - | 402 |
| AFS | 8,377 | 17,890 | 33,122 | 7,198 | 42,515 | 2,011 | 17 | 111,130 | - | - | 111,130 |
| LAR | 11 | - | - | 15 | 6,203 | 848 | 2 | 7,079 | - | - | 7,079 |
| | 13,486 | 33,846 | 76,608 | 12,994 | 70,825 | 9,465 | 256 | 217,480 | - | - | 217,480 |
| 31 December 2009 | | | | | | | | | | | |
| HFT | 8,128 | 10,427 | 50,150 | 6,103 | 28,820 | 6,892 | 893 | 111,413 | 69 | 111,482 | |
| DFV (2) | 122 | 3 | 385 | 418 | 394 | 1,087 | 20 | 2,429 | 174 | 2,603 | |
| AFS | 18,350 | 12,789 | 33,727 | 7,472 | 50,464 | 2,550 | 30 | 125,382 | 17,916 | 143,298 | |
| LAR | 1 | - | - | - | 7,924 | 1,853 | 93 | 9,871 | - | - | 9,871 |
| | 26,601 | 23,219 | 84,262 | 13,993 | 87,602 | 12,382 | 1,036 | 249,095 | 18,159 | 267,254 | |

Notes:

- (1) Asset-backed securities.
(2) Designated as at fair value.

Refer to the Risk and balance sheet management section for information on ratings.

RBS Group – Annual Results 2010

Notes to statutory results (continued)

15. Derivatives

| | 31 December 2010 | | 31 December 2009 | |
|--------------------------------|------------------|-------------------|------------------|-------------------|
| | Assets £m | Liabilities £m | Assets £m | Liabilities £m |
| Exchange rate contracts | | | | |
| Spot, forwards and futures | 39,859 | 41,424 | 26,559 | 24,763 |
| Currency swaps | 28,696 | 34,328 | 25,221 | 23,337 |
| Options purchased | 14,698 | - | 16,572 | - |
| Options written | - | 13,623 | - | 15,499 |
| Interest rate contracts | | | | |
| Interest rate swaps | 251,312 | 243,807 | 263,902 | 251,829 |
| Options purchased | 57,359 | - | 55,471 | - |
| Options written | - | 54,141 | - | 55,462 |
| Futures and forwards | 3,060 | 1,261 | 2,088 | 2,033 |
| Credit derivatives | 26,872 | 25,344 | 41,748 | 39,127 |
| Equity and commodity contracts | 5,221 | 10,039 | 6,638 | 9,484 |
| Group before RFS MI | 427,077 | 423,967 | 438,199 | 421,534 |
| RFS MI | - | - | 3,255 | 2,607 |
| Group | 427,077 | 423,967 | 441,454 | 424,141 |

The Group enters into master netting agreements in respect of its derivative activities. These arrangements, which give the Group a legal right to set-off derivative assets and liabilities with the same counterparty, do not result in a net presentation in the Group's balance sheet for which IFRS requires an intention to settle net or to realise the asset and settle the liability simultaneously, as well as a legally enforceable right to set-off. They are, however, effective in reducing the Group's credit exposure from derivative assets. The Group has executed master netting agreements with the majority of its derivative counterparties resulting in a significant reduction in its net exposure to derivative assets. Of the £427 billion derivative assets shown above, £330 billion (31 December 2009 - £359 billion) were subject to such agreements. Furthermore, the Group holds cash collateral of £31.1 billion (31 December 2009 - £33.7 billion) against this net derivative asset exposure, refer to page 113 of the Risk and balance sheet management section.

Notes to statutory results (continued)

16. Available-for-sale financial assets

Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs and are subsequently measured at fair value with changes in fair value reported in shareholders' equity until disposal, at which stage the cumulative gain or loss is recognised in profit or loss. When there is objective evidence that an available-for-sale financial asset is impaired, any decline in its fair value below original cost is removed from equity and recognised in profit or loss.

Impairment losses are recognised when there is objective evidence of impairment. The Group reviews its portfolios of available-for-sale financial assets for such evidence which includes: default or delinquency in interest or principal payments; significant financial difficulty of the issuer or obligor; and it becoming probable that the issuer will enter bankruptcy or other financial reorganisation. However, the disappearance of an active market because an entity's financial instruments are no longer publicly traded is not evidence of impairment. Furthermore, a downgrade of an entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortised cost is not necessarily evidence of impairment. Determining whether objective evidence of impairment exists requires the exercise of management judgment. The unrecognised losses on the Group's available-for-sale debt securities are concentrated in its portfolios of mortgage-backed securities. The losses reflect the widening of credit spreads as a result of the reduced market liquidity in these securities and the current uncertain macroeconomic outlook in the US and Europe. The underlying securities remain unimpaired.

During 2010 gains were realised by US Retail & Commercial (£260 million) and RBS N.V. (£237 million). The gain in US Retail & Commercial, which was principally part of its balance sheet restructuring exercise, was largely offset in the income statement by losses crystallised on the termination of swaps hedging fixed-rate funding related hedges.

| | 2010 | 2009 |
|---|---------|---------|
| | £m | £m |
| Available-for-sale reserve | | |
| At beginning of year | (1,755) | (3,561) |
| Unrealised gains | 179 | 1,202 |
| Realised (gains)/losses | (519) | 981 |
| Tax | 74 | (377) |
| Recycled to profit or loss on disposal of businesses, net of £5 million tax | (16) | - |
| At end of year | (2,037) | (1,755) |

The above excludes losses attributable to the non-controlling interest of RFS minority interests of £28 million (2009 – £169 million gain).

Notes on statutory results (continued)

17. Capital resources

The Group's regulatory capital resources in accordance with Financial Services Authority (FSA) definitions were as follows:

| | 2010 | 2009 |
|--|----------|----------|
| | £m | £m |
| Composition of regulatory capital | | |
| Tier 1 | | |
| Ordinary and B shareholders' equity | 70,388 | 69,890 |
| Non-controlling interests | 1,719 | 16,895 |
| Adjustments for: | | |
| - goodwill and other intangible assets – continuing businesses | (14,448) | (17,847) |
| - goodwill and other intangible assets – discontinued businesses | - | (238) |
| - unrealised losses on available-for-sale (AFS) debt securities | 2,061 | 1,888 |
| - reserves arising on revaluation of property and unrealised gains on AFS equities | (25) | (207) |
| - reallocation of preference shares and innovative securities | (548) | (656) |
| - other regulatory adjustments * | (1,097) | (1,184) |
| Less excess of expected losses over provisions net of tax | (1,900) | (2,558) |
| Less securitisation positions | (2,321) | (1,353) |
| Less APS first loss | (4,225) | (5,106) |
| Core Tier 1 capital | 49,604 | 59,524 |
| Preference shares | 5,410 | 11,265 |
| Innovative Tier 1 securities | 4,662 | 5,213 |
| Tax on the excess of expected losses over provisions | 758 | 1,020 |
| Less material holdings | (310) | (601) |
| Total Tier 1 capital | 60,124 | 76,421 |
| Tier 2 | | |
| Reserves arising on revaluation of property and unrealised gains on AFS equities | 25 | 207 |
| Collective impairment provisions | 778 | 796 |
| Perpetual subordinated debt | 1,852 | 4,950 |
| Term subordinated debt | 16,745 | 20,063 |
| Non-controlling and other interests in Tier 2 capital | 11 | 11 |
| Less excess of expected losses over provisions | (2,658) | (3,578) |
| | | (1,353) |
| Less securitisation positions | (2,321) | (1,353) |
| Less material holdings | (310) | (601) |
| Less APS first loss | (4,225) | (5,106) |
| Total Tier 2 capital | 9,897 | 15,389 |
| Supervisory deductions | | |

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| | | |
|--|---------|---------|
| Unconsolidated investments | | |
| - RBS Insurance | (3,962) | (4,068) |
| - other investments | (318) | (404) |
| Other deductions | (452) | (93) |
| Deductions from total capital | (4,732) | (4,565) |
| Total regulatory capital | 65,289 | 87,245 |
| * Includes reduction for own liabilities carried at fair value | (1,182) | (1,057) |

RBS Group – Annual Results 2010

Notes on statutory results (continued)

18. Contingent liabilities and commitments

| | 2010 | 2009 |
|---|---------|---------|
| | £m | £m |
| Contingent liabilities | | |
| Guarantees and assets pledged as collateral security | 31,070 | 36,579 |
| Other contingent liabilities | 12,253 | 13,410 |
| | 43,323 | 49,989 |
| Commitments | | |
| Undrawn formal standby facilities, credit lines and other commitments to lend | | |
| - less than one year | 117,581 | 126,961 |
| - one year and over | 149,241 | 162,174 |
| Other commitments | 4,154 | 3,483 |
| | 270,976 | 292,618 |
| Group before RFS Holdings minority interest | 314,299 | 342,607 |
| RFS Holdings minority interest (1) | 32 | 9,054 |
| Total contingent liabilities and commitments | 314,331 | 351,661 |

Note:

- (1) RFS Holdings minority interest contingent liabilities and commitments of £32 million at 31 December 2010 (2009 - £9,054 million) comprised:
- (a) Guarantees of £31 million (2009 - £3,429 million);
 - (b) Other contingent liabilities of £1 million (2009 - £602 million);
 - (c) There were no undrawn formal standby facilities, credit lines and other commitments to lend (2009 - £2,499 million); and
 - (d) There were no other commitments (2009 - £2,524 million).

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.

19. Litigation

As a participant in the financial services industry, RBS Group operates in a legal and regulatory environment that exposes it to potentially significant litigation risks. As a result, the company and other members of RBS Group are involved in various disputes and legal proceedings in the United Kingdom, the United States and other jurisdictions, including litigation. Such cases are subject to many uncertainties, and their outcome is often difficult to predict, particularly in the earlier stages of a case.

Other than as set out in this section "Litigation", so far as RBS Group is aware, no member of RBS Group is or has been engaged in or has pending or threatened any governmental, legal or arbitration proceedings which may have or have had in the recent past (covering the 12 months immediately preceding the date of this document) a significant effect

on RBS Group's financial position or profitability.

RBS Group – Annual Results 2010

Notes on statutory results (continued)

19. Litigation (continued)

Unarranged overdraft charges

In the US, Citizens Financial Group, in common with other US banks, has been named as a defendant in a class action asserting that Citizens charges excessive overdraft fees. The plaintiffs claim that overdraft fees resulting from point of sale and automated teller machine (ATM) transactions violate the duty of good faith implied in Citizens' customer account agreement and constitute an unfair trade practice. RBS Group considers that it has substantial and credible legal and factual defences to these claims and will defend them vigorously. RBS Group is unable reliably to estimate the liability, if any, that might arise or its effect on RBS Group's consolidated net assets, operating results or cash flows in any particular period.

Shareholder litigation

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

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

On 11 January 2011, the District Court dismissed all claims except those based on the purchase of RBSG Series Q, R, S, T, and/or U non-cumulative dollar preference shares. The Court has not yet considered potential grounds for dismissal of the remaining claims, and directed RBS Group to re-file its motion to dismiss those claims within 45 days of its ruling. On 28 January 2011, a new complaint was filed asserting claims under Sections 10 and 20 of the Exchange Act on behalf of a putative class of purchasers of ADRs.

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

RBS Group considers that it has substantial and credible legal and factual defences to the remaining and prospective claims and will defend them vigorously. RBS Group is unable to reliably estimate the liability, if any, that might arise or its effect on RBS Group's consolidated net assets, operating results or cash flows in any particular period.

RBS Group – Annual Results 2010

Notes on statutory results (continued)

19. Litigation (continued)

Other securitisation and securities related litigation in the United States

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

World Online International N.V.

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

Madoff

In December 2010, Irving Picard, as trustee for the bankruptcy estates of Bernard L. Madoff and Bernard L. Madoff Investment Securities LLC filed a claim against RBS NV for \$270 million. This is a clawback action similar to claims filed against six other institutions in December. RBS NV (or its subsidiaries) invested in Madoff funds through feeder funds. The Trustee alleges that RBS NV received \$71 million in redemptions from the feeder funds and \$200 million from its swap counterparties while RBS NV “knew or should have known of Madoff’s possible fraud.” The Trustee alleges that those transfers were preferences or fraudulent conveyances under the US bankruptcy code and New York law and he asserts the purported right to claw them back for the benefit of Madoff’s estate. RBS Group considers that it has substantial and credible legal and factual defences to the claim and intends to defend it vigorously.

Summary of other disputes, legal proceedings and litigation

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

RBS Group – Annual Results 2010

Notes on statutory results (continued)

20. Investigations

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

Political and regulatory scrutiny of the operation of retail banking and consumer credit industries in the United Kingdom and elsewhere continues. The nature and impact of future changes in policies and regulatory action are not predictable and are beyond RBS Group's control but could have a significant effect on RBS Group's businesses and earnings.

Retail banking

In the European Union, regulatory actions included an inquiry into retail banking initiated on 13 June 2005 in all of the then 25 member states by the European Commission's Directorate General for Competition. The inquiry examined retail banking in Europe generally. On 31 January 2007, the European Commission (EC) announced that barriers to competition in certain areas of retail banking, payment cards and payment systems in the European Union had been identified. The EC indicated that it will consider using its powers to address these barriers and will encourage national competition authorities to enforce European and national competition laws where appropriate. In addition, in late 2010, the EC launched an initiative pressing for increased transparency of bank fees.

Multilateral interchange fees

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

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

Notes on statutory results (continued)

20. Investigations (continued)

Multilateral interchange fees (continued)

Visa's cross-border MIFs were exempted in 2002 by the EC for a period of five years up to 31 December 2007 subject to certain conditions. On 26 March 2008, the EC opened a formal inquiry into Visa's current MIF arrangements for cross border payment card transactions with Visa branded debit and consumer credit cards in the European Union and on 6 April 2009 the EC announced that it had issued Visa with a formal Statement of Objections. At the same time Visa announced changes to its interchange levels and introduced some changes to enhance transparency. There is no deadline for the closure of the inquiry. However, on 26 April 2010 Visa announced it had reached an agreement with the EC as regards immediate cross border debit card MIF rates only and in December 2010 the commitments were finalised for a four year period commencing December 2010 under Article 9 of Regulation 1/2003. The EC is continuing its investigations into Visa's cross border MIF arrangements for deferred debit and credit transactions.

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

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

Payment Protection Insurance

Having conducted a market study relating to Payment Protection Insurance (PPI), on 7 February 2007 the OFT referred the PPI market to the Competition Commission (CC) for an in-depth inquiry. The CC published its final report on 29 January 2009 and announced its intention to order a range of remedies, including a prohibition on actively selling PPI at point of sale of the credit product (and for 7 days thereafter), a ban on single premium policies and other measures to increase transparency (in order to improve customers' ability to search and improve price competition). Barclays Bank PLC subsequently appealed certain CC findings to the CAT. On 16 October 2009, the CAT handed down a judgment quashing the ban on selling PPI at the point of sale of credit products and remitted the matter back to the CC for review. On 14 May 2010, the CC published its Provisional Decision following its review of remedies in the PPI market indicating that the CC still intends to impose a prohibition on selling PPI at point of sale of the credit product. On 14 October 2010, the CC published its final decision on remedies following the remittal which confirmed the point of sale prohibition. The CC intends to make the final order in the first quarter of 2011, with the key measures coming into force in October 2011 and April 2012.

RBS Group – Annual Results 2010

Notes on statutory results (continued)

20. Investigations (continued)

Payment Protection Insurance (continued)

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

Following unsuccessful negotiations with the industry, the FSA issued consultation papers on PPI complaint handling and redress in September 2009 and again in March 2010. The FSA published its final policy statement on 10 August 2010 and instructed firms to implement the measures contained in it by 1 December 2010. The new rules impose significant changes with respect to the handling of mis-selling PPI complaints. On 8 October 2010, the British Bankers' Association filed an application for judicial review of the FSA's policy statement and of related guidance issued by the FOS. The court hearing took place from 25 to 28 January 2011 and judgment is awaited. RBS Group is unable to reliably estimate the liability, if any, that might arise from this litigation or its effect on RBS Group's consolidated net assets, operating results or cash flows in any particular period. Separately, discussions continue between the FSA and RBS Group in respect of concerns expressed by the FSA over certain categories of historical PPI sales.

Personal current accounts

On 16 July 2008, the OFT published the results of its market study into Personal Current Accounts (PCA) in the United Kingdom. The OFT found evidence of competition and several positive features in the personal current account market but believed that the market as a whole was not working well for consumers and that the ability of the market to function well had become distorted.

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

On 22 December 2009, the OFT published a further report in which it stated that it continued to have significant concerns about the operation of the personal current account market in the United Kingdom, in particular in relation to unarranged overdrafts, and that it believed that fundamental changes are required for the market to work in the best interests of bank customers. The OFT stated that it would discuss these issues intensively with banks, consumer groups and other organisations, with the aim of reporting on progress by the end of March 2010. On 16 March 2010, the OFT announced that it had secured agreement from the banks on four industry-wide initiatives, namely 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 its plan to conduct six-monthly ongoing reviews, to fully review the market again in 2012 and to undertake a brief analysis on barriers to entry.

Notes on statutory results (continued)

20. Investigations (continued)

Personal current accounts (continued)

The first six-monthly ongoing review was completed in September 2010. The OFT noted progress in the areas of switching, transparency and unarranged overdrafts for the period March to September 2010, as well as highlighting further changes the OFT expects to see in the market. The next progress report is expected to be published by the OFT in March 2011.

On 26 May 2010, the OFT announced its review of barriers to entry. The review concerns retail banking for individuals and small and medium size enterprises (up to £25 million turnover) and will look at products which require a banking licence to sell mortgages, loan products and, where appropriate, other products such as insurance or credit cards where cross-selling may facilitate entry or expansion. The OFT published its report in November 2010. It advised that it expected its review to be relevant to the Independent Commission on Banking, the FSA, HM Treasury and the Department for Business, Innovation and Skills and to the devolved governments in the United Kingdom. The OFT has not indicated whether it will undertake any further work. The report maintained that barriers to entry remain, in particular regarding switching, branch networks and brands. At this stage, it is not possible to estimate the effect of the OFT's report and recommendations regarding barriers to entry upon RBS Group.

Equity underwriting

On 10 June 2010, the OFT announced its intention to conduct a market study into equity underwriting and related services and sought views on scope by 9 July 2010. The OFT study was formally launched on 6 August 2010. The OFT undertook to examine the underwriting services for the different types of share issue used by FTSE 350 firms to raise capital in the UK including rights issues, placings and follow-on offers but excluding initial public offerings. The OFT has been looking at the way that the market works and the following three key issues: (i) how underwriting services are purchased; (ii) how underwriting services are provided; and (iii) how the regulatory environment affects the provision of underwriting services. The OFT published its report on 27 January 2011 identifying certain concerns around the level of equity underwriting fees. The OFT has identified a number of options which would enable companies and institutional shareholders to address these concerns and allow them to drive greater competition in the market. It is currently consulting on its provisional decision not to refer the market to the CC. RBS Group is engaged in the OFT market study and it is not possible to estimate with any certainty what effect this study and any related developments may have on RBS Group, its business or results of operations.

Independent Commission on Banking

On 16 June 2010, HM Treasury published the terms of reference for the Government's Independent Commission on Banking (ICB). The ICB is considering the structure of the United Kingdom banking sector and is looking at structural and non-structural measures to reform the banking system and to promote competition. It is mandated to formulate policy recommendations with a view to: (i) reducing systemic risk in the banking sector, exploring the risk posed by banks of different size, scale and function; (ii) mitigating moral hazard in the banking system; (iii) reducing the likelihood and impact of a bank's failure; and (iv) promoting competition in retail and investment banking with a view to ensuring that the needs of banks' customers are served efficiently and considering the extent to which large banks can gain competitive advantage from being perceived as "too big to fail".

Notes on statutory results (continued)

20. Investigations (continued)

Independent Commission on Banking (continued)

The ICB reports to the Cabinet Committee on Banking Reform and is required to produce a final report by the end of September 2011. RBS Group has responded to the call for evidence by the ICB. In addition it has attended a private hearing, as well as public hearings in Edinburgh and Cardiff in December 2010. An issues paper by the ICB is expected in spring 2011. At this stage it is not possible to estimate the effect of the ICB's report and recommendations upon RBS Group, if any.

US dollar clearing activities

In May 2010, following a criminal investigation by the United States Department of Justice (DoJ) into its dollar clearing activities, Office of Foreign Assets Control compliance procedures and other Bank Secrecy Act compliance matters, RBS NV formally entered into a Deferred Prosecution Agreement (DPA) with the DoJ resolving the investigation. The investigation was in relation to activities before the Consortium Members acquired ABN AMRO Holding N.V. (now known as RBS Holdings N.V.). The agreement was signed by RBS NV and is binding on that entity and its subsidiaries. Pursuant to the DPA, RBS NV paid a penalty of US\$500 million and agreed that it will comply with the terms of the DPA and continue to co-operate fully with any further investigations. Payment of the penalty was made from a provision established in April 2007 when an agreement in principle to settle was first announced. Upon satisfaction of the conditions of the DPA for the period of 12 months from May 2010, the matter will be fully resolved. Failure to comply with the terms of the DPA during the 12 month period could result in the DoJ recommencing its investigations, the outcome of which would be uncertain and could result in public censure and fines or have an adverse effect on RBS Holdings N.V.'s operations, any of which could have a material adverse effect on its business, reputation, results of operation and financial condition.

Securitisation and collateralised debt obligation business

In September and October 2010, the SEC requested voluntary production of information concerning residential mortgage backed securities underwritten by subsidiaries of RBS Group during the period from September 2006 to July 2007 inclusive. In November 2010, the SEC commenced formal proceedings and requested testimony from RBS employees. The investigation is in its preliminary stages and it is difficult to predict any potential exposure that may result.

In June 2009, in connection with an investigation into the role of investment banks in the origination and securitisation of sub prime loans in Massachusetts, the Massachusetts Attorney General issued subpoenas to various banks, including an RBS Group subsidiary, seeking information related to residential mortgage lending practices and sales and securitisation of residential mortgage loans. This investigation is ongoing and RBS Group is co-operating.

RBS Group – Annual Results 2010

Notes on statutory results (continued)

20. Investigations (continued)

Securitisation and collateralised debt obligation business (continued)

Previously, in 2008, 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 as part of the due diligence process from the independent due diligence firms. RBS Group completed its production of documents requested by the New York State Attorney General in 2009, principally producing documents related to loans that were pooled into one securitisation transaction. More recently, in September 2010, RBS Group subsidiaries received a request from the Nevada State Attorney General requesting information related to securitisations of mortgages issued by three specific originators. The investigation by the Nevada Attorney General is in the early stages and therefore it is difficult to predict the potential exposure from any such investigation. RBS Group and its subsidiaries are co-operating with these various investigations and requests.

US mortgages

RBS's Global Banking & Markets N.A. (GBM N.A.), 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). GBM N.A. 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, GBM N.A. 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, GBM N.A. made such representations and warranties itself. Where GBM N.A. has given those or other representations and warranties (whether relating to underlying loans or otherwise), GBM N.A. 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, GBM N.A. may be able to assert claims against third parties who provided representations or warranties to GBM N.A. when selling loans to it; although the ability to make recoveries against such parties and outcome of such claims would be uncertain. During the two-year period ended 31 December 2010, GBM N.A. has received approximately US\$38 million in repurchase demands in respect of loans made and related securities sold where obligations in respect of contractual representations or warranties were undertaken by GBM N.A.. However, repurchase demands presented to GBM N.A. are subject to challenge and, to date, GBM N.A. has rebutted a significant percentage of these claims.

GBM N.A. has been named as a defendant in a number of suits relating to its role as issuer and underwriter of RMBS (See Note 19). Those lawsuits are in their early stages and we are not able to predict the outcome of such proceedings or their effect on the Group.

RBS Group – Annual Results 2010

Notes on statutory results (continued)

20. Investigations (continued)

US mortgages (continued)

Citizens Financial Group (CFG) has not been an issuer or underwriter of non-agency RMBS. However, CFG 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, CFG 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. During the two-year period ended 31 December 2010, CFG has received approximately US\$26 million in repurchase demands in respect of loans originated. However, repurchase demands presented to CFG are subject to challenge and, to date, CFG has rebutted a significant percentage of these claims.

Although there has 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) over the last year (including as a result of interventions by certain states and local governments), to date, CFG has not been materially impacted by such disruptions and the Group has not ceased making foreclosures.

The Group cannot estimate what the future level of repurchase demands or ultimate exposure of GBM N.A. or CFG may be, and cannot give any assurance that the historical experience will continue in the future. Furthermore, the Group is unable estimate the extent to which the matters described above will impact it and future developments may have an adverse impact on the Group's business, financial condition, results of operations, cash flow and the value of its securities.

Other investigations

In April 2009, the FSA notified RBS Group that it was commencing a supervisory review of the acquisition of ABN AMRO in 2007 and the 2008 capital raisings and an investigation into conduct, systems and controls within the Global Banking & Markets division of RBS Group. RBS Group and its subsidiaries co-operated fully with this review and investigation. On 2 December 2010, the FSA confirmed that it had completed its investigation and had concluded that no enforcement action, either against RBS Group or against individuals, was warranted. RBS Group is engaging constructively with the FSA with regard to the publication of a report by the FSA relating to the supervisory review, subject to any necessary commercial constraints.

In July 2010, the FSA notified RBS Group that it was commencing an investigation into the sale by Coutts & Co of ALICO (American Life Insurance Company) Premier Access Bond Enhanced Variable Rate Fund to customers between 2001 and 2008 as well as its subsequent review of those sales. On 11 January 2011 the FSA amended the date range on which their investigation is focused and the investigation start date is now December 2003. RBS Group and its subsidiaries are co-operating fully with this investigation.

RBS Group – Annual Results 2010

Notes on statutory results (continued)

20. Investigations (continued)

Other investigations (continued)

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

The Federal Reserve and state banking supervisors have been reviewing RBS Group's US operations and RBS Group and its subsidiaries have been required to make improvements with respect to various matters, including enterprise-wide governance, Bank Secrecy Act and anti-money laundering compliance, risk management and asset quality. RBS Group is in the process of implementing measures for matters identified to date. RBS Group may become subject to formal and informal supervisory actions and may be required by its US banking supervisors to take further actions and implement additional remedial measures with respect to these and additional matters. Any limitations or conditions placed on RBS Group's activities in the United States, as well as the terms of any supervisory action applicable to RBS Group and its subsidiaries, could have a material adverse effect on RBS Group's business, results of operations and financial condition.

21. The Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS), the UK's statutory fund of last resort for customers of authorised financial services firms, pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the industry. In relation to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year (which runs from 1 April to 31 March), subject to annual maxima set by the Financial Services Authority (FSA). In addition, the FSCS has the power to raise levies ('exit levies') on firms who have ceased to participate in the scheme and are in the process of ceasing to be authorised for the amount that the firm would otherwise have been asked to pay during the relevant levy year. The FSCS also has the power to raise exit levies on such firms which look at their potential liability to pay levies in future years.

FSCS has borrowed from HM Treasury to fund the compensation costs associated with Bradford & Bingley, Heritable Bank, Kaupthing Singer & Friedlander, Landsbanki 'Icesave' and London Scottish Bank plc. These borrowings are on an interest-only basis until 31 March 2012. The annual limit on the FSCS interest and management expenses levy for the period September 2008 to March 2012 in relation to these institutions has been capped at £1 billion per annum.

RBS Group – Annual Results 2010

Notes on statutory results (continued)

21. The Financial Services Compensation Scheme (continued)

The FSCS will receive funds from asset sales, surplus cash flow, or other recoveries in relation to these institutions which will be used to reduce the principal amount of the FSCS's borrowings. After the interest only period a schedule for repayment of any outstanding borrowings will be agreed between the FSCS and HM Treasury in the light of market conditions at that time and the FSCS will begin to raise compensation levies (principal repayments). No provision has been made for these levies as the amount is not yet known.

The Group has accrued £144.4 million for its share of FSCS management expenses levies for the 2010/11 and 2011/12 scheme years.

22. Gender equality in insurance contracts

A ruling is expected in March 2011 from the European Court of Justice (ECJ) in a case relating to gender equality in the pricing of and the provision of benefits under insurance contracts and whether a person's gender can be used as one of the factors in calculating insurance premiums. At this stage, it is not possible to estimate the effect, if any, which the ECJ's ruling may have on the Group.

23. Date of approval

This announcement was approved by the Board of directors on 23 February 2011.

24. Post balance sheet events

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

RBS Group – Annual Results 2010

Average balance sheet – statutory

| | 2010 | | | 2009 | | |
|----------------------------------|--------------------------|----------------|-----------|--------------------------|----------------|-----------|
| | Average balance £m | Interest £m | Rate % | Average balance £m | Interest £m | Rate % |
| Assets | | | | | | |
| Interest-earning assets | | | | | | |
| – | | | | | | |
| banking business | 690,983 | 22,703 | 3.29 | 752,495 | 26,377 | 3.51 |
| Trading business | 276,330 | | | 291,092 | | |
| Non-interest earning assets | | | | | | |
| | 704,891 | | | 979,893 | | |
| Total assets | 1,672,204 | | | 2,023,480 | | |
| Liabilities | | | | | | |
| Interest-bearing liabilities – | | | | | | |
| banking business | 600,160 | 8,856 | 1.48 | 676,390 | 13,273 | 1.96 |
| Trading business | 293,993 | | | 331,380 | | |
| Non-interest-bearing liabilities | | | | | | |
| - demand deposits | 53,016 | | | 43,605 | | |
| - other liabilities | 648,129 | | | 914,802 | | |
| Shareholders' equity | 76,906 | | | 57,303 | | |
| Total liabilities | 1,672,204 | | | 2,023,480 | | |

| | 2010 % | 2009 % |
|---|-----------|-----------|
| Average yields, spreads and margins of the banking business | | |
| Gross yield on interest-earning assets of banking business | 3.29 | 3.51 |
| Cost of interest-bearing liabilities of banking business | (1.48) | (1.96) |
| Interest spread of banking business | 1.81 | 1.55 |
| Benefit from interest-free funds | 0.19 | 0.19 |
| Net interest margin of banking business | 2.00 | 1.74 |

Notes:

- (1) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.
- (2) Interest-earning assets and interest-bearing liabilities exclude the Retail bancassurance long-term assets and liabilities, attributable to policyholders, in view

of their distinct nature. As a result, interest income has been increased by £6 million (2009 - £20 million).

- (3) Changes in the fair value of interest-bearing financial instruments designated as at fair value through profit or loss are recorded in other operating income in the consolidated income statement. In the average balance sheet shown above, interest includes increased interest income and decreased interest expense related to these instruments of £11 million (2009 - increased by £46 million) and £30 million (2009 - increased by £350 million) respectively and the average balances have been adjusted accordingly.
- (4) Interest receivable has been decreased by £90 million in respect of a non-recurring receivable.
- (5) Interest payable has been increased by £319 million in respect of a non-recurring adjustment.

RBS Group – Annual Results 2010

Capital resources and ratios – statutory

| | 2010 | 2009 |
|---|-----------|-----------|
| | £m | £m |
| Capital base | | |
| Core Tier 1 capital | 49,604 | 59,524 |
| Preference shares and tax deductible securities | 10,072 | 16,478 |
| Deductions from Tier 1 capital net of tax credit on expected losses | 448 | 419 |
| Tier 1 capital | 60,124 | 76,421 |
| Tier 2 capital | 9,897 | 15,389 |
| | 70,021 | 91,810 |
| Less: Supervisory deductions | (4,732) | (4,565) |
| Total regulatory capital | 65,289 | 87,245 |
| Risk-weighted assets | | |
| Credit risk | 385,900 | 513,200 |
| Counterparty risk | 68,100 | 56,500 |
| Market risk | 80,000 | 65,000 |
| Operational risk | 37,100 | 33,900 |
| | 571,100 | 668,600 |
| Asset Protection Scheme relief | (105,600) | (127,600) |
| | 465,500 | 541,000 |
| Risk asset ratio | | |
| Core Tier 1 | 10.7% | 11.0% |
| Tier 1 | 12.9% | 14.1% |
| Total | 14.0% | 16.1% |

RBS Group – Annual Results 2010

Risk factors

Set out below is a summary of certain risks which could adversely affect the Group. These 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 2010 Annual Report & Accounts.

- RBSG or any of its UK bank subsidiaries may face the risk of full nationalisation or other resolution procedures and 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 RBSG's businesses.
- The Group's ability to implement its strategic plan depends on the success of its efforts to refocus on its core strengths and its balance sheet reduction programme. As part of the Group's strategic plan and implementation of the State Aid restructuring plan agreed with the EC and HM Treasury, the Group is undertaking an extensive restructuring which may adversely affect the Group's business, results of operations and financial condition and give rise to increased operational risk and may impair the Group's ability to raise new Tier 1 capital due to restrictions on its ability to make discretionary dividend or coupon payments on certain securities.
- The Group's businesses, earnings and financial condition have been and will continue to be affected by geopolitical conditions, the global economy, the instability in the global financial markets and increased competition. These have resulted in significant changes in market conditions including interest rates, foreign exchange rates, credit spreads, and other market factors and consequent changes in asset valuations.
- The Group requires access to sources of liquidity, which have been constrained in recent years, and a failure to access liquidity due to market conditions or otherwise could adversely affect the Group's financial condition. In addition, the 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 actual or perceived failure or worsening credit of the Group's counterparties (including monolines or other credit insurers) or borrowers and depressed asset valuations resulting from poor market conditions have adversely affected and could continue to adversely affect the Group.
- 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.
 - The Group's insurance businesses are subject to inherent risks involving claims on insured events.

Risk factors (continued)

- The 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 UK authorities), or if the Group is unable to issue Contingent B Shares to HM Treasury under certain circumstances.
- The Group could fail to attract or retain senior management, which may include members of the Board, or other key employees, and it may suffer if it does not maintain good employee relations.
- Any significant developments in regulatory or tax legislation could have an effect on how the Group conducts its business and on its results of operations and financial condition, and the recoverability of certain deferred tax assets recognised by the Group is subject to uncertainty.
- The Group is subject to substantial regulation and oversight, and any significant regulatory or legal developments could have an adverse effect on how the Group conducts its business and on its results of operations and financial condition. In addition, the Group is and may be subject to litigation and regulatory investigations that may impact its business, results of operations and financial condition.
 - Operational and reputational risks are inherent in the Group's operations.
- The Group may be required to make contributions to its pension schemes and government compensation schemes, either of which may have an adverse impact on the Group's results of operations, cash flow and financial condition.
- As a result of the UK Government's majority shareholding in the Group they can, and in the future may decide to, exercise a significant degree of influence over the Group including suspending dividends and certain coupon payments, modifying or cancelling contracts or limiting the 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 Group from the Official List.
- The Group's participation in the APS is costly and complex and may not produce the benefits expected and the occurrence of associated risks may have a material adverse impact on the Group's business, capital or tax position, financial condition and results of operations. Any changes to the regulatory treatment of the APS may negatively impact the Group's capital position and any withdrawal from, or termination of, the APS will be costly.

Statement of directors' responsibilities

The responsibility statement below has been prepared in connection with the Group's full Annual Report and Accounts for the year ended 31 December 2010.

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

- the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- the Business review, which is incorporated into the Directors' report, includes a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

| | | |
|----------------------------|---|--|
| Philip Hampton Chairman | Stephen Hester Group Chief Executive | Bruce Van Saun Group Finance Director |
|----------------------------|---|--|

23 February 2011

Board of directors

| | | |
|----------------|----------------------------------|---|
| Chairman | Executive directors | Non-executive directors |
| Philip Hampton | Stephen Hester Bruce Van Saun | Colin Buchan Sandy Crombie Penny Hughes Joe MacHale John McFarlane Brendan Nelson Arthur 'Art' Ryan Philip Scott |

RBS Group – Annual Results 2010

Additional information

| Information | 2010 | 2009 |
|------------------------------------|---------|---------|
| Ordinary share price | £0.391 | £0.292 |
| Number of ordinary shares in issue | 58,458m | 56,366m |
| Market capitalisation | £42.8bn | £31.4bn |
| Net asset value per ordinary share | £0.64 | £0.65 |

Statutory results

Financial information contained in this document does not constitute statutory accounts within the meaning of section 435 of the Companies Act 2006 ('the Act'). The statutory accounts for the year ended 31 December 2009 have been filed with the Registrar of Companies and those for the year ended 31 December 2010 will be filed with the Registrar of Companies following the company's Annual General Meeting. The reports 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.

Filing with the US Securities and Exchange Commission

A report on Form 20-F will be filed with the Securities and Exchange Commission in the United States.

Financial calendar

| | |
|---|-----------------|
| 2011 first quarter interim management statement | 6 May 2011 |
| 2011 interim results announcement | 5 August 2011 |
| 2011 third quarter interim management statement | 4 November 2011 |

RBS Group – Annual Results 2010

Signatures

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

Date: 24 February 2011

THE ROYAL BANK OF
SCOTLAND GROUP plc
(Registrant)

By: /s/ Jan Cargill

Name: Jan Cargill
Title: Deputy Secretary

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