

Risk and capital management Governance



The Group Board of directors sets the overall risk appetite and philosophy; the risk and capital framework underpins delivery of the Board's strategy. The Board is supported by three committees:

- **Group Audit Committee ("GAC")**, comprising independent non-executive directors, focuses on financial reporting and application of accounting policies as part of the internal control and risk assessment framework. GAC monitors the identification, evaluation and management of all significant risks throughout the Group. This work is supported by Group Internal Audit, which provides an independent assessment of the design, adequacy and effectiveness of internal controls.
- **Advances Committee ("AC")**, reporting to the Board, deals with transactions that exceed the Group Credit Committee's delegated authority.
- **Group Executive Management Committee ("GEMC")**, an executive committee, ensures that implementation of strategy and operations are in line with the agreed risk appetite. GEMC is supported by the following:
 - **Group Risk Committee ("GRC")** recommends and approves limits, processes and policies that ensure the effective management of all material non-balance sheet risks across the Group.
 - **Group Credit Committee ("GCC")** approves credit proposals under authority delegated to it by the Board and/or Advances Committee.
 - **Group Asset and Liability Management Committee ("GALCO")** is responsible for identifying, managing and controlling the Group balance sheet risks. These risks are managed by setting limits and controls for capital adequacy, funding and liquidity, intra-group exposures, and non-trading interest rate, equity and foreign currency risk.

Risk and capital

It is the Group's policy to optimise return to shareholders while maintaining a strong capital base and credit rating to support business growth and meet regulatory capital requirements at all times.

The Group currently uses a target range for the tier 1 capital ratio of 7.0% to 8.0% for its long-term capital planning with the aim of operating around the mid-point of this range. This is in excess of minimum regulatory requirements.

Capital adequacy and risk management are closely aligned. The Group undertakes a regular assessment of its internal capital requirement based on a quantification of the material risks to which it is exposed. This assessment includes the use of stress tests to assess whether the Group's capital resources are adequate to remain above minimum requirements during a macroeconomic recession. The results of this internal capital assessment are reviewed by the Group Board and are used to ensure the adequacy of the Group's available capital resources, to measure risk-adjusted returns, to inform the annual business and financial planning process and to inform the Board's approval of risk appetite limits.

The allocation of capital resources to divisions is determined as part of the annual business and financial planning process.

Risk appetite is measured as the maximum level of retained risk the Group will accept to deliver its business objectives. Risk appetite is generally defined through both quantitative and qualitative techniques including stress testing, risk concentration, value-at-risk and risk underwriting criteria, ensuring that appropriate principles, policies and procedures are in place and applied.

The main risks facing the Group are shown below. These should be considered in conjunction with the Risk factors set out on pages 32 and 33 which could affect the Group's performance.

- **Credit risk:** is the risk arising from the possibility that the Group will incur losses from the failure of customers to meet their obligations.
- **Funding and liquidity risk:** is the risk the Group is unable to meet its obligations as they fall due.
- **Market risk:** the Group is exposed to market risk because of positions held in its trading portfolios and its non-trading businesses.
- **Pension obligation risk:** is the risk that the liabilities of the Group's various defined benefit pension schemes will exceed their assets as a result of which the Group is required or chooses to make additional contributions to schemes.
- **Equity risk:** reflects the variability in the value of equity investments resulting in gains or losses.
- **Insurance risk:** the Group is exposed to insurance risk, either directly through its businesses or through using insurance as a tool to mitigate other risk exposures.
- **Operational risk:** is the risk arising from the Group's people, processes, systems, physical assets and external events.
- **Regulatory risk:** is the risk arising from failing to meet the requirements and expectations of the Group's many regulators, or from a failure to address or implement any change in these requirements or expectations.

These risk and capital management processes performed well throughout 2007, and continued working through the market disruption seen since August 2007.

Management responsibilities

All staff have a role to play in the day to day management of risk in their division, in line with Group policy, which is set and managed by specialist staff in;

- Risk Management: credit, market, regulatory, enterprise and insurance risk, together with risk analytics.
- Group Treasury: balance sheet, capital management, intra-group credit exposure, funding and liquidity and hedging policies.

Independence underpins the approach to risk management, which is reinforced throughout the Group by appropriate reporting lines.

Developments in 2007

Following its acquisition by RFS Holdings, ABN AMRO is subject to the Group's high level controls and oversight by RBS' control functions. Although its risk systems are not yet integrated with those of the Group, the data relating to ABN AMRO are presented on a consistent basis. In order to facilitate comparisons with prior years the data relating to the Group excluding ABN AMRO are separately identified. ABN AMRO data are analysed between businesses acquired by RBS and those acquired by Fortis and Santander.