

**The Royal Bank of Scotland N.V. – Indian Branches
(Incorporated in the Netherlands with limited liability)**

BASEL II – PILLAR 3 DISCLOSURES AS AT 31 MARCH 2013

The Royal Bank of Scotland N.V. - Indian Branches ('the Bank') is subject to the Basel II framework with effect from March 31, 2008 as stipulated by the Reserve Bank of India (RBI). The Basel II framework consists of three-mutually reinforcing pillars:

- (i) Pillar 1: Minimum capital requirements for credit risk, market risk and operational risk
- (ii) Pillar 2: Supervisory review of capital adequacy
- (iii) Pillar 3: Market discipline

Market discipline (Pillar 3) comprises set of disclosures on the capital adequacy and risk management framework of the Bank. These disclosures have been set out in the following sections.

I. SCOPE OF APPLICATION

The Pillar 3 disclosures apply to The Royal Bank of Scotland N.V. - Indian Branches which is operating in India as a branch of The Royal Bank of Scotland N.V. incorporated with limited liability in the Netherlands.

II. CAPITAL STRUCTURE

Summary information on main terms and conditions/features of capital instruments

As per the RBI capital adequacy norms, the Bank's regulatory capital is classified into Tier-I capital and Tier-II capital. Tier-I capital includes paid-up equity capital, statutory reserves, other disclosed free reserves, capital reserves and innovative perpetual debt instruments (Tier-I bonds) eligible for inclusion in Tier-I capital that comply with requirement specified by RBI. Tier-II capital includes general provision and loss reserve, investment reserve and Hybrid capital (upper Tier-II bonds) eligible for inclusion in Tier-II capital.

Tier-I bonds (Innovative Perpetual Debt Instruments) are perpetual in nature with a call option after the instrument has run for 10 years. Interest on Tier-I bonds is payable semi-annually. These Tier-I bonds have a step-up clause on interest rates ranging from 0 to 100 basis points.

The upper Tier-II bonds (Hybrid debt Capital) have an original maturity of 15 years with call option after 10 years. The interest on upper Tier-II bonds is payable semi-annually. The upper Tier-II debt instruments have a step-up clause on interest rates of 100 basis points.

The bank has not borrowed any Subordinate Debt/Innovative Perpetual Debt Instrument/Hybrid capital during the year ended 31 March 2013.

The Royal Bank of Scotland N.V. – Indian Branches
(Incorporated in the Netherlands with limited liability)

Capital Funds

		<i>(Rs. in crores)</i>	
		31 March 2013	31 March 2012
A	Tier I Capital	2,617.50	2,550.41
	Of which		
	- Paid-up Share Capital	169.02	169.02
	- Reserves and surplus	2,484.26	2,428.62
	- Innovative Perpetual Debt Instrument (IPDI)	310.18	310.18
	- Amount deducted from Tier 1 capital		
	- Deferred Tax Assets	(341.72)	(337.96)
	- Intangible assets	(4.23)	(3.13)
	- Others	-	(16.31)
B	Tier 2 Capital (net of deductions) (B.1+B.2+B.3-B.4)	836.32	838.91
	Of which		
B.1	Debt Capital Instruments eligible for inclusion as Upper Tier 2 Capital (Hybrid Capital)	637.60	566.39
	- Total amount outstanding	715.70	715.70
	- Of which amount raised during the current year	Nil	Nil
	- Amount eligible as capital funds	637.60	566.39
B.2	Subordinated debt eligible for inclusion in Tier 2 capital	-	74.42
	- Total amount outstanding	394.48	757.90
	- Of which amount raised during the current year	Nil	Nil
	- Amount eligible as capital funds	-	74.42
B.3	Other Tier 2 Capital - Provision for Standard Assets and Investment Reserves.	198.72	198.10
B.4	Deductions from Tier 2 Capital	-	-
C	Total Eligible Capital	3,453.82	3,389.32

III. CAPITAL ADEQUACY

a. Capital Management

The Bank actively manages its capital position to ensure compliance with regulatory norms meeting current and future business needs in line with group's strategy.

Organizational set-up

The capital management framework of the Bank is administered by the India Asset Liability Committee (ALCO) and the India Risk and Control Committee (RCC) under the supervision of the India EXCO.

Regulatory capital

The Bank is subject to the capital adequacy norms stipulated by the RBI guidelines on Basel II. The RBI guidelines on Basel II require the Bank to maintain a minimum ratio of total capital to risk weighted assets of 9.0%, with a minimum Tier-I capital adequacy ratio of 6.0%. The total capital adequacy ratio of the Bank at March 31, 2013 as per the RBI guidelines on Basel II is 14.50% with a Tier-I capital adequacy ratio of 10.99%. Under Pillar 1 of the RBI guidelines on Basel II, the Bank follows the standardized approach for credit risk, Standardized Duration method for market risk and Basic Indicator approach for operational risk.

The Royal Bank of Scotland N.V. – Indian Branches (Incorporated in the Netherlands with limited liability)

Internal assessment of capital

Effective management of the capital is achieved by supervision of actual capital ratios and forecasting capital ratios over four year horizon. The Bank's capital management framework also includes a comprehensive internal capital adequacy assessment process (ICAAP) conducted annually. The ICAAP encompasses capital planning for a four year time horizon, identification and measurement of material risks and the relationship between risk and capital.

The Bank's capital management framework is complemented by its risk management framework (detailed in the following sections), which includes a comprehensive assessment of material risks.

Stress testing which is a key aspect of the ICAAP and the risk management framework provides an insight on the impact of extreme but plausible scenarios on the Bank's risk profile and capital position. Based on the approved stress testing framework, the Bank conducts stress tests on its various portfolios and assesses the impact on its capital ratios and the adequacy of capital buffers for current and future periods. The Bank periodically assesses and refines its stress tests in an effort to ensure that the stress scenarios capture material risks as well as reflect possible extreme market moves that could arise as a result of market conditions.

Monitoring and reporting

The Management maintains an active oversight over the Bank's capital adequacy levels. On a quarterly basis an analysis of the capital adequacy position and the risk weighted assets and an assessment of the various aspects of Basel II on capital and risk management as stipulated by RBI, are reported to the ALCO and EXCO.

b. Capital requirements for various risk areas

As required by RBI guidelines on Basel II, the Bank's capital requirements as at 31 March 2013 have been computed using the Standardized approach for credit risk, Standardized Duration method for market risk and Basic Indicator approach for operational risk. The minimum capital required to be held at 9.00% for credit, market and operational risks is given below:

		<i>(Rs. in crores)</i>	
		31 March 2013	31 March 2012
A	Capital requirements for Credit Risk	1,700.80	1,919.39
	- Portfolios subject to standardized approach	1,700.80	1,919.39
	- Securitisation exposures	-	-
B	Capital requirements for Market Risk	172.72	196.96
	- Standardized duration approach		
	- Interest rate risk	118.72	142.96
	- Foreign exchange risk	54.00	54.00
	- Equity risk	-	-
C	Capital requirements for Operational risk		
	- Basic indicator approach	270.54	331.60
D	Capital Adequacy Ratio of the Bank (%)	14.50%	12.46%
E	Tier I CRAR (%)	10.99%	9.38%
F	Tier II CRAR (%)	3.51%	3.08%

The Royal Bank of Scotland N.V. – Indian Branches (Incorporated in the Netherlands with limited liability)

RISK MANAGEMENT FRAMEWORK:

As a financial intermediary, the Bank is exposed to various types of risks including credit, market, liquidity, operational, legal, compliance and reputation risks. The objective of the risk management framework at the Bank is to identify measure, control, monitor and manage as well as report risks in a clear manner and that the policies and procedures established to address these risks are strictly adhered to.

The important aspects of the Bank's risk management are a robust risk approval mechanism, well defined processes and guidelines and an elaborate internal control mechanism. The risk approval mechanism covers all the key areas of risk such as credit, market and operational risk and is involved in quantification of these risks wherever possible for effective and continuous monitoring.

Measurement of risks for capital adequacy purposes

Under Pillar 1 of the extant RBI guidelines on Basel II, the Bank currently follows the Standardized approach for credit risk and Standardized Duration approach for market risk and Basic Indicator approach for operational risk.

Objectives and Policies

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

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

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

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

Structure and Organization

The Bank has a separate & independent Risk Management department headed by the Country Risk Officer (CRO). CRO oversees all the risk functions the Bank viz. Credit Risk, Market Risk, Operational Risk & Regulatory risk duly supported by the respective functional heads who directly manage these risk functions.

There are four lines of business, for which the risk function is overseen by respective Risk heads i.e. M&IB, Commercial Banking, Private Banking and Retail. Reporting to the four risk heads is a team of credit risk officers. All wholesale (M&IB and Commercial) credit exposures and subsequent reviews need to be approved by credit officers with appropriate delegated credit approval authorities.

The credit risk analysis and credit risk approval (sanction) functions, which are part of credit risk management, have completely distinct and separate reporting lines from business/ commercial teams. Credit risk management does not have business targets for revenues, profits or assets. Credit risk function reports to the Head of Corporate credit, India, who has been delegated approval authority by the Group Credit Committee through the Chief Credit Officer, APAC. The credit risk officers, in the office of the Deputy Country Credit Officer, prepare the credit application, financial analysis and credit recommendation by performing checks on the model used, financial spreading, qualitative inputs, facility characteristics, collateral characteristics. The proposal is then sent to the appropriate approving authority which has the authority to take a decision on the proposal. Credit approvals are on '4 eyes basis', wherein a credit risk officer and a business approver with requisite approval authority need to sign each credit

The Royal Bank of Scotland N.V. – Indian Branches (Incorporated in the Netherlands with limited liability)

decision. Credit approval authorities are delegated to individuals based on their overall experience and track record.

Risk Management is independent of business and Risk Management has the veto power on credit approvals.

Apart from the credit risk management functions outlined above, bank also has a separate teams for Market risk management for managing all market risk relating to trading portfolio, Operational Risk management for managing all types operational risk associated with Bank's day to day operations and Regulatory Risk management for managing all types of regulatory/ reputation/ compliance risk aspects

IV. CREDIT RISK

The Bank is exposed to credit risk in its lending operations. Credit risk is the risk of loss that may occur from the failure of any counterparty to abide by the terms and conditions of any financial contract with the Bank, principally the failure to make required payments as per the terms and conditions of the contracts.

Credit Risk Management Policy

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

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

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

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

All credit exposures, once approved, are monitored and reviewed periodically against the approved limits. Besides this there are monthly risk migration analysis and monthly watch list meetings.

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

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

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

The Royal Bank of Scotland N.V. – Indian Branches (Incorporated in the Netherlands with limited liability)

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

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

Definition and classification of non-performing assets (NPAs)

Advances are classified into performing and non-performing advances (NPAs) as per RBI guidelines. NPAs are further classified into sub-standard, doubtful and loss assets based on the criteria stipulated by RBI. A substandard asset is one, which has remained a NPA for a period less than or equal to 12 months. An asset is classified as doubtful if it has remained in the sub-standard category for more than 12 months. A loss asset is one where loss has been identified by the Bank or internal or external auditors or during RBI inspection but the amount has not been written off fully.

An asset, including a leased asset, becomes non-performing when it ceases to generate income for the Bank.

An NPA is defined as a loan or an advance where:

- (i) Interest and/or installment of principal remain overdue for more than 90 days in respect of a term loan. Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the Bank;
- (ii) if the interest due and charged during a quarter is not serviced fully within 90 days from the end of the quarter;
- (iii) the account remains 'out of order' in respect of an overdraft/cash credit facility. An account is treated as 'out of order' if:
 - a. the outstanding balance remains continuously in excess of the sanctioned limit/drawing power for 90 days; or
 - b. where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of the balance sheet; or
 - c. credits in the account are not enough to cover the interest debited during the accounting period; or
 - d. drawings have been permitted in the account for a continuous period of 90 days based on drawing power computed on the basis of stock statements that are more than three months old even though the unit may be working or the borrower's financial position is satisfactory; or
 - e. the regular ad hoc credit limits have not been reviewed/renewed within 180 days from the due date/date of adhoc sanction.
- (iv) a bill purchase discounted by the Bank remains overdue for a period of more than 90 days;
- (v) interest and or installment of principal in respect of an agricultural loan remains overdue for two crop seasons for short duration crops and one crop season for long duration crops;
- (vi) In respect of a securitization transaction undertaken in terms of the RBI guidelines on securitization, the amount of liquidity facility remains outstanding for more than 90 days;
- (vii) In respect of derivative transactions, if the overdue receivables representing positive mark-to-market value of a derivative contract, remain unpaid for a period of 90 days from the specified due date for payment.

Restructured assets

The Bank would ensure that prudential guidelines in respect of income recognition, asset classification & provisioning (including restructuring of advances) as specified by the RBI from time to time at the minimum, should be adhered to at all times.

The Royal Bank of Scotland N.V. – Indian Branches
(Incorporated in the Netherlands with limited liability)

CREDIT RISK EXPOSURES

Total Gross Credit Risk Exposure Including Geographic Distribution of Exposure

(Rs. in crores)

	31 March 2013			31 March 2012		
	Domestic	Overseas #	Total	Domestic	Overseas #	Total
Fund Based	19,013.09	Nil	19,013.09	23,185.48	Nil	23,185.48
Non Fund Based	11,624.27	Nil	11,624.27	12,437.69	Nil	12,437.69
Total	30,637.35	Nil	30,637.35	35,623.17	Nil	35,623.17

Distribution of advances by industry sector

(Rs. in crores)

S.No.	Industry Classification	31 March 2013		31 March 2012	
		Funded	Non funded	Funded	Non funded
1	Mining	6.00	0.24	1.01	1.23
2	Iron and Steel	281.04	14.06	60.59	0.34
3	Other Metal and Metal Products	126.68	98.97	114.72	144.41
4	All Engineering	1,583.31	1,459.79	1,277.40	804.37
5	Electricity	57.72	422.76	125.30	280.36
6	Cotton Textiles	101.40	8.35	95.62	-
7	Food Processing	432.16	96.80	277.53	175.04
8	Paper and Paper Products	154.69	131.16	110.27	65.59
9	Rubber and Rubber Products	131.58	32.87	183.23	24.74
10	Chemicals, Dyes, Paints etc	1,030.30	50.91	525.84	36.92
11	Leather and Leather Products	17.74	0.03	24.54	8.41
12	Gems and Jewellery	4,097.53	-	3,750.72	26.90
13	Construction	81.63	329.70	155.85	207.10
14	Petroleum	-	-	3.89	28.02
15	Automobiles including trucks	845.56	190.99	765.19	0.09
16	Computer Software	-	207.58	77.23	254.82
17	Infrastructure	48.41	47.31	2,392.05	-
18	Banking	-	554.71	367.99	2,740.52
19	Other Industries	3,011.51	3,135.40	1,341.61	1,916.41
20	Residual exposures	526.66	188.61	883.93	3.04
	Total	12,533.91	6,970.23	12,534.50	6,718.31

Residual contractual maturity breakdown of Assets

(Rs. in crores)

Particulars	31 March 2013		31 March 2012	
	Advances	Investments	Advances	Investments
Upto 1 day	567.95	0.00	339.73	-
2 to 7 days	723.90	0.00	763.79	19.71
8 to 14 days	628.66	0.00	392.23	-
15 to 28 days	1,394.18	99.49	829.60	9.95
29 days to 3 months	4,648.93	2,349.47	6,715.46	1,866.10
Over 3 months & up to 6 months	1,725.07	1,151.60	1,026.94	231.66
Over 6 months & up to 1 year	390.46	631.56	187.05	474.32
Over 1 year & up to 3 years	2,196.37	1,257.51	1,911.53	1,205.99
Over 3 year & up to 5 years	55.29	2,119.60	64.06	1,919.61
Over 5 years	203.10	1,514.27	304.11	1,994.03
Total	12,533.91	9,123.50	12,534.50	7,721.38

The Royal Bank of Scotland N.V. – Indian Branches
(Incorporated in the Netherlands with limited liability)

Movement of NPAs and Provision for NPAs

<i>(Rs. in crores)</i>			
	Particulars	31 March 2013	31 March 2012
A	Amount of NPAs (Gross)	279.59	346.51
	Substandard	32.19	120.65
	Doubtful	247.37	222.20
	Loss	0.04	3.65
B	Net NPAs	36.52	93.35
C	NPA Ratios		
	- Gross NPAs to gross advances (%)	2.19%	2.71%
	- Net NPAs to net advances (%)	0.29%	0.74%
D	Movement of NPAs (Gross)		
	- Opening balance	346.51	614.48
	- Additions during the year	53.51	145.75
	- Reductions during the year	(120.42)	(413.71)
	- Closing balance	279.59	346.51
E	Movement of Provision for NPAs		
	- Opening balance	253.16	440.77
	- Provision made during the year	60.57	55.59
	- Write – offs / Write – back of excess provision	(70.65)	(243.20)
	- Closing balance	243.08	253.16

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

V. Credit Risk: Use of rating Agency under the Standardized approach

The Bank has not applied any external ratings for its funded and non funded short-term and long-term instrument / bank facilities' and has treated them as unrated exposure.

Details of Gross credit risk exposure (Fund based and Non-fund based) based on Risk Weight

<i>(Rs. in crores)</i>		
	31 March 2013	31 March 2012
Below 100% risk weight	11,386.44	16,837.70
100% risk weight	18,967.90	18,125.31
More than 100% risk weight	283.01	660.15
Deductions		
- Investments in subsidiaries	Nil	Nil

VI. CREDIT RISK MITIGATION

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

The Royal Bank of Scotland N.V. – Indian Branches (Incorporated in the Netherlands with limited liability)

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

Detail of total credit exposure position as on 31 March 2013

	<i>(Rs. in crores)</i>	
	31 March 2013	31 March 2012
Covered by		
- financial collaterals	303.50	537.86
- Guarantees	1,200.27	3,717.41

VII. SECURITISATION

There were no securitisation transactions entered during the year (Previous year - Nil).

VIII. MARKET RISK IN TRADING BOOK

Market risk is the risk to the Bank's earnings and capital due to changes in the market level of interest rates or prices of securities and foreign exchange, as well as the volatilities of those changes. The Bank is exposed to market risk through its trading activities, which are carried out both for customers and on a proprietary basis. The Bank adopts a comprehensive approach to market risk management for its trading, investment and asset/liability portfolios. The policies ensure that operations in securities, foreign exchange and derivatives are conducted in accordance with sound and acceptable business practices and are as per the extant regulatory guidelines, laws governing transactions in financial securities and the financial environment. The policies contain the limit structure that governs transactions in financial instruments. The policies are reviewed periodically to incorporate changed business requirements, economic environment and changes in regulations.

The Bank uses various risk metrics, both statistical and non-statistical, including:

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

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

The Bank periodically reports on the various investments and their related risk measures to the EXCO. The Bank also periodically submits the required reports to the regulator as per the regulatory reporting requirements.

The Royal Bank of Scotland N.V. – Indian Branches
(Incorporated in the Netherlands with limited liability)

Capital Requirement for Market Risk

(Rs. in crores)

	Amount of Capital required	
	31 March 2013	31 March 2012
- Interest rate risk	118.72	238.51
- Foreign exchange risk (including gold)	54.00	36.00
- Equity position risk	Nil	Nil

IX. OPERATIONAL RISK

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including. Operational risk includes legal risk but excludes strategic and reputation risk. Operational risk is an integral and unavoidable part of the RBS Group's business as it is inherent in the processes it operates to provide services to customers and generate profit for shareholders.

The objective of the Bank's operational risk management is to manage and control operational risks in a cost effective manner within targeted levels of operational risk consistent with the Bank's risk appetite as specified in the Operational Risk Management Policy (the Policy) approved by the EXCO. To ensure appropriate responsibility is allocated for the management, reporting and escalation of operational risk, the Group operates three lines of defense model which outlines principles for the roles, responsibilities and accountabilities for operational risk management.

Operational risk – three lines of defense model

1st line of defense

The Business: The Business is responsible for setting risk appetite, owns and manages its risks within the overall Group risk appetite, and is responsible for complying with all Group policies. The business must test and certify the adequacy and effectiveness of its controls in place to meet these responsibilities.

2nd line of defense

Risk Management: It is responsible for owning and developing the risk management framework and tools, which the business uses to discharge its responsibilities. The 2nd line of defence must provide oversight and challenge to the 1st line on management of its risks.

3rd line of defense

Group Internal Audit is the 3rd Line of Defense and provides independent assurance over the key risks to the organization, which includes an assessment of the entire control framework.

The Operational Risk Policy Standards provide the direction for delivering effective operational risk management. They comprise principles and processes that enable the consistent identification, assessment, management, monitoring and reporting of operational risk across the Group. The objectives of the standards are to protect the Group from financial loss or damage to its reputation, its customers or staff and to ensure that it meets all necessary regulatory and legal requirements.

The standards are supported by several key operational risk management techniques of which the Bank applies the following techniques:

- Risk assessments: business units identify and assess operational risks to ensure that they are effectively managed, prioritized, documented and aligned to risk appetite;
- Risk Event and Loss data management: each business unit's internal loss data management process captures all operational risk loss events above certain minimum thresholds. The data is used to enhance

The Royal Bank of Scotland N.V. – Indian Branches (Incorporated in the Netherlands with limited liability)

the adequacy and effectiveness of controls, identify emerging themes, enable formal loss event reporting and inform risk and control assessments and scenario analysis.

Escalation of individual events to senior management is determined by the seriousness of the event. Operational loss events are categorized under the following headings:

- Clients, products and business practices;
- Technology and infrastructure failures;
- Employment practices and workplace safety;
- Internal fraud;
- External fraud;
- Execution, delivery and process management;
- Malicious damage; and
- Disaster and public safety

- Risk Issues Management: This process is meant to ensure that operational risk issues are captured and classified consistently, and that there is robust governance over their closure and acceptance.

- New products approval process: this process ensures that all new products or significant variations to existing products are subject to a comprehensive risk assessment. Products are evaluated and approved by specialist areas and are subject to executive approval prior to launch; and

- Control Environment Certification: This requires to provide a bi-annual assessment and certification regarding, adequacy and effectiveness of the internal risk and control framework for which they are responsible; management of material risk within the business, within defined risk appetite and tolerance levels; and compliance with the Group Policy Framework and supporting policy standards .

Scope and nature of reporting and measurement systems

Reporting forms an integral part of operational risk management. The Group's risk management processes are designed to ensure that issues are identified, escalated and managed on a timely basis. Exposures for each division are reported through monthly risk issue reports, which provide detail on the risk issues and action plans.

Events that have a material, actual or potential impact on the branch's finances, reputation or customers, are escalated and reported to divisional and Group executive.

Policies for mitigating

The objective of operational risk management is not to remove operational risk altogether, but to manage the risk to an acceptable level, taking into account the cost of minimizing the risk with the resultant reduction in exposure. Strategies to manage operational risk include avoidance, transfer, acceptance and mitigation by controls.

Each business unit must manage its operational risk exposure within an acceptable level, testing the adequacy and effectiveness of controls and other risk mitigants regularly and documenting the results. Where unacceptable control weaknesses are identified, action plans must be produced and tracked to completion.

Approach for Operational Risk Capital Assessment

As per the RBI guidelines on Basel II, the Bank has adopted Basic Indicator approach for computing capital charge for operational risk. The capital required for operational risk at March 31, 2013 was Rs. 270.54 crores.

The Royal Bank of Scotland N.V. – Indian Branches (Incorporated in the Netherlands with limited liability)

X. INTEREST RATE RISK IN THE BANKING BOOK (IRRBB)

Risk management framework for Interest Rate Risk in the Banking book (IRRBB) also referred as Non-Trading Interest Rate Risk (NTIRR) covers the interest rate risk outside the interest rate trading business.

The Bank holds various interest rate sensitive assets, liabilities and off balance sheet items linked to various benchmark interest rates and with different re-pricing and maturity dates. IRRBB or NTIRR arises where there is potential for changes in benchmark interest rates to result in a movement in bank's future income.

Governance

India ALCO is responsible for evolving appropriate systems and procedures for identification and analysis of various balance sheet risks including IRRBB or NTIRR and laying down parameters for efficient management of these risks. India ALCO comprises of senior management of the branch and meets periodically. The ALCO focuses on setting interest rate risk appetite by setting limits on relevant indicators, which positively contributes to optimising the balance sheet structure and Net Interest Income (NII) over time, while limiting the susceptibility to interest changes. ALCO periodically monitors risk positions of the branch, ensures compliance with regulatory requirements and internal limits and provides strategic guidance for management of the IRRBB or NTIRR.

Risk measurement and reporting framework

Presently the Bank uses following tools for managing IRRBB or NTIRR:

- Gap analysis: The interest rate gap or mismatch risk is measured by calculating gaps over different time intervals as at a given date. This static analysis measure mismatches between rate sensitive liabilities (RSL) and rate sensitive assets (RSA). The report is prepared monthly by grouping rate sensitive assets, liabilities and off-balance sheet positions into time buckets according to residual maturity or next re-pricing period. The difference between RSA and RSL for each time bucket signifies the gap in that time bucket. The direction of the gap indicates whether net interest income is positively or negatively impacted by a change in interest rates and the magnitude of the gap helps in finding out the change in net interest income for any given interest rate shift.
- Earnings at risk (EaR): The interest rate gap reports mentioned above indicate whether the Bank is in a position to benefit from rising interest rates by having a positive gap ($RSA > RSL$) or whether it is in a position to benefit from declining interest rates by having a negative gap ($RSL > RSA$). EaR measures the change in NII over a one year time horizon for various levels of parallel shift in interest rates.
- Economic value: Change in the interest rates have a long-term impact on the capital position of the Bank, as the economic value of the Branch's assets, liabilities and off-balance sheet positions get affected by these rate changes. The Bank applies modified duration approach and monitors impact of various levels of parallel shift in interest rate curves on the capital position.
- PV01: PV01 measures the impact on economic value of a 1 basis point (0.01%) change in interest rates. The Bank also uses PV01 limits to manage IRRBB or NTIRR.

The Royal Bank of Scotland N.V. – Indian Branches
(Incorporated in the Netherlands with limited liability)

Details of increase (decline) in earnings and economic value for upward and downward rate shocks, assuming parallel shift in the interest rate curves, based on the local currency positions as are given below:

Earnings perspective:

Amounts in Rs. Crore	31-Mar-13		31-Mar-12	
	-200	200	-200	200
INR	(29.7)	29.7	(72.8)	72.8
USD	(23.1)	23.1	(19.2)	19.2
GBP	2.6	(2.6)	0.2	(0.2)
EUR	(0.6)	0.6	(3.0)	3.0
JPY	15.5	(15.5)	32.9	(32.9)
RES	0.7	(0.7)	(0.1)	0.1
Total	(34.5)	34.5	(62.0)	62.0

Economic value perspective:

Amounts in Rs. Crore	31-Mar-13		31-Mar-12	
	-200	200	-200	200
INR	145.1	(145.1)	74.2	(74.2)
USD	(6.1)	6.1	(9.7)	9.7
GBP	(1.2)	1.2	(2.7)	2.7
EUR	(5.0)	5.0	(8.2)	8.2
JPY	(10.0)	10.0	(38.6)	38.6
RES	(0.6)	0.6	(0.5)	0.5
Total	122.1	(122.1)	14.5	(14.5)