inContact, Inc.
Form DEF 14A
April 30, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

Filed by the Registrant x

Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement
x Definitive Proxy Statement
¨ Definitive Additional Materials
¨ Soliciting Material Pursuant to Section 240.14a-12

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

INCONTACT, INC.

(Name of Registrant as Specified in Its Charter)

Commission File Number: 001-33762

Not Applicable

(Name of Persons Filing Proxy Statement If Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

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3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined):

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1) Amount Previously Paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

inContact, Inc.

7730 South Union Park Avenue, Suite 500

Salt Lake City, UT 84047

ANNUAL MEETING OF STOCKHOLDERS

June 14, 2012

NOTICE OF MEETING

The annual meeting of the stockholders of inContact, Inc., a Delaware corporation, will be held at 1:00 p.m., on June 14, 2012, at 7730 South Union Park Avenue, Suite 500, Salt Lake City, UT 84047, for the following purposes:

to elect seven directors;

to approve an amendment to the inContact 2008 Equity Incentive Plan increasing the number of common shares available for awards under the Plan by 2,000,000 to a total of 5,272,500 shares;

to ratify the Audit Committee s appointment of Deloitte & Touche LLP as inContact s independent registered public accounting firm for the year ending December 31, 2012; and

to act upon such other matters as may properly come before the meeting or any adjournment or postponement of the meeting.

Stockholders at the close of business on April 18, 2012 are entitled to vote in person or by proxy at the annual meeting. The annual meeting will be open to the public.

Kimm Partridge, Corporate Secretary

April 30, 2012

inContact, Inc.

7730 South Union Park Avenue, Suite 500

Salt Lake City, UT 84047

PROXY STATEMENT

This proxy statement is provided to stockholders of inContact, Inc. (inContact, we, us, our, or the Company) in connection with the annual meeting of stockholders and any adjournments or postponements of the annual meeting. The annual meeting will be held at 1:00 p.m., on June 14, 2012, at 7730 South Union Park Avenue, Suite 500, Salt Lake City, UT 84047.

ABOUT THE MEETING, VOTING, STOCKHOLDER PROPOSALS

AND COMPANY INFORMATION

Delivery and Availability of Proxy Materials

Under U.S. Securities and Exchange Commission (SEC) rules, we are furnishing proxy materials to our stockholders primarily via the Internet, instead of mailing printed copies of those materials to each stockholder. Beginning April 30, 2012, we mailed to our stockholders (other than those who previously requested electronic or paper delivery) a notice containing instructions on how to access our proxy materials, including our proxy statement and our annual report. On that date, our proxy statement and our Annual Report (of which our 2011 Annual Report on Form 10-K is a part) were available for review over the Internet at the website listed in the notice. The notice also instructs you on how to access your proxy card to vote through the Internet or by telephone.

This process is designed to expedite stockholders receipt of proxy materials, lower the cost of the annual meeting and help conserve natural resources. However, if you would prefer to receive printed proxy materials, please follow the instructions included in the notice. If you have previously elected to receive our proxy materials electronically, you will continue to receive these materials via e-mail unless you elect otherwise.

Matters to be Voted On at the Meeting and Solicitation

By authority of the Board of Directors, inContact is soliciting your vote for:

- election of seven directors;

- to approve an amendment to the inContact 2008 Equity Incentive Plan increasing the number of common shares available for awards under the Plan by 2,000,000 to a total of 5,272,500 shares;

- to ratify the Audit Committee s appointment of Deloitte & Touche LLP as inContact s independent registered public accounting firm for the year ending December 31, 2012; and

- to act upon such other matters as may properly come before the meeting or any adjournment or postponement of the meeting.

The cost of this solicitation is being borne by inContact. Proxies may be solicited on our behalf by our directors, officers and regular employees by telephone or other means. There will be no special or additional compensation for these services. Brokerage houses, custodians, nominees and fiduciaries will be requested to forward the soliciting materials to the beneficial owners of record of our common shares, and we will reimburse them for their related charges and expenses. We may also elect to engage a proxy solicitation firm to distribute and solicit proxies.

Persons Entitled to Vote

Stockholders of record at the close of business on April 18, 2012, the record date, are entitled to vote on matters that come before the meeting. Shares can be voted only if the stockholder is present in person or is represented by proxy.

How to Vote

If you own your shares through a bank or broker, you should follow the separate instructions they provide you. If your shares are registered in your name:

- You may vote in person at the annual meeting.

- You may vote over the Internet. You may vote over the Internet regardless of whether you receive your annual meeting materials through the mail or over the Internet. Simply follow the instructions on your notice of Internet access to the proxy materials or your proxy card. If you vote over the Internet, you should not vote by telephone or vote by returning a proxy card.

- You may vote by telephone. You may vote by telephone regardless of whether you receive your annual meeting materials through the mail or over the Internet. Simply follow the instructions on the proxy card. If you vote over the telephone, you should not vote by Internet or vote by returning a proxy card.

- You may vote by mail. If you received a proxy card through the mail, simply complete and sign your proxy card and mail it in the enclosed envelope. If you mark your voting instructions on the proxy card, your shares will be voted as you instruct. If no voting specification is made on your signed and returned proxy card, Theodore Stern or Paul Jarman, the persons named as proxy holders on the proxy card, will vote FOR the election of the director nominees, FOR approval of the proposed amendment to the inContact 2008 Equity Incentive Plan, and FOR the ratification of the appointment by the Audit Committee of the independent auditor. If any other business is brought before the meeting, any unspecified proxies will be voted in accordance with the judgment of the proxy holders voting those shares. If you vote by mail, you should not vote by telephone or over the Internet.

Changing Your Vote

You can change your vote submitted by Internet, telephone or written proxy card by revoking it at any time before it is cast at the annual meeting in one of three ways:

- notify our Corporate Secretary in writing before the annual meeting that you are revoking your proxy;

- submit another proxy with a date later than your last vote made by Internet, telephone or proxy; or

- vote in person at the annual meeting.

Number of Votes and Quorum

Each share of inContact common stock that you own as of the record date entitles you to one vote. On April 18, 2012 there were 43,798,788 outstanding shares of our common stock. The presence of the owners of a majority of the shares entitled to vote at the annual meeting constitutes a quorum. Presence may be in person or by proxy. You will be considered part of the quorum if you attend the annual meeting, vote by Internet or telephone or return a signed and dated proxy card. Abstentions, broker non-votes and shares voted by a broker or bank holding shares for a beneficial owner are counted as present and entitled to vote for determining a quorum.

Required Vote to Approve each Proposal

Election of Directors: Each of the seven Board of Director positions is separately elected. The persons who receive the most votes for each of the seven director positions will be elected. Any shares not voted (whether by abstention or otherwise) have no impact on the vote.

Amendment of the inContact 2008 Equity Incentive Plan: The proposal to amend the inContact 2008 Equity Incentive Plan to increase the number of common shares available for awards under the Plan by 2,000,000 to a total of 5,272,500 shares requires the affirmative vote of a majority of the votes cast. Any shares not voted (whether by abstention or otherwise) have no impact on the vote.

Ratification of Appointment of Deloitte & Touche LLP, as independent registered public accounting firm for 2012: This proposal requires the affirmative vote of a majority of the votes cast. Any shares not voted (whether by abstention or otherwise) have no impact on the vote.

Board Recommendations on Proposals

The Board recommends a vote FOR election of each director nominated by the Board, FOR approval of the proposed amendment to the inContact 2008 Equity Incentive Plan, and FOR ratification of the appointment of Deloitte & Touche LLP.

Selection of the Board s Director Nominees

Each of the seven nominees now serves as a director and was approved for inclusion on our slate of directors by the entire Board. Each nominee has indicated a willingness to serve as a director for the ensuing year, but in case any nominee is not a candidate at the meeting for any reason, the proxies named in the accompanying proxy form may vote for a substitute nominee selected by the Corporate Governance and Nominating Committee. Theodore Stern is Chairman of the Board. One of our directors, Paul Jarman, is also our President and Chief Executive Officer.

On June 14, 2011, Enterprise Network Holdings, Inc. (ENH), made a substantial investment in our common stock and in connection with that investment we entered into an Investor Rights Agreement. The Investor Rights Agreement provides, in part, that so long as ENH holds (1) 100% of the common shares purchased, or (2) if ENH holds less than 100% of such shares, it holds at least the greater of 50% of the common shares acquired or 10% of the total voting power of our common stock then outstanding, then ENH shall have the right to designate two persons to be nominated for election as directors, and at each meeting of stockholders where directors are elected we will cause the ENH designees to be nominated for election and recommend their election as directors. As described below, Hamid Akhavan is nominated for election as a director with our recommendation that he be so elected. Mr. Akhaven is one of the nominees designated by ENH under the Investor Rights Agreement. To date, ENH has not elected to nominate a second person for election as a director, although it reserves the right to do so in the future in accordance with the terms of the Investor Rights Agreement.

The Corporate Governance and Nominating Committee is responsible for reviewing the requisite skills and characteristics of new Board members as well as the composition of the Board as a whole. We believe that the minimum qualifications for serving as a director are that a nominee demonstrates an ability to make a meaningful contribution to the Board s oversight of inContact s business and affairs and have an unsullied reputation with respect to ethical conduct. Nominees for director will include individuals who, taking into account their diversity, skills, and experience in the context of the needs of the Board, as well as other relevant factors such as conflicts of interest and other commitments, would enhance the Board s ability to manage and direct our affairs and business. Although we do not have a formal policy on diversity for board members, it is a factor in assessing potential board members. Diversity not only encompasses racial and gender diversity, but it also relates to diversity of experience and background in an effort to ensure that the composition of our directors provides a strong and well balanced foundation of skill and experience.

Standard for Director Independence

The Board applies the definition of independence adopted by Nasdaq for determining independence of our directors. Based on that definition, we believe all of the directors nominated for election at our 2012 annual meeting are independent, except for our Chairman of the Board, Mr. Stern, Mr. Akhavan and our Chief Executive Officer, Mr. Jarman.

How Stockholders Can Recommend a Candidate for Election to the Board

Stockholders who wish to recommend a candidate for election to our Board should write to: Corporate Secretary, inContact, Inc. 7730 South Union Park Avenue, Suite 500, Salt Lake City, UT 84047, stating in detail the qualifications of a candidate for consideration by the Board. In considering Board candidates, the Board seeks individuals of proven judgment and competence who have strong reputations in their respective fields. The Board considers such factors as experience, education, employment history, special talents or personal attributes, anticipated participation in Board activities, and geographic and diversity factors. The process for identifying and evaluating nominees would include detailed consideration of the recommendations and opinions of members of our Board, our executive officers, and our stockholders. There would be no difference in the process of evaluation of candidates recommended by a stockholder and those recommended by other sources.

How to Communicate with the Board

Stockholders interested in communicating directly with our Board may do so by writing to: Board of Directors, inContact, Inc. 7730 South Union Park Avenue, Suite 500, Salt Lake City, UT 84047. All such written correspondence is delivered to the director or directors to whom it is addressed or, if addressed generally to the Board, to all directors. Concerns relating to accounting, internal controls, or auditing matters are immediately forwarded to the Chief Executive Officer, Chief Financial Officer, and Chairman of the Audit Committee.

Board Attendance at Annual Meeting

Two members of our Board of Directors attended the 2011 annual meeting of shareholders. We encourage attendance by members of the board and senior executives, but attendance is not required.

Business Sought to be Presented from the Floor

Our Bylaws provide that any item of business not included in the notice of annual meeting, including the nomination of a director, that a stockholder intends to bring to the floor of the annual meeting for action can be ruled out of order and the matter dismissed without further consideration, if the stockholder does not give written notice to inContact describing the business the stockholder intends to bring to the floor of the meeting within five business days after inContact gives written notice of the date and place of the annual meeting to its stockholders. Any such notice must be delivered to inContact on or before May 7, 2012, for the annual meeting scheduled on June 14, 2012.

How to Submit a Stockholder Proposal for Inclusion in the 2013 Proxy Statement; Discretionary Voting

Stockholder proposals may be submitted for inclusion in our 2013 proxy statement after the 2012 annual meeting, but must be received no later than 5:00 p.m. MST on Tuesday, January 2, 2013. Proposals should be sent via registered, certified, or express mail to: Corporate Secretary, inContact, Inc. 7730 South Union Park Avenue, Suite 500, Salt Lake City, UT 84047.

As to any proposal that is not submitted for inclusion in our proxy statement for the 2013 annual meeting of stockholders, but is instead sought to be presented directly at the meeting, certain rules adopted by the SEC permit management to vote proxies in its discretion if: (1) we receive notice of the proposal before the close of business on March 18, 2013, and advise stockholders in the proxy statement about the nature of the proposal and how management intends to vote on such matter; or (2) we do not receive notice of the proposal prior to the close of business on March 18, 2013.

Where to Find inContact s Code of Ethics

inContact has a Code of Ethics that applies to all of its employees and directors, including its Chief Executive Officer, Chief Financial Officer and other officers. We will provide to any person, without charge, a copy of the Code of Ethics upon written or oral request directed to Corporate Secretary, inContact, Inc. 7730 South Union Park Avenue, Suite 500, Salt Lake City, UT 84047, telephone (801) 715-5021. Furthermore, a copy of the Code of Ethics is accessible on the Corporate Governance section of the Investor Relations page on our corporate website, http://www.inContact.com.

Where to Find inContact s Corporate Governance and Nominating Committee, Audit Committee and Compensation Committee Charters

The Board of Directors of inContact has formed a Corporate Governance and Nominating Committee, Audit Committee and Compensation Committee. Each of these Committees has a formal charter, which is made available for your examination on our corporate website at http://www.inContact.com. We will provide to any person, without charge, a copy of any of the charters upon written or oral request directed to Corporate Secretary, inContact, Inc. 7730 South Union Park Avenue, Suite 500, Salt Lake City, UT 84047, telephone (801) 715-5021.

Where to Find More Information on inContact

Our corporate website is http://www.inContact.com. We make available on this website, free of charge, access to our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statement on Schedule 14A and amendments to those materials filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically submit such material to the SEC. The SEC makes available on its website, free of charge, reports, proxy and information statements, and other information regarding issuers, such as us, that file electronically with the SEC. The SEC s website is http://www.sec.gov.

Directors and Officers

The following table sets forth the names, ages, and positions with inContact for each of the directors and officers.

Name	**Age**	**Positions**	**Since**
Theodore Stern	82	Chairman of the Board of Directors	1999
Steve Barnett	69	Director	2000
Paul F. Koeppe	62	Director	2004
Blake O. Fisher, Jr.	68	Director	2004
Mark J. Emkjer	56	Director	2009
Hamid Akhavan	50	Director	2011
Paul Jarman	42	Director and Chief Executive Officer	1997
Gregory Ayers	50	Executive Vice President and Chief Financial Officer	2009
Scott Welch	47	Executive Vice President and Chief Operating Officer	2004
Frank Maylett	49	Executive Vice President of Sales	2008
Mariann McDonagh	50	Executive Vice President and Chief Marketing Officer	2010
Sunny Gosain	40	Executive Vice President and Chief Product Officer	2011
Bassam Salem	39	Executive Vice President and Chief Business Officer	2011

All directors hold office until the next annual meeting of stockholders and until their successors are elected and qualify. Officers serve at the discretion of our Board. The following is information on the business experience of each director now serving and a discussion of the qualifications, attributes and skills that led to the Board of Directors conclusion that the nominee should serve as a director.

Theodore Stern became a director of inContact in June 1999 and subsequently the Chairman of the Board of Directors and Chief Executive Officer in September 2000. Mr. Stern served in those positions until January 1, 2005, when the two positions were separated. He served on the board of directors of Distributed Energy Systems Corporation, a manufacturer of renewable generation systems located in Wallingford, CT from November 2003 to May 2010. He holds a Bachelor of Mechanical Engineering from the Pratt Institute and a Master of Science degree in Theoretical Mathematics from New York University. Mr. Stern is a member of the National Academy of Engineering. Mr. Stern has over 20-years experience serving as a director with public companies. Through that service he gained experience as chairman and as a member of audit, compensation and governance committees, which we believe brings a wealth of experience and savvy to developing and overseeing the development of our strategic and operating plans consistent with effective corporate governance policies. His eleven years of service as our Chairman gives him an in-depth knowledge of who we are and where we are going, which we believe to be valuable in making our decisions for the future.

Steve Barnett has been self-employed for the past six years as an advisor to manufacturing and distribution companies, as well as to public entities, on improving business operations. Mr. Barnett currently serves as an advisor to, and is on the Board of Directors of a private national real estate development company, and a private electrical systems manufacturing company. He is Chairman of the Board of a technology company specializing in juvenile safety products. He also serves on the Board of Directors for Medis Technologies Ltd., a company specializing in advanced technology regarding unique fuel cell power packs for portable electronic devices, and he also serves on the Board of Directors for OSI Geospatial Inc., a TSE company which delivers advanced geospatial systems and software that enable shared real-time situational awareness for military and homeland security, safety and security application on a worldwide basis. Mr. Barnett served on the board of Bank Leumi USA from 2000 to 2007. Mr. Barnett graduated from the University of Chicago Law School with a Doctor of Jurisprudence degree. Mr. Barnett has served as a director of inContact for 12 years, so his long time service also provides a historical perspective that enhances the development of our strategic and operational plans going forward. His experience as a director for other software and technology companies enables him fulfill an oversight function with respect to our research and development efforts and how to focus those efforts on exploiting market opportunities.

Paul F. Koeppe was President, CEO and founder of Superconductivity, Inc., a manufacturer of superconducting magnetic energy storage systems from 1988 to 1997 when it was acquired by American Superconductor, an electricity solutions company. He then served as Executive Vice President of Strategic Planning for American Superconductor until his retirement in 2001. From 1993 to 1995, Paul was acting CEO and chairman of the executive committee of the board of directors of Best Power, Inc., a supplier of uninterruptible power supply equipment. Beginning August 2009, he serves as the Chairman of the Board of Directors and Chairman of the Audit Committee for ZBB Energy Corporation, a manufacturer of large capacity energy storage systems, and served as Interim CEO from November 2009 until January 2010. Mr. Koeppe has also served as a Director of Distributed Energy Systems Corp., a public company engaged in the business of creating and delivering products and services to the energy marketplace and also as a Director of Northern Power Systems from 1998 to until 2003 when Northern was acquired by Distributed Energy Systems Corp. He holds a Bachelors Degree in Business Administration and Associate Degrees in Materials Management and Electrical Power Technology. Mr. Koeppe now serves as the chairman of the audit committee of ZBB Energy Corporation, which (together with his other experience) brings significant financial experience to our Board, as well as experience with sound corporate governance and internal control policies. Furthermore, his substantial experience as an executive officer followed by board service provides to us executive and employee compensation experience that we depend on to guide the policies we establish for compensating and incentivizing our employees.

Blake O. Fisher, Jr. provided management and financial consulting to the telecommunications and utility industries from May 2004 through December 2008, including financial consulting to the USDA on Rural Utilities Service s broadband program. From May 2004 to December 2004 he served as Chief Financial Officer for Fiber Utilities of Iowa, an entity that provides operation and construction services to municipal utilities. From May 2002 to May 2004 he was retired from business activities. From February 1996 to May 2002, he held senior management positions with McLeodUSA, a telecommunications provider, initially as Chief Financial Officer, then as President of the company s Western region and as Chief Development Officer. He also serves on the Board of Directors for Headwaters Incorporated, an energy and building products company. The Board believes

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that Mr. Fisher s chief financial officer experience is of substantial benefit in discharging the Board s oversight function with respect to financial controls and procedures, the Board s relationship with our financial staff and auditors, annual budget development and strategic planning.

Mark J. Emkjer is currently the CEO of the Health Services Division of WebMD. From May 2004 to January 2009 he was CEO, President and Board Member of Accelrys, Inc., a software company serving the pharmaceutical and biotech industries. Prior to Accelrys, Mr. Emkjer was the President and CEO of Sunquest, a public company listed on Nasdaq that develops laboratory and pharmacy information systems for hospitals worldwide. Mr. Emkjer has held executive-level positions with other companies since graduating with a Masters in Business Administration and International Finance from the University of Miami in Florida. Mr. Emkjer s substantial experience as an executive in software companies provides significant industry experience and knowledge with respect to our product, product development, market opportunities and operational aspects of a software company. The Board believes this software industry knowledge and experience provides valuable insights for short-term and long-term operational and strategic planning.

Hamid Akhavan is currently the CEO of Siemens Enterprise Communications. His extensive management experience includes product development, and international sales and marketing, as well as technology, IT and procurement. Prior to joining Siemens Enterprise Communications, Mr. Akhavan served as Chief Operating Officer (COO) at Deutsche Telekom Group, where he was responsible for the company s mobile operations in Europe, and he was also Chairman of the Executive Operating Board at Deutsche Telekom. He was also previously the CEO at T-Mobile International AG. The Board believes that Mr. Akhavan s extensive management experience in the telecommunications industry and his international experience provide valuable insight to the Company as it increases its international presence.

Paul Jarman has served as an officer of inContact during the past nine years. He has served as President since December 2002 and as Chief Executive Officer since January 2005. Prior to December 2002 he served as an Executive Vice President. Mr. Jarman is one of the original founders of inContact. He earned a Bachelor of Science degree in Accounting from the University of Utah. We believe Mr. Jarman s qualifications to serve on our Board include his executive management experience, including experience for several years as our Chief Executive Officer and a long history and familiarity with inContact, which provides the Board with essential insight into the day-to-day operations of the Company.

Executive Officers

Information on our executive officers is presented in our Annual Report on Form 10-K for the year ended December 31, 2011.

STOCK OWNERSHIP

The following table sets forth the number and percentage of the outstanding shares of common stock that, according to the information supplied to inContact, were beneficially owned by each person who, to the knowledge of the Company, is the beneficial owner of more than 5% of the outstanding common stock. Except as otherwise indicated, the persons named in the table have sole voting and dispositive power with respect to all shares beneficially owned, subject to community property laws where applicable. The number of shares owned and percent of class is as of April 18, 2012 for the principal stockholders, unless otherwise noted.

Name and Address	**Common Shares**	**Percentage of Class (1)**
Principal stockholders:		
Enterprise Network Holdings, Inc. 1881 Campus Commons Dr Reston, VA 20191	7,188,442	16.4%
FMR LLC (2) 82 Devonshire Street Boston, MA 02109	3,273,378	7.5%
Marathon Capital Management, LLC (3) 4 North Park Dr, Suite 106 Hunt Valley, MD 21030	2,901,620	6.6%

(1) These figures represent the percentage of ownership of the named persons assuming each of them alone has exercised any warrants or purchase rights the person may hold to purchase common shares.

(2) Based on information contained in a Schedule 13G filed with the Securities and Exchange Commission on February 14, 2012, reflecting the shareholder s beneficial ownership as of December 31, 2011. Fidelity Management and Research Company, a wholly owned subsidiary of FMR LLC, holds the shares and is a registered investment adviser.

(3) Based on information contained in a Schedule 13G filed with the Securities and Exchange Commission on February 1, 2012, reflecting the shareholder s beneficial ownership as of December 31, 2011. James G. Kennedy is the president of Marathon Capital Management, LLC, which is a registered investment adviser.

The following table sets forth, as of April 18, 2012, the number and percentage of the outstanding shares of common stock that, according to the information supplied to inContact, were beneficially owned by (i) each person who is currently a director, (ii) each executive officer, and (iii) all current directors and executive officers as a group. Except as otherwise indicated, the persons named in the table have sole voting and dispositive power with respect to all shares beneficially owned, subject to community property laws where applicable.

Name and Address	**Common Shares**	**Percentage of Class (1)**
Officers and directors:		
Theodore Stern (2)	1,729,632	3.9%
Steve Barnett (2)	623,602	1.4%
Paul F. Koeppe (2)	446,302	1.0%
Blake O. Fisher, Jr. (2)	229,302	0.5%
Mark J. Emkjer (2)	83,586	0.2%
Hamid Akhavan (3)	7,188,442	16.4%
Paul Jarman (2)	1,101,219	2.5%
Gregory S. Ayers (2)	341,667	0.8%
Scott Welch (2)	276,667	0.6%
Frank Maylett (2)	345,314	0.8%
Mariann McDonagh (2)	183,334	0.4%
Sunny Gosain (2)		0.0%
Bassam Salem (2)	141,667	0.3%
All Executive Officers and Directors as a Group (13 persons)	12,690,734	28.9%

(1) These figures represent the percentage of ownership of the named groups and individuals assuming each of them alone has exercised options to purchase common shares, and percentage ownership of all officers and directors as a group, assuming all purchase rights held by such individuals are exercised.

(2) These figures include: for Mr. Stern options to purchase 55,000 shares of common stock at exercise prices ranging from $3.05 per share to $4.57 per share and 91,919 shares issuable under restricted stock units; for Mr. Barnett options to purchase 135,000 shares at exercise prices ranging from $2.00 to $4.57 per share and 110,302 shares issuable under restricted stock units; for Mr. Koeppe options to purchase 117,000 shares at an exercise prices ranging from $2.00 to $4.57 per share, and 107,302 shares issuable under restricted stock units; for Mr. Fisher options to purchase 107,000 shares at exercise prices ranging from $2.00 to $4.57 per share and 107,302 shares issuable under restricted stock units; for Mr. Emkjer 83,586 shares issuable under restricted stock units; for Mr. Jarman options to purchase 945,134 shares of common stock at exercise prices ranging from $1.76 to $5.39 per share; for Mr. Ayers options to purchase 341,667 shares of common stock at exercise prices ranging from $1.78 to $3.34 per share; for Mr. Welch options to purchase 276,667 shares of common stock at exercise prices ranging from $1.76 to $4.20 per share; for Mr. Maylett options to purchase 345,314 shares of common stock at exercise prices ranging from $1.69 to $3.34 per share; for Ms. McDonagh options to purchase 183,334 shares of common stock at exercise prices ranging from $3.09 to $3.34 per share; and for Mr. Salem options to purchase 141,667 shares of common stock at exercise prices ranging from $3.34 to $3.93.

(3) These shares are owned by Enterprise Network Holdings, Inc., the parent company of Siemens Enterprise Communications, Inc., of which Mr. Akhavan is the CEO.

THE BOARD AND ITS COMMITTEES; CORPORATE GOVERNANCE; SECTION 16 COMPLIANCE

The Board and Committees

Our Board of Directors has seven members. The Chairman of the Board, Theodore Stern, provides business consulting services to inContact for a monthly fee. Our Chief Executive Officer, Paul Jarman, is a member of the Board and is a full time employee of inContact. Hamid Akhavan is CEO of Siemens Enterprise Communications, Inc., a reseller of our inContact portfolio of software services with certain exclusive territorial rights and a subsidiary of Enterprise Network Holdings, Inc. who owns approximately 16.5% of inContact s common stock. The other four members of the Board, Steve Barnett, Paul F. Koeppe, Blake O. Fisher, Jr. and Mark J. Emkjer, are non-employee directors, and the Board has determined that these persons (who constitute a majority of the Board) are independent directors under the criteria set forth in Rule 5605(a)(2) of the Nasdaq Listing Rules. The Board met eight times during the year ended December 31, 2011. All directors attended at least 75% of the meetings of the Board, once elected or appointed to the Board.

In 2007, the Board formed a Corporate Governance and Nominating Committee which is appointed by the Board to: (1) identify individuals qualified to serve as members of the Board and, where appropriate, recommend individuals to be nominated by the Board for election by the stockholders or to be appointed by the Board to fill vacancies consistent with the criteria approved by the Board; (2) develop and periodically evaluate and recommend changes to inContact s Corporate Governance Guidelines and Code of Ethics, and to review the Company s policies and programs that relate to matters of corporate responsibility, including public issues of significance to the Company and its stakeholders; and (3) oversee an annual evaluation of the performance of the Board. The current members of the Corporate Governance and Nominating Committee are Steve Barnett (Chairman), Blake O. Fisher, Jr., Paul F. Koeppe and Mark J. Emkjer. The Corporate Governance and Nominating Committee met three times in 2011, and all director members of the committee attended the meetings. The Corporate Governance and Nominating Committee operates under a written charter adopted by the Board of Directors, which sets forth the responsibilities and powers delegated by the Board to the Corporate Governance and Nominating Committee.

In 2000, the Board formed the Audit Committee, the current members of which are Blake O. Fisher, Jr. (Chairman), Steve Barnett, Paul F. Koeppe and Mark J. Emkjer. The Audit Committee provides oversight for financial reporting matters, internal controls, and compliance with the Company s financial policies, and meets with its auditors when appropriate. The Audit Committee met five times in 2011, and all director members of the committee attended at least 75% of the meetings. The Board has determined that Steve Barnett, Paul F. Koeppe and Blake O. Fisher, Jr. are audit committee financial experts within the meaning of Item 407(d)(5) of Regulation S-K. Further, the Board has determined that each of the members of the Audit Committee is independent under the standard set forth in Rule 5605(a)(2) of the Nasdaq Listing Rules. The Audit Committee operates under a written charter adopted by the Board of Directors, which sets forth the responsibilities and powers delegated by the Board to the Audit Committee.

During 2000, the Board also formed the Compensation Committee, the current members of which are Paul F. Koeppe, (Chairman), Steve Barnett, Blake O. Fisher, Jr. and Mark J. Emkjer. The Compensation Committee considers salary and benefit matters for the executive officers and key personnel of the Company. The Compensation Committee met six times in 2011, and all director members of the committee attended at least 75% of the meetings. The Compensation Committee operates under a written charter adopted by the Board of Directors, which sets forth the responsibilities and powers delegated by the Board to the Compensation Committee.

Corporate Governance Guidelines and Code of Ethics

In 2007, the Board adopted Corporate Governance Guidelines for inContact. Under the Guidelines, the Audit Committee is required to conduct, at least annually, an appropriate review of all related party transactions for potential conflict of interest situations on an ongoing basis, and all such transactions must be approved by the

Audit Committee. For purposes of this review, related party transactions means transactions required to be disclosed pursuant to Item 404 of Regulation S-K adopted by the Commission, which are related party transactions we report in this proxy statement.

The bylaws of the Company provide that no contract or transaction between inContact and one or more of its directors or officers, or between inContact and any other corporation, firm, association, or other organization in which one or more of its directors or officers are financially interested, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the Board of Directors or committee that authorizes or approves the contract or transaction, or because their votes are counted for such purpose, provided that:

- the material facts as to his, her, or their relationship or interest as to the contract or transaction are disclosed or are known to the Board of Directors or the committee and noted in the minutes, and the Board of Directors or committee, authorizes the contract or transaction in good faith by the affirmative vote of a majority of disinterested directors, even though the disinterested directors are less than a quorum;

- the material facts as to his, her, or their relationship or interest as to the contract or transaction are disclosed or are known to the stockholders entitled to vote thereon, and the contract or transaction is specifically approved or ratified in good faith by the majority of shares entitled to vote, counting the votes of the common or interested directors or officers; or

- the contract or transaction is fair as to inContact as of the time it is authorized or approved.

Under the Company s Code of Ethics, an officer has an obligation to disclose to the Board of Directors or appropriate committee any situation that may present a conflict of interest between inContact and the officer.

Board Leadership Structure and Role in Risk Oversight

Our Chief Executive Officer is a member of the Board, but a different director who is not an executive officer serves as Chairman of the Board. The Board believes that this leadership structure is best at this time, as it facilitates the ability of the Board and its committees to bring independent evaluation and thinking to strategic planning for our present and future operations, and allows the Board, without the participation of our executives, to fulfill its oversight function with respect to what we do and how we do it. We believe the benefit of having the Chief Executive Officer on the Board is the information and insight about our business that he brings to each Board meeting and adds to the totality of information our Directors receive for consideration.

Our directors believe it is a Board-level function to provide oversight with respect to the management of risks. Accordingly, our Board regularly engages in risk oversight by evaluating our circumstances and opportunities for the purpose of trying to strike a reasonable balance between anticipated risks we are willing to accept to create opportunities to achieve rewards that are consistent with our short and long-term business objectives. While certain risks are in the purview of Committees of the Board, and are scrutinized closely at the Committee level, the full Board has responsibility for risk oversight.

Our Board believes each action, either directly or indirectly by association with other circumstances and events, could create or enhance risk exposure at any level of our operations. As management modifies and refines our strategic plan, it:

- Assesses risks it believes may be associated with implementation of the strategy,

- Briefs the Board on the potential risks,

- Seeks from the Board guidance on how to proceed and appropriate authorization, and

Develops systemic processes and procedures it believes will enable employees to monitor the level of various risks as part of a process to gather information reported up the ladder to the Board for consideration in its oversight of our risk profile and deciding on future strategies and actions.

Our Board is assisted in its oversight responsibilities by the standing Board committees, which have assigned areas of oversight responsibility for various matters as described in the Committee charters. For example, our Audit Committee assists the Board s oversight of the integrity of our financial statements, the qualifications and independence of our independent registered public accounting firm, and the performance of our internal audit function and independent registered public accounting firm. Pursuant to its charter the Audit Committee also considers our policies with respect to risk assessment and risk management. The Compensation Committee oversees the compensation of our chief executive officer and other executive officers and evaluates the appropriate compensation incentives to motivate senior management to grow long-term stockholder returns without undue risk taking. Our Corporate Governance and Nominating Committee periodically evaluate and recommend changes to our Corporate Governance Guidelines and Code of Ethics.

With respect to consideration of risks related to compensation, our Board has reviewed potential risks related to compensation policies and practices applicable to all employees and has concluded that they are not reasonably likely to have a material adverse effect on our company.

Audit Committee Report

The purposes of the Audit Committee are set forth in the Committee s written charter. As provided in the charter, the role of the committee is to assist the Board of Directors in its oversight on matters relating to accounting, financial reporting, internal control, auditing, regulatory compliance activities and other matters the Board deems appropriate. The Committee also selects inContact s independent registered public accounting firm in accordance with the provisions set out in the charter. Management, however, is responsible for the preparation, presentation and integrity of inContact s financial statements, and for the procedures designed to assure compliance with accounting standards and applicable laws and regulations. The independent registered public accounting firm is responsible for planning and carrying out proper audits and reviews.

In fulfilling its responsibilities, the Audit Committee has reviewed and discussed the audited financial statements contained in the 2011 Annual Report on Form 10-K of inContact with management and the independent registered public accounting firm. In addition, the Committee has discussed with the independent registered public accounting firm the matters required to be discussed pursuant to Statement of Auditing Standards No. 61, as modified or supplemented. The Committee has also received from the independent registered public accounting firm the written disclosures and letter required by applicable requirements of the Public Company Accounting Oversight Board, considered whether the provision of non-audit services by the independent registered public accounting firm is compatible with maintaining the independent registered public accounting firm s independence, and discussed with the independent registered public accounting firm its independence.

In reliance on the reviews and discussions with management and the independent registered public accounting firm referred to above, and subject to the limitations on the responsibilities and role of the Audit Committee set forth in the charter and discussed above, the Committee recommended to the Board of Directors, and the Board approved, that the audited financial statements of inContact be included in its 2011 Annual Report on Form 10-K for filing with the Securities and Exchange Commission.

Respectfully submitted by the members of the Audit Committee of the Board of Directors:

Blake O. Fisher, Jr. (Chairman)

Paul F. Koeppe

Steve Barnett

Mark J. Emkjer

Section 16(a) Filing Compliance

Section 16(a) of the Securities Exchange Act of 1934 (Exchange Act) requires officers and directors of inContact and persons who own more than ten percent of a registered class of its equity securities to file reports of ownership and changes in their ownership on Forms 3, 4 and 5 with the Commission, and forward copies of such filings to the Company. Based on the copies of filings received by the Company during the most recent fiscal year the directors, officers and beneficial owners of more than ten percent of the equity securities of inContact registered pursuant to Section 12 of the Exchange Act have filed on a timely basis all required Forms 3, 4 and 5 and any amendments thereto.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

The primary objectives of our compensation policies are to attract and retain experienced and well-qualified executive officers, and provide incentives for financial and business achievements that benefit our stockholders. The Compensation Committee of the Board is charged with the responsibility of evaluating compensation and benefits for our executive officers and recommending specific compensation packages to the Board. The Compensation Committee also evaluates and recommends compensation arrangements for our non-employee Directors to the Board.

How the Compensation Committee Performs its Tasks

With respect to executives other than the Chief Executive Officer, the Compensation Committee seeks and receives recommendations from the Chief Executive Officer with respect to performance and appropriate levels of compensation. For 2011, the Compensation Committee approved a compensation package for the executive officers that closely followed the Chief Executive Officer s recommendation, which included a fixed base salary and a cash bonus based on performance. The Chairman of the Board discusses his recommendations for compensation for our Chief Executive Officer with him with a view to obtaining the input of our Chief Executive Officer with respect to his own evaluation of his performance and goals for the coming year and a compensation package that is reasonable in relation to the compensation recommended for our other executive officers. Based on these discussions the Chairman of the Board recommended to the Committee a package for 2011 that included a fixed base salary and a cash bonus based on performance.

The Compensation Committee s conclusions and recommendations on the compensation packages for our executive officers are based on the total mix of information from the sources described above, as well as the Committee members general knowledge of executive compensation practices and their personal evaluations of the likely effects of compensation levels and structure on the attainment of our business and financial objectives.

At the annual meeting of stockholders in 2011, the non-binding advisory vote on approval of executive compensation for inContact s name executive officers was affirmative by a substantial margin with respect to those stockholders who voted on the matter. Accordingly, the Committee intends to continue to craft compensation arrangements for executive officers that are consistent with past practices. A substantial majority of stockholders voting on the non-binding advisory vote on how frequently we seek a non-binding advisory vote on executive compensation selected three years, so we intend to hold such a vote every three years consistent with that input from the stockholders.

Objectives of our Compensation Programs

We are committed to providing total compensation packages that are intended to retain and motivate talented employees. We believe in pay for performance and we link performance to pay throughout our organization in order to create the appropriate level of incentives. We actively manage our compensation structures and levels to adapt to changes in the marketplace and the continuing evolution of inContact. Changes in the economic and business climate over the past years have resulted in heightened interest and concern by stockholders and others with respect to compensation levels for executives in American business. The Compensation Committee is sensitive to these concerns and pursues its work with a view to establishing compensation packages and arrangements that address our need to attract and retain executive officers and incentivize those officers to manage our business to achieve short-term objectives for the coming year and long-term sustainable growth, while at the same time paying compensation at a level that is within the limits of our budget.

The Elements of our Compensation Packages

In line with our compensation objectives, the Compensation Committee seeks to maintain the salary component of each officer s compensation at a moderate level; to provide bonuses based on short-term financial performance; and to also provide stock awards, consisting primarily of options, the value of which the Committee believes will be appropriate in relation to future shareholder value, depending on long-term appreciation in the market value of our common stock. The Committee analyzes each of these elements separately, and then expands the analysis to consider each element in the context of the overall compensation packages. inContact also provides what it considers to be a moderate package of retirement, medical and other benefits. In determining the proper allocation of each executive officer s compensation among these elements, the Compensation Committee has sought to achieve for each executive an appropriate balance between economic security and compensation that is at risk based on our performance.

Base Salary

Generally, we believe that executive base salaries are at a level that are commensurate with salaries for executives at companies in similar positions and with similar responsibilities as our executive officers in order to compensate them at a level appropriate to their position and responsibilities and to provide economic security that the Committee believes facilitates retention. Base salaries for our executive officers are reviewed annually by the Committee, and adjusted from time to time to reflect individual responsibilities, performance, and experience.

Cash Bonus

The Compensation Committee believes Software revenue and consolidated gross profit are important performance measures. inContact manages its business and reports financial results based on product-based segments: Software and Telecom. Since the end of 2005, inContact has focused its business development and marketing efforts on promoting the Software segment services, which carry significantly higher gross margins than the Telecom segment services. Accordingly, for 2011 we decided the amount of Software segment revenue and consolidated gross profit are meaningful indicators of executive officer performance in achieving inContact s business goals, because increasing consolidated gross margin indicates increasing revenue from higher margin Software revenue.

In January 2011, the Board approved an Executive Officer Bonus Plan for the 2011 year and it was a variable cash based incentive plan under which bonuses could be earned based on achieving stated performance criteria. The plan was based on achieving two separate performance criteria Company financial performance and achievement of individual key performance goals. Financial performance measure components included cumulative quarterly software revenue, gross profit, and EBITDAS (net income before income taxes, interest income, depreciation and amortization, and stock-based compensation), which were derived from our budget for the year, as approved by the Board of Directors, and were intended to be targets that were likely to be achieved, but not assured. Individual key performance goals for each executive officer were focused on achieving expectations with respect to tasks and objectives that facilitate and improve operations and, as a result, our financial operating results. The mix between bonuses earned on achieving financial goals versus individual key performance goals varied for our executive officers based on an evaluation of how the functions of the position most significantly impact our operations and performance. For example, bonus compensation for our Chief Executive Officer and Chief Financial Officer were based 100% on attainment of financial performance because their functions have a greater impact on financial performance than on completion of sales goals, effective product delivery, customer service, or other internal operations. For our other named executive officers, the percent of overall bonus paid on attainment of our financial performance goals was 50%, and the remainder was based on attainment of individual key performance goals. No bonus was paid on the financial performance component of the plan unless we achieved a minimum threshold of the cumulative quarterly software revenue goals. No bonus was paid on the individual key performance component of the plan unless we achieved at least a minimum threshold of our cumulative quarterly software revenue goals. The maximum bonus payable for the year ranged from a high of $130,000 for our Chief Executive Officer to a low of $60,000 for our Chief Business Officer.

In order for a bonus to be paid for financial performance or individual key performance goals, a minimum threshold of cumulative quarterly software revenue needed to be achieved. In order for the maximum bonus payment to potentially be earned, inContact needed to achieve 100% of the quarterly cumulative software revenue targets. If inContact did not achieve at least 93.5% of the cumulative quarterly software revenue targets for the applicable periods, no bonus was paid for that period. If 93.5% of the cumulative quarterly software revenue target was achieved, each participant earned 70% of the maximum bonus payment applicable to the cumulative software revenue target portion of the Company financial performance bonus. If more than 93.5%, but less than 100%, of the target was achieved, the amount of the bonus payment related to the software revenue target increased proportionately (10% more bonus for each 2.2% increase in the cumulative software revenue achieved). The cumulative quarterly software revenue targets in 2011, the amount achieved and the percent of target actually achieved are listed below:

Quarter Ended	Cumulative Software Revenue Target ($)	Cumulative Software Revenue Achieved ($)	Percent of Target Achieved
March 31	9,748,000	9,334,000	96%
June 30	20,517,000	18,837,000	92%
September 30	32,424,000	28,852,000	89%
December 31	46,000,000	39,870,000	87%

If the quarterly minimum cumulative software revenue target was achieved, then the calculation of the Company financial performance criteria portion of the bonus was weighted 70% for achieving the cumulative software revenue target, 20% for achieving the cumulative gross profit target and 10% for achieving the cumulative EBITDAS target. Similar to the cumulative software revenue target, if inContact did not achieve at least 93.5% of the gross profit target and 93.5% of the EBITDAS target, then the bonus for that component of the Company financial performance bonus was not paid. If more than 93.5%, but less than 100%, of the targets were achieved, the amount of the bonus payment related to the respective targets increased proportionately in the same proportion as the cumulative software revenue. The quarterly cumulative gross profit and EBITDAS targets and the amount achieved are listed below:

Quarter Ended	Cumulative Gross Profit Target ($)	Cumulative Gross Profit Achieved ($)	Cumulative EBITDAS Target ($)	Cumulative EBITDAS Achieved ($)
March 31	9,149,000	8,773,000	581,000	989,000
June 30	19,222,000	17,782,000	1,501,000	1,043,000
September 30	30,218,000	26,479,000	2,132,000	453,000
December 31	42,539,000	36,595,000	3,852,000	(308,000)

The only quarter in which inContact achieved at least 93.5% of the cumulative software revenue was the first quarter of 2011. Based on the actual achievement in the three different financial targets for the first quarter, 82% of the potential Company financial performance bonus for the first quarter was paid. No other quarterly payments were made related to the 2011 cash based incentive plan.

If at least 93.5% of the quarterly minimum cumulative software revenue target was achieved, then the calculation of the individual performance criteria portion of the bonus was based on the respective named executive officers individual performance measures. The first quarter was the only quarter in which a bonus based on individual performance criteria was paid since it was the only quarter in which the minimum software revenue target was achieved.

The amount of bonus paid under the cash based incentive plan to each of our named executive officers is listed in the Summary Compensation Table.

In order to provide a further incentive to focus on developing sales in the Software segment, if at the end of the year we had attained more than 100% of our goals with respect to dollar value of booked software contracts or ending software revenue run rate, then our executive officers would have earned a stretch bonus that ranged between 10% of 2011 base salary for certain of our executive vice presidents up to 14% of 2011 base salary for our Chief Executive Officer. Since we did not meet 100% of our goals with respect to dollar value of booked software contracts or ending software revenue run rate, no stretch bonus was paid.

On January 31, 2012, the Board of Directors approved, upon recommendation of the Compensation Committee, cash bonus payments to certain of our executive officers as additional compensation for the year ended December 31, 2011. These bonus payments are outside of the executive officer bonus plan and were awarded in recognition of significant transactions reported during 2011 that the Committee believes have, and will likely continue to, enhance shareholder value. The bonus payments were: $26,000 to Paul Jarman, our Chief Executive Officer; $20,000 to Gregory S. Ayers, our Chief Financial Officer; $18,000 to Scott Welch, our Chief Operating Officer; and, $12,000 to Bassam Salem, our Chief Business Officer.

For 2012, the Executive Officer Bonus Plan is expected to focus on Company financial performance. Attainment of individual key performance goals by our named executive officers (other than the Chief Executive Officer and Chief Financial Officer) may be imposed by the Chief Executive Officer as additional conditions to payment of bonuses assuming financial performance goals are achieved. Financial performance measures will be calculated semi-annually and includes increases in cumulative software revenue, software bookings, and consolidated EBITDAS, which will be compared to our budget for the year, as approved by the Board of Directors, and are intended to be targets that are likely to be achieved, but not assured. If the Chief Executive Officer elects to establish individual key performance goals for our named executive officers, those goals will likely focus on achieving expectations with respect to tasks and objectives that facilitate and improve operations and, as a result, our financial operating results. The three components of the financial performance goals will each have a threshold and will be calculated independent of the other components. If at the end of the year we attain more than 100% of our goals with respect to December 2012 software revenue run rate, then our executive officers will earn a stretch bonus that ranges between $40,000 for certain of our executive officers up to $60,000 for our Chief Executive Officer.

Stock Options

The Compensation Committee uses stock options as an important component of our overall compensation program due to its effect on retaining executives, aligning executives financial interests with the interests of stockholders and rewarding the achievement of inContact s long-term strategic goals. Stock options provide our executive officers with the opportunity to purchase and maintain an equity interest in inContact and to share in the appreciation of the value of our stock. All stock options granted to executive officers in 2011 were approved by the Compensation Committee and Board of Directors. In January 2011, the Compensation Committee determined that the granting of options to our executive officers as part of their overall compensation for 2011 was appropriate to provide long-term incentives. Stock options were also issued in 2011 as inducements to accept employment with inContact, as in the case of Sunny Gosain, our Chief Product Officer. The detail of options granted in 2011 is located at Grants of Plan Based Awards. In January 2012, the Compensation Committee determined to grant 50,000 options to Bassam Salem, who was appointed as a named executive officer in November 2011, to better align the number of options he holds with the other named executive officers, which the Compensation Committee believes will better align his interest with the interests of the stockholders.

The 401(k) Plan

Under the 401(k) Plan, our executive officers and generally all full-time domestic exempt and non-exempt employees may contribute a portion of their compensation to the plan on a pre-tax basis. There were no changes to these arrangements during 2011.

Employee Stock Purchase Plan (Purchase Plan)

The purpose of the Purchase Plan is to provide an opportunity for eligible employees to purchase a limited number of shares of our common stock at a discount through voluntary automatic payroll deductions. The Purchase Plan is designed to attract, retain, and reward our employees and to strengthen the mutuality of interest between our employees and our stockholders. Our Board may at any time amend, suspend or discontinue the Purchase Plan, subject to any stockholder approval needed to comply with the requirements of the SEC and the Internal Revenue Code. The aggregate number of shares of our common stock that may be issued under the Purchase Plan will not exceed 1,000,000 shares (subject to mandatory adjustment in the event of a stock split, stock dividend, recapitalization, reorganization or similar transaction). The maximum amount eligible for purchase of shares through the Purchase Plan by any employee in any year will be $25,000. The purchase price a participant pays for the shares is equal to the greater of $2.00 or 85% of the closing market bid price of the common stock on the first business day or the last business day of each participation period, whichever is lower. This percentage may be changed prior to a participation period at the sole discretion of the Compensation Committee administering the Purchase Plan to any whole percentage that is not less than 85% and not greater than 100%. Officers and members of the Board of Directors who are eligible employees are permitted to participate. An employee is ineligible to participate if immediately after a grant the employee would own stock possessing five percent or more of the total combined voting power or value of all classes of stock of inContact. We issued 80,000 shares of common stock under the Purchase Plan during 2011. A total of 108,000 shares of common stock have been issued under the Purchase Plan.

Severance Policy

Executive officers that have been employed by inContact for at least one year will receive severance benefits upon the involuntary termination of their employment in the event of a purchase of inContact or a change of control. The policy is intended to help keep executive officers focused on their work responsibilities during the uncertainty that accompanies a potential change of control, to provide benefits for a period of time after a change of control transaction, and to help us attract and retain key talent. Under the policy, the Chief Executive Officer would receive 24 months of base salary and our other named executive officers would receive 18 months of base salary. These payments are made if the executive officer s employment terminates within six months of the change of control under certain circumstances. The Board of Directors adopted a formal written policy in August 2011 for applying the change in control severance compensation arrangement established previously. The amount due in the event of a purchase or change in control of inContact did not change.

Regulatory Considerations

The tax and accounting consequences of utilizing various forms of compensation are considered when adopting new or modifying existing compensation. We have administered our incentive and equity compensation programs, severance plans and change in control agreements in compliance with federal tax rules affecting non-qualified deferred compensation.

Under Section 162(m) of the Internal Revenue Code, publicly-held corporations may not take a tax deduction for compensation in excess of $1.0 million paid to any of the executive officers named in the Summary Compensation Table during any fiscal year. There is an exception to the $1.0 million limitation for performance-based compensation meeting certain requirements. To maintain flexibility in compensating executives in a manner designed to promote varying corporate goals, the compensation committee has not adopted a policy requiring all compensation to be deductible under 162(m). However, the compensation committee considers deductibility under Section 162(m) with respect to compensation arrangements for executives. We believe our annual and long-term incentive compensation programs for executives qualify as performance-based compensation and are not subject to any deductibility limitations under Section 162(m).

Code of Ethics Violations

It is our policy under our Code of Ethics to take appropriate action against any executive officer whose actions are found to violate the Code or any other policy of inContact. Disciplinary actions may include immediate termination of employment and, where inContact has suffered a loss, pursuing its remedies against the executive officer responsible. inContact will cooperate fully with the appropriate authorities where laws have been violated.

Insider Trading and Blackout Policy

Our Insider Trading and Blackout Policy prohibits directors, officers, employees and consultants from trading Company securities during regularly scheduled blackout periods surrounding the announcement of earnings and filing annual and quarterly reports with the SEC as well as all other times an individual is in possession of material non-public information. Prohibited trading includes purchases and sales of stock derivative securities such as put and call options and convertible debentures or preferred stock, and debt securities (debentures, bonds and notes).

Summary of Compensation Table

The following table sets forth certain information with respect to compensation for each year in the three-year period ended December 31, 2011 earned by or paid to our named executive officers:

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary (1)	Bonus (2)	Non-Equity Incentive Plan Compensation (3)	Option Awards (4)	All Other Comp (5)	Total Compensation
Paul Jarman	2011	$ 250,000	$ 26,000	$ 26,650	$ 153,927	$ 13,321	$ 469,898
Chief Executive Officer	2010	$ 246,154	$	$ 24,700	$	$ 12,839	$ 283,693
	2009	$ 200,144	$	$ 76,685	$ 95,093	$ 13,383	$ 385,305
Gregory S. Ayers	2011	$ 209,192	$ 20,000	$ 20,500	$ 90,545	$ 14,671	$ 354,908
EVP and Chief Financial Officer	2010	$ 198,942	$	$ 19,500	$	$ 15,633	$ 234,075
	2009	$ 150,144	$	$ 51,525	$ 312,612	$ 13,128	$ 527,409
Scott Welch	2011	$ 199,192	$ 18,000	$ 17,775	$ 90,545	$ 16,871	$ 342,383
EVP and Chief Operating Officer	2010	$ 188,346	$	$ 19,500	$	$ 16,905	$ 224,751
	2009	$ 176,144	$	$ 51,513	$ 57,056	$ 17,794	$ 302,507
Frank Maylett (6)	2011	$ 204,193	$	$ 114,174	$ 135,818	$ 13,321	$ 467,506
EVP of Sales	2010	$ 195,000	$	$ 81,389	$	$ 12,827	$ 289,216
	2009	$ 186,683	$	$ 134,856	$ 69,235	$ 14,299	$ 405,073
Mariann McDonagh (7)	2011	$ 209,969	$ 50,000	$ 21,250	$ 90,545	$ 18,825	$ 390,589
EVP and Chief Marketing Officer	2010	$ 138,462	$ 34,615	$	$ 417,147	$ 11,909	$ 602,133
	2009	$	$	$	$	$	$
Sunny Gosain (8)	2011	$ 96,923	$ 21,667	$	$ 564,510	$ 4,591	$ 687,691
EVP and Chief Product Officer	2010	$	$	$	$	$	$
	2009	$	$	$	$	$	$
Bassam Salem (9)	2011	$ 188,492	$ 12,000	$ 13,275	$ 150,718	$ 14,245	$ 378,730
EVP and Chief Business Officer	2010	$	$	$	$	$	$
	2009	$	$	$	$	$	$

(1) Amounts shown include deferrals to the 401(k) Plan.

(2) These amounts represent bonuses paid outside of plans established. With the exception of amounts reported for Ms. McDonagh and Mr. Gosain, which are guaranteed bonuses, the amounts reported were awarded in recognition of significant transactions reported during 2011 that the Compensation Committee believes have, and will likely continue to, enhance shareholder value.

(3) Our executives were eligible for cash bonuses under plans established for the stated years, subject to achieving certain performance objectives.

(4) This column represents the aggregate grant date fair value of stock option awards granted during the year indicated, in accordance with ASC Topic 718 and do not correspond to the actual value that may be realized by the named executives.

(5) The 2011 amounts for Mr. Jarman, Mr. Maylett and Mr. Gosain reflect employee benefit insurance premiums. The 2011 amounts for Mr. Ayers, Mr. Welch, Ms. McDonagh and Mr. Salem reflect 401(k) matching contributions and employee benefit insurance premiums.

(6) The amount of non-equity incentive plan compensation listed for Mr. Maylett includes $114,174, $81,389 and $113,677 of sales commissions paid for 2011, 2010 and 2009, respectively.

(7) Per the terms of her employment, Ms. McDonagh receives an annual guaranteed bonus of $50,000, which is paid ratably over the year.

(8) Mr. Gosain became Executive Vice President and Chief Product Officer in August 2011. Mr. Gosain s salary was pro-rated to reflect his service for the months employed. Per the terms of his employment, Mr. Gosain s bonus was from a guaranteed bonus of $65,000, paid ratably over his first year of employment.

(9) Mr. Salem became Executive Vice President and Chief Business Officer in November 2011. Mr. Salem was employed by inContact prior to be elected to his current position. His compensation includes all monies earned by Mr. Salem as an employee in 2011.

Grants of Plan Based Awards

The following table sets forth certain information with respect to grants of plan-based awards for the year ended December 31, 2011 with respect to the named executive officers. Each of the stock options granted during the year vest in three equal annual installments commencing one year after the date of grant and expire five years from grant date.

GRANTS OF PLAN-BASED AWARDS

Name	Date	Number of Securities Underlying Options	Exercise Price of Option Awards ($/Sh) (1)	Closing Market Price on Date of Grant ($/Sh)	Grant Date Fair Value of Option Awards (2)
Paul Jarman	01/18/11	85,000	$ 3.34	$ 3.34	$ 153,927
Gregory Ayers	01/18/11	50,000	$ 3.34	$ 3.34	$ 90,545
Scott Welch	01/18/11	50,000	$ 3.34	$ 3.34	$ 90,545
Frank Maylett	01/18/11	75,000	$ 3.34	$ 3.34	$ 135,818
Mariann McDonagh	01/18/11	50,000	$ 3.34	$ 3.34	$ 90,545
Sunny Gosain	08/08/11	300,000	$ 3.57	$ 3.57	$ 564,510
Bassam Salem	01/18/11	25,000	$ 3.34	$ 3.34	$ 45,273
Bassam Salem	06/13/11	50,000	$ 3.93	$ 3.93	$ 105,445

(1) The exercise price was determined by using the closing price of the stock on the grant date.

(2) This column shows the grant date fair value of the plan-based stock option awards to the named executives during 2011 in accordance with ASC Topic 718. Generally, the grant date fair value is the amount that we will expense in our financial statements over the vesting schedule for the award. Fair value of each stock option is calculated using the Black-Scholes value on the grant date.

Discussion of Summary Compensation Table and Plan Based Awards

The annual base salary of our executive officers is determined each year at the discretion of the Compensation Committee. The annual salaries for our current executive officers are:

Name	2011 Salary	2012 Salary
Paul Jarman	$ 250,000	$ 280,000
Gregory S. Ayers	$ 210,000	$ 240,000
Scott Welch	$ 200,000	$ 225,000
Frank Maylett	$ 205,000	$ 220,000
Mariann McDonagh	$ 224,000	$ 224,000
Sunny Gosain (1)	$ 240,000	$ 240,000
Bassam Salem (1)	$ 200,000	$ 240,000

(1) Mr. Gosain joined inContact in August 2011. Mr. Salem joined inContact in March 2010 and was elected as Chief Business Officer in November 2011.

As additional compensation for 2011, Mr. Maylett was paid a commission of $114,174. The commission was based on the contract monthly recurring charges at the time new customer service commenced, if the aggregate amount of such new charges equaled or exceeded 70% of the budgeted amount for each calendar quarter in 2011. The commission percent varied and ranged from 8.4% if the aggregate amount of new charges was 70% of the targeted amount to 13% if the aggregate amount of new charges was 124% of the targeted amount. Total commission earned during 2011 by Mr. Maylett under these arrangements was $114,174. Mr. Maylett did not participate in the 2011 Executive Officer Bonus Plan because his incentives are provided through the commission arrangement. For 2012, Mr. Maylett will be paid a commission based on the contract monthly recurring charges at the time new customer service commenced, if the aggregate amount of such new charges equaled or exceeded 70 percent of the budgeted amount for each calendar quarter in 2012.

Ms. McDonagh was elected Executive Vice President of Marketing on April 26, 2010. The terms of her employment provides for an annual guaranteed bonus of $50,000, which is paid ratably over the year.

Mr. Gosain was elected Executive Vice President and Chief Product Officer in August 2011. The terms of his employment provide for an annual base salary of $240,000, participation in the 2011 Executive Officer Bonus Plan for the remainder of 2011 with a maximum bonus of $90,000 and a guaranteed bonus of $65,000, paid ratably over the first year of employment, stock options to purchase 300,000 common shares at an exercise price equal to the fair market value of the common stock on the grant date, exercisable over a term of five years from date of grant that vest in three equal annual installments, and the right to participate in pension, insurance and other benefit plans available to other inContact executive officers.

Potential Payments Upon Change In Control

The Board of Directors adopted a severance compensation policy for our named executive officers in 2006, which was formally written and adopted in August 2011. The severance policy provides that our executive officers that have been employed by inContact for at least a year shall receive severance benefits upon the involuntary termination of their employment within six months after a change of control.

A change in control occurs if: (i) any person acquires beneficial ownership of 50% or more of either the then-outstanding shares of our common stock, or the combined voting power of our then-outstanding voting securities entitled to vote generally in the election of directors; (ii) persons who currently constitute the Board of Directors cease for any reason to constitute at least a majority of the Board; or (iii) consummation of a reorganization, merger or consolidation, or sale or other disposition of all or substantially all of our assets, or our acquisition of assets or stock of another entity, in each case, unless, (a) all or substantially all of the individuals and entities who were the beneficial owners of either the outstanding shares of our common stock, or the combined voting power of our outstanding voting securities entitled to vote generally in the election of directors immediately prior to the transaction beneficially own, directly or indirectly, more than 50% of, respectively, our then-outstanding shares of common stock and the combined voting power of our then-outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from the transaction, (b) no person beneficially owns, directly or indirectly, 50% or more of, respectively, the then-outstanding shares of common stock of the corporation resulting from the transaction, or the combined voting power of the then-outstanding voting securities of such corporation except to the extent that such ownership existed prior to the transaction, and (c) at least a majority of the members of the board of directors of the corporation resulting from the transaction were members of the Board at the time of the execution of the initial agreement, or of the action of the Board, providing for the transaction.

Under the policy, the Chief Executive Officer would receive 24 months of base salary and our other named executive officers would receive 18 months of base salary and amounts payable would be paid in a lump sum on the 65th day following the participant s termination date. The following table shows the amount of severance that would have been paid to our executive officers serving at the end of 2011 assuming the benefit accrued as of December 31, 2011:

Name	Benefit	Change in Control
Paul Jarman	24 months salary	$ 500,000
Gregory S. Ayers	18 months salary	$ 315,000
Scott Welch	18 months salary	$ 300,000
Frank Maylett	18 months salary	$ 307,500
Mariann McDonagh	18 months salary	$ 336,000
Sunny Gosain (1)	18 months salary	$
Bassam Salem	18 months salary	$ 300,000

(1) Mr. Gosain was elected Executive Vice President and Chief Product Officer effective in August 2011. Upon completion of one year of service, Mr. Gosain will be entitled to receive 18 months of compensation or $360,000 in accordance with the policy.

Option Exercises and Stock Vested

During 2011, there were no shares acquired by any of the named executive officers upon vesting of any restricted or other stock awards. During 2011, certain executive officers exercised stock options, as described in the following table:

OPTION EXERCISES AND STOCK VESTED

	Option Awards	
Name	Number of Shares Acquired on Exercise	Value Realized on Exercise
Scott Welch	100,000	$ 267,000
Frank Maylett	4,686	$ 8,575

Outstanding Equity Awards at Fiscal Year End

The table on the following page sets forth certain information with respect to outstanding equity awards at December 31, 2011 with respect to the named executive officers:

	Option Awards			
	Number of Securities Underlying Unexercised Options (#)		Option Exercise Price	Option Expiration Date
Name	Exercisable	Unexercisable		
Paul Jarman	111,244		$ 2.70	11/04/13
	18,541		$ 5.39	11/04/13
	87,015		$ 2.00	11/04/13
	150,000		$ 2.50	11/04/13
	150,000		$ 2.50	11/04/13
	75,000		$ 2.00	11/04/13
	225,000		$ 3.50	11/04/13
	66,667	33,333	$ 1.76	03/11/14
		85,000	$ 3.34	01/18/16
Gregory S. Ayers	216,666	108,334	$ 1.78	03/16/14
		50,000	$ 3.34	01/18/16
Scott Welch	25,000		$ 3.05	11/04/13
	150,000		$ 3.50	11/04/13
	25,000		$ 4.20	11/04/13
	40,000	20,000	$ 1.76	03/11/14
		50,000	$ 3.34	01/18/16
Frank Maylett	245,314		$ 2.87	11/04/13
	33,333	16,667	$ 1.69	03/06/14
	16,667	8,333	$ 1.76	03/11/14
		75,000	$ 3.34	01/18/16
Mariann McDonagh	83,334	166,666	$ 3.09	04/26/15
		50,000	$ 3.34	01/18/16
Sunny Gosain		300,000	$ 3.57	08/08/16
Bassam Salem	58,334	116,666	$ 3.42	03/15/15
		25,000	$ 3.34	01/18/16
		50,000	$ 3.93	06/13/16

Board Compensation

In June 2011, the Board of Directors affirmed without change the annual compensation package for the non-employee Directors originally adopted in June 2010. Under the package non-employee directors receive a cash payment of $50,000 per year paid in monthly installments and an award of restricted stock units on July 1 of each year commencing in 2010 in number equal to $50,000 divided by the fair market value of inContact s common stock at July 1 of each annual period, which is the grant date. The restricted stock units vest in equal monthly installments over the one-year period following the date of the award; provided, that vesting is accelerated in the event of a greater than 50% change in voting control of inContact or membership of the Board of Directors or a disposition of more than 50% of the assets of inContact (a Corporate Event). Each restricted stock unit represents the right to receive one share of inContact common stock (subject to adjustment in the event of a stock dividend, share combination, recapitalization or similar event as provided in the Plan) upon termination of service as a director for any reason or the occurrence of a Corporate Event. The compensation package also provides for additional annual issuances of restricted stock units to the chairperson of the Audit Committee, Compensation Committee, or Corporate Governance and Nominating Committee of the Board, in number equal to $10,000 divided by the fair market value of inContact s common stock on July 1 of each annual period, which is the grant date. As non-employee directors serve for a term commencing with election at the annual meeting, we believe compensation arrangements should follow the same period of service.

Directors who are also our full-time employees or who are executive officers of significant shareholders receive no additional compensation for serving as a Director. The following table summarizes the compensation paid to the non-employee Directors for the year ended December 31, 2011:

Name	Fees Earned or Paid in Cash	Stock Awards: Value of Restricted Stock Units (1)	Total
Theodore Stern (2)	$ 134,000	$ 50,000	$ 184,000
Steve Barnett	$ 50,000	$ 59,998	$ 109,998
Paul F. Koeppe	$ 50,000	$ 59,998	$ 109,998
Blake O. Fisher, Jr.	$ 50,000	$ 59,998	$ 109,998
Mark Emkjer	$ 50,000	$ 50,000	$ 100,000
Hamid Akhavan (3)	$	$	$

(1) This column represents the aggregate grant date fair value of restricted stock units granted during the year calculated in accordance with ASC Topic 718 and do not correspond to the actual value that may be realized by the Directors.
(2) During 2011, Mr. Stern was paid monthly consulting fees for a total of $84,000, which is included in Fees Earned or Paid in Cash.
(3) Hamid Akhavan is the chief executive officer of a significant shareholder s subsidiary and consequently, does not earn compensation for serving as a director.

Compensation Committee Interlocks and Insider Participation

The current members of the Compensation Committee are Paul F. Koeppe, Steve Barnett, Blake O. Fisher, Jr. and Mark J. Emkjer, and no other directors served on the Compensation Committee during 2011. No interlocking relationship exists between our Board of Directors or Compensation Committee and the board of directors or compensation committee of any other company, nor has any interlocking relationship existed in the past.

Report of Compensation Committee on Executive Compensation

Paul F. Koeppe is the Chairman of the Compensation Committee and Steve Barnett, Blake O. Fisher, Jr. and Mark J. Emkjer serve on the Committee. The Compensation Committee has reviewed and discussed the

Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management. Based on that review and discussion with management, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this proxy statement.

Respectfully submitted,

Paul F. Koeppe, Chairman

Steve Barnett

Blake O. Fisher, Jr.

Mark J. Emkjer

1999 Long Term Stock Incentive Plan

The purpose of the Long Term Stock Incentive Plan (the Plan) adopted in March 1999, is to provide directors, officers, employees and consultants with additional incentives by increasing their ownership interests in inContact. Directors, officers and other employees of inContact and its subsidiaries are eligible to participate in the Plan. In addition, awards may be granted to consultants providing valuable services to inContact. As of December 31, 2011, inContact and its affiliates employed approximately 400 individuals who are eligible to participate in the Plan. The Board grants awards under the Plan. Awards may include incentive stock options, non-qualified stock options, stock appreciation rights, stock units, restricted stock, restricted stock units, performance shares, performance units or cash awards.

The Board has discretion to determine the terms of an award under the Plan, including the type of award, number of shares or units covered by the award, option price, term, vesting schedule, and post-termination exercise period or payment. Notwithstanding this discretion: (i) the number of shares subject to an award granted to any individual in any calendar year may not exceed 100,000 shares; (ii) the option price per share of common stock may not be less than 100% of the fair market value of such share at the time of grant or less than 110% of the fair market value of such shares if the option is an incentive stock option granted to a stockholder owning more than ten percent of the combined voting power of all classes of the stock of inContact (a 10% stockholder); and (iii) the term of any incentive stock option may not exceed 10 years, or five years if the option is granted to a 10% stockholder. Awards under the Plan in the form of qualified incentive stock options outstanding or exercised totaled 941,854 shares as of December 31, 2011.

A maximum of 1,200,000 shares of common stock may be subject to outstanding awards, determined immediately after the grant of any award under the Plan. Shares of common stock, which are attributable to awards that have expired, terminated, or been canceled or forfeited during any calendar year, are available for issuance or use in connection with future awards.

The Plan was effective March 11, 1999, and is not limited in duration. No incentive stock option may be granted more than 10 years after the effective date. The Plan may be amended by the Board without the consent of the stockholders, except that stockholder approval is required for any amendment that materially increases the aggregate number of shares of stock that may be issued under the plan or materially modifies the requirements as to eligibility for participation in the Plan.

2008 Equity Incentive Plan

The inContact 2008 Equity Incentive Plan was adopted by our Board in April 2008 and approved by our stockholders at the annual meeting in June 2008. Please see the description of this plan presented below under PROPOSAL NO. 2 INCREASE NUMBER OF SHARES AVAILABLE FOR AWARDS UNDER THE 2008 EQUITY INCENTIVE PLAN.

Description of Employee Stock Purchase Plan

In 2004, inContact adopted the 2005 Employee Stock Purchase Plan (Purchase Plan). The purpose of the Purchase Plan is to promote inContact s operating performance and growth potential by encouraging employees to acquire equity in inContact, thereby aligning their long-term interests with those of inContact. The Purchase Plan provides that up to 1,000,000 shares of common stock may be sold to participating employees. It expires at the beginning of 2014. The Compensation Committee of the Board of Directors administers the Purchase Plan.

The Purchase Plan permits eligible employees to purchase inContact common stock through payroll deductions during 35 consecutive participation periods beginning in 2005. Each participation period is three months in length. In general, eligible employees can elect for each participation period to purchase full shares through payroll deductions of up to 10 percent of base pay, but in no event may the participant s rights to purchase shares of common stock accrue at a rate that exceeds $25,000 of fair market value of common stock in a calendar year. The purchase price a participant pays for the shares is equal to the greater of $2.00 or 85% of the closing market bid price of the common stock on the first business day or the last business day of each participation period, whichever is lower. This percentage may be changed prior to a participation period by at the sole discretion of, the Compensation Committee administering the Purchase Plan to any whole percentage that is not less than 85% and not greater than 100%.

Eligibility to participate is extended to all regular employees of inContact and its participating subsidiaries. Officers and members of the Board of Directors who are eligible employees are also permitted to participate. An employee is ineligible to participate if immediately after a grant the employee would own stock possessing five percent or more of the total combined voting power or value of all classes of stock of inContact. We issued 80,000 and 28,000 shares of common stock under the Purchase Plan during 2011 and 2010, respectively.

The Purchase Plan may be amended by the Board of Directors from time to time as it deems desirable without approval of the stockholders of the inContact, except to the extent stockholder approval is required by Rule 16b-3 of the Exchange Act, applicable Nasdaq or stock exchange rules, applicable provisions of the Internal Revenue Code, or other applicable laws or regulations. The Board of Directors may terminate the Purchase Plan at any time in its sole discretion.

Certain Relationships and Related Person Transactions

ENH is a more than 5% shareowner of the Company. Concurrent with selling 7.2 million shares of common stock to ENH in June 2011, inContact entered into a commercial agreement with Siemens Enterprise Communications, Inc. (Siemens), a subsidiary of ENH, whereby Siemens became a world-wide reseller of inContact s portfolio of cloud-based solutions with minimum revenue purchase commitments of $5.0 million and $10.0 million during 2012 and 2013, respectively. No revenue was recorded during the year ended December 31, 2011 related to this agreement. inContact purchased phones from Siemens for $146,000 during the year ended December 31, 2011. ENH paid $18,000 to be a sponsor at our user conference during the year ended December 31, 2011.

Also, see the discussions above under The Board and its Committees, Executive Compensation, and Board Compensation.

PROPOSAL NO. 1

ELECTION OF DIRECTORS

At the annual meeting, all seven inContact directors will be elected to serve until the annual meeting of shareholders in the year 2013. The Board nominates for election as directors:

Theodore Stern	Paul Jarman	Steve Barnett	Mark J. Emkjer	Blake O. Fisher, Jr.	Paul F. Koeppe	Hamid Akhavan

These nominees have been selected by the Corporate Governance and Nominating Committee and nominated for election by the Board of Directors, and will be elected by a plurality of the votes cast. Any shares not voted, whether by abstention or otherwise, have no impact on the vote.

Although it is anticipated that each nominee will be able to serve as a director, should any nominee become unavailable to serve, the proxies will be voted for such other person or persons as may be designated by our Board.

Each of the seven director positions is voted on separately. The persons who receive the most votes for each of the seven director positions will be elected. The Board of Directors recommends a vote FOR the election of each of the nominees listed above.

PROPOSAL NO. 2

INCREASE NUMBER OF SHARES AVAILABLE FOR AWARDS UNDER THE 2008 EQUITY INCENTIVE PLAN

The inContact 2008 Equity Incentive Plan (the 2008 Plan) was adopted by our Board in April 2008 and approved by our stockholders at the annual meeting in June 2008. In December 2008, the 2008 Plan was amended by the Board to decrease the number of common shares available for awards under the Plan from 1,500,000 to 1,272,500, on account of stock options issued to certain employees outside of the Plan. In June 2009 and June 2010, the Stockholders approved the Board proposals to increase the number of common shares available for awards under the 2008 Plan from 1,272,500 to 2,272,500 and 2,272,500 to 3,272,500, respectively, at the annual meetings.

The Board believes that stock-based incentives are essential to attract and retain the services of individuals who are likely to make significant contributions to our success, to encourage ownership of our common stock by employees and directors, and to promote our success by providing both rewards for exceptional performance and long-term incentives for future contributions to the Company.

The 2008 Plan currently authorizes the issuance of up to 3,272,500 shares of common stock (or 7.5% of outstanding shares at April 18, 2012) pursuant to awards granted under the Plan. Of those shares, 3,123,420 are subject to outstanding awards, leaving only 151,850 shares available for future awards. The Board of Directors does not believe that the number of shares available for issuance under the 2008 Plan is sufficient in light of our compensation strategy and objectives. Accordingly, the Board is proposing to increase the number of shares available under the 2008 Plan by 2,000,000 shares, from 3,272,500 to 5,272,500, increasing the percentage ratio of the amount of shares available under the Plan to 12.0% of outstanding shares as of April 18, 2012. Specifically, the Board is requesting the stockholders to approve an amendment to Article III of Section 1 of the 2008 Plan so that it reads as follows:

Section 1. **Stock Subject to Plan.** The Stock to be subject to or related to Plan Awards may be either authorized and unissued shares or shares held in the treasury of the Company. The maximum number of shares of Stock with respect to which Plan Awards may be granted under the Plan, subject to adjustment in accordance with the provisions of Article IX, shall be 5,272,500 shares.

The Board recommends that shareholders approve amendment of the Plan in order to allow the Company to continue to offer stock options and alternative equity awards to employees, directors and consultants as part of its overall compensation package. The material features of the 2008 Plan are summarized below.

Material Features of the Plan

General. The Plan provides that grants may be made in any of the following forms:

- Incentive stock options
- Nonqualified stock options

Stock units

Stock awards

Stock appreciation rights (SARs)

Dividend equivalents

Other stock-based awards

The Plan (as amended if the proposed amendment is approved) will authorize 5,272,500 shares of our common stock for issuance, subject to adjustment in certain circumstances as described below. If and to the extent options and SARs granted under the Plan terminate, expire or are cancelled, forfeited, exchanged or surrendered without being exercised or if any stock awards, stock units, or other stock-based awards are forfeited, terminated, or otherwise not paid in full, the shares subject to such grants will become available again for purposes of the Plan. Shares surrendered in payment of the exercise price of an option will become available again for issuance or transfer under the Plan. To the extent any grants are paid in cash, and not in shares of common stock, any shares previously subject to such grants will again be available for issuance or transfer under the Plan.

Administration. The Plan will be administered and interpreted by the Board of Directors or a committee designated by the Board. We have designated our Compensation Committee (the Committee) to fulfill that role of Plan administrator. However, our Board of Directors will approve and the Committee will administer all grants made to non-employee directors. References to the Committee include our Board of Directors where appropriate. The Committee may delegate authority to administer the Plan to one or more subcommittees, as it deems appropriate.

The Committee has the authority to (i) determine the individuals to whom grants will be made under the Plan, (ii) determine the type, size, terms and conditions of the grants, (iii) determine when grants will be made and the duration of any applicable exercise or restriction period, including the criteria for exercisability and the acceleration of exercisability, (iv) amend the terms and conditions of any previously issued grant, subject to the limitations described below and (v) deal with any other matters arising under the Plan. The Committee presently consists of Paul F. Koeppe, Blake O. Fisher, Jr., Steve Barnett and Mark J. Emkjer, each of whom is a non-employee director of our company.

Eligibility for Participation. All of our employees and the employees of our subsidiaries, all of our non-employee directors, and consultants and advisors who perform services for us and our subsidiaries are eligible to receive grants under the Plan. As of December 31, 2011, we employed or used the services of approximately 400 persons who are eligible to receive grants under the Plan. The Committee is authorized to select the persons to receive grants from among those eligible and the Committee will determine the number of shares of our common stock that are subject to each grant.

Types of Awards.

Stock Options

The Committee may grant options intended to qualify as incentive stock options within the meaning of section 422 of the Code (ISOs) or nonqualified stock options that are not intended to so qualify (NQSOs) or any combination of ISOs and NQSOs. Anyone eligible to participate in the Plan may receive a grant of NQSOs. Only our employees and employees of our subsidiaries may receive a grant of ISOs.

The Committee will fix the exercise price per share of options on the date of grant. The exercise price of options granted under the Plan will be equal to the grant date closing price of a share of stock as reported on the exchange where our stock trades. However, if the grantee of an ISO is a person who holds more than 10% of the total combined voting power of all classes of our outstanding stock, the exercise price per share of an ISO granted to such person must be at least 110% of grant date closing price.

The Committee will determine the term of each option, but for an ISO the term shall not exceed ten years from the date of grant. However, if the grantee of an ISO is a person who holds more than 10% of the combined voting power of all classes of our outstanding stock, the term of the ISO may not exceed five years from the date of grant. To the extent that the aggregate fair market value of shares of our common stock, determined on the date of grant, with respect to which ISOs become exercisable for the first time by a grantee during any calendar year exceeds $100,000, such ISOs will be treated as NQSOs.

The Committee will determine the terms and conditions of options, including when they become exercisable. The Committee may accelerate the exercisability of any options. The Committee will also determine under what circumstances a grantee may exercise an option after termination of employment or service. Generally, if a grantee ceases to be employed by, or provide service to, us for any reason other than disability, death, or termination for cause, the grantee s options will terminate 90 days following the date on which the grantee ceases to be employed by, or provide service to, us. If a grantee ceases to be employed by, or provide service to, us on account of the grantee s disability or death, the grantee s options will terminate one year following the date on which the grantee ceases to be employed by, or provide service to, us. In each case described above, the Committee may specify a different option termination date, but in any event no later than the expiration of the option term. If a grantee ceases to be employed by, or provide service to, us on account of termination for cause, the grantee s options will terminate immediately.

A grantee may exercise an option by delivering notice of exercise to us. The grantee will pay the exercise price and any withholding taxes for the option: (i) in cash, (ii) unless the Committee determines otherwise, by delivering shares of our common stock already owned by the grantee and having a fair market value on the date of exercise equal to the exercise price or by attestation to ownership of shares of our common stock having a fair market value on the date of exercise at least equal to the exercise price, (iii) by payment through a broker in accordance with the procedures permitted by Regulation T of the Federal Reserve Board or (iv) by such other method as the Committee may approve.

SARs

The Committee may grant SARs to anyone eligible to participate in the Plan. SARs may be granted in connection with, or independently of, any option granted under the Plan. Upon exercise of an SAR, the grantee will receive an amount equal to the excess of the fair market value of our common stock on the date of exercise over the base amount for the SAR. Payment will be made in shares of our common stock.

The base amount of each SAR will be determined by the Committee and will be equal to the per share exercise price of the related option or, if there is no related option, an amount that is at least equal to the last reported sale price of a share of our common stock on the date of grant of the SAR. The Committee will determine the terms and conditions of SARs, including when they become exercisable. The Committee may accelerate the exercisability of any SARs. SARs may only be exercised while the grantee is employed by, or providing service to, us and our subsidiaries or within a specified period of time after termination of employment or service, as determined by the Committee.

Dividend Equivalents

The Committee may grant dividend equivalents in connection with stock units or other stock-based awards. Dividend equivalents are payable in cash or shares of our common stock and may be paid currently or accrued as contingent obligations. The terms and conditions of dividend equivalents will be determined by the Committee.

Other Stock-Based Awards

The Committee may grant other stock-based awards, which are grants other than options, SARs, stock units, and stock awards. The Committee may grant other stock-based awards to anyone eligible to participate in the Plan. These grants will be based on or measured by shares of our common stock, and will be payable in cash, in shares of our common stock, or in a combination of cash and shares of our common stock. Such awards may include restricted stock awards, stock units, or phantom stock awards, and may be granted alone, in addition to, or in tandem with any other award permitted by the Plan. The terms and conditions for other stock-based awards will be determined by the Committee.

Qualified Performance-Based Compensation. The Plan permits the Committee to impose objective performance goals that must be met with respect to grants of awards to employees under the Plan, in order for the grants to be considered qualified performance-based compensation for purposes of section 162(m) of the Code (see Federal Income Tax Consequences below). Prior to, or soon after the beginning of, the performance period, the Committee will establish in writing the performance goals that must be met, the applicable performance period, the amounts to be paid if the performance goals are met, and any other conditions. The Committee may provide in the grant agreement that qualified performance-based grants will be payable or restrictions on such grants will lapse, in whole or part, in the event of the grantee s death or disability during the performance period or under other circumstances consistent with Treasury regulations.

The performance goals, to the extent designed to meet the requirements of section 162(m) of the Code, will be based on one or more of the following measures: stock price, earnings per share, net earnings, operating earnings, earnings before income taxes, EBITDA (earnings before interest expense, income tax, and depreciation and amortization expense), return on assets, stockholder return, return on equity, growth in assets, unit volume, sales or market share, or strategic business criteria consisting of one or more objectives based on meeting specified revenue goals, market penetration goals, geographic business expansion goals, cost targets or goals relating to acquisitions or divestitures.

The Committee will not have the discretion to increase the amount of compensation that is payable upon achievement of the designated performance goals. After the announcement of our financial results for the performance period, the Committee will certify and announce the results for the performance period. If and to the extent that the Committee does not certify that the performance goals have been met, the grants of stock awards, stock units, other stock-based awards and dividend equivalents for the performance period will be forfeited or will not be made, as applicable.

Deferrals. The Committee may permit or require grantees to defer receipt of the payment of cash or the delivery of shares of our common stock that would otherwise be due to the grantee in connection with any stock units or other stock-based awards under the Plan. The Committee will establish the rules and procedures applicable to any such deferrals and may provide for interest or other earnings to be paid on such deferrals.

Adjustment Provisions. If there is any change in the number or kind of shares of our common stock outstanding (i) by reason of a stock dividend, spinoff, recapitalization, stock split, or combination or exchange of shares, (ii) by reason of a merger, reorganization or consolidation, (iii) by reason of a reclassification or change in par value, or (iv) by reason of any other extraordinary or unusual event affecting the outstanding shares of our common stock as a class, or if the value of outstanding shares of our common stock is substantially reduced as a result of a spinoff or payment by us of an extraordinary dividend or distribution, the maximum number of shares of our common stock available for issuance under the Plan, the maximum number of shares of our common stock for which any individual may receive grants in any year, the kind and number of shares covered by outstanding grants, the kind and number of shares issued and to be issued under the Plan, and the price per share or the applicable market value of such grants will be equitably adjusted by the Committee, in such manner as the Committee deems appropriate, to reflect any increase or decrease in the number of, or change in the kind or value of, the issued shares of our common stock to preclude, to the extent practicable, the enlargement or dilution of rights and benefits under the Plan and such outstanding grants. Any fractional shares resulting from such adjustment will be eliminated. Any adjustments to outstanding grants shall be consistent with section 409A or 422 of the Code, to the extent applicable.

Transferability of Grants. Only the grantee may exercise rights under a grant during the grantee s lifetime. A grantee may not transfer those rights except by will or the laws of descent and distribution; provided, however, that a grantee may transfer a grant other than an ISO pursuant to a domestic relations order.

Participants Outside of the United States. If any individual who receives a grant under the Plan is subject to taxation in a country other than the United States, the Committee may make the grant on such terms and conditions as the Committee deems appropriate to comply with the laws of the applicable country.

No Repricing of Options. Neither our Board nor the Committee can amend the Plan or options previously granted under the Plan to permit a repricing of options, without prior stockholder approval.

Amendment and Termination of the Plan. Our Board may amend or terminate the Plan at any time, subject to stockholder approval if such approval is required under any applicable laws or stock exchange requirements. The Plan will terminate on June 30, 2018, unless the Plan is terminated earlier by our Board or is extended by our Board with stockholder consent.

Stockholder Approval for Qualified Performance-Based Compensation. If stock awards, stock units, other stock-based awards or dividend equivalents are granted as qualified performance-based compensation under section 162(m) of the Code, the Plan must be re-approved by our stockholders no later than the first stockholders meeting that occurs in the fifth year following the year in which our stockholders previously approved the Plan.

Federal Income Tax Consequences of the Plan

The federal income tax consequences of grants under the Plan will depend on the type of grant. The following description provides only a general description of the application of federal income tax laws to grants under the Plan. This discussion is intended for the information of stockholders considering how to vote at the Annual Meeting and not as tax guidance to grantees, as the consequences may vary with the types of grants made, the identity of the grantees and the method of payment or settlement. The summary does not address the effects of other federal taxes (including possible golden parachute excise taxes) or taxes imposed under state, local, or foreign tax laws.

From the grantees standpoint, as a general rule, ordinary income will be recognized at the time of delivery of shares of our common stock or payment of cash under the Plan. Future appreciation on shares of our common stock held beyond the ordinary income recognition event will be taxable as capital gain when the shares of our common stock are sold. The tax rate applicable to capital gain will depend upon how long the grantee holds the shares. We, as a general rule, will be entitled to a tax deduction that corresponds in time and amount to the ordinary income recognized by the grantee, and we will not be entitled to any tax deduction with respect to capital gain income recognized by the grantee.

Exceptions to these general rules arise under the following circumstances:

- If shares of our common stock, when delivered, are subject to a substantial risk of forfeiture by reason of any employment or performance-related condition, ordinary income taxation and our tax deduction will be delayed until the risk of forfeiture lapses, unless the grantee makes a special election to accelerate taxation under section 83(b) of the Code.

- If an employee exercises a stock option that qualifies as an ISO, no ordinary income will be recognized, and we will not be entitled to any tax deduction, if shares of our common stock acquired upon exercise of the stock option are held until the later of (A) one year from the date of exercise and (B) two years from the date of grant. However, if the employee disposes of the shares acquired upon exercise of an ISO before satisfying both holding period requirements, the employee will recognize ordinary income at the time of the disposition equal to the difference between the fair market value of the shares on the date of exercise (or the amount realized on the disposition, if less) and the exercise price, and we will be entitled to a tax deduction in that amount. The gain, if any, in excess of the amount recognized as ordinary income will be long-term or short-term capital gain, depending upon the length of time the employee held the shares before the disposition.

A grant may be subject to a 20% tax, in addition to ordinary income tax, at the time the grant becomes vested, plus interest, if the grant constitutes deferred compensation under section 409A of the Code and the requirements of section 409A of the Code are not satisfied.

Section 162(m) of the Code generally disallows a publicly held corporation s tax deduction for compensation paid to its chief executive officer or certain other officers in excess of $1 million in any year. Qualified performance-based compensation is excluded from the $1 million deductibility limit, and therefore remains fully deductible by the corporation that pays it. We intend that options and SARs granted under the Plan will be qualified performance-based compensation. Stock units, stock awards, dividend equivalents, and other stock-based awards granted under the Plan may be designated as qualified performance-based compensation if the Committee conditions such grants on the achievement of specific performance goals in accordance with the requirements of section 162(m) of the Code.

We have the right to require that grantees pay to us an amount necessary for us to satisfy our federal, state or local tax withholding obligations with respect to grants. We may withhold from other amounts payable to a grantee an amount necessary to satisfy these obligations. The Committee may permit a grantee to satisfy our withholding obligation with respect to grants paid in shares of our common stock by having shares withheld, at the time the grants become taxable, provided that the number of shares withheld does not exceed the individual s minimum applicable withholding tax rate for federal, state and local tax liabilities.

The affirmative vote of the holders of a majority of the common shares voted on the proposal and represented at the annual meeting in person or by proxy is required to approve the amendment to the 2008 Plan. The Board of Directors recommends that you vote FOR this proposal.

PROPOSAL NO. 3

RATIFICATION OF THE APPOINTMENT OF DELOITTE & TOUCHE LLP

AS INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR 2012

The Audit Committee has selected and appointed the firm of Deloitte & Touche LLP as the independent registered public accounting firm to examine our financial statements for the year ended December 31, 2012. Deloitte & Touche LLP audited our financial statements for 2011 and 2010. We do not expect representatives of Deloitte & Touche LLP will attend the annual meeting.

Ratification of the selection of Deloitte & Touche LLP is not required by our bylaws or otherwise. The Board is submitting the selection to our stockholders for ratification as a matter of good corporate practice. If the selection is not ratified, the Audit Committee will consider whether it is appropriate to select another registered public accounting firm. Even if the selection is ratified, the Audit Committee in its discretion may select a different registered public accounting firm at any time after the annual meeting if it determines such a change would be in the interests of inContact and its stockholders.

Accountant Fees and Services

The aggregate fees and expenses from our principal accounting firm, Deloitte & Touche LLP for fees and expenses incurred during fiscal years ended December 31, 2011 and 2010 were as follows (in thousands):

	2011	**2010**
Audit fees	$ 311	$ 339
Audit related fees	9	7
Total audit and related fees	320	346
Other consulting fees	36	
Tax fees	138	64
Total fees	$ 494	$ 410

Audit related fees were for reviews of our filings on certain other SEC filings, meetings with the Audit Committee and work required by our filing registration statements.

Each of the permitted non-audit services has been pre-approved by the Audit Committee or the Audit Committee s Chairman pursuant to delegated authority by the Audit Committee, other than de minimus non-audit services for which the pre-approval requirements are waived in accordance with the rules and regulations of the Securities and Exchange Commission.

Policy for Approval of Audit and Permitted Non-Audit Services

The Audit Committee charter provides that the Audit Committee will pre-approve audit services and non-audit services to be provided by our independent auditors before the accountant is engaged to render these services. The Audit Committee may consult with management in the decision-making process, but may not delegate this authority to management. The Audit Committee may delegate its authority to pre-approve services to one or more committee members, provided that the designees present the pre-approvals to the full committee at the next committee meeting.

The affirmative vote of the holders of a majority of the common shares voted on the proposal and represented at the annual meeting in person or by proxy is required to ratify the selection of Deloitte & Touche LLP. The Board of Directors recommends that you vote FOR this proposal.

OTHER MATTERS

As of the date of this proxy statement, the Board knows of no other matters that may come before the annual meeting. However, if any matters other than those referred to herein should be presented properly for consideration and action at the annual meeting, or any adjournment or postponement thereof, the proxies will be voted with respect thereto in accordance with the best judgment and in the discretion of the proxy holders.

The cost of soliciting proxies in the accompanying form is paid by us. In addition to solicitations by mail, a number of regular employees of inContact may solicit proxies in person or by telephone.

The above notice and proxy statement are sent by order of the Board of Directors.

Paul Jarman, Chief Executive Officer

April 30, 2012

nt style="DISPLAY: inline; FONT-SIZE: 10pt; FONT-FAMILY: arial"> 6.6%

Tier 1	9.3%	10.0%
Total	11.9%	14.1%

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Principal risks and uncertainties

The principal risks and uncertainties for the Group in the second half of 2009 are:

The company may face the risk of full nationalisation and under such circumstances shareholders may lose the full value of their shares.
HM Treasury, the Bank of England and the FSA have extensive powers to stabilise banks. These include private sector transfer, transfer to a 'bridge bank' established by the Bank of England and nationalisation. Stabilisation measures may only be taken if the FSA is satisfied that a relevant entity is failing, or is likely to fail, to satisfy the conditions which an FSA-authorised institution must satisfy. HM Treasury may also take the parent company of a relevant entity into temporary public ownership and it has wide discretion in taking actions in relation to the company's issued securities.

The Group's business, earnings and financial prospects may be affected if it is unable to participate in the Asset Protection Scheme, or if the costs of participation outweigh the benefits.

On 26th February 2009, the Group announced its intention to participate in the asset protection scheme (APS) announced by HM Treasury on 19th January 2009. The Group's ability to participate in the APS is subject to a number of conditions which may not be satisfied resulting in the Group being unable to participate in the APS. Furthermore, if the Group is able to participate in the APS, there can be no assurance that the benefits of participation in the APS will outweigh its cost. European State Aid clearance must be obtained by the UK Government before the Group can participate in the APS. The European Commission may require significantly greater restructuring by the Group than is currently envisaged under the Group's strategic plan, including divestments, balance sheet reduction and business exits.

The Group's businesses, earnings and financial condition have been and will continue to be affected by the continued deterioration in the global economy, as well as ongoing instability in the global financial markets.
Many of the economies in which the Group operates, including the United Kingdom and the United States, face recessionary conditions which are expected to continue or worsen over the near to medium term. Financial markets around the world have yet to recover from recent unprecedented dislocation and illiquidity. These circumstances may cause the Group to experience further reductions in business activity, increased funding costs and funding pressures, decreased asset values, additional write downs and impairment charges and lower profitability or losses during the second half of 2009.

Lack of liquidity is a risk to the Group's business and its ability to access sources of liquidity has been, and will continue to be, constrained.
Credit markets have experienced a severe reduction in liquidity. The Group's liquidity management focuses on maintaining a diverse and appropriate funding strategy for its assets, controlling the mis-match of maturities and carefully monitoring its undrawn commitments and contingent liabilities. Further tightening of credit markets could have a negative impact on the Group in the second half of 2009.

Governmental support schemes are subject to cancellation or change, which may have a negative impact on the availability of funding in the markets in which the Group operates.
To the extent government support schemes are cancelled or changed, the Group may face limited access to, have insufficient access to, or incur the higher costs associated with, funding alternatives.

The financial performance of the Group has been and will be affected by borrower credit quality.
Risks arising from changes in credit quality and the recoverability of loans and amounts due from counterparties are inherent in a wide range of the Group's businesses. Whilst economies have stabilised during the first half of 2009, the

Group may see adverse changes in the credit quality of its borrowers and counterparties in the second half of 2009 with increasing delinquencies and defaults leading to higher impairment charges.

The actual or perceived failure or worsening credit of the Group's counterparties could adversely affect the Group.
The Group's ability to engage in funding transactions with counterparties in the financial markets, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds and other institutional clients has been and will continue to be adversely affected by the actual or perceived failure or worsening credit of these counterparties. Many of these transactions expose the Group to credit risk in the event of default of the Group's counterparty or client.

The Group's earnings and financial condition have been, and its future earnings and financial condition are likely to continue to be, affected by depressed asset valuations resulting from poor market conditions.
Financial markets have been subject to significant stress conditions. Severe market events resulted in the Group recording large write-downs on its credit market exposures in 2008 and the first half of 2009. Any further deterioration in economic and financial market conditions could lead to additional impairment charges and write-downs during the second half of 2009. Recent market volatility and illiquidity has made it difficult to value certain of the Group's exposures. The value ultimately realised by the Group may be materially different from the current or estimated fair value.

The value or effectiveness of any credit protection that the Group has purchased from monoline and other insurers and other market counterparties (including credit derivative product companies) depends on the value of the underlying assets and the financial condition of the insurers and such counterparties.
The Group has credit exposure arising from over-the-counter derivative contracts, mainly credit default swaps (CDSs), which are carried at fair value. Since 2007, the actual and perceived creditworthiness of monoline, credit derivative product companies and other market counterparties has deteriorated rapidly and this may continue in the second half of 2009. As a result the Group may recognise further credit valuation adjustments on CDSs bought from these counterparties.

Changes in interest rates, foreign exchange rates, bond, equity and commodity prices, and other market factors have significantly affected and will continue to affect the Group's business. Some of the most significant market risks the Group faces are interest rate, foreign exchange, bond, equity and commodity price risks.
The most significant market risks the Group faces are interest rate, foreign exchange and bond and equity price risks. Changes in interest rates and spreads in the second half of 2009 may affect the interest rate margin realised between lending and borrowing. Changes in currency rates affect the value of assets and liabilities denominated in foreign currencies and affect earnings reported by the Group's non-UK subsidiaries and may affect income from foreign exchange dealing. The performance of financial markets during the second half of 2009 may cause reductions in the value of the Group's investment and trading portfolios.

The Group's borrowing costs and its access to the debt capital markets depend significantly on its credit ratings.
Any future reductions in the long-term credit ratings of the Group or one of its principal subsidiaries (particularly the Royal Bank) could increase its borrowing costs, limit the Group's access to the capital markets and money markets, trigger additional collateral requirements, and adversely affect its competitive position.

The Group's business performance could be adversely affected if its capital is not managed effectively.
The Group is required by regulators in the United Kingdom and in other jurisdictions in which it undertakes regulated activities to maintain adequate capital. Adequate capital is also necessary for the Group's financial flexibility in the face of continuing turbulence and uncertainty in the global economy. Any developments that limit the Group's ability to manage its balance sheet and capital resources effectively (including, for example, reductions in profits and retained earnings, increases in risk-weighted assets, delays in the disposal of certain assets or the inability to syndicate loans) could have a material adverse impact on its financial condition.

Principal risks and uncertainties (continued)

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.
To establish the value of instruments measured at fair value, the Group relies on quoted market prices or, where the market for a financial instrument is not sufficiently active, valuation models. These valuation models are complex, and the related assumptions, judgements and estimates often relate to matters that are inherently uncertain, such as expected cash flows, the ability of borrowers to service debt, residential and commercial property price appreciation and depreciation, and relative levels of defaults and deficiencies. Valuations in future periods, reflecting prevailing market conditions, may result in further significant changes in the fair values of these instruments.

The Group's future earnings and financial condition in part depend on the success of the Group's strategic refocus on core strengths and its disposal programme.
The Group has embarked on a restructuring focused on achieving appropriate risk-adjusted returns, reducing reliance on wholesale funding and lowering the Group's exposure to capital intensive businesses. The Group will also continue its disposal programme and continue to review its portfolio to identify further disposals of non-core assets. Global markets remain challenging and the execution of the Group's current and future strategic plans may not be successful. In connection with the implementation of these plans, the Group may incur restructuring charges, which may be material.

The Group operates in markets that are highly competitive and consolidating. If the Group is unable to perform effectively, its business and results of operations will be adversely affected.
The markets in which the Group operates are expected to remain highly competitive. Consolidation among banks in the United Kingdom, the United States and throughout Europe in combination with the introduction of new entrants into the US and UK markets from other European and Asian countries and increased government ownership of, and involvement in, banks, could cause the Group to experience stronger competition for corporate, institutional and retail clients and greater pressure on profit margins in the second half of 2009.

The Group agreed to certain undertakings in relation to the operation of its business in the First Placing and Open Offer Agreement and the Second Placing and Open Offer Agreement and the proposed APS, which may serve to limit the Group's operations.
The Group undertook in connection with the First Placing and Open Offer Agreement and the Second Placing and Open Offer Agreement and the proposed APS to support certain initiatives in relation to lending in the UK and to regulate management remuneration and the rate of growth of the Group's balance sheet. These undertakings may serve to limit the Group's operations.

The Group could fail to attract or retain senior management or other key employees.
The failure to attract or retain a sufficient number of appropriately skilled personnel could prevent the Group from successfully implementing its strategy, which could have a material adverse effect on the Group's financial condition.

Each of the Group's businesses is subject to substantial regulation and oversight. Any significant regulatory developments could have an effect on how the Group conducts its business and on its results of operations and financial condition.
The Group is subject to financial services laws, regulations, administrative actions and policies wherever it operates. Recently there have been unprecedented levels of government intervention and changes to the regulations governing financial institutions, including recent nationalisations in the United Kingdom, the United States and other European countries. Significant regulatory developments could have an adverse impact on how the Group conducts its business and on its results of operations and financial condition.

Principal risks and uncertainties (continued)

The Group's results have been and could be further adversely affected in the event of goodwill impairment.
The Group recognises goodwill initially at cost and subsequently at cost less any accumulated impairment losses. It is tested for impairment annually or more frequently when events or circumstances indicate that it might be impaired. The recoverable amount (the higher of value in use and fair value less cost to sell) of an individual cash generating unit is compared to its carrying value. The recoverable amount of the Group's cash generating units are affected by market conditions and the performance of the economies in which the Group operates. Where the Group is required to recognise a goodwill impairment, it is recorded in the Group's income statement, although it has no effect on the Group's regulatory capital position.

The Group may be required to make further contributions to its pension schemes if the value of pension fund assets is not sufficient to cover potential obligations.
Given current economic and financial market difficulties and the prospect that they may continue over the near and medium term, the Group may be required or elect to make further contributions to its pension schemes and such contributions could be significant.

The Group is and may be subject to litigation and regulatory investigations that may impact its business.
The Group's operations are diverse and complex and it operates in legal and regulatory environments that expose it to potentially significant litigation, regulatory investigation and other regulatory risk. As a result, the Group is, and may in the future be, involved in various disputes, legal proceedings and regulatory investigations in the United Kingdom, the United States and other jurisdictions, including class-action litigation. These are subject to many uncertainties, and their outcomes are often difficult to predict. Adverse regulatory action or adverse judgements in litigation could result in restrictions or limitations on the Group's operations or significant reputational damage.

Operational risks are inherent in the Group's operations.
The activities of the Group depend on the ability to process a very large number of transactions efficiently and accurately while complying with applicable laws and regulations. Operational risk and losses can result from fraud, errors by employees or third-parties, failure to document transactions properly or to obtain proper authorisation, failure to comply with regulatory requirements and conduct of business rules (including those arising out of anti-money laundering and anti-terrorism legislation), equipment failures, natural disasters or the inadequacy or failure of systems and controls, including those of the Group's suppliers or counterparties. Although the Group has implemented risk controls and loss mitigation actions, it is not possible to be certain that such actions have been or will be effective in controlling each of the operational risks faced by the Group.

The Group is exposed to the risk of changes in tax legislation and its interpretation and to increases in the rate of corporate and other taxes in the jurisdictions in which it operates.
The Group's activities are subject to tax at various rates around the world computed in accordance with local legislation and practice. Action by governments to increase tax rates or to impose additional taxes would reduce the Group's profitability. Revisions to tax legislation or to its interpretation might also affect the Group's results in the future.

Principal risks and uncertainties (continued)

The Group’s insurance businesses are subject to inherent risks involving claims.
Future claims in the Group’s general and life assurance business may be higher than expected as a result of changing trends in claims experience resulting from catastrophic weather conditions, demographic developments, changes in mortality and other causes outside the Group’s control. These trends could affect the profitability of current and future insurance products and services. The Group reinsures some of the risks it has assumed and is exposed to the risk of loss should its reinsurers become unable or unwilling to pay claims made by the Group against them.

The Group’s operations have inherent reputational risk.
Reputational risk is inherent in the Group’s business. Negative public opinion may adversely affect the Group’s ability to keep and attract customers and, in particular, corporate and retail depositors.

In the United Kingdom and in other jurisdictions, the Group is responsible for contributing to compensation schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers.
In the United Kingdom, the Financial Services Compensation Scheme is the UK’s statutory fund of last resort for customers of authorised financial services firms. It is funded by levies on firms authorised by the FSA, including the Group. Other jurisdictions where the Group operates have introduced or plan to introduce similar compensation, contributory or reimbursement schemes (such as in the United States with the Federal Deposit Insurance Corporation). As a result the Group may incur additional costs and liabilities.

The Group’s business and earnings may be affected by geopolitical conditions.
The performance of the Group is significantly influenced by the geopolitical and economic conditions in the countries in which it operates. The Group has a presence in countries where its businesses could be exposed to the risk of business interruption and economic slowdown following the outbreak of a pandemic, or the risk of sovereign default following the assumption by governments of the obligations of private sector institutions. The Group also faces the risk of trade barriers, exchange controls and other measures taken by sovereign governments which may impact a borrower’s ability to repay. Terrorist acts and threats and the response to them of governments could also adversely affect levels of economic activity and have an adverse effect upon the Group's business.

The restructuring proposals for ABN AMRO are complex and may not realise the anticipated benefits for the Group.
The restructuring of ABN AMRO is complex involving substantial reorganisation of ABN AMRO’s operations and legal structure. The restructuring plan is being implemented and significant elements have been completed within the planned timescales and the integration of the Group’s businesses continues. However, risks remain that the Group may not realise all the anticipated benefits of the acquisition.

The recoverability of certain deferred tax assets recognised by the Group depends on the Group's ability to generate sufficient future taxable profits and there being no adverse changes to tax legislation.

In accordance with IFRS, the Group has recognised deferred tax assets on losses available to relieve future profits from tax only to the extent that it is probable that they will be recovered. The losses are quantified on the basis of current tax legislation and are subject to change in respect of the rate of tax or the rules for computing taxable profits and allowable losses. Failure to generate sufficient future taxable profits or changes in tax legislation may reduce the recoverable amount of the recognised deferred tax assets. If the Group participates in the APS, it is anticipated that certain UK tax losses, which are recognised as deferred tax assets, will be foregone as part consideration for the Group's participation in the scheme.

Further details on the Group’s credit, liquidity and market risks are included on pages 112 to 131.

Risk and capital management across the Group is based on the risk appetite set by the Board, which sets strategic direction, contributes to, and ultimately approves annual plans for each division, and regularly reviews and monitors the Group's performance in relation to risk through monthly Board reports.

Commentary and outlook

Whilst the future for many aspects of the global economy remains uncertain, it is clear that the first half of 2009 saw a decisive shift. The extreme volatility and risk aversion that characterised the end of 2008 moderated and equity and fixed income markets largely recovered value lost at the start of the year in a sustained rally that ran for most of the second quarter. Intervention by governments and central banks has prevented further failure in the world's financial system. At this point in what has already been a sharp economic slowdown, the key focus is on whether a broader economic recovery can be established, limiting the recession's duration.

For RBS, as for many of its peers, it appears that the full impact of the slowdown already witnessed has yet to be fully realised in terms of loan impairments. This is true for both retail portfolios, where unemployment is likely to rise further even if the broader economy stabilises, and corporate portfolios, where default rates have yet to peak. The Group's investment in remedial and collection processes is therefore of major importance. The Group is committed to working with its customers to restructure debt and aid recovery wherever possible; doing so both maximises current value and supports the Group's franchises in the longer term.

As importantly, this approach drives a focus on early identification and intervention in portfolios most exposed to economic weakness. Responsibility for this rests with the Group's businesses and functions across the Group; the Group's risk management teams continue to work closely with customer and product groups to identify vulnerable customers or portfolio segments and to implement mitigation strategies.

Recovery from a slowdown as sharp as that recently experienced, especially as it will involve the correction of material imbalances in the global economy, is likely to be accompanied by periods of volatility. Whilst not anticipating a return to the extreme uncertainty and market dislocation witnessed during the past two years, a return to the extended period of extreme stability that preceded them is also not expected. The Group's profile – in both its core and non-core activities – remains such that events in many of the world's geographies and markets have the potential to impact the Group's performance.

Effective risk management is therefore of strategic importance for RBS and refinements to the Group's risk management framework continue to be implemented. Updated limit frameworks for both credit and market risk support strategic priorities by targeting resources on areas that are core to the Group's future success. The Group will continue to invest in people, both through recruitment and development, at all levels in the risk management organisation. Through these and other changes, the risk management framework and function are being developed to support the Group's execution against its strategic plan.

Risk governance

Risk and capital management strategy is owned and set by the Group's Board of Directors, and implemented by executive management led by the Group Chief Executive. There are a number of committees and executives that support the execution of the business plan and strategy.

Refer to the 2008 Form 20-F for further information on the risk and capital management strategy, noting the following changes:

- The Group Executive Management Committee has been replaced by the Executive Committee;
- As a result of the Group adopting a new credit approval framework based on delegated individual authority, a new forum – the Executive Credit Group – was formed to consider, on behalf of the Board of Directors, credit applications that exceed the highest level of individual authority provided by the framework; and
- The Group Chief Executive's Advisory Group (GCEAG) has been disbanded and its responsibilities assigned to other fora. Executive Committee and Management Committee members now meet twice weekly. The risk management scope of the GCEAG has been incorporated into the agenda of the Executive Risk Forum.

Presentation of information

The information in this section has been prepared on a Group before RFS Holdings minority interest basis unless otherwise indicated as prepared on a statutory basis.

Capital

The Group aims to maintain appropriate levels of capital. For details on capital adequacy, refer to the 2008 Form 20-F.

Capital resources and ratios
The Group's regulatory capital resources on a proportional consolidation basis excluding RFS minority interest at 30 June 2009, in accordance with Financial Services Authority (FSA) definitions, were as follows:

	30 June 2009 £m	31 December 2008 £m	30 June 2008 £m
Capital base			
Core Tier 1 capital: ordinary shareholders' funds and minority interests less intangibles	35,177	34,041	26,097
Preference shares and tax deductible securities	13,949	23,091	16,200
Tax on the excess of expected losses over provisions	599	308	437
Less deductions from Tier 1 capital	(329)	(316)	(218)
Tier 1 capital	49,396	57,124	42,516
Tier 2 capital	18,879	28,967	25,966
Tier 3 capital	232	260	215
	68,507	86,351	68,697
Less: Supervisory deductions	(4,536)	(4,155)	(4,157)
Total regulatory capital	63,971	82,196	64,540
Risk-weighted (or equivalent risk-weighted) assets			
Credit risk	404,100	433,400	385,000
Counterparty risk	53,000	61,100	37,100
Market risk	56,300	46,500	32,500
Operational risk	33,900	36,800	37,100
	547,300	577,800	491,700
Risk asset ratio (Group before RFS Holdings minority interest)			
Core Tier 1	6.4%	5.9%	5.3%
Tier 1	9.0%	9.9%	8.6%
Total	11.7%	14.2%	13.1%
Risk asset ratio			
Core Tier 1	7.0%	6.6%	6.5%
Tier 1	9.3%	10.0%	9.1%
Total	11.9%	14.1%	13.2%

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Capital resources and ratios (continued)

The components of the Group’s regulatory capital resources at 30 June 2009 in accordance with FSA definitions were as follows:

	30 June 2009 £m	31 December 2008 £m	30 June 2008 £m
Composition of regulatory capital			
Tier 1			
Ordinary shareholders' equity	47,820	45,525	53,283
Minority interests	2,123	5,436	5,808
Adjustments for:			
Goodwill and other intangible assets - continuing	(15,117)	(16,386)	(27,534)
Goodwill and other intangibles assets - discontinued	-	-	(47)
Unrealised losses on available-for-sale debt securities	4,194	3,687	919
Reserves arising on revaluation of property and unrealised gains on available-for-sale equities	(25)	(984)	(2,623)
Reallocation of preference shares and innovative securities	(656)	(1,813)	(1,813)
Other regulatory adjustments	(263)	9	(37)
Less expected losses over provisions net of tax	(1,502)	(770)	(1,095)
Less securitisation positions	(1,397)	(663)	(764)
Core Tier 1 capital	35,177	34,041	26,097
Preference shares	11,207	16,655	10,608
Innovative Tier 1 securities	2,742	6,436	5,592
Tax on the excess of expected losses over provisions	599	308	437
Less deductions from Tier 1 capital	(329)	(316)	(218)
Total Tier 1 capital	49,396	57,124	42,516
Tier 2			
Reserves arising on revaluation of property and unrealised gains on available-for-sale equities	25	984	2,623
Collective impairment allowances	744	666	326
Perpetual subordinated debt	4,094	9,079	8,419
Term subordinated debt	17,832	20,282	17,012
Minority and other interests in Tier 2 capital	11	11	100
Less deductions from Tier 2 capital	(3,827)	(2,055)	(2,514)
Total Tier 2 capital	18,879	28,967	25,966
Tier 3	232	260	215
Supervisory deductions			
Unconsolidated investments	4,461	4,044	4,119
Other deductions	75	111	38

Total deductions other than from Tier 1 capital	4,536	4,155	4,157
Total regulatory capital	63,971	82,196	64,540

Credit risk

Key elements of the Group's credit risk management framework are laid out in the 2008 Form 20-F. Key developments in the first half of 2009 were:

- The introduction of a new credit approval framework for wholesale credit, replacing credit committees with individual delegated authorities and requiring at least two individuals to approve each credit decision, one from the business and one from risk management. Both parties must hold sufficient delegated authority. The level of authority granted to an individual is dependent on their experience and expertise with only a small number of senior executives holding the highest authority provided under the framework.
- Further refinement and embedding of the frameworks to manage the various dimensions of concentration risk: country, sector and single name.

Credit risk assets

Credit risk assets consist of loans and advances (including overdraft facilities), instalment credit, finance lease receivables and other traded instruments across all customer types. Reverse repurchase agreements and issuer risk are excluded.

	30 June 2009 £bn
UK Retail	98
UK Corporate	100
Wealth	14
Global Banking & Markets	264
Global Transaction Services	7
Ulster Bank	40
US Retail and Commercial	56
RBS Insurance	3
Other	-
Core	582
Non-core	156
	738

Total credit risk assets fell 14% to £738 billion at 30 June 2009, largely owing to a reduction in loans and advances to customers and banks and to the impact of sterling strengthening during the first half of the year. In the UK, credit risk assets fell only 1% while outside the UK the reduction was 22%.

Credit risk (continued)

Credit concentration risk (including country risk)
The country risk table below shows credit risk assets exceeding £1 billion by borrower domicile for countries designated internally as risk countries. Exposure is stated gross of mitigating action which may have been taken to reduce or eliminate exposure to country risk events.

	30 June 2009				31 December 2008			
	Consumer £m	Banks, financial institutions and sovereign £m	Corporate £m	Total £m	Consumer £m	Banks, financial institutions and sovereign £m	Corporate £m	Total £m
UAE	596	1,647	2,733	4,976	757	1,813	2,989	5,559
India	970	906	3,047	4,923	1,020	743	3,801	5,564
Russia	91	290	3,305	3,686	51	362	5,361	5,774
Turkey	12	926	2,192	3,130	25	966	3,036	4,027
China	22	1,477	1,473	2,972	25	1,207	2,027	3,259
South Korea	1	1,339	1,004	2,344	2	1,743	1,104	2,849
Taiwan	995	589	558	2,142	1,019	1,394	825	3,238
Romania	512	478	836	1,826	584	305	917	1,806
Mexico	1	234	1,589	1,824	4	268	2,000	2,272
Czech Republic	2	697	818	1,517	2	769	1,058	1,829
Kazakhstan	48	495	661	1,204	70	917	859	1,846
Brazil	3	713	457	1,173	4	1,012	642	1,658
Poland	6	178	983	1,167	7	347	1,309	1,663
Hungary	4	79	1,078	1,161	5	176	831	1,012
South Africa	33	543	452	1,028	27	361	507	895
Saudi Arabia	23	392	597	1,012	23	536	679	1,238

Note:
(1) Risk countries are defined as those with an internal rating of A+ and below. In addition, United Arab Emirates is included which has a rating of AA.

The outlook for developing markets has improved but remains challenging in line with global trends. Sovereigns are more resilient than during previous downturns, but the collapse in world trade resulted in a severe growth shock across all regions in the first half of 2009. Although most economies have now stabilised and are showing tentative signs of recovery, prospects vary and significant risks remain. Asia is still growing and best placed to rebound as sovereigns continue to provide strong fiscal stimulus, however, growth will remain below trend as export dependency is reduced only slowly. Middle East governments remain strong, but corporates have been hit by the real estate correction. Latin America is reasonably resilient, but still closely linked to the US and to commodities markets. Risks are highest in some Eastern European countries owing to onerous private sector debt levels and weaker sovereign liquidity.

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Risk and capital management (continued)

Credit risk (continued)

Credit risk assets by industry and geography (Core and Non-Core)

Industry analysis plays an important part in assessing potential concentration risk in the loan portfolio. Heightened monitoring applies to industry sectors where the Group believes there is a high degree of risk or potential for volatility in the future.

Credit risk assets by industry sector	30 June 2009 £bn	31 December 2008 (1) £bn
Personal	184	198
Banks and financial institutions	152	180
Property (2)	104	113
Manufacturing	54	68
Transport and storage	50	59
Technology, media, telecommunications	35	42
Wholesale and retail trade	32	35
Building	26	29
Public sectors and quasi-government	25	40
Power, water and waste	20	27
Natural resources and nuclear	20	25
Tourism and leisure	18	20
Business services	14	15
Agricultural and fisheries	4	4
	738	855

Notes:

(1) Prior period amounts have been restated to reflect internal reclassifications of certain business lines.

(2) Property includes direct property financing plus related exposures.

Credit risk assets by geography	30 June 2009 £bn	31 December 2008 £bn
United Kingdom	324	327
Western Europe (excluding UK)	182	226
North America	136	178
Asia & Pacific	41	56
Latin America	24	31
CEE & Central Asia	17	22
Middle East & Africa	14	15
	738	855

Single name concentrations

Some progress was made against exceptions arising from the Group's refined single name concentration framework during the first half of the year, although illiquid markets have reduced the scope for exposure management. In a number of cases, exposure has reduced, however negative rating migration has also created additional cases that exceed the framework's parameters. Overall there were fewer exceptions at the end of the period than at the beginning the number of corporate exceptions reduced from 552 to 501 while financial institution exceptions reduced from 150 to 122. Refining the framework and embedding it in core business processes remains a key focus going forward.

Risk and capital management (continued)

Credit risk (continued)

Credit risk asset quality
Refer to the 2008 Form 20-F and 2008 Pillar 3 Disclosure for details of the Group's credit grading framework and processes.

Credit risk assets by asset quality band	PD range	30 June 2009 ££bn	31 December 2008 ££bn
AQ1	0% - 0.034%	162	208
AQ2	0.034% - 0.048%	24	30
AQ3	0.048% - 0.095%	33	45
AQ4	0.095% - 0.381%	119	159
AQ5	0.381% - 1.076%	126	157
AQ6	1.076% - 2.153%	102	107
AQ7	2.153% - 6.089%	52	48
AQ8	6.089% - 17.222%	26	26
AQ9	17.222% - 100%	17	12
AQ10	100%	34	19
Other (1)		43	44
		738	855

Notes:
(1) "Other" largely comprises assets covered by the standardised approach for which a probability of default (PD) equivalent to those assigned to assets covered by the internal ratings based approach is not available.

Credit risk (continued)

Key credit portfolios (Analysis refers to combined Core/Non-Core portfolios unless otherwise stated)

The discussions below relate to credit risk assets in specific portfolios within the Group.

Commercial property

The commercial property portfolio credit risk assets total £90.8 billion, an 8% decrease from the beginning of the year, split between: UK (£58.0 billion); Western Europe (£22.1 billion); North America (£6.8 billion); and other regions (£3.9 billion). As part of the strategic review, 40% of the Group's commercial property portfolio was designated Non-Core.

Lending is spread across: investment (70%); development (28%); and other (2%). Speculative lending represents less than 2% of the portfolio. The Group's appetite for originating speculative commercial property lending is limited and any such business requires exceptional approval under the credit approval framework.

The decrease in asset valuations continues to place strain on the portfolio with more clients seeking covenant renegotiations while discussing structural enhancements and/or potential equity injections. The average loan-to-value (LTV) is 89%. The average interest coverage ratios for GBM and UK Corporate portfolios are 168% and 162% respectively.

The Group's lending approach has always been predominantly cashflow driven and that has mitigated the impact of asset devaluation, however, the outlook remains challenging with further pressure on asset values expected, limited liquidity to support refinancing and increasing concerns about tenant failures. The Group is working closely with clients to restructure loans and achieve outcomes that benefit both parties. Portfolios are subject to specific monitoring within originating divisions and a separate unit has been established and staffed in the first half of 2009 to ensure that specialised expertise is deployed to actively manage this portfolio on a global and coordinated basis. 13% of the portfolio was non-performing at 30 June 2009, compared to 6% at 31 December 2008.

UK residential mortgages

The UK mortgage portfolio totalled £79 billion at 30 June 2009, an increase of 6% during the first half of the year and 9% higher than June 2008, due to strong sales growth and lower redemption rates. Brands are the Royal Bank of Scotland, NatWest, the One Account, and First Active. The assets comprise prime mortgage lending and include 7% (£5.4 billion) of exposure to residential buy-to-let. There is a very small legacy self certification book (0.4% of total assets) which was withdrawn from sale in 2004.

The average LTV for new business was 65% in the first half of 2009 versus 67% for 2008. The maximum LTV available to new customers remains 90% and there has been strong volumes of low LTV applications in the first half of the year coupled with continued subdued demand for higher LTV business.

The arrears rate (three or more payments missed) on the combined Royal Bank of Scotland and NatWest brands was 1.8% at 30 June 2009, up from 1.5% as at 31 December 2008 and 1.16% as at June 2008. The arrears rate on the buy-to-let portfolio was 1.6% at 30 June 2009 (1.5% at 31 December 2008; 0.9% at 30 June 2008).

The mortgage impairment charge was £65 million in the first half of 2009 versus £33 million for the full year 2008. The increase is mainly attributable to declining house prices driving lower recoveries. Provision cover at 30 June 2009 was 0.20% versus 0.18% at 31 December 2008.

Credit risk (continued)

The number of repossessions in the first half of 2009 totalled 567, versus 551 in the second half of 2008. Forbearance policies support customers in financial difficulty and include not initiating repossession proceedings for 6 months after a customer falls in to arrears. The Group also participates in the Government's Mortgage Rescue and Homeowner Mortgage Support Schemes.

The Republic of Ireland and Northern Ireland residential mortgages
The residential mortgage portfolio in Ireland across the Ulster Bank and First Active brands totalled £21.8 billion at 30 June 2009; 91.7% is in the Republic of Ireland and 8.3% in Northern Ireland. This represents a decline of 2% in the Republic of Ireland and an increase of 2% in Northern Ireland from balances at 31 December 2008.

During the first half of 2009 loan to value and affordability criteria were further tightened, particularly in higher risk segments, e.g. buy to let. The bank also introduced new products - Momentum and SecureStep - in both Northern Ireland and the Republic of Ireland. These products aim to support market activity while continuing to meet the bank's risk criteria.

The arrears rate (three or more payments missed) increased to 2.7% at 30 June 2009 from 1.5% at 31 December 2008. As a result the loan loss impairment charge for the first half of the year was £42 million versus £23 million for the full year 2008.

Repossessions remained low and totalled 21 for first half of the year, similar to levels experienced in 2008.

US residential mortgages
Citizens Financial Group's (CFG) residential real estate portfolio totalled $45.9 billion at 30 June 2009 (versus $50.1 billion at 31 December 2008) comprising $13.3 billion in first mortgages and $32.6 billion of home equity loans and lines. Included in this $4.2 billion decline, is the sale of $2.4 billion in real estate assets from December through May 2009 to the Federal National Mortgage Association (Fannie Mae) with the remaining fall attributed to pre-payment and declining originations.

CFG has historically adopted conservative risk policies in comparison to the general market. Loan acceptance criteria were tightened further during 2009 to reflect deteriorating economic conditions. Limited exposures to sub-prime underwriting (FICO <=620, approximately 0.6%), and Alt-A /other non-conforming balances combined with reduced lending to volatile geographic regions have protected the Bank.

Excluding the Serviced By Others portfolio (SBO) of $6 billion at 30 June 2009, the portfolio average indexed LTV increased to 68% for June 2009, up from 63% in December 2008. *

Due to general US economic conditions, delinquencies in the both home equity and mortgage books are steadily rising. At 30 June 2009, 2.7% of home equity loans and 3.7% of mortgages were one payment or more past due (compared to 1.5% and 1.7% respectively at 31 December 2008). Significant investment has been made in problem debt management capability. Loan modification options are being used where appropriate to support troubled customers, including government-sponsored programmes.

Due to its loan to value and geographic profile, the SBO home equity portfolio continues to be particularly affected by the current economic climate, with net credit losses of $291 million, equivalent to an annualised 9.4% of balances, in the first half of the year (versus 5.3% in 2008). The LTV trend is obscured by the portfolio's contraction with higher

LTV a key driver of losses taken to date: average LTV stood at 101% at 30 June 2009 verses 100% at 31 December 2008. Management action to contain losses through optimising problem debt management performance continues to be a specific focus.

* Prior period figure has been restated to incorporate updated methodology and additional data.

Credit risk (continued)

Automotive sector

Exposure to the automotive sector decreased from £13.3 billion at 31 December 2008(1) to £10.8 billion at 30 June 2009.

Credit risk assets by sector	£bn	%
Original equipment manufacturer / Commercial vehicles	1.9	18
Captive finance companies	0.6	5
Component suppliers	1.5	14
Retail / Services	5.0	46
Rental	1.8	17
Total	10.8	100

Credit risk assets by geography	£bn	%
Americas	2.4	22
Central Eastern Europe	0.7	6
UK	4.1	38
Western Europe	2.9	27
Asia	0.7	7
Total	10.8	100

The sector faces numerous challenges: its exposure to discretionary consumer spending; historically high leverage; volatile input prices; and ongoing political and societal pressure to reduce fuel emissions forcing fundamental changes to business and franchise models. The Group therefore maintains a cautious stance against the sector and remains focused on larger, more diversified customers. Notwithstanding this approach, the scale of downturn has impacted the performance of the portfolio with negative rating migration and higher default rates occurring.

Over the past six months, the Group's exposure to the large US automobile manufacturers has been subject to close scrutiny and material reductions in direct lending have been achieved. The resulting size and structure of the facilities were such that minimal provisions were required on exposure to these names.

Note:

(1) Prior period figure has been restated to incorporate updated methodology and additional data.

Shipping

The Group's shipping portfolio largely comprises financing exposure, distributed as shown in the table below.

Credit risk assets by sector	£bn	%
Dry bulk	2.5	25

Tankers	4.2	41
Container	1.1	11
Gas/offshore	1.8	17
Other	0.6	6
Total	10.2	100

88% of exposure (against delivered tonnage) is secured on vessels built in the last 8 years.

Despite the significant fall in asset values and the challenging outlook across all sectors, all shipping loans are performing. The Group's focus on modern assets, with stronger cash flow and liquidity, is reflected in the fact that only £1.5 billion of the portfolio was subject to enhanced monitoring as at 30 June 2009.

Risk and capital management (continued)

Credit risk (continued)

Oil and gas

Credit risk assets by sector	£bn	%
Vertically integrated	5.9	32
Exploration and production	2.7	14
Oilfield services	2.2	12
Midstream	3.2	17
Refining and marketing	3.1	17
Other	1.5	8
Total	18.6	100

RBS and ABN AMRO had a number of exposures that overlapped, primarily in relation to well rated, vertically integrated companies and several of the larger global exploration and production companies. The Group's strategy is to continue to focus primarily on the more stable midstream and integrated oil sectors, together with well secured exposures to larger exploration and production companies based on a conservative outlook for oil prices that is regularly reassessed. Unsecured exposures are primarily to oil majors and state owned entities.

Risk and capital management (continued)

Credit risk (continued)

Asset quality

Loans and advances to customers by geography and industry
The following table analyses the balance sheet carrying value of loans and advances to customers (excluding reverse repurchase agreements and stock borrowing) by industry and geography.

	30 June 2009			31 December 2008	30 June 2008
	Core	Non-core	Total		
	£m	£m	£m	£m	£m
UK Domestic					
Central and local government	3,302	138	3,440	3,091	3,381
Finance	17,480	7,462	24,942	28,013	17,940
Individuals – home	83,432	2,048	85,480	80,967	79,114
Individuals – other	25,058	1,096	26,154	26,979	27,264
Other commercial and industrial comprising:					
- Manufacturing	10,762	1,996	12,758	15,067	14,078
- Construction	5,261	3,513	8,774	10,171	10,565
- Service industries and business activities	42,149	12,532	54,681	58,552	58,938
- Agriculture, forestry and fishing	2,839	86	2,925	2,972	2,969
- Property	17,203	33,623	50,826	52,087	50,301
Finance leases and instalment credit	5,026	11,494	16,520	17,363	15,964
Interest accruals	605	188	793	1,687	1,749
	213,117	74,176	287,293	296,949	282,263
UK International					
Central and local government	1,213	61	1,274	3,015	1,255
Finance	19,453	3,810	23,263	35,009	23,541
Individuals – other	375	73	448	490	476
Other commercial and industrial comprising:					
- Manufacturing	7,436	607	8,043	10,932	7,757
- Construction	2,173	820	2,993	3,255	2,645
- Service industries and business activities	23,161	3,137	26,298	29,782	23,562
- Agriculture, forestry and fishing	133	25	158	146	124
- Property	12,670	9,365	22,035	21,923	18,231
Interest accruals	3	445	448	37	31
	66,617	18,343	84,960	104,589	77,622
Overseas					
Europe					
Central and local government	960	534	1,494	1,830	2,709
Finance	2,619	6,134	8,753	9,731	13,501
Individuals – home	14,461	6,582	21,043	23,394	17,893

Individuals – other	2,387	660	3,047	4,641	4,642
Other commercial and industrial comprising:					
- Manufacturing	10,417	6,571	16,988	25,842	15,158
- Construction	2,163	1,670	3,833	5,183	4,674
- Service industries and business activities	25,341	8,195	33,536	40,444	43,463
- Agriculture, forestry and fishing	1,023	64	1,087	1,327	1,297
- Property	9,846	9,627	19,473	19,769	16,108
Finance leases and instalment credit	322	1,187	1,509	1,815	1,705
Interest accruals	220	234	454	798	799
	69,759	41,458	111,217	134,774	121,949

Risk and capital management (continued)

Credit risk (continued)

Asset quality (continued)

Loans and advances to customers (continued)

	30 June 2009 Core £m	Non-core £m	Total £m	31 December 2008 £m
US				
Central and local government	224	62	286	482
Finance	12,924	816	13,740	16,088
Individuals – home	23,142	4,830	27,972	34,235
Individuals – other	8,209	3,920	12,129	14,368
Other commercial and industrial comprising:				
- Manufacturing	6,955	1,997	8,952	13,127
- Construction	407	282	689	885
- Service industries and business activities	17,644	4,620	22,264	27,913
- Agriculture, forestry and fishing	219	2	221	30
- Property	1,944	3,906	5,850	6,579
Finance leases and instalment credit	2,563	35	2,598	3,066
Interest accruals	236	119	355	471
	74,467	20,589	95,056	117,244
Rest of World				
Central and local government	375	3	378	7,079
Finance	8,491	1,378	9,869	11,722
Individuals – home	397	343	740	795
Individuals – other	1,320	560	1,880	4,592
Other commercial and industrial comprising:				
- Manufacturing	3,558	2,380	5,938	6,196
- Construction	232	423	655	756
- Service industries and business activities	7,589	2,264	9,853	13,152
- Agriculture, forestry and fishing	32	187	219	153
- Property	693	1,455	2,148	2,918
Finance leases and instalment credit	34	6	40	111
Interest accruals	87	62	149	270
	22,808	9,061	31,869	47,744
Total				
Central and local government	6,074	798	6,872	15,497
Finance	60,967	19,600	80,567	100,563
Individuals – home	123,462	13,803	137,265	139,391
Individuals – other	35,319	6,309	41,628	51,070

Other commercial and industrial comprising:				
- Manufacturing	39,128	13,551	52,679	71,164
- Construction	10,236	6,708	16,944	20,250
- Service industries and business activities	115,884	30,748	146,632	169,843
- Agriculture, forestry and fishing	4,246	364	4,610	4,628
- Property	42,356	57,976	100,332	103,276
Finance leases and instalment credit	7,945	12,722	20,667	22,355
Interest accruals	1,151	1,048	2,199	3,263
Loans and advances to customers – gross	446,768	163,627	610,395	701,300
Loan impairment provisions	(5,449)	(8,198)	(13,647)	(9,324)
Total loans and advances to customers	441,319	155,429	596,748	691,976

Credit risk (continued)

Asset quality (continued)

Risk elements in lending

The following table shows the estimated amount of loans classified as non-accrual, accruing past due and potential problem loans. The figures are stated before deducting the value of security held or related provisions.

	30 June 2009			31 December
	Core	Non-core	Total	2008
	£m	£m	£m	£m
Loans accounted for on a non-accrual basis (2):				
- Domestic	5,295	6,676	11,971	8,579
- Foreign	3,242	12,016	15,258	8,503
	8,537	18,692	27,229	17,082
Accruing loans which are contractually overdue 90 days or more as to principal or interest (3):				
- Domestic	1,460	984	2,444	1,201
- Foreign	244	812	1,056	508
	1,704	1,796	3,500	1,709
Total risk elements in lending	10,241	20,488	30,729	18,791
Potential problem loans:(4)				
- Domestic	110	163	273	218
- Foreign	13	10	23	8
	123	173	296	226
Closing provisions for impairment as a % of total risk elements in lending and potential problem loans	54%	40%	44%	50%
Risk elements in lending as a % of gross lending to customers excluding reverse repos	2.26%	12.52%	5.04%	2.66%
Risk elements in lending and potential problem loans as a % of gross lending to customers excluding reverse repos	2.29%	12.63%	5.08%	2.69%

Notes:

(1) For the analysis above, 'Domestic' consists of the United Kingdom domestic transactions of the Group. 'Foreign' comprises the Group's transactions conducted through offices outside the UK and through those offices in the UK

specifically organised to service international banking transactions.

(2) All loans against which an impairment provision is held are reported in the non-accrual category.

(3) Loans where an impairment event has taken place but no impairment recognised. This category is used for fully collateralised non-revolving credit facilities.

(4) Loans for which an impairment event has occurred but no impairment provision is necessary. This category is used for fully collateralised advances and revolving credit facilities where identification as 90 days overdue is not feasible.

Credit risk (continued)

Impairments

Impairment loss provision methodology
Refer to the 2008 Form 20-F for information regarding the impairment loss provision methodology.

Impairment charge
The following table shows total impairment losses charged to the income statement.

	First half 2009			First half
	Core	Non-core	Total	2008
	£m	£m	£m	£m
New impairment losses	2,257	5,404	7,661	1,617
Less: recoveries of amounts previously written off	80	60	140	138
Charge to income statement	2,177	5,344	7,521	1,479
Comprising:				
Loan impairment losses	2,170	4,626	6,796	1,406
Impairment losses on available-for-sale securities	7	718	725	73
Charge to income statement	2,177	5,344	7,521	1,479

	First half 2009	First half 2008
	£m	£m
Impairment losses by division:		
UK Retail	824	440
UK Corporate	551	96
Wealth	22	5
Global Banking & Markets	237	17
Global Transaction Services	13	4
Ulster Bank	157	18
US Retail & Commercial	369	126
RBS Insurance	6	-
Other	(2)	(36)
Core	2,177	670
Non-core	5,344	809
	7,521	1,479

Analysis of loan impairment charge

First half 2009 First half

	Core £m	Non-core £m	Total £m	2008 £m
Latent loss impairment charge	454	270	724	328
Collectively assessed impairment charge	1,274	729	2,003	940
Individually assessed impairment charge (1)	434	3,627	4,061	138
Charge to income statement	2,162	4,626	6,788	1,406
Charge as a % of customer loans and advances – gross (2)	0.97%	5.65%	2.22%	0.46%

Notes:
(1) Excludes loan impairment charge against loans and advances to banks of £8 million (first half 2008 - nil; full year 2008 - £118 million).
(2) Gross of provisions and excluding reverse repurchase agreements.

Risk and capital management (continued)

Credit risk (continued)

Impairments (continued)

Loan impairment provisions
Operating loss is stated after charging loan impairment losses of £6,796 million (first half 2008 - £1,406 million; full year 2008 - £6,478 million). The balance sheet loan impairment provisions increased in the half year ended 30 June 2009 from £9,451 million to £13,773 million, and the movements thereon were:

	First half 2009			First half
	Core	Non-core	Total	2008
	£m	£m	£m	£m
At 1 January	4,905	4,546	9,451	4,956
Transfers to disposal groups	-	-	-	(147)
Currency translation and other adjustments	(529)	24	(505)	72
Disposals	-	-	-	(40)
Amounts written-off	(952)	(980)	(1,932)	(1,261)
Recoveries of amounts previously written-off	80	60	140	138
Charge to the income statement	2,170	4,626	6,796	1,406
Unwind of discount	(99)	(78)	(177)	(90)
Total	5,575	8,198	13,773	5,034

Provisions at 30 June 2009 include £126 million (31 December 2008 - £127 million; 30 June 2008 - £3 million) in respect of loans and advances to banks.

Analysis of loan impairment provisions

	30 June 2009			31 December
	Core	Non-core	Total	2008
	£m	£m	£m	£m
Latent loss provisions	1,477	822	2,299	1,719
Collectively assessed provisions	3,219	1,334	4,553	3,692
Individually assessed provisions	753	6,042	6,795	3,913
Total provisions (1)	5,449	8,198	13,647	9,324
Total provision as a % of customer loans and advances – gross (2)	1.2%	5.0%	2.2%	1.3%

Notes:
(1) Excludes provisions against loans and advances to banks of £126 million (31 December 2008 - £127 million; 30 June 2008 - £3 million).
(2) Gross of provisions and excluding reverse repurchase agreements.

Provisions coverage
The Group's provision coverage ratios are shown in the table below.

	30 June 2009			31 December
	Core	Non-core	Total	2008
Total provision expressed as a:				
% of REIL	54%	40%	45%	50%
% of REIL and PPL	54%	40%	44%	50%

Liquidity risk

The policy of the Group is to ensure that it is able to meet its obligations as they fall due.

The Group has an approved risk appetite supported by explicit targets and metrics to control the size and extent of both short term liquidity and long term funding risk. The Group Asset and Liability Committee (GALCO) chaired by the Group Finance Director has the responsibility to set Group policy and ensure that this is cascaded and communicated to the business divisions.

Group Treasury is the functional area with responsibility for the monitoring and control of the Group's funding and liquidity positions. Group Treasury is supported by a governance process that includes a weekly Liquidity Risk forum comprising functional areas across the organisation responsible for liquidity management, and divisional and regional asset and liability committees.

Structural balance sheet management

The maturity mismatch between deposits and lending is limited and controlled by policies aimed at ensuring assets can be funded over the term of their economic life. The mismatch analysis takes into account the impact of behaviour under normal and stress conditions to evaluate the appropriate balance of funding resources.

Stress testing

The Group uses stress tests as a tool to evaluate the impact of both disrupted market conditions and specific events to measure the impact both on, and off, balance sheet. The stress tests show the degree of resilience in times of stress and the ability for contingency actions to mitigate stressed conditions. The assumptions and nature of the risks driving the stress tests are refined and updated in the light of changing conditions.

Contingency planning

Contingency plans are developed to anticipate the potential for deterioration in market conditions and ensure that the Group has considered how it can respond to adverse developments. The contingency plan considers actions including the use of liquid assets, reduction in lending commitments, increased deposit balances and the use of collateral and management of derivative exposures.

Global developments in 2009

Liquidity conditions in money and debt markets have improved significantly since the beginning of Q2 2009. Following a difficult first quarter, most indicators of stresses in financial markets are close to or better than before the collapse of Lehman Brothers in September 2008. Contributing to the improvement has been a combination of ongoing central bank and other official liquidity support schemes, guarantee schemes and rate cuts. Signs of improvement in underlying macroeconomic trends also helped to sustain a recovery in markets for risky assets, including in debt markets.

Policy rates have reached low levels for the economic cycle in the major currency areas. Unsecured interbank rates, as benchmarked by Libor/Euribor have fallen to all-time lows – 3 month rates are now well below 1% for prime banks in the G3 currency areas. Trading activity at longer term maturities has also picked up and interbank repo of non-government collateral appears to have recovered strongly following the severe stress experienced in 2008. The US Federal Deposit Insurance Corporation's (‘FDIC’) Temporary Liquidity Guarantee Program (‘TLGP’) allowed around $300 billion of debt to be issued by US financial firms in the first half of the year. A similar amount has been issued by European banks, mostly in EUR and USD, covered by institutions' respective home-country guarantee initiatives. However in recent months unguaranteed financial debt issuance, including bank capital has become possible and guaranteed issuance has slowed markedly since May.

Risk and capital management (continued)

Liquidity risk (continued)

Important developments in central bank liquidity programmes since February include:

- In the UK, the Bank of England reduced interest rates to 0.5% in March, and later the same month the Bank of England initiated 'quantitative easing' through its Asset Purchase Facility. Gilt purchases dominate activity to date, while direct purchases of commercial paper and corporate bonds have been relatively small.

- In the US, the Federal Reserve has maintained its target for the funds rate at 0-0.25% while supplementing its credit-easing programmes with a new Term Asset-Backed Securities Loan Facility ('TALF') although initial take up of the TALF has been slow.

- In the Euro Area, the European Central Bank ('ECB') decided in early May to hold three 1-year repo operations against its general collateral list. The first of these was received enthusiastically in June, resulting in significant supply of ECB liquidity to the banking system and bringing downward pressure on short term rates.

Liquidity management

The reduction in the size of the overall funded balance sheet of the Group has reduced reliance on wholesale funding markets. The funding markets have been recovering throughout the course of 2009 and this has eased pressure on the funding position of the Group. The improvements in the markets have enabled the Group to issue £4.9 billion of unguaranteed term debt with maturity beyond 12 months and there has been a reduction of funding in short term debt markets. The structure of the balance sheet has improved and the gap between customer loans and customer deposits (excluding repos) fell by £49,325 million from £240,982 million as at 31 December 2008 to £191,657 million as at 30 June 2009. As a result, the loan to deposit ratio reduced from 152.4% to 144.5%.

The Group continues to develop diversified sources of funding across its retail, corporate and wholesale franchises in line with the strategy to rely more on retail and other customer funds to support its lending business.

The Group will seek to build on this improvement in its funding position in the expectation that trading in term markets improve providing the opportunity to increase the maturity profile of wholesale liabilities.

	First half 2009 £m	%	Full year 2008 £m	%
Deposits by Banks	135,601	16.3	178,943	18.8
Debt securities in issue:				
Commercial paper	49,270	5.9	69,891	7.3
Certificates of deposits	76,095	9.2	73,925	7.8
MTNs	104,190	12.5	94,298	9.9
Other (bonds)	4,394	0.5	14,231	1.5
Securitisations	14,761	1.8	17,113	1.8
	248,710	29.9	269,458	28.3
Subordinated debt	32,106	3.9	43,678	4.6

Total wholesale funding	416,417	50.1	492,079	51.7
Customer deposits	415,267	49.9	460,318	48.3
Total	831,684	100.0	952,397	100.0

Customer accounts

Customer accounts are the largest source of funding for the Group and are highly diversified across both retail and corporate franchises, representing a stable source of core funding. The level of customer deposits decreased over the period from £460,318 million at 31 December 2008 to £415,267 million at 30 June 2009.

Liquidity risk (continued)

Repo agreements

The repo market represents borrowings that are secured against a range of debt assets and other securities. Repo activity represents an ongoing source of financing activity and the market has not stabilised.

Debt securities in issue and subordinated liabilities

The proportion of outstanding debt instruments issued, with a remaining maturity of greater than 12 months has increased from 45% in 31 December 2008 to 47% in June 2009 reflecting a lengthening of the maturity profile of debt issuance over the period.

	First half 2009 £m	%	Full year 2008 £m	%
Less than one year	149,265	53.2	172,234	55.0
1-5 years	67,390	24.0	61,842	19.8
More than 5 years	64,161	22.8	79,060	25.2
Total	280,816	100.0	313,136	100.0

The reduction in the amount of debt instruments with maturities of less than one year reflects the Group's strategy to reduce its reliance on short-term markets and instruments coupled with favourable exchange rate movements. The net movement in maturities of greater than one year is mainly as a result of the exchange and tender offers completed in April 2009 partially offset by new debt issuance.

Short term debt and bank deposits

The short term debt markets have improved markedly over the course of 2009 and the Group has been able to readily access this source of funding with increased maturities and reduced costs of spread. This easing of market conditions has enabled the Group to reduce reliance on central bank facilities and move toward its strategic objective of self reliance in the markets.

Undrawn commitments

The Group has seen a decrease in undrawn commitments from £352 billion at 31 December 2008 to £299 billion at 30 June 2009 both as a result of the strengthening of sterling against the US dollar and the euro as well as decreased volumes. The decrease in volumes is consistent with the strategic objective to reduce liquidity risk in off-balance sheet activity.

Conduits

The Group has a multi seller conduit business that funds assets through the issuance of short term asset backed commercial paper. The total of assets held in Group sponsored conduits fell from £49.9 billion at December 2008 to £35.0 billion at 30 June 2009 as the Group reduced its exposure to this business in line with strategy.

Market risk

Market risk arises from changes in interest rates, foreign currency, credit spread, equity prices and risk related factors such as market volatilities. The Group manages market risk centrally within its trading and treasury portfolios through a comprehensive market risk management framework. This framework contains limits based on, but not limited to: value-at-risk (VaR), scenario analysis, position and sensitivity analyses.

The Group discloses market risk in VaR terms. VaR is a measure that produces estimates of the potential change in the market value of a portfolio over a specified time horizon at given confidence levels. The Group uses a historical simulation methodology with a two year time horizon and a 99% confidence level.

At the Group level the risk appetite is expressed in the form of a combination of VaR, sensitivity and scenario limits. The Group recently changed its VaR confidence level from 95% to 99% as it believes this provides greater clarity in respect of potential economic outcomes. The table below sets out VaR for the Group's portfolios with prior periods restated to reflect the 99% confidence level for consistency and comparability.

The Group continued to update and enhance its market risk management framework during the first half of 2009. In addition to the move to VaR based on a 99% confidence level, the Group has improved and strengthened its market risk limit framework, increasing the transparency of market price risk taken across the Group’s businesses in both the trading and non-trading portfolios.

The Group’s market risk appetite is defined within this limit framework which is cascaded down through legal entity, division, business and ultimately trader level market risk limits.

The VaR disclosure is broken down into trading and non-trading (referred to in previous disclosures as Treasury VaR), where trading VaR relates to the main trading activities of the Group and non-trading reflects the VaR associated with reclassified assets, money market business and the management of internal funds flow within the Group’s businesses.

As part of the Strategic Review announced on 26 February 2009, the designation of assets between Core and Non-Core divisions was completed during the period. The period end Core/Non-Core VaR as of 30 June 2009 shown below reflects the conclusion of this process. Average, Maximum and Minimum VaR for Core/Non-Core are measures that require daily data. The Non-Core division was not defined at the start of the period and average, maximum and minimum VaR are measures that require daily data. These three measures have been prepared on a best efforts basis and reflect the process of designating Non-Core assets.

	Average £m	Period end £m	Maximum £m	Minimum £m
Trading VaR (Group before RFS Holdings minority interest and statutory basis)				
Interest rate	65.6	81.4	112.8	42.5
Credit spread	125.3	199.6	231.2	66.9
Currency	17.7	15.6	35.8	9.2
Equity	13.0	11.7	21.6	8.3
Commodity	12.7	11.5	21.4	6.5

Diversification effects		(129.2)		
30 June 2009	143.3	190.6	229.0	76.8
Core (30 June 2009)	99.6	94.3	135.6	54.2
Non-Core (30 June 2009)	77.3	130.4	166.5	28.6

Risk and capital management (continued)

Market risk (continued)

	Average £m	Period end £m	Maximum £m	Minimum £m
Interest rate	38.7	54.4	94.0	18.2
Credit spread	71.5	61.5	130.8	51.7
Currency	7.6	17.0	18.0	3.5
Equity	22.4	18.3	42.6	11.0
Commodity	9.9	10.0	25.8	0.2
Diversification effects		(52.4)		
31 December 2008	82.3	108.8	155.7	49.3
Interest rate	29.1	33.7	56.1	18.2
Credit spread	72.7	75.5	96.3	51.7
Currency	6.0	7.1	8.6	3.5
Equity	23.1	19.9	42.6	11.0
Commodity	9.5	23.0	25.3	0.2
Diversification effects		(67.7)		
30 June 2008	70.4	91.5	106.0	49.3

	Average £m	Period end £m	Maximum £m	Minimum £m
Non-trading VaR (Group before RFS Holdings minority interest and statutory basis)				
Interest rate	17.6	16.6	26.1	12.9
Credit spread	198.9	205.4	270.3	65.4
Currency	1.2	1.1	3.8	0.2
Equity	4.0	3.7	7.2	2.2
Diversification effects		(27.0)		
30 June 2009	199.6	199.8	274.9	76.1
Core (30 June 2009)	82.6	81.6	133.5	55.0
Non-Core (30 June 2009)	123.1	132.6	145.3	20.2
Interest rate	10.6	24.4	32.9	5.2
Credit spread	10.5	65.2	65.2	5.5
Currency	0.6	2.2	5.7	0.1
Equity	3.4	7.0	8.0	0.8
Diversification effects		(22.7)		

31 December 2008	14.8	76.1	76.1	7.7

	Average £m	Period end £m	Maximum £m	Minimum £m
Interest rate	7.4	9.1	10.2	5.2
Credit spread	7.7	7.0	10.6	5.6
Currency	0.4	0.3	1.0	0.2
Equity	1.7	1.7	2.6	0.8
Diversification effects		(8.7)		
30 June 2008	10.0	9.4	13.4	7.7

Market risk (continued)

The data in the tables above exclude exposures to super senior tranches of asset-backed CDOs, as VaR does not provide an appropriate measure of risk for these exposures due to the continued illiquidity and opaqueness of pricing of these instruments. For these exposures, the maximum potential loss is equal to the aggregate net exposure of £548 million at 30 June 2009. For more information, please refer to market turmoil exposure - Super senior CDOs on page 145 and Note 12, Financial instruments - collateralised debt obligations.

The Group uses the most recent two years of market data in its VaR model. Accordingly the VaR at June 2009 incorporates all of the market volatility experienced since the credit crisis began in August 2007. On average this means that a given underlying risk position expressed in VaR terms will be considerably larger than previously reported. If one assumes future volatility declines in comparison to the average over the last two years then the half year may well represent a peak VaR number for a given position. The Group has reduced its underlying trading positions in the first half of 2009, but the increase in market volatility factored into the VaR calculation has more than offset this; consequently the Trading VaR has increased when compared with previous periods.

Non-Core credit spread trading VaR increased materially during the period, not only for the reason described above, but also owing to additional hedges against the risk of counterparty failure. As this counterparty risk is itself not in VaR, these hedges increase reported VaR.

The non-trading VaR increased not only because of more volatile market data in the VaR models, but also as a result of reclassification of certain trading portfolio assets.

The Group's VaR should be interpreted in light of the limitations of the methodologies used, detailed as follows:

- Historical Simulation VaR may not provide the best estimate of future market movements. It can only provide a prediction of the future based on events that occurred in the two year time series. Therefore, events that are more severe than those in the historical data series cannot be predicted.
- VaR that uses a 99% confidence level does not reflect the extent of potential losses beyond that percentile.
- VaR uses a one-day time horizon which will not fully capture the profit and loss implications of positions that cannot be liquidated or hedged within one day.
- The Group computes the VaR of trading portfolios at the close of business. Positions may change substantially during the course of the trading day and intraday profit and losses will be incurred.

These limitations mean that the Group cannot guarantee that losses will not exceed the VaR.

Risk and capital management (continued)

Market risk (continued)

The following table details the combined other than trading (non-trading businesses and retail and commercial banking activities) VaR at a 99% confidence level, which relates mainly to interest rate risk and credit spreads.

Statutory basis	Average £m	Period end £m	Maximum £m	Minimum £m
30 June 2009	187.2	190.6	203.2	177.3
31 December 2008	133.1	134.9	197.0	86.4

Structural interest rate and currency VaR (statutory basis)

Structural interest rate risks mainly arise in retail and commercial banking assets and liabilities.

Statutory basis	Average £m	Period end £m	Maximum £m	Minimum £m
30 June 2009	91.3	100.4	112.5	69.3
31 December 2008	128.1	60.1	194.6	60.3

Statutory basis	30 June 2009 £m
EUR	39.3
GBP	25.2
USD	83.8
Other	5.1

Currency risk (statutory basis)

The Group does not maintain material non-trading open currency positions other than the structural foreign currency translation exposures arising from its investments in foreign subsidiaries and associated undertakings and their related currency funding. The Group's policy in relation to structural positions is to match fund the structural foreign currency exposure arising from net asset value, including goodwill, in foreign subsidiaries, equity accounted investments and branches, except where doing so would materially increase the sensitivity of either the Group's or the subsidiary's regulatory capital ratios to currency movements. The policy requires structural foreign exchange positions to be reviewed regularly by GALCO. GALCO approves open structural exposures, primarily in USD and EUR and expressed in currency notional amounts, which are sufficient to reduce the sensitivity of regulatory capital ratios to exchange rate movements within defined tolerance limits.

Foreign exchange differences arising on the translation of foreign operations are recognised directly in equity together with the effective portion of foreign exchange differences arising on hedging instruments.

Equity classification of foreign currency denominated preference share issuances requires that these shares be held on the balance sheet at historic cost. Consequently, these share issuances have the effect of increasing the Group's structural foreign currency position.

See the 2008 Form 20-F for background on the Group's structural currency risk exposures.

The tables below set out the Group's structural foreign currency exposures.

30 June 2009	Net assets of overseas operations £m	Minority Interests £m	Net investments in foreign operations £m	Net investment hedges £m	Structural foreign currency exposures £m
US dollar	15,551	(3)	15,554	(3,330)	12,224
Euro	18,282	13,619	4,663	(1,300)	3,363
Other non sterling	5,639	536	5,103	(3,585)	1,518
Total	39,472	14,152	25,320	(8,215)	17,105
31 December 2008					
US dollar	17,480	(19)	17,499	(3,659)	13,840
Euro	26,943	15,431	11,512	(7,461)	4,051
Chinese RMB	3,928	1,898	2,030	(1,082)	948
Other non sterling	5,088	621	4,467	(3,096)	1,371
Total	53,439	17,931	35,508	(15,298)	20,210

Retranslation gains and losses on the Group's net investments in operations, together with those on instruments hedging these investments, are recognised directly in equity. Changes in foreign currency exchange rates will affect equity in proportion to the structural foreign currency exposure. A five percent strengthening of foreign currencies would result in a gain of £900 million (31 December 2008 – £1,010 million) recognised in equity. A five percent weakening of foreign currencies would result in a loss of £810 million (31 December 2008 – £960 million) recognised in equity. There are no Chinese RMB exposures at 30 June 2009 following the sale of the Group's interest in Bank of China. These movements in equity would offset retranslation effects on the Group's foreign currency denominated risk weighted assets, reducing the sensitivity of the Group's tier 1 capital ratio to movements in foreign currency exchange rates.

Market turmoil exposures

Explanatory note

These disclosures are focused around certain of the Group's exposures which have been particularly affected by the widespread market disruptions. They reflect the recommendations in the report of the Financial Stability Forum on Enhancing Market and Institutional Resilience and Committee of European Banking Supervisors report on banks' transparency on activities and products affected by the recent market turmoil.

Acronyms used in Market turmoil exposures section

The following acronyms are used in this section

ABCP	Asset-backed commercial paper
ABS	Asset-backed security
CDO	Collateralised debt obligation
CDPC	Credit derivative product company
CDS	Credit default swap
CLO	Collateralised loan obligation
CP	Commercial paper
CMBS	Commercial mortgage-backed security
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Corporation
Ginnie Mae	Government National Mortgage Association
GSE	Government Sponsored Entity
IASB	International Accounting Standards Board
RoW	Rest of the world, excluding Europe and US
RMBS	Residential mortgage-backed security
SIV	Structured investment vehicle
SPE	Special purpose entity
US agencies	Ginnie Mae, Fannie Mae, Freddie Mac and similar entities

Market turmoil exposures (continued)

Asset-backed exposures

The carrying value of the Group's debt securities at 30 June 2009 was £229.1 billion compared to £253.2 billion at 31 December 2008 ('2008'). This comprised securities issued by central and local governments of £104.7 billion (2008 - £95.0 billion), asset-backed securities of £90.5 billion (2008 - £111.1 billion), £13.4 billion (2008 - £15.0 billion) of securities issued by banks and building societies and £20.5 billion (2008 - £32.0 billion) issued by corporates, US federal agencies and other entities. This section focuses on asset-backed securities, an area of interest following the market dislocations in 2008.

The Group's credit market activities give rise to risk concentrations that have been particularly affected by the market turmoil experienced since the second half of 2007. The Group structures, originates, distributes and trades debt in the form of loan, bond and derivative instruments in all major currencies and debt capital markets in North America, Western Europe, Asia and major emerging markets.

The tables below summarise the net exposures and balance sheet carrying values of these securities by measurement classification, product and geography of underlying assets at 30 June 2009 ('2009') and 31 December 2008.

	Held-for-trading		Available-for-sale		Loans and receivables		Designated at fair value		Total	
	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Net exposure (1)										
RMBS: G10 governments (2)	16,228	18,631	29,649	32,926	-	-	-	-	45,877	51,557
RMBS: other	4,003	5,831	7,559	11,524	2,602	2,578	133	182	14,297	20,115
CMBS	1,326	1,178	1,531	918	1,413	1,437	193	13	4,463	3,546
CDOs & CLOs	961	2,463	1,751	2,538	890	1,282	1	-	3,603	6,283
Other ABS	461	195	4,466	6,572	3,841	3,621	16	40	8,784	10,428
Total	22,979	28,298	44,956	54,478	8,746	8,918	343	235	77,024	91,929
Carrying value:										
RMBS: G10 governments (2)	16,228	18,631	29,649	32,926	-	-	-	-	45,877	51,557
RMBS: other	5,962	9,218	7,839	11,865	2,602	2,618	133	182	16,536	23,883
CMBS	2,241	2,751	1,704	1,126	1,413	1,437	204	13	5,562	5,327
CDOs & CLOs	6,629	7,774	5,159	9,579	890	1,284	1	-	12,679	18,637
Other ABS	1,479	1,505	4,466	6,572	3,841	3,621	16	41	9,802	11,739
Total	32,539	39,879	48,817	62,068	8,746	8,960	354	236	90,456	111,143

Notes:

(1) Net exposures represent the carrying value after taking account of hedge protection purchased from monolines and other counterparties but exclude the effect of counterparty credit valuation adjustments. The hedges provide credit protection of principal and interest cash flows in the

event of default by the counterparty. The value of this protection is based on the underlying instrument being protected.

(2) RMBS: G10 government securities comprises securities that are:

(a) guaranteed or effectively guaranteed by the US government, via its support for US federal agencies and GSEs.

(b) guaranteed by the Dutch government.

(c) covered bonds, referencing primarily Dutch and Spanish government-backed loans.

Risk and capital management (continued)

Market turmoil exposures (continued)

Asset-backed exposures (continued)

	US		UK		Europe		RoW		Total	
	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Net exposure:										
RMBS: G10 governments	30,798	33,508	271	321	14,771	17,682	37	46	45,877	51,557
RMBS: other	4,589	7,012	5,521	6,981	3,728	5,592	459	530	14,297	20,115
CMBS	2,691	1,147	1,115	1,225	618	1,095	39	79	4,463	3,546
CDOs & CLOs	1,886	3,276	124	386	1,578	2,450	15	171	3,603	6,283
Other ABS	2,392	3,508	1,154	1,368	4,644	4,299	594	1,253	8,784	10,428
Total	42,356	48,451	8,185	10,281	25,339	31,118	1,144	2,079	77,024	91,929
Carrying value:										
RMBS: G10 governments	30,798	33,508	271	321	14,771	17,682	37	46	45,877	51,557
RMBS: other	5,067	8,558	6,243	8,105	4,719	6,593	507	627	16,536	23,883
CMBS	3,201	2,144	1,199	1,395	1,017	1,646	145	142	5,562	5,327
CDOs & CLOs	10,094	14,703	224	588	2,185	3,046	176	300	12,679	18,637
Other ABS	2,966	3,582	1,252	1,622	4,694	5,098	890	1,437	9,802	11,739
Total	52,126	62,495	9,189	12,031	27,386	34,065	1,755	2,552	90,456	111,143

Risk and capital management (continued)

Market turmoil exposures (continued)

Asset-backed exposures (continued)
Asset backed securities ('ABS') are securities with an interest in an underlying pool of referenced assets. The risks and rewards of the referenced pool are passed on to investors by the issue by a special purpose entity of securities with varying seniority. The tables below analyse carrying values of the Group's ABS by rating, measurement classification and fair value hierarchy level.

		RMBS						
30 June 2009	G10 govern-ments £m	Prime £m	Non conforming £m	Sub-prime £m	CMBS £m	CDOs & CLOs £m	Other ABS £m	Total £m
AAA rated:(1)								
Held-for-trading	16,228	4,317	194	306	1,789	3,816	486	27,136
Available-for-sale	29,261	4,786	706	401	1,311	4,014	3,341	43,820
Loans and receivables	-	582	1,327	194	229	320	939	3,591
Designated at fair value	-	120	-	13	199	-	-	332
	45,489	9,805	2,227	914	3,528	8,150	4,766	74,879
BBB- and above rated:(1)								
Held-for-trading	-	640	67	230	416	771	634	2,758
Available-for-sale	388	867	245	200	271	461	988	3,420
Loans and receivables	-	163	156	159	1,169	549	1,972	4,168
Designated at fair value	-	-	-	-	5	-	16	21
	388	1,670	468	589	1,861	1,781	3,610	10,367
Non-investment grade:(1)								
Held-for-trading	-	24	91	92	36	1,439	70	1,752
Available-for-sale	-	257	265	111	3	411	17	1,064
Loans and receivables	-	6	5	10	7	-	285	313
Designated at fair value	-	-	-	-	-	-	-	-
	-	287	361	213	46	1,850	372	3,129
Not publicly rated:								

Held-for-trading	-	1	-	-	-	603	289	893
Available-for-sale	-	-	1	-	119	273	120	513
Loans and receivables	-	-	-	-	8	21	645	674
Designated at fair value	-	-	-	-	-	1	-	1
	-	1	1	-	127	898	1,054	2,081
Total:								
Held-for-trading	16,228	4,982	352	628	2,241	6,629	1,479	32,539
Available-for-sale	29,649	5,910	1,217	712	1,704	5,159	4,466	
Loans and receivables	-	751	1,488	363	1,413	890	3,841	48,8178,746
Designated at fair value	-	120	-	13	204	1	16	354
Total	45,877	11,763	3,057	1,716	5,562	12,679	9,802	90,456
Of which carried at fair value:								
Level 2(2)	45,877	10,562	1,559	1,342	3,794	9,611	5,301	78,046
Level 3(3)	-	448	11	11	355	2,180	658	3,663
	45,877	11,010	1,570	1,353	4,149	11,791	5,959	81,709

Risk and capital management (continued)

Market turmoil exposures (continued)

Asset-backed exposures (continued)

31 December 2008	G10 govern-ments £m	RMBS Prime £m	Non conforming £m	Sub-prime £m	CMBS £m	CDOs & CLOs £m	Other ABS £m	Total £m
AAA rated:(1)								
Held-for-trading	18,622	6,226	203	393	2,306	4,698	380	32,828
Available-for-sale	32,926	8,384	1,914	522	982	6,459	4,826	56,013
Loans and receivables	-	476	1,415	431	405	652	1,443	4,822
Designated at fair value	-	166	-	16	9	-	-	191
	51,548	15,252	3,532	1,362	3,702	11,809	6,649	93,854
BBB- and above rated:(1)								
Held-for-trading	-	985	79	564	407	1,439	890	4,364
Available-for-sale	-	338	194	267	144	1,642	1,292	3,877
Loans and receivables	-	94	64	105	1,031	561	1,296	3,151
Designated at fair value	-	-	-	-	4	-	41	45
	-	1,417	337	936	1,586	3,642	3,519	11,437
Non-investment grade:(1)								
Held-for-trading	-	59	69	636	38	1,299	120	2,221
Available-for-sale	-	47	74	124	-	1,057	50	1,352
Loans and receivables	-	-	3	30	-	-	72	105
Designated at fair value	-	-	-	-	-	-	-	-
	-	106	146	790	38	2,356	242	3,678
Not publicly rated:								
Held-for-trading	9	2	1	1	-	338	115	466
Available-for-sale	-	-	1	-	-	421	404	826
Loans and receivables	-	-	-	-	1	71	810	882
	-	-	-	-	-	-	-	-

Designated at fair value								
	9	2	2	1	1	830	1,329	2,174
Total:								
Held-for-trading	18,631	7,272	352	1,594	2,751	7,774	1,505	39,879
Available-for-sale	32,926	8,769	2,183	913	1,126	9,579	6,572	62,068
Loans and receivables	-	570	1,482	566	1,437	1,284	3,621	8,960
Designated at fair value	-	166	-	16	13	-	41	236
Total	51,557	16,777	4,017	3,089	5,327	18,637	11,739	111,143
Of which carried at fair value:								
Level 2(2)	51,322	16,062	2,485	2,459	3,316	14,643	6,677	96,964
Level 3(3)	235	145	50	64	574	2,710	1,441	5,219
	51,557	16,207	2,535	2,523	3,890	17,353	8,118	102,183

Notes:

(1) Credit ratings are based on those from rating agencies Standard & Poor's (S&P). Moody's and Fitch and have been mapped onto the S&P scale.

(2) Valuation is based significantly on observable market data. Instruments in this category are valued using:

- (a) quoted prices for identical instruments in markets which are not considered to be active; or quoted prices for similar instruments trading in active or not so active markets; or
- (b) valuation techniques where all the inputs that have a significant effect on the valuation are directly or indirectly based on observable market data.

(3) Instruments in this category have been valued using a valuation technique where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data.

Market turmoil exposures (continued)

Residential mortgage-backed securities

Residential mortgage backed securities ('RMBS') are securities that represent an interest in a portfolio of residential mortgages. Repayments made on the underlying mortgages are used to make payments to holders of the RMBS. The risk of the RMBS will vary primarily depending on the quality of the underlying mortgages and the credit enhancement in the securitisation structure.

Several tranches of notes are issued, each secured against the same portfolio of mortgages, but providing differing levels of seniority to match the risk appetite of investors. The most junior (or equity) notes will suffer early capital and interest losses experienced by the referenced mortgage collateral, with each more senior note benefiting from the protection provided by the subordinated notes below. Additional credit enhancements may be provided to the holder of senior RMBS notes, including guarantees over the value of the exposures, often provided by monoline insurers.

The Group's ABS are analysed below by geographic region and nature of collateral. The US market has more established definitions for the quality of the underlying mortgage collateral and these are used as the basis for the Group's RMBS categorisation:

G10 governments – collateral comprises guaranteed mortgages and covered mortgage bonds. Guaranteed mortgages are mortgages that form part of a mortgage backed security issuance by a government agency, or in the US, an entity that benefits from a guarantee (direct or indirect) provided by the US government. For US RMBS, this category includes, amongst others, RMBS issued by US agencies such as Ginnie Mae, Freddie Mac and Fannie Mae. For European RMBS this includes mortgages guaranteed by the Dutch government. Covered mortgage bonds, primarily referencing Dutch and Spanish government-backed loans, are debt instruments that have recourse to a pool of mortgage assets, where investors have a preferred claim if a default occurs. These underlying assets are segregated from the other assets held by the issuing entity.

Prime – the underlying mortgages are of a higher credit quality than non-conforming and sub-prime mortgages (see below), but exclude G10 government mortgages.

Non-conforming (or 'Alt-A' used for US exposures) – the underlying mortgages have a higher credit quality than sub-prime mortgages, but lower than those for prime borrowers. Within the US mortgage industry, non-conforming mortgages are those that do not meet the lending criteria for US agency mortgages (described above). For non-US mortgages, judgement is applied in identifying loans with similar characteristics to US non-conforming loans, and also includes self-certified loans. Alt-A describes a category of mortgages in which lenders consider the risk to be greater than prime mortgages though less than sub-prime. The offered interest rate is usually representative of the associated risk level.

Sub-prime – the underlying mortgages are loans to sub-prime borrowers typically having weakened credit histories that include payment delinquencies, and potentially more severe problems such as court judgements and bankruptcies. They may also display reduced repayment capacity as measured by credit scores, high debt-to-income ratios, or other criteria indicating heightened risk of default.

Risk and capital management (continued)

Market turmoil exposures (continued)

Residential mortgage-backed securities (continued)
The tables below shows the Group's RMBS net exposures and carrying values by underlying asset type, measurement classification, the geographical location of the property securing the mortgage and the year in which the underlying securitisation was originated.

	30 June 2009					31 December 2008				
	G10 govern-ments	Prime	Non conforming	Sub-prime	Total	G10 govern-ments	Prime	Non conforming	Sub-prime	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Total										
Net exposure:(1)										
Held-for-trading	16,228	3,218	346	439	20,231	18,631	5,140	346	345	24,462
Available-for-sale	29,649	5,910	1,217	432	37,208	32,926	8,768	2,184	572	44,450
Loans and receivables	-	751	1,488	363	2,602	-	569	1,482	527	2,578
Designated at fair value	-	120	-	13	133	-	166	-	16	182
	45,877	9,999	3,051	1,247	60,174	51,557	14,643	4,012	1,460	71,672
Carrying values:(2)										
Held-for-trading	16,228	4,982	352	628	22,190	18,631	7,272	352	1,594	27,849
Available-for-sale	29,649	5,910	1,217	712	37,488	32,926	8,769	2,183	913	44,791
Loans and receivables	-	751	1,488	363	2,602	-	570	1,482	566	2,618
Designated at fair value	-	120	-	13	133	-	166	-	16	182
	45,877	11,763	3,057	1,716	62,413	51,557	16,777	4,017	3,089	75,440

Notes:

(1) Net exposures represent the carrying value after taking account of hedge protection purchased from monolines and other counterparties but excludes the effect of counterparty credit valuation adjustment. Carrying value is the amount recorded on the balance sheet.

(2) Carrying value is the amount recorded on the balance sheet.

(3) G10 government RMBS net exposures and carrying values include:

(a) £6.7 billion (2008 - £7.6 billion) available-for-sale exposures guaranteed by the Dutch government.

(b) £6.9 billion (2008 - £5.7 billion) guaranteed by the US government via Ginnie Mae of which £1.1 billion (2008 - £0.5 billion) are held-for-trading.

(c) £23.8 billion (2008 - £ 27.8 million) effectively guaranteed by the US government by way of its support for Freddie Mac and Fannie Mae of which £15.1 billon (2008 - £18.1 billion) are held-for-trading.

(d)

£8.0 billion (2008 - £10.0 billion) all classified as available-for-sale, covered bonds.

Risk and capital management (continued)

Market turmoil exposures (continued)

Residential mortgage-backed securities (continued)

	30 June 2009					31 December 2008				
	US agency £m	Prime £m	Alt-A £m	Sub-prime £m	Total £m	US agency £m	Prime £m	Alt-A £m	Sub-prime £m	Total £m
United States										
Net exposure:										
Held-for-trading	16,191	433	346	439	17,409	18,577	968	346	302	20,193
Available-for-sale	14,607	2,667	566	51	17,891	14,932	4,364	760	53	20,109
Loans and receivables	-	84	-	3	87	-	215	-	3	218
	30,798	3,184	912	493	35,387	33,509	5,547	1,106	358	40,520
Carrying values:										
Held-for-trading	16,191	490	353	575	17,609	18,577	1,043	352	1,427	21,399
Available-for-sale	14,607	2,668	566	328	18,169	14,932	4,364	760	394	20,450
Loans and receivables	-	84	-	3	87	-	215	-	3	218
	30,798	3,242	919	906	35,865	33,509	5,622	1,112	1,824	42,067
Of which originated in:										
2004 and earlier	8,260	701	95	308	9,364	5,534	709	122	474	6,839
2005	3,131	801	501	164	4,597	6,014	2,675	718	259	9,666
2006	1,039	925	105	187	2,256	1,690	614	115	718	3,136
2007 and later	18,368	815	218	247	19,648	20,271	1,624	157	373	22,425
	30,798	3,242	919	906	35,865	33,509	5,622	1,112	1,824	42,067

	30 June 2009					31 December 2008				
	Guaranteed £m	Prime £m	Non conforming £m	Sub-prime £m	Total £m	Guaranteed £m	Prime £m	Non conforming £m	Sub-prime £m	Total £m
United Kingdom										
Net exposure:										
Held-for-trading	-	239	-	-	239	9	249	-	33	291
Available-for-sale	271	2,493	651	79	3,494	313	3,133	1,423	154	5,023
Loans and receivables	-	314	1,364	248	1,926	-	118	1,482	205	1,805
Designated at fair value	-	120	-	13	133	-	166	-	16	182
	271	3,166	2,015	340	5,792	322	3,666	2,905	408	7,301

Carrying values:										
Held-for-trading	-	954	-	5	959	9	1,336	-	70	1,415
Available-for-sale	271	2,493	651	81	3,496	313	3,133	1,423	154	5,023
Loans and receivables	-	314	1,364	248	1,926	-	118	1,482	205	1,805
Designated at fair value	-	120	-	13	133	-	166	-	16	182
	271	3,881	2,015	347	6,514	322	4,753	2,905	445	8,425
Of which originated in:										
2004 and earlier	7	273	-	32	312	9	806	-	72	887
2005	-	776	-	24	800	-	1,000	652	42	1,694
2006	8	1,957	464	127	2,556	13	2,295	756	209	3,273
2007 and later	256	875	1,551	164	2,846	300	652	1,497	122	2,571
	271	3,881	2,015	347	6,514	322	4,753	2,905	445	8,425

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Risk and capital management (continued)

Market turmoil exposures (continued)

Residential mortgage-backed securities (continued)

	30 June 2009					31 December 2008				
Europe	Guaranteed (1) £m	Covered bonds (2) £m	Prime and non-conforming (3) £m	Sub-prime £m	Total £m	Guaranteed (1) £m	Covered bonds (2) £m	Prime £m	Sub-prime £m	Total £m
Net exposure										
Held-for-trading	-	-	2,542	-	2,542	-	-	3,898	10	3,908
Available-for-sale	6,722	8,049	592	41	15,404	7,642	10,040	1,106	57	18,845
Loans and receivables	-	-	450	103	553	-	-	208	313	521
	6,722	8,049	3,584	144	18,499	7,642	10,040	5,212	380	23,274
Carrying values										
Held-for-trading	-	-	3,525	8	3,533	-	-	4,839	30	4,869
Available-for-sale	6,722	8,049	592	41	15,404	7,642	10,040	1,107	57	18,846
Loans and receivables	-	-	451	102	553	-	-	208	352	560
	6,722	8,049	4,568	151	19,490	7,642	10,040	6,154	439	24,275
Of which originated in:										
2004 and earlier	377	632	684	25	1,718	418	702	954	48	2,122
2005	1,033	2,364	754	27	4,178	1,165	2,993	1,090	17	5,265
2006	1,758	3,822	1,585	84	7,249	2,059	4,466	2,466	148	9,139
2007 and later	3,554	1,231	1,545	15	6,345	4,000	1,879	1,644	226	7,749
	6,722	8,049	4,568	151	19,490	7,642	10,040	6,154	439	24,275

Notes:

(1) Guaranteed by the Dutch government

(2) Covered bonds referencing primarily Dutch and Spanish mortgages

(3) Non-conforming net exposures and carrying values: £123 million at 30 June 2009 (2008 – nil)

Risk and capital management (continued)

Market turmoil exposures (continued)

Residential mortgage-backed securities (continued)

	30 June 2009				31 December 2008			
	Guaranteed	Prime	Sub-prime	Total	Guaranteed	Prime	Sub-prime	Total
Rest of the World	£m	£m	£m	£m	£m	£m	£m	£m
Net exposure								
Held-for-trading	37	4	-	41	46	24	-	70
Available-for-sale	-	156	263	419	-	164	308	472
Loans and receivables	-	28	8	36	-	28	6	34
	37	188	271	496	46	216	314	576
Carrying values								
Held-for-trading	37	11	41	89	46	54	67	167
Available-for-sale	-	157	262	419	-	164	308	472
Loans and receivables	-	28	8	36	-	28	6	34
	37	196	311	544	46	246	381	673
Of which originated in:								
2004 and earlier	-	25	58	83	-	37	65	102
2005	-	1	33	34	-	30	34	64
2006	37	3	175	215	46	2	187	235
2007 and later	-	167	45	212		177	95	272
	37	196	311	544	46	246	381	673

Risk and capital management (continued)

Market turmoil exposures (continued)

Residential mortgage-backed securities (continued)
US - the Group's largest concentration of RMBS assets is the portfolio of US agency asset-backed securities comprising mainly current year vintage positions amounting to £30.8 billion at 30 June 2009 (2008: £33.5 billion). Due to the US government backing, explicit or implicit, in these securities, the counterparty credit risk exposure is low. £16.2 billion (2008: £18.6 billion) is held in actively traded portfolios, actively transacted, and possesses a high degree of liquidity. Trading in this portfolio has driven a shift to more recent vintages. However, the majority of the decrease in exposure during the period has been due to the strengthening of sterling against the US dollar. Available-for-sale exposures of £14.6 billion (£14.9 billion) relate to liquidity portfolios held by US Retail & Commercial.

Europe - these are liquidity portfolios comprising £6.7 billion (2008 - £7.6 billion) available-for-sale portfolio of European RMBS, referencing primarily Dutch and Spanish government-backed loans and £8.0 billion (2008 - £10.0 billion) of European RMBS comprised covered mortgage bonds. The decrease in both of these portfolios primarily reflects exchange rate movements. These exposures are part of the liquidity portfolios held by Group Treasury.

UK and the rest of the world - the Group has other portfolios of RMBS from secondary trading activities, warehoused positions previously acquired with the intention of further securitisation and a portfolio of assets from the unwinding of a securities arbitrage conduit. This conduit was established to benefit from the margin between the assets purchased and the notes issued.

Material disposals of prime RMBS occurred in the period, in particular £1.5 billion of 2005 vintage US securities, £0.5 billion of Spanish and Portuguese mortgages and £0.6 billion of positions which have synthetic hedges against them. Other declines were due to redemptions and foreign exchange movements. Sub-prime balances reduced across ratings, geographies and vintages, due to pay downs, maturities and sales during the period, while non-conforming exposures fell mainly due to UK available-for-sale redemptions.

Market turmoil exposures (continued)

Commercial mortgage-backed securities

Commercial mortgage-backed securities ('CMBS') are securities that are secured by loans mortgaged on commercial land and buildings. The securities are structured in the same way as an RMBS but typically the underlying assets referenced will be of greater individual value. The performance of the securities is dependent on the sector of the occupier of the commercial property and the geographical region.

The Group accumulated CMBS for the purpose of re-securitisation and secondary trading. The largest holding of CMBS arose as a result of the Group's purchase of senior tranches in mezzanine and high grade CMBS structures from third parties. These securities are predominantly hedged with monoline insurers. As a result, the Group's risk is limited to the counterparty credit risk exposure on the hedge provider.

The following table shows the composition of the Group's holdings of CMBS portfolios.

	30 June 2009					31 December 2008				
	US	UK	Europe	RoW	Total	US	UK	Europe	RoW	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
US federal agency	1,418	n/a	n/a	n/a	1,418	649	n/a	n/a	n/a	649
Office	641	770	242	-	1,653	428	915	402	-	1,745
Retail	460	45	66	39	610	295	43	2	49	389
Mixed use	62	27	473	3	565	20	99	975	45	1,139
Multi-family	279	131	3	-	413	159	143	-	-	302
Hotel	119	26	-	-	145	40	35	-	-	75
Healthcare	1	30	75	-	106	24	13	81	-	118
Leisure	-	77	-	-	77	-	76	-	-	76
Industry	63	-	8	-	71	40	-	49	-	89
Other	159	92	150	103	504	490	71	137	47	745
	3,202	1,198	1,017	145	5,562	2,145	1,395	1,646	141	5,327

Underlying CMBS carrying values declined due to foreign exchange movements driven by the strengthening of sterling against the US dollar and the euro, as well as modest pay downs, sales and write-downs. This was partially offset by revised asset classifications, including US federal agency issued securities.

There have been no material acquisitions of CMBS by the Group in the period. Where exposures within CMBS types have increased, this is due to a change of sector exposure from permitted substitutions, particularly within US structures, and revised sector classifications.

Asset-backed collateralised debt and loan obligations

Collateralised debt obligations ('CDOs') are securities whose performance is dependant on a portfolio of underlying cash and synthetic exposures to referenced assets generally ABS, but may also include other classes of assets. The collateralised loan obligations ('CLOs') have referenced portfolios which primarily consist of leveraged loans.

The Group's ABS CDO and CLO net exposures comprised:

31 December

	30 June 2009 £m	2008 £m
Super senior CDOs	548	1,182
Other CDOs	909	1,658
CLOs	2,146	3,443
	3,603	6,283

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Market turmoil exposures (continued)

The Group's CDO exposures comprise:

- Super senior CDO risk structured by the Group from 2003 to 2007 that the Group was unable to sell to third parties due to prevailing illiquid markets, with net exposures of £0.5 billion (2008: £1.2 billion).
- Other CDO net exposures of £0.9 billion (2008:£1.7 billion) purchased from third parties, some of which are fully hedged through CDS with other banks or monoline insurers.

Given the significance of net losses incurred on super senior CDOs in recent years, additional disclosures on these exposures are discussed below.

Super senior CDOs

Super senior CDOs represent the most senior positions in a CDO. Instruments subordinate to the super senior CDO (usually a combination of equity, mezzanine and senior notes) absorb losses before the super senior note is affected. Losses will only be suffered by the super senior note holders once defaults on the underlying reference assets exceed a specified threshold. This threshold is usually referred to in terms of a percentage of defaults in the asset pool; known as the 'attachment point'. These super senior instruments carry an AAA rating at origination or are senior to other AAA rated notes in the same structure. The level of defaults occurring on recent vintage sub-prime mortgages and other asset classes has been higher than originally expected. As a result the protection afforded by the subordinate securities has been significantly eroded and consequently the super senior notes have a higher probability of suffering losses than at origination. The majority of the underlying collateral is now rated below investment grade.

Depending on the quality of the underlying reference assets on issue, the super senior tranches will be either classified as high grade or mezzanine. The majority of the Group's exposure relates to high grade super senior tranches of ABS CDOs. The table below summarises the carrying amounts and net exposures after hedge protection of the Group's super senior CDOs as at 30 June 2009. The collateral rating is determined with reference to S&P ratings where available. Where S&P ratings are not available the lower of Moody's and Fitch ratings have been used.

	30 June 2009(1)			31 December 2008(2)		
	High grade £m	Mezzanine £m	Total £m	High grade £m	Mezzanine £m	Total £m
Gross exposure	6,314	2,586	8,900	7,104	2,884	9,988
Hedges and protection	(3,040)	(614)	(3,654)	(3,423)	(691)	(4,114)
	3,274	1,972	5,246	3,681	2,193	5,874
Write-downs on net open positions and amortisations	(2,756)	(1,942)	(4,698)	(2,592)	(2,100)	(4,692)
Net exposure after hedges and write-downs	518	30	548	1,089	93	1,182
Average price	17%	3%	16%	29%	6%	23%

Notes:

(1) Net exposure represents the carrying value after taking account of hedge protection purchased from monolines and other counterparties but excludes the effect of counterparty credit valuation adjustment; includes portfolios carried at fair value only.

(2) Exposures at 31 December 2008 have been restated to reflect transactions that have been liquidated and now represent long positions in asset-backed securities.

Market turmoil exposures (continued)

The change in net exposure during the year is analysed in the table below.

	High grade £m	Mezzanine £m	Total £m
Net exposure at 1 January 2009	1,089	93	1,182
Write downs	(417)	(50)	(467)
Foreign exchange and other movements	(154)	(13)	(167)
Net exposure at 30 June 2009	518	30	548

During 2009 the super senior exposures, which are predominantly US positions, have fallen by approximately 50%. This reflects the further price declines in the underlying collateral as well as the foreign exchange effect as sterling has strengthened against the US dollar in the first half of 2009.

Other CDOs

The net exposure of the Group's other senior CDO exposures was £0.9 billion after hedge protection with financial institutions (more than 80%) or monolines. The unhedged exposures comprise smaller positions with various types of underlying collateral, rating and vintage characteristics. The positions hedged with derivative protection from financial institutions include a number of positions referencing early vintages of RMBS and other ABS assets. The Group therefore has no net exposure to these CDOs before credit valuation adjustment. Due to the early vintage, the assets underlying these structures have not deteriorated to the same degree as the more recently issued securities. During 2009 the other CDO exposures, which are predominantly US positions, have fallen significantly. This reflects further price declines in the underlying collateral as well as the strengthening of sterling against the US dollar in the first half of 2009. The price declines relate to exposures with more recent vintages.

CLOs

The Group's CLO exposures arise from its trading activities and consist of retained interests and from notes purchased from third-party structures. The Group holds super senior securities in two CLO structures which were originated by the Group in 2005 and 2007. The underlying collateral of these structures predominantly references leveraged loans.

In the first half of 2009, there were further write downs in line with the decline in the market, some deal amortisations and disposal of positions where market opportunities occurred.

Market turmoil exposures (continued)

Other asset backed securities

Other asset backed securities are securities issued by securitisation vehicles, similar to those in RMBS and CMBS structures, which reference cash flow generating assets other than mortgages. The wide variety of referenced underlying assets results in diverse asset performance levels.

The Group has accumulated these assets from a range of trading and funding activities. The carrying value of the Group's other asset-backed securities by underlying asset type and geographical region are shown below.

	30 June 2009					31 December 2008				
	US	UK	Europe	RoW	Total	US	UK	Europe	RoW	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Covered bonds	-	-	2,190	-	2,190	-	-	3,301	-	3,301
Consumer	245	182	1,071	499	1,997	956	408	118	729	2,211
Aircraft leases	380	13	8	65	466	459	23	-	273	755
Other leases	16	611	286	-	913	1	492	455	-	948
Student loans	694	-	-	-	694	953	-	-	-	953
Trade receivables	623	7	-	-	630	15	9	-	-	24
Utilities and energy	241	2	283	177	703	47	19	48	143	257
Auto and equipment	90	8	337	3	438	160	30	466	29	685
Film/entertainment	-	-	-	-	-	86	-	-	-	86
Other	677	429	519	146	1,771	904	641	710	263	2,518
	2,966	1,252	4,694	890	9,802	3,581	1,622	5,098	1,437	11,738

The covered bonds comprise asset-backed securities issued by Spanish financial institutions. These securities benefit from credit enhancement provided by the issuing institutions. The reduction in carrying value of the Group's Other ABS exposures reflects asset disposals, and the strengthening of sterling against the US dollar and the euro. There have been no material acquisitions of other ABS by the Group in the period. Where exposures within specific asset types have increased, this is due to a combination of permitted substitutions within structures and revised sector classifications, particularly in relation to other consumer and trade receivable positions.

Market turmoil exposures (continued)

Counterparty valuation adjustments

Credit valuation adjustments

Counterparty valuation adjustments ('CVAs') 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. During 2009, as credit spreads of monoline insurers have generally widened, there has been an increase in the total CVA as set out in the table below.

	30 June 2009 £m	31 December 2008 £m
Monoline insurers	6,845	5,988
CDPCs	821	1,311
Other counterparties	1,821	1,738
Total CVA adjustments	9,487	9,037

The Group has purchased protection from monoline insurers ("monolines") mainly against specific ABS, CDOs and CLOs. Monolines are entities which specialise in providing credit protection against the notional and interest cash flows due to the holders of debt instruments in the event of default by the debt security counterparty. This protection is typically held in the form of derivatives such as credit default swaps ('CDS') referencing the underlying exposures held by the Group.

The Group has also purchased credit protection, both tranched and single name credit derivatives, from credit derivative product companies ('CDPC'). CDPCs are similar to monolines however they are not regulated as insurers. The Group's exposure to CDPCs is predominantly due to tranched credit derivatives ("tranches"). A tranche references a portfolio of assets and provides protection against total portfolio default losses exceeding a certain percentage of the portfolio notional (the attachment point) up to another percentage (the detachment point). The Group has predominantly traded senior tranches with CDPCs, the average attachment and detachment points are 15% and 50% respectively, and the majority of the loans and bonds in the reference portfolios are investment grade.

The CVA for monolines is calculated on a trade-by-trade basis, and is derived using market observable monoline credit spreads. The majority of the monoline CVA relates to credit derivatives hedging exposures to ABS. The CDPC CVA is calculated using a similar approach. However, in the absence of market observable credit spreads, the cost of hedging the counterparty risk is estimated by analysing the underlying trades and the cost of hedging expected default losses in excess of the capital available in each vehicle.

The CVA for all other counterparties is calculated with reference to observable credit spreads. The calculation is performed on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the risk.

The widening of monoline credit spreads during the year contributed to a significant increase in the total size of CVA adjustments recorded.

Market turmoil exposures (continued)

Monoline insurers

The Group's monoline exposures are predominantly denominated in US dollars and the weakening of the US dollar against sterling has significantly reduced the gross exposure to these counterparties. This has been partially offset by an increase in the fair value of the CDS protection from monolines as the market price of the securities protected continued to decline.

The perceived credit quality of the monolines has also continued to deteriorate as reflected by ratings downgrades, wider credit spreads and lower recovery rate assumptions seen in the market. This has resulted in increased levels of CVA being recorded against the Group's monoline exposure.

Summary of the Group's exposure to monoline counterparties:

	30 June 2009 £m	31 December 2008 £m
Gross exposure to monolines	10,950	11,581
Hedges with financial institutions	(524)	(789)
Credit valuation adjustment	(6,845)	(5,988)
Net exposure to monolines	3,581	4,804

The net income statement effect arising from the change in level of monoline CVA and related trades is shown below. The US dollar weakening against sterling is the primary cause of the loss arising on foreign exchange, hedges and other movements.

	£m
Credit valuation adjustment at 1 January 2009	(5,988)
Credit valuation adjustment at 30 June 2009	(6,845)
Increase in credit valuation adjustment	(857)
Foreign exchange and other movements	(937)
Net effect relating to reclassified debt securities	(27)
	(1,821)

Market turmoil exposures (continued)

Monoline insurers (continued)

The asset categories protected by CDSs written by monolines and the related CVA by monoline credit rating at the balance sheet date are analysed in the table below.

	30 June 2009				31 December 2008			
	Notional amount: protected assets £m	Fair value: Protected assets £m	Gross exposure £m	Credit valuation adjustment £m	Notional amount: protected assets £m	Fair value: protected assets £m	Gross exposure £m	Credit valuation adjustment £m
AAA/AA rated:								
CDO of RMBS	-	-	-	-	-	-	-	-
RMBS	3	2	1	-	3	2	1	-
CMBS	503	357	146	61	613	496	117	51
CLOs	5,610	4,219	1,391	599	6,506	4,882	1,624	718
Other ABS	1,308	849	459	206	1,548	990	558	251
Other	265	174	91	44	267	167	100	47
	7,689	5,601	2,088	910	8,937	6,537	2,400	1,067
A/BBB rated:								
CDO of RMBS	-	-	-	-	5,385	1,363	4,022	1,938
RMBS	-	-	-	-	90	63	27	10
CMBS	-	-	-	-	4,236	1,892	2,344	1,378
CLOs	-	-	-	-	6,009	4,523	1,486	778
Other ABS	-	-	-	-	910	433	477	243
Other	-	-	-	-	265	122	143	79
	-	-	-	-	16,895	8,396	8,499	4,426
Sub-investment grade:								
CDO of RMBS	4,972	687	4,285	2,745	394	32	362	263
RMBS	76	64	12	2	-	-	-	-
CMBS	3,757	1,212	2,545	1,886	-	-	-	-
CLOs	4,953	3,795	1,158	797	350	268	82	60
Other ABS	1,747	1,129	618	353	1,208	1,037	171	123
Other	488	244	244	152	237	169	68	49
	15,993	7,131	8,862	5,935	2,189	1,506	683	495
Total:								
CDO of RMBS	4,972	687	4,285	2,745	5,779	1,395	4,384	2,201
RMBS	79	66	13	2	93	65	28	10

CMBS	4,260	1,569	2,691	1,947	4,849	2,388	2,461	1,429
CLOs	10,563	8,014	2,549	1,396	12,865	9,673	3,192	1,557
Other ABS	3,055	1,978	1,077	559	3,666	2,460	1,206	617
Other	753	418	335	196	769	458	311	175
	23,682	12,732	10,950	6,845	28,021	16,439	11,582	5,988

The Group also has indirect exposure to monolines through wrapped securities and other assets with credit enhancement monolines. These securities are traded with the benefit of this credit enhancement. Any deterioration in the credit rating of the monoline is reflected in the fair value of these assets.

Market turmoil exposures (continued)

Credit derivative product companies
The Group's exposure to CDPCs has reduced considerably due to a combination of tighter credit spreads and a decrease in the relative value of senior tranches compared to the underlying reference portfolios. The trades with CDPCs are predominantly denominated in US and Canadian dollars and therefore the strengthening of sterling against these currencies has further reduced the exposure.

The overall level of CVA has decreased in line with the reduction in the exposure, however, on a relative basis the CVA has increased. This reflects the perceived deterioration of the credit quality of the CDPCs as reflected by ratings downgrades.

Summary of the Group's exposure to CDPC:

	30 June 2009 £m	31 December 2008 £m
Gross exposure to CDPCs	2,303	4,776
Credit valuation adjustment	(821)	(1,311)
Net exposure to CDPCs	1,482	3,465

The net income statement effect arising from the change in level of CVA and related trades is shown in the table below. The Group has additional market risk hedges in place which effectively cap the exposure to CDPCs where the Group has significant risk. As the exposure to these CDPCs has reduced, losses have been incurred on the additional hedges. These losses, together with losses arising on trades hedging CVA, are the primary cause of the loss arising on hedges, foreign exchange and other movements.

	£m
Credit valuation adjustment at 1 January 2009	(1,311)
Credit valuation adjustment at 30 June 2009	(821)
Decrease in credit valuation adjustment	490
Hedges, foreign exchange and other movements	(1,059)
	(569)

Market turmoil exposures (continued)

Credit derivative product companies (continued)

Further analysis of the Group's exposure to CDPCs by CDPC credit rating is shown below. Some of the CDPCs with the AAA/AA and A/BBB rating at 31 December 2008 were subsequently downgraded or had ratings withdrawn.

	30 June 2009				31 December 2008			
	Notional amount: protected assets £m	Fair value: protected reference assets £m	Gross exposure £m	Credit valuation adjustment £m	Notional amount: protected assets £m	Fair value: protected reference assets £m	Gross exposure £m	Credit valuation adjustment £m
AAA/AA rated	1,636	1,580	56	18	19,092	15,466	3,626	908
A/BBB rated	15,965	14,484	1,481	470	6,147	4,997	1,150	403
Sub-investment grade	1,399	1,097	302	151	-	-	-	-
Rating withdrawn	3,914	3,450	464	182	-	-	-	-
	22,914	20,611	2,303	821	25,239	20,463	4,776	1,311

Market turmoil exposures (continued)

Leveraged finance

Leveraged finance is employed to facilitate corporate finance transactions, such as acquisitions or buy-outs. A bank acting as a lead manager will typically underwrite a loan, alone or with others, and then syndicate the loan to other participants ('syndicate portfolio'). The Group has typically also held a portion of these loans as part of its long term portfolio once primary syndication is completed ('hold portfolio').

Since the beginning of the credit market dislocation in the second half of 2007, investor appetite for leveraged loans and similar risky assets has fallen dramatically, with secondary prices falling due to selling pressure and margins increasing, and reduced activity in the primary market. There were a small number of modest deals with reduced leverage executed in the first half of 2008 priced at less than mid-2007 levels. Concerted efforts to sell positions during the first half of 2008 were only partially successful due to the rapid deterioration in market conditions since origination of the loans. Most of the leveraged finance loans held as part of syndicated lending activity were reclassified from the held-for-trading to loans and receivables in the second half of 2008.

During the first half of 2009, there have been a small number of sales and further impairments have been recorded. The strengthening of sterling against other major currencies also had a substantial impact on this book, which has significant US dollar and euro positions.

The table below shows the Group's leveraged finance exposures by industry and geography.

	30 June 2009					31 December 2008				
	Americas	UK	Europe	RoW	Total	Americas	UK	Europe	RoW	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Gross exposure:										
TMT (1)	1,625	1,652	1,477	506	5,260	2,507	1,484	2,001	535	6,527
Industrial	1,616	1,553	1,641	175	4,985	1,686	1,612	1,924	188	5,410
Retail	69	1,134	1,327	79	2,609	268	1,285	1,440	89	3,082
Other	350	1,566	1,228	131	3,275	487	1,391	1,282	126	3,286
	3,660	5,905	5,673	891	16,129	4,948	5,772	6,647	938	18,305
Net exposure:										
TMT (1)	1,283	1,517	1,367	506	4,673	2,247	1,385	1,982	534	6,148
Industrial	578	1,126	1,416	172	3,292	607	1,157	1,758	186	3,708
Retail	69	537	1,257	79	1,942	223	978	1,424	89	2,714
Other	350	1,383	1,204	131	3,068	484	1,307	1,281	127	3,199
	2,280	4,563	5,244	888	12,975	3,561	4,827	6,445	936	15,769
Of which:										
Drawn	1,825	3,859	4,193	813	10,690	2,511	4,125	5,159	824	12,619
Undrawn	455	704	1,051	75	2,285	1,050	702	1,286	112	3,150
	2,280	4,563	5,244	888	12,975	3,561	4,827	6,445	936	15,769

Of which:										
Syndicate portfolio (2)	1,428	1,398	1,125	88	4,039	2,138	2,121	1,663	101	6,023
Hold portfolio	852	3,165	4,119	800	8,936	1,423	2,706	4,782	835	9,746
	2,280	4,563	5,244	888	12,975	3,561	4,827	6,445	936	15,769

Notes:

(1) Telecommunications, media and technology

(2) includes held-for-trading exposures of £38 million (2008 - £102 million)

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Market turmoil exposures (continued)

Leveraged finance (continued)

The table below analyses the movement in the amounts reported above.

	Drawn £m	Undrawn £m	Total £m
Balance at 1 January 2009	12,619	3,150	15,769
Transfers in (from credit trading business)	506	41	547
Sales	(327)	(147)	(474)
Repayments and facility reductions	(549)	(314)	(863)
Funded deals	97	(97)	-
Lapsed/collapsed deals	(28)	(19)	(47)
Changes in fair value	(34)	(6)	(40)
Accretion of interest	71	n/a	71
Impairment provisions	(679)	n/a	(679)
Exchange and other movements	(986)	(323)	(1,309)
Balance at 30 June 2009	10,690	2,285	12,975

Market turmoil exposures (continued)

SPEs and conduits

SPEs

For background on the Group's involvement with securitisations and special purpose entities ('SPEs'), refer to Business Review – SPEs and conduits in the 2008 Form 20-F.

The table below sets out the asset categories together with the carrying amount of the assets and associated liabilities for those securitisations and other asset transfers, other than conduits (discussed below), where the assets continue to be recorded on the Group's balance sheet.

	30 June 2009		31 December 2008	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Residential mortgages	62,799	17,812	49,184	20,075
Credit card receivables	2,975	1,567	3,004	3,197
Other loans	10,472	1,031	1,679	1,071
Finance lease receivables	950	750	1,077	857

The increase in residential mortgage and other loan assets above primarily relate to balances that have been securitised to facilitate access to central bank special liquidity schemes. As all the notes issued by the SPEs are purchased by Group companies, securitised assets are significantly greater than secured liabilities.

Conduits

The Group sponsors and administers a number of asset-backed commercial paper ('ABCP') conduits. A conduit is an SPE that issues commercial paper and uses the proceeds to purchase or fund a pool of assets. The commercial paper is secured on the assets and is redeemed either by further commercial paper issuance, repayment of assets or funding from liquidity facilities. Commercial paper is short-dated, typically up to three months.

The Group's conduits can be divided into multi-seller conduits and own-asset conduits. The Group consolidates both types of conduit where the substance of the relationship between the Group and the conduit vehicle is such that the vehicle is controlled by the Group. The Group also extends liquidity commitments to multi-seller conduits sponsored by other banks, but typically does not consolidate these entities.

Funding and liquidity

The Group's multi-seller conduits have continued to fund the vast majority of their assets solely through ABCP issuance. There have been no significant systemic failures within the financial markets similar to that experienced in the second half of 2008 following Lehman Brothers bankruptcy filing in September 2008. The improvement in market conditions has allowed these conduits to move towards more normal ABCP funding and reduced the need for backstop funding from the Group.

The Group's own-asset conduit programmes have been established to diversify the Group's funding. The conduits allow the Group to access central government funding schemes and the external ABCP market.

The average maturity of ABCP issued by the Group's conduits as at 30 June 2009 was 55.2 days compared with 72.1 days at 31 December 2008 due to a combination of restructured deals having shorter terms than normal rolling periods and effect of issuers seeking longer terms at end of any year due to general illiquidity at the end of the year/early January.

Market turmoil exposures (continued).

The total assets held by the Group's sponsored conduits are £35.0 billion (31 December 2008 - £49.9 billion). Since the related backstop liquidity facilities are sanctioned on the basis of total conduit purchase commitments, the liquidity facility commitments exceed the level of assets held, with the difference representing undrawn commitments.

Multi-seller conduits

The Group sponsors six multi-seller conduits which finance assets from Europe, North America and Asia-Pacific. Assets purchased or financed by the multi-seller conduits include auto loans, residential mortgages, credit card receivables, consumer loans and trade receivables. These conduits were established to provide customers of the Group access to diversified and flexible funding sources.

The third-party assets financed by the conduits receive credit enhancement from the originators of the assets. This credit enhancement, which is specific to each transaction, can take the form of over-collateralisation, excess spread or subordinated loan, and typically ensures the asset acquired by the conduit has a rating equivalent to at least a single-A credit. In addition, in line with general market practice, the Group provides a small second-loss layer of programme-wide protection to the multi-seller conduits. Given the nature and investment grade equivalent quality of the first loss enhancement provided by the originators of the assets, the Group has only a minimal risk of loss on its programme wide exposure. The issued ABCP is rated A-1 / P-1 by Moody's and Standard & Poor's.

The Group provides liquidity back-up facilities to the conduits it sponsors. The conduits are able to draw funding under these facilities in the event of a disruption in the ABCP market, or when certain trigger events prevent the issue of ABCP. The maturity of commercial paper issued by the Group's conduits is managed to mitigate the short-term contingent liquidity risk of providing back-up facilities. Group limits sanctioned for such liquidity facilities as at 30 June 2009 totalled approximately £28.2 billion (31 December 2008 - £42.9 billion). For a very small number of transactions within one multi-seller conduit the liquidity facilities have been provided by third-party banks, this typically occurs on transactions where the third-party bank does not use, or have, its own conduit vehicles.

The multi-seller conduits form the majority of the Group's conduit business (64.2% (31 December 2008 - 69.4%).

The Group's maximum exposure to loss on its multi-seller conduits is £28.3 billion (31 December 2008 - £43.2 billion), being the total amount of the Group's liquidity commitments plus the extent of programme-wide credit enhancements of conduit assets for which liquidity facilities were provided by third parties.

Own-asset conduits

The Group also holds three own-asset conduits which have assets that have previously been funded by the Group. These vehicles represent 28% (31 December 2008 - 25%) of the Group's conduit business (as a percentage of the total liquidity and credit enhancements committed by the Group), with £11.8 billion of ABCP outstanding at 30 June 2009 (31 December 2008 - £14.8 billion). The Group's maximum exposure to loss on its own-asset conduits is £12.9 billion (31 December 2008 - £15.9 billion), being the total drawn and undrawn amount of the Group's liquidity commitments to these conduits.

Securitisation arbitrage conduits

The Group no longer sponsors any securitisation arbitrage conduits.

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Market turmoil exposures (continued).

Conduits (continued)

The Group's exposure from conduits which are consolidated by the Group including those to which the Group is economically exposed on a shared basis with other consortium members and its involvement with third-party conduits, are set out below.

	30 June 2009			31 December 2008		
	Sponsored conduits £m	Third party £m	Total £m	Sponsored conduits £m	Third party £m	Total £m
Total assets held by the conduits	35,007			49,857		
Commercial paper issued	33,452			48,684		
Liquidity and credit enhancements:						
Deal specific liquidity:						
- drawn	1,440	2,361	3,801	1,172	3,078	4,250
- undrawn	39,744	1,161	40,905	57,929	198	58,127
Programme-wide liquidity:						
- drawn	-	99	99	-	102	102
- undrawn	-	-	-	-	504	504
PWCE (1)	1,663	-	1,663	2,391	-	2,391
	42,847	3,621	46,468	61,492	3,882	65,374
Maximum exposure to loss (2)	41,184	3,621	44,805	59,101	3,882	62,983

Notes:

(1) Programme-wide credit enhancement

(2) Maximum exposure to loss is determined as the Group's total liquidity commitments to the conduits and additionally programme-wide credit support which would absorb first loss on transactions where liquidity support is provided by a third party.

The Group's exposures from the conduit shared with the other consortium members is set out below:

	30 June 2009 £m	31 December 2008 £m
Total assets held by the conduits	11,189	13,286

Commercial paper issued	11,189	13,028
Liquidity and credit enhancements:		
Deal specific liquidity:		
- drawn	-	258
- undrawn	11,311	13,566
	11,311	13,824
Maximum exposure to loss	11,311	13,824

During the period both multi-seller and own asset conduit assets have been reduced in line with the wider Group balance sheet management.

Risk and capital management (continued)

Market turmoil exposures (continued)

Conduits (continued)

Collateral analysis, geographic, profile, credit ratings and weighted average lives of the assets in the assets relating to the Group's consolidated conduits and related undrawn commitments are set out in the tables below.

	Funded assets					
	Loans £m	Securities £m	Total £m	Undrawn £m	Liquidity for third parties £m	Total exposure £m
30 June 2009						
Auto loans	5,785	280	6,065	1,838	-	7,903
Corporate loans	213	9,193	9,406	186	-	9,592
Credit card receivables	3,375	-	3,375	1,601	-	4,976
Trade receivables	1,437	-	1,437	790	-	2,227
Student loans	1,260	-	1,260	265	(132)	1,393
Consumer loans	1,742	-	1,742	520	-	2,262
Mortgages:						
- Prime	3,971	1,900	5,871	230	-	6,101
- Non-conforming	1,821	-	1,821	468	-	2,289
- Sub-prime	-	-	-	-	-	-
- Commercial	656	499	1,155	87	(22)	1,220
- Buy-to-let	-	-	-	-	-	-
CDOs	-	-	-	-	-	-
Other	1,349	1,526	2,875	292	-	3,167
	21,609	13,398	35,007	6,277	(154)	41,130
31 December 2008						
Auto loans	9,924	383	10,307	1,871	-	12,178
Corporate loans	430	11,042	11,472	534	-	12,006
Credit card receivables	5,844	-	5,844	922	-	6,766
Trade receivables	2,745	-	2,745	1,432	(71)	4,106
Student loans	2,555	-	2,555	478	(132)	2,901
Consumer loans	2,371	-	2,371	409	-	2,780
Mortgages						
- Prime	4,416	2,250	6,666	1,188	-	7,854
- Non-conforming	2,181	-	2,181	727	-	2,908
- Sub-prime	-	-	-	-	-	-
- Commercial	1,228	507	1,735	66	(23)	1,778
- Buy-to-let	-	-	-	-	-	-
CDOs	-	-	-	-	-	-
Other	1,851	2,130	3,981	1,615	-	5,596

33,545	16,312	49,857	9,242	(226)	58,873

Risk and capital management (continued)

Market turmoil exposures (continued)

Conduits (continued)

	CP funded assets										
	Geographic distribution					Weighted average life	Credit ratings (S&P equivalent)				
	UK	Europe	US	RoW	Total		AAA	AA	A	BBB	Below BBB
	£m	£m	£m	£m	£m	Years	£m	£m	£m	£m	£m
30 June 2009											
Auto loans	595	1,075	3,846	549	6,065	1.9	3,085	2,274	706	-	-
Corporate loans	1,266	3,640	2,738	1,762	9,406	1.7	9,078	223	105	-	-
Credit card receivables	390	-	2,796	189	3,375	1.0	2,794	212	369	-	-
Trade receivables	-	465	637	335	1,437	1.1	349	561	496	31	-
Student loans	116	-	1,144	-	1,260	1.2	1,144	116	-	-	-
Consumer loans	657	999	86	-	1,742	2.4	71	132	1,539	-	-
Mortgages											
Prime	-	1,896	-	3,975	5,871	2.8	2,364	3,448	20	-	39
Non-conforming	808	1,013	-	-	1,821	4.5	316	460	1,045	-	-
Sub-prime	-	-	-	-	-	-	-	-	-	-	-
Commercial	685	373	57	40	1,155	15.1	-	31	745	373	6
Buy-to-let	-	-	-	-	-	-	-	-	-	-	-
CDOs	-	-	-	-	-	-	-	-	-	-	-
Other	243	900	383	1,349	2,875	2.4	90	432	2,210	143	-
	4,760	10,361	11,687	8,199	35,007	2.4	19,291	7,889	7,235	547	45
31 December 2008											
Auto loans	801	1,706	7,402	398	10,307	1.7	6,075	883	3,349	-	-
Corporate Loans	1,714	4,347	3,289	2,122	11,472	4.9	10,767	132	573	-	-
Credit card receivables	633	-	4,999	212	5,844	0.7	3,465	62	2,171	146	-
Trade receivables	68	922	1,371	384	2,745	0.7	120	1,025	1,600	-	-
Student loans	144	-	2,411	-	2,555	2.6	2,296	144	115	-	-
Consumer loans	708	1,195	468	-	2,371	1.7	387	993	923	68	-
Mortgages											
Prime	-	2,244	-	4,422	6,666	2.8	2,675	3,876	115	-	-
Non-conforming	960	1,221	-	-	2,181	4.6	351	368	475	987	-
Sub-prime	-	-	-	-	-	-	-	-	-	-	-
Commercial	713	453	74	495	1,735	11.0	274	518	474	469	-
Buy-to-let	-	-	-	-	-	-	-	-	-	-	-
CDOs	-	-	-	-	-	-	-	-	-	-	-
Other	166	1,198	684	1,933	3,981	1.2	3	958	2,786	234	-
	5,907	13,286	20,698	9,966	49,857	3.0	26,413	8,959	12,581	1,904	-

Market turmoil exposures (continued)

Structured investment vehicles
The Group does not sponsor any structured investment vehicles.

Investment funds set up and managed by the Group
The Group has established and manages a number of money market funds for its customers. When a new money market fund is launched, the Group typically provides a limited amount of seed capital to the funds. The Group has investments in these funds of £723.2 million at 30 June 2009 (31 December 2008: £107.0 million). These funds are not consolidated by the Group.

Money market funds
The Group's money market funds held assets of £13.2 billion at 30 June 2009 (31 December 2008 - £13.9 billion). The sub-categories of money market funds are:

- £9.1 billion (31 December 2008 - £8.3 billion) in money market funds managed by the Group denominated in sterling, US dollars and euro. The funds invest in short-dated, highly rated money market securities with the objective of ensuring stability of capital and net asset value per share, appropriate levels of liquid assets, together with an income which is comparable to the short dated money market interest rate in the relevant currency.
- £0.7 billion (31 December 2008 - £0.8 billion) in money market 'Plus' funds managed by the Group denominated in sterling, US dollars and euro. The funds invest in longer-dated, highly rated securities with the objective of providing enhanced returns over the average return on comparable cash deposits.
- £3.4 billion (31 December 2008 - £4.8 billion) in third party multi-manager money market funds denominated in sterling, US dollars and euro. The funds invest in short dated, highly rated securities with the objective of maximising current income consistent with the preservation of capital and liquidity.

Non-money market funds
The Group has also established a number of non-money market funds to enable investors to invest in a range of assets including bonds, equities, hedge funds, private equity and real estate. As the Group does not have significant holdings in these funds, they are not consolidated by the Group.

The Group non-money market funds had total assets of £14.2 billion at 30 June 2009 (31 December 2008 - £17.7 billion). The sub-categories of non-money market funds are:

- £1.1 billion (31 December 2008 - £1.1 billion) in committed capital to generate returns from equity and equity-like investments in private companies.
- £12.8 billion (31 December 2008 - £16.5 billion) in third party, multi-manager funds. These funds offer multi-manager and fund of funds' products across bond, equity, hedge fund, private equity and real estate asset classes.
- £0.3 billion (31 December 2008 - £0.1 billion) in various derivative instruments with the objective of providing returns linked to the performance of underlying equity indices.

The investors in both money market and non money market funds have recourse to the assets of the funds only. At 30 June 2009 the Group had exposure to one fund amounting to £145 million (31 December 2008 - £144 million).

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Additional information

Other information	30 June 2009	31 December 2008
Ordinary share price	£0.3864	£0.494
Number of ordinary shares in issue	56,366m	39,456m
Employee numbers in continuing operations (full time equivalents rounded to the nearest hundred)		
UK Retail	26,900	28,400
UK Corporate	12,700	13,200
Wealth	5,000	5,200
Global Banking & Markets	17,200	17,800
Global Transaction Services	3,600	3,900
Ulster Bank	5,200	5,400
US Retail & Commercial	15,100	16,200
RBS Insurance	14,600	14,700
Group Manufacturing	46,000	47,600
Central items	4,300	4,300
Core	150,600	156,700
Non-Core	15,000	17,300
	165,600	174,000
Integration	700	900
Share of shared assets	300	400
RFS minority interest	24,800	24,500
Group total	191,400	199,800

Statutory results

Financial information contained in this document does not constitute statutory accounts within the meaning of section 240 of the Companies Act 1985 ('the Act'). The statutory accounts for the year ended 31 December 2008 have been filed with the Registrar of Companies. The auditors have reported on these accounts: their report was unqualified and did not contain a statement under section 237(2) or (3) of the Act.

Selected financial data

The dollar financial information included below has been translated for convenience at the rate of £1.00 to US$1.6452 the Noon Buying Rate on 30 June 2009.

Summary consolidated income statement

	First half 2009		First half 2008
	$m	£m	£m
Net interest income	13,440	8,169	8,695
Non-interest income	22,493	13,672	5,147
Total income	35,933	21,841	13,842
Operating expenses	(19,563)	(11,891)	(10,719)
Profit before other operating charges and impairment losses	16,370	9,950	3,123
Insurance net claims	(3,511)	(2,134)	(2,189)
Impairment losses	(13,260)	(8,060)	(1,661)
Operating loss before tax	(401)	(244)	(727)
Tax	725	441	333
Profit/(loss) from continuing operations	324	197	(394)
(Loss)/profit from discontinued operations	(102)	(62)	234
(Loss) for the period	222	135	(160)
Profit attributable to:			
Minority interests	1,038	631	452
Preference dividends	898	546	215
Ordinary shareholders	(1,714)	(1,042)	(827)
	222	135	(160)

Summary consolidated balance sheet

	30 June 2009		31 December 2008
	$m	£m	£m
Loans and advances	1,423,394	865,180	1,012,919
Debt securities and equity shares	430,498	261,669	293,879
Derivatives and settlement balances	955,118	580,548	1,010,391
Other assets	183,482	111,526	84,463
Total assets	2,992,492	1,818,923	2,401,652
Owners equity	91,582	55,666	58,879

Minority interests	27,024	16,426	21,619
Subordinated liabilities	58,738	35,703	49,154
Deposits	1,294,251	786,683	897,556
Derivatives, settlement balances and short positions	982,762	597,351	1,025,641
Other liabilities	538,135	327,094	348,803
Total liabilities and equity	2,992,492	1,818,923	2,401,652

Selected financial data (continued)

Other financial data

	First half 2009	First half 2008
Earnings per ordinary share - pence (1)	(2.2)	(6.8)
Diluted earnings per ordinary share - pence (1)	(2.2)	(6.8)
Dividends per ordinary share - pence	-	23.1
Share price per ordinary share at period end - £ (1)	0.3864	2.10
Market capitalisation at period end - £ billion	21.8	34.7
Net asset value per ordinary share - £	0.85	3.30
Return on average total assets - %	(0.10)	(0.08)
Return on average ordinary shareholders' equity - %	(5.0)	(4.0)
Average shareholders' equity as a percentage of average total assets - %	2.6	2.7
Ratio of earnings to fixed charges and preference dividends		
- including interest on deposits	0.93	0.94
- excluding interest on deposits	0.52	0.40
Ratio of earnings to fixed charges only		
- including interest on deposits	0.98	0.95
- excluding interest on deposits	0.78	0.46

(1) First half 2008 data have been restated for the effect of the capitalisation issue in September 2008.

Appendix 1 Article 11 unaudited pro forma information

Unaudited pro forma condensed consolidated financial information

Basis of preparation

The unaudited pro forma condensed consolidated financial information (the "unaudited pro forma financial information") comprises the unaudited pro forma condensed consolidated balance sheet as at 30 June 2009 (the "unaudited pro forma balance sheet") and the unaudited pro forma condensed consolidated income statements for the six months ended 30 June 2009 and 30 June 2008 and years ended 31 December 2008 and 31 December 2007 (the "pro forma income statements") based on the published audited and unaudited financial statements of RBS, prepared in accordance with IFRS, after giving effect to the distribution of those ABN AMRO businesses attributable to Santander and the Dutch government (the "other Consortium members").

The pro forma financial information has been prepared assuming that the distribution to the other Consortium members had occurred as follows:

- pro forma balance sheet: 30 June 2009.
- pro forma income statements: on acquisition on 17 October 2007.

The pro forma financial information and accompanying notes should be read in conjunction with the unaudited financial
statements of RBS for the six months ended 30 June 2009 and the audited financial statements for the year ended 31 December 2008, included on pages 53 to 59.

The pro forma financial information is presented for information purposes only and does not represent what the results of operations would actually have been had the distribution to other Consortium members occurred on the dates indicated nor is it necessarily indicative of the results of operations or financial position that may or may be expected to be achieved in the future.

Appendix 1 Article 11 unaudited pro forma information

Unaudited pro forma income statement for the six months ended 30 June 2009

	RBS (1) £m	RFS Minority interest (2) £m	Pro forma RBS £m
Continuing operations			
Net interest income	8,169	(1,514)	6,655
Net fees and commissions	3,648	(533)	3,115
Income from trading activities	1,994	49	2,043
Gain on redemption of own debt	3,790	-	3,790
Other operating income (excluding insurance premium income)	1,419	(645)	774
Insurance net premium income	2,821	(164)	2,657
Non-interest income	13,672	(1,293)	12,379
Total Income	21,841	(2,807)	19,034
Operating expenses	(11,891)	1,973	(9,918)
Profit/(loss) before other operating charges and impairment losses	9,950	(834)	9,116
Insurance net claims	(2,134)	243	(1,891)
Impairment (losses)/gains	(8,060)	539	(7,521)
Operating loss before tax	(244)	(52)	(296)
Tax	441	(29)	412
Profit/(loss) from continuing operations	197	(81)	116
Profit/(loss) attributable to:			
Minority interests	635	(81)	554
Other owners	546	-	546
Ordinary shareholders	(984)	-	(984)
	197	(81)	116
Per 25p ordinary share (pence)			
Continuing operations			
Basic	(2.1)		(2.1)

Fully diluted	(2.1)	(2.1)
Number of shares (million)		
Weighted average ordinary shares	46,719	46,719
Weighted average diluted ordinary shares	46,719	46,719

Notes:

(1) The financial information for RBS has been extracted from the unaudited financial statements for the six months ended 30 June 2009 included on page 53.

(2) The financial information for RFS Minority interest has been extracted from RBS's unaudited accounting records for the six months ended 30 June 2009 without adjustment and represent those parts of the ABN AMRO businesses attributable to the other Consortium members.

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Appendix 1 Article 11 unaudited pro forma information

Unaudited pro forma income statement for the year ended 31 December 2008

	RBS (1) £m	RFS Minority interest (2) £m	Pro forma RBS £m
Continuing operations			
Net interest income	18,675	(2,911)	15,764
Net fees and commission	7,445	(1,011)	6,434
Income from trading activities	(8,477)	(352)	(8,829)
Other operating income (excluding insurance premium income)	1,899	64	1,963
Insurance net premium income	6,326	(617)	5,709
Non-interest income	7,193	(1,916)	5,277
Total income	25,868	(4,827)	21,041
Operating expenses	(54,202)	19,303	(34,899)
(Loss)/profit before other operating charges and impairment losses	(28,334)	14,476	(13,858)
Insurance net claims	(4,430)	513	(3,917)
Impairment (losses)/gains	(8,072)	640	(7,432)
Operating (loss)/profit before tax	(40,836)	15,629	(25,207)
Tax	2,323	(328)	1,995
(Loss)/profit from continuing operations	(38,513)	15,301	(23,212)
(Loss)/profit attributable to:			
Minority interests	(14,889)	15,301	412
Other owners	596	-	596
Ordinary shareholders	(24,220)	-	(24,220)
	(38,513)	15,301	(23,212)
Per 25p ordinary share (pence)			
Continuing operations			
Basic	(146.2)		(146.2)

Fully diluted	(146.2)	(146.2)
Number of shares (million)		
Weighted average ordinary shares	16,563	16,563
Weighted average diluted ordinary shares	16,563	16,563

Notes:

(1) The financial information for RBS has been extracted from the audited financial statements for the year ended 31 December 2008 included on page 158 of the Form 6-K filed with the SEC on 30 September 2009.

(2) The financial information for RFS Minority interest has been extracted from RBS's unaudited accounting records for the six months ended 30 June 2009 without adjustment and represent those parts of the ABN AMRO businesses attributable to the other Consortium members.

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Appendix 1 Article 11 unaudited pro forma information

Unaudited pro forma condensed income statement for the six months ended 30 June 2008

	RBS (1) £m	RFS Minority Interest (2) £m	Pro forma RBS £m
Continuing operations			
Net interest income	8,695	(1,194)	7,501
Net fees and commissions	3,729	(551)	3,178
Income from trading activities	(3,373)	32	(3,341)
Other operating income (excluding insurance premium income)	1,635	(183)	1,452
Insurance net premium income	3,156	(295)	2,861
Non-interest income	5,147	(997)	4,150
Total income	13,842	(2,191)	11,651
Operating expenses	(10,719)	1,748	(8,971)
Profit/(loss) before other operating charges and impairment losses	3,123	(443)	2,680
Insurance net claims	(2,189)	262	(1,927)
Impairment	(1,661)	182	(1,479)
Operating (loss)/profit before tax	(727)	1	(726)
Tax	333	(30)	303
Loss from continuing operations	(394)	(29)	(423)
Loss attributable to:			
Minority interests	(727)	(29)	(756)
Other owners	(215)	-	(215)
Ordinary shareholders	548	-	548
	(394)	(29)	(423)
Per 25p ordinary share (pence)			
Continuing operations			
Basic	4.5		4.5
Fully diluted	4.5		4.5

Number of shares (million)		
Weighted average ordinary shares	12,197	12,197
Weighted average diluted ordinary shares	12,197	12,197

Notes:

(1) The financial information for RBS has been extracted from the unaudited financial statements for the six months ended 30 June 2009 included on page 53.

(2) The financial information for the RFS Minority Interest has been extracted from RBS's unaudited accounting records for the six months ended 30 June 2008 without adjustment and represent those parts of the ABN AMRO businesses attributable to the other Consortium members.

Appendix 1 Article 11 unaudited pro forma information

Unaudited pro forma condensed income statement for the year ended 31 December 2007

	RBS (1) £m	RFS Minority Interest (2) £m	Pro forma RBS £m
Continuing operations			
Net interest income	12,069	(545)	11,524
Net fees and commissions	6,085	(224)	5,861
Income from trading activities	1,292	139	1,431
Other operating Income (excluding insurance premium income)	4,833	(97)	4,736
Insurance net premium income	6,087	(105)	5,982
Non-interest income	18,297	(287)	18,010
Total income	30,366	(832)	29,534
Operating expenses	(13,942)	620	(13,322)
Profit/(loss) before other operating charges and impairment losses	16,424	(212)	16,212
Insurance net claims	(4,624)	96	(4,528)
Impairment	(1,968)	38	(1,930)
Operating profit/(loss) before tax	9,832	(78)	9,754
Tax	(2,044)	(6)	(2,050)
Profit/(loss) from continuing operations	7,788	(84)	7,704
Profit/(loss) attributable to:			
Minority interests	239	(84)	155
Other owners	246	-	246
Ordinary shareholders	7,303	-	7,303
	7,788	(84)	7,704
Per 25p ordinary share (pence)			
Continuing operations			
Basic	64.0		64.0
Fully diluted	63.4		63.4

Number of shares (million)		
Weighted average ordinary shares	11,413	11,413
Weighted average diluted ordinary shares	11,611	11,611

Notes:
(1) The financial information for RBS has been extracted from the audited financial statements for the year ended 31 December 2008 included on page 158 of the Form 6-K filed with the SEC on 30 September 2009.
(2) The financial information for the RFS Minority Interest has been extracted from RBS's unaudited accounting records for the six months ended 30 June 2008 without adjustment and represents results for the 76 day period since acquisition of those parts of the ABN AMRO businesses attributable to the other Consortium members.

Appendix 1 Article 11 unaudited pro forma information

Unaudited pro forma balance sheet as at 30 June 2009

	RBS (1) £m	RFS Minority interest (2) £m	Pro forma RBS £m
Assets			
Cash and balances at central banks	39,946	(5,644)	34,302
Loans and advances to banks	95,406	(11,706)	83,700
Loans and advances to customers	769,774	(129,012)	640,762
Debt securities and equity shares	261,669	(18,390)	243,279
Derivatives	557,284	(1,394)	555,890
Deferred taxation	8,392	(819)	7,573
Intangible assets	18,180	(3,063)	15,117
Property, plant and equipment	17,895	(1,603)	16,292
Other assets	50,377	(2,847)	47,530
Total assets	1,818,923	(174,478)	1,644,445
Liabilities			
Deposits by banks	170,994	8,749	179,743
Customer accounts	615,689	(125,407)	490,282
Debt securities in issue	274,180	(25,470)	248,710
Settlement balances and short positions	60,287	(5)	60,282
Derivatives	537,064	(2,432)	534,632
Subordinated liabilities	35,703	(3,597)	32,106
Other liabilities	52,914	(12,013)	40,901
Total liabilities	1,746,831	(160,175)	1,586,656
Minority interests	16,426	(14,303)	2,123
Equity owners	55,666	-	55,666
Total equity	72,092	(14,303)	57,789
Total liabilities and equity	1,818,923	(174,478)	1,644,445

Notes:

(1) The financial information for RBS has been extracted from the unaudited financial statements for the six months ended 30 June 2009 included on page 55.

(2) The financial information for RFS Minority interest has been extracted from RBS's unaudited accounting records for the six months ended 30 June 2009 without adjustment and represent those parts of the ABN AMRO businesses attributable to the other Consortium members.

Contents

Appendix 2 Asset Protection Scheme

1. Explanatory note

The terms of RBS's participation in the Asset Protection Scheme ("APS") were agreed in principle with HM Treasury in February. Issues still outstanding include the final sign off of assets to be covered, the completion of due diligence, some detailed aspects of the structure of the scheme and EU State Aid approval.

2. Highlights of the Scheme

Objectives
- Credit protection provided by the UK government, which alongside liability management and other measures, would allow RBS to pass the Financial Services Authority stress tests
- Enhance RBS's financial strength and provide stability for customers, depositors and investors as RBS's restructuring programme is executed
- Enhance the Group's capacity to extend new lending in the UK

Current proposed Scheme operation and terms
- Protection for £316 billion covered assets from 1 January 2009, subject to final agreement with HM Treasury on the covered asset pool
- APS assets are a static pool, with no substitution allowed for assets that mature
- Scheme expected to cover both banking assets and trading assets
- APS assets include the Group's global exposures across multiple jurisdictions and multiple legal entities HM Treasury currently proposes to extend APS protection to RBS plc; RBS plc will then enter into back-to-back arrangements with other legal entities across the Group to extend APS protection to all APS assets
- First loss of £19.5 billion in addition to impairments and write-downs on the APS pool recognised at 31 December 2008
- RBS will bear all losses (net of recoveries) up to the first loss point. Losses (net of recoveries) in excess of the first loss will be 90% borne by HM Treasury
- Management and administration of APS assets will be performed by RBS
- Scheme proposes rigorous governance and specific approval processes for APS assets
- HMT will have representation on the Group's senior oversight committee for the APS and will have wide-ranging rights to audit the management and administration of the Scheme
- Significant RWA relief is expected on the APS assets. On the basis of the proposed pool at 30 June 2009 this relief is estimated at approximately £150 billion.

Asset selection
- Assets were selected for both credit and capital reasons. Key criteria included:
  - Risk and degree of impairment in base case and stressed scenario
  - Liquidity of the exposure
- Both core and non-core assets analysed. Inclusion of core assets reflects their risk profile and provides capacity to meet UK lending commitments.
- Inclusion of equity type exposure and real assets (e.g. hotels, ships, aircraft) and Citizens retail assets was not permitted.

3. Capital effect

The Asset Protection Scheme announced in February, when concluded, is expected to further strengthen the Group's capital ratios, as the assets covered by the Scheme will carry lower risk weightings as a result of UK Government asset insurance. This augments the impact of RBS's own extensive restructuring measures. The Scheme is currently expected to provide approximately £150 billion of risk-weighted asset relief. In addition, HM Treasury will subscribe to a total of £19.5 billion of new B Shares qualifying as capital on implementation of the APS, with a further £6 billion as a contingent reserve. The APS should strengthen Core Tier 1 by more than 5% pro forma. This figure is RBS's current estimate and subject to finalisation of the detailed terms and conditions, confirmation of asset eligibility and pricing (all of which require state aid approval) and without taking account of the £6 billion contingent tranche of B share issuance outlined in February.

4. Credit impairments and write downs

Of the Group's credit impairments and write downs recorded in the first half of 2009, approximately 70% relates to assets proposed for APS. Set out below are the estimated proportions of each division's credit impairments and write downs relating to these assets:

	%
UK Retail	65
UK Corporate	50
Global Banking & Markets	50
Ulster	85
Non-Core	75

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5. Balance sheet and risk weighted assets

The tables below show approximate balances relating to assets proposed for APS, by balance sheet caption and underlying product category, at 31 December 2008.

	Carrying value (1) £bn	Undrawn commitments and other aspects (2) £bn	Provisions and other related adjustments (3) £bn	Covered amount £bn
Loans and advances (4)				
Residential mortgages	15.3	-	0.1	15.4
Consumer finance	11.4	1.6	1.8	14.8
Commercial property lending	52.3	10.0	0.8	63.1
Leveraged finance	18.3	4.7	2.5	25.5
Project finance	1.9	1.0	-	2.9
Other structured finance	16.4	4.5	0.4	21.3
Other corporate loans	73.3	25.7	2.3	101.3
	188.9	47.5	7.9	244.3
Securities				
RMBS (5)	0.7	0.2	0.2	1.1
CMBS (6)	1.6	0.2	0.2	2.0
CDOs (7) and CLOs (8)	2.3	0.4	5.7	8.4
Other asset-backed securities	3.7	-	0.3	4.0
Other debt securities	2.5	0.6	0.1	3.2
	10.8	1.4	6.5	18.7
Derivatives				
Monoline insurers	5.6	10.9	6.0	22.5
CDPCs (9)	3.5	2.3	1.3	7.1
Other counterparties	16.8	5.7	0.7	23.2
	25.9	18.9	8.0	52.8
Total	225.6	67.8	22.3	315.8

Notes:

(1) Carrying value represents the amounts recorded on the balance sheet at 31 December 2008 and includes assets classified as loans and receivables , fair valued through profit or loss and available-for-sale ('AFS')

(2) Undrawn commitments and other aspects comprises:

- undrawn commitments
- add-back of AFS reserves

- master netting arrangements relating to derivatives
- potential future exposures on certain derivatives

(3) Provisions and other related adjustments comprises:

- credit impairment provisions and write downs
- life-to-date mark-to-market changes on assets measured at fair value through profit or loss
- valuation adjustment on derivative contracts

(4) The asset categories are as defined by the HM Treasury draft terms and conditions and may vary from the Group's categorisations of such assets
(5) Residential mortgage-backed securities
(6) Commercial mortgage-backed securities
(7) Collateralised debt obligations
(8) Collateralised loan obligations
(9) Credit derivative product companies

Risk weighted assets relating to the assets proposed for the scheme were approximately £165 billion at 31 December 2008.

SIGNATURE

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 authorised.

The Royal Bank of Scotland Group plc
Registrant

	/s/ G Whittaker
Name:	Guy Whittaker
Title:	Group Finance Director
Date:	30 September 2009