Annual Report and Accounts 2017

Royal Bank of Scotland

Financial review

Strategic report

Approval of Strategic Report

The Strategic Report for the year ended 31 December 2017 set out on pages 2 to 59 was approved by the Board of directors on 22 February 2018.

By order of the Board.

Aileen Taylor
Company Secretary
22 February 2018

Chairman
Howard Davies

Executive directors
Ross McEwan
Ewen Stevenson

Non-executive directors
Frank Dangeard
Alison Davis
Morten Friis
Robert Gillespie
Penny Hughes
Yasmin Jetha
Brendan Nelson
Baroness Noakes
Mike Rogers
Mark Seligman
Dr Lena Wilson

Board of directors and secretary

Chairman
Howard Davies
Nominations (Chairman)

Executive directors
Ross McEwan
Executive (Executive Committee Chairman)

Ewen Stevenson
Executive

Independent non-executive directors

Frank Dangeard
Risk, Technology

Alison Davis
Technology (Chairman), Remuneration, Sustainability

Morten Friis
Audit, Risk

Robert Gillespie
Remuneration (Chairman), Nominations, Sustainability

Penny Hughes
Sustainability (Chairman) Nominations, Risk

Yasmin Jetha
Sustainability, Technology

Brendan Nelson
Audit (Chairman), Nominations, Risk

Baroness Noakes
Risk (Chairman), Audit, Nominations

Mike Rogers
Remuneration, Sustainability

Mark Seligman
Senior Independent Director
Nominations, Remuneration

Dr Lena Wilson
Sustainability

Chief Governance & Regulatory Officer and Board Counsel
Aileen Taylor (Company Secretary)

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The Royal Bank of Scotland plc
Registered in Scotland No. SC90312

Audit	member of the Group Audit Committee
Executive	member of the Executive Committee
Nominations	member of the Group Nominations and Governance Committee
Remuneration	member of the Group Performance and Remuneration Committee
Risk	member of the Board Risk Committee
Sustainability	member of the Sustainable Banking Committee
Technology	member of the Technology and Innovation Committee

Presentation of information

In the Report and Accounts, and unless specified otherwise, the terms 'the Royal Bank', 'RBS plc' or 'the Bank' mean The Royal Bank of Scotland plc, the 'Group' means the Bank and its subsidiaries, 'RBSG' or the 'holding company' mean The Royal Bank of Scotland Group plc', 'RBS Group' means the holding company and its subsidiaries, and 'NatWest' means National Westminster Bank Plc.

RBS Group ring-fencing

The UK ring-fencing legislation requiring the separation of essential banking services from investment banking services will take effect from 1 January 2019.

To comply with these requirements it is the RBS Group's intention to place the majority of the UK and Western European banking business in ring-fenced banking entities under an intermediate holding company. NatWest Markets will be a separate non ring-fenced bank, and RBSI Holdings will also be placed outside the ring-fence, both as direct subsidiaries of RBS Group.

The impact of these changes on the Group will be significant in 2018, including the transfer of the business due to be within the ring-fence to NatWest Holdings and its subsidiaries. In Q2 2018 once these transfers have been completed the Bank will be renamed NatWest Markets Plc, from which point the principal activity will be the continuation of the RBS Group's trading and investment banking activities.

For details on the future capital, funding and liquidity requirements of the Group see pages 14 to 17 of the Capital and risk management section.

The final ring-fenced legal structure and the actions to be taken to achieve it, remain subject to, amongst other factors, additional regulatory, Board and other approvals as well as employee information and consultation procedures. All such actions and their respective timings may be subject to change, or additional actions may be required, including as a result of external and internal factors including further regulatory, corporate or other developments.

Ring-fencing structure and actions

On 1 January 2017 the RBS Group made a number of key changes to the legal entity structure as detailed below to support the move towards a ring-fenced structure. There are also plans to make further changes prior to 1 January 2019.

On 21 November 2017, The Royal Bank of Scotland plc (RBS plc) applied to the Court of Session in Edinburgh (the Court) to initiate a "Ring-Fencing Transfer Scheme" (RFTS) under the Financial Services and Markets Act 2000, including:

- Transfer the UK retail and Commercial banking business to Adam & Company PLC (Adam);
- Transfer the covered bonds in issue and Mentor business to NatWest; and
- Transfer branches and other properties to either NatWest or Adam.

The RFTS is expected to take effect over the weekend of 28-30 April 2018. At the same time, RBS plc will be renamed "NatWest Markets Plc", Adam will be renamed "The Royal Bank of Scotland plc" and assume banknote-issuing responsibility.

May 2018

In May 2018, the RBS Group intends to commence, in the Court of Session, a second RFTS to transfer certain derivatives from NatWest to NatWest Markets Plc (previously RBS plc). If approved by the Court, the transfers are expected to be implemented in August 2018.

July 2018

In July 2018, the RBS Group plans to restructure NatWest Markets Plc (previously RBS plc) capital structure via a Court approved capital reduction. As part of this restructure, the shares in NatWest Holdings, which owns the ring-fenced sub-group, will be distributed to RBSG. This will separate the ring-fenced sub-group from the non-ring-fenced entities, as required by the ring-fencing legislation.

January 2019

Once the RFTS, other restructuring and the ring-fencing legislation is in force:

Ring-fenced activities

- RBS plc (previously Adam) will manage the RBS branded banking business in its UK branch network;
- NatWest will continue to manage NatWest branded banking business and its branch network in the UK and Western Europe;
- NatWest will operate as the shared service provider to the rest of the group and will act as the market-facing arm for the ring-fenced banking group's payments and hedging activities;
- Adam will continue to be a trading name of RBS plc (previously Adam) and will continue to operate its private banking and wealth management activities;
- Coutts & Company will continue its private banking and wealth management activities; and
- Ulster Bank Limited and Ulster Bank Ireland DAC will continue to operate in Northern Ireland and the Republic of Ireland respectively.

Non-ring-fenced activities

- NatWest Markets Plc will continue to undertake RBS's trading and investment banking activities; and
- RBS International Limited (RBSI), along with Isle of Man Bank, will continue to serve the markets and customers today. In addition, RBSI becomes the focal point for funds banking activity through its recently opened London branch.

Segmental reporting
The Group continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. To support this, and in preparation for the UK ring-fencing regime the previously reported operating segments were realigned in Q4 2017 and a number of business transfers completed. For full details, see the Report of the directors.

Reportable operating segments
Following the Q4 2017 changes, the reportable operating segments are as below. For full business descriptions, see Report of directors and Note 35 on the accounts.

- NatWest Markets,
- Central items & other

Disposal groups and discontinued operations
NatWest Holdings Limited (NatWest Holdings)

The transfer of the Group's Personal & Business Banking (PBB) (including the former Williams & Glyn segment), Commercial & Private Banking (CPB) and certain parts of Central items and NatWest Markets, due to be included in the ring-fenced bank, to subsidiaries of NatWest Holdings, is planned for Q2 2018. It will be followed by a transfer of NatWest Holdings to RBSG. Accordingly, all of the activities to be undertaken by NatWest Holdings and its subsidiaries are classified as disposal groups as at 31 December 2017 and presented as discontinued operations, with comparatives re-presented. UK Personal and Business Banking, Ulster Bank RoI, Commercial Banking and Private Banking are no longer reportable segments

RBS International

The Royal Bank of Scotland International (Holdings) Limited (RBSI Holdings), which was mainly reported in the RBS International reporting segment, was sold to RBSG on 1 January 2017 in preparation for ring-fencing. RBSI Holdings was classified as a disposal group as at 31 December 2016 and its assets and liabilities presented in aggregate in accordance with IFRS 5. RBS International is no longer a reportable segment

Top and emerging risks

The RBS Group employs a continuous process for identifying and managing its top and emerging risks. These are defined as scenarios that could have a significant negative impact on the RBS Group's ability to operate. A number of scenarios attracted particular attention in 2017 that relate to the RBS Group but which are also applicable to the Group. The factors discussed below and elsewhere in this report should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties facing the Group. Refer to the Risk Factors section on pages 189 to 222.

Macro-economic and political risks

The RBS Group remains vulnerable to changes and uncertainty in the external economic and political environment, which have intensified in the past year. Stress testing and scenario planning is used extensively to inform strategic planning and risk mitigation relating to a range of macroeconomic and political risks. Scenarios identified as having a potentially material negative impact on the RBS Group include: the impact of the UK's exit from the EU; a second Scottish independence referendum; a UK recession including significant falls in house prices; global financial market volatility linked to advanced economy interest rate increases or decreases; a protracted period of low interest rates in the UK; vulnerabilities in emerging market economies resulting in contagion in the RBS Group's core markets; a eurozone crisis; and major geopolitical instability.

Risks related to the competitive environment

The RBS Group's target markets are highly competitive, which poses challenges in terms of achieving some strategic objectives. Moreover, changes in technology, customer behaviour and business models in these markets have accelerated. The RBS Group monitors the competitive environment and associated regulatory technological strategy development and makes adjustments as appropriate.

Impact of cyber attacks

Cyber attacks are increasing in frequency and severity across the industry. The RBS Group has participated in industry-wide cyber attack simulations in order to help test and develop defence planning. To mitigate the risks, a number of control enhancements have been delivered as part of a bankwide security programme. This has improved the protection of IT systems and data for both staff and customers. Further enhancements are underway and planned to ensure the RBS Group continues to maintain an effective control environment as the cyber threats evolve.

Regulatory and legal risks

Future litigation and conduct charges could be substantial. The RBS Group is involved in a number of litigation and investigations matters, including: ongoing class action litigation, securitisation and mortgage-backed securities related litigation, investigations into foreign exchange trading and rate-setting activities, continuing LIBOR-related litigation and investigations, and investigations into the treatment of small and medium- sized business customers in financial difficulty, anti-money laundering, sanctions, mis-selling (including mis-selling of payment protection insurance products). Settlements may result in additional financial penalties, non-monetary penalties or other consequences, which may be material.

More detail on these issues can be found in the Litigation, Investigations and Reviews and Risk Factors sections. To prevent future conduct from resulting in similar impacts, the RBS Group continues to embed a strong and comprehensive risk and compliance culture.

Failure of information technology systems

The RBS Group's information technology systems are complex. As such, recovering from failure may be challenging. To mitigate these risks, a major investment programme has significantly improved the resilience of the systems and further progress is expected. System sustainability has improved as we continue to simplify and modernise our infrastructure and applications.

An increase in obligations to support pension schemes

The value of pension scheme assets may not be adequate to fund pension scheme liabilities. The actuarial deficit in the RBS Group pension schemes may therefore increase, requiring the RBS Group to increase its current and future cash contributions. An acceleration of certain previously-committed pension contributions was made in Q1 2016 to reduce this risk. Depending on the economic and monetary conditions and longevity of scheme members prevailing at that time, the actuarial deficit may increase at subsequent valuations and is also expected to be affected by ring-fencing.

Operational and execution risks

Increased losses may arise from a failure to execute major projects successfully. These currently include the transformation plan, the restructuring of NatWest Markets, compliance with structural reform requirements including the statutory ring-fencing requirements implemented as a result of the Independent Commission on Banking and the implementation of obligations under the policy framework for resolution (including Operational Continuity in Resolution). These support the delivery of a robust control environment and the embedding of a strong and pervasive customer-centred organisation and risk culture, are essential to meet the RBS Group's strategic objectives. These projects cover organisational structure, business strategy, information technology systems, operational processes and product offerings. The RBS Group continues to work to implement change in line with its project plans while assessing the risks to implementation and is taking steps to mitigate those risks where possible.

Risks to income, costs and business models arising from regulatory requirements

The RBS Group is exposed to the risk of further increases in regulatory capital requirements as well as risks related to new regulations that could affect its business models. The RBS Group considers and incorporates the implications of proposed or potential regulatory activities in its strategic and financial plans.

Inability to recruit or retain suitable staff

There is a risk that the RBS Group lacks sufficient capability or capacity at a senior level to deliver, or to adapt to, change. The RBS Group monitors people risk closely and has plans in place to support retention of key roles, with wider programmes supporting engagement and training for all staff.

Financial summary
Summary consolidated income statement for the year ended 31 December 2017

	2017 £m	2016 £m
Net interest income	48	97
Fees and commissions receivable	282	310
Fees and commissions payable	(275)	(262)
Income from trading activities	737	967
Loss on redemption of own debt	—	(52)
Other operating income	119	7
Non-interest income	863	970
Total income	911	1,067
Operating expenses	(2,386)	(5,569)
Loss before impairment releases	(1,475)	(4,502)
Impairment releases	79	130
Operating loss before tax	(1,396)	(4,372)
Tax credit/(charge)	160	(229)
Loss from continuing operations	(1,236)	(4,601)
Profit from discontinued operations, net of tax	1,192	(162)
Loss for the year	(44)	(4,763)
Attributable to:		
Non-controlling interests	5	4
Preference shareholders	—	23
Ordinary shareholders	(49)	(4,790)
	(44)	(4,763)

2017 Highlights and key developments

The Group reported an operating loss before tax of £1,396 million, compared with £4,372 million in 2016, primarily driven by a decrease in operating expenses which included a £664 million (2016 - £3,391 million) provision in relation to various investigations and litigation matters relating to the issuance of residential mortgage-backed securities (RMBS).

Loss attributable to shareholders of £49 million compared with a loss of £4,790 million in 2016, reflecting a tax credit of £160 million (2016 - £229 million tax charge). Profit from discontinued operations increased to £1,192 million, compared with a loss of £162 million in 2016.

Discontinued operations includes the results of the activities to be undertaken by NatWest Holdings and its subsidiaries due to be transferred to RBSG in Q2 2018 and RBS International Holdings (RBSI holdings) which was sold to RBSG in January 2017.

Term Funding Scheme

The Group has received £19 billion of funding under the Bank of England's Term Funding Scheme (£5 billion drawn in 2016, £14 billion in 2017) as at 31 December 2017. The participation of the scheme is split between NatWest Plc (£17 billion) and RBS plc (£2 billion).

Net Interest Income

Net interest income was £48 million compared with £97 million in 2016, principally driven by a decrease in NatWest Markets, partially offset by a reduction in losses in Central items mainly in relation to a reduction in debt securities in issue.

Non-interest income

Non-interest income decreased by £107 million to £863 million compared with £970 million in 2016. Net fees and commissions decreased to £7 million compared with £48 million in 2016.

Income from trading activities decreased by £230 million to £737 million compared with £967 million in 2016, primarily reflecting own credit adjustments on held-for-trading liabilities which were a loss of £70 million in 2017 compared with a gain of £143 million 2016.

Other operating income increased to £119 million (2016 - £7 million), reflecting a profit on the sale of subsidiaries of £81 million, compared with a loss of £81 million in 2016. There were no own credit adjustments on designated at fair value liabilities were compared with £39 million in 2016, following the early adoption of IFRS 9 on 1 January 2017. These adjustments are now reflected in the Statement of comprehensive income.

Operating expenses

Operating expenses decreased by £3,183 million to £2,386 million, compared with £5,569 million in 2016.

The increases in staff costs of £498 million, to £894 million, from £396 million in 2016, and in premises and equipment costs of £123 million to £152 million from £29 million in 2016, was primarily due to restructuring costs and the transfer of Services staff and assets to NatWest Markets in preparation for ring-fencing legislation with offsetting movements in other costs.

Litigation and conduct costs included a £664 million provision in relation to various investigations and litigation matters relating to the issuance of RMBS compared with £3,391 million in 2016. Restructuring costs were £307 million (2016 - £77 million) relating to the restructure of the NatWest Markets business including the run-down of the legacy business.

Tax

The tax credit of £160 million for the year (2016 - £229 million charge) reflects the impact of the banking surcharge, non-deductible bank levy and conduct charges for which no tax relief has been recognised, a reduction in the carrying value and impact of UK tax rate changes on deferred tax balances. These factors have been offset partially by the release of tax provisions that reflect the reduction of exposures in countries where the Group is ceasing operations.

Impairments

Impairment releases were £79 million compared with £130 million in 2016 and mainly comprised releases relating to the legacy business.

Discontinued operations

Profit from discontinued operations increased to £1,192 million, compared with a loss of £162 million in 2016. This includes the results of all of the activities to be undertaken by NatWest Holdings and its subsidiaries, due to be transferred to RBSG in Q2 2018 and RBS International Holdings (RBSI Holdings) which was sold to RBSG in January 2017. The components of profit from discontinued operations are set out in Note 19.

Total income decreased £981 million to £10,350 million compared to £11,331 million in 2016, this included: an increase in personal and business banking, driven by deposit re-pricing; offset by the absence of contribution from RBSI Holdings once no longer part of the Group (2016 contribution - £275 million); IFRS volatility losses in Treasury reflecting movements in interest rate expectations; and a £789 million loss on the redemption of own debt which was issued to RBSG.

Operating expenses reduced from £9,887 million to £7,729 million, mainly driven by a reduction in restructuring costs and litigation and conduct costs, where income statement charges in relation to the Group's State Aid obligations were £50 million in 2017, compared with £750 million in 2016 and income statement charges in relation to PPI were £175 million in 2017, compared with £601 million in 2016. There was also a reduction of c £600 million in staff costs reflecting cost saving initiatives.

Capital and leverage ratios
Capital resources, RWAs and leverage based on the relevant local regulatory capital transitional arrangements for the significant legal entities within the Group are set out below.

	31 December 2017			31 December 2016		
	RBS plc	NatWest	UBI DAC	RBS plc	NatWest	UBI DAC
Risk asset ratios	%	%	%	%	%	%
CET1	14.7	23.5	31.2	13.1	16.1	29.0
Tier 1	16.1	23.5	31.2	14.1	16.1	29.0
Total	18.7	30.9	33.8	19.1	23.3	31.9
Capital (2)	£m	£m	£m	£m	£m	£m
CET1	20,169	13,301	5,481	23,333	10,393	5,224
Tier 1	21,966	13,301	5,481	25,292	10,393	5,224
Total	25,600	17,536	5,941	34,151	15,016	5,746
Risk-weighted assets	£m	£m	£m	£m	£m	£m
Credit risk						
- non-counterparty	94,259	48,575	16,079	127,019	56,066	16,263
- counterparty	13,691	266	321	21,214	473	505
Market risk	15,809	136	68	15,698	676	12
Operational risk	13,052	7,724	1,101	14,862	7,209	1,215
Total RWAs	136,811	56,701	17,569	178,793	64,424	17,995
Leverage						
Tier 1 capital (£m)	21,966	13,301	5,481	25,292	10,393	5,224
Leverage exposure (£m)	390,055	213,474	27,857	447,238	169,586	27,337
Leverage ratio (%)	5.6	6.2	19.7	5.7	6.1	19.1

Notes:
(1) UBI DAC refers to Ulster Bank Ireland DAC.
(2) Refer to page 29.

Key points
RBS plc
- The CET1 ratio increased by 160 basis points to 14.7% partly benefitting from underlying RWA reduction in NatWest Markets and commercial business.
- The impact of the annual phasing in of the CRR end-point rules relating to significant investments was a reduction of 90 basis points in the CET 1 ratio. However, this was partially offset by the ring-fencing related transfers that took place on 1 January 2017. RBSI became a subsidiary of RBSG plc and Lombard and Invoice Finance subsidiaries were transferred to NatWest.
- RWAs decreased by £42.0 billion to £136.8 billion, mainly as a result of the CRR phase-in relating to significant investments which reduced standardised credit risk RWAs by £20.1 billion. The remainder of the movement is driven by the reductions in NatWest Markets and commercial business.
- The leverage ratio on a PRA transitional basis decreased to 5.6% as a result of the reduction in capital in the period.

NatWest
- The CET1 ratio increased from 16.1% to 23.5%, mainly due to the reduction in significant investments following ring-fencing related transfers. UBI DAC was transferred to NatWest Holdings Limited on 1 January 2017.
- RWAs decreased by £7.7 billion, mainly as a result of phasing-in of CRR end-point rules relating to significant investments.
- The leverage ratio on a PRA transitional basis improved from 6.1% to 6.2%. Whilst the exposure has increased due to higher central bank balances and mortgage growth, the impact of ring-fencing related transfers on CET1 capital has offset this.

UBI DAC
- The CET1 ratio increased to 31.2% reflecting higher capital and lower RWAs. UBICDAC paid a dividend of €1.5 billion to its parent company in January 2018, this will reduce its CET 1 ratio to 23.6%.
- RWAs decreased by £0.4 billion mainly due to lower exposures.
- The leverage ratio increased due to higher capital

Consolidated balance sheet at 31 December 2017

	2017 £m	2016 £m
Assets		
Cash and balances at central banks	153	73,813
Amounts due from fellow subsidiaries	201	1,037
Other loans and advances to banks	19,061	29,458
Loans and advances to banks	19,262	30,495
Amounts due from holding company and fellow subsidiaries	—	1,116
Other loans and advances to customers	49,374	343,839
Loans and advances to customers	49,374	344,955
Debt securities	30,539	71,652
Equity shares	87	445
Settlement balances	2,512	5,557
Derivatives	159,278	247,744
Intangible assets	—	6,165
Property, plant and equipment	159	4,536
Deferred tax	166	1,798
Prepayments, accrued income and other assets	829	2,288
Assets of disposal groups	463,878	8,366
Total assets	726,237	797,814
Liabilities		
Amounts due to fellow subsidiaries	79	2,117
Other deposits by banks	17,014	38,436
Deposits by banks	17,093	40,553
Amounts due to holding company and fellow subsidiaries	6	18,528
Other customers accounts	39,097	357,537
Customer accounts	39,103	376,065
Debt securities in issue	12,362	20,362
Settlement balances	2,818	3,641
Short positions	28,527	22,076
Derivatives	153,330	237,577
Provisions for liabilities and charges	3,979	11,840
Accruals and other liabilities	805	6,450
Deferred tax	128	525
Subordinated liabilities	—	19,515
Liabilities of disposal groups	432,832	23,391
Total liabilities	690,977	761,995
Non-controlling interests	57	62
Owners' equity	35,203	35,757
Total equity	35,260	35,819
Total liabilities and equity	726,237	797,814

Commentary on consolidated balance sheet

2017 compared with 2016

Total assets of £726.2 billion as at 31 December 2017 were down £71.6 billion, 9.0%, compared with 31 December 2016. Funded assets which exclude derivatives increased by £16.9 billion, 3.1%, to £567.0 billion compared with £550.1 billion at 31 December 2016.

Assets and liabilities of disposal groups increased by £455.5 billion and £409.4 billion, to £463.9 billion and £432.8 billion respectively. The business to be undertaken by NatWest Holdings and its subsidiaries due to be transferred to RBSG in Q2 2018 are included as at 31 December 2017. The RBSI business transferred to RBSG on 1 January 2017 is included as at 31 December 2016. The majority of the year-on-year movement in individual balance sheet lines have been materially impacted by the transfer of these businesses so the following commentary is primarily limited to the nature of the remaining balance at 31 December 2017. Refer to page 40 and Note 19 on the accounts for further details.

Movements in the fair value of derivative assets, down £88.5 billion, 35.7%, to £159.3 billion, and liabilities down, £84.2 billion, 35.5%, to £153.3 billion, mainly reflect maturities, derivative mitigation activities, and buyouts in the NatWest Markets legacy business together with mark-to-market movement as US dollar weakened against the Euro and Sterling and interest rate yields widened during the year.

Loans and advances to customers were £49.4 billion. Third party loans excluding reverse repurchase agreements were £22.6 billion, mainly relating to NatWest Markets and includes derivative cash collateral. Reverse repurchase agreements, mainly in NatWest Markets were £26.7 billion.

Settlement balance assets were down £3.0 billion, 54.8% to £2.5 billion and liabilities were down £0.8 billion, 22.6% to £2.8 billion reflecting lower trading volumes in NatWest Markets in the run up to year end.

Deposits by banks were £17.1 billion and included derivative cash collateral. Within this bank deposits were down £25.4 billion, 66.0% to £13.1 billion and repurchase agreements and stock borrowing increased by £1.9 billion, 90.3%, to £4.0 billion.

Debt securities in issue of £12.4 billion included the issuance in the year of £3.6 billion sterling equivalent MREL eligible securities

Owner’s equity decreased by £0.6 billion, 1.5%, to £35.2 billion, primarily driven by the attributable loss for the year more than offset by cash flow hedge losses.

Cash flow

	2017 £m	2016 £m
Net cash flows from operating activities	(58,081)	6,969
Net cash flows from investing activities	(3,647)	(5,398)
Net cash flows from financing activities	(10,046)	(13,532)
Effects of exchange rate changes on cash and cash equivalents	(570)	7,913
Net decrease in cash and cash equivalents	(72,344)	(4,048)

2017

The major factors contributing to the net cash outflow from operating activities of £58,081 million
were a decrease of £53,765 million in operating assets and liabilities, provisions utilised of £5,639 million, income accruals of £1,182 million, loans and advances written-off net of recoveries of £1,048 million. These were partially offset by provisions charged net of releases of £1,877m, depreciation and amortisation of £802m and loss on redemption of own debt of £789 million.

Net cash outflows from investing activities of £3,647 million related to the net outflows from purchase and sale of securities of £4,840 million, the purchase of property, plant and equipment of £1,123 million, offset by net cash inflows from disposals of £1,912 million and sale of property, plant and equipment of £404 million.

Net cash outflows from financing activities of £10,046 million relate primarily to the redemption of subordinated liabilities of £9,624 million and interest paid on subordinated liabilities of £417 million.

2016

The major factors contributing to the net cash inflow from operating activities of £6,969 million were the increase of £19,191 million in operating assets and liabilities, other provisions charged net of releases of £6,323 million, interest on subordinated liabilities of £1,228 million and depreciation and amortisation of £775 million. These were partially offset by outflows from the elimination of foreign exchange differences £6,416 million, contribution to defined benefit schemes of £4,783 million, loans and advances written-off net of recoveries of £3,552 million, operating loss before tax from continuing operations of £3,732 million and other provisions utilised of £2,643 million.

Net cash outflows from investing activities of £5,398 million related to the net outflows from purchase and sale of securities of £3,941 million, the purchase of property, plant and equipment of £902 million and £976 million outflows from disposals, offset by net cash inflows from the sale of property, plant and equipment of £421 million.

Net cash outflows from financing activities of £13,532 million relate primarily to the redemption of subordinated liabilities of £10,556 million, redemption of equity preference shares of £1,744 million and interest paid on subordinated liabilities of £1,210 million.

Capital and risk management

Presentation of information

Except as otherwise indicated, information in the Capital and risk management section (pages 13 to 59) is within the scope of the Independent auditor's report. Unless otherwise indicated, disclosures in this section include disposal groups in relevant exposures and measures.

Capital and risk management are generally conducted on an overall basis within RBS Group such that common policies, procedures, frameworks and models apply across the RBS Group. Therefore, for the most, discussion on these qualitative aspects reflect those in the RBS Group as relevant for the businesses and operations in the Group.

Future NatWest Markets Plc capital and risk profile

The disclosures in the rest of the Capital and risk management section cover capital and risk profile measures for the Group at 31 December 2017.

The impact of the implementation of ring-fencing on the Group in 2018 will be significant, including the transfer of the business due to be within the ring-fence to NatWest Holdings and its subsidiaries. In 2018 once these transfers have been completed the Group will be renamed NatWest Markets Plc, from which point the principal activity will be the continuation of the RBS Group's trading and investment banking activities.

Given the significant change in risk profile of the Group, this section provides guidance on the post-ring-fence profile. The targets and expectations discussed in this section represent management's current expectations and are subject to change and regulatory approvals, including as a result of the factors described in this document and in the "Risk Factors" on pages 189 to 222.

Target capital and balance sheet metrics **(unaudited)**

The capital, funding and balance sheet structure of the future NatWest Markets Plc and its subsidiaries (NatWest Markets Group) is expected to be as follows:

- Trading liabilities, including repos, largely matched against trading assets.
- Loss absorbing capacity from MREL down-streamed from the parent company, RBSG plc.
- The debt securities in issue currently in the Group, excluding covered bonds, will remain in NatWest Markets Plc. The covered bonds will be transferred to NatWest.
- Debt issuance of £2 - £4 billion per annum.
- Presence in the short term wholesale funding market maintained.
- Metrics managed to ensure compliance with regulatory minima or internal risk appetite, whichever is higher.

Notwithstanding a planned capital reduction exercise in July 2018, by 2020 NatWest Markets Group is targeting capital and balance sheet metrics as follows:

Metric (1)	Estimate
CET 1 capital ratio	~14%
Total capital ratio (2)	> 28%
Leverage ratio	> 4%
RWAs	~ £35 billion
Funded assets	~ £100 billion
Liquidity coverage ratio	> 100%
Net stable funding ratio (3)	> 100%

Notes:
(1) All metrics presented relate to NatWest Markets Group (including legacy).
(2) Including the benefit of downstreamed internal MREL.
(3) Based on the expected regulatory regime, which is a NSFR requirement of 100% included as part of the CRR 2 package of legislative proposals published in November 2016 by the European Commission.

NatWest Markets segmental RWAs at 31 December 2017 **(unaudited)**

	£bn
Credit risk	16.1
Counterparty credit risk	15.3
Market risk	16.2
Operational risk	5.3
Total RWAs	52.9

Note:
(1) The RBS Group segmental RWAs, comparable to the estimated future steady state metrics presented above.

Continuing operations: Group balance sheet profile at 31 December 2017

The balance sheet structure of the future NatWest Markets Group is expected to be broadly similar to the NatWest Markets segment at 31 December 2017. The Group balance sheet profile as at 31 December 2017, presented as continuing balance sheet in the tables on pages 15 to 16, is summarised as follows:

Assets	£bn	£bn	Liabilities
Reverse repos	38.6	28.4	Repos
Securities	30.6	28.5	Short positions
Loans - derivative collateral	21.5	22.7	Deposits - derivative collateral
Loans - other	8.5	5.2	Deposits - other
		12.4	Debt securities in issue
Other assets	3.9	7.6	Other liabilities
Funded assets	103.1	104.8	Funded liabilities
Derivative assets	159.3	153.3	Derivative liabilities
Total assets (1)	262.4	258.1	Total liabilities
		13.0	*of which: wholesale funding (2)*
		5.2	*of which: short-term wholesale funding (2)*
Net derivative assets	4.9	2.9	Net derivative liabilities

Notes:
(1) RBS Treasury holds £93.6 billion of cash and balances at central banks as part of the Group's liquidity portfolio at 31 December 2017, including £13.6 billion relating to NatWest Markets. Post the ring-fence transfers in 2018, NatWest Markets is expected to hold its own separate liquidity portfolio.
(2) Excludes derivative collateral.

Future NatWest Markets Plc capital and risk profile continued

Balance sheet: fair value hierarchy at 31 December 2017

The following table shows financial instruments carried at fair value on the Group's balance sheet by valuation hierarchy.

Assets	Level 1 £bn	Level 2 £bn	Level 3 £bn	Total £bn	Level 1 £bn	Level 2 £bn	Level 3 £bn	Total £bn	Liabilities
Loans and advances	—	58.5	0.1	58.6	—	52.1	0.2	52.3	Deposits
Debt securities	20.0	7.2	0.8	28.0	—	4.1	0.3	4.4	Debt securities in issue
Equity shares	—	—	0.1	0.1	23.7	4.8	—	28.5	Short positions
Derivatives	—	157.5	1.7	159.2	—	151.8	1.6	153.4	Derivatives
	20.0	223.2	2.7	245.9	23.7	212.8	2.1	238.6	
Proportion	8.1%	90.8%	1.1%	100.0%	9.9%	89.2%	0.9%	100.0%	

For notes regarding the above table please refer to page 121.

Balance sheet analysis: continuing operations and disposal groups – summary balance sheet

In accordance with IFRS 5, assets and liabilities of disposal groups are presented as a single line on the balance sheet. The table below analyses the balance sheet and related measures of the Group between the continuing activities and disposal groups. The continuing activities primarily reflect the NatWest Markets segment. The disposal groups relate to the Group's retail and commercial banking activities which are expected to become part of the consolidated ring-fenced group, NatWest Holdings Plc, in 2018.

	Group				Bank			
	2017			2016	2017			2016
	Continuing balance sheet £m	Disposal groups £m	Gross of disposal groups £m	Gross of disposal groups £m	Continuing balance sheet £m	Disposal groups £m	Gross of disposal groups £m	Gross of disposal groups £m
Assets								
Cash and balances at central banks	153	97,625	97,778	73,875	93	61,532	61,625	70,615
Loans and advances to banks	19,262	11,299	30,561	30,526	18,814	21,889	40,703	39,018
Loans and advances to customers	49,374	291,599	340,973	352,846	45,658	102,816	148,474	160,191
Debt securities and equity shares	30,626	47,965	78,591	72,097	27,384	44,491	71,875	67,967
Investments in Group undertakings	—	—	—	—	496	33,002	33,498	35,760
Settlement balances	2,512	16	2,528	5,557	1,640	4	1,644	4,707
Deferred tax	166	1,585	1,751	1,798	165	356	521	272
Assets of disposal groups	463,878	(463,878)	—	—	269,038	(269,038)	—	—
Other assets	988	11,823	12,811	13,356	596	2,774	3,370	3,607
Derivatives	159,278	1,966	161,244	247,759	162,005	2,174	164,179	251,476
Total assets	726,237	—	726,237	797,814	525,889	—	525,889	633,613
Deposits by banks	17,093	54,141	71,234	40,554	18,304	109,493	127,797	139,288
Customer accounts	39,103	349,619	388,722	399,337	37,097	94,843	131,940	142,218
Debt securities in issue	12,362	8,963	21,325	20,362	12,362	8,567	20,929	18,881
Settlement balances and short positions	31,345	36	31,381	25,717	27,618	21	27,639	20,364
Derivatives	153,330	1,651	154,981	237,586	155,098	2,435	157,533	240,898
Provisions for liabilities and charges	3,979	3,576	7,555	11,857	2,230	2,046	4,276	4,884
Subordinated liabilities	—	9,753	9,753	19,515	—	8,364	8,364	17,870
Liabilities of disposal groups	432,832	(432,832)	—	—	228,027	(228,027)	—	—
Other liabilities	933	5,093	6,026	7,067	631	2,258	2,889	3,334
Total liabilities	690,977	—	690,977	761,995	481,367	—	481,367	587,737

Notes:
(1) Loans and advances to banks and loans and advances to customers in continuing group balance sheet includes £6,842 million and £14,671 million of derivative cash collateral respectively at 31 December 2017.
(2) Deposits by banks and customer accounts in continuing group balance sheet includes £12,394 million and £10,271 million of derivative cash collateral respectively at 31 December 2017.

Future NatWest Markets Plc capital and risk profile continued

Balance sheet analysis: continuing operations and disposal groups – selected financial data

	Group				Bank			
	2017			2016	2017			2016
	Continuing balance sheet £m	Disposal groups £m	Gross of disposal groups £m	Gross of disposal groups £m	Continuing balance sheet £m	Disposal groups £m	Gross of disposal groups £m	Gross of disposal groups £m
Selected financial data								
Gross loans and advances to customers (1)	22,780	295,229	318,009	328,369	24,844	103,885	128,729	140,302
- residential mortgages	39	161,067	161,106	153,315	—	27,126	27,126	29,046
- other personal	10	13,954	13,964	14,487	10	2,927	2,937	3,082
- property & construction	439	34,607	35,046	39,003	431	17,153	17,584	19,750
- other	22,292	85,601	107,893	121,564	24,403	56,679	81,082	88,424
Customer loan impairment provisions	141	3,630	3,771	4,407	164	1,069	1,233	1,558
- residential mortgages	—	994	994	1,015	—	56	56	66
- other personal	—	762	762	899	—	175	175	219
- property & construction	18	563	581	625	57	301	358	283
- other	123	1,311	1,434	1,868	107	537	644	990
REIL	220	8,631	8,851	10,242	263	2,892	3,155	4,007
- residential mortgages	—	3,872	3,872	4,087	—	407	407	470
- other personal	—	932	932	1,112	—	226	226	272
- property & construction	63	1,481	1,544	1,634	130	881	1,011	982
- other	157	2,346	2,503	3,409	133	1,378	1,511	2,283
Reverse repurchase agreements (2) (3)	38,615	2,117	40,732	41,744	29,657	2,116	31,773	30,255
Repurchase agreements	28,362	10,058	38,420	32,335	12,910	10,058	22,968	19,279
Total debt securities	30,539	47,764	78,303	71,652	27,334	44,343	71,677	67,669
- HFT debt securities	27,481	—	27,481	24,501	23,565	—	23,565	20,502
- LAR debt securities	2,583	1,059	3,642	3,968	3,299	—	3,299	5,742
- HTM debt securities	—	4,128	4,128	4,769	—	4,128	4,128	4,769
- AFS debt securities	475	42,577	43,052	38,414	470	40,215	40,685	36,656
Gross unrealised gains on AFS debt securities	1	1,121	1,122	1,430	1	1,119	1,120	1,418
Gross unrealised losses on AFS debt securities	—	(115)	(115)	(198)	—	(114)	(114)	(190)
Customer deposits (1)								
- personal deposits	3	167,772	167,775	164,824	3	28,454	28,457	27,563
- corporate deposits	1,344	121,998	123,342	125,103	3,371	34,096	37,467	50,268
- financial institution deposits	13,423	53,180	66,603	82,315	23,170	25,624	48,794	40,741
	14,770	342,950	357,720	372,242	26,544	88,174	114,718	118,572
Debt securities in issue								
- CD & CP	2,378	2,259	4,637	3,208	2,378	2,259	4,637	3,208
- MTNs	9,984	—	9,984	11,738	9,984	—	9,984	11,738
- Covered bonds	—	6,308	6,308	3,935	—	6,308	6,308	3,935
- Other	—	396	396	1,481	—	—	—	—
Derivative notionals (£bn)	15,195	286	15,481	21,129	15,165	283	15,448	21,092
Derivative net asset post netting and collateral (£m)	4,852	1,298	6,150	12,237	4,512	1,220	5,732	11,384
Derivative net liabilities post netting and collateral (£m)	2,931	1,129	4,060	7,817	2,826	1,086	3,912	7,466
Asset quality	%	%	%	%	%	%	%	%
AQ1-AQ4	95	72	81	81	95	81	89	89
AQ5-AQ8	5	27	19	18	5	19	11	10
AQ9	—	1	—	1	—	—	—	1
AQ10 (4)	—	—	—	—	—	—	—	—
Total	100	100	100	100	100	100	100	100

Notes:
(1) Gross loans and advances to customers and customer deposits exclude reverse repos and repo agreements respectively.
(2) Fair value of securities received as collateral for Group reverse repos were £38.6 billion (2016 - £41.7 billion), of which £28.5 billion (2016 - £30.5 billion) had been rehypothecated for the Group's own transactions, in line with normal market practice.
(3) Fair value of securities received as collateral for Bank reverse repos were £29.7 billion (2016 - £30.3 billion), of which £21.5 billion (2016 - £19.0 billion) had been rehypothecated for the Bank's own transactions, in line with normal market practice.
(4) AQ10 excludes past due.

Future NatWest Markets Plc capital and risk profile continued

Credit risk: management basis (unaudited)

Credit risk management use current and potential exposure (see page 37 for definitions) to manage and monitor risk profile. Current exposure is broadly aligned to the balance sheet but reflects legally enforceable netting relating to securities financing transactions and derivatives. The current and potential exposure of continuing operations (NatWest Markets) is presented below.

	Continuing activities - wholesale						
2017	Insurers and funds £m	Securitisations £m	Banks £m	NBFIs (1) £m	Sovereign (2) £m	Other £m	Total £m
AQ1-AQ4	5,768	4,778	1,379	1,968	1,271	4,577	19,741
AQ5-AQ8	200	257	200	528	11	2,080	3,276
AQ9	—	2	—	—	—	29	31
AQ10	1	8	4	20	—	537	570
Current exposure	5,969	5,045	1,583	2,516	1,282	7,223	23,618
Of which:							
- Counterparty risk	*2,799*	*1,019*	*1,360*	*1,973*	*627*	*5,090*	*12,868*
- Non-counterparty risk	*3,170*	*4,026*	*223*	*543*	*655*	*2,133*	*10,750*
Potential exposure	16,937	7,510	8,205	5,066	1,947	15,310	54,975

- Material sectors included in the other category are Natural Resources (£2.8 billion), Property (£1.7 billion), Transport (£0.9 billion) and Services (£0.8 billion).
- Measured against the Group's asset quality scale, 84% of total current exposure was rated in the AQ1-AQ4 bands, equating to an indicative investment grade rating of BBB- or above.
- The majority of the exposure was in the UK (49%) with further exposure in Western Europe (20%), US (20%), RoI (2%) and rest of the world (9%).
- Credit quality across the wholesale portfolio remained stable reflecting resilient market conditions during the year.
- The difference in potential and current exposure mainly relates to the variation in measurement of counterparty credit risk.

Traded market risk

The table below analyses 1-day 99% internal VaR, as at and for the year ended 31 December 2017, for the trading portfolios of RBS plc (equivalent to the future NatWest Markets Plc) and RBS Securities Inc (RBSSI), segregated by type of market risk exposure.

	RBS plc				RBSSI			
1-day 99% internal VaR	Average £m	Maximum £m	Minimum £m	Period end £m	Average £m	Maximum £m	Minimum £m	Period end £m
Interest rate	13.5	20.8	8.6	15.0	3.3	6.0	1.6	1.6
Credit spread	11.8	18.9	8.5	16.4	0.7	3.4	0.5	0.5
Currency	4.8	9.8	2.4	3.4	—	—	—	—
Equity	1.2	2.1	0.4	0.4	—	—	—	—
Commodity	0.3	1.4	—	0.2	0.1	0.4	—	—
Diversification (1)	(12.6)	—	—	(15.3)	(0.5)	—	—	(0.2)
Total	19.0	29.2	13.3	20.1	3.6	6.5	1.8	1.9

Note:
(1) The Group benefits from diversification as it reduces risk by allocating positions across various financial instrument types, currencies and markets. The extent of the diversification benefit depends on the correlation between the assets and risk factors in the portfolio at a particular time. The diversification factor is the sum of the VaR on individual risk types less the total portfolio VaR.

Risk management framework (unaudited)

Introduction

The RBS Group operates an integrated risk management framework, centred around the embedding of a strong risk culture, which is designed to achieve the correct balance between prudential and conduct obligations. Each element of the risk management framework functions both individually and as part of a larger continuum. The framework ensures the tools and capability are in place to facilitate risk management and decision-making across the organisation.

The RBS Group's strategy is informed and shaped by an understanding of the risk landscape, including a range of significant risks and uncertainties in the external economic, political and regulatory environment. Identifying these risks and understanding how they affect the RBS Group, informs risk appetite and risk management practice.

Risk appetite, which is supported by a robust set of principles, policies and practices, defines our levels of tolerance for a variety of risks.

It is a key element of the RBS Group's risk management framework and culture, providing a structured approach to risk-taking within agreed boundaries.

Effective governance underpinned by our three lines of defence model, is essential to ensure the right decisions are being made by the right people at the right time. Governance includes regular and transparent risk reporting as well as discussion and decision-making at senior management committees, which informs management strategies across the organisation.

The RBS Group aims to have the right tools in place to support effective risk management. Having the appropriate capability, people and infrastructure is central. This is supported by a strong emphasis on systems, training and development to ensure threats are anticipated and managed appropriately within the boundaries determined by the agreed risk appetite.

Measurement, evaluation and transparency are also fundamental elements of the framework, providing robust analysis of the materiality and likelihood of specific threats as well as supporting understanding and communication of the financial and non-financial risks the RBS Group is exposed to.

The RBS Group has a strong focus on defining the control environment to ensure the effective operation of policies and processes embedded in the customer-facing businesses, thus facilitating the management of the risks they take in the course of their day-to-day activities.

Risk management framework (unaudited) continued

The RBS Group also has a strong focus on continually improving the way risk is managed, particularly in terms of how threats are anticipated or responded to, but also in terms of simplifying or enhancing existing controls, policies and practice.

Essential to this is the ability to scan both the medium- and long-term horizon for risks. Stress testing is used to quantify, evaluate and understand the potential impact that changes to risks may have on the financial strength of the RBS Group, including its capital position. In turn, the results of stress tests can be used to inform and shape strategy.

Given the evolving external landscape, including the structural reform required by the UK's ring-fencing requirements, in 2017 there was an emphasis on enhancing both the risk culture and risk appetite elements of the framework – as well as the interconnectivity between framework components.

All the RBS Group employees share ownership of the way risk is managed. The businesses, the control and support functions, and Internal Audit work together to make sure business activities and policies are consistent with risk appetite; following the three lines of defence model. The RBS Group constantly monitors its risk profile against its defined risk appetite and limits, taking action when required to balance risk and return.

Risk culture

A strong risk culture is essential if the RBS Group is to achieve its ambition to build a truly customer-focused bank. RBS Group's risk culture target is to make risk simply part of the way that employees work and think.

Such a culture must be built on strong risk practices and appropriate risk behaviours must be embedded throughout the organisation.

To achieve this, the RBS Group is focusing on leaders as role models and taking action to build clarity, continuing to develop capability and motivate employees to reach the required standards of risk culture behaviour, including:

- Taking personal accountability and proactively managing risk.
- Respecting risk management and the part it plays in daily work.
- Understanding clearly the risks associated with individual roles.
- Aligning decision-making to the RBS Group's risk appetite.
- Considering risk in all actions and decisions.
- Escalating risks and issues early.
- Taking action to mitigate risks.
- Learning from mistakes and near-misses.
- Challenging others' attitudes, ideas and actions.
- Reporting and communicating risks transparently.

To embed and strengthen the required risk culture, a number of the RBS Group-wide activities were undertaken in 2017. These included ethical scenario training, mandatory Group Policy Learning, and Managing Our Performance meetings designed to enhance risk culture at a team and individual employee level.

To support a consistent tone from the top, senior management regularly communicate the importance of the required risk behaviours, linking them to the achievement of good customer outcomes.

The RBS Group's target risk culture behaviours have now been embedded into Our Standards. These are clearly aligned to the core values of "serving customers", "working together", "doing the right thing" and "thinking long term". They act as a clear starting point for a strong and effective risk culture because Our Standards are used for performance management, recruitment and selection and development.

Risk culture behaviour assessment is incorporated into performance assessment and compensation processes for enhanced governance staff. In Q1 2017, an objective aligned to the RBS Group's risk culture target was set for the Executive Committee. Activity against that objective over the year was integral to performance reviews.

A risk culture measurement and reporting framework has been developed, enabling the RBS Group to benchmark both internally and externally. The purpose of the framework is to assess progress in embedding the RBS Group's target risk culture where risk is simply part of the way we work and think. In 2017, external validation indicated that good progress had been made against that objective demonstrating that the continued focus and actions are moving the RBS Group towards its target risk culture.

Risk-based key performance indicators

The RBS Group-wide remuneration policy ensures that the remuneration arrangements for all employees reflect the principles and standards prescribed by the PRA rulebook and the FCA handbook.

Training

Enabling employees to have the capabilities and confidence to manage risk is core to the RBS Group's learning strategy.

The RBS Group offers a wide range of risk learning, both technical and behavioural, across the risk disciplines. This training can be mandatory, role-specific or for personal development.
Mandatory learning for all staff is focused on keeping employees, customers and the RBS Group safe. This is easily accessed online and is assigned to each person according to their role and business area. The system allows monitoring at all levels to ensure completion.

Risk management framework (unaudited) continued

Code of Conduct

Aligned to the RBS Group's values is the Code of Conduct (Our Code). The code provides guidance on expected behaviour and sets out the standards of conduct that support the values. It explains the effect of decisions that are taken and describes the principles that must be followed.

These principles cover conduct-related issues as well as wider business activities. They focus on desired outcomes, with practical guidelines to align the values with commercial strategy and actions. The embedding of these principles facilitates sound decision-making and a clear focus on good customer outcomes. They are also consistent with the people management and remuneration processes and support a positive and strong risk culture through appropriate remuneration structures.

A simple decision-making guide – the "YES check" – has been included in the Code of Conduct. It is a simple set of five questions, designed to ensure the RBS Group values guide day-to-day decisions:

- Does what I am doing keep our customers and the RBS Group safe and secure?
- Would customers and colleagues say I am acting with integrity?
- Am I happy with how this would be perceived on the outside?
- Is what I am doing meeting the standards of conduct required?
- In five years' time would others see this as a good way to work?

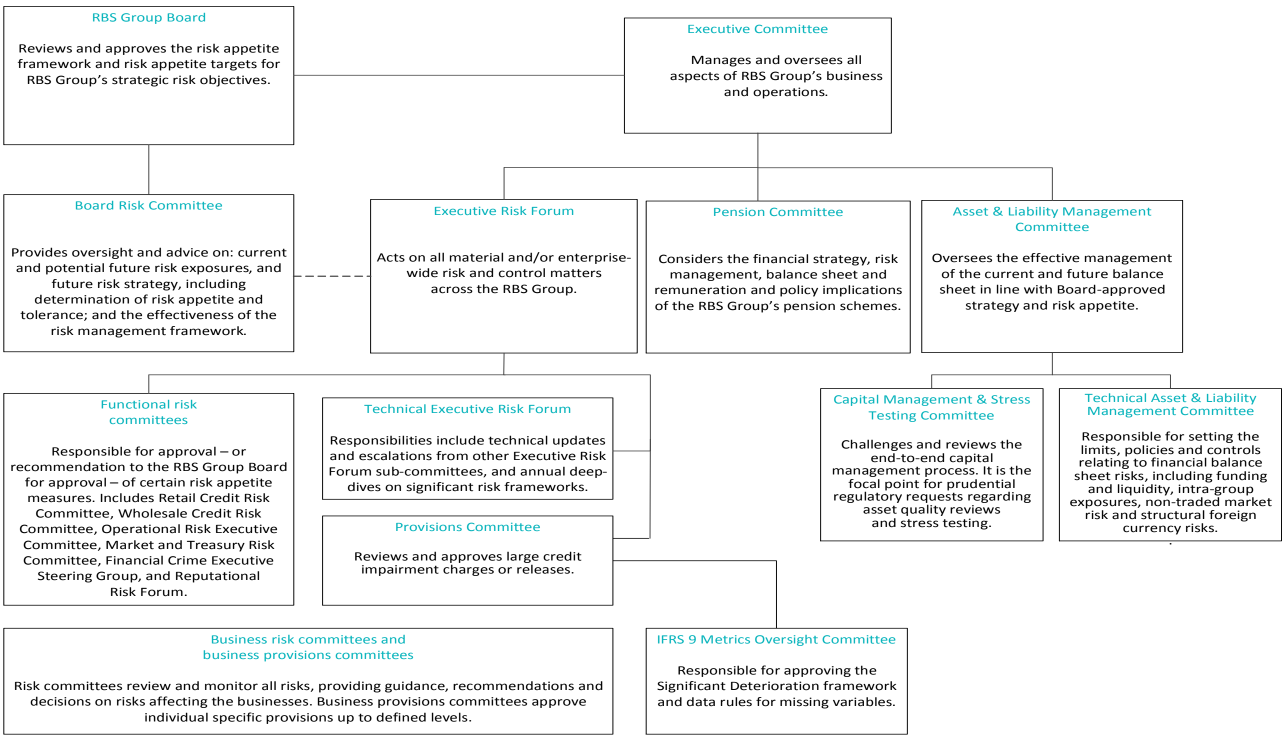
Each of the five questions is a prompt to think about how the situation fits with the RBS Group's values. It ensures that employees can think through decisions that do not have a clear answer, and guides their judgements.

If conduct falls short of the RBS Group's required standards, the accountability review process is used to assess how this should be reflected in pay outcomes for those individuals concerned. The RBS Group's approach to remuneration and related policies promotes effective risk management through a clear distinction between fixed remuneration – which reflects the role undertaken by an individual – and variable remuneration, which is directly linked to, and reflects performance and can be risk-adjusted. The RBS Group Performance & Remuneration Committee considers risk performance and conduct when determining overall bonus pools. Such pay decisions aim to reinforce the need for all employees to demonstrate acceptable risk management practice.

Risk governance

Committee structure

The diagram illustrates the RBS Group risk committee structure in 2017 and the main purposes of each committee.

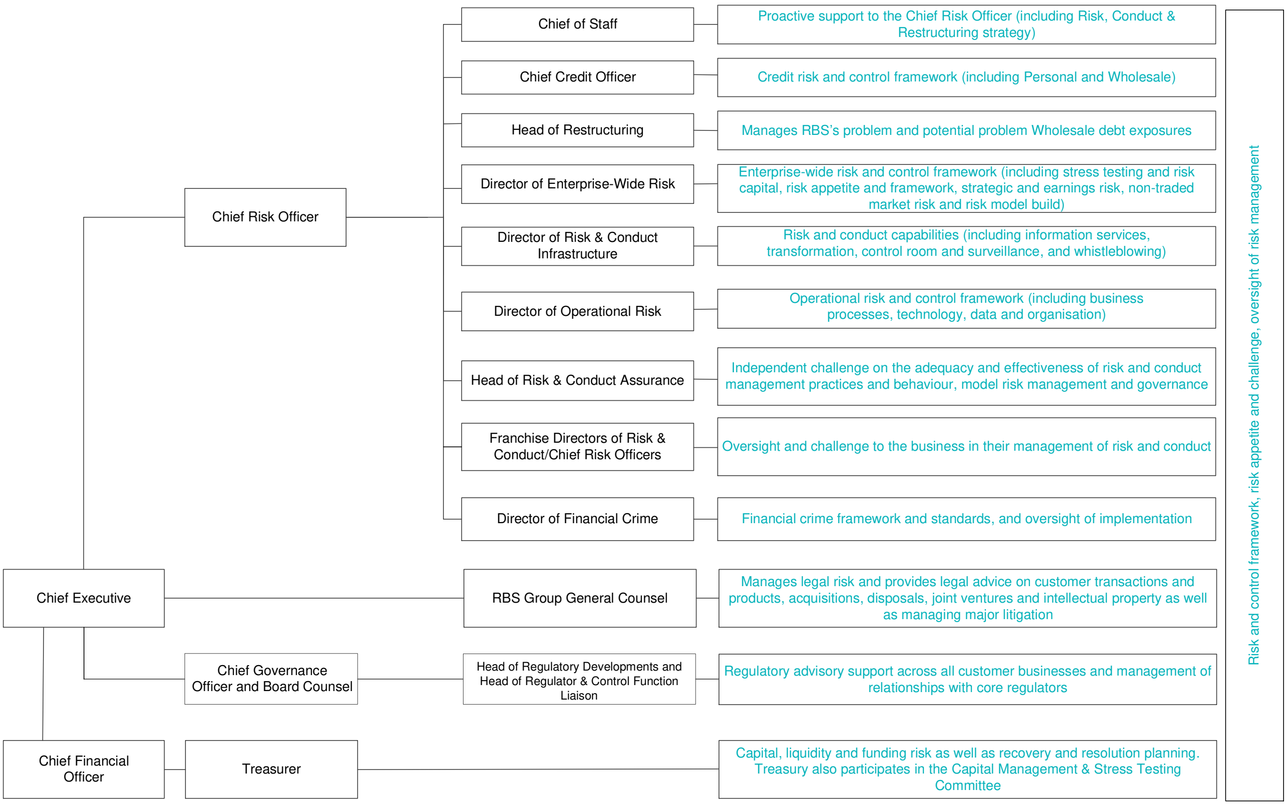


Note:
(1) The IFRS 9 Metrics Oversight Committee has delegated authority from the RBS Group Provisions Committee to approve the Significant Deterioration framework, the data rules for missing variables, materiality decisions relating to the expected credit loss calculation, adjustments relating to the expected credit loss calculation if necessary, and changes in expected credit loss provision calculation methodology.

Risk management framework (unaudited) continued

Risk management structure

The diagram illustrates the RBS Group's risk management structure in 2017 and key risk management responsibilities.



Notes:
(1) RBS Group risk management framework
In 2017, the Chief Risk Officer (CRO) led Risk, Conduct & Restructuring. The CRO reported directly to the Chief Executive and had a dotted reporting line to the Board Risk Committee – as well as a right of access – to the chairman of the Board Risk Committee.
Risk, Conduct & Restructuring was a function independent of the franchises, structured by risk discipline to facilitate the effective management of risk.
Risk, Conduct & Restructuring was organised into eight functional areas: Chief of Staff; Credit Risk; Restructuring; Enterprise-Wide Risk; Risk & Conduct Infrastructure; Operational Risk; Risk & Conduct Assurance; and Financial Crime. There were also Directors of Risk & Conduct/Chief Risk Officers for each of the franchises and for Services.
Risk committees in the customer businesses and key functional risk committees oversaw risk exposures arising from management and business activities and focused on ensuring that they were adequately monitored and controlled.
(2) Regulatory Affairs
In 2017, Regulatory Affairs was responsible for providing leadership of the RBS Group's relationships with its regulators. Regulatory Affairs is part of Corporate Governance & Regulatory Affairs. Remediation & Complaints reports to the Services Chief Operating Officer.

Risk management framework (unaudited) continued

Three lines of defence

The RBS Group uses the three lines of defence model to articulate accountabilities and responsibilities for managing risk across the organisation. The three lines of defence model is adopted across the industry to support the embedding of effective risk management and is expressed through a set of principles as outlined below:

First line of defence – Management and supervision

The first line of defence includes customer franchises, Technology and Services as well as support and control functions such as Human Resources, Communications & Marketing and Finance. Responsibilities include:

- Owning, managing and supervising, within a defined risk appetite, the risks which exist in business areas and support functions.
- Ensuring appropriate controls are in place to mitigate risk, balancing control, customer service and competitive advantage.
- Ensuring that the culture of the business supports balanced risk decisions and compliance with policy, laws and regulations.
- Ensuring the business has effective mechanisms for identifying, reporting and managing risk and controls.

Second line of defence – Oversight and control

The second line of defence includes Risk, Conduct & Restructuring, Legal, and the financial control element of the RBS Group's Finance function. Responsibilities include:

- Working with the businesses and functions to develop risk and control policies, limits and tools for the business to use in order to discharge its responsibilities.
- Overseeing and challenging the management of risks and controls.
- Leading the articulation, design and development of risk culture and appetite.
- Analysing the aggregate risk profile and ensuring that risks are being managed within risk appetite.
- Providing expert advice to the business on risk management.
- Providing senior executives with relevant management information and reports, and escalating concerns where appropriate.

Third line of defence – Internal Audit

Responsibilities include:

- Providing assurance to the Group Audit Committee that the main business risks have been identified and effective controls are in place to manage these risks.
- Engaging with management to provide perspectives, insights and challenge in order to influence the building of a sustainable bank.
- Providing independent assurance to the Financial Conduct Authority, Prudential Regulation Authority, Central Bank of Ireland and other key jurisdictional regulators on specific risks and controls.

Risk appetite

Risk capacity defines the maximum level of risk the RBS Group can assume before breaching constraints determined by regulatory capital and liquidity needs, the operational environment, and from a conduct perspective. Articulating risk capacity helps determine where risk appetite should be set, ensuring there is a buffer between internal risk appetite and the RBS Group's ultimate capacity to absorb losses.

Risk appetite defines the level and types of risk the RBS Group is willing to accept, within risk capacity, in order to achieve strategic objectives and business plans. It links the goals and priorities to risk management in a way that guides and empowers staff to serve customers well and achieve financial targets.

Risk appetite framework

The risk appetite framework bolsters effective risk management by promoting sound risk-taking through a structured approach, within agreed boundaries. It also ensures emerging risks and risk-taking activities that would be out of appetite are identified, assessed, escalated and addressed in a timely manner.

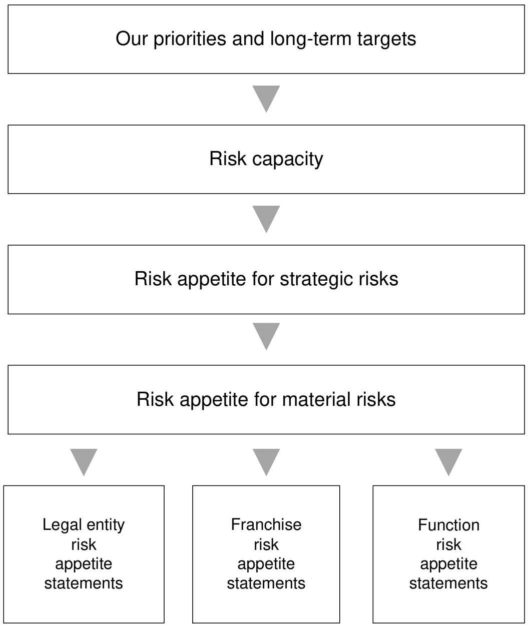
To facilitate this, a detailed annual review of the framework is carried out. The review includes:

- Assessing the adequacy of the framework when compared to internal and external expectations.
- Ensuring the framework remains effective as a strong control environment for risk appetite.
- Assessing the level of embedding of risk appetite across the organisation.

The RBS Group Board approves the risk appetite framework annually.

Risk management framework (unaudited) continued

Establishing risk appetite



The effective communication of risk appetite is essential in embedding appropriate risk-taking into the RBS Group's culture.

Risk appetite is communicated across the RBS Group through risk appetite statements. The risk appetite statements provide clarity on the scale and type of activities that can be undertaken in a manner that is easily conveyed to staff.

Risk appetite statements consist of qualitative statements of appetite supported by risk limits and triggers that operate as a defence against excessive risk-taking. They are established at RBS Group level for all strategic risks and material risks, and at legal entity, franchise, and function level for all other risks.

The annual process of establishing risk appetite statements is completed alongside the business and financial planning process. This ensures plans and risk appetite are appropriately aligned.

The Board sets risk appetite for our most material risks to help ensure the RBS Group is well placed to meet its priorities and long-term targets even under challenging economic environments. It is the basis on which the RBS Group remains safe and sound while implementing its strategic business objectives.

The RBS Group's risk profile is frequently reviewed and monitored to ensure it remains in appetite and that management focus is concentrated on all strategic risks, material risks and emerging risk issues. The RBS Group has effective processes in place for reporting risk profile relative to risk appetite to the RBS Group Board and senior management.

Risk control frameworks and limits

Risk control frameworks and their associated limits are an integral part of the risk appetite framework and a key part of embedding risk appetite in day-to-day risk management decisions. The risk control frameworks manage risk by expressing a clear tolerance for material risk types that is aligned to business activities.

The RBS Group policy framework directly supports the qualitative aspects of risk appetite, helping to rebuild and maintain stakeholder confidence in the RBS Group's risk control and governance. Its integrated approach is designed to ensure that appropriate controls, aligned to risk appetite, are set for each of the strategic and material risks it faces, with an effective assurance process put in place to monitor and report on performance.

Risk identification and measurement

Risk identification and measurement within the risk management process comprise:

- Regular assessment of the overall risk profile, incorporating market developments and trends, as well as external and internal factors.
- Monitoring of the risks associated with lending and credit exposures.
- Assessment of trading and non-trading portfolios.
- Review of potential risks in new business activities and processes.
- Analysis of potential risks in any complex and unusual business transactions.

The RBS Group has developed a risk directory which contains details of the financial and non-financial risks that it faces each day. It provides a common risk language to ensure consistent terminology is used across the RBS Group. The risk directory is subject to annual review. This ensures that the directory continues to provide a comprehensive and meaningful list of the inherent risks within the businesses.

Risk management framework (unaudited) continued

Risk treatment and mitigation

Risk treatment and mitigation is an important aspect of ensuring that risk profile remains within risk appetite. Risk mitigation strategies are discussed and agreed with the businesses.

When evaluating possible strategies, costs and benefits, residual risks (risks that are retained) and secondary risks (those caused by the risk mitigation actions) are considered. Monitoring and review processes are in place to track results.

Information about regulatory developments and discussions is communicated to each customer-facing business and function. This helps identify and execute any required mitigating changes to strategy or to business models.

Early identification and effective management of changes in legislation and regulation are critical to the successful mitigation of conduct and regulatory risk. The effects of all changes are managed to ensure timely compliance readiness. Changes assessed as having a high or medium-high impact are managed closely.

Top and emerging risks that may affect future results and performance are reviewed and monitored. Action is taken to mitigate potential risks as and when required. In depth analysis is carried out, including the stress testing of exposures relative to the risk.

The Board Risk Committee, Asset & Liability Management Committee and Executive Risk Forum provide governance and oversight.

Risk and conduct assurance

Risk & Conduct Assurance is an independent second line of defence function which provides assurance to both internal and external stakeholders including the Board, senior management, risk functions, franchises, Internal Audit and regulators.

The function has three main elements – assurance, model risk and risk culture. Risk & Conduct Assurance teams perform quality assurance on targeted credit, market, financial crime and conduct risk activities. They also review selected key controls and manage model risk governance and validation activities. In addition, the Head of Risk & Conduct Assurance oversees the delivery of work to embed and strengthen the RBS Group's desired risk culture.

The Head of Risk & Conduct Assurance also oversees the three lines of defence model, including relevant principles. For further information refer to page 22.

Assurance

Qualitative reviews are carried out to assess various risk aspects as appropriate, including: the quality of risk portfolios, the accuracy of the Basel Model Inputs and related probability of default/loss given default classifications, the quality of risk management practices, policy compliance and adherence to risk appetite. This can include testing the bank's credit portfolios and market risk exposures to assist in early identification of emerging risks, as well as undertaking targeted reviews to examine specific concerns raised either by these teams or by their stakeholders.

The adequacy and effectiveness of selected key controls owned and operated by the Risk function are also tested (with a particular focus on credit risk and market risk controls). The team's remit includes selected controls within the scope of Section 404 of the US Sarbanes-Oxley Act 2002 as well as selected controls supporting risk data aggregation and reporting.

Assurance is carried out on Anti-Money Laundering, Sanctions, and Anti-Bribery & Corruption processes and controls. This helps inform whether or not the financial crime control environment is adequate and effective and whether financial crime risk is appropriately identified, managed and mitigated. Assurance of conduct policies is predominantly focused on the Risk, Conduct & Restructuring-owned conduct policies. Targeted work is also carried out to assist the RBS Group in meeting its promises to customers as well as its regulatory requirements.

The Risk & Conduct Assurance Committee ensures a consistent and fair approach to all aspects of the team's assurance review activities. The committee also monitors and validates the ongoing programme of reviews and tracks the remediation of the more material review actions.

Model risk

Model risk is the risk that a model is specified incorrectly (not achieving the objective for which it is designed), implemented incorrectly (an error in translating the model specification into the version actually used), or being used incorrectly (correctly specified but applied inappropriately).

The RBS Group uses a variety of models as part of its risk management process and activities. Key examples include the use of model outputs to support risk assessments in the credit approval process, ongoing credit risk management, monitoring and reporting, as well as the calculation of risk-weighted assets. Other examples include the use of models to measure market risk exposures and calculate associated capital requirements, as well as for the valuation of positions. The models used for stress-testing purposes also play a key role in ensuring the RBS Group holds sufficient capital, even in stressed market scenarios.

Model Risk Governance

Model Risk Governance is responsible for setting policy and providing a governance framework for all of the RBS Group's models and related processes. It is also responsible for defining and monitoring model risk appetite in conjunction with model owners and model users, monitoring the model risk profile and reporting on the model population as well as escalating issues to senior management, through the Model Risk Forum, and the respective franchise and function risk committees.

Model Risk Management

Model Risk Management performs independent model validation for material models. It works with individual businesses and functions to monitor adherence to model risk standards, ensuring that models are developed and implemented appropriately and that their operational environment is fit for purpose.

Risk management framework (unaudited) continued

Model Risk Management performs reviews of relevant risk and pricing models in two instances: (i) for new models or amendments to existing models and (ii) as part of its ongoing programme to assess the performance of these models.

Model Risk Management reviews may test and challenge the logic and conceptual soundness of the methodology, or the assumptions underlying a model. Reviews may also test whether or not all appropriate risks have been sufficiently captured as well as checking the accuracy and robustness of calculations.

Based on the review and findings from Model Risk Management, the RBS Group's model or risk committees consider whether a model can be approved for use. Models used for regulatory reporting may additionally require regulatory approval before implementation.

Model Risk Management reassesses the appropriateness of approved risk models on a periodic basis. Each periodic review begins with an initial assessment. Based on the initial assessment, an internal model governance committee will decide to re-ratify a model or to carry out additional work. In the initial assessment, Model Risk Management assesses factors such as a change in the size or composition of the portfolio, market changes, the performance of – or any amendments to – the model and the status of any outstanding issues or scheduled activities carried over from previous reviews.

Model Risk Management also monitors the performance of the RBS Group's portfolio of models to ensure that they appropriately capture underlying business rationale.

For more specific information relating to market risk models and pricing models, refer to page 46.

Stress testing: capital management

Stress testing is a key risk management tool and a fundamental component of the RBS Group's approach to capital management. It is used to quantify, evaluate and understand the potential impact of specified changes to risk factors on the financial strength of the RBS Group, including its capital position. Stress testing includes:

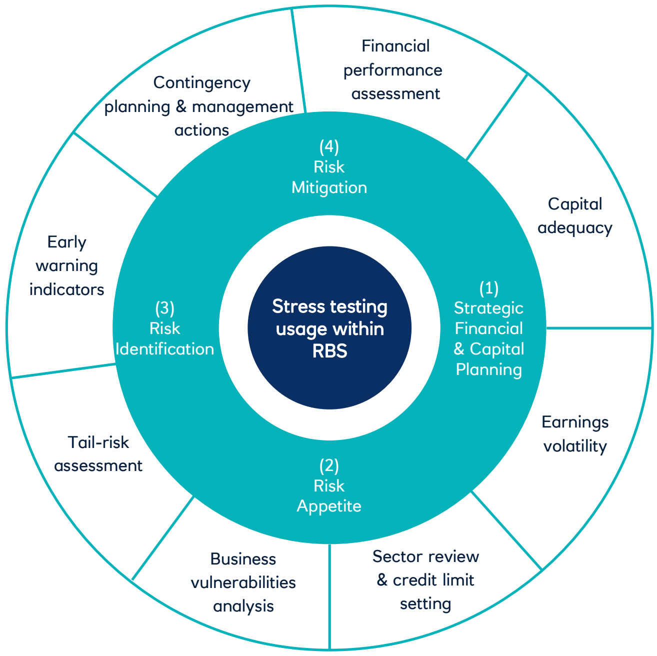
- Scenario testing, which examines the impact of a hypothetical future state to define changes in risk factors; and
- Sensitivity testing, which examines the impact of an incremental change to one or more risk factors.

Risk management framework (unaudited) continued

The process for stress testing consists of four broad stages:

Define scenarios	• Identify RBS Group-specific vulnerabilities and risks. • Define and calibrate scenarios to examine risks and vulnerabilities. • Formal governance process to agree scenarios.
Assess impact	• Translate scenarios into risk drivers. • Assess impact to positions, income and costs. • Impact assessment captures input from across the RBS Group.
Calculate results and assess implications	• Aggregate impacts into overall results. • Results form part of risk management process. • Scenario results are used to inform the RBS Group's business and capital plans.
Develop and agree management actions	• Scenario results are analysed by subject matter experts and appropriate management actions are then developed. • Scenario results and management actions are reviewed and agreed by senior management through executive committees including Executive Risk Forum, Board Risk Committee and the Board.

Stress testing is used widely across the RBS Group. Key areas are summarised in the diagram below:



Specific areas that involve capital management include:

1) *Strategic financial and capital planning:* through assessing the impact of sensitivities and scenarios on the capital plan and capital ratios.
2) *Risk appetite:* through gaining a better understanding of the drivers of – and the underlying risks associated with – risk appetite.
3) *Risk identification:* through a better understanding of the risks that could potentially impact the RBS Group's financial strength and capital position.
4) *Risk mitigation:* through identifying actions that can be taken to mitigate risks, or could be taken, in the event of adverse changes to the business or economic environment. Risk mitigation is substantially supplemented through the RBS Group's recovery plan.

Regular reverse stress testing is also carried out. This examines circumstances that can lead to specific, defined outcomes such as business failure. Reverse stress testing allows the RBS Group to examine potential vulnerabilities in its business model more fully.

Capital sufficiency: going concern forward-looking view

Going concern capital requirements are examined on a forward-looking basis – including as part of the annual budgeting process – by assessing the resilience of capital adequacy and leverage ratios under hypothetical future states. A range of future states are examined. In particular, capital requirements are assessed:

- Based on a forecast of future business performance given expectations of economic and market conditions over the forecast period.
- Based on a forecast of future business performance under adverse economic and market conditions over the forecast period. A range of scenarios of different severity may be examined.

The examination of capital requirements under normal economic and market conditions enables the RBS Group to demonstrate how its projected business performance allows it to meet all internal and regulatory capital requirements as they arise over the plan horizon. For example, the RBS Group will assess its ability to issue loss-absorbing debt instruments in sufficient quantity to meet regulatory timelines. The cost of issuance will be factored into business performance metrics.

The examination of capital requirements under adverse economic and market conditions is assessed through stress testing.

The results of stress tests are not only used widely across the RBS Group but also by the regulators to set specific capital buffers. The RBS Group takes part in a number of stress tests run by regulatory authorities to test industry-wide vulnerabilities under crystallising global and domestic systemic risks. In 2017, the RBS Group took part in the Bank of England stress test. Details of the stress test are set out on page 216 of the RBS Group 2017 Annual Report and Accounts.

Risk management framework (unaudited) continued

Internal assessment of capital adequacy

An internal assessment of material risks is carried out annually to enable an evaluation of the amount, type and distribution of capital required to cover these risks. This is referred to as the Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP consists of a point-in-time assessment of the RBS Group's exposures and risks at the end of the financial year together with a forward-looking stress capital assessment. The ICAAP is approved by the Board and submitted to the PRA.

The ICAAP is used to form a view of capital adequacy separately to the minimum regulatory requirements. The ICAAP is used by the PRA to make an assessment of the RBS Group-specific capital requirements through the Pillar 2 framework.

Capital allocation

The RBS Group has mechanisms to allocate capital across its legal entities and businesses which aim to optimise the utilisation of capital resources taking into account applicable regulatory requirements, strategic and business objectives and risk appetite.

The framework for allocating capital is approved by the Asset & Liability Management Committee.

Governance

Capital management is subject to substantial review and governance. Formal approval of capital management policies is either by the Asset & Liability Management Committee or by the Board on the recommendation of the Board Risk Committee.

The Board approves the capital plans, including those for key legal entities and businesses as well as the results of the stress tests relating to those capital plans.

Stress testing: liquidity

Liquidity risk monitoring and contingency planning

In implementing the liquidity risk management framework, a suite of tools is used to monitor, limit and stress test the risks on the balance sheet. Limit frameworks are in place to control the level of liquidity risk, asset and liability mismatches and funding concentrations.

Liquidity risks are reviewed at significant legal entity and business levels daily, with performance reported to the Asset & Liability Management Committee at least monthly. Liquidity Condition Indicators are monitored daily which ensures any build-up of stress is detected early and the response escalated appropriately through recovery planning.

Internal assessment of liquidity

Under the liquidity risk management framework, the RBS Group maintains the Individual Liquidity Adequacy Assessment Process (ILAAP). This includes assessment of net stressed liquidity outflows. The RBS Group considers a range of extreme but plausible stress scenarios on its liquidity position over various time horizons, as outlined below.

Type	Description
Idiosyncratic scenario	The market perceives the Group to be suffering from a severe stress event, which results in an immediate assumption of increased credit risk or concerns over solvency.
Market-wide scenario	A market stress event affecting all participants in a market through contagion, counterparty failure and other market risks. The RBS Group is affected under this scenario but no more severely than any other participants with equivalent exposure.
Combined scenario	This scenario models the combined impact of an idiosyncratic and market stress occurring at once. The combined scenario reflects the contingency that a severe name-specific event occurs at the Group in conjunction with a broader market stress, causing wider damage to the market and financial sector and severely affecting funding markets and assets.

The RBS Group uses the most severe combination of these to set the internal stress testing scenario. The results of this enable the RBS Group to set its internal liquidity risk appetite, which complements the regulatory liquidity coverage ratio requirement.

Stress testing: recovery and resolution planning

The RBS Group maintains a recovery plan that sets out credible recovery options that could be implemented in the event of a severe stress to restore its business to a stable and sustainable condition, focusing on addressing the capital and liquidity position of the RBS Group and its constituent legal entities.

The recovery plan sets out a range of triggers that activate the implementation of the recovery plan and sets out the operational plan for implementation of appropriate recovery options.

The recovery plan is a key component of risk management including the framework for managing capital.

The recovery plan is prepared and updated annually and approved by the Board. Following Board approval it is also submitted to the PRA each year. The recovery plan is assessed for appropriateness on an ongoing basis, and is maintained in line with regulatory requirements.

RBS Securities Inc. maintained a separate recovery plan to address specific risks. This plan was aligned to the 2017 RBS recovery plan to ensure it operated consistently in the event of a stress scenario.

Risk management framework (unaudited) continued

Resolution would be implemented if the RBS Group was assessed by the UK authorities to have failed and the appropriate regulator placed the RBS Group into resolution. The process of resolution is owned and implemented by the Bank of England (as UK Resolution Authority).

The RBS Group is working with UK and global regulators to ensure that it is compliant with the principles of resolution planning. This includes, but is not limited to, establishing appropriate loss-absorbing capacity and ability to maintain operational continuity in resolution, across all of RBS Group's main legal entities, including NatWest Bank Plc. Reflecting the degree of change required to ensure the RBS Group is resolvable, a multi-year programme in place to develop resolution capability and meet regulatory requirements.

Stress testing: market risk

Traded market risk

The RBS Group undertakes daily market risk stress testing to identify vulnerabilities and potential losses in excess of, or not captured in, value-at-risk. The calculated stresses measure the impact of changes in risk factors on the fair values of the trading and available-for-sale portfolios.

The RBS Group conducts historical, macroeconomic and vulnerability-based stress testing. Historical stress testing is a measure that is used for internal management. Using the historical simulation framework employed for value-at-risk, the current portfolio is stressed using historical data since 1 January 2005. This methodology simulates the impact of the 99.9 percentile loss that would be incurred by historical risk factor movements over the period, assuming variable holding periods specific to the risk factors and the businesses.

Historical stress tests form part of the market risk limit framework and their results are reported daily to senior management. Macroeconomic stress tests are carried out periodically as part of the bank-wide, cross-risk capital planning process. The scenario narratives are translated into risk factor shocks using historical events and insights by economists, risk managers and the first line.

Market risk stress results are combined with those for other risks into the capital plan presented to the Board. The cross-risk capital planning process is conducted once a year, with a planning horizon of five years. The scenario narratives cover both regulatory scenarios and macroeconomic scenarios identified by RBS Group.

Vulnerability-based stress testing begins with the analysis of a portfolio and expresses its key vulnerabilities in terms of plausible, vulnerability scenarios under which the portfolio would suffer material losses. These scenarios can be historical, macroeconomic or forward-looking/hypothetical. Vulnerability-based stress testing is used for internal management information and is not subject to limits. However, the results for relevant scenarios are reported to senior management.

Non-traded market risk

Non-traded exposures are reported to the PRA on a quarterly basis as part of the Stress Testing Data Framework. The return provides the regulator with an overview of the RBS Group's banking book interest rate exposure, providing detailed product information analysed by interest rate driver and other characteristics – including accounting classification, currency and, counterparty type.

Scenario analysis based on hypothetical adverse scenarios is performed on non-traded exposures as part of the industry-wide Bank of England and European Banking Authority stress exercises. In addition, the RBS Group produces its own internal scenario analysis as part of the financial planning cycles.

Non-traded market risk exposures are capitalised through the ICAAP. The process covers the following risk types: gap risk, basis risk, credit spread risk, pipeline risk, structural foreign exchange risk, prepayment risk and accounting volatility risk. The ICAAP is completed with a combination of value and earnings measures. The total non-traded market risk capital requirement is determined by adding the different charges for each sub risk type. The ICAAP methodology captures at least ten years of historical volatility, produced with 99% confidence level. Methodologies are reviewed by Model Risk Management and the results are approved by the Capital Management & Stress Testing Committee.

Capital, liquidity and funding risk

Definitions (unaudited)

Capital consists of reserves and instruments issued that are available that have a degree of permanency and are capable of absorbing losses. A number of strict conditions set by regulators must be satisfied to be eligible to count as capital.

Capital adequacy risk is the risk that there is or will be insufficient capital and other loss absorbing debt instruments to operate effectively including meeting minimum regulatory requirements, operating within Board approved RBS Group risk appetite and supporting its strategic goals.

Liquidity consists of assets that can be readily converted to cash within a short timeframe with a reliable value. Liquidity risk is the risk of being unable to meet financial obligations as and when they fall due.

Funding consists of on-balance sheet liabilities that are used to provide cash to finance assets. Funding risk is the risk of not maintaining a diversified, stable and cost-effective funding base.

Liquidity and funding risks arise in a number of ways, including through the maturity transformation role that banks perform. The risks are dependent on factors such as:

- Maturity profile;
- Composition of sources and uses of funding;
- The quality and size of the liquidity portfolio;
- Wholesale market conditions; and
- Depositor and investor behaviour.

Sources (unaudited)

Capital

The determination of what instruments and financial resources are eligible to be counted as capital is laid down by applicable regulation. Capital is categorised by applicable regulation under two tiers (Tier 1 and Tier 2) according to the ability to absorb losses on either a going or gone concern basis, degree of permanency and the ranking of absorbing losses. There are three broad categories of capital across these two tiers:

- CET1 capital - CET1 capital must be perpetual and capable of unrestricted and immediate use to cover risks or losses as soon as these occur. This includes ordinary shares issued and retained earnings.
- Additional Tier 1 (AT1) capital - This is the second type of loss absorbing capital and must be capable of absorbing losses on a going concern basis. These instruments are either written down or converted into CET1 capital when a pre-specified CET1 ratio is reached.
- Tier 2 capital - Tier 2 capital is the bank entities' supplementary capital and provides loss absorption on a gone concern basis. Tier 2 capital absorbs losses after Tier 1 capital. It typically consists of subordinated debt securities with a minimum maturity of five years.

Minimum requirement for own funds and eligible liabilities (MREL)

In addition to capital, other specific loss absorbing instruments, including senior notes issued by RBS Group, may be used to cover certain gone concern capital requirements which, in the EU, is referred to as MREL. Gone concern refers to the situation in which resources must be available to enable an orderly resolution, in the event that the Bank of England (BoE) deems that the RBS Group has failed

RBS maintains a prudent approach to the definition of liquidity resources. Liquidity resources are divided into primary and secondary liquidity as follows:

- Primary liquid assets include cash and balances at central banks, treasury bills and other high quality government and US agency bonds.
- Secondary liquid assets are eligible as collateral for local central bank liquidity facilities. These assets include own-issued securitisations or whole loans that are retained on balance sheet and pre-positioned with a central bank so that they may be converted into additional sources of liquidity at very short notice.

The Group's primary funding sources are as follows:

Type	Description
Customer deposits	Licensed deposit-taking entities operating as retail, commercial and private banking franchises.
Wholesale markets	Short-term (less than 1 year) unsecured money markets and secured repo market funding.
Term debt	Issuance of long-term (more than 1 year) unsecured and secured debt securities.
Central bank funding facilities	The use of such facilities can be both part of a wider strategic objective to support initiatives to help stimulate economic growth or as part of the broader liquidity management and funding strategy.

Managing capital requirements: regulated entities (unaudited)

In line with paragraph 135 of IAS 1 'Presentation of Financial Statements', the Group manages capital having regard to regulatory requirements. Regulatory capital is monitored and reported on an individual regulated bank legal entity basis ('bank entities'), which is the CRR transitional basis as relevant in the jurisdiction for significant subsidiaries of the RBS Group. The RBS Group itself is monitored and reported on a consolidated and CRR end-point basis.

For disclosure purposes, significant subsidiaries are determined with reference to RBS Group RWAs, using 5% as the threshold. The significant legal entities in the Group are the Royal Bank of Scotland plc (RBS plc), National Westminster Bank Plc (NatWest) and Ulster Bank Ireland DAC (UBI DAC).

Liquidity and funding disclosures are presented for the Group rather than for RBS plc.

Capital, liquidity and funding risk continued

Key developments in 2017 (unaudited)

RBS plc

14.7% CET1 ratio

- The CET1 ratio increased by 160 basis points to 14.7% partly benefitting from underlying RWA reduction in NatWest Markets and Commercial Banking.
- The impact of the annual phasing in of the CRR end-point rules relating to significant investments was a reduction of 90 basis points in the CET 1 ratio. However, this was partially offset by the ring-fencing related transfers that took place on 1 January 2017. RBSI became a subsidiary of RBSG plc and the Lombard and Invoice Finance subsidiaries were transferred to NatWest Plc.
- RWAs decreased by £42.0 billion to £136.8 billion, mainly as a result of the CRR phase-in relating to significant investments which reduced standardised credit risk RWAs by £20.1 billion. The remainder of the movement is driven by the reductions in NatWest Markets and Commercial Banking referred to above.

5.6% leverage ratio

- The leverage ratio on a PRA transitional basis reduced from 5.7% to 5.6% as a result of the reduction in capital in the period.

NatWest

23.5% CET1 ratio

- The CET1 ratio increased from 16.1% to 23.5%, mainly due to the reduction in significant investments following ring-fencing related transfers. UBI DAC was transferred to NatWest Holdings Limited with effect from 1 January 2017.
- RWAs decreased by £7.7 billion, mainly as a result of phasing-in of CRR end-point rules relating to significant investments.

6.2% leverage ratio

- The leverage ratio on a PRA transitional basis improved from 6.1% to 6.2%. Whilst the exposure has increased due to higher central bank balances and mortgage growth, the impact of ring-fencing related transfers on CET1 capital has offset this.

UBI DAC

31.2% CET1 ratio

- The CET1 ratio on increased to 31.2% reflecting higher capital and lower RWAs. UBIDAC paid a dividend of €1.5 billion to its parent company in January 2018, this will reduce its CET 1 ratio to 23.6%.
- RWAs decreased by £0.4 billion mainly due to lower exposures.

19.7% leverage ratio

- The leverage ratio on a CBI transitional basis increased due to higher capital.

RBS plc Group

Liquidity position:

- The Group's liquidity portfolio increased by £23 billion in the year to £186 billion, mainly within primary liquidity and driven by TFS participation, increased deposits in the franchises and Treasury issuance, offset by funding maturities and calls of securities.

Funding position:

- The loan:deposit ratio was 93%, including disposal groups, at the end of 2017, an increase from 91% in 2016.
- RBS International Holdings ceased to be part of the RBS plc Group with effect from 1 January 2017.
- Within continuing operations, NatWest Markets loans and deposits both reduced, reflecting run-down and disposals.
- Within disposal groups, deposit increases more than offset mortgage lending growth in UK PBB and Private Banking

Capital management (unaudited)

Capital management is the process by which the bank entities ensure that they have sufficient capital and other loss absorbing instruments to operate effectively including meeting minimum regulatory requirements, operating within Board approved RBS Group risk appetite, maintaining credit ratings and supporting strategic goals. Capital management is critical in supporting the bank entities' businesses and is also considered at the Group level. It is enacted through an RBS Group-wide end to end framework.

Capital, liquidity and funding risk continued

Capital planning is integrated into the RBS Group's wider annual budgeting process and is assessed and updated at least monthly. As a key operating entity, capital plans are produced and managed for the bank. This is summarised below. Other elements of capital management, including risk appetite and stress testing, are set out on pages 22 and 25.

Produce capital plans	• Capital plans are produced for the RBS Group, its key operating entities and its businesses over a five year planning horizon under expected and stress conditions. Stressed capital plans are produced to support internal stress testing through the ICAAP or for regulatory purposes. • Shorter term forecasts are developed frequently in response to actual performance, changes in internal and external business environment and to manage risks and opportunities.
↓	
Assess capital adequacy	• Capital plans are developed to maintain capital of sufficient quantity and quality to support the RBS Group's business and strategic plans over the planning horizon within approved risk appetite, as determined via stress testing, and minimum regulatory requirements. • Capital resources and capital requirements are assessed across a defined planning horizon. • Impact assessment captures input from across the RBS Group including from businesses.
↓	
Inform capital actions	• Capital planning informs potential capital actions including managing capital through buy backs, redemptions or through new issuance to external investors or via internal transactions. • Decisions on capital actions will be influenced by strategic and regulatory requirements, the cost and prevailing market conditions. • As part of capital planning, the RBS Group will monitor its portfolio of external capital securities and assess the optimal blend and most cost effective means of financing.

Capital planning is one of the tools that the Group uses to monitor and manage capital risk on a going and gone concern basis, including the risk of excessive leverage.

Liquidity and funding management follows a similar process to that outlined above for capital.

Liquidity portfolio management (unaudited)

The size of the portfolio is determined by referencing the RBS Group's liquidity risk appetite. The Group retains a prudent approach to setting the composition of the liquidity portfolio, which is subject to internal policies and limits over quality of counterparty, maturity mix and currency mix.

The Group categorises its liquidity portfolio, including its locally managed liquidity portfolios, into primary and secondary liquid assets. The majority of the portfolio is centrally managed by RBS Treasury, for which the RBS Treasurer is responsible. This portfolio is held in the PRA regulated UK Domestic Liquidity Subgroup (UK DoLSub) comprising RBS's five licensed deposit taking UK banks: The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Co and Adam & Company PLC.

Ulster Bank Ireland DAC, a significant operating subsidiary of RBS plc, holds a locally managed portfolio to comply with local regulations that may differ from PRA rules.

The liquidity value of the portfolio is determined by taking current market prices and applying a discount or haircut, to give a liquidity value that represents the amount of cash that can be generated by the asset. Separate from the liquidity portfolio, RBS holds high quality assets to meet payment systems collateral requirements; these are managed by RBS Treasury.

Ring-fencing implications

As a result of the legal entity restructuring in response to the UK government's ring-fencing legislation, the current Royal Bank of
Scotland plc (expected to be renamed NatWest Markets plc at the time of the RFTS during the first half of 2018) will separately hold and manage its own liquidity portfolio outside of the ring-fenced group.

It will cease to form part of the UK DoLSub at a point in time in the second half of 2018 (subject to regulatory agreement).Treasury has commenced the transfer of the existing liquidity portfolio from RBS plc into National Westminster Bank Plc (where the majority of the UK DoLSub liquidity portfolio will be held post ring-fencing) to ensure appropriate levels of liquidity are held in both RBS plc and the UK DoLSub.

Post ring-fencing, the UK DoLSub will comprise the four licensed banks that remain within the ring-fence, which will no longer be subsidiaries of the current RBS plc. RBS Securities Inc. will continue to hold separate liquidity to meet local regulatory requirements.

The size of the liquidity portfolio to be held by the future NatWest Markets plc should not be considered comparable to that held by the current RBS plc.

For further information, please refer to RBS Group ring-fencing on page 109.

Funding risk management (unaudited)

The Group manages funding risk through a comprehensive framework which measures and monitors the funding risk on the balance sheet.

The asset and liability types broadly match. Customer deposits provide more funding than customer loans utilise; repurchase agreements are largely covered by reverse repurchase agreements; interbank lending and funding largely nets off and derivative assets are broadly netted against derivative liabilities.

Capital, liquidity and funding risk continued

Minimum capital requirements (unaudited)

Capital adequacy ratios

The bank entities are subject to minimum requirements in relation to the amount of capital they must hold in relation to RWAs. The table below summarises the minimum ratios of capital to RWAs that the UK bank entities are expected to have to meet once CRR is fully implemented by 1 January 2019.

Type	CET1	Total Tier 1	Total capital
Minimum capital requirements	4.5%	6.0%	8.0%
Capital conservation buffer	2.5%	2.5%	2.5%
UK countercyclical capital buffer (1)	1.0%	1.0%	1.0%
Total (2)	8.0%	9.5%	11.5%

Notes:
(1) The countercyclical capital buffer (CCyB) applied to UK designated assets is set by the Financial Policy Committee (FPC). The UK CCyB may be set between 0% and 2.5% and is linked to the state of the UK economy. The Bank of England's Financial Policy Committee (FPC) increased the UK CCyB from 0.0% to 0.5%, with effect from June 2018; subsequently in November 2017 the FPC announced a further increase to 1.0% effective November 2018. Foreign exposures may be subject to different CCyBs depending on the CCyB rate set in the jurisdiction of the foreign exposure.
(2) The minimum requirements do not include any capital that the bank entities may be required to hold as a result of the Pillar 2 assessment for RBS Group.
(3) Under the applicable regulatory framework set by the Central Bank of Ireland, the minimum total capital ratio with which UBI DAC must comply is 10.50% with a minimum CET1 ratio of 7.00%. At this time, the Republic of Ireland has set its countercyclical buffer to 0.00%.

Leverage ratio

In November 2016, the European Commission published a proposal for the adoption of a legally binding 3% of Tier 1 capital minimum leverage ratio as part of the CRR 2 package of legislation. There remains considerable uncertainty regarding the timing of the implementation of CRR 2 proposals and at present there is no binding minimum ratio of capital to leverage exposure that applies to individual bank entities as regulated by the PRA in the UK and the CBI in the Republic of Ireland.

Capital, liquidity and funding risk continued

Measurement

Capital, RWAs and leverage (unaudited)

Under Capital Requirements Regulation (CRR), regulators within the European Union monitor capital and leverage on a legal entity basis, with local transitional arrangements on the phasing in of end-point CRR. The capital resources, leverage and RWAs based on the relevant transitional basis for the significant legal entities within the Group are set out below.

	2017			2016		
	RBS plc	NatWest	UBI DAC	RBS plc	NatWest	UBI DAC
Capital (1)	£m	£m	£m	£m	£m	£m
CET1	20,169	13,301	5,481	23,333	10,393	5,224
Tier 1	21,966	13,301	5,481	25,292	10,393	5,224
Total	25,600	17,536	5,941	34,151	15,016	5,746
RWAs						
Credit risk						
- non-counterparty	94,259	48,575	16,079	127,019	56,066	16,263
- counterparty	13,691	266	321	21,214	473	505
Market risk	15,809	136	68	15,698	676	12
Operational risk	13,052	7,724	1,101	14,862	7,209	1,215
Market risk	136,811	56,701	17,569	178,793	64,424	17,995
Risk asset ratios	%	%	%	%	%	%
CET1	14.7	23.5	31.2	13.1	16.1	29.0
Tier 1	16.1	23.5	31.2	14.1	16.1	29.0
Total	18.7	30.9	33.8	19.1	23.3	31.9
Leverage						
Tier 1 capital (£m)	21,966	13,301	5,481	25,292	10,393	5,224
Leverage exposure (£m)	390,055	213,474	27,857	447,238	169,586	27,337
Leverage ratio (%)	5.6	6.2	19.7	5.7	6.1	19.1

Note:
(1) CRR as implemented by the Prudential Regulation Authority in the UK, with effect from 1 January 2014. All regulatory adjustments and deductions to CET1 have been applied in full with the exception of unrealised gains on available-for-sale securities which has been included from 2015 under the PRA transitional basis.

General:
From 1 January 2015, RBS has been required to meet at least 56% of its Pillar 2A capital requirement with CET1 capital and the balance with Additional Tier 1 and/or Tier 2 capital. The Pillar 2A capital requirement is the additional capital that RBS must hold, in addition to meeting its Pillar 1 requirements in order to comply with the PRA's overall financial adequacy rule.

Measures in relation to end-point CRR basis, including RWAs, are based on the current interpretation, expectations, and understanding, of the CRR requirements, as well as further regulatory clarity and implementation guidance from the UK and EU authorities (end-point CRR basis).

Capital base:
(1) Own funds are based on shareholders' equity.
(2) The adjustment arising from the application of the prudent valuation requirements to all assets measured at fair value, has been included in full. Additional valuation adjustments relating to unearned credit spreads on exposures under the advanced internal ratings approach has been included in the determination of the expected loss amount deducted from CET1.
(3) Where the deductions from AT1 capital exceed AT1 capital, the excess is deducted from CET1 capital.
(4) Insignificant investments in equities of other financial entities (net): long cash equity positions are considered to have matched maturity with synthetic short positions if the long position is held for hedging purposes and sufficient liquidity exists in the relevant market. All the trades are managed and monitored together within the equities business.
(5) Based on our current interpretations of the Commission Delegated Regulation issued in December 2013 on credit risk adjustments, standardised latent provision has been reclassified to specific provision and is not included in Tier 2 capital.

RWAs:
(1) Current securitisation positions are shown as risk-weighted at 1,250%.
(2) RWA uplifts include the impact of credit valuation adjustments and asset valuation correlation on large financial sector entities.
(3) RWAs reflect implementation of the full internal model method suite, and include methodology changes that took effect immediately on CRR implementation.
(4) Counterparties which meet the eligibility criteria under CRR are exempt from the credit valuation adjustments volatility charges.

Capital, liquidity and funding risk continued

Capital resources

	2017			2016		
	RBS plc £m	NatWest £m	UBI DAC £m	RBS plc £m	NatWest £m	UBI DAC £m
Shareholders' equity (excluding non-controlling interests)						
Shareholders' equity	44,522	15,355	5,684	45,876	15,297	5,556
Preference shares - equity	—	—	—	—	—	—
	44,522	15,355	5,684	45,876	15,297	5,556
Regulatory adjustments and deductions						
Own credit	10	—	(1)	(152)	—	(3)
Defined benefit pension fund adjustment	(196)	(11)	(49)	(198)	(15)	61
Cash flow hedging reserve	49	—	—	(261)	—	—
Deferred tax assets	(50)	(537)	(259)	(47)	(599)	(250)
Prudential valuation adjustments	(471)	(1)	—	(524)	(1)	—
Qualifying deductions exceeding AT1 capital	—	(41)	(13)	—	(199)	(33)
Goodwill and other intangible assets	—	(490)	(1)	(521)	(477)	—
Expected losses less impairments	(579)	(511)	(133)	(642)	(534)	(165)
Instruments of financial sector entities where the institution has a significant investment	(22,539)	(456)	—	(20,433)	(3,019)	—
Significant investments in excess of secondary capital	—	—	—	—	(80)	—
Other regulatory adjustments	(577)	(7)	253	235	20	58
	(24,353)	(2,054)	(203)	(22,543)	(4,904)	(332)
CET1 capital	20,169	13,301	5,481	23,333	10,393	5,224
Additional Tier 1 (AT1) capital						
Qualifying instruments and related share premium subject to phase out	1,877	140	—	2,993	175	—
Tier 1 deductions						
Instruments of financial sector entities where the institution has a significant investment	(80)	(181)	—	(1,034)	(374)	—
Other regulatory adjustments	—	—	(13)	—	—	(33)
Qualifying deductions exceeding AT1 capital	—	41	13	—	199	33
	(80)	(140)	—	(1,034)	(175)	—
Tier 1 capital	21,966	13,301	5,481	25,292	10,393	5,224
Qualifying Tier 2 capital						
Qualifying instruments and related share premium	4,353	4,412	473	12,161	4,735	555
Tier 2 deductions						
Instruments of financial sector entities where the institution has a significant investment	(719)	(177)	—	(3,302)	(112)	—
Other regulatory adjustments	—	—	(13)	—	—	(33)
	(719)	(177)	(13)	(3,302)	(112)	(33)
Tier 2 capital	3,634	4,235	460	8,859	4,623	522
Total regulatory capital	25,600	17,536	5,941	34,151	15,016	5,746

Note:
(1) CRR as implemented by the Prudential Regulation Authority in the UK, with effect from 1 January 2014. All regulatory adjustments and deductions to CET1 have been applied in full with the exception of unrealised gains on available-for-sale securities which has been included from 2015 under the PRA transitional basis.

Capital, liquidity and funding risk continued

Leverage exposure (unaudited)

The leverage exposure is based on the CRR Delegated Act.

	2017			2016		
	RBS plc	NatWest	UBI DAC	RBS plc	NatWest	UBI DAC
Leverage	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	61,625	34,763	286	70,615	1,198	249
Derivatives	164,179	2,277	517	251,476	3,082	878
Loans and advances	154,953	216,467	23,065	167,174	214,748	22,506
Reverse repos	34,224	—	764	32,035	—	308
Other assets	110,908	6,210	2,217	112,313	9,893	2,350
Total assets	525,889	259,717	26,849	633,613	228,921	26,291
Derivatives						
- netting	(164,101)	(1,696)	(76)	(243,316)	(2,202)	(109)
- potential future exposures	51,654	287	255	67,090	190	235
Securities financing transactions gross up	2,958	—	—	3,809	—	—
Undrawn commitments	33,714	10,466	1,066	41,375	9,930	1,102
Regulatory deductions and other adjustments	(24,372)	(2,188)	(237)	(23,702)	(5,101)	(182)
Exclusion of core UK-group exposures	(35,687)	(53,112)	—	(31,631)	(62,152)	—
Leverage exposure	390,055	213,474	27,857	447,238	169,586	27,337

Liquidity portfolio

The table below shows the liquidity portfolio by product, liquidity value and carrying value. Liquidity value is lower than carrying value as it is stated after discounts (or haircuts) applied to instruments by the Bank of England and other central banks. At 31 December 2017 the liquidity portfolio included within assets of disposal groups.

	Liquidity value									
	2017					2016				
	31 December			Average		31 December			Average	
	UK DoLSub (1)	Other	Total	UK DoLSub (1)	Total	UK DoLSub (1)	Other	Total	UK DoLSub (1)	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	91,377	2,221	93,598	76,386	79,267	66,598	2,227	68,825	56,772	59,065
Central and local government bonds										
AAA rated governments	2,760	651	3,411	4,074	4,601	3,936	760	4,696	3,692	4,326
AA- to AA+ rated governments and US agencies	24,084	1,888	25,972	20,849	22,402	19,348	1,244	20,592	18,757	20,066
	26,844	2,539	29,383	24,923	27,003	23,284	2,004	25,288	22,449	24,392
Primary liquidity	118,221	4,760	122,981	101,309	106,270	89,882	4,231	94,113	79,221	83,457
Secondary liquidity (2)	62,144	411	62,555	61,577	62,114	68,007	683	68,690	65,588	66,774
Total liquidity value	180,365	5,171	185,536	162,886	168,384	157,889	4,914	162,803	144,809	150,231
Total carrying value	203,733	5,306	209,039			184,136	5,082	189,218		

The table below shows the liquidity value of the liquidity portfolio by currency.

	GBP	USD	EUR	Other	Total
Total liquidity portfolio	£m	£m	£m	£m	£m
2017	138,985	11,416	33,664	1,471	185,536
2016	128,461	9,344	24,101	897	162,803

Notes:
(1) The PRA regulated UK DoLSub comprising RBS Group's five licensed deposit-taking UK banks: The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Co and Adam & Company PLC. In addition, certain of RBS Group's significant operating subsidiaries, including Ulster Bank Ireland DAC, hold managed portfolios that comply with local regulations that may differ from PRA rules.
(2) Comprises assets eligible for discounting at the Bank of England and other central banks.

Credit risk: management basis

The following disclosures in this section are audited:

- Forbearance.
- Impairment provisioning and write-offs.

Definition

Credit risk is the risk of financial loss due to the failure of a customer or counterparty to meet its obligation to settle outstanding amounts.

Sources of credit risk (unaudited)

The principal sources of credit risk for the Group are lending, off-balance sheet products, derivatives and securities financing, and debt securities. The Group is also exposed to settlement risk through foreign exchange, trade finance and payments activities.

The commentary that follows relates to Wholesale only. Credit risk governance for Personal is disclosed in the RBS Group Annual Report and Accounts 2017.

Credit risk management function (unaudited)

Risk governance

The credit risk management function is led by the Chief Credit Officer (CCO). The function's activities include:

- Approving credit limits for customers.
- Defining concentration risk and implementing the credit risk control framework.
- Oversight of the first line of defence to ensure that credit risk remains within the risk appetite set by the Board.
- Developing and monitoring compliance with credit risk policies.
- Conducting Group-wide assessments of provision adequacy.

The CCO has overall responsibility for the credit risk function and chairs the Wholesale Credit Risk Committee. The committee has authority for risk appetite (within the appetite set by the Board), strategy, frameworks and policy as well as oversight of the Group's credit profile. The Provisions Committee has authority over provisions adequacy and approves proposals from business provisions committees in accordance with approval thresholds. The Provisions Committee is chaired either by the CCO or the Head of Provisions & Restructuring Credit.

Controls

Credit policy standards are in place for the Wholesale portfolio. They are expressed as a set of mandatory controls.

Risk appetite (unaudited)

The Group's approach to lending is governed by comprehensive credit risk appetite frameworks. The frameworks are closely monitored and actions are taken to adapt lending criteria as appropriate. Credit risk appetite aligns to the strategic risk appetite set by the Board, which includes capital adequacy, earnings volatility, funding and liquidity, and stakeholder confidence. The credit risk appetite frameworks have been designed to reflect factors (e.g. strategic and emerging risks) that influence the ability to operate within risk appetite. Tools such as stress testing and economic capital are used to measure credit risk volatility and develop links between the credit risk appetite frameworks and risk appetite limits. The frameworks are supported by a suite of policies and transaction acceptance standards that set out the risk parameters within which franchises must operate.

For Wholesale the four formal frameworks used, and their basis for classification, are detailed in the following table.

Framework	Basis for classification	
	Size	Other
Single name concentration	Net exposure or loss given default for a given probability of default	
Sector	Exposure [1]	Risk – based on economic capital and other qualitative factors
Country	Exposure [1]	
Product and asset class	Exposure – net/gross dependent on type of risk and limit definition.	Risk – based on heightened risk characteristics

Note:
(1) Potential exposure as defined on the following page.

Risk identification and measurement (unaudited)

Credit stewardship

Risks are identified through relationship management and credit stewardship of portfolios or customers. Credit risk stewardship takes place throughout the customer relationship, beginning with the initial approval. It includes the application of credit assessment standards, credit risk mitigation and collateral, ensuring that credit documentation is complete and appropriate, carrying out regular portfolio or customer reviews and problem debt identification and management.

Risk measurement

The Group uses current exposure and potential exposure as its measures of credit risk exposure. Unless otherwise stated, current exposure and potential exposure are reported:

- Net of collateral – cash and gold collateral for all product types as well as financial collateral for derivative and securities financing products.
- Net of provisions – credit valuation adjustments for derivative and securities financing products; individual, collective and latent provisions across all other product types.

Exposures backed by guarantees are allocated to the guarantor rather than the direct obligor. This does not affect the current or potential exposure amount, but does affect allocations to obligors, sectors, country and product and asset classes.

Credit risk: management basis continued

The following table summarises the differences between current exposure and potential exposure across product types:

Product	Current exposure	Potential exposure[1,2]
Lending	Drawn balances	Legally-committed limits
Derivatives and securities financing	Measured using the mark-to-market value after the effect of enforceable netting agreements and net of legally enforceable financial collateral.[3]	Measured using scaled credit limit utilisation, which takes into account mark-to-market movements, any collateral held and expected market movements over a specified horizon.[3]
Contingent obligations	Issued amount of the guarantee or letter of credit	Legally-committed amount
Leases	Net present value plus residual value	
Banking book debt securities	Purchase value less subsequent amortisation	
Trading book bonds Equity securities Settlement risk Suretyships Intra-group credit exposures	Not reported as credit risk	

Notes:
(1) Potential exposure includes all drawn exposure and all legally-committed undrawn exposure.
(2) Potential exposure cannot be less than current exposure.
(3) Current exposure and potential exposure for exchange-traded derivatives are defined as exposure at default.

Risk models (unaudited)

The output of credit risk models is used in the credit approval process – as well as for ongoing assessment, monitoring and reporting – to inform risk appetite decisions. These models are divided into different categories. Where the calculation method is on an individual counterparty or account level, the models used will be probability of default (PD), loss given default (LGD), or exposure at default (EAD). The economic capital model is used for credit risk appetite setting.

Asset quality

Credit grades are assigned at legal entity level for Wholesale customers.

All credit grades map to both an internal asset quality scale, used for external financial reporting, and a master grading scale for Wholesale exposures, which is used for internal management reporting across portfolios. Accordingly, measures of risk exposure may be aggregated and reported at differing levels of detail depending on stakeholder or business requirements. Performing loans are defined as AQ1-AQ9 (where the PD is less than 100%) and non-performing loans as AQ10 (where the PD is 100%).

Risk mitigation (unaudited)

Risk mitigation techniques, as set out in the appropriate credit policies, are used in the management of credit portfolios across the Group. These techniques mitigate credit concentrations in relation to an individual customer, a borrower group or a collection of related borrowers. Where possible, customer credit balances are netted against obligations. Mitigation tools can include structuring a security interest in a physical or financial asset, the use of credit derivatives including credit default swaps, credit-linked debt instruments and securitisation structures, and the use of guarantees and similar instruments (for example, credit insurance) from related and third parties.

Counterparty credit risk

The Group mitigates counterparty credit risk arising from both derivatives transactions and repurchase agreements through the use of market standard documentation, enabling netting, and through collateralisation.

Amounts owed by the Group to a counterparty are netted against amounts the counterparty owes the Group, in accordance with relevant regulatory and internal policies. This is only done if a netting agreement is in place.

Credit risk: management basis continued

Risk assessment and monitoring (unaudited)

Wholesale customers – including corporates, banks and other financial institutions – are grouped by industry sectors and geography as well as by product/asset class and are managed on an individual basis.

A credit assessment is carried out before credit facilities are made available to customers. The assessment process is dependent on the complexity of the transaction.

For lower risk transactions below specific thresholds, credit decisions can be approved through self-sanctioning within the business. This is facilitated through an auto-decisioning system, which utilises scorecards, strategies and policy rules to provide a recommended credit decision. Such credit decisions must be within the approval authority of the relevant business sanctioner.

For all other transactions credit is only granted to customers following joint approval by an approver from the business and the credit risk function. Credit risk management is organised in terms of the complexity of the assessment rather than aligned to franchises. The joint business and credit approvers act within a delegated approval authority under the Wholesale Credit Authorities Framework approved by the Executive Risk Forum. The level of delegated authority held by approvers is dependent on their experience and expertise. Only a small number of senior executives hold the highest authority provided under the Wholesale Credit Authorities Framework.

Both business and credit approvers are accountable for the quality of each decision taken but the credit risk approver holds ultimate sanctioning authority.

Transaction Acceptance Standards provide detailed transactional lending and risk acceptance metrics and structuring guidance. Transaction Acceptance Standards are one of the tools used to manage risk appetite at the customer/transaction level and are supplementary to the Credit Policy.

Where the customer is part of a group, the credit assessment considers aggregated credit risk limits for the customer group as well as the nature of the relationship with the broader group (for example parental support) and its impact on credit risk.

Credit relationships are reviewed, and credit grades (PD and LGD) re-approved, annually. The review process assesses borrower performance, including reconfirmation or adjustment of risk parameter estimates; the adequacy of security; compliance with terms and conditions; and refinancing risk.

Underwriting standards are monitored on an ongoing basis to ensure they remain adequate in the current market environment and are not weakened to sustain growth.

A key aspect of credit risk stewardship is ensuring that, when signs of customer stress are identified, appropriate debt management actions are applied.

Problem debt management

Wholesale (unaudited)

Early problem identification

Each segment has defined early warning indicators to identify customers experiencing financial difficulty, and to increase monitoring if needed. Early warning indicators may be internal, such as a customer's bank account activity, or external, such as a publicly-listed customer's share price. If early warning indicators show a customer is experiencing potential or actual difficulty, or if relationship managers or credit officers identify other signs of financial difficulty they may decide to classify the customer within the Risk of Credit Loss framework.

Risk of Credit Loss framework

The framework focuses on Wholesale customers whose credit profiles have deteriorated since origination. Expert judgement is applied by experienced credit risk officers to classify cases into categories that reflect progressively deteriorating credit risk to the bank. There are two classifications which apply to non-defaulted customers within the framework – Heightened Monitoring and Risk of Credit Loss. The framework also applies to those customers that have met the bank's default criteria (AQ10 exposures).

Heightened Monitoring customers are performing customers who have met certain characteristics, which have led to material credit deterioration. Collectively, characteristics reflect circumstances that may affect the customer's ability to meet repayment obligations. Characteristics include trading issues, covenant breaches, material PD downgrades and past due facilities. Sector specific characteristics also exist. Heightened Monitoring customers require pre-emptive actions (outside the customer's normal trading patterns) to return or maintain their facilities within the bank's current risk appetite prior to maturity.

Risk of Credit Loss customers are performing customers who have met the criteria for Heightened Monitoring and also pose a risk of credit loss to the bank in the next 12 months, should mitigating action not be taken or not be successful.

Once classified as either Heightened Monitoring or Risk of Credit Loss, a number of mandatory actions are taken in accordance with policies. This includes a review of the customer's credit grade, facility and security documentation and the valuation of security. Depending on the severity of the financial difficulty and the size of the exposure, the customer relationship strategy is reassessed by credit officers, by specialist credit risk or relationship management units in the relevant business or by Restructuring.

Agreed customer management strategies are regularly monitored by both the business and credit teams. The largest Risk of Credit Loss exposures in the Group and in each business are regularly reviewed by a Risk of Credit Loss Committee. The committee members are experienced credit, business and Restructuring specialists. The purpose of the committee is to review and challenge the strategies undertaken for those customers who pose the largest risk of credit loss to the bank.

Credit risk: management basis continued

Appropriate corrective action is taken when circumstances emerge that may affect the customer's ability to service its debt (see Heightened Monitoring characteristics). Corrective actions may include granting a customer various types of concessions. Any decision to approve a concession will be a function of specific country and sector appetite, the credit quality of the customer, the market environment and the loan structure and security. All customers granted forbearance are classified Heightened Monitoring as a minimum.

Other potential outcomes of the relationship review are to: take the customer off the Risk of Credit Loss framework; offer additional lending and continue monitoring; transfer the relationship to Restructuring if appropriate; or exit the relationship altogether.

Restructuring

For the Wholesale problem debt portfolio, customer relationships are managed by the Restructuring team. The purpose of Restructuring is to protect the bank's capital. Where practicable, Restructuring does this by working with corporate and commercial customers to support their turnaround and recovery strategies and enable them to return to mainstream banking. Restructuring will always aim to recover capital in a fair and efficient manner.

Specialists in Restructuring work with customers experiencing financial difficulties and showing signs of financial stress. Throughout Restructuring's involvement the mainstream relationship manager will remain an integral part of the customer relationship, unless an exit strategy is deemed appropriate. The objective is to find a mutually acceptable solution, including restructuring of existing facilities, repayment or refinancing.

Where a solvent outcome is not possible, insolvency may be considered as a last resort. However, helping the customer return to financial health and restoring a normal banking relationship is always the preferred outcome.

Forbearance

Forbearance across the RBS Group takes place when a concession is made on the contractual terms of a loan/debt in response to a customer's financial difficulties. Concessions granted where there is no evidence of financial difficulty, or where any changes to terms and conditions are within current risk appetite, or reflect improving credit market conditions for the customer, are not considered forbearance.

The aim of forbearance is to support and restore the customer to financial health while minimising risk. To ensure that forbearance is appropriate for the needs and financial profile of the customer, the Group applies minimum standards when assessing, recording, monitoring and reporting forbearance.

Loans/debt may be forborne more than once, generally where a temporary concession has been granted and circumstances warrant another temporary or permanent revision of the loan's terms.

Types of forbearance

In the Wholesale portfolio, forbearance may involve covenant waivers, amendment to margin, payment concessions and loan rescheduling (including extensions in contractual maturity), capitalisation of arrears, and debt forgiveness or debt for equity swap.

Monitoring of forbearance

In the Wholesale portfolio, all customers are assigned a PD and related facilities an LGD. These are re-assessed prior to finalising any forbearance arrangement in light of the loan's amended terms.

The ultimate outcome of a forbearance strategy is unknown at the time of execution. It is highly dependent on the cooperation of the borrower and the continued existence of a viable business or repayment outcome. Where forbearance is no longer viable, the Group will consider other options such as the enforcement of security, insolvency proceedings or both, albeit these are options of last resort.

Provisioning for Wholesale forbearance

Provisions for forborne loans are assessed in accordance with normal provisioning policies (refer to impairment loss provision methodology). The customer's financial position and prospects as well as the likely effect of the forbearance, including any concessions granted, and revised PD or LGD gradings, are considered in order to establish whether an impairment provision is required.

Wholesale loans granted forbearance are individually assessed in most cases and are not therefore segregated into a separate risk pool.

Forbearance may result in the value of the outstanding debt exceeding the present value of the estimated future cash flows. This may result in the recognition of an impairment loss or a write-off.

In the case of non-performing forborne loans, the loan impairment provision assessment almost invariably takes place prior to forbearance being granted. The amount of the loan impairment provision may change once the terms of the forbearance are known, resulting in an additional provision charge or a release of the provision in the period the forbearance is granted.

For performing loans, credit metrics are an integral part of the latent provision methodology, and an extended emergence period for forborne loans is applied.

The transfer of wholesale loans from impaired to performing status follows assessment by relationship managers and credit. When no further losses are anticipated and the customer is expected to meet the loan's revised terms, any provision is written off or released and the balance of the loan returned to performing status. This course of action is not dependent on a specified time period and follows the credit risk manager's assessment.

Credit risk: management basis continued

Impairment, provisioning and write-offs

In the overall assessment of credit risk, impairment, provisioning and write-offs are used as key indicators of credit quality.

Impairment

A financial asset is impaired if there is objective evidence that the amount, or timing, of future cash flows has been adversely affected. Refer to accounting policies on page 92 for details of the quantification of impairment losses.

Days-past-due measures are typically used to identify evidence of impairment. In both the Wholesale and Personal portfolios, a period of 90 days past due is used. In sovereign portfolios, the period used is 180 days past due. Indicators of impairment include the borrower's financial condition; a forbearance event; a loan restructuring; the probability of bankruptcy; or evidence of diminished cash flows.

Provisioning

The amount of an impairment loss is measured as the difference between the asset carrying amount and the present value of the estimated future cash flows discounted at the financial asset's original effective interest rate. The current net realisable value of the collateral will be taken into account in determining the need for a provision. This includes cash flows from foreclosure (less costs of obtaining and selling the collateral), whether or not foreclosure is probable. Impairment provisions are not recognised where amounts due are expected to be settled in full on the realisation of collateral.

The Group uses one of the following three methods to quantify the provision required: individual, where the quantification method is on a case-by-case assessment of future cash flows; collective, a quantitative review of the relevant portfolio; and latent, where PD, LGD, drawn balance and emergence period are considered in the calculation.

Sensitivity of impairments to assumptions

Key assumptions relating to impairment levels are economic conditions, the interest rate environment, the ease and timing of enforcing loan agreements in varying legal jurisdictions and the level of customer co-operation.

In addition, for secured lending, key assumptions relate to the valuation of the security and collateral held, as well as the timing and cost of asset disposals based on underlying market depth and liquidity. Assessments are made by relationship managers on a case-by-case basis for individually-assessed provisions and are validated by credit teams. Impairments less than £1 million are approved by credit officers under their delegated authority. For individual impairments greater than £1 million, oversight is provided by the Provisions Committee.

Available-for-sale portfolios

Available-for-sale portfolios are also regularly reviewed for evidence of impairment, including: default or delinquency in interest or principal payments; significant financial difficulty of the issuer or obligor; and increased likelihood that the issuer will enter bankruptcy or other financial reorganisation.

Determining whether evidence of impairment exists requires the exercise of management judgement. It should be noted that the following factors are not, of themselves, evidence of impairment, but may be evidence of impairment when considered with other factors:

- Disappearance of an active market because an entity's financial instruments are no longer publicly traded.
- A downgrade of an entity's credit rating.
- A decline in the fair value of a financial asset below its cost or amortised cost.

Write-offs

Impaired loans and receivables are written-off when there is no longer any realistic prospect of recovery of part, or the entire loan. For loans that are individually assessed for impairment, the timing of write-off is determined on a case-by-case basis. Such loans are reviewed regularly and write-offs may be prompted by bankruptcy, insolvency, forbearance and similar events. For details of the typical time frames, from initial impairment to write off, for collectively assessed portfolios refer to the accounting policies section on page 92.

Amounts recovered after a loan has been written-off are credited to the loan impairment charge for the period in which they are received.

Credit risk: management basis continued

Portfolio summaries

The table below summarises current and potential exposure, by sector and asset quality. The table is unaudited except for forbearance, which is audited.

	Wholesale						Total	Total	
2017	Insurers and funds £m	Securitisations £m	Banks £m	NBFIs (1) £m	Sovereign (2) £m	Other £m	continuing activities £m	disposal groups £m	Total £m
AQ1-AQ4	5,768	4,778	1,379	1,968	1,271	4,577	19,741	313,588	333,329
AQ5-AQ8	200	257	200	528	11	2,080	3,276	115,583	118,859
AQ9	—	2	—	—	—	29	31	2,958	2,989
AQ10	1	8	4	20	—	537	570	5,706	6,276
Continuing activities	5,969	5,045	1,583	2,516	1,282	7,223	23,618	—	23,618
Of which:									
- *Counterparty risk*	*2,799*	*1,019*	*1,360*	*1,973*	*627*	*5,090*	*12,868*	—	—
- *Non-counterparty risk*	*3,170*	*4,026*	*223*	*543*	*655*	*2,133*	*10,750*	—	—
Disposal groups	5,197	1,998	8,354	2,440	142,145	277,701	—	437,835	437,835
Total current exposure including disposal groups	11,166	7,043	9,937	4,956	143,427	284,924	23,618	437,835	461,453
Total potential exposure including disposal groups	25,555	9,510	16,673	8,556	144,281	348,632	54,975	498,232	553,207
Of which:									
- *Continuing activities potential exposure*	*16,937*	*7,510*	*8,205*	*5,066*	*1,947*	*15,310*	*54,975*	—	—
- *Disposal groups potential exposure*	*8,618*	*2,000*	*8,468*	*3,490*	*142,334*	*333,322*	—	*498,232*	—
Risk of Credit Loss	—	—	—	85	—	5	90	569	659
Forbearance stock (3,4)	—	—	—	—	—	—	—	7,806	7,806
Flow into forbearance (3,5)	—	—	—	—	—	—	—	2,277	2,277
Of which:									
- *Performing*	—	—	—	—	—	—	—	*1,468*	*1,468*
- *Non-performing*	—	—	—	—	—	—	—	*809*	*809*
Provisions (6)	2	3	—	34	—	141	179	3,595	3,774

	Wholesale				
2016	Banks and other FIs £m	Sovereign (2) £m	Other £m	Personal £m	Total £m
AQ1-AQ4	38,029	113,657	48,375	111,899	311,960
AQ5-AQ8	4,216	133	69,977	45,299	119,625
AQ9	32	4	588	2,622	3,246
AQ10	325	—	3,435	3,693	7,453
Total current exposure	42,602	113,794	122,375	163,513	442,284
Total potential exposure	75,733	114,601	181,475	169,699	541,508
Risk of Credit Loss	1	4	848	—	853
Forbearance stock (3,4)	63	1	4,184	5,241	9,489
Flow into forbearance (3,5)	5	1	3,204	824	4,034
Of which:					
- *Performing*	*4*	—	*1,758*	*436*	*2,198*
- *Non-performing*	*2*	*1*	*1,446*	*388*	*1,837*
Provisions (6)	54	1	2,135	2,158	4,348

Notes:
(1) Non-bank financial institutions.
(2) Includes exposure to central governments, central banks and sub-sovereigns such as local authorities.
(3) Audited.
(4) Wholesale forbearance stock represents loans that have been subject to a forbearance event in the two years up to the reporting date.
(5) Completed during the year.
(6) Provision (including latent).

Credit risk: management basis continued

Key points (unaudited)

- As a result of UK ring-fencing requirements, the table above highlights both continuing activities and disposal groups for 2017. The disclosures focus on the go-forward non-ring-fenced NatWest Markets business. Disposal groups reflect the majority of the UK Corporate, Personal, CRE and Shipping exposures.
- Material sectors included in the other category within continuing operations are Natural Resources (£2.8 billion), Property (£1.7 billion), Transport (£0.9 billion) and Services (£0.8 billion).
- Measured against the Groups asset quality scale, as at 31 December 2017, 84% of total current exposure for continued operations was rated in the AQ1-AQ4 bands, equating to an indicative investment grade rating of BBB- or above.
- The majority of the continuing exposure was in the UK (49%) with further exposure in Western Europe (20%), US (20%), RoI (2%) and rest of the world (9%).
- Credit quality across the Wholesale portfolio remained stable reflecting resilient market conditions during the year.
- The difference in potential and current exposure measures mainly related to the variation in measurement of counterparty credit risk as described on page 37.

Market risk

The Group is exposed to traded market risk through its trading activities and to non-traded market risk as a result of its banking activities. It manages its traded and non-traded market risk exposures separately. Each type of market risk is discussed separately. The traded market risk section begins below. The non-traded market risk section begins on page 47.

Pension-related activities also give rise to market risk. Refer to page 51 for more information on risk related to pensions.

Traded market risk

The following disclosures in this section are audited:

- Internal VaR.

Definition

Within trading books, traded market risk is the risk arising from changes in fair value on positions, assets, liabilities or commitments as a result of fluctuations in market prices.

Disclosures in this section relate to individual legal entities on a solo basis within the Group, reflecting the way the Group manages the risk or the basis on which it reports the risk measure to the regulator. The legal entities have been selected based on their materiality for the risk measure in question.

Key developments in 2017 (unaudited)

- During H1 2017, revised traded market risk appetite metrics were approved by the Board and cascaded to the franchises. In Q4 2017, the limits for NatWest Markets were revised to accommodate trading book positions from the legacy portfolio which has now been re-integrated into NatWest Markets.
- Political events during the year, including elections in the UK, France and the Netherlands, resulted in periods of market volatility. European interest rates remained at historically low levels, although the Bank of England and US Federal Reserve began raising interest rates.
- Traded VaR increased on an average basis compared to 2016, but remained within risk appetite. This was partly because the level of risk was reduced in H1 2016 as a result of concerns over the stability of the financial sector, leading to a lower average risk profile for that year. The risk profile subsequently returned to a more normalised level. Refinements to the VaR methodology used for certain credit products also contributed to the increase.

Sources of risk (unaudited)

The primary objective of the Group's trading activities is to provide a range of financing, risk management and investment services to its customers - including major corporations and financial institutions around the world. From a market risk perspective, the trading activities are focused on the following markets: rates; currencies; securitised products; and traded credit.

The Group undertakes transactions in financial instruments including debt securities, loans, deposits and equities, as well as securities financing and derivatives.

Following the reintegration of legacy portfolios, traded market risk now almost entirely resides in NatWest Markets.

The key categories of traded market risk are:

- Interest rate risk – which is the risk that a position's fair value will change due to a change in the absolute level of interest rates, in the spread between two rates, in the shape of the yield curve or in any other interest rate relationship.
- Credit spread risk – which is the risk that the value of a position will change due to changes in the real or market-perceived ability of a borrower to pay related cash flows or obligations.
- Foreign currency price risk – which is the risk that the fair value of a position will change due to the change in foreign currency rates, including gold.
- Equity price risk – which is the risk that the fair value of a position will change due to the change in equity prices.
- Commodity price risk – which is the risk that the fair value of a position will change due to the change in commodity prices.

Trading activities may also give rise to counterparty credit risk. For information on the management of this risk, refer to the Credit risk section on page 37.

Risk governance (unaudited)

Responsibility for identifying, measuring, monitoring and controlling the market risk arising from trading activities lies with the relevant trading business, with second-line-of-defence oversight provided by the Traded Market Risk function.

Traded market risk positions are reported monthly to the Executive Risk Forum (ERF) and quarterly to the Board Risk Committee.

Market risk policy statements set out the governance and risk management framework through effective identification, measurement, reporting, mitigation, monitoring and control.

Risk appetite (unaudited)

The Group's qualitative appetite for traded market risk is set out in the traded market risk appetite statement.

Its quantitative appetite is expressed in terms of exposure limits in the form of Board risk measures (approved by the RBS Group Board on the recommendation of the Board Risk Committee) and key risk measures (approved by the Technical Executive Risk Forum).

These limits are cascaded further down the organisation as required, as approved by the Technical Executive Risk Forum.

The limit framework at RBS Group level comprises value-at-risk (VaR) and stressed value-at-risk (SVaR). More details on these are provided on the following pages.

The limit framework at trading unit level also comprises additional metrics that are specific to the market risk exposures within its scope. These additional metrics aim to control various risk dimensions such as product type, exposure size, aged inventory, currency and tenor.

For each trading business, a document known as a dealing authority compiles details of all applicable limits and trading restrictions.

The limits are reviewed to reflect changes in risk appetite, business plans, portfolio composition and the market and economic environments.

Traded market risk continued

To ensure approved limits are not breached and that the RBS Group remains within its risk appetite, triggers at RBS Group and lower levels have been set such that if exposures exceed a specified level, action plans are developed by the front office and Traded Market Risk.

For further information on risk appetite, refer to page 22.

Risk controls and assurance (unaudited)

For information on risk controls and assurance, refer to page 24.

Risk identification and assessment (unaudited)

Identification and assessment of traded market risk is achieved through gathering, analysing, monitoring and reporting market risk information at desk, business, franchise and RBS-wide levels. Industry expertise, continued system developments and techniques such as stress testing are also used to enhance the effectiveness of the identification and assessment of all material market risks.

This is complemented by the New Product Approval process, in which the market risk team participates to assess and quantify the market risk associated with all proposed new products.

Risk monitoring (unaudited)

Traded market risk exposures are monitored against limits and analysed daily by market risk reporting and control functions. A daily report that summarises market risk exposures against the limits at RBS, franchise, business and desk levels is sent to senior management and market risk managers across the function.

The Market Risk function also prepares daily risk reports that detail exposures against a more granular set of limits and triggers.

Limit reporting is supplemented with regulatory capital and stress testing information as well as ad hoc reporting.

A risk review of trading businesses is undertaken weekly with senior risk and front office staff. This includes a review of profit and loss drivers, notable position concentrations and other positions of concern.

Businesses' profit and loss performance is monitored automatically through loss triggers which, if breached, require a remedial action plan to be agreed between the Market Risk function and the front office. The loss triggers are set using both a fall-from-peak approach and an absolute loss level.

In addition, as noted under Risk governance above, regular updates on traded market risk positions are provided to the ERF and Board Risk Committee.

Risk measurement

The Group uses a comprehensive set of methodologies and techniques to measure traded market risk, namely VaR, SVaR and the incremental risk charge. Risks that are not adequately captured by VaR or SVaR are captured by the Risks not in VaR (RNIV) framework to ensure that the Group is adequately capitalised for market risk. In addition, stress testing is used to identify any vulnerabilities and potential losses in excess of VaR and SVaR.

The key inputs into these measurement methods are market data and risk factor sensitivities. Sensitivities refer to the changes in trade or portfolio value that result from small changes in market parameters that are subject to the market risk limit framework. Revaluation ladders are used in place of sensitivities to capture the impact of large moves in risk factors or the joint impact of two risk factors.

These methods have been designed to capture correlation effects and allow the Group to form an aggregated view of its traded market risk across risk types, markets and business lines while also taking into account the characteristics of each risk type.

Value-at-risk (unaudited)

For internal risk management purposes, VaR assumes a time horizon of one trading day and a confidence level of 99%.

The internal VaR model – which captures all trading book positions including those products approved by the regulator – is based on a historical simulation, utilising market data from the previous 500 days on an equally weighted basis.

The model also captures the potential impact of the following key risk factors: interest rate risk; credit spread risk; foreign currency price risk; equity price risk; and commodity price risk. These are defined under Sources of risk.

When simulating potential movements in risk factors, a combination of absolute, relative and rescaled returns is used, depending on the risk factor.

The performance and adequacy of the VaR model are tested on a regular basis through the following processes:

- Back-testing – Internal and regulatory back-testing is conducted on a daily basis. (For information on internal back-testing, refer to page 46.)
- Ongoing model validation – VaR model performance is assessed both regularly and on an ad-hoc basis if market conditions or book constitution change significantly.
- Model Risk Management review – As part of the model lifecycle, all risk models (including the VaR model) are independently reviewed to ensure that the model is still fit for purpose given current market conditions and book constitution (refer to page 24).

Traded market risk continued

1-Day 99% traded internal VaR

The table below analyses 1-day 99% internal VaR for the trading portfolios of RBS plc and RBS Securities Inc (RBSSI), segregated by type of market risk exposure.

	2017				2016			
RBS plc	Average £m	Maximum £m	Minimum £m	Period end £m	Average £m	Maximum £m	Minimum £m	Period end £m
Interest rate	13.5	20.8	8.6	15.0	12.5	22.2	7.9	14.8
Credit spread	11.8	18.9	8.5	16.4	9.4	13.8	5.8	10.0
Currency	4.8	9.8	2.4	3.4	4.6	13.0	1.0	5.6
Equity	1.2	2.1	0.4	0.4	0.5	2.1	0.2	1.9
Commodity	0.3	1.4	—	0.2	0.7	2.2	0.1	0.1
Diversification (1)	(12.6)			(15.3)	(10.8)			(9.3)
Total	19.0	29.2	13.3	20.1	16.9	26.9	9.8	23.1

	2017				2016			
RBSSI	Average £m	Maximum £m	Minimum £m	Period end £m	Average £m	Maximum £m	Minimum £m	Period end £m
Interest rate	3.3	6.0	1.6	1.6	1.9	4.0	0.7	4.0
Credit spread	0.7	3.4	0.5	0.5	0.4	0.8	0.1	0.6
Commodity	0.1	0.4	—	—	0.2	0.5	—	0.3
Diversification (1)	(0.5)			(0.2)	(0.5)			(0.5)
Total	3.6	6.5	1.8	1.9	2.0	4.5	0.7	4.4

Note:
(1) The Group benefits from diversification as it reduces risk by allocating positions across various financial instrument types, currencies and markets. The extent of the diversification benefit depends on the correlation between the assets and risk factors in the portfolio at a particular time. The diversification factor is the sum of the VaR on individual risk types less the total portfolio VaR.

Key points

RBS plc
- Traded VaR fluctuated throughout 2017, reflecting political developments, market events, customer flows and other macroeconomic factors.
- On an average basis, total traded VaR increased in 2017 compared to 2016, but remained within risk appetite. This was partly because the level of risk was reduced in H1 2016 as a result of concerns over the stability of the financial sector, leading to a lower average risk profile for that year. The risk profile subsequently returned to a more normalised level. Refinements applied to the VaR methodology used for certain credit products during 2017 also contributed to the increase.
- On a period-end basis, total traded VaR was in the middle of the range for the year.

RBSSI
- The increase in traded VaR on an average basis was mainly driven by the Rates US business.

Traded market risk continued

VaR back-testing (unaudited)

The main approach employed to assess the ongoing performance of the VaR model is back-testing, which counts the number of days when a loss exceeds the corresponding daily VaR estimate, measured at a 99% confidence level.

Two types of profit and loss (P&L) are used in back-testing comparisons: Actual P&L and Hypothetical (Hypo) P&L.

The Actual P&L for a particular business day is the firm's actual P&L for that day in respect of the trading activities, including any intraday activities, adjusted by stripping out fees and commissions, brokerage, and additions to and releases from reserves that are not directly related to market risk.

The Hypo P&L reflects the firm's Actual P&L excluding any intra-day activities.

A portfolio is said to produce a back-testing exception when the Actual or Hypo P&L exceeds the VaR level on a given day. Such an event may be caused by a large market movement or may highlight issues such as missing risk factors or inappropriate time series. Any such issues identified are analysed and addressed through taking appropriate remediation or development action. Both Actual and Hypo back-testing exceptions are monitored.

Back-testing at the legal entity level is performed and reported on 1-day 99% regulatory VaR. Back-testing for NatWest Markets businesses is performed on 1-day 99% internal VaR.

Stressed VaR (SVaR) (unaudited)

As with VaR, the SVaR methodology produces estimates of the potential change in the market value of a portfolio, over a specified time horizon, at a given confidence level. SVaR is a VaR-based measure using historical data from a one-year period of stressed market conditions.

The risk system simulates 99% VaR on the current portfolio for each 250-day period from 2005 to the current VaR date, moving forward one day at a time. The SVaR is the worst VaR outcome of the simulated results.

This is in contrast with VaR, which is based on a rolling 500-day historical data set. A time horizon of ten trading days is assumed with a confidence level of 99%.

The internal traded SVaR model captures all trading book positions.

Internal traded SVaR is monitored at RBS Group level.

Risks not in VaR (RNIVs) (unaudited)

The RNIV framework is used to identify and quantify market risks that are inadequately captured by the internal VaR and SVaR models.

RNIV calculations form an integral part of ongoing model and data improvement efforts to capture all market risks in scope for model approval in VaR and SVaR.

Stress testing (unaudited)

For information on stress testing, refer to page 28.

Incremental risk charge (IRC) (unaudited)

The IRC model quantifies the impact of rating migration and default events on the market value of instruments with embedded credit risk (in particular, bonds and credit default swaps) that are held in the trading book. It further captures basis risk between different instruments, maturities and reference entities.

Model validation (unaudited)

The Group uses a variety of models to manage and measure market risk. These include pricing models (used for valuation of positions) and risk models (for risk measurement and capital calculation purposes). They are developed and signed off in NatWest Markets, with material models subject to independent review by Model Risk Management. For general information on the independent model validation carried out by Model Risk Management, which applies also to market risk models (including VaR models), refer to page 24. Additional details relating to pricing and market risk models are presented below.

Pricing models

Pricing models are developed by a dedicated front office quantitative team, in conjunction with the trading desk. They are used for the valuation of positions for which prices are not directly observable and for the risk management of the portfolio.

Any pricing models that are used as the basis for valuing books and records are subject to approval and oversight by asset-level modelled product review committees.

These committees comprise representatives of the major stakeholders in the valuation process - trading, finance, market risk, model development and model review functions. Model approval by such a committee requires review and approval by these stakeholders, including independent model review by Model Risk Management.

The review process includes the following steps:

- The committees prioritise models for review by Model Risk Management, considering the materiality of the risk booked against the model and an assessment of the degree of model risk, that is the valuation uncertainty arising from the choice of modelling assumptions.
- Model Risk Management quantifies the model risk, which may include comparing front office model outputs with those of alternative models independently developed by Model Risk Management.
- The sensitivities derived from the pricing models are validated.
- The conclusions of the review are used to inform risk limits and by Finance to inform model reserves.

Risk models

All model changes are approved through model governance committees at franchise level. Changes to existing models are subject to Model Risk Management review and the Group follows regulatory guidance for assessing the materiality of extensions and changes to the internal model approach for market risk.

Model Risk Management's independent oversight provides additional assurance that the Group holds appropriate capital for the market risk to which it is exposed.

In addition to Model Risk Management's independent oversight, the model testing team monitors the model performance for market risk through back-testing, which is discussed in more detail on page 46, and other processes.

Non-traded market risk
The following disclosures in this section are audited:
- Internal banking book VaR.
- Foreign exchange risk.

Definition
Non-traded market risk is the risk to the value of assets or liabilities outside the trading book, or the risk to income, that arises from changes in market prices such as interest rates, foreign exchange rates and equity prices, or from changes in managed rates.

All non-traded market risk disclosures are on an overall Group basis, reflecting either the way the Group manages the risk or the basis on which it reports the risk measure to the regulator.

Key developments in 2017 (unaudited)
- During 2017, revised non-traded market risk appetite metrics were approved by the RBS Group Board and cascaded to the franchises.
- Political events during the year, notably elections in the UK, France and the Netherlands, resulted in periods of market volatility. UK and European interest rates remained at low levels, although the Bank of England and the US Federal Reserve began raising interest rates. These events did not affect non-traded market risk management strategy during the year.
- Non-traded market risk VaR peaked in H1 2017, mainly driven by an increase in bonds held within Treasury's liquidity portfolio, which was aimed at investing surplus cash, rather than meeting increased liquidity requirements. The appreciation of foreign currency bonds within this portfolio, primarily US and German sovereign debt, also contributed. The target allocation between cash and bonds, which is determined by the cash requirement of the liquid asset buffer, was reached in H1 2017 and the size of the portfolio remained largely unchanged during H2 2017.

Sources of risk (unaudited)
The majority of non-traded market risk exposure arises from retail and commercial banking activities from assets and liabilities that are not classified as held-for-trading.

Non-traded market risk is largely managed in line with the following key categories: interest rate risk; credit spread risk; foreign exchange risk; equity risk; and accounting volatility risk.

Interest rate risk
Non-traded interest rate risk (NTIRR) arises from the provision to customers of a range of banking products that have differing interest rate characteristics. When aggregated, these products form portfolios of assets and liabilities with varying degrees of sensitivity to changes in market interest rates. Mismatches in these characteristics can give rise to volatility in net interest income as interest rates vary.

NTIRR comprises three primary risk factors: gap risk, basis risk and option risk. For more information, refer to page 48.

Credit spread risk
Credit spread risk arises from the potential adverse economic impact of a move in the spread between bond yields and swap rates, where the bond portfolios are accounted at fair value through equity.

Foreign exchange risk
Non-traded foreign exchange risk exposures arise from two main sources:
- *Structural foreign exchange risk* – arising from the capital deployed in foreign subsidiaries, branches and joint arrangements and related currency funding where it differs from sterling.
- *Non-trading book foreign exchange risk* – arising from customer transactions and profits and losses that are in a currency other than the functional currency of the transacting operation.

Equity risk
Non-traded equity risk is the potential variation in income and reserves arising from changes in the values of equity positions. Equity exposures may arise through strategic acquisitions, venture capital investments and certain restructuring arrangements.

Accounting volatility risk
Accounting volatility risk arises when an exposure is accounted for at amortised cost but economically hedged by a derivative that is accounted for at fair value. Although this is not an economic risk, the difference in accounting between the exposure and the hedge creates volatility in the income statement.

Risk governance (unaudited)
Responsibility for identifying, measuring, monitoring and controlling the market risk arising from non-trading activities lies with the relevant business, with second-line-of-defence oversight provided by the Non-Traded Market Risk function, which reports into the Director of Enterprise Wide Risk.

Risk positions are reported monthly to the RBS Group's Executive Risk Forum (ERF) and quarterly to the Board Risk Committee, as well as to the Asset and Liability Committee (ALCo) (monthly in the case of interest rate, credit spread and accounting volatility risks and quarterly in the case of foreign exchange and equity risks).

Market risk policy statements set out the governance and risk management framework through effective identification, measurement, reporting, mitigation, monitoring and control.

Non-traded market risk continued

Risk appetite (unaudited)

The Group's qualitative appetite is set out in the non-traded market risk appetite statement.

Its quantitative appetite is expressed in terms of exposure limits. These comprise both Board risk measures (which are approved by the RBS Group Board on the recommendation of the Board Risk Committee) and key risk measures (which are approved by the ALCo).

These limits are cascaded further down the organisation as required, as approved by the Technical Executive Risk Forum in the case of the Board risk measures and by the ALCo in the case of the key risk measures.

The limit framework at RBS Group level comprises value-at-risk (VaR), stressed value-at-risk (SVaR), sensitivity and stress limits, and earnings-at-risk limits.

The limits are reviewed to reflect changes in risk appetite, business plans, portfolio composition and the market and economic environments.

To ensure approved limits are not breached and that RBS Group remains within its risk appetite, triggers at RBS Group and lower levels have been set such that if exposures exceed a specified level, action plans are developed by the front office, Market Risk and Finance.

For further information on risk appetite, refer to page 22.

Risk controls and assurance (unaudited)

For information on risk controls and assurance, refer to page 24.

Risk assessment, monitoring and mitigation (unaudited)

Interest rate risk

Non-traded interest rate risk (NTIRR) factors are grouped into the following categories:

- Gap risk – which arises from the timing of rate changes in non-trading book instruments. The extent of gap risk depends on whether changes to the term structure of interest rates occur consistently across the yield curve (parallel risk) or differentially by period (non-parallel risk).
- Basis risk – which captures the impact of relative changes in interest rates for financial instruments that have similar tenors but are priced using different interest rate indices, or on the same interest rate indices but with different tenors.
- Option risk – which arises from option derivative positions or from optional elements embedded in assets, liabilities and/or off-balance sheet items, where RBS or its customer can alter the level and timing of their cash flows. Option risk can be further characterised into automatic option risk and behavioural option risk. One example of behavioural option risk is pipeline risk. This is the risk of loss arising from personal customers owning an option to draw down a loan (typically a mortgage loan) at a committed rate. Changes in interest rates can result in greater or fewer customers than anticipated taking up the committed offer. The risk depends on customer behaviour as the option will not automatically be exercised.

Due to the long-term nature of many retail and commercial portfolios and their varied interest rate repricing characteristics and maturities, it is likely that net interest income will vary from period to period, even if interest rates remain the same. New business originated in any period will alter the RBS Group's interest rate sensitivity if the resulting portfolio differs from portfolios originated in prior periods, depending on the extent to which exposure has been hedged.

In order to manage exposures within these limits, the RBS Group aggregates its interest rate positions and hedges them externally using cash and derivatives - primarily interest rate swaps.

This task is primarily carried out by RBS Group Treasury, to which all businesses except NatWest Markets transfer most of their NTIRR. The main exposures and limit utilisations are reported to the ALCo and the ERF monthly and to the Board Risk Committee quarterly.

Credit spread risk

The bond portfolios primarily comprise high-quality securities that are maintained as a liquidity buffer to ensure the Group can continue to meet its obligations in the event that access to wholesale funding markets is restricted. Additionally other high-quality bond portfolios are held for collateral purposes and to support payment systems.

Credit spread risk is monitored daily through sensitivities and VaR measures. The dealing authorities in place for the bond portfolios further mitigate the risk by imposing constraints by duration, asset class and credit rating. Exposures and limit utilisations are reported to senior management on a daily basis as well as to the ERF monthly and the Board Risk Committee quarterly.

Non-traded market risk continued

Foreign exchange risk

The only material non-traded open currency positions are the structural foreign exchange exposures arising from investments in foreign subsidiaries, branches and associates and their related currency funding. These exposures are assessed and managed by RBS Group Treasury to predefined risk appetite levels under delegated authority from the ALCo. RBS Group Treasury seeks to limit the potential volatility impact on the RBS Group's Common Equity Tier 1 (CET1) ratio from exchange rate movements by maintaining a structural open currency position. Gains or losses arising from the retranslation of net investments in overseas operations are recognised in equity reserves and reduce the sensitivity of capital ratios to foreign exchange rate movements primarily arising from the retranslation of non-sterling-denominated RWAs. Sensitivity is minimised where, for a given currency, the ratio of the structural open position to RWAs equals the RBS Group's CET1 ratio. The sensitivity of this ratio to exchange rates is monitored monthly and reported to the RBS Group ALCo at least quarterly. Foreign exchange exposures arising from customer transactions are sold down by businesses on a regular basis in line with RBS Group policy.

Equity risk

Non-traded equity risk is the potential variation in the income and reserves arising from changes in equity valuations. Any such risk is identified prior to any investments and then mitigated through a framework of controls.

Investments, acquisitions or disposals of a strategic nature are referred to the RBS Group's Acquisitions & Disposals Committee (ADCo). Once approved by ADCo for execution, such transactions are referred for approval to the RBS Group Board, the RBS Group Executive Committee, the RBS Group Chief Executive, the RBS Group Chief Financial Officer or as otherwise required. Decisions to acquire or hold equity positions in the non-trading book that are not of a strategic nature, such as customer restructurings, are taken by authorised persons with delegated authority under the credit approval framework.

Accounting volatility risk

Accounting volatility can be mitigated through hedge accounting. The profit and loss impact of the derivatives can be mitigated by marking the exposure to market. However, volatility will remain in cases where accounting rules mean that hedge accounting is not an option. Accounting volatility is reported to the ALCo monthly and capitalised as part of the Internal Capital Adequacy Assessment Process.

Risk measurement

The market risk exposures that arise as a result of the Group's retail and commercial banking activities are measured using a combination of value-based metrics (VaR and sensitivities) and earnings-based metrics, as explained in greater detail for each of the key non-traded risk exposure types disclosed in this section.

The following table presents 1-day internal banking book VaR at a 99% confidence level, analysed by type of risk.

	Period-end 2017 £m	Period-end 2016 £m
Interest rate	27.1	20.6
Credit spread	50.1	62.9
Pipeline risk	0.7	0.4
Diversification (1)	(16.7)	(22.4)
Total	61.2	61.5

Note:
(1) RBS benefits from diversification across various financial instrument types, currencies and markets. The extent of the diversification benefit depends on the correlation between the assets and risk factors in the portfolio at a particular time. The diversification factor is the sum of the VaR on individual risk types less the total portfolio VaR.

Key points

- Total non-traded VaR was broadly unchanged at the end of 2017 compared to one year previously.
- Credit spread VaR fell due to refinements in the source of the market data used for the VaR model. One of the largest loss dates dropped out of the historical time series for VaR during Q3 2017, which also contributed to the decline.
- Interest rate VaR increased due to lower diversification between sterling, euro and US dollar interest rates.
- The Group's VaR was lower than that of its subsidiary NatWest Plc because a significant proportion of fixed-rate exposure held by NatWest has associated hedges held at the RBS plc solo level. Therefore, the Group's VaR reflects both the exposures and the associated hedges, whereas NatWest's VaR reflects only the exposures.

Non-traded market risk continued

Interest rate risk (unaudited)

NTIRR can be measured from either an economic value-based or earnings-based perspective, or a combination of the two. Value-based approaches measure the change in value of the balance sheet assets and liabilities over a longer timeframe, including all cash flows. Earnings-based approaches measure the potential short-term (generally one-year) impact on the income statement of changes in interest rates.

The RBS Group uses both approaches to quantify its interest rate risk: VaR as its value-based approach and sensitivity of net interest income (NII) as its earnings-based approach.

These two approaches provide different yet complementary views of the impact of interest rate risk on the balance sheet at a point in time. The scenarios employed in the NII sensitivity approach incorporate business assumptions and simulated modifications in customer behaviour as interest rates change. In contrast, the VaR approach assumes static underlying positions and therefore does not provide a dynamic measurement of interest rate risk. In addition, while the NII sensitivity calculations are measured to a 12-month horizon and thus provide a shorter-term view of the risks on the balance sheet, the VaR approach can identify risks not captured in the sensitivity analysis, in particular the impact of duration and repricing risk on earnings beyond 12 months.

NII sensitivity is calculated and monitored at RBS Group level.

Value-at-risk (unaudited)

VaR is a statistical estimate of the potential change in the market value of a portfolio (and, thus, the impact on the income statement) over a specified time horizon at a given confidence level.

The Group's standard VaR metrics – which assume a time horizon of one trading day and a confidence level of 99% – are based on interest rate repricing gaps at the reporting date. Daily rate moves are modelled using observations over the last 500 business days. These incorporate customer products plus associated funding and hedging transactions as well as non-financial assets and liabilities such as property, plant and equipment, capital and reserves. Behavioural assumptions are applied as appropriate.

The non-traded interest rate risk VaR metrics for the Group's retail and commercial banking activities are included within the banking book VaR table above. The VaR captures the risk resulting from mismatches in the repricing dates of assets and liabilities. It includes any mismatch between structural hedges and stable non and low interest-bearing liabilities such as equity and money transmission accounts as regards their interest rate repricing behavioural profile.

Foreign exchange risk

The table below shows the Group's structural foreign currency exposures.

2017	Net investments in foreign operations £m	Net investment hedges (1) £m	Structural foreign currency exposures £m
US dollar	623	—	623
Euro	5,315	(195)	5,120
Swiss franc	448	(419)	29
Other non-sterling	908	(484)	424
Total	7,294	(1,098)	6,196
2016			
US dollar	(1,327)	—	(1,327)
Euro	4,957	(583)	4,374
Swiss franc	564	(440)	124
Other non-sterling	934	(506)	428
Total	5,128	(1,529)	3,599

Note:
(1) Economic hedges mainly represent US dollar and euro preference shares in issue that are treated as equity under IFRS and do not qualify as hedges for accounting purposes. They provide an offset to structural foreign exchange exposures to the extent that there are net assets in overseas operations available.

Key points

- The main driver of the increase in structural foreign currency exposure was the rise in US dollar exposure following the recapitalisation of the RBS Group's business in the US as a result of the FHFA settlement.
- Euro-denominated structural foreign currency exposures also increased, but a dividend paid by UBIDAC in January 2018 reduced euro structural exposure by approximately £1.3 billion.

Calculation of regulatory capital (unaudited)

Non-traded market risk exposures are capitalised through the Internal Capital Adequacy Assessment Process (ICAAP). This process covers the following risk types: gap risk, basis risk, credit spread risk, pipeline risk, structural foreign exchange risk, prepayment risk and accounting volatility risk. ICAAP is performed using a combination of value-based and earnings-based measures.

The total non-traded market risk capital requirement is determined by adding the different charges for each sub risk type. The ICAAP methodology captures at least ten years of historical volatility and is produced to a 99% confidence level. Methodologies are reviewed by Model Risk Management and results are approved by the Capital Management and Stress Testing Committee.

Pension risk (unaudited)

Definition

Pension obligation risk is the risk to the RBS Group caused by its contractual or other liabilities to, or with respect to, a pension scheme (whether established for its employees or those of a related company or otherwise). It is also the risk that the RBS Group will make payments or other contributions to, or with respect to, a pension scheme because of a moral obligation or because the RBS Group considers that it needs to do so for some other reason.

Sources of pension risk

The Group has exposure to pension risk through its defined benefit schemes worldwide. The five largest schemes, which represent around 98% of the RBS Group's pension liabilities are: the Main Section of The Royal Bank of Scotland Group Pension Fund (the Main scheme), the AA Section of The Royal Bank of Scotland Group Pension Fund, the Ulster Bank Pension Scheme, the Ulster Bank Pension Scheme (Republic of Ireland), and the Royal Bank of Scotland International Pension Trust. The Main scheme is the principal source of pension risk. Further detail on the Group's pension obligations can be found in Note 4 on the consolidated accounts.

Pension scheme liabilities vary with changes in long-term interest rates and inflation as well as with pensionable salaries, the longevity of scheme members and legislation. Pension scheme assets vary with changes in interest rates, inflation expectations, credit spreads, exchange rates, and equity and property prices. The RBS Group is exposed to the risk that the schemes' assets, together with future returns and additional future contributions, are insufficient to meet liabilities as they fall due. In such circumstances, the RBS Group could be obliged (or might choose) to make additional contributions to the schemes, or be required to hold additional capital to mitigate this risk.

Prior to 6 April 1997, individuals who contracted out of the UK State Second Pension were entitled to a Guaranteed Minimum Pension (GMP). Men accrued GMP at different rates to women. The Government intends that GMP should be equalised but until the mechanism is defined, pension funds are uncertain of their obligations. In the meantime, no allowance is made for GMP equalisation in the IAS 19 defined benefit obligations and risk disclosures.

Key developments in 2017

A memorandum of understanding between Ulster Bank Ireland DAC and Ulster Bank Pension Trustees Limited was agreed. A contribution of €200 million was paid to the pension scheme and the investment strategy amended to include more hedging assets.

Throughout 2017, various pension risk stress-testing initiatives were undertaken, focused both on internally-defined scenarios and on scenarios to meet integrated Bank of England stress-testing requirements. For more information on stress testing, refer to the following page.

Pension risk management function

Risk governance

The Main scheme operates under a trust deed. The corporate trustee, RBS Pension Trustee Limited, is a wholly owned subsidiary of National Westminster Bank Plc. The trustee board comprises six directors selected by the RBS Group and four directors representing members. The trustee is supported by RBS Investment Executive Ltd (RIEL), which specialises in pension investment strategy.

The Pension Committee, which is chaired by the RBS Group Chief Financial Officer, acts as a sub-committee of the Executive Committee and formulates the RBS Group's view of pension risk. The Pension Committee considers mechanisms that could potentially be used for managing risk within the funds as well as financial strategy. The Pension Committee is a key component of the RBS Group's approach to managing pension risk and it reviews and monitors risk management, asset strategy and financing issues on behalf of the RBS Group. The Pension Committee also serves as a formal link between the RBS Group, RIEL and the trustee.

For further information on Risk governance, refer to page 20.

Risk appetite

Investment policy for the schemes is defined by the trustee with input from RIEL where appropriate and other specialist advisers employed by the trustee. While the trustee is responsible for the management of the scheme assets, it consults with the RBS Group on material changes to the Main scheme's risk appetite and investment policy.

The RBS Group maintains an independent view of the risk inherent in pension funds, with an associated risk appetite, and has defined metrics against which risk is measured. In addition to the scrutiny provided by the Pension Committee, the RBS Group undertakes regular pension risk monitoring and reporting to the Board and the Board Risk Committee on the material pension schemes that the RBS Group has an obligation to support.

Risk controls

A pension risk management framework is in place to provide formal controls for pension risk reporting, modelling, governance and stress testing. A pension risk policy, which sits within the RBS Group policy framework, is also in place and is subject to associated framework controls.

Risk identification and measurement

Pension risk reports are submitted to the Executive Risk Forum and the Board Risk Committee four times a year in the Risk & Conduct Management Quarterly Report. This includes an assessment of the overall deficit or surplus position, estimated capital requirements, and an assessment of the associated assets and liabilities.

Pension risk (unaudited) continued

The RBS Group also undertakes stress tests and scenario analyses on its material defined benefit pension schemes each year as part of its risk measurement framework. These stress tests are also used to satisfy the requests of regulatory bodies such as the Bank of England. The stress testing framework includes pension risk capital calculations for the purposes of the Internal Capital Adequacy Assessment Process as well as additional stress tests for a number of internal management purposes.

Pension stress tests take the form of both stochastic and deterministic stresses over time horizons ranging from instantaneous to seven years in duration. They are designed to examine the behaviour of the pension schemes' assets and liabilities under a range of financial and demographic shocks. The results of the stress tests and their consequential impact on the RBS Group's balance sheet, income statement and capital position are incorporated into the overall the RBS Group-wide stress test results.

RBS plc is one of several companies within the RBS Group that participates in the Main scheme, and could be required to fund any deficit that arises. The table below shows the sensitivity of the Main scheme's assets and liabilities (measured according to IAS 19 'Employee Benefits'). It includes changes in interest rates and equity values at the year-end, taking account of the current asset allocation and hedging arrangements.

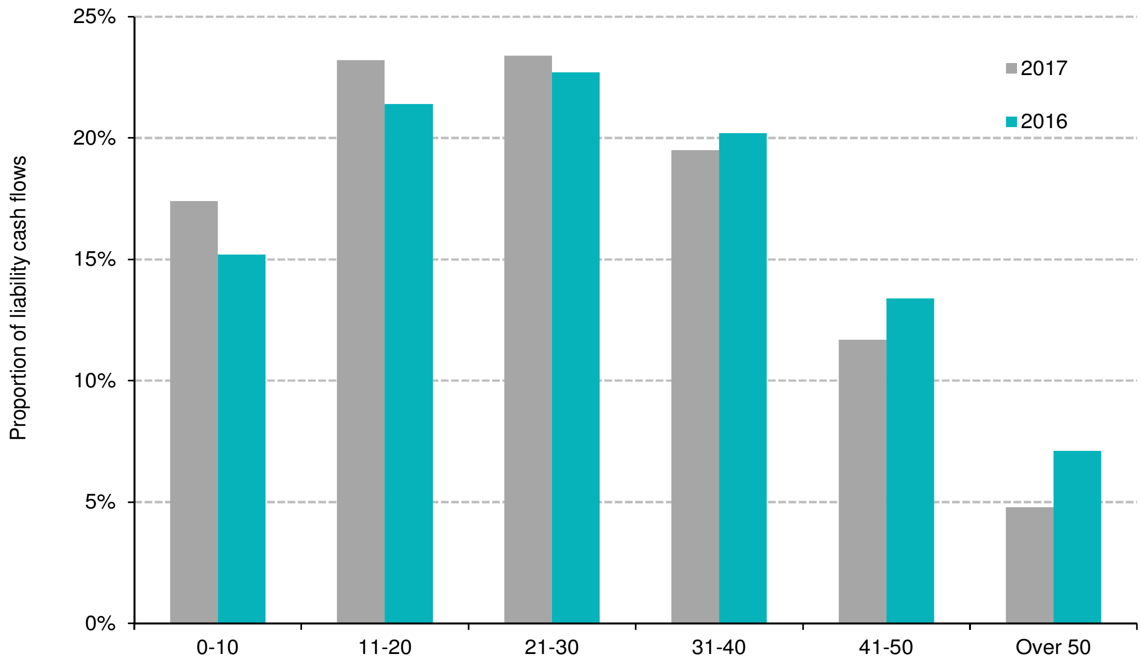
2017	Increase in value of assets £m	Increase in value of liabilities £m	Increase in net pension assets/ (obligations) £m
Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields	1,199	750	449
Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields	1,289	1,329	(40)
Fall in AA credit spreads of 0.25% at all durations with no change in nominal or real swap yields or other credit spreads	7	2,055	(2,048)
Fall in equity values of 10% (1)	(909)	—	(909)
2016			
Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields	1,048	502	546
Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields	1,485	1,552	(67)
Fall in AA credit spreads of 0.25% at all durations with no change in nominal or real swap yields or other credit spreads	9	2,074	(2,065)
Fall in equity values of 10% (1)	(905)	—	(905)

Note:

(1) Includes both quoted and private equity.

Pension risk (unaudited) continued

The chart below shows the pension liability cash flow profile, allowing for expected indexation of future payments. The majority of expected cash flows (84%) are anticipated within the next 40 years. The profile will vary depending on the assumptions made regarding inflation expectations and mortality.



Risk mitigation

The trustee has taken measures to mitigate inflation and interest rate risks, both by investing in suitable financial assets and by entering into inflation and interest rate swaps. The Main scheme also uses derivatives to manage the allocation of the portfolio to different asset classes and to manage risk within asset classes.

The assets of the Main scheme, which represented around 90% of the RBS Group's pension plan assets at 31 December 2017, are invested in a diversified portfolio. This includes quoted and private equity, government and corporate fixed interest and index-linked bonds, property and other alternative assets.

Conduct risk (unaudited)

Definition

Conduct risk is the risk that the behaviour of the RBS Group and its staff towards customers, or in the markets in which it operates, leads to unfair or inappropriate customer outcomes resulting in reputational damage, financial loss or both. The damage or loss may be the result of a failure to comply with (or adequately plan for changes to) relevant official sector policy, laws, regulations, or major industry standards, or of failing to meet the expectations of customers or regulators.

Sources of conduct risk

Conduct risk exists across all stages of the RBS Group's relationships with its customers – from the development of its business strategies, to post-sales processes – and arises from a variety of activities. These include product design, marketing and sales, complaint handling, staff training, and handling of confidential insider information. Conduct risk also arises if the RBS Group does not take effective action to prevent fraud, bribery and money laundering. As set out in Note 29 on the consolidated accounts, the RBS Group and certain members of staff are party to legal proceedings and are subject to investigation and other regulatory action in the UK, the US and other jurisdictions.

Key developments in 2017

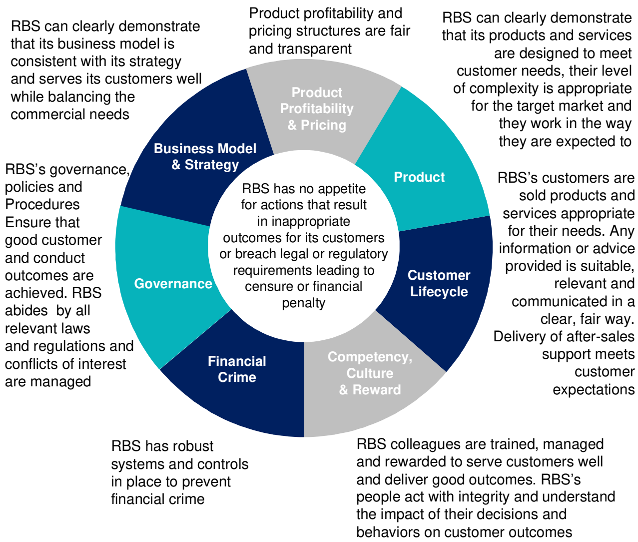
Parts of the Conduct & Regulatory Affairs function were merged with the Risk function with effect from 1 January 2017. Regulatory Affairs moved to Corporate Governance & Secretariat while Remediation and Complaints moved to Services' Chief Operating Office. The change was designed to take advantage of synergies across the risk, conduct and regulatory agendas.

The RBS Group continued to remediate historical conduct issues, while also focusing its customer-facing businesses and support functions around the needs of its customers including the delivery of a number of regulatory change programmes. Conduct and litigation costs were £1.1 billion in 2017 compared with £5.2 billion in 2016 in continuing and discontinued operations.

- The remediation of PPI continued, with the FCA confirming August 2019 as the deadline for PPI mis-selling claims.
- The FCA is reviewing the business models of UK retail banks, building societies and credit unions, to understand how recent changes are affecting competition and conduct in the sector.
- Following an enforcement notice from the Central Bank of Ireland in respect of tracker mortgages, a significant remediation programme was established.
- Work progressed to meet the requirements of the revised Markets in Financial Instruments Directive and Regulation (MiFID II/MiFIR) in advance of their introduction in early 2018.
- Work also progressed on the conduct-related aspects of the UK's ring-fencing requirements.
- Changes were implemented to support compliance with the second Payment Services Directive in advance of its introduction in early 2018.
- The RBS Group updated its policies to reflect changes required in relation to the 4th Money Laundering directive, which came into force in H1 2017 to combat terrorist and criminal financing.
- The Criminal Finances Act 2017 came into force in H2 2017, introducing a new corporate offence of failure to prevent the facilitation of tax evasion. Policies and procedures in place to prevent such activity were reviewed and enhanced.

Conduct risk management function

The management of conduct risk is based on seven key elements, ensuring that conduct risk exposures are understood and managed in accordance with agreed risk appetite.



Risk governance

The RBS Group defines appropriate standards of conduct and drives adherence to those standards through its framework for managing conduct risk. The RBS Group Board and its senior committees receive updates on conduct risk exposures and action plans through regular reporting.

Key elements of the governance structure are set out below:

- The Risk, Conduct & Restructuring Executive Committee considers emerging material risks and issues, and implements Board and Executive Committee risk management policy decisions.
- The Financial Crime Risk Executive Committee (accountable to the Executive Risk Forum) ensures that the customer-facing businesses and the Services function fulfil strategic objectives by identifying and managing their financial crime risks effectively.

Conduct risk (unaudited) continued

Controls

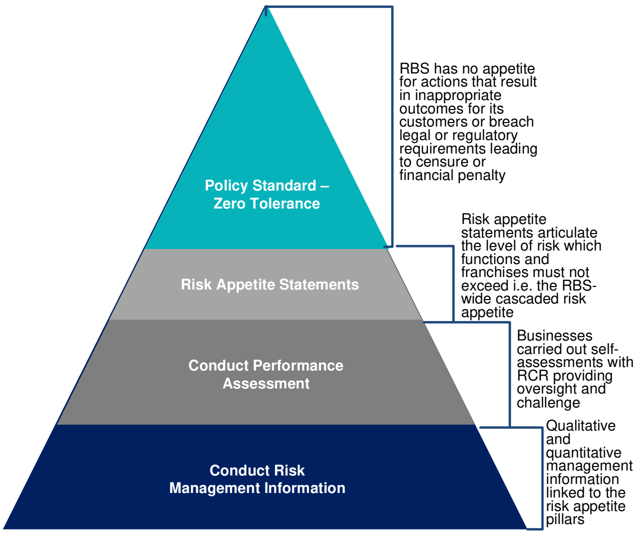
Under the policy framework, there are 18 conduct policies. These are designed to provide both high-level direction and stipulate RBS Group-wide requirements. The policies provide the necessary clarity to staff on their conduct obligations and ensure the RBS Group meets its regulatory obligations.

Risk assessments are used to identify material conduct risks and inform key controls across all business areas. The risk assessment process is designed to confirm risks are effectively managed and prioritised. The process also ensures controls are tested.

Scenario analysis is used to assess the impact of extreme but plausible conduct risks including financial crime. The scenarios assess the exposures that could significantly affect the RBS Group's financial performance or reputation and are an important component in the operational risk framework and capital model.

Risk appetite

The conduct risk appetite framework was established in 2015 and has been embedded across the RBS Group.



The conduct risk appetite framework and the Conduct Performance Assessment, which forms part of it, facilitate a consistent approach across RBS Group for assessing conduct risk.

The conduct risk appetite statements, in line with RBS Group-wide risk appetite, articulate the levels of risk which franchises and functions must not exceed. Where businesses are operating outside conduct appetite, the problems are addressed through agreed risk mitigation plans.

The Conduct Performance Assessment was run in Q1 and Q3 2017, reporting on risk exposures and the operating effectiveness of controls across the businesses. During Q4 2017, the Conduct Performance Assessment was discontinued, in advance of the roll-out of a new approach in early 2018, providing a real-time quantitative view, supported by qualitative assessment.

Risk monitoring and measurement

The RBS Group Board and senior RBS Group committees receive updates on conduct risk exposures and action plans through regular reporting. The reporting is intended to be focused, forward-looking and action-oriented.

The most material conduct matters are reported to the appropriate committees, including the RBS Group Board, the Group Audit Committee and Board Risk Committee.

An annual Money Laundering Reporting Officer's Report is submitted to the Board and shared with the FCA. This covers RBS Group's Anti-Money Laundering (AML) framework and the operation and effectiveness of the systems and controls in place to comply with AML laws and regulations. In addition, it covers the systems and controls in place to prevent the financing of terrorism and to ensure compliance with sanctions.

The Group Audit Committee is provided with a whistleblowing report twice a year. The report comments on the operational effectiveness of our whistleblowing framework, internally branded as 'Speak Up', and any trends emerging from completed investigations. It details cases by internal reporting categories based on the RBS Group definition of whistleblowing included in the Speak Up policy. The Speak Up policy encompasses both the legislative definition contained within the Public Interest Disclosure Act 1998 and the regulatory definition within FCA and PRA regulations and guidance. It extends these to include conduct or behaviour which does not meet the expected standards documented in Our Code.

Each business in the RBS Group has enhanced its use of management information by linking it to the relevant Conduct risk appetite statements. This is required to help ensure appropriate customer outcomes are delivered and that the management information is compliant with the Basel Committee on Banking Supervision's principles for effective risk data aggregation and risk reporting.

Risk mitigation

Information is communicated to each customer-facing business and function about regulatory developments and discussions with regulators. This helps identify and execute any required changes to strategy or to business models.

Early identification and effective management of changes in legislation and regulation are critical to the successful mitigation of conduct risk. The effects of all changes are managed to ensure timely compliance readiness. Changes assessed as having a high or medium-high impact are managed closely.

Mandatory learning, across the RBS Group, helps to ensure colleagues have the information necessary to carry out their duties in a way that complies with expected standards.

Operational risk (unaudited)

Definition

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or external events. It arises from day-to-day operations and is relevant to every aspect of the business.

Operational risk may directly affect customers, lead to financial loss or damage RBS Group's reputation (for example, cyber attacks, a major IT systems failure or fraudulent activity). There can also be a link between operational risk failures and conduct risk issues.

Sources of operational risk

Operational risk may arise from a failure to manage operations, systems, transactions and assets appropriately. This can take the form of human error, an inability to deliver change adequately or on time, the non-availability of technology services, or the loss of customer data. Fraud and theft are sources of operational risk, as is the impact of natural and man-made disasters. It can also arise from a failure to account for changes in law or regulations or to take appropriate measures to protect assets.

Key developments in 2017

The RBS Group continued to work to embed its enhanced operational risk framework, improving links between risk appetite and risk exposure and building a more robust control environment.

The year also saw a continued focus on the risks arising from the execution of major projects, including: the Transformation portfolio; the restructuring of NatWest Markets; preparations for the implementation of the corporate structural reform agenda – for example the Independent Commission on Banking's ring-fencing proposals, recovery and resolution planning, as well as Brexit; the planned activities to meet the European Commission state aid obligations; and, the effect on the RBS Group's control environment due to cost reduction measures. These projects are essential in order for the RBS Group to achieve its strategic objectives. Risk, Conduct & Restructuring ensured the associated risks to these projects were assessed and understood with mitigating activity in place wherever possible.

There was also a strong focus on the RBS Group's risk and control assessment methodology. Following on from work carried out in 2016, the aim of this consistent, bank-wide methodology was to enhance understanding of the risk profile for the most critical products and services. In 2017, coverage was significantly extended across the RBS Group, with outputs used to inform Group-wide reporting.

The external fraud threat remained high with data used by organised crime gangs to deceive customers through social engineering, and the continued evolution of financial malware. In 2017, there was an increase in fraud perpetrated by scams. The RBS Group has a bank-wide response plan to address the increased threat, which focuses on profiling capabilities and educating customers about fraud protection as well as continued work to drive and support industry best practice. This aligned with fraud prevention programmes across the RBS Group, with the objective of mitigating the effects of external fraud on customers and the RBS Group itself. The plan was successfully implemented and key strategic initiatives enhanced the RBS Group's fraud prevention and detection capabilities, enabling it to limit the effects of fraudulent activity on its customers. As a result, the RBS Group recorded a year-on-year decrease in the number of its customers falling victim to fraud in 2017.

The RBS Group continued to support an industry-led education initiative – Take Five to Stop Fraud – which offers advice to help the public protect themselves from preventable financial fraud. The initiative is led by Financial Fraud Action UK Ltd and is being delivered in conjunction with the Home Office, law enforcement and other banks.

The information and cyber security risk facing the RBS Group continued to change in line with the constantly evolving threats. Internal security improvement programmes progressed across the RBS Group, developing new and strengthening existing controls in order to protect the Group and its customers. The RBS Group continuously developed and used proactive threat management and intelligence processes to understand, manage and mitigate credible threats.

The RBS Group decommissioned a number of internet-facing websites to reduce the attack surface visible to hackers and fraudsters. Improvements were also made to prevent data leakage, secure externally bound email as well as enhance malware defences and management of user access to key systems. Internal training programmes continued to ensure all employees are fully aware of the threats facing RBS Group and remain vigilant to unauthorised attempts by internal or external parties to access systems and data.

Operational risk management function

Risk governance

A strong operational risk management function is vital to support the RBS Group's ambitions to serve its customers better. Improved management of operational risk against a defined appetite directly supports the strategic risk objective of improving stakeholder confidence and is vital for stability and reputational integrity.

The operational risk function, which is the second line of defence, is tasked with delivering a robust operational risk management framework and culture across the RBS Group. The Director of Operational Risk reports to the Chief Risk Officer.

Operational risk (unaudited) continued

Operational risk is responsible for the design, development, delivery and continuous improvement of the operational risk management framework. The Operational Risk Policy is incorporated into the RBS Group Policy Framework and provides direction for the consistent identification, assessment, management, monitoring and reporting of operational risk. Through a network of oversight teams, the function seeks to ensure the integrity of the framework, and manages overall operational risk profile against risk appetite.

The Operational Risk Executive Committee (OREC), which is a sub-committee of the Executive Risk Forum (ERF), acts on all operational risk matters. OREC's duties include reviewing operational risk exposure against risk appetite; identifying and assessing both current and emerging material operational risks; reviewing and monitoring the operational risk profile; and reviewing and approving material operational risk policy management framework changes.

Risk appetite

The operational risk appetite framework supports effective management of key operational risks. It expresses the level and types of operational risk the RBS Group is willing to accept in order to achieve its strategic objectives and business plans.

The RBS Group's operational risk appetite is expressed through a set of qualitative risk appetite statements and quantitative measures which are defined at an aggregate, RBS Group-wide and individual business level. Appetite covers the RBS Group's most material operational risks, defined by a materiality assessment, which in turn considers past, current and future risk exposures. Appetite exposures for all material risks are regularly reported to business risk committees, the OREC, ERF and Board Risk Committee.

The aggregation of operational risk appetite allows the RBS Group to monitor and report on its material risk exposures against predetermined limits. This drives management intervention and action at defined points, such as the breach of an early warning trigger.

Above these sit an RBS Group-level operational risk appetite statement which encompasses the full range of operational risks. This drives the strategic risk measurement of stakeholder confidence and is reviewed annually by the ERF. The statement is supported by three simple measures: (i) the relationship between operational risk losses and RBS Group's gross income; (ii) metrics covering control environment performance; and (iii) the requirement for the material RBS Group-wide operational risks to be managed within risk appetite.

Risk controls

The Control Environment Certification (CEC) process is a half yearly self-assessment by the CEOs of RBS Group's customer-facing franchises and business units, as well as the heads of the RBS Group's support and control functions. It gives an assessment on the adequacy and effectiveness of the internal control environment in a consistent and comparable manner, highlighting areas where targeted effort is needed to meet the standards required in order to create a safer and more secure bank for customers. It covers material risks and the key controls that underpin them, including financial, operational and compliance controls, as well as supporting risk management frameworks.

The CEC outcomes, including forward-looking assessments for the next two half-yearly cycles and the progress made to improve the control environment, are reported to the RBS Group Board, the Group Audit Committee and the Board Risk Committee. They are also shared with external auditors.

The CEC process helps to ensure compliance with the RBS Group Policy Framework, Sarbanes-Oxley 404 requirements concerning internal control over financial reporting (as referenced in the RBS Group 2017 Annual Report and Accounts Compliance report on page 107), and certain requirements of the UK Corporate Governance Code.

Risk identification and measurement

Across all business areas, risk and control assessments are used to identify and assess material operational and conduct risks and key controls. To support identification of risk concentrations, all risks and controls are mapped to the risk directory. Risk assessments are refreshed at least annually to ensure they remain relevant and capture any emerging risks.

The process is designed to confirm that risks are effectively managed and prioritised in line with the stated risk appetite. Controls are tested at the appropriate frequency to verify that they remain fit-for-purpose and operate effectively.

During 2017, work continued to increase the coverage of the enhanced end-to-end risk and control assessment methodology. This approach, which strengthens understanding of the risk profile of key products and services, is used to identify and quantify the most material operational risks. Subject matter experts and key stakeholders are engaged from across the RBS Group to underpin management action in line with RBS Group's financial and non-financial appetite statement. The results of the risk and control assessments support the RBS Group's on-going journey to build on, and enhance, its control environment.

Monitoring and reporting are part of the RBS Group's operational risk management processes, which aim to ensure that risks are identified, considered by senior executives, and managed effectively. The most material operational risks and their position relevant to risk appetite are regularly reviewed at the OREC, along with any emerging risks and the actions taken to mitigate them. These are also reported to the Board Risk Committee and the ERF. Exposures specific to each business are communicated through regular risk and control reports discussed at business risk committees.

Operational risk (unaudited) continued

The RBS Group uses the standardised approach to calculate its operational risk capital requirement. This is based on multiplying three years' average historical gross income by coefficients set by the regulator based on type of income.

As part of the wider Internal Capital Adequacy Assessment Process an operational risk economic capital model is used as a key capital benchmark. The model uses loss data and scenario analysis inputs from the operational risk framework, plus external loss data and certain other factors to provide a risk-sensitive view of the RBS Group's operational risk capital requirement.

Scenario analysis is used to assess how extreme but plausible operational risks will affect the RBS Group. It provides a forward-looking basis for evaluating and managing operational risk exposures.

Refer to the Capital, liquidity and funding risk section for operational risk capital requirement figures.

Event and loss data management

The operational risk event and loss data management process ensures the RBS Group captures and records operational risk loss events that meet defined criteria. Loss data is used for regulatory and industry reporting and is included in capital modelling when calculating economic capital for operational risk.

The most serious events are escalated in a simple, standardised process to all senior management, by way of a 'Group Notifiable Event Process'.

All losses and recoveries associated with an operational risk event are reported against their financial accounting date. A single event can result in multiple losses (or recoveries) that may take time to crystallise. Losses and recoveries with a financial accounting date in 2017 may relate to events that occurred, or were identified in, prior years.

Risk mitigation

Risks are mitigated through the application of key preventative and detective controls. This is an integral step in the risk assessment methodology, which determines residual risk exposure. Control owners are accountable for the design, execution, performance and maintenance of key controls.

These key controls are regularly assessed for adequacy and tested for effectiveness. The control testing results are monitored and, where a material change in performance is identified, it results in a re-evaluation of the associated risk.

The RBS Group purchases insurance to provide the business with financial protection against specific losses and to comply with statutory or contractual requirements.

Business risk (unaudited)

Definition

Business risk is the risk that the RBS Group makes inappropriate business or strategic choices or that the RBS Group is not able to execute its chosen strategy in line with its budget.

Sources of risk

Business risk arises as a result of the RBS Group's exposure to the macro-environment, to the competitive environment, and to technological changes. In addition, internal factors such as volatility in sales volumes, and input costs, and other operational risks such as RBS Group's ability to assess the business operating environment, or to execute its chosen strategy, contribute to business risk.

Key developments in 2017

The RBS Group continued to reduce its business risk profile by implementing its strategic plan to shift the business mix towards the UK and retail and commercial banking segments, with higher risk activities in NatWest Markets curtailed.

The RBS Group also continued with its simplification and cost reduction programmes during 2017.

As negotiations on the prospective withdrawal of the UK from the European Union have progressed, the RBS Group has been closely monitoring and assessing the operating environment and its effect on business risk.

In July 2017, the RBS Group reached a settlement with the Federal Housing Finance Agency, paying US$5.5 billion to resolve claims in relation to the issuance and underwriting of residential mortgage-backed securities in the US. This was an important step forward in resolving one of the most significant legacy matters facing the RBS Group.

In September 2017, the RBS Group received final approval from the European Commission for its alternative remedies package, designed to promote competition for banking services to the SME marketplace. This approval allows the RBS Group to resolve its final State Aid divestment obligation and brings clarity for customers and staff.

Governance

The Board has ultimate responsibility for business risk and for approving strategic plans, initiatives and changes to strategic direction.

The RBS Group's strategic planning process is managed by Strategy and Corporate Development. The Risk and Finance functions are key contributors to strategic planning.

Responsibility for the day-to-day management of business risk lies primarily with the franchises, with oversight by the Finance function. The franchises are responsible for delivery of their business plans and the management of such factors as pricing, sales volumes, marketing expenditure and other factors that can introduce volatility into earnings.

Business risk (unaudited) continued

Risk identification

Business risk is identified and managed at the product and transaction level. Estimated revenue, costs and capital are key considerations in the design of any new product or in any new investment decision.

Business risk is reported, assessed and challenged at every governance level within the organisation. Each franchise monitors its financial performance relative to plans and reports this on a regular basis to the finance directors of each franchise.

Risk mitigation

The RBS Group operates a monthly rolling forecasting process to identify projected changes in, or risks to, key financial metrics, and ensures appropriate actions are taken.

Reputational risk (unaudited)

Definition

Reputational risk is the risk to the RBS Group's public image from a failure to meet stakeholders' expectations in relation to performance, conduct or business profile. Stakeholders include customers, investors, employees, suppliers, government, regulators, special interest and consumer groups, media and the general public.

Sources of risk

Reputational risk can arise from the conduct of employees; activities of customers and the sectors and countries in which they operate; provision of products and transactions; as well as operations and infrastructure.

Governance

Reputational risk has RBS Group Board-level oversight reinforced by a Reputational Risk Policy. The Board Risk Committee and Sustainable Banking Committee are responsible for overseeing how RBS Group manages its reputation. The RBS Group Board's oversight of reputational issues is supported by the senior RBS Group-wide Reputational Risk Forum (RRF) which opines on cases and issues that represent a material reputational risk to the whole organisation. The RRF, which has delegated authority from the Executive Risk Forum (ERF), also acts as a central forum to review sector or theme-specific reputational risk acceptance positions, including environmental, social and ethical risk positions, for example, in the Defence and Gambling sectors.

Risk appetite

The RBS Group manages and articulates its appetite for reputational risk through the implementation of a qualitative reputational risk appetite statement and a committee-based governance framework. This has improved the identification, assessment and management of customers, transactions, products and issues that present a material reputational risk, resulting in a greater awareness and focus on the importance of this risk. Moreover, the RBS Group has seen a rise in the number of cases being referred to franchise and group-wide reputational risk fora as a result of increased awareness of the framework as well as training on reputational risk.

Risk mitigation

Reputational risk is mitigated through the policy and governance framework, with ongoing staff training to ensure early identification, assessment and escalation of material issues. Lessons learned from committee meetings have also improved the way cases and issues are debated and decisions made.

The most material threats to the RBS Group's reputation continued to originate from historical and more recent conduct issues. As a result, the RBS Group has been the subject of investigations and reviews by a number of its regulators, some of which have resulted in fines and public censure. Refer to the Litigation, investigations and reviews section of Note 29 on the consolidated accounts on page 155.

Report of the directors

The directors present their report together with the audited accounts for the year ended 31 December 2017.

Group structure

The Royal Bank of Scotland plc (the 'Bank') is a wholly-owned subsidiary of The Royal Bank of Scotland Group plc (the 'holding company'), which is incorporated in Great Britain and has its registered office at 36 St Andrew Square, Edinburgh EH2 2YB. The 'Group' comprises the Bank and its subsidiary and associated undertakings. Details of the principal subsidiary undertakings and their activities are shown in Note 15 on the accounts. A full list of related undertakings of the company is shown in Note 41 on the accounts. 'RBS Group' comprises the holding company and its subsidiary and associated undertakings.

The financial statements of The Royal Bank of Scotland Group plc can be obtained from RBS Corporate Governance and Regulatory Affairs, RBS Gogarburn, Edinburgh, EH12 1HQ, the Registrar of Companies or through the RBS Group's website rbs.com

Following placing and open offers in December 2008 and in April 2009, HM Treasury (HMT) owned approximately 70.3% of the enlarged ordinary share capital of the holding company. In December 2009, the holding company issued a further £25.5 billion of new capital to HMT in the form of B shares. HMT sold 630 million of its holding of the holding company's ordinary shares in August 2015. In October 2015 HMT converted its entire holding of 51 billion B shares into 5.1 billion new ordinary shares of £1 each in the holding company.

The final dividend payment on the Dividend Access Share (DAS) owned by HMT of £1.2 billion was paid in March 2016 effecting the immediate retirement of the DAS which was redesignated as a single B share and subsequently cancelled.

At 31 December 2017, HMT's holding in the holding company's ordinary shares was 70.5%.

RBS Group ring-fencing

The UK ring-fencing legislation requiring the separation of essential banking services from investment banking services will take effect from 1 January 2019.

To comply with these requirements it is the RBS Group's intention to place the majority of the UK and Western European banking business in ring-fenced banking entities under an intermediate holding company. NatWest Markets will be a separate non ring-fenced bank, and RBSI Holdings will also be placed outside the ring-fence, both as direct subsidiaries of RBS Group.

The final ring-fenced legal structure and the actions to be taken to achieve it, remain subject to, amongst other factors, additional regulatory, Board and other approvals as well as employee information and consultation procedures. All such actions and their respective timings may be subject to change, or additional actions may be required, including as a result of external and internal factors including further regulatory, corporate or other developments.

On 1 January 2017 the RBS Group made a number of key changes to the legal entity structure as detailed below to support the move towards a ring-fenced structure. There are also plans to make further changes prior to 1 January 2019.

November 2017

On 21 November 2017, The Royal Bank of Scotland plc (RBS plc) applied to the Court of Session in Edinburgh (the Court) to initiate a "Ring-Fencing Transfer Scheme" (RFTS) under the Financial Services and Markets Act 2000, including:

- Transfer the UK retail and Commercial banking business to Adam & Company PLC (Adam);
- Transfer the covered bonds in issue and Mentor business to NatWest; and
- Transfer branches and other properties to either NatWest or Adam.

The RFTS is expected to take effect over the weekend of 28-30 April 2018. At the same time, RBS plc will be renamed "NatWest Markets Plc", Adam will be renamed "The Royal Bank of Scotland plc" and assume banknote-issuing responsibility.

May 2018

In May 2018, the RBS Group intends to commence, in the Court of Session, a second RFTS to transfer certain derivatives from NatWest to NatWest Markets Plc (previously RBS plc). If approved by the Court, the transfers are expected to be implemented in August 2018.

July 2018

In July 2018, the RBS Group plans to restructure NatWest Markets Plc (previously RBS plc) capital structure via a Court approved capital reduction. As part of this restructure, the shares in NatWest Holdings, which owns the ring-fenced sub-group, will be distributed to RBSG. This will separate the ring-fenced sub-group from the non-ring-fenced entities, as required by the ring-fencing legislation.

January 2019

Once the RFTS, other restructuring and the ring-fencing legislation is in force:

Ring-fenced activities

- RBS plc (previously Adam) will manage the RBS branded banking business in its UK branch network;
- NatWest will continue to manage NatWest branded banking business and its branch network in the UK and Western Europe;
- NatWest will operate as the shared service provider to the rest of the group and will act as the market-facing arm for the ring-fenced banking group's payments and hedging activities;
- Adam will continue to be a trading name of RBS plc (previously Adam) and will continue to operate its private banking and wealth management activities;
- Coutts & Company will continue its private banking and wealth management activities; and
- Ulster Bank Limited and Ulster Bank Ireland DAC will continue to operate in Northern Ireland and the Republic of Ireland respectively.

Non-ring-fenced activities

- NatWest Markets Plc will continue to undertake RBS's trading and investment banking activities; and
- RBS International Limited (RBSI), along with Isle of Man Bank, will continue to serve the markets and customers today. In addition, RBSI becomes the focal point for funds banking activity through its recently opened London branch.

Business structure

Disposal groups and discontinued operations

NatWest Holdings Limited (NatWest Holdings)

The transfer of the Group's Personal & Business Banking (PBB) (including the former Williams & Glyn segment), Commercial & Private Banking (CPB) and certain parts of Central items and NatWest Markets, due to be included in the ring-fenced bank, to subsidiaries of NatWest Holdings, is planned for Q2 2018. It will be followed by a transfer of NatWest Holdings to RBSG. Accordingly, all of the activities to be undertaken by NatWest Holdings and its subsidiaries are classified as disposal groups at 31 December 2017 and presented as discontinued operations, with comparatives re-presented. UK Personal and Business Banking, Ulster Bank RoI, Commercial Banking and Private banking are no longer reportable segments

RBS International

The Royal Bank of Scotland International (Holdings) Limited (RBSI Holdings), which was mainly reported in the RBS International reporting segment, was sold to RBSG on 1 January 2017 in preparation for ring-fencing. RBSI Holdings was classified as a disposal group at 31 December 2016 and its assets and liabilities presented in aggregate in accordance with IFRS 5. RBS International is no longer a reportable segment

RBS Holdings N.V. (formerly ABN AMRO Holding N.V.)

In 2017 NatWest Markets announced its plan to repurpose the existing licence in the Netherlands. This proposed approach should minimise disruption to the business and allow it to continue to serve customers in the event of any loss of EU passporting, as a result of the UK's departure from the EU. NatWest Markets and RBS N.V are working together to ensure the banking licence is maintained and the entity is made operationally ready. In parallel, work continues to decrease the RBS N.V. legacy assets and liabilities further.

Segmental reporting

Segmental reorganisation and business transfers

The Group continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. To support this, and in preparation for the UK ring-fencing regime the previously reported operating segments were realigned in Q4 2017 and a number of business transfers completed.

Segmental reorganisation the previously reported operating segments are now realigned and comparatives have been re-presented as follows:

- The former Capital Resolution reported operating segment has been integrated into the NatWest Markets reportable segment, with the exception of the costs in relation to the retail mortgage backed securities (RMBS) claims, which have been transferred to the Central & Other items reportable segment.

Business transfers - on 1 October 2017 the following changes were made to Group's businesses, which impacts its financial reporting but where comparatives have not been re-presented:

- Shipping and other activities, which were formerly in Capital Resolution, were transferred from NatWest Markets to Commercial Banking business which is classified as disposal groups at 31 December 2017.
- Commercial Banking whole business securitisations and relevant financial institutions (RFI) were transferred to NatWest Markets during December 2017. RFIs are prohibited from being within the ring-fence due to their nature and exposure to global financial markets, the move is in preparation for the implementation of the UK ring-fencing regime.

Reportable operating segments

Following the changes in relation to the segmental reorganisation and the transfers to disposal groups the reportable operating segments are as follows:

NatWest Markets offers its customers global market access, providing them with trading, risk management and financing solutions through its trading and sales operations in London, Singapore and Stamford and sales offices in Dublin, Hong Kong and Tokyo; and

Central items & other includes balances in relation to legacy litigation issues and disposal groups in the relevant periods

Results and dividends

The loss attributable to the ordinary shareholders of the Group for the year ended 31 December 2017 was £49 million compared with a loss of £4,790 million for the year ended 31 December 2016, as set out in the consolidated income statement on page 82.

The Bank did not pay a dividend on ordinary shares in 2017 or 2016.

Strategic report

Activities

The Group is engaged principally in providing a wide range of banking and other financial services.

Risk factors

The Group's future performance and results could be materially different from expected results depending on the outcome of certain potential risks and uncertainties. Full details of these and other risk factors are set out on pages 189 to 222.

The reported results of the Group are also sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of the Group's critical accounting policies and key sources of accounting judgments are included in Accounting policies on pages 87 to 99.

The Group's approach to risk management, including its financial risk management objectives and policies and information on the Group's exposure to price, credit, liquidity and cash flow risk, is discussed in the Capital and risk management section.

Financial performance

A review of the Group's performance during the year ended 31 December 2017 and the Group's financial position as at that date is contained in the Financial review on pages 8 to 12.

Employees

Our colleagues

As at 31 December 2017, the Group employed 71,200 people (full-time equivalent basis, including temporary workers) in continuing and discontinuing operations throughout the world. Details of related costs are included in Note 3 on the consolidated accounts. The Board of Directors has considered ring-fencing preparations during the year and in advance of the legislation taking effect on 1 January 2019.

Engaging our colleagues is critical to delivering on our strategy and ambition as a bank. Further details on our approach can be found on page 33 and 34 of the RBS Group strategic report.

Building a healthy culture

Building a healthy culture that embodies Our Values is one of RBS Group’s core priorities.

Our Values guide the way the RBS Group identify the right people to serve our customers well, and how the RBS Group manage, engage and reward colleagues. They are at the heart of both Our Standards (the bank wide behavioural framework) and Our Code (the bank wide Code of Conduct).

Engaging our colleagues

The RBS Group know that building an engaged, healthy and inclusive workforce is crucial to achieving our ambition. Every year RBS Group asks colleagues to share their thoughts on what it’s like to work here via our annual colleague survey.

The 2017 results were the most positive we’ve seen in recent times. Key measures of engagement, leadership and our culture have improved significantly, and the RBS Group are now above the global financial services norm in the majority of our survey categories.

Rewarding our colleagues

Our approach to performance management provides clarity for colleagues about how their contribution links to our ambition. It recognises behaviour that supports our values and holds individuals to account for behaviour and performance that does not.

The RBS Group have a focus on paying the right wage to colleagues and the RBS Group rates of pay continue to exceed the Living Wage Foundation Benchmarks.

Developing our colleagues

The RBS Group continued to deliver ‘Determined to Lead’, which is the core management system for the bank. It provides consistent tools to lead and engage colleagues. This programme has continued in 2017 with over 3,000 leaders participating.

In 2017 we launched the next stage in Service Excellence training, our customer service programme and had over 16,000 colleagues complete Level one.

Professionalising colleagues is important to the RBS Group. We continue to work closely with the Chartered Banker Institute (CBI) and Chartered Banker Professional Standards Board (CB:PSB) to offer RBS Group colleagues professional qualifications. In 2017 over 3,000 colleagues completed their CBI qualification and 96% completed the training element of the CB:PSB Foundation Standard.

The RBS Group also offer a wide range of additional learning opportunities.

Youth Employment

In 2017, we welcomed 471 people across the RBS Group Graduate and Apprenticeship schemes as well as around 150 Summer Interns.

Health and wellbeing of our colleagues

Wellbeing is a strong foundation for making the RBS Group a great place to work. For the third year running the RBS Group participated in the Global Challenge (formerly GCC) and with 34,000 colleagues taking part we won the Global Challenge 1st Most Active Organisation Financial Industry. Building on this success, we embraced the rapid acceleration of digital wellbeing and are one of the few large organisations to pilot a digital wellbeing platform.

During 2017 the RBS Group has continued to support Time to Change (removing the stigma of mental health) and actively encouraged open dialogue across the bank to support Mental Health in the Workplace.

The RBS Group were successful in running bankwide major online campaigns to support Mental Health Awareness Week and World Mental Health Day.

As the RBS Group continue to support our colleagues through change we have fully utilised the services of our Employee Assistance Programme.

Employee consultation

The RBS Group recognise employee representatives such as trade unions and work councils in a number of businesses and countries. There has been ongoing engagement and discussion with those bodies given the scale of change taking place across the RBS Group. Management have continued to meet regularly with our European Employee Council to discuss developments and update on the progress of our strategic plans.

Inclusion

Building a more inclusive RBS Group is essential for our customers and colleagues. Our inclusion policy standard applies to all our colleagues globally.

During 2017, we continued to roll out unconscious bias learning to all RBS Group colleagues (over 70,000 trained, to date) to create a solid platform for the wider inclusion agenda.

The RBS Group continue to work towards our goal of having at least 30% senior women in our top three leadership layers across each Franchise and Function by 2020 and to be fully gender balanced (50/50) by 2030. We have a positive action approach in place, tailored by business, according to the specific challenges they face.

The RBS Group disability plan for training, career development and promotion of disabled persons employed by the company will support us becoming a disability smart organisation, with upper quartile performance, by 2018.

We continue to focus on building an ethnically diverse RBS Group. We will introduce explicit targets for BAME representation at senior levels in 2018.

Our LGBTQ agenda continues to deliver a better experience for our LGBTQ colleagues and customers. The RBS Group have processes in place to support updating gender and title on customers' banking records and to support colleagues undergoing gender transition.

The RBS Group have been recognised for our work on Equality, Diversity and Inclusion by retaining our Platinum ranking from Opportunity Now (gender), retaining our Gold ranking for Race for Opportunity (race); retaining a position in the Times Top 50 Employers for Women; becoming a Top Ten Global Employer in Stonewall's Global Equality Index (LGBT), Silver Status from The Business Disability Forum and being rated a Top 10 Employer by Working Families. In 2017 we were proud to be named 'Diverse Company of the Year' at the National Diversity Awards and winning Workplace Adjustments Innovation of the Year at the Disability Smart Awards.

The RBS Group continue to support our c.20,000 strong employee-led networks.

Going concern

The Group's business activities and financial position, the factors likely to affect its future development and performance and its objectives and policies in managing the financial risks to which it is exposed and its capital are discussed in the Financial review. The risk factors which could materially affect the Group's future results are set out on pages 189 to 222. The Group's regulatory capital resources and significant developments in 2017 and anticipated future developments are detailed on pages 30 to 32. The liquidity and funding section on pages 33 to 34 describes the Group's funding and liquidity profile, including changes in key metrics and the build up of liquidity reserves.

Having reviewed the Group's forecasts, projections and other relevant evidence, the directors have a reasonable expectation that the Group and the company will continue in operational existence for the foreseeable future. Accordingly, the financial statements of the Group and of the company have been prepared on a going concern basis.

Corporate governance

Internal control over financial reporting

The internal controls over financial reporting for the Group are consistent with those at the RBS Group level. The RBS Group is required to comply with Section 404 of the US Sarbanes-Oxley Act of 2002 and assess the effectiveness of internal control over financial reporting as of 31 December 2017.

The RBS Group has assessed the effectiveness of its internal control over financial reporting as of 31 December 2017 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in the 2013 publication of 'Internal Control - Integrated Framework'.

Based on its assessment, management has concluded that, as of 31 December 2017, the RBS Group's internal control over financial reporting is effective.

The RBS Group's auditors have audited the effectiveness of the RBS Group's internal control over financial reporting and have given an unqualified opinion.

Management's report on the RBS Group's internal control over financial reporting will be filed with the Securities and Exchange Commission as part of the RBS Group's 2017 Annual Report on Form 20-F.

Board of directors

The Board is the main decision-making forum for the Bank. It has overall responsibility for management of the business and affairs of the Group, the establishment of Group strategy and the allocation and raising of capital, and is accountable to shareholders for financial and operational performance. The Board considers strategic issues and ensures the Group manages risk effectively through approving and monitoring the Group's risk appetite, considering Group stress scenarios and agreed mitigants and identifying longer term strategic threats to the Group's business operations. The Board's terms of reference includes key aspects of the Bank's affairs reserved for the Board's decision and are reviewed at least annually.

There are a number of areas where the Board has delegated specific responsibility to management, including the Chief Executive and the Chief Financial Officer. These include responsibility for the operational management of the Group's businesses as well as reviewing high level strategic issues and considering risk appetite, risk policies and risk management strategies in advance of these being considered by the Board and/or its Committees.

Specific delegated authorities are also in place in relation to business commitments across the Group.

The roles of Chairman and Chief Executive are distinct and separate, with a clear division of responsibilities. The Chairman leads the Board and ensures the effective engagement and contribution of all executive and non-executive directors.

The Chief Executive has responsibility for all Group businesses and acts in accordance with authority delegated by the Board. The non-executive directors combine broad business and commercial experience with independent and objective judgement and they provide independent challenge to the executive directors and the leadership team.

The Group Audit Committee comprises at least three independent non-executive directors and assists the Board in discharging its responsibilities for the disclosure of the financial affairs of the Group. It reviews the accounting policies, financial reporting and regulatory compliance practices of the Group, the Group's system and standards of internal controls, and monitors the Group's processes for internal audit and external audit and reviews the practices of the segmental Risk and Audit Committees.

The Board Risk Committee comprises at least three independent non-executive directors. It provides oversight and advice to the Board on current and potential future risk exposures of the Group and risk strategy. It reviews the Group's performance on risk appetite and oversees the operation of the Group Policy Framework.

The Group Performance and Remuneration Committee comprises at least three independent non-executive directors and has oversight of the Group's policy on remuneration. It also considers senior executive remuneration and makes recommendations to the Board on remuneration of executive directors.

The Group Nominations and Governance Committee comprises four non-executive directors, and is chaired by the Chairman of the Group. It is responsible for assisting the Board in the formal selection and appointment of directors. It reviews the structure, size and composition of the Board, and membership and chairmanship of Board committees. The Committee also has responsibility for monitoring the Group's governance arrangements in order to ensure best corporate governance standards and practices are upheld.

The Technology and Innovation Committee comprises of independent non-executive directors. Recognising the strategic importance of technology and innovation to the RBS Group's business, the Board established a new Board Committee in August 2017.The Technology and Innovation Committee is responsible for assisting the Board in overseeing and monitoring execution of our strategic direction in relation to technology and innovation. Alison Davis chairs this new committee, supported by Frank Dangeard, and Yasmin Jetha as members.

The Sustainable Banking Committee comprises of independent non-executive directors. It is responsible for overseeing and challenging how management is addressing sustainability and reputation issues relating to all stakeholder groups, except where such issues have already been dealt with by other Board committees.

The Executive Committee comprises the Group's most senior executives and supports the Group Chief Executive in managing the Group's businesses. It reviews strategic issues and initiatives, monitors financial performance and capital allocations, and considers risk strategy, policy and risk management.

Share capital
Details of the ordinary and preference share capital at 31 December 2017 are shown in Note 25 on the accounts.

Directors
The names of the current directors are shown on page 2.

Howard Davies, Alison Davis, Frank Dangeard, Morten Friis, Robert Gillespie, Penny Hughes, Ross McEwan, Brendan Nelson, Baroness Noakes, Mike Rogers and Ewen Stevenson all served throughout the year and to the date of signing the financial statements.

Sandy Crombie stepped down as director on 1 January 2018. John Hughes was appointed to the Board on 21 June. Unfortunately John subsequently resigned as a director on 1 September 2017, due to health issues. Yasmin Jetha was appointed on 21 June 2017 and became a member of the Sustainable Banking Committee and Technology and Innovation Committee. Mark Seligman was appointed on 1 April 2017 and assumed the role of Senior Independent Director on 1 January 2018. Dr Lena Wilson was appointed on 1 January 2018 and became a member of the Sustainable Banking Committee on the 31 January 2018.

All directors of the company are required to stand for election or re-election annually by shareholders at the Annual General Meeting.

Directors' interests
The interests of the directors in the shares of the holding company at 31 December 2017 are disclosed in the Report and Accounts of that company. None of the directors held an interest in the loan capital of the holding company or in the shares or loan capital of the Bank or any of the subsidiaries of the Bank, during the period from 1 January 2017 to 22 February 2018.

Directors' indemnities
In terms of section 236 of the Companies Act 2006 (the "Companies Act"), Qualifying Third Party Indemnity Provisions have been issued by the holding company to its directors, members of the Group's Executive Committee, individuals authorised by the PRA/FCA and certain directors and/or officers of the Group's subsidiaries.

In terms of section 236 of the Companies Act, Qualifying Pension Scheme Indemnity Provisions have been issued to all trustees of the Group's pension schemes.

Post balance sheet events
Other than the matter disclosed in Note 40 on the accounts, there have been no significant events between the year end and the date of approval of these accounts which would require a change to or disclosure in the accounts.

Political donations
During 2017, no political donations were made in the UK or EU, nor any political expenditure incurred in the UK or EU.

Directors' disclosure to auditors
Each of the directors at the date of approval of this report confirms that:

(a) so far as the director is aware, there is no relevant audit information of which the Bank's auditors are unaware; and

(b) the director has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the Bank's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act.

Auditors
EY LLP are the auditors. The auditors, EY LLP, have indicated their willingness to continue in office. A resolution to re-appoint EY LLP as the company's auditors will be proposed at the forthcoming Annual General Meeting.

By order of the Board
Aileen Taylor

Company Secretary
22 February 2018

The Royal Bank of Scotland plc
is registered in Scotland No. SC90312.

Statement of directors' responsibilities

This statement should be read in conjunction with the responsibilities of the auditor set out in their report on page 67.

The directors are responsible for the preparation of the Annual Report and Accounts. The directors are required by Article 4 of the IAS Regulation (European Commission Regulation No 1606/2002) to prepare Group accounts, and as permitted by the Companies Act 2006 have elected to prepare Bank accounts, for each financial year in accordance with International Financial Reporting Standards as adopted by the European Union. They are responsible for preparing accounts that present fairly the financial position, financial performance and cash flows of the Group and the Bank. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the Annual Report and Accounts complies with the Companies Act 2006. They are also responsible for safeguarding the assets of the Bank and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors confirm that to the best of their knowledge:

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

By order of the Board

Howard Davies
Chairman

Ross McEwan
Chief Executive

Ewen Stevenson
Chief Financial Officer

22 February 2018

Board of directors

Chairman
Howard Davies

Executive directors
Ross McEwan
Ewen Stevenson

Non-executive directors
Frank Dangeard
Alison Davis
Morten Friis
Robert Gillespie
Penny Hughes
Yasmin Jetha
Brendan Nelson
Sheila Noakes
Mike Rogers
Mark Seligman
Dr Lena Wilson

Financial statements

Opinion

We have audited the financial statements (see table below) of The Royal Bank of Scotland plc (the Parent Company) and its subsidiaries (together, the 'Group') for the year ended 31 December 2017. In our opinion:

- the financial statements of The Royal Bank of Scotland plc (the Bank) and its subsidiaries (together, the 'Group') give a true and fair view of the state of the Group's and of the Bank's affairs as at 31 December 2017 and of the Group's profit for the year then ended;
- the financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Bank financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of The Royal Bank of Scotland plc which comprise:

Group	Bank
• Consolidated balance sheet as at 31 December 2017; • Consolidated income statement for the year then ended; • Consolidated statement of comprehensive income for the year then ended; • Consolidated statement of changes in equity for the year then ended; • Consolidated cash flow statement for the year then ended; • Related notes 1 to 41 to the financial statements; • Accounting Policies on pages 88 to 199; and • Capital and risk management section of the Business review except information identified as 'unaudited' on pages 13 to 59.	• Balance sheet as at 31 December 2017; • Statement of changes in equity for the year then ended; • Cash flow statement for the year then ended; and • Related notes 1 to 41 to the financial statements which refer to the Bank.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the Bank financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Group and Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Conclusions relating to going concern

In relation to the ISAs(UK) which require us to report to you, we have nothing to report in respect of the following matters:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Group's or the Bank's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in the accounting policies, in addition to complying with its legal obligation to apply IFRSs as adopted by the European Union, the Group has applied IFRSs as issued by the International Accounting Standards Board (IASB). In our opinion the Group financial statements comply with IFRSs as issued by the IASB.

Overview of our audit approach

Key Audit Matters	• Provisions for conduct, litigation and regulatory matters, customer remediation and claims. • Future profitability estimates impacting the recognition of deferred tax, impairment in goodwill and, in the Bank accounts, investments in subsidiaries. • Impairment of loans and advances. • Valuation of financial instruments with higher risk characteristics including related income from trading activities. • Hedge effectiveness testing including the impact on non-interest income. • Costs recharged to or from other RBS Group companies (applicable to the Bank only) • Provision for restructuring costs. • Pension valuation and obligations. • IT access management.
Audit scope	• The significant components of our audit cover the reportable segments identified in the financial statements together with the central functions of the Group based in the UK and overseas and include Finance, the Services function and Treasury. • We performed an audit of the complete financial information of two components. • The components where we performed full or specific audit procedures accounted for 93% or more of Group total income, equity and total assets.
Materiality	Overall Group materiality has been set at £220 million which represents 0.6% of total equity.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk
Provisions for conduct, litigation and regulatory matters, customer remediation and claims	
The continued litigious environment and the heightened regulatory scrutiny gives rise to a high level of judgement in determining appropriate provisions and disclosures. At the year end, the Group has reported £7.6 billion (2016: £11.8 billion) of provisions for liabilities and charges, including £5.6 billion (2016: £10.1 billion) for conduct and litigation claims (including balances in disposal groups), including RMBS, PPI and the FCA review of RBS's treatment of SMEs as detailed in Note 21 of the financial statements on page 143. Management judgement is needed to determine whether an obligation exists and a provision should be recorded at 31 December 2017 in accordance with the accounting criteria set under IAS 37. This includes determining if: • It is probable that an economic outflow such as a payment will occur; and • The amount of the payment (or other economic outflow) can be estimated reliably. The measurement of the provision is based on the best estimate of the expenditure required to settle the present obligation. The most significant areas of judgement are: • Completeness of provisions recognised: judgement is in the determination of whether an outflow in respect of identified material conduct matters are probable or can be estimated reliably; • Measurement of provisions recognised: appropriateness of assumptions and judgements used in the estimation of material provisions; and • Adequacy of disclosures of provision for liabilities and charges and contingent liabilities.	We tested the design and operating effectiveness of the Group's key controls over the identification, estimation, monitoring and disclosure of provisions considering the potential for management override of controls. The controls tested included those designed and operated by management to identify and monitor claims, assess the completeness and accuracy of data used to estimate provisions. We examined the relevant regulatory correspondence to assess developments in key cases, the Group's complaint handling reports and litigation reports to identify potentially material cases. For cases where a provision was not recognised, we considered whether the outcome was probable and reliably estimable in accordance with the accounting criteria. For the significant provisions made, we understood, assessed and challenged the provisioning methodology. We tested the underlying data and assumptions used in the determination of the provisions recorded, including expected claim rates, legal costs, and the timing of settlement. We also considered peer bank settlements in similar cases, We sent external confirmations to the Group's external counsel for significant matters and corroborated management's conclusion by independently obtaining the underlying information used in estimating the provisions. Where appropriate, we involved our conduct risk specialists. For key cases we considered the regulatory developments and management's interaction with the Regulators and concluded on the reasonableness of the assumptions used by management also by comparing the results of our independently performed benchmarking and sensitivity analysis. We also verified historical data and whether they supported current estimates. In addition, we attended key management meetings and reviewed minutes of legal and conduct provision committee meetings to conclude on the effectiveness of management's review controls and the appropriateness of the conclusions reached We tested the disclosure provided on conduct, litigation and regulatory provisions to determine whether it complied with accounting standards. Given the inherent estimation uncertainty and the judgmental nature of these provisions, we evaluated the appropriateness of the disclosure made in the financial statements.

Key observations communicated to the Group Audit Committee

We are satisfied that the Group's provisions for conduct, litigation and regulatory matters, customer remediation and claims are within a reasonable range and recognised in accordance with IFRS. We did not identify any material unrecorded provisions.

We highlighted the following matters:

- In assessing and evaluating the total U.S. RMBS provision of £3.2 billion, management and the Board considered other industry settlements and claims. It is a reasonable reflection of the Group's current position given the prevailing uncertainty as to the outcome of the remaining discussions with the U.S. Department of Justice and other parties. The risk of future material additional charges is appropriately disclosed in the financial statements;
- The PPI provision remains sensitive to key assumptions, the most significant of which is future complaint volumes. Management's estimate was within our range of outcomes based on reasonable alternative assumptions; and
- The provision related to the FCA review of the Group's treatment of SMEs is sensitive to a number of assumptions. Management's estimate is within an acceptable range based on the current information available to us.

Relevant references in the Annual Report and Accounts

Accounting policies (page 88)

Note 21 of the financial statements (page 143)

Risk	Our response to the risk
Future profitability estimates impacting the recognition of deferred tax and the impairment of goodwill and, in the Bank accounts, investments in subsidiaries.	
The recognition and carrying value of deferred tax assets, goodwill and, in the Bank accounts, investments in subsidiaries are based on estimates of future profitability which require significant management judgement. At year end the Group had reported Goodwill of £5.2 billion (2016: £5.5 billion) and deferred tax assets of £1.8 billion including amounts in disposal groups (2016: £1.8 billion). The Bank has reported investments in subsidiaries of £33.5 billion, including amounts in disposal groups (2016: £35.8 billion). In testing for impairment, the Group estimates the value in use of its cash generating units based on the business forecasts. • Revenue and cost forecasts impacted by the Group's transformation programme and reorganisation,business and strategic changes underway and the changing competitive environment; • Key assumptions used in the recoverability and valuation assessments (discount rates, growth rates, macroeconomic assumptions, etc.); and • Assumptions regarding the economic consequences of Brexit and other political developments over an extended period. The recognition of deferred tax assets considers the future profit forecasts of the legal entities as well as interpretation of recent changes to tax rates and laws.	We tested the design and operating effectiveness of the Group's key controls around the preparation and review of the forecasts. We tested the controls over the value in use model including the significant assumptions, inputs, calculations, methodologies and judgements. With the support of our valuation specialists, we tested whether key macroeconomic assumptions used in the Group's forecasting process were reasonable. We evaluated how the discount rates and long term growth rates used by management compared to peer practice, external market data and corroborative calculations. We considered the Group's cost reduction programme and the extent to which annual cost reductions had been met. We assessed the achievability of future cost reduction plans including considering how these compared to peer banks and the external commentary. We also considered the results of the independent review of the forecasts undertaken by the Risk function and management's challenge of the carrying values and key assumptions in relevant executive committees of the Group. We tested how previous management forecasts compared to actual results to evaluate the accuracy of the forecasting process. We also assessed how these forecasts impacted the carrying value of deferred tax, goodwill and investments. We evaluated how management considered alternative assumptions and performed sensitivity analysis on the assumptions used. We considered how key events, such as Banking Structural Reform and Brexit impacted management's estimates. We performed our own scenario analysis for certain assumptions we considered could have a significant impact on the results of the impairment tests. With the support of our taxation specialists, we assessed the estimate of future taxable profits to calculate the level of deferred tax assets recognised on the balance sheet including the time horizon used for recoverability of losses and other temporary differences. In addition, we attended and observed management meetings where key judgements were discussed, including those used in the value in use model and the carrying value of deferred tax assets. We also reviewed Board and Executive Committee minutes to assess the effectiveness of management's review process and the appropriateness of the conclusions reached.

Key observations communicated to the Group Audit Committee

We are satisfied that the carrying values of deferred tax assets, goodwill and, in the parent company accounts, investments in subsidiaries are reasonable and the related disclosures are in compliance with IFRS. We highlighted the following:

- Results of our sensitivity analysis of the value in use and headroom to changes in the key assumptions in the forecasts including the long term growth rate, discount rate and factors impacting the underlying level of profitability both at a Group level and for individual segments;
- Sensitivity of the goodwill and the investment in subsidiaries to the Group's forecast cost reduction and the impact of the amount and timing of actual cost reductions achieved; and
- Inherent uncertainty of the five year forecasts and the difficulty predicting revenue and costs over this period, particularly with respect to the impact of Banking Structural Reform, the economic consequences of Brexit and other political developments, and disruptions in the business model over an extended period.

Relevant references in the Annual Report and Accounts

Accounting policies (page 88)
Note 15 (page 137), Note 16 (page 138) and Note 23 (page 145) of the financial statements.

Risk	Our response to the risk
Impairment of loans and advances	
A significant degree of judgement is required to determine the timing and amount of impairment to recognise with respect to loans and advances. At year end the Group reported total gross loans and advances of £375.3 billion (2016: £387.8 billion) (including balances in disposal groups) and impairment provisions of £3.8 billion (2016: £4.4 billion). We have focused on the following significant judgements and estimates which could give rise to material misstatement or management bias: • Completeness and timing of recognition of loss events in accordance with criteria set out in IAS 39; • For individually assessed provisions, the measurement of the provision may be dependent on the valuation of collateral, estimates of exit values and the timing of cash flows; • For modelled provisions measurement is primarily dependent upon key assumptions relating to probability of default, ability to repossess collateral and recovery rates; and • Completeness and valuation of post model adjustments.	We tested the design and operating effectiveness of key controls focussing on the following: • Identification of loss events, including early warning and default warning indicators; • Annual credit reviews; • Assessment and approval of individual impairment provisions; • Governance including model validation and the assessment of the suitability of models, appropriateness of assumptions, consideration of post model adjustments and approval of provisions; and • Completeness and accuracy of data input into models and provision calculators. In addition, we periodically attended and observed risk committee and provision committee meetings. For modelled provisions we tested data inputs and agreed a sample of data used in the models and calculators to source systems. We used our credit risk specialists to test the assumptions and calculations. We evaluated the methodology to establish model parameters and assessed the appropriateness of the models used. We performed code reviews for a sample of models and calculators. Where possible, assumptions were benchmarked against Pillar 3, EBA stress tests and our internally developed ranges. Where post model adjustments were made as a result of limitations in existing models, we confirmed the extent of the model shortcoming, recalculated and assessed the appropriateness of the adjustment. Based on current economic and market circumstances, we considered the need for sector or systemic overlay adjustments. In Ulster Bank RoI we specifically focused on key data inputs and model parameters, including probabilities of modelled outcome and collateral haircuts and reviewed management's back testing of key assumptions.

Risk	Our response to the risk
Impairment of loans and advances	
	To test the completeness of the identification of loans with loss events we selected a sample of performing loans and independently assessed whether any IAS 39 loss indicators were present. For loans individually assessed for impairment we based our sample on factors including high risk sectors such as shipping, construction, oil and gas and commercial real estate. With input from our valuation specialists we formed an independent view of collateral or exit values, cash flow assumptions and exit strategies. We re-performed the discounted cash flow calculations and compared our measurement outcome to that prepared by management and investigated any differences arising. We assessed the appropriateness and presentation of disclosures against relevant accounting standards.

Key observations communicated to the Group Audit Committee

We are satisfied that credit impairment provisions were reasonable and in compliance with IFRS. We highlighted the following:

- Our testing of controls did not identify significant deficiencies.;
- Our testing of models and model assumptions did not highlight material differences. For individually assessed impairments, in a few instances we reported judgemental differences in respect of the extent of the impairment identified, however none of these differences were considered material.; and
- Overall, we were satisfied with the completeness of the identification of loss events.

Relevant references in the Annual Report and Accounts

Accounting policies (page 88)
Note 11 of the financial statements (page 130)

Risk	Our response to the risk
Valuation of financial instruments with higher risk characteristics including related income from trading activities	
The valuation of financial instruments with higher risk characteristics involves both significant judgment and risk of inappropriate revenue recognition through mis-marking. The judgement in estimating fair value of these instruments can involve complex valuation models and significant fair value adjustments both of which may be reliant on data inputs where there is limited market observability. At year end RBS Plc reported level 3 assets £2.7 billion (2016: £4.4 billion) and level 3 liabilities £2.1 billion (2016: £2.9 billion). The potential risk of inappropriate recognition of revenue is most likely to arise through the valuation of these instruments given the level of management judgement involved. The key judgements and estimates are: • Complex model-dependent valuations, which are aligned with material pricing models as defined by the RBS Modelled Product Review Committee. These include interest-rate swaps linked to pre-payment behaviour and interest rate and foreign exchange options with exotic features such as those having multiple call dates or with a variable notional; • Pricing inputs and calibrations for illiquid instruments, which are largely aligned with material positions defined as level 3 within RBS's IFRS 7 fair value hierarchy disclosure. These include rarely traded debt securities, and derivative instruments whose valuation is dependent upon the correlation between certain interest rates or uncertainty surrounding the discount rate associated with complex collateral arrangements;	We performed trade life-cycle product walkthroughs to confirm our understanding of RBS's process and controls in the area of revenue recognition relating to financial instruments with higher risk characteristics. We tested the design and operating effectiveness of the Group's controls over financial instrument valuations, including independent price verification, model approval/review, collateral management and income statement analysis and reporting. We performed further procedures as set out below for each risk characteristic with involvement from our financial instrument valuation and modelling specialists. These procedures were performed at multiple points in the year to validate the appropriateness of revenue recognition. Our testing on complex model-dependent valuations involved the specialist review of detailed model documentation and use of internally developed EY challenger models to analyse and challenge judgements and assumptions applied within each relevant model. Our re-pricing of instruments valued using illiquid pricing inputs covered material products associated with this risk and the results were compared to the valuations recorded by management. For a sample of derivatives, our valuation testing used independent models and data .For cash positions analytical procedures were performed to validate the population of identified illiquid positions and, prices of comparable positions and other data points were used to independently value these.

Risk	Our response to the risk
Valuation of financial instruments with higher risk characteristics including related income from trading activities	
• Fair value adjustments made to uncollateralised derivatives to reflect funding risk, counterparty credit risk and other product and deal specific considerations. These include RBS's Funding Valuation Adjustments (FVA),Credit Valuation Adjustments (CVA) relating to derivative counterparties whose credit spread is less readily able to be determined, and material product and deal specific adjustments on long dated uncollateralised derivative portfolios; and • The manipulation of revenue recognition is most likely to arise through the inappropriate valuation of these instruments given the level of management judgement involved.	Our testing of fair value adjustments for counterparty credit, funding risk and other product and deal specific considerations on uncollateralised derivatives involved: (i) comparing valuation judgements applied by management to our knowledge of current industry practice through benchmarking exercises (ii) re-valuing a sample of counterparty level FVA and CVA calculations using independent models, (iii) testing funding spreads to third party data and analysis of recent trade activity to verify the drivers of differences between book value and trade value, (iv) independent challenge of illiquid CVA inputs and (v) testing assumptions of material product and deal specific adjustments, including analysis of recent trade activity. Where differences between our independent valuation and management's valuation were outside our thresholds, we performed additional testing over each variance to support our assessment of the appropriateness of the fair value. This work included our own analysis of: (i) recent trade activity, involving trade exits to back-test key valuation judgements, (ii) collateral disputes and material differences with counterparty valuations, (iii) income statement attribution, particularly unexplained income statement in the year for the relevant instruments and (iv) associated valuation adjustments e.g. model fair value adjustments to reflect the associated uncertainty given lack of market data.

Key observations communicated to the Group Audit Committee

We are satisfied that the fair value of financial instruments with higher risk characteristics and the recognition of related income is reasonable and in accordance with IFRS.
We highlighted the following to the Group Audit Committee:

- Our independent valuation of a sample of derivatives were either within our threshold or, where initially outside, were corroborated by other data, for example, trade exit activity, valuation adjustments for model or data limitations, or benchmarking to peer practice. Valuations of hard-to-price cash positions were within our thresholds; and
- The Group's recognition of fair value adjustments on uncollateralised derivatives is within a reasonable range of outcomes based upon our testing procedures which included revaluation exercises, benchmarking to peer practice and experience from recent trade activity.

Relevant references in the Annual Report and Accounts

Accounting policies (page 88)
Note 9 of the financial statements (page 117)

Risk	Our response to the risk
Hedge effectiveness testing including the impact on non-interest income	
The Group undertakes fair value and cash flow hedge accounting programs to mitigate income statement volatility arising from the Group's activities. Hedge effectiveness testing for both of these programs is identified as a risk area because the application of accounting rules and execution of hedge effectiveness testing lead to significant adjustments to the balance sheet and income statement which are inherently complex and involve some management judgement. These adjustments impact non-interest income and there is an incentive to manipulate the hedge effectiveness results, to avoid undesirable income statement volatility. Any hedge ineffectiveness remains in the income statement. The hedge ineffectiveness for the Group is included in disposal groups for the year ended 31 December 2017 as the treasury business transferred from the Group in preparation for the UK ring-fencing regime. While the majority of the RBS process for hedge accounting is automated a risk arises that management design an effectiveness testing methodology that does not comply with IAS 39 requirements or manually override otherwise automated results to influence the income statement impact.	We tested the design and operating effectiveness of key controls including the performance, review and approval of monthly hedge effectiveness testing performed by management. We challenged the assumptions applied in testing hedge effectiveness in accordance with IAS 39. With the support of our hedge accounting specialists we independently re-performed a sample of hedge effectiveness tests. This included testing hedge relationships and manual adjustments made to the effectiveness assessment.
Key observations communicated to the Group Audit Committee	
We are satisfied that the Group has appropriately applied hedge accounting in accordance with IFRS. We highlighted that hedge ineffectiveness is correctly recorded in the income statement and we concurred with management's assessment that there are no hedge relationships that should have been discontinued. We concluded on the effectiveness of controls in place over hedge accounting as at year end.	
Relevant references in the Annual Report and Accounts	
Accounting policies (page 88) Note 12 of the financial statements (page 132)	

Risk	Our response to the risk
Costs recharged to or from other RBS Group companies (applicable to the Bank only)	
The majority of group-wide costs are paid centrally by the Bank and recharged to other RBS Group companies. The multi-layered nature of the Group operating structure combined with the total volume and value of transactions means there is a risk that recharged costs are inaccurate and therefore the total cost reported in the Bank may not be complete.	We tested the design and operating effectiveness of the Bank's key controls over the completeness and accuracy of cost recharges. This included understanding RBS Group's recharging processes and controls, including how management ensures the assessment is complete. We also tested a sample of cost recharges.
Key observations communicated to the Group Audit Committee	
We are satisfied that costs in the Group which have been charged to or from other RBS Group companies are reasonable. We highlighted the following: • The results of our testing of changes made during the year over the legal entity recharging process and the specific actions taken by management designed to enhance processes.; and • Further developments being taken in 2018 and that the majority of legal entity re-charging is now part of one process making it more streamlined.	
Relevant references in the Annual Report and Accounts	
Accounting policies (page 88)	

Risk	Our response to the risk
Provision for restructuring costs	
Transformation programmes as well as organisational changes lead to impairment, restructuring provisions and other severance payments. The timing and amount of restructuring costs recognised depend on management judgement to determine when the accounting criteria have been met to support recognition in the current period. At year end, the Group recorded total restructuring provisions of £478 million (2016 £430 million). Management judgement is needed to determine whether an obligation exists and a provision should be recorded at 31 December 2017 in accordance with the accounting criteria set under IAS 37. This includes determining if: • There is a legal or constructive obligation as a result of a past event; • It is probable that an economic outflow such as a payment will occur; and • The amount of the payment (or other economic outflow) can be estimated reliably. The most significant areas of judgement when recognising these costs are: • Determining whether a constructive obligation has been met. For example, has the Group indicated to other parties that it will accept certain responsibilities; and • Judgement involved in the measurement of the provision based on estimated costs.	We tested the design and operating effectiveness of the Group's key controls around the recognition and measurement of these restructuring costs. This included the review and approval of provisions recorded by finance and the estimate of the costs to record. We enquired of management involved in transactions to verify a proper understanding of the transactions and its impacts, both on accounting and disclosures. We obtained a breakdown of the direct and indirect restructuring costs recorded during the year. We selected a sample of provisions for restructuring costs and assessed them for compliance with IAS 37 by considering the criteria which outline when a constructive obligation has been met in order to recognise a provision. For staff costs, this included determining whether the plans had been communicated with employees. For premises and equipment, this included determining whether the unavoidable costs to execute the planned exit exceed the benefit. We assessed the measurement of the provision by testing the underlying data and assumptions used in estimating the amount recorded. We also assessed any impact to goodwill and intangibles.

Key observations communicated to the Group Audit Committee

We are satisfied that the restructuring costs are appropriately recorded and in compliance with IFRS. We highlighted the following:

- Timing of the recognition of certain restructuring provisions and the controls in place to estimate the amount of the provision and consider the relevant accounting judgements; and
- Our assessment of IAS37 criteria that resulted in differences that were not material being recorded by management.

Relevant references in the Annual Report and Accounts

Accounting policies (page 88)

Note 21 (page 143) of the financial statements.

Risk	Our response to the risk
Pension valuation and retirement benefit obligations	
RBS operates a number of defined benefit schemes which in total are significant in the context of the overall balance sheet. At year end the Group reported a net pension asset of £236 million (2016: £54 million liability). The valuations of the retirement benefit liabilities are calculated with reference to a number of actuarial assumptions and inputs including discount rate, rate of inflation and mortality rates. The net pension asset is sensitive to changes in the assumptions.	We tested the design and operating effectiveness of key controls over the completeness and accuracy of data extracted and supplied to the Group's actuaries, which is used to calculate the pension schemes' surplus or deficit. We also tested the controls associated with the actuarial assumptions setting process and the measurement of the fair value of the schemes' assets. We concluded that the key controls were designed, implemented and operated effectively. With the support of our actuarial specialists, we understood the judgements made in determining the assumptions used by management to value the retirement benefit liabilities and we challenged and verified whether these assumptions met the requirements of the applicable accounting standards , the specific circumstances of the schemes and their participants, and were in line with market practice,. Our audit procedures included an assessment of the methodology adopted by the actuaries in determining the assumptions,, a comparison of life expectancy assumptions with relevant mortality tables, benchmarking inflation and discount rates against external market data, considering changes in historical assumptions and evaluating the independence, qualifications and results of work performed by management's actuaries involved in the valuation process. We tested the fair value measurement of scheme assets by independently calculating a fair value for a sample of the assets held. Our sample included cash, equity instruments, derivative financial instruments and other assets. We also tested the existence of the sampled pension assets by obtaining written confirmation from the relevant pension asset custodian and by examining the relevant legal documentation. We also tested the actuaries' calculation of the pension liabilities by independently rolling forward the prior year figures allowing for the ageing of members, accrual of benefits over the year and changes in financial and demographic assumptions over the period. We read and tested the disclosures made in the financial statements, including the sensitivities to the key assumptions.

Key observations communicated to the Group Audit Committee

We are satisfied that the valuation and disclosure of the retirement benefit obligations recorded at 31 December 2017 is reasonable and in accordance with requirements of the relevant accounting standards.

We described and discussed the results of our internal benchmarking of key actuarial assumptions including the discount rate, inflation, mortality and pension payments. We concluded that assumptions tested are within a reasonable range. We also presented the results of our independent valuation of a sample of pension assets.

In determining the accounting for the pension schemes, we understood management's assessment of the impact of IFRIC 14 on the amount of the surplus recognised in the financial statements and verified its compliance with the applicable accounting standards.

Relevant references in the Annual Report and Accounts

Accounting policies (page 88)
Note 4 of the financial statements (page 103)

Risk	Our response to the risk
IT systems and controls	
Our audit procedures have a focus on IT systems and controls due to the pervasive nature and complexity of the IT environment, the large volume of transactions processed in numerous locations daily and the reliance on automated and IT dependent manual controls. Our areas of audit focus included user access management, developer access to the production environment and changes to the IT environment. These are key to ensuring IT dependent and application based controls are operating effectively.	We tested the design and operating effectiveness of the Group's IT access controls over the information systems that are critical to financial reporting. We tested IT general controls (logical access, changes management and aspects of IT operational controls). This included testing that requests for access to systems were appropriately reviewed and authorised. We tested the Group's periodic review of access rights. We inspected requests of changes to systems for appropriate approval and authorisation. We considered the control environment relating to various interfaces, configuration and other application layer controls identified as key to our audit. Where deficiencies were identified, we tested compensating controls or performed alternate procedures. In addition, we understood where relevant, changes were made to the IT landscape during the audit period and tested those changes that had a significant impact on financial reporting.
Key observations communicated to the Group Audit Committee	
We are satisfied that IT controls relevant to financial reporting operated effectively at year-end. We noted that a number of user access related deficiencies were identified. Compensating controls were tested or alternate procedures were performed.	
Relevant references in the Annual Report and Accounts	
Accounting policies (page 88)	

An overview of the scope of our audit

Tailoring the scope
Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each component of the Group. Taken together, this enables us to form an opinion on the financial statements. We take into account the size and risk profile of the component and its activities, the organisation of the Group and effectiveness of group-wide controls, changes in the business environment and other factors such as recent internal audit results when assessing the level of work to be performed at each component.

Our audit of the significant components covers the reportable segments identified in the financial statements, together with the central functions of the Group based in the UK and overseas, and includes Finance, the Services function and Treasury. In assessing the risk of material misstatement to the Group financial statements, and to ensure that we had adequate quantitative coverage of significant accounts in the financial statements, we selected two components covering entities within the UK and five other countries, which represent the principal business units within the Group.

Of the two components selected, we performed an audit of the complete financial information of both components ('full scope components') which were selected based on their size or risk characteristics.

Component	Scope	Key locations
NatWest Markets	Full	United Kingdom, United States and Singapore
Central items and other (including Global Financial Services, Services and Treasury)	Full	United Kingdom, India and Poland

Changes from the prior year
In Q4 2017, changes were made to the Group's businesses in preparation for the UK ring-fencing regime. As a result, Personal & Business Banking (previously a full scope component), Ulster Bank RoI (previously a specific scope component), Commercial Banking (previously a full scope component), Private Banking (previously a specific scope component) and certain parts of Central items and NatWest Markets are due to be included in the ring-fenced bank and are no longer reportable operating segments but presented as discontinued operations. As this change occurred in Q4 2017, our initial audit scoping performed quarterly included these components.

The table below illustrates the coverage obtained from the work performed by our audit teams; the coverage includes the full scope and specific scope components presented in disposal groups as noted above. As the Group made a loss during the year and several operations were moved to discontinued operations, we considered total assets, total equity and the absolute value of the amounts in the income statement (meaning the magnitude of the amounts without regard to their positive or negative value) to verify we had appropriate overall coverage on the income statement.

	Full scope[(1)]	Specific scope[(2)]	Other procedures[(3)]	Total
Total assets	90%	9%	1%	100%
Total equity	51%	48%	1%	100%
Absolute value of the income statement	84%	7%	9%	100%

Involvement with component teams

In establishing our overall approach to the Group audit, we determined the type of work that needed to be undertaken in each of the components by us, as the primary audit engagement team, or by component auditors in the United Kingdom or from other EY global network firms operating under our instruction. Of the four full scope components, audit procedures were performed on one of these directly by the primary audit engagement team. Of the two specific scope components, where work was performed by component auditors, we determined the appropriate level of involvement to enable us to determine that sufficient audit evidence had been obtained as a basis for our opinion on the Group as a whole.

The primary audit engagement team interacted regularly with the component audit teams where appropriate throughout the course of the audit, which included holding planning meetings, maintaining regular communications on the status of the audits, reviewing key working papers and taking responsibility for the scope and direction of the audit process. The primary audit engagement team also participated in meetings with key management personnel in the components and, for certain overseas locations, implemented a programme of planned visits. These visits involved discussing the audit approach with the component team and any issues arising from their work, as well as meeting with local management. This, together with the additional procedures performed at Group level, gave us appropriate evidence for our opinion on the Group financial statements.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group and Bank to be £220 million (2016 materiality: £210 million), which is 0.6% of the total equity of the Group and 0.6% of the Bank. We considered that equity represented a relevant measure used by investors, regulators and other stakeholders when assessing the performance of the Group and Bank. Our materiality was based on the equity of the Group given the significant losses and volatility of results in recent years. During the course of our audit, we reassessed initial materiality and increased it from our initial level of £210 million in light of the fact that many legacy items are now reflected in equity.

Notes:
(1) Full scope: audit procedures on all significant accounts.
(2) Specific scope: audit procedures on selected accounts
(3) Other procedures: considered in analytical procedures.

Performance materiality

The application of materiality at the individual account or balance level is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and corrected misstatements exceed materiality.

On the basis of our risk assessments, together with our assessment of the Group’s overall control environment, our judgement was that performance materiality was 50% of our planning materiality, namely £110 million (2016: £105 million). We have set performance materiality at this percentage (which is at the lowest end of the range of our audit methodology) based on various considerations including the past history of misstatements, our ability to assess the likelihood of misstatements, the effectiveness of the control environment and other factors affecting the entity and its financial reporting.

Audit work of component teams for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component team is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the range of performance materiality allocated by the primary audit engagement team to components was between £45 million and £85 million.

Reporting threshold

An amount below which identified misstatements are considered to be clearly trivial.

We agreed with the Group Audit Committee that we would report to them all corrected and uncorrected audit misstatements in excess of £11 million, which is set at 5% of planning materiality, as well as misstatements below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative and qualitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Accounting developments effective 1 January 2018 – IFRS 9 Financial Instruments

IFRS 9 replaces the current financial instruments standard IAS 39 effective 1 January 2018. It represents a fundamental change to the way financial instruments are classified, measured and assessed for credit impairment. The Group has established a Group-wide programme to implement the necessary changes as a result of this standard and disclosed the impact of transition on equity. Our audit work on this accounting change has been performed throughout 2017, for the purpose of the transition disclosure included in the 2017 financial statements, and continues through 2018. Our procedures on the impact disclosed included:

- Assessing the key interpretations made by management for compliance with IFRS 9
- Classification and measurement:
    - Testing the intent of holding the instruments and their contractual characteristics in order to assess their classification
- Credit impairment:
    - Testing the assumptions and judgements used in the impairment models to calculate expected credit losses, including the incorporation of economic forecasts
    - Testing the data used to run the models
    - Testing the IT applications used in the credit impairment process

We also tested the design and operating effectiveness of key controls over the completeness and accuracy of the transition disclosure included in the financial statements.

Other information

The other information comprises the information included in the Annual Report and Accounts, including the Strategic Report (set out on pages 3 to 59), Report of the directors (set out on pages 60 to 64), Statement of directors’ responsibilities (set out on page 65, Additional information (set out on pages 187 to 222), Abbreviations and acronyms (set out on page 223), Glossary of terms (set out on pages 224 to 230), Forward-looking statements (set out on page 231), and Principal offices (set out on page 232) other than the financial statements and our auditor’s report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Group and the Bank and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or the directors' report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Bank, or returns adequate for our audit have not been received from branches not visited by us; or
- the Bank financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit

Responsibilities of directors

As explained more fully in the directors' responsibilities statement (set out on page 64), the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for the implementation of such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group and Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Bank or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Group and have a direct impact on the preparation of the financial statements. We determined that the most significant are:
    - Companies Act 2006
    - Financial Reporting Council (FRC) and the UK Corporate Governance Code
    - Tax Legislation (governed by HM Revenue and Customs)
    - Financial Conduct Authority (FCA) rules
    - CRDIV (Basel III) and Prudential Regulatory Authority (PRA) rules
- We understood how the Group is complying with those frameworks by reviewing the RBS Policy Framework, holding discussions with the Group's general counsel, external counsel compliance group, regulatory group, internal audit, amongst others. We inquired as to any known instances of non-compliance or suspected non-compliance with laws and regulations. We also reviewed the Group's Complaints Management Policy and Whistleblowing Policy.
- We assessed the susceptibility of the group's financial statements to material misstatement, including how fraud might occur by holding discussions with senior management, including the Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, Head of Internal Audit and Group Audit Committee Chairman. We also reviewed the Group's fraud-related policies and mandates of different governance forums assessing fraud.
- As part of our audit procedures, we were aware to the risk of fraud, especially in the areas of estimation and those we assessed having the risk of management override.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved inquiring of key management, reviewing the key policies and reports on the aforementioned regulatory frameworks as well as reviewing the correspondence exchanged with the Regulators.
- We communicated with the component teams to assess if there were any specific considerations for these areas which were then incorporated in the Group-wide approach.
- We have tested the design and operating effectiveness of the Group's key controls by walking through key processes and testing controls.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other matters we are required to address

- Following the recommendation of the Group Audit Committee we were appointed by the Group at its annual general meeting on 4 May 2016 to audit the financial statements of the Group for the period ending 31 December 2016 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments is 2 years, covering periods from our appointment through 31 December 2017.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Bank and we remain independent of the Group and the Bank in conducting the audit.
- The audit opinion is consistent with the additional report to the Group Audit Committee

Jonathan Bourne (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
22 February 2018

Note:
(1) The maintenance and integrity of the RBS web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated income statement for the year ended 31 December 2017

	Note	2017 £m	2016 £m	2015 £m
Interest receivable		270	336	886
Interest payable		(222)	(239)	(707)
Net interest income	1	48	97	179
Fees and commissions receivable		282	310	653
Fees and commissions payable		(275)	(262)	(254)
Income from trading activities		737	967	1,061
Loss on redemption of own debt		—	(52)	(263)
Other operating income		119	7	(72)
Non-interest income	2	863	970	1,125
Total income		911	1,067	1,304
Staff costs		(894)	(396)	(964)
Premises and equipment		(152)	(29)	(81)
Other administrative expenses		(1,389)	(5,142)	(5,475)
Depreciation and amortisation		49	(2)	(18)
Operating expenses	3	(2,386)	(5,569)	(6,538)
Loss before impairment releases		(1,475)	(4,502)	(5,234)
Impairment releases	11	79	130	153
Operating loss before tax		(1,396)	(4,372)	(5,081)
Tax credit/(charge)	6	160	(229)	458
Loss from continuing operations		(1,236)	(4,601)	(4,623)
Profit/(loss) from discontinued operations, net of tax	19	1,192	(162)	3,037
Loss for the year		(44)	(4,763)	(1,586)
Attributable to:				
Non-controlling interests		5	4	320
Preference shareholders		—	23	44
Ordinary shareholders		(49)	(4,790)	(1,950)
		(44)	(4,763)	(1,586)

The accompanying notes on pages 100 to 186, the accounting policies on pages 88 to 99 and the audited sections of the Financial review: Capital and risk management on pages 13 to 59 form an integral part of these financial statements.

Consolidated statement of comprehensive income for the year ended 31 December 2017

	Note	2017 £m	2016 £m	2015 £m
Loss for the year		(44)	(4,763)	(1,586)
Items that do not qualify for reclassification				
Gain/(loss) on remeasurement of retirement benefit schemes	4	63	(1,041)	(73)
Loss on fair value of credit in financial liabilities designated at fair value through profit or loss due to own credit risk		(68)	—	—
Tax		(20)	288	306
		(25)	(753)	233
Items that do qualify for reclassification				
Available-for-sale financial assets		24	(98)	13
Cash flow hedges		(864)	577	(740)
Currency translation		134	764	(1,123)
Tax		209	(87)	136
		(497)	1,156	(1,714)
Other comprehensive (loss)/income after tax		(522)	403	(1,481)
Total comprehensive loss for the year		(566)	(4,360)	(3,067)
Attributable to:				
Non-controlling interests		—	7	315
Preference shareholders		—	23	44
Ordinary shareholders		(566)	(4,390)	(3,426)
		(566)	(4,360)	(3,067)

Note:
(1) A profit of £1,188 million (2016 – loss £166 million; 2015 – profit £2,714 million) from discontinued operations was attributable to ordinary and equity preference shareholders.

The accompanying notes on pages 100 to 186, the accounting policies on pages 88 to 99 and the audited sections of the Financial review: Capital and risk management on pages 13 to 59 form an integral part of these financial statements.

Balance sheet as at 31 December 2017

		Group		Bank	
		2017	2016	2017	2016
	Note	£m	£m	£m	£m
Assets					
Cash and balances at central banks	8	153	73,813	93	70,615
Amounts due from subsidiaries	8	201	1,037	3,090	18,152
Other loans and advances to banks	8	19,061	29,458	15,724	20,866
Loans and advances to banks	8	19,262	30,495	18,814	39,018
Amounts due from holding company and fellow subsidiaries	8	—	1,116	2,632	27,122
Other loans and advances to customers	8	49,374	343,839	43,026	133,069
Loans and advances to customers	8	49,374	344,955	45,658	160,191
Debt securities subject to repurchase agreements	27	7,538	18,107	7,538	15,206
Other debt securities		23,001	53,545	19,796	52,463
Debt securities	13	30,539	71,652	27,334	67,669
Equity shares	14	87	445	50	298
Investments in Group undertakings	15	—	—	496	35,169
Settlement balances		2,512	5,557	1,640	4,707
Amounts due from holding company and fellow subsidiaries	12	362	1,306	3,687	6,144
Other derivatives	12	158,916	246,438	158,318	245,332
Derivatives	12	159,278	247,744	162,005	251,476
Intangible assets	16	—	6,165	—	521
Property, plant and equipment	17	159	4,536	5	1,523
Deferred tax	23	166	1,798	165	272
Prepayments, accrued income and other assets	18	829	2,288	591	1,563
Assets of disposal groups	19	463,878	8,366	269,038	591
Total assets		726,237	797,814	525,889	633,613
Liabilities					
Amounts due to subsidiaries	8	79	2,117	2,961	107,177
Other deposits by banks	8	17,014	38,436	15,343	32,111
Deposits by banks	8	17,093	40,553	18,304	139,288
Amounts due to holding company and fellow subsidiaries	8	6	18,528	11,982	31,664
Other customers accounts	8	39,097	357,537	25,115	110,554
Customer accounts	8	39,103	376,065	37,097	142,218
Debt securities in issue	8	12,362	20,362	12,362	18,881
Settlement balances		2,818	3,641	1,411	2,774
Short positions	20	28,527	22,076	26,207	17,590
Amounts due to holding company and fellow subsidiaries	12	486	1,228	2,466	5,036
Other derivatives	12	152,844	236,349	152,632	235,862
Derivatives	12	153,330	237,577	155,098	240,898
Provisions for liabilities and charges	21	3,979	11,840	2,230	4,884
Accruals and other liabilities	22	805	6,450	531	3,334
Deferred tax	23	128	525	100	—
Amounts due to holding company	8	—	11,212	—	11,212
Other subordinated liabilities	8	—	8,303	—	6,658
Subordinated liabilities	24	—	19,515	—	17,870
Liabilities of disposal groups	19	432,832	23,391	228,027	—
Total liabilities		690,977	761,995	481,367	587,737
Non-controlling interests		57	62	—	—
Owners' equity	25	35,203	35,757	44,522	45,876
Total equity		35,260	35,819	44,522	45,876
Total liabilities and equity		726,237	797,814	525,889	633,613

Owner's equity of the Bank as 31 December 2017 includes the loss for the year then ended of £983 million (2016 loss - £3,451 million).

The accompanying notes on pages 100 to 186, the accounting policies on pages 88 to 99 and the audited sections of the Financial review: Capital and risk management on pages 13 to 59 form an integral part of these financial statements.

The accounts were approved by the Board of directors on 22 February 2018 and signed on its behalf by:

Howard Davies	Ross McEwan	Ewen Stevenson	The Royal Bank of Scotland plc
Chairman	Chief Executive	Chief Financial Officer	Registration No. SC90312

Statement of changes in equity for the year ended 31 December 2017

	Group			Bank		
	2017 £m	2016 £m	2015 £m	2017 £m	2016 £m	2015 £m
Called-up share capital						
At 1 January and 31 December	6,609	6,609	6,609	6,609	6,609	6,609
Share premium account						
At 1 January and 31 December	26,807	26,807	26,807	26,807	26,807	26,807
Merger reserve						
At 1 January	10,881	10,865	10,834	—	(16)	(47)
Unwind of merger reserve	—	16	31	—	16	31
At 31 December	10,881	10,881	10,865	—	—	(16)
Available-for-sale reserve						
At 1 January	291	366	400	249	297	252
Unrealised gains	200	261	88	213	267	121
Realised gains	(176)	(359)	(70)	(161)	(328)	(44)
Tax	(15)	23	(18)	(21)	13	(32)
Recycled to profit or loss on ceding control of Citizens (1)	—	—	9	—	—	—
Transfer to retained earnings	—	—	(43)	—	—	—
At 31 December	300	291	366	280	249	297
Cash flow hedging reserve						
At 1 January	842	423	1,026	261	286	755
Amount recognised in equity	(120)	1,626	668	(61)	643	398
Amount transferred from equity to earnings	(744)	(1,049)	(1,350)	(363)	(683)	(944)
Tax	227	(158)	106	114	15	77
Recycled to profit or loss on ceding control of Citizens (2)	—	—	(36)	—	—	—
Transfer to retained earnings	—	—	9	—	—	—
At 31 December	205	842	423	(49)	261	286
Foreign exchange reserve						
At 1 January	817	8	1,762	(282)	(192)	(246)
Retranslation of net assets	145	1,082	(79)	(69)	(41)	30
Foreign currency (losses)/gains on hedges of net assets	(25)	(276)	(74)	36	(49)	24
Tax	(3)	48	11	—	—	—
Recycled to profit or loss on disposal of businesses	19	(45)	4	11	—	—
Recycled to profit or loss on ceding of control Citizens (3)	—	—	(974)	—	—	—
Transfer to retained earnings	—	—	(642)	—	—	—
At 31 December	953	817	8	(304)	(282)	(192)

For notes to these tables refer to the following page

Statement of changes in equity for the year ended 31 December 2017

	Group			Bank		
	2017 £m	2016 £m	2015 £m	2017 £m	2016 £m	2015 £m
Retained earnings						
At 1 January	(10,490)	(3,225)	(2,135)	12,232	17,386	18,423
(Loss)/profit attributable to ordinary and equity preference shareholders						
- continuing operations	(1,237)	(4,601)	(4,620)	(473)	(2,920)	(2,321)
- discontinued operations	1,188	(166)	2,714	(510)	(531)	1,290
Equity preference dividends paid	—	(23)	(44)	—	(23)	(44)
Transfer from available-for-sale reserve	—	—	43	—	—	—
Transfer from cash flow hedging reserve	—	—	(9)	—	—	—
Transfer from foreign exchange reserve	—	—	642	—	—	—
Costs of placing Citizens equity	—	—	(29)	—	—	—
Gain/(loss) on remeasurement of the retirement benefit schemes						
- gross	63	(1,041)	(67)	4	63	84
- tax	(38)	288	306	(36)	(21)	(20)
Changes in fair value of credit in financial liabilities designated at fair value through profit or loss						
- gross	(68)	—	—	(68)	—	—
- tax	18	—	—	18	—	—
Redemption of preference shares classified as debt (4)	—	(1,744)	—	—	(1,744)	—
Shares issued under employee share schemes	(5)	(10)	(58)	(5)	(10)	(58)
Share-based payments						
- gross	17	32	36	17	32	36
- tax	—	—	(4)	—	—	(4)
At 31 December	(10,552)	(10,490)	(3,225)	11,179	12,232	17,386
Owners' equity at 31 December	35,203	35,757	41,853	44,522	45,876	51,177
Non-controlling interests						
At 1 January	62	54	2,385	—	—	—
Currency translation adjustments and other movements	(5)	3	28	—	—	—
Profit attributable to non-controlling interests						
- continuing operations	1	—	(3)	—	—	—
- discontinued operations	4	4	323	—	—	—
Dividends paid	(5)	—	(31)	—	—	—
Movements in available-for-sale securities						
- unrealised gains	—	—	25	—	—	—
- tax	—	—	(5)	—	—	—
Movements in cash flow hedging reserve						
- amount recognised in equity	—	—	32	—	—	—
- tax	—	—	(4)	—	—	—
Actuarial losses recognised in retirement benefit schemes	—	—	(6)	—	—	—
Equity raised (5)	—	—	2,491	—	—	—
Equity withdrawn and disposals	—	1	(24)	—	—	—
Loss of control of Citizens	—	—	(5,157)	—	—	—
At 31 December	57	62	54	—	—	—
Total equity at 31 December	35,260	35,819	41,907	44,522	45,876	51,177
Total equity is attributable to:						
Non-controlling interests	57	62	54	—	—	—
Preference shareholders	—	—	1,421	—	—	1,421
Ordinary shareholders	35,203	35,757	40,432	44,522	45,876	49,756
	35,260	35,819	41,907	44,522	45,876	51,177

Notes:
(1) 2015 Net of tax - £6 million charge.
(2) 2015 Net of tax - £16 million credit.
(3) No tax impact.
(4) Issued by RBS plc to the holding company which were redeemed in April 2016.
(5) Includes £2,491 million relating to the secondary offering of Citizens in March 2015.

The accompanying notes on pages 100 to 186, the accounting policies on pages 88 to 99 and the audited sections of the Financial review: Capital and risk management on pages 13 to 59 form an integral part of these financial statements.

Cash flow statement for the year ended 31 December 2017

		Group			Bank		
		2017	2016	2015	2017	2016	2015
	Note	£m	£m	£m	£m	£m	£m
Cash flows from operating activities							
Operating (loss)/profit before tax from continuing operations		(1,396)	(4,372)	(5,081)	(641)	(2,721)	(2,825)
Profit/(loss) before tax from discontinued operations		2,013	783	3,678	(653)	(215)	1,374
Adjustments for non-cash items and other adjustments included within income statement		(3,766)	(3,864)	(6,972)	1,364	(3,428)	6,171
Cash contribution to defined benefit pension schemes		(621)	(4,783)	(1,059)	(251)	(200)	(32)
Changes in operating assets and liabilities		(53,765)	19,191	10,787	(73,979)	9,327	992
Income taxes (paid)/received		(546)	14	(231)	(197)	335	(192)
Net cash flows from operating activities	30	(58,081)	6,969	1,122	(74,357)	3,098	5,488
Cash flows from investing activities							
Sale and maturity of securities		11,175	7,564	6,345	11,988	7,648	17,877
Purchase of securities		(16,015)	(11,505)	(12,882)	(14,655)	(10,259)	(11,451)
Sale of property, plant and equipment		404	421	1,541	65	48	305
Purchase of property, plant and equipment		(1,123)	(902)	(761)	(187)	(508)	(338)
Net divestment of/(investment in) business interests and intangible assets	31	1,912	(976)	53	712	(1,424)	(3,937)
Net cash flows from investing activities		(3,647)	(5,398)	(5,704)	(2,077)	(4,495)	2,456
Cash flows from financing activities							
Proceeds of non-controlling interests issued		—	—	2,491	—	—	—
Redemption of debt preference shares		—	(1,744)	—	—	(1,744)	—
Non-controlling interests equity withdrawn and disposals		—	1	—	—	—	—
Redemption of subordinated liabilities		(9,624)	(10,556)	(2,279)	(9,431)	(10,535)	(1,894)
Dividends paid		(5)	(23)	(75)	—	(23)	(44)
Interest on subordinated liabilities		(417)	(1,210)	(1,313)	(237)	(1,157)	(1,338)
Net cash flows from financing activities		(10,046)	(13,532)	(1,176)	(9,668)	(13,459)	(3,276)
Effects of exchange rate changes on cash and cash equivalents		(570)	7,913	525	87	7,316	575
Net (decrease)/increase in cash and cash equivalents		(72,344)	(4,048)	(5,233)	(86,015)	(7,540)	5,243
Cash and cash equivalents at 1 January		98,027	102,075	107,308	99,073	106,613	101,370
Cash and cash equivalents at 31 December	34	25,683	98,027	102,075	13,058	99,073	106,613

The accompanying notes on pages 100 to 186, the accounting policies on pages 88 to 99 and the audited sections of the Financial review: Capital and risk management on pages 13 to 59 form an integral part of these financial statements.

1. Presentation of accounts

The accounts are prepared on a going concern basis (see the Report of the directors, page 60) and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the IFRS Interpretations Committee of the IASB as adopted by the European Union (EU) (together IFRS). The EU has not adopted the complete text of IAS 39 'Financial Instruments: Recognition and Measurement'; it has relaxed some of the standard's hedging requirements. The Group has not taken advantage of this relaxation: its financial statements are prepared in accordance with IFRS as issued by the IASB.

The company is incorporated in the UK and registered in Scotland. Its accounts are presented in accordance with the Companies Act 2006. With the exception of investment property and certain financial instruments as described in Accounting policies 9, 14, 16 and 18, the accounts are presented on an historical cost basis.

NatWest Holdings was classified as a disposal group at 31 December 2017. RBSI Holdings was classified as a disposal group at 31 December 2016 and Citizens was classified as a disposal group at 31 December 2015. They are measured at fair value less costs to sell. Refer to Note 19 for further information.

The Group adopted two revisions to IFRSs effective 1 January 2017:

In January 2016, the IASB amended IAS 7 'Cash Flow Statements' to require disclosure of the movements in financing liabilities. This is shown in Note 33.

In January 2016, the IASB amended IAS 12 'Income taxes' to clarify the recognition of deferred tax assets in respect of unrealised losses.

Neither of these amendments has had a material effect on the Group's financial statements.

2. Basis of consolidation

The consolidated accounts incorporate the financial statements of the company and entities (including certain structured entities) that are controlled by the Group. The Group controls another entity (a subsidiary) when it is exposed, or has rights, to variable returns from its involvement with that entity and has the ability to affect those returns through its power over the other entity; power generally arises from holding a majority of voting rights. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated accounts at their fair value. A subsidiary is included in the consolidated financial statements from the date it is controlled by the Group until the date the Group ceases to control it through a sale or a significant change in circumstances. Changes in the Group's interest in a subsidiary that do not result in the Group ceasing to control that subsidiary are accounted for as equity transactions.

All intergroup balances, transactions, income and expenses are eliminated on consolidation. The consolidated accounts are prepared under uniform accounting policies.

3. Revenue recognition

Interest income on financial assets that are classified as loans and receivables, available-for-sale or held-to-maturity and interest expense on financial liabilities other than those measured at fair value are determined using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees payable or receivable that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows. Negative effective interest accruing to financial assets is presented in interest payable.

Financial assets and financial liabilities held-for-trading or designated as at fair value through profit or loss are recorded at fair value. Changes in fair value are recognised in profit or loss.

Fees in respect of services are recognised as the right to consideration accrues through the provision of the service to the customer. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable. The application of this policy to significant fee types is outlined below.

Payment services - this comprises income received for payment services including cheques cashed, direct debits, Clearing House Automated Payments (the UK electronic settlement system) and BACS payments (the automated clearing house that processes direct debits and direct credits). These are generally charged on a per transaction basis. The income is earned when the payment or transaction occurs. Charges for payment services are usually debited to the customer's account monthly or quarterly in arrears. Income is accrued at period end for services provided but not yet charged.

Credit and debit card fees - fees from card business include:

- Interchange received: as issuer, the Group receives a fee (interchange) each time a cardholder purchases goods and services. The Group also receives interchange fees from other card issuers for providing cash advances through its branch and automated teller machine networks. These fees are accrued once the transaction has taken place.
- Periodic fees payable by a credit card or debit card holder are deferred and taken to profit or loss over the period of the service.

Lending (credit facilities) - commitment and utilisation fees are determined as a percentage of the outstanding facility. If it is unlikely that a specific lending arrangement will be entered into, such fees are taken to profit or loss over the life of the facility, otherwise they are deferred and included in the effective interest rate on the loan.

Brokerage fees - in respect of securities, foreign exchange, futures or options transactions entered into on behalf of a customer are recognised as income on execution of a significant act.

Trade finance – income from the provision of trade finance is recognised over the term of the finance unless specifically related to a significant act, in which case income is recognised when the act is executed.

Investment management - fees charged for managing investments are recognised as revenue as the services are provided. Incremental costs that are directly attributable to securing an investment management contract are deferred and charged as expense as the related revenue is recognised.

4. Assets held for sale and discontinued operations

A non-current asset (or disposal group) is classified as held for sale if the Group will recover its carrying amount principally through a sale transaction rather than through continuing use. A non-current asset (or disposal group) classified as held for sale is measured at the lower of its carrying amount and fair value less costs to sell. If the asset (or disposal group) is acquired as part of a business combination it is initially measured at fair value less costs to sell.

Assets and liabilities of disposal groups classified as held for sale and non-current assets classified as held for sale are shown separately on the face of the balance sheet.

The results of discontinued operations, comprising the post-tax profit or loss of discontinued operations and the post-tax gain or loss recognised either on measurement to fair value less costs to sell or on disposal of the discontinued operation, are shown as a single amount on the face of the income statement; an analysis of this amount is presented in Note 19 on the accounts. A discontinued operation is a cash generating unit or a group of cash generating units that either has been disposed of, or is classified as held for sale, and (a) represents a separate major line of business or geographical area of operations, (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or (c) is a subsidiary acquired exclusively with a view to resale.

5. Employee benefits

Short-term employee benefits, such as salaries, paid absences, and other benefits are accounted for on an accruals basis over the period in which the employees provide the related services. Employees may receive variable compensation satisfied by cash, by debt instruments issued by the Group or by RBSG shares. The treatment of share-based compensation is set out in Accounting policy 24. Variable compensation that is settled in cash or debt instruments is charged to profit or loss over the period from the start of the year to which the variable compensation relates to the expected settlement date taking account of forfeiture and clawback criteria.

Contributions to defined contribution pension schemes are recognised in profit or loss when payable.

For defined benefit schemes, the defined benefit obligation is measured on an actuarial basis using the projected unit credit method and discounted at a rate determined by reference to market yields at the end of the reporting period on high quality corporate bonds of equivalent term and currency to the scheme liabilities. Scheme assets are measured at their fair value. The difference between scheme assets and scheme liabilities, the net defined benefit asset or liability, is recognised in the balance sheet. A defined benefit asset is limited to the present value of any economic benefits available to the Group in the form of refunds from the plan or reduced contributions to it.

The charge to profit or loss for pension costs (recorded in operating expenses) comprises:
the current service cost
interest, computed at the rate used to discount scheme liabilities, on the net defined benefit liability or asset
past service cost resulting from a scheme amendment or curtailment
gains or losses on settlement.

A curtailment occurs when the Group significantly reduces the number of employees covered by a plan. A plan amendment occurs when the Group introduces, or withdraws, a defined benefit plan or changes the benefits payable under an existing defined benefit plan. Past service cost may be either positive (when benefits are introduced or changed so that the present value of the defined benefit obligation increases) or negative (when benefits are withdrawn or changed so that the present value of the defined benefit obligation decreases). A settlement is a transaction that eliminates all further obligation for part or all of the benefits.

Actuarial gains and losses (i.e. gains or and losses on re-measuring the net defined benefit asset or liability) are recognised in other comprehensive income in full in the period in which they arise.

6. Intangible assets and goodwill

Intangible assets acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to profit or loss over the assets' estimated economic lives using methods that best reflect the pattern of economic benefits and is included in Depreciation and amortisation. These estimated useful economic lives are:

Computer software	3 to 12 years
Other acquired intangibles	5 to 10 years

Expenditure on internally generated goodwill and brands is written-off as incurred. Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have been established. These costs include payroll, the costs of materials and services, and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred as are all training costs and general overheads. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

Intangible assets include goodwill arising on the acquisition of subsidiaries and joint ventures. Goodwill on the acquisition of a subsidiary is the excess of the fair value of the consideration transferred, the fair value of any existing interest in the subsidiary and the amount of any non-controlling interest measured either at fair value or at its share of the subsidiary's net assets over the Group's interest in the net fair value of the subsidiary's identifiable assets, liabilities and contingent liabilities. Goodwill arises on the acquisition of a joint venture when the cost of investment exceeds the Group's share of the net fair value of the joint venture's identifiable assets and liabilities. Goodwill is measured at initial cost less any subsequent impairment losses. Goodwill arising on the acquisition of associates is included within their carrying amounts. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

7. Property, plant and equipment

Items of property, plant and equipment (except investment property - see Accounting policy 9) are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, these are accounted for separately.

Depreciation is charged to profit or loss on a straight-line basis so as to write-off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases) over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Freehold land is not depreciated.

The estimated useful lives of the Group's property, plant and equipment are:

Freehold buildings	50 years
Long leasehold property (leases with more than 50 years to run)	50 years
Short leaseholds	unexpired period of the lease
Property adaptation costs	10 to 15 years
Computer equipment	up to 5 years
Other equipment	4 to 15 years

The residual value and useful life of property, plant and equipment are reviewed at each balance sheet date and updated for any changes to previous estimates.

8. Impairment of intangible assets and property, plant and equipment

At each balance sheet date, the Group assesses whether there is any indication that its intangible assets, or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss if any. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

If an asset does not generate cash flows that are independent from those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. For the purposes of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units or groups of cash-generating units expected to benefit from the combination. The recoverable amount of an asset or cash-generating unit is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash-generating unit that have not been taken into account in estimating future cash flows. If the recoverable amount of an intangible or tangible asset is less than its carrying value, an impairment loss is recognised immediately in profit or loss and the carrying value of the asset reduced by the amount of the loss.

A reversal of an impairment loss on intangible assets (excluding goodwill) or property, plant and equipment can be recognised when an increase in service potential arises provided the increased carrying value is not greater than it would have been had no impairment loss been recognised. Impairment losses on goodwill are not reversed.

9. Investment property

Investment property comprises freehold and leasehold properties that are held to earn rentals or for capital appreciation or both. Investment property is not depreciated but is stated at fair value. Fair value is based on current prices for similar properties in the same location and condition. Any gain or loss arising from a change in fair value is recognised in profit or loss.
Rental income from investment property is recognised on a straight-line basis over the term of the lease in Other operating income. Lease incentives granted are recognised as an integral part of the total rental income.

10. Foreign currencies

The Group's consolidated financial statements are presented in sterling which is the functional currency of the company.

Group entities record transactions in foreign currencies in their functional currency, the currency of the primary economic environment in which they operate, at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the foreign exchange rates ruling at the balance sheet date. Foreign exchange differences arising on the settlement of foreign currency transactions and from the translation of monetary assets and liabilities are reported in income from trading activities except for differences arising on cash flow hedges and hedges of net investments in foreign operations (see Accounting policy 23).

Non-monetary items denominated in foreign currencies that are stated at fair value are translated into the relevant functional currency at the foreign exchange rates ruling at the dates the values are determined. Translation differences arising on non-monetary items measured at fair value are recognised in profit or loss except for differences arising on available-for-sale non-monetary financial assets, for example equity shares, which are recognised in other comprehensive income unless the asset is the hedged item in a fair value hedge.

Assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into sterling at foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of a foreign operation are recognised in other comprehensive income. The amount accumulated in equity is reclassified from equity to profit or loss on disposal of a foreign operation.

11. Leases

As lessor

Contracts with customers to lease assets are classified as finance leases if they transfer substantially all the risks and rewards of ownership of the asset to the customer; all other contracts with customers to lease assets are classified as operating leases.

Finance lease receivables are included in the balance sheet, within Loans and advances to customers, at the amount of the net investment in the lease being the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Finance lease income is allocated to accounting periods so as to give a constant periodic rate of return before tax on the net investment and included in Interest receivable. Unguaranteed residual values are subject to regular review; if there is a reduction in their value, income allocation is revised and any reduction in respect of amounts accrued is recognised immediately.

Rental income from operating leases is recognised in income on a straight-line basis over the lease term unless another systematic basis better represents the time pattern of the asset's use. Operating lease assets are included within Property, plant and equipment and depreciated over their useful lives (see Accounting policy 7). Operating lease rentals receivable are included in Other operating income.

As lessee

The Group's contracts to lease assets are principally operating leases. Operating lease rental expense is included in Premises and equipment costs and recognised as an expense on a straight-line basis over the lease term unless another systematic basis better represents the benefit to the Group.

12. Provisions

The Group recognises a provision for a present obligation resulting from a past event when it is more likely than not that it will be required to transfer economic benefits to settle the obligation and the amount of the obligation can be estimated reliably.

Provision is made for restructuring costs, including the costs of redundancy, when the Group has a constructive obligation to restructure. An obligation exists when the Group has a detailed formal plan for the restructuring and has raised a valid expectation in those affected by starting to implement the plan or by announcing its main features.

If the Group has a contract that is onerous, it recognises the present obligation under the contract as a provision. An onerous contract is one where the unavoidable costs of meeting the Group's contractual obligations exceed the expected economic benefits. When the Group vacates a leasehold property, a provision is recognised for the costs under the lease less any expected economic benefits (such as rental income).

Contingent liabilities are possible obligations arising from past events, whose existence will be confirmed only by uncertain future events, or present obligations arising from past events that are not recognised because either an outflow of economic benefits is not probable or the amount of the obligation cannot be reliably measured. Contingent liabilities are not recognised but information about them is disclosed unless the possibility of any outflow of economic benefits in settlement is remote.

13. Tax

Income tax expense or income, comprising current tax and deferred tax, is recorded in the income statement except income tax on items recognised outside profit or loss which is credited or charged to other comprehensive income or to equity as appropriate.

Current tax is income tax payable or recoverable in respect of the taxable profit or loss for the year arising in profit or loss, other comprehensive income or equity. Provision is made for current tax at rates enacted or substantively enacted at the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that they will be recovered. Deferred tax is not recognised on temporary differences that arise from initial recognition of an asset or a liability in a transaction (other than a business combination) that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is calculated using tax rates expected to apply in the periods when the assets will be realised or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, at the balance sheet date.

Deferred tax assets and liabilities are offset where the Group has a legally enforceable right to offset and where they relate to income taxes levied by the same taxation authority either on an individual Group company or on Group companies in the same tax group that intend, in future periods, to settle current tax liabilities and assets on a net basis or on a gross basis simultaneously.

14. Financial assets

On initial recognition, financial assets are classified into held-to-maturity investments; held-for-trading; designated as at fair value through profit or loss; loans and receivables; or available-for-sale financial assets. Normal purchases of financial assets classified as loans and receivables are recognised on the settlement date; all other normal transactions in financial assets are recognised on the trade date.

Held-to-maturity investments - a financial asset may be classified as a held-to-maturity investment only if it has fixed or determinable payments, a fixed maturity and the Group has the positive intention and ability to hold to maturity. Held-to-maturity investments are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see Accounting policy 3) less any impairment losses.

Held-for-trading - a financial asset is classified as held-for-trading if it is acquired principally for sale in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial assets are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Income from trading activities includes gains and losses on held-for-trading financial assets as they arise.

Designated as at fair value through profit or loss - financial assets may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both, that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

Financial assets that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Gains and losses are recognised in profit or loss as they arise.

Loans and receivables - non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables, except those that are classified as available-for-sale or as held-for-trading, or designated as at fair value through profit or loss. Loans and receivables are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see Accounting policy 3) less any impairment losses.

Available-for-sale financial assets - financial assets that are not classified as held-to-maturity; held-for-trading; designated as at fair value through profit or loss; or loans and receivables are classified as available-for-sale. Financial assets can be designated as available-for-sale on initial recognition. Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Unquoted equity investments whose fair value cannot be measured reliably are carried at cost and classified as available-for-sale financial assets. Impairment losses and exchange differences resulting from retranslating the amortised cost of foreign currency monetary available-for-sale financial assets are recognised in profit or loss together with interest calculated using the effective interest method (see Accounting policy 3) as are gains and losses attributable to the hedged risk on available-for-sale financial assets that are hedged items in fair value hedges (see Accounting policy 23). Other changes in the fair value of available-for-sale financial assets and any related tax are reported in other comprehensive income until disposal, when the cumulative gain or loss is reclassified from equity to profit or loss.

Reclassifications - held-for-trading and available-for-sale financial assets that meet the definition of loans and receivables (non-derivative financial assets with fixed or determinable payments that are not quoted in an active market) may be reclassified to loans and receivables if the Group has the intention and ability to hold the financial asset for the foreseeable future or until maturity. The Group typically regards the foreseeable future for this purpose as twelve months from the date of reclassification. Additionally, held-for-trading financial assets that do not meet the definition of loans and receivables may, in rare circumstances, be transferred to available-for-sale financial assets or to held-to-maturity investments. Reclassifications are made at fair value. This fair value becomes the asset's new cost or amortised cost as appropriate. Gains and losses recognised up to the date of reclassification are not reversed.

Fair value - the Group's approach to determining the fair value of financial instruments measured at fair value is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments. Further details are given in Note 9 on the accounts.

15. Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as held-to-maturity, as available-for-sale or as loans and receivables is impaired. A financial asset or group of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

Financial assets carried at amortised cost - if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables or as held-to-maturity investments has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition. For collateralised loans and receivables, estimated future cash flows include cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

Where, in the course of the orderly realisation of a loan, it is exchanged for equity shares or property, the exchange is accounted for as the sale of the loan and the acquisition of equity securities or investment property. Where the Group's interest in equity shares following the exchange is such that the Group controls an entity, that entity is consolidated.

Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant. In making collective impairment assessments, financial assets are grouped into portfolios on the basis of similar risk characteristics. Future cash flows from these portfolios are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics.

Historical loss experience is adjusted, on the basis of observable data, to reflect current conditions not affecting the period of historical experience. Impairment losses are recognised in profit or loss and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses. If, in a subsequent period, the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

Impaired loans and receivables are written off, i.e. the impairment provision is applied in writing down the loan's carrying value partially or in full, when the Group concludes that there is no longer any realistic prospect of recovery of part or all of the loan. For loans that are individually assessed for impairment, the timing of write off is determined on a case-by-case basis. Such loans are reviewed regularly and write off will be prompted by bankruptcy, insolvency, renegotiation and similar events.

The typical time frames from initial impairment to write off for the Group's collectively-assessed portfolios are:
Retail mortgages: write off usually occurs within five years, or when an account is closed if earlier.
Credit cards: the irrecoverable amount is written off after 12 months; three years later any remaining amounts outstanding are written off.
Overdrafts and other unsecured loans: write off occurs within six years.
Business and commercial loans: write offs of commercial loans are determined in the light of individual circumstances; the period does not exceed five years. Business loans are generally written off within five years.

Amounts recovered after a loan has been written off are credited to the loan impairment charge for the period in which they are received.

Financial assets carried at fair value - when a decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in other comprehensive income and there is objective evidence that it is impaired, the cumulative loss is reclassified from equity to profit or loss. The loss is measured as the difference between the amortised cost (including any hedge accounting adjustments) of the financial asset and its current fair value. Impairment losses on available-for-sale equity instruments are not reversed through profit or loss, but those on available-for-sale debt instruments are reversed, if there is an increase in fair value that is objectively related to a subsequent event.

16. Financial liabilities

Financial liabilities are recognised initially at fair value and classified into held-for-trading; designated as at fair value through profit or loss; or amortised cost. Issues of financial liabilities measured at amortised cost are recognised on settlement date; all other normal transactions in financial liabilities are recognised on trade date.

Held-for-trading - a financial liability is classified as held-for-trading if it is incurred principally for repurchase in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial liabilities are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Gains and losses are recognised in profit or loss as they arise.

Designated as at fair value through profit or loss - financial liabilities may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

Financial liabilities that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Income from trading activities includes gains and losses on held-for-trading financial liabilities as they arise.

Financial liabilities designated as at fair value through profit or loss principally comprise structured liabilities issued by the Group: designation significantly reduces the measurement inconsistency between these liabilities and the related derivatives carried at fair value.

Amortised cost - all other financial liabilities are measured at amortised cost using the effective interest method (see Accounting policy 3).

Fair value - the Group's approach to determining the fair value of financial instruments measured at fair value is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 9 on the accounts.

17. Financial guarantee contracts

Under a financial guarantee contract, the Group, in return for a fee, undertakes to meet a customer's obligations under the terms of a debt instrument if the customer fails to do so. A financial guarantee is recognised as a liability; initially at fair value and, if not designated as at fair value through profit or loss, subsequently at the higher of its initial value less cumulative amortisation and any provision under the contract measured in accordance with Accounting policy 12. Amortisation is calculated so as to recognise fees receivable in profit or loss over the period of the guarantee.

18. Loan commitments

Provision is made for loan commitments, other than those classified as held-for-trading, if it is probable that the facility will be drawn and the resulting loan will be recognised at an amount less than the cash advanced. Syndicated loan commitments in excess of the level of lending under the commitment approved for retention by the Group are classified as held-for-trading and measured at fair value.

19. Derecognition

A financial asset is derecognised when the contractual right to receive cash flows from the asset has expired or when it has been transferred and the transfer qualifies for derecognition. A transfer requires that the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Group assesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. The asset remains on the balance sheet if substantially all the risks and rewards have been retained. It is derecognised if substantially all the risks and rewards have been transferred. If substantially all the risks and rewards have been neither retained nor transferred, the Group assesses whether or not it has retained control of the asset. If the Group has retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement; if the Group has not retained control of the asset, it is derecognised.

A financial liability is removed from the balance sheet when the obligation is discharged, or is cancelled, or expires. On the redemption or settlement of debt securities (including subordinated liabilities) issued by the Group, the Group derecognises the debt instrument and records a gain or loss being the difference between the debt's carrying amount and the cost of redemption or settlement. The same treatment applies where the debt is exchanged for a new debt issue that has terms substantially different from those of the existing debt. The assessment of whether the terms of the new debt instrument are substantially different takes into account qualitative and quantitative characteristics including a comparison of the present value of the cash flows under the new terms with the present value of the remaining cash flows of the original debt issue discounted at the effective interest rate of the original debt issue.

20. Sale and repurchase transactions

Securities subject to a sale and repurchase agreement under which substantially all the risks and rewards of ownership are retained by the Group continue to be shown on the balance sheet and the sale proceeds recorded as a financial liability. Securities acquired in a reverse sale and repurchase transaction under which the Group is not exposed to substantially all the risks and rewards of ownership are not recognised on the balance sheet and the consideration paid is recorded as a financial asset.

Securities borrowing and lending transactions are usually secured by cash or securities advanced by the borrower. Borrowed securities are not recognised on the balance sheet or lent securities derecognised.

Cash collateral given or received is treated as a loan or deposit; collateral in the form of securities is not recognised. However, where securities borrowed are transferred to third parties, a liability for the obligation to return the securities to the stock lending counterparty is recorded.

21. Netting

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when, and only when, the Group currently has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. The Group is party to a number of arrangements, including master netting agreements, that give it the right to offset financial assets and financial liabilities, but where it does not intend to settle the amounts net or simultaneously, the assets and liabilities concerned are presented gross.

22. Capital instruments

The Group classifies a financial instrument that it issues as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms and as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities. The components of a compound financial instrument issued by the Group are classified and accounted for separately as financial assets, financial liabilities or equity as appropriate.

Incremental costs and related tax that are directly attributable to an equity transaction are deducted from equity.

The consideration for any ordinary shares of the company purchased by the Group (treasury shares) is deducted from equity. On the cancellation of treasury shares their nominal value is removed from equity and any excess of consideration over nominal value is treated in accordance with the capital maintenance provisions of the Companies Act. On the sale or reissue of treasury shares the consideration received and related tax are credited to equity, net of any directly attributable incremental costs.

23. Derivatives and hedging

Derivative financial instruments are initially recognised, and subsequently measured, at fair value. The Group's approach to determining the fair value of financial instruments is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 9 on the accounts.

A derivative embedded in a contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract; unless the entire contract is measured at fair value with changes in fair value recognised in profit or loss.

Gains and losses arising from changes in the fair value of derivatives that are not the hedging instrument in a qualifying hedge are recognised as they arise in profit or loss. Gains and losses are recorded in Income from trading activities except for gains and losses on those derivatives that are managed together with financial instruments designated at fair value; these gains and losses are included in Other operating income. The Group enters into three types of hedge relationship: hedges of changes in the fair value of a recognised asset or liability or unrecognised firm commitment (fair value hedges); hedges of the variability in cash flows from a recognised asset or liability or a highly probable forecast transaction (cash flow hedges); and hedges of the net investment in a foreign operation.

Hedge relationships are formally designated and documented at inception. The documentation identifies the hedged item and the hedging instrument and details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in fair values or cash flows attributable to the hedged risk, consistent with the documented risk management strategy, hedge accounting is discontinued. Hedge accounting is also discontinued if the Group revokes the designation of a hedge relationship.

Fair value hedge - in a fair value hedge, the gain or loss on the hedging instrument is recognised in profit or loss. The gain or loss on the hedged item attributable to the hedged risk is recognised in profit or loss and, where the hedged item is measured at amortised cost, adjusts the carrying amount of the hedged item. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; or if the hedging instrument expires or is sold, terminated or exercised; or if hedge designation is revoked. If the hedged item is one for which the effective interest rate method is used, any cumulative adjustment is amortised to profit or loss over the life of the hedged item using a recalculated effective interest rate.

Cash flow hedge - in a cash flow hedge, the effective portion of the gain or loss on the hedging instrument is recognised in other comprehensive income and the ineffective portion in profit or loss. When the forecast transaction results in the recognition of a financial asset or financial liability, the cumulative gain or loss is reclassified from equity to profit or loss in the same periods in which the hedged forecast cash flows affect profit or loss. Otherwise the cumulative gain or loss is removed from equity and recognised in profit or loss at the same time as the hedged transaction. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; if the hedging instrument expires or is sold, terminated or exercised; if the forecast transaction is no longer expected to occur; or if hedge designation is revoked. On the discontinuance of hedge accounting (except where a forecast transaction is no longer expected to occur), the cumulative unrealised gain or loss is reclassified from equity to profit or loss when the hedged cash flows occur or, if the forecast transaction results in the recognition of a financial asset or financial liability, when the hedged forecast cash flows affect profit or loss. Where a forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss is reclassified from equity to profit or loss immediately.

Hedge of net investment in a foreign operation - in the hedge of a net investment in a foreign operation, the portion of foreign exchange differences arising on the hedging instrument determined to be an effective hedge is recognised in other comprehensive income. Any ineffective portion is recognised in profit or loss. Non-derivative financial liabilities as well as derivatives may be the hedging instrument in a net investment hedge. On disposal or partial disposal of a foreign operation, the amount accumulated in equity is reclassified from equity to profit or loss.

24. Share-based compensation

The Group operates a number of share-based compensation schemes under which it awards RBSG shares and share options to its employees. Such awards are generally subject to vesting conditions: conditions that vary the amount of cash or shares to which an employee is entitled. Vesting conditions include service conditions (requiring the employee to complete a specified period of service) and performance conditions (requiring the employee to complete a specified period of service and specified performance targets to be met). Other conditions to which an award is subject are non-vesting conditions (such as a requirement to save throughout the vesting period).

The cost of employee services received in exchange for an award of shares or share options granted is measured by reference to the fair value of the shares or share options on the date the award is granted and takes into account non-vesting conditions and market performance conditions (conditions related to the market price of RBSG shares): an award is treated as vesting irrespective of whether any market performance condition or non-vesting condition is met. The fair value of options granted is estimated using valuation techniques which incorporate exercise price, term, risk-free interest rates, the current share price and its expected volatility. The cost is expensed on a straight-line basis over the vesting period (the period during which all the specified vesting conditions must be satisfied) with a corresponding increase in equity in an equity-settled award, or a corresponding liability in a cash-settled award. The cost is adjusted for vesting conditions (other than market performance conditions) so as to reflect the number of shares or share options that actually vest. If an award is modified, the original cost continues to be recognised as if there had been no modification. Where modification increases the fair value of the award, this increase is recognised as an expense over the modified vesting period.

A new award of shares or share options is treated as the modification of a cancelled award if, on the date the new award is granted, the Group identifies them as replacing the cancelled award. The cancellation of an award through failure to meet non-vesting conditions triggers an immediate expense for any unrecognised element of the cost of an award.

25. Cash and cash equivalents

In the cash flow statement, cash and cash equivalents comprises cash and deposits with banks with an original maturity of less than three months together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

26. Shares in Group entities

The Bank's investments in its subsidiaries are stated at cost less any impairment.

Critical accounting policies and key sources of estimation uncertainty

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law and IFRS require the directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's 'Conceptual Framework for Financial Reporting'. The judgements and assumptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results.

(i) Goodwill

The Group capitalises goodwill arising on the acquisition of businesses, as discussed in Accounting policy 6. The carrying value of goodwill as at 31 December 2017 was £5,249 million held in assets of disposals groups (2016 - £5,249 million held in intangible assets).

Goodwill is the excess of the cost of an acquired business over the fair value of its net assets. Goodwill is not amortised but is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

Impairment testing in accordance with Accounting policy 8 inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of cash-generating units; and the valuation of their separable assets. The sensitivity of the assessment to changes in assumptions is discussed in Note 16 on the accounts.

(ii) Provisions for liabilities

As set out in Note 21 on the accounts, at 31 December 2017 the Group recognised provisions for liabilities in respect of Payment Protection Insurance, £1,052 million (2016 - £1,252 million), other customer redress, £825 million (2016 - £1,041 million), residential mortgage backed securities, £3,243 million (2016 - £6,752 million), litigation and other regulatory proceedings, £517 million (2016 - £1,057 million) and property and other £1,918 million (2016 - £1,738 million. Provisions are liabilities of uncertain timing or amount, and are recognised when there is a present obligation as a result of a past event, the outflow of economic benefit is probable and the outflow can be estimated reliably. Judgement is involved in determining whether an obligation exists, and in estimating the probability, timing and amount of any outflows. Where the Group can look to another party such as an insurer to pay some or all of the expenditure required to settle a provision, any reimbursement is recognised when, and only when, it is virtually certain that it will be received.

Payment Protection Insurance - the Group has established a provision for redress payable in respect of the mis-selling of Payment Protection Insurance policies. The provision is management's best estimate of the anticipated costs of redress and related administration expenses. The determination of appropriate assumptions to underpin the provision requires significant judgement by management. The principal assumptions underlying the provision together with sensitivities to changes in those assumptions are given in Note 21 on the accounts.

Provisions for litigation - the Group and members of the Group are party to legal proceedings in the United Kingdom, the United States and other jurisdictions, arising out of their normal business operations. The measurement and recognition of liabilities in respect of litigation involves a high degree of management judgement. Before the existence of a present obligation as the result of a past event can be confirmed, numerous facts may need to be established, involving extensive and time-consuming discovery, and novel or unsettled legal questions addressed. Once it is determined there is an obligation, assessing the probability of economic outflows and estimating the amount of any liability can be very difficult. In many proceedings, it is not possible to determine whether any loss is probable or to estimate the amount of any loss. Furthermore, for an individual matter, there can be a wide range of possible outcomes and often it is not practicable to quantify a range of such outcomes. The Group's outstanding litigation is periodically assessed in consultation with external professional advisers, where appropriate, to determine the likelihood of the Group incurring a liability. A detailed description of the Group's material legal proceedings and a discussion of the nature of the associated uncertainties are given in Note 29 on the accounts.

Tax contingencies - determining the Group's income tax charge and its provisions for income taxes necessarily involves a significant degree of estimation and judgement. The tax treatment of some transactions is uncertain and tax computations are yet to be agreed with the tax authorities in a number of jurisdictions. The Group recognises anticipated tax liabilities based on all available evidence and, where appropriate, in the light of external advice. Any difference between the final outcome and the amounts provided will affect current and deferred income tax assets and liabilities in the period when the matter is resolved.

(iii) Deferred tax

The Group makes provision for deferred tax on temporary differences where tax recognition occurs at a different time from accounting recognition. Deferred tax assets of £166 million were recognised as at 31 December 2017 (2016 - £1,798 million).

The Group has recognised deferred tax assets in respect of losses, principally in the UK, and temporary differences. Deferred tax assets are recognised in respect of unused tax losses and other temporary differences to the extent that it is probable that there will be future UK taxable profits against which the losses and other temporary differences can be utilised. The Group has considered the carrying value of the deferred tax asset as at 31 December 2017 that, based on management's estimates, sufficient taxable profits will be generated in future years to recover recognised deferred tax assets. These estimates are based on forecast performance and take into account Brexit, the Group's plans to implement the UK ring-fencing regime and the resultant transfers between members of the Group.

Deferred tax assets of £4,705 million (2016 - £5,728 million) have not been recognised in respect of tax losses and other temporary differences where the availability of future taxable profits is uncertain. Further details about the Group's deferred tax assets are given in Note 23 on the accounts.

(iv) Loan impairment provisions

The Group's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans classified as loans and receivables and carried at amortised cost in accordance with Accounting policy 15.

A loan is impaired when there is objective evidence that events since the loan was granted have affected expected cash flows from the loan. Such objective evidence, indicative that a borrower's financial condition has deteriorated, can include for loans that are individually assessed: the non-payment of interest or principal; debt renegotiation; probable bankruptcy or liquidation; significant reduction in the value of any security; breach of limits or covenants; and deteriorating trading performance and, for collectively assessed portfolios: the borrowers' payment status and observable data about relevant macroeconomic measures.

The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate.

There are two components to the Group's loan impairment provisions: individual and collective.

Individual component - all impaired loans that exceed specific thresholds are individually assessed for impairment. Individually assessed loans principally comprise the Group's portfolio of commercial loans to medium and large businesses. Impairment losses are recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held. These estimates take into account the customer's debt capacity and financial flexibility; the level and quality of its earnings; the amount and sources of cash flows; the industry in which the counterparty operates; and the realisable value of any security held. Estimating the quantum and timing of future recoveries involves significant judgement. The size of receipts will depend on the future performance of the borrower and the value of security, both of which will be affected by future economic conditions; additionally, collateral may not be readily marketable. The actual amount of future cash flows and the date they are received may differ from these estimates and consequently actual losses incurred may differ from those recognised in these financial statements.

Collective component - this is made up of two elements: loan impairment provisions for impaired loans that are below individual assessment thresholds (collectively assessed provisions) and for loan losses that have been incurred but have not been separately identified at the balance sheet date (latent loss provisions). Collectively assessed provisions are established on a portfolio basis using a present value methodology taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates and the related average life. These portfolios include mortgages, credit card receivables and other personal lending. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends. Latent loss provisions are held against estimated impairment losses in the performing portfolio that have yet to be identified as at the balance sheet date. To assess the latent loss within its portfolios, the Group has developed methodologies to estimate the time that an asset can remain impaired within a performing portfolio before it is identified and reported as such.

(v) Fair value - financial instruments

In accordance with Accounting policies 14, 16 and 23, financial instruments classified as held-for-trading or designated as at fair value through profit or loss and financial assets classified as available-for-sale are recognised in the financial statements at fair value. All derivatives are measured at fair value.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. It also uses the assumptions that market participants would use when pricing the asset or liability. In determining fair value the Group maximises the use of relevant observable inputs and minimises the use of unobservable inputs.

Where the Group manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, it measures the fair value of a group of financial assets and financial liabilities on the basis of the price that it would receive to sell a net long position (i.e. an asset) for a particular risk exposure or to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction at the measurement date under current market conditions.

Credit valuation adjustments are made when valuing derivative financial assets to incorporate counterparty credit risk. Adjustments are also made when valuing financial liabilities measured at fair value to reflect the Group's own credit standing.

Where the market for a financial instrument is not active, fair value is established using a valuation technique. These valuation techniques involve a degree of estimation, the extent of which depends on the instrument's complexity and the availability of market-based data. Further details about the Group's valuation methodologies and the sensitivity to reasonably possible alternative assumptions of the fair value of financial instruments valued using techniques where at least one significant input is unobservable are given in Note 9 on the accounts.

Accounting developments
International Financial Reporting Standards

A number of IFRSs and amendments to IFRS were in issue at 31 December 2017 that would affect RBS Group from 1 January 2018 or later.

Effective 1 January - IFRS 9

In July 2014, the IASB published IFRS 9 'Financial Instruments' with an effective date of 1 January 2018. IFRS 9 replaces the current financial instruments standard IAS 39, setting out new accounting requirements in a number of areas.

The principle features of IFRS 9 are as follows:

Recognition and derecognition

The sections in IAS 39 setting out the criteria for the recognition and derecognition of financial instruments have been included unamended in IFRS 9.

Classification and measurement

Financial assets - There are three classifications for financial assets in IFRS 9..

Amortised cost - Financial assets with terms that give rise to interest and principal cash flows only and which are held in a business model whose objective is to hold financial assets to collect their cash flow are measured at amortised cost.
Fair value through other comprehensive income - Financial assets with terms that give rise to interest and principal cash flows only and which are held in a business model whose objective is achieved by holding financial assets to collect their cash flow and selling them are measured at fair value through other comprehensive income.
Fair value through profit and loss - Other financial assets are measured at fair value through profit and loss.

At initial recognition, any financial asset may be irrevocably designated as measured at fair value through profit or loss if such designation eliminates a measurement or recognition inconsistency.

The measurement basis of the majority of the Group's financial assets is unchanged on application of IFRS 9.

Financial liabilities – Since early adopting the IFRS 9 accounting for fair value attributable to own credit risk in 2017, there are no further material changes on accounting for financial liabilities on adoption of IFRS 9.

Hedge accounting

IFRS 9's hedge accounting requirements are designed to align the accounting more closely to the risk management framework; permit a greater variety of hedging instruments; and remove or simplify some of the rule-based requirements in IAS 39. The elements of hedge accounting: fair value, cash flow and net investment hedges are retained. The Group accounting policy choice is continue with the IAS 39 hedge accounting framework.

Credit impairment

IFRS 9's credit impairment requirements apply to financial assets measured at amortised cost, to those measured at fair value through other comprehensive income, to lease receivables and to certain loan commitments and financial guarantee contracts. On initial recognition a loss allowance is established at an amount equal to 12-month expected credit losses (ECL) that is the portion of life-time expected losses resulting from default events that are possible within the next 12 months. Where a significant increase in credit risk since initial recognition is identified, the loss allowance increases so as to recognise all expected default events over the expected life of the asset. The Group expects that financial assets where there is objective evidence of impairment under IAS 39 will be credit impaired under IFRS 9, and carry loss allowances based on all expected default events.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted: determined by evaluating at the balance sheet date for each customer or loan portfolio a range of possible outcomes using reasonable and supportable information about past events, current conditions, forecasts of future events and economic conditions. The estimation of ECL also takes into account the discount of future cash flows. Recognition and measurement of credit impairments under IFRS 9 are more forward-looking than under IAS 39.

An RBS Group-wide programme has implemented the necessary changes in the modelling of credit loss parameters, and the underlying credit management and financial processes. The result is an increase in overall credit impairment provisions when compared with the current basis of measurement under IAS 39.

Transition

The classification and measurement and impairment requirements will be applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods.

In summary, on 1 January 2018, the estimated impact on the Group was a £76 million post tax decrease in equity, comprising:

- Reclassification of financial instruments - £557 million pre tax increase.
- Change in impairment methodology - £617 million pre tax reduction.
- Net tax impact - £16 million decrease .

The estimated impact on 1 January 2018 on the Bank was a £246 million post tax increase in equity, comprising:

- Reclassification of financial instruments - £546 million pre tax increase.
- Change in impairment methodology - £179 million pre tax reduction.
- Net tax impact - £121 million decrease .

There will be no restatement of accounts prior to 2018.

The Group has opted to early adopt the IFRS 9 amendment on negative compensation with effect from 1 January 2018; this is expected to be endorsed for use in the EU in early 2018.

Effective 1 January 2018 - other standards

IFRS 15 'Revenue from Contracts with Customers' was issued in May 2014. It will replace IAS 11 'Construction Contracts', IAS 18 'Revenue' and several Interpretations. Contracts are bundled or unbundled into distinct performance obligations with revenue recognised as the obligations are met. A restatement is not expected on initial application of this standard.

IFRS 2 'Share-based payment' was amended in June 2016 to clarify the accounting for net settlement of tax in respect of share-based payments and the calculation of the cost of modified awards and those with vesting conditions that are not market conditions.

IFRIC Interpretation 22 'Foreign Currency Transaction and Advance Consideration' was issued in December 2016 clarifying the date of a foreign exchange transaction to be used on initial recognition of a related asset or other item.

IAS 40 'Investment Property' was amended in December 2016 to clarify that transfers into or out of the investment property classification may only occur on a change of use or the property ceasing to meet the definition of an investment property. The effective date is 1 January 2018.

On adoption, none of these standards are expected to have a material effect on the Group's results.

Effective after 2018

IFRS 16 'Leases' was issued in January 2016 to replace IAS 17 'Leases'. There are no substantial changes to the accounting for leases by lessors nor for finance leases; operating leases will be brought on balance sheet through the recognition of assets representing the contractual rights of use, and liabilities will be recognised for the contractual payments that exist. The effective date is 1 January 2019.

IFRS 17 'Insurance contracts' was issued in May 2017 to replace IFRS 4 and to establish a comprehensive standard for inceptors of insurance policies. The effective date is 1 January 2021.

IFRIC Interpretation 23 'Uncertainty over income tax treatments' was issued in June 2017 to clarify how to apply judgement in assessing the tax position of the reporting entity. The effective date is 1 January 2019.

In October 2017, the IASB amended IAS 28 'Investments in associates and joint ventures' to require long term, non-equity interests in these investments to be tested for impairment first in accordance with IFRS 9 and then in accordance with IAS 28. The effective date of the amendment is 1 January 2019.

In February 2018 the IASB amended IAS 'Employee Benefits' to clarify the need to update assumptions whenever there is a plan amendment, curtailment or settlement during the reporting period. The effective date is 1 January 2019.

The Group is assessing the effect of adopting these standards on its financial statements.

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1 Net interest income

	2017 £m	2016 £m	2015 £m
Loans and advances to customers	192	258	759
Loans and advances to banks	10	8	47
Debt securities	68	70	80
Interest receivable (1)	270	336	886
Customer accounts: demand deposits	3	20	63
Customer accounts: other time deposits	7	25	39
Balances with banks	9	5	152
Debt securities in issue	204	219	367
Internal funding of trading businesses	(1)	(30)	86
Interest payable (1)	222	239	707
Net interest income	48	97	179

2 Non-interest income

	2017 £m	2016 £m	2015 £m
Fees and commissions receivable			
Payment services	1	23	45
Lending (credit facilities)	84	82	267
Brokerage	63	97	244
Investment management	1	—	—
Trade finance	3	28	55
Other	130	80	42
	282	310	653
Fees and commissions payable	(275)	(262)	(254)
Income from trading activities			
Foreign exchange	378	520	600
Interest rate	249	236	289
Credit	144	97	236
Changes in fair value of own debt and derivative liabilities attributable to own credit			
- debt securities in issue	(70)	143	(63)
Equities and other	36	(29)	(1)
	737	967	1,061
Loss on redemption of own debt	—	(52)	(263)
Other operating income			
Operating lease and other rental income	8	(5)	(15)
Changes in the fair value of own debt designated as at fair value through profit or loss attributable to own credit risk (2)			
- debt securities in issue	—	39	80
Other changes in the fair value of financial assets and liabilities designated as at fair value through profit or loss and related derivatives	(11)	(23)	95
Changes in the fair value of investment properties	—	(1)	(24)
Profit on sale of securities	61	82	35
Profit on sale of property, plant and equipment	—	15	57
Profit/(loss) on sale of subsidiaries and associates	81	(81)	(86)
Loss on disposal or settlement of loans and receivables	(38)	(45)	(352)
Share of profits of associated entities	1	5	24
Other income (3)	17	21	114
	119	7	(72)

Notes:
(1) Negative interest on loans and advances is classed as interest payable and on customer deposits is classed as interest receivable.
(2) Measured as the change in fair value from movements in the year in the credit risk premium payable by the Group. Ahead of adopting IFRS9 Financial Instruments from 1 January 2018, the Group has adopted the provisions in respect of the presentation of gains and losses on financial liabilities designated as at fair value through profit or loss from 1 January 2017.
(3) Includes income from activities other than banking.

3 Operating expenses

	2017 (3) £m	2016 £m	2015 £m
Wages, salaries and other staff costs	827	342	892
Social security costs	58	44	49
Share-based compensation	3	3	8
Pension costs			
- defined benefit schemes (see Note 4)	(7)	1	2
- defined contribution schemes	13	6	13
Staff costs	894	396	964
Premises and equipment	152	29	81
Other administrative expenses (1)	1,389	5,142	5,475
Property, plant and equipment depreciation and write down	(49)	2	2
Intangible assets amortisation	—	—	16
Depreciation and amortisation	(49)	2	18
	2,386	5,569	6,538

Restructuring and divestment costs

Included in operating expenses are the following restructuring and divestment costs.

	2017 £m	2016 £m	2015 £m
Restructuring			
Staff costs	226	59	372
Premises & depreciation	(26)	5	3
Other administrative expenses (2)	107	13	31
	307	77	406

Notes:
(1) Includes litigation and conduct costs. Further details are provided in Note 21.
(2) Includes other administrative expenses, write down of goodwill and other intangible assets.
(3) In prior periods, staff and premises formed part of the discontinued operation therefore are included as an allocation within other administrative expenses of the continued operation. Post resegmentation, these costs are included in continued operations as part of the respective cost headings.

The average number of persons employed, rounded to the nearest hundred, in continuing operations (all NatWest Markets) during the year, excluding temporary staff, was 3,400 (2016 – 1,800; 2015 – 2,800); on the same basis there were 69,100 people employed in discontinued operations (2016 – 80,100; 2015 – 94,700). The number of persons employed by the Group in continuing operations at 31 December, excluding temporary staff, was as follows:

	2017	2016	2015
UK	2,100	1,000	1,300
USA	500	200	200
Europe	500	100	500
Rest of the World	2,200	200	200
Total	5,300	1,500	2,200

The number of people employed in discontinued operations at 31 December was 62,800 (2016 – 75,300; 2015 – 84,800).

3 Operating expenses continued

Variable compensation awards

The following tables analyse the RBS Group variable compensation awards for 2017.

	2017 £m	2016 £m	Change %
Non-deferred cash awards (1)	51	56	(9)
Total non-deferred variable compensation	51	56	(9)
Deferred bond awards	134	138	(3)
Deferred share awards	157	149	5
Total deferred variable compensation	291	287	1
Total variable compensation (2)	342	343	—
of which			
- continuing operations	122	104	
- discontinued operations	220	239	

Reconciliation of variable compensation awards to income statement charge	2017 £m	2016 £m	2015 £m
Variable compensation awarded	342	343	373
Less: deferral of charge for amounts awarded for current year	(133)	(103)	(97)
Income statement charge for amounts awarded in current year	209	240	276
Add: current year charge for amounts deferred from prior years	96	147	140
Less: forfeiture of amounts deferred from prior years	(7)	(106)	(102)
Income statement charge for amounts deferred from prior years	89	41	38
Income statement charge for variable compensation (2)	298	281	314
of which			
- continuing operations	111	56	
- discontinued operations	187	225	

Notes:
(1) Cash awards are limited to £2,000 for all employees.
(2) Excludes other performance related compensation.

4 Pensions

Defined contribution schemes

The Group sponsors a number of defined contribution pension schemes in different territories, which new employees are offered the opportunity to join.

Defined benefit schemes

The Group sponsors a number of pension schemes in the UK and overseas, including the Main and AA sections of The Royal Bank of Scotland Group Pension Fund which operate under UK trust law and is managed and administered on behalf of their members in accordance with the terms of the trust deed, the scheme rules and UK legislation.

Pension fund trustees are appointed to operate each fund and ensure benefits are paid in accordance with the scheme rules and national law. The trustees are the legal owner of a scheme's assets, and have a duty to act in the best interests of all scheme members.

The schemes generally provide a pension of one-sixtieth of final pensionable salary for each year of service prior to retirement up to a maximum of 40 years and are contributory for current members. These have been closed to new entrants some ten years ago, although current members continue to build up additional pension benefits, currently subject to 2% maximum annual salary inflation while they remain employed by the Group.

The corporate trustee is RBS Pension Trustee Limited (the Trustee), a wholly owned subsidiary of National Westminster Bank Plc, Principal Employer of the Main scheme. The Board of the Trustee comprises four member trustee directors selected from eligible active staff, deferred and pensioner members who apply and six appointed by the Group. Under UK legislation a defined benefit pension scheme is required to meet the statutory funding objective of having sufficient and appropriate assets to cover its liabilities (the pensions that have been promised to members).

Investment strategy

The assets of the AA section, which represent 91% of the continuing plan assets at 31 December 2017, are invested in a diversified portfolio of indexed–linked bonds, fixed interest bonds, equities and derivative instruments.

The AA section employs derivative instruments to achieve a desired asset class exposure and to reduce the scheme's interest rate, inflation and currency risk. This means that the net funding position is considerably less sensitive to changes in market conditions than the value of the assets or liabilities in isolation.

Derivatives have been executed at prevailing market rates and within standard market bid/offer spreads with a number of counterparty banks, including The Royal Bank of Scotland plc.

The investment strategy of other schemes is similar to that of the AA section, adjusted to take account of the nature of liabilities, risk appetite of the trustees, size of the scheme and any local regulatory constraints.

	AA Section	
Major classes of plan assets as a percentage of total plan assets	2017 %	2016 %
Quoted assets		
Quoted equities	7.2	6.3
Private equity	1.2	1.0
Index-linked bonds	49.8	54.8
Government fixed interest bonds	5.5	—
Corporate and other bonds	17.8	17.6
	—	
Unquoted assets		
Real estate	4.2	4.0
Derivatives	7.2	7.6
Cash and other assets	7.1	8.7
	100.0	100.0

4 Pensions continued

The schemes does not invest directly in RBSG but can have exposure to it within its investment programmes through indirect exposure to RBSG ordinary shares through index tracking investments, swaps contracts (before allowing for collateral posted against the mark value of the swaps) and cash deposits placed with the Group. The trustees are responsible for ensuring that indirect investments in RBSG do not exceed the 5% regulatory limit.

Amounts in the Financial statements

The Group recognises the net pension scheme surplus or deficit as a net asset or liability. In doing so, the funded status is adjusted to reflect any schemes with a surplus that the Group may not be able to access, as well as any minimum funding requirement to pay in additional contributions.

	All schemes	
Amounts recognised on the balance sheet	2017 £m	2016 £m
Fund assets at fair value	1,272	48,438
Present value of fund liabilities	1,036	43,177
Funded status	236	5,261
Asset ceiling/minimum funding	—	5,315
Retirement benefit asset/(liability)	236	(54)

Net pension asset/(liability) comprises	2017 £m	2016 £m
Net assets of schemes in surplus (included in Prepayments, accrued income and other assets, Note 18)	290	267
Net liabilities of schemes in deficit (included in Accruals and other liabilities, Note 22)	(54)	(321)
	236	(54)

The income statement charge comprises:

	2017 £m	2016 £m	2015 £m
Continuing operations	(7)	1	2
Discontinued operations	374	260	454
	367	261	456

4 Pensions continued

Changes in value of net pension liability/(asset)	AA section Fair value of plan assets £m	AA section Present value of defined benefit obligations £m	AA section Asset ceiling/ minimum funding (1) £m	AA section Net pension liability/ (asset) £m	All schemes Fair value of plan assets £m	All schemes Present value of defined benefit obligations £m	All schemes Asset ceiling/ minimum funding (1) £m	All schemes Net pension liability/ (asset) £m
At 1 January 2016	893	713	—	(180)	34,696	35,115	3,130	3,549
Currency translation and other adjustments	—	—		—	537	602		65
Income statement								—
Net interest expense	34	27		(7)	1,451	1,322	122	(7)
Current service cost		1		1		258		258
Past service cost				—		8		8
Loss on curtailment or settlements				—		2		2
	34	28	—	(6)	1,451	1,590	122	261
Statement of comprehensive income								
Return on plan assets above recognised interest income	245	—		(245)	9,254			(9,254)
Experience gains and losses		(19)		(19)		(793)		(793)
Effect of changes in actuarial financial assumptions		208		208		9,557		9,557
Effect of changes in actuarial demographic assumptions		(11)		(11)		(543)		(543)
Asset ceiling/minimum funding adjustments				—			2,074	2,074
	245	178	—	(67)	9,254	8,221	2,074	1,041
Contributions by employer	4	—		(4)	4,783			(4,783)
Contributions by plan participants and other scheme members	—	—			12	12		—
Liabilities extinguished upon settlement	—	—			(43)	(129)		(86)
Benefits paid	(27)	(27)			(1,465)	(1,465)		—
Transfer to disposal groups	—	—			(787)	(769)	(11)	7
At 1 January 2017	1,149	892	—	(257)	48,438	43,177	5,315	54
Currency translation and other adjustments					47	47	3	3
Income statement								
Net interest expense	30	23		(7)	1,263	1,119	142	(2)
Current service cost		1		1		285		285
Past service cost						19		19
Loss on curtailments or settlements						65		65
	30	24	—	(6)	1,263	1,488	142	367
Statement of comprehensive income								
Return on plan assets above recognised interest income	30			(30)	1,683			(1,683)
Experience gains and losses		3		3		99		99
Effect of changes in actuarial financial assumptions		17		17		719		719
Effect of changes in actuarial demographic assumptions		(16)		(16)		(826)		(826)
Asset ceiling/minimum funding adjustments							1,628	1,628
	30	4	—	(26)	1,683	(8)	1,628	(63)
Contributions by employer	1			(1)	621			(621)
Contributions by plan participants and other scheme members					10	10		—
Liabilities extinguished upon settlement					(744)	(755)		(11)
Transfers to fellow subsidiaries					3	35		32
Benefits paid	(53)	(53)			(2,364)	(2,364)		
Transfer to disposal groups	—	—	—	—	(47,685)	(40,594)	(7,088)	3
At 31 December 2017	1,157	867	—	(290)	1,272	1,036	—	(236)

Note:
(1) In recognising the net surplus or deficit of a pension scheme, the funded status of each scheme is adjusted to reflect any minimum funding requirement imposed on the sponsor and any ceiling on the amount that the sponsor has an unconditional right to recover from a scheme.

4 Pensions continued

Funding and contributions by the Group

In the UK, the Trustees of defined benefit pension schemes are required to perform funding valuations every three years. The Trustees and the sponsoring company, with the support of the Scheme Actuary, agree the assumptions used to value the liabilities and a Schedule of Contributions required to eliminate any funding deficit. The funding assumptions incorporate a margin for prudence over and above the expected cost of providing the benefits promised to members, taking into account the sponsor's covenant and the investment strategy of the scheme. Similar arrangements apply in the other territories where the Group sponsors defined benefit pension schemes. The last funding valuation of the AA section was at 31 December 2015 and next funding valuation is due at 31 December 2018, to be agreed by 31 March 2020.

The triennial funding valuation of the bank as at 31 December 2015 determined the funding level to be 101%, pension liabilities to be £892 million and the surplus to be £5 million.

Assumptions

Placing a value on the Group's defined benefit pension schemes' liabilities requires the Group's management to make a number of assumptions, with the support of independent actuaries who provide advice and guidance to the Group. The ultimate cost of the defined benefit obligations to the Group will depend upon actual future events and the assumptions made are unlikely to be exactly borne out in practice, meaning the final cost may be higher or lower than expected.

The most significant assumptions used for the AA section are shown below:

	Principal IAS 19 actuarial assumptions		Principal assumptions of AA section 2015 triennial valuation
	2017	2016	2015
	%	%	
Discount rate	2.6	2.7	Fixed interest swap yield curve plus 1.3% per annum at all durations
Inflation assumption (RPI)	3.1	3.2	Retail price index RPI swap yield curve
Rate of increase in salaries	1.8	1.8	
Rate of increase in deferred pensions	2.1	2.2	
Rate of increase in pensions in payment	2.9	3.0	(RPI floor 0%, cap 5%): Limited price indexation (LPI) (0,5) swap yield curve
Proportion of pension converted to a cash lump sum at retirement	12	12	12%
Longevity at age 60 for current pensioners (years)			
Males	28.3	28.6	29.1
Females	29.7	30.1	30.7
Longevity at age 60 for future pensioners currently aged 40 (years)			
Males	29.5	30.2	31.0
Females	31.7	32.3	33.6

Discount rate

The Group discounts its defined benefit pension obligations at discount rates determined by reference to the yield on 'high quality' corporate bonds.

The sterling yield curve (applied to 84% of the Group's defined benefit obligations) is constructed by reference to yields on 'AA' corporate bonds from which a single discount rate is derived based on a cash flow profile similar in structure and duration to the pension obligations.

The weighted average duration of the AA section's defined benefit obligation at 31 December 2017 is 21 years (2016 – 21 years). Significant judgement is required when setting the criteria for bonds to be included in the population from which the yield curve is derived.

The criteria include issue size, quality of pricing and the exclusion of outliers. Judgement is also required in determining the shape of the yield curve at long durations: a constant credit spread relative to gilts is assumed.

4 Pensions continued

The table below shows how the present value of the defined benefit obligation would change if the key assumptions used were changed. The sensitivity analysis presented below may not be representative of the actual change in the defined benefit obligation as it is unlikely that the changes in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

	AA section (decrease)/increase in obligation at 31 December	
	2017 £m	2016 £m
0.25% increase in the discount rate	(45)	(45)
0.25% increase in inflation	32	38
0.25% additional rate of increase in pensions in payment	33	33
Longevity increase of one year	29	30

The defined benefit obligation is attributable to the different classes of AA section members in the following proportions:

Membership category	2017 %	2016 %
Active members	3.7	3.7
Deferred members	63.0	63.0
Pensioner and dependants	33.3	33.3
	100.0	100.0

The experience history of Group schemes is shown below:

	AA section		
History of defined benefit schemes	2017 £m	2016 £m	2015 £m
Fair value of plan assets	1,157	1,149	893
Present value of plan obligations	867	892	713
Net surplus	290	257	180
Experience (losses)/gains on plan liabilities	(3)	19	5
Experience gains/(losses) on plan assets	30	245	(20)
Actual return on plan assets	60	279	13
Actual return on plan assets - %	5.2%	31.2%	1.4%

5 Auditor's remuneration

Ernst & Young LLP (EY) are the Group's auditors for the audit of the 2017 annual accounts. Amounts paid to EY for statutory audit and other services are set out below:

	Group	
	2017	2016
EY	£m	£m
Fees payable for the audit of the Group's annual accounts	7.0	7.0
Fees payable to the auditor and its associates for other services to the Group		
- the audit of the Bank's subsidiaries pursuant to legislation	9.5	9.5
Total audit and audit-related assurance service fees	16.5	16.5

Fees payable to the auditor for non-audit services are disclosed in the consolidated financial statements of The Royal Bank of Scotland Group plc.

6 Tax

	Group		
	2017 £m	2016 £m	2015 £m
Current tax			
Credit for the year	28	187	449
Over provision in respect of prior years	53	54	79
	81	241	528
Deferred tax			
Credit/(charge) for the year	125	(123)	(71)
Reduction in the carrying value of deferred tax assets	(30)	(300)	—
(Under)/over provision in respect of prior year	(16)	(47)	1
Tax credit/(charge) for the year	160	(229)	458

The actual tax credit/(charge) differs from the expected tax credit/(charge) computed by applying the standard rate of UK corporation tax of 19.25% (2016 – 20.00%; 2015 – 20.25%) as follows:

	2017 £m	2016 £m	2015 £m
Expected tax credit	269	874	1,029
Losses and temporary differences in year where no deferred tax asset recognised	(265)	(679)	(953)
Foreign profits taxed at other rates	119	329	417
UK tax rate change impact (1)	(7)	4	15
Items not allowed for tax			
- losses on disposal and write-downs	(27)	(5)	(28)
- regulatory and legal actions	7	(454)	(61)
- other disallowable items	(19)	(33)	(51)
Non-taxable items	19	—	5
Losses brought forward and utilised	—	3	5
Reduction in carrying value of deferred tax asset in respect of			
- UK losses	(30)	(300)	—
Banking surcharge	57	25	—
Adjustments in respect of prior years (2)	37	7	80
Actual tax credit/(charge)	160	(229)	458

Notes:

(1) In recent years, the UK government has steadily reduced the rate of UK corporation tax, with the latest enacted rates standing at 20% with effect from 1 April 2015, 19% from 1 April 2017 and 17% from 1 April 2020. The Finance (No 2) Act 2015 restricts the rate at which tax losses are given credit in future periods to the main rate of UK corporation tax, excluding the Banking Surcharge 8% rate introduced by this Act. Deferred tax assets and liabilities at 31 December 2017 take into account the reduced rates in respect of tax losses and non-banking temporary differences and where appropriate, the banking surcharge inclusive rate in respect of other banking temporary differences.

(2) Prior year tax adjustments incorporate refinements to tax computations made on submission and agreement with the tax authorities. Current taxation balances include provisions in respect of uncertain tax positions, in particular in relation to restructuring and other costs where the taxation treatment remains subject to agreement with the relevant tax authorities.

7 Loss dealt with in the accounts of the bank

As permitted by section 408(3) of the Companies Act 2006, no income statement for the Bank has been presented as a primary financial statement.

8 Financial instruments - classification

The following tables show the Group's financial assets and liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown within other assets and other liabilities.

	Group						
Assets	Held-for-trading £m	Designated as at fair value through profit or loss £m	Available-for-sale £m	Loans and receivables £m	Held-to-maturity £m	Other assets £m	Total £m
Cash and balances at central banks	—	—	—	153	—		153
Loans and advances to banks							
- amounts due from fellow subsidiaries	173	—	—	28	—		201
- reverse repos	11,844	—	—	36	—		11,880
- other (1)	6,846	—	—	335	—		7,181
Loans and advances to customers							
- amounts due from holding company and fellow subsidiaries	—	—	—	—	—		—
- reverse repos	24,427	—	—	2,308	—		26,735
- other	15,309	—	—	7,330	—		22,639
Debt securities	27,481	—	475	2,583	—		30,539
Equity shares	25	6	56	—	—		87
Settlement balances	—		—	2,512	—		2,512
Derivatives							
- amounts due from fellow subsidiaries	362						362
- other	158,916						158,916
Assets of disposal groups	—					463,878	463,878
Other assets	—	—	—	—	—	1,154	1,154
At 31 December 2017	245,383	6	531	15,285	—	465,032	726,237
Cash and balances at central banks	—	—	—	73,813	—		73,813
Loans and advances to banks							
- amounts due from fellow subsidiaries	288	—	—	749	—		1,037
- reverse repos	11,120	—	—	1,740	—		12,860
- other (1)	6,732	—	—	9,866	—		16,598
Loans and advances to customers							
- amounts due from holding company and fellow subsidiaries	—	—	—	1,116	—		1,116
- reverse repos	26,587	—	—	2,297	—		28,884
- other	17,500	82	—	297,373	—		314,955
Debt securities	24,501	—	38,414	3,968	4,769		71,652
Equity shares	128	88	229	—	—		445
Settlement balances	—		—	5,557			5,557
Derivatives							
- amounts due from holding company and fellow subsidiaries	1,306						1,306
- other	246,438						246,438
Assets of disposal groups						8,366	8,366
Other assets	—	—	—	—	—	14,787	14,787
At 31 December 2016	334,600	170	38,643	396,479	4,769	23,153	797,814
Analysis of assets of disposal groups							
At 31 December 2017	2,011	90	42,744	401,497	4,128	13,408	463,878

For the notes to this table refer to page 111.

8 Financial instruments - classification continued

Liabilities	Held-for-trading £m	Designated as at fair value through profit or loss £m	Amortised cost £m	Other liabilities £m	Total £m
	Group				
Deposits by banks					
- amounts due to fellow subsidiaries	29	—	50		79
- repos	4,029	—	—		4,029
- other (2)	12,457	—	528		12,985
Customer accounts					
- amounts due to holding company and fellow subsidiaries	—	—	6		6
- repos	24,333	—	—		24,333
- other (3)	11,507	—	3,257		14,764
Debt securities in issue (4)	1,107	3,299	7,956		12,362
Settlement balances	—	—	2,818		2,818
Short positions	28,527	—			28,527
Derivatives					
- amounts due to fellow subsidiaries	486	—			486
- other	152,844	—			152,844
Subordinated liabilities					
- amounts due to fellow subsidiaries	—	—	—		—
- other	—	—	—		—
Liabilities of disposal groups				432,832	432,832
Other liabilities	—	—	—	4,912	4,912
At 31 December 2017	235,319	3,299	14,615	437,744	690,977
Deposits by banks					
- amounts due to fellow subsidiaries	507	—	1,610		2,117
- repos	4,125	—	1,114		5,239
- other (2)	20,651	—	12,546		33,197
Customer accounts					
- amounts due to holding company	—	—	18,528		18,528
- repos	23,186	—	3,910		27,096
- other (3)	12,688	1,458	316,295		330,441
Debt securities in issue (4)	1,614	4,487	14,261		20,362
Settlement balances	—	—	3,641		3,641
Short positions	22,076	—			22,076
Derivatives					
- amounts due to holding company and fellow subsidiaries	1,228	—			1,228
- other	236,349	—			236,349
Subordinated liabilities					
- amounts due to holding company	—	—	11,212		11,212
- other	—	383	7,920		8,303
Liabilities of disposal groups				23,391	23,391
Other liabilities	—	—	2,028	16,787	18,815
At 31 December 2016	322,424	6,328	393,065	40,178	761,995

Analysis of liabilities of disposal groups					
At 31 December 2017	1,661	1,242	423,446	6,483	432,832

For the notes to this table refer to page 111.

8 Financial instruments - classification continued

The above includes amounts due from/to:

	Group			
	2017		2016	
	Holding company £m	Fellow subsidiaries £m	Holding company £m	Fellow subsidiaries £m
Assets				
Loans and advances to banks	—	201	—	1,037
Loans and advances to customers	—	—	972	144
Derivatives	—	362	260	1,046
Liabilities				
Deposits by banks	—	79	—	2,117
Customer Accounts	3	3	18,528	—
Derivatives	—	486	373	855

Notes:
(1) Includes items in the course of collection from other banks of nil (2016 - £781 million).
(2) Includes items in the course of transmission to other banks of £1 million (2016 - £295 million).
(3) There are no customer accounts designated as at fair value through profit or loss (2016 - £155 million) with a carrying value higher than the principal amount. No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial both during the period and cumulatively. Measured as the change in fair value from movements in the period in the credit risk premium payable.
(4) Comprises bonds and medium term notes of £16,688 million (2016 - £17,154 million) and certificates of deposit and other commercial paper of £4,637 million (2016 - £3,208 million).

Amounts relating to continuing operations included in operating loss before tax:

	Group		
	2017 £m	2016 £m	2015 £m
(Loss)/gains on financial assets/liabilities designated as at fair value through profit or loss	(11)	22	174
Losses on disposal or settlement of loans and receivables	(38)	(45)	(352)

Amounts included in profit from discontinued operations, net of tax, were £14 million loss (2016 – £15 million loss; 2015 – £111 million gain) in relation to financial assets/liabilities as at fair value through profit or loss; and £2 million loss (2016 - £137 million loss; 2015 - £199 million loss) in relation to disposal or settlement of loans and receivables.

8 Financial instruments - classification continued

The following tables show the bank's financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown within other assets and other liabilities.

	Bank						
Assets	Held-for-trading £m	Designated as at fair value through profit or loss £m	Available-for-sale £m	Loans and receivables £m	Held-to-maturity £m	Other assets £m	Total £m
Cash and balances at central banks	—	—	—	93	—	—	93
Loans and advances to banks							
- amounts due from fellow subsidiaries	1,364	—	—	1,726	—	—	3,090
- reverse repos	8,683	—	—	36	—	—	8,719
- other (1)	6,846	—	—	159	—	—	7,005
Loans and advances to customers							
- amounts due from fellow subsidiaries	1,353	—	—	1,279	—	—	2,632
- reverse repos	18,630	—	—	2,308	—	—	20,938
- other	15,263	—	—	6,825	—	—	22,088
Debt securities	23,565	—	470	3,299	—	—	27,334
Equity shares	24	—	26	—	—	—	50
Investment in Group undertakings	—	—	—	—	—	496	496
Settlement balances	—		—	1,640	—	—	1,640
Derivatives							
- amounts due from fellow subsidiaries	3,687						3,687
- other	158,318						158,318
Assets of disposal groups						269,038	269,038
Other assets	—	—	—	—	—	761	761
As at 31 December 2017	237,733	—	496	17,365	—	270,295	525,889
Cash and balances at central banks	—	—	—	70,615	—		70,615
Loans and advances to banks							
- amounts due from fellow subsidiaries	906	—	—	17,246	—		18,152
- reverse repos	7,107	—	—	1,740	—		8,847
- other (1)	6,734	—	—	5,285	—		12,019
Loans and advances to customers							
- amounts due from holding company and fellow subsidiaries	2,062	—	—	25,060	—		27,122
- reverse repos	19,111	—	—	2,297	—		21,408
- other	17,042	82	—	94,537	—		111,661
Debt securities	20,503	—	36,655	5,742	4,769		67,669
Equity shares	121	—	177	—	—		298
Investment in Group undertakings	—	—	—	—	—	35,169	35,169
Settlement balances	—	—	—	4,707			4,707
Derivatives							
- amounts due from holding company and fellow subsidiaries	6,144						6,144
- other	245,332			—			245,332
Other assets	—	—	—	—	—	4,470	4,470
At at 31 December 2016	325,062	82	36,832	227,229	4,769	39,639	633,613
Analysis of assets of disposal groups							
At 31 December 2017	2,219	58	40,361	186,140	4,128	36,132	269,038

For the notes to this table refer to page 114.

8 Financial instruments - classification continued

	Bank				
Liabilities	Held-for-trading £m	Designated as at fair value through profit or loss £m	Amortised cost £m	Other liabilities £m	Total £m
Deposits by banks					
- amounts due to fellow subsidiaries	966	—	1,995		2,961
- repos	2,357	—	—		2,357
- other (2)	12,459	—	527		12,986
Customer accounts					
- amounts due to holding company and fellow subsidiaries	9,840	—	2,142		11,982
- repos	10,553	—	—		10,553
- other (3)	11,499	—	3,063		14,562
Debt securities in issue (4)	1,107	3,299	7,956		12,362
Settlement balances	—	—	1,411		1,411
Short positions	26,207	—	—		26,207
Derivatives					
- amounts due to fellow subsidiaries	2,466		—		2,466
- other	152,632		—		152,632
Liabilities of disposal groups				228,027	228,027
Other liabilities	—	—	—	2,861	2,861
At 31 December 2017	230,086	3,299	17,094	230,888	481,367
Deposits by banks					
- amounts due to fellow subsidiaries	1,328	—	105,849		107,177
- repos	2,381	—	1,114		3,495
- other (3)	20,627	—	7,989		28,616
Customer accounts					
- amounts due to holding company and fellow subsidiaries	7,997	—	23,667		31,664
- repos	11,874	—	3,910		15,784
- other (4)	12,678	94	81,998		94,770
Debt securities in issue (5)	1,614	4,487	12,780		18,881
Settlement balances	—	—	2,774		2,774
Short positions	17,590	—	—		17,590
Derivatives					
- amounts due to holding company and fellow subsidiaries	5,036	—	—		5,036
- other	235,862	—	—		235,862
Subordinated liabilities					
- amounts due to holding company	—	—	11,212		11,212
- other	—	383	6,275		6,658
Other liabilities	—	—	1,276	6,942	8,218
At 31 December 2016	316,987	4,964	258,844	6,942	587,737
Analysis of liabilities of disposal groups					
At 31 December 2017	2,438	465	222,201	2,923	228,027

For the notes to this table refer to page 114.

8 Financial instruments - classification continued

The above includes amounts due from/to:

	Bank					
	2017			2016		
	Holding company £m	Fellow subsidiaries £m	Subsidiaries £m	Holding company £m	Fellow subsidiaries £m	Subsidiaries £m
Assets						
Loans and advances to banks	—	201	2,889	—	656	17,496
Loans and advances to customers	—	—	2,632	972	399	25,751
Derivatives	—	362	3,325	260	1,046	4,838
Liabilities						
Deposits by banks	—	79	2,882	—	2,108	105,069
Customer accounts	3	3	11,976	18,528	—	13,136
Derivatives	—	486	1,980	373	855	3,808

Notes:
(1) Includes items in the course of collection from other banks of nil (2016 - £271 million).
(2) Includes items in the course of transmission to other banks of £1 million (2016 - £165 million).
(3) There are no customer accounts designated as at fair value through profit or loss (2016 - £17 million) with a carrying value higher than the principal amount. No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial both during the period and cumulatively. Measured as the change in fair value from movements in the period in the credit risk premium payable.
(4) Comprises bonds and medium term notes of £16,292 million (2016 - £15,673 million) and certificates of deposit and other commercial paper of £4,637 million (2016 - £3,208 million).

8 Financial instruments - classification continued

The tables below present information on financial assets and liabilities that are offset on the balance sheet under IFRS or subject to enforceable master netting agreements only, together with financial collateral received or given.

	Group								
	Offsetable instruments			Offsetable potential not recognised by IFRS					
2017	Gross £m	IFRS offset £m	Balance sheet £m	Effect of master netting and similar agreements £m	Cash collateral £m	Other financial collateral £m	Net amount after the effect of netting arrangements and related collateral £m	Instruments outside netting arrangements £m	Balance sheet total £m
Assets									
Derivatives	173,058	(15,573)	157,485	(128,018)	(20,297)	(5,836)	3,334	1,793	159,278
Reverse repos	65,540	(32,639)	32,901	(329)	—	(32,530)	42	5,714	38,615
Loans to customers	760	(760)	—	—	—	—	—	22,639	22,639
Settlement balances	700	(668)	32	—	—	—	32	2,480	2,512
	240,058	(49,640)	190,418	(128,347)	(20,297)	(38,366)	3,408	32,626	223,044
Liabilities									
Derivatives	167,862	(16,042)	151,820	(128,018)	(18,028)	(3,952)	1,822	1,510	153,330
Repos	58,694	(32,639)	26,055	(329)	—	(25,726)	—	2,307	28,362
Customer accounts	291	(291)	—	—	—	—	—	14,770	14,770
Settlement balances	1,621	(668)	953	—	—	—	953	1,865	2,818
	228,468	(49,640)	178,828	(128,347)	(18,028)	(29,678)	2,775	20,452	199,280
2016									
Assets									
Derivatives	294,275	(51,080)	243,195	(197,778)	(28,700)	(8,435)	8,282	4,549	247,744
Reverse repos	69,762	(31,728)	38,034	(1,052)	—	(36,895)	87	3,710	41,744
Loans to customers	600	(600)	—	—	—	—	—	316,071	316,071
Settlement balances	1,711	(1,529)	182	—	—	—	182	5,375	5,557
	366,348	(84,937)	281,411	(198,830)	(28,700)	(45,330)	8,551	329,705	611,116
Liabilities									
Derivatives	285,121	(50,574)	234,547	(197,778)	(20,412)	(11,048)	5,309	3,030	237,577
Repos	61,742	(31,728)	30,014	(1,052)	—	(28,960)	2	2,321	32,335
Customer accounts	1,106	(1,106)	—	—	—	—	—	348,969	348,969
Settlement balances	1,677	(1,529)	148	—	—	—	148	3,493	3,641
	349,646	(84,937)	264,709	(198,830)	(20,412)	(40,008)	5,459	357,813	622,522

Loans and deposits on the balance sheet include cash collateral given or taken against the derivative portfolio. Where offset is available but not recognised under IFRS, this is reflected in the cash collateral column.

8 Financial instruments - classification continued

	Bank								
	Offsetable instruments			Offsetable potential not recognised by IFRS					
2017	Gross	IFRS offset	Balance sheet	Effect of master netting and similar agreements	Cash collateral	Other financial collateral	Net amount after the effect of netting arrangements and related collateral	Instruments outside netting arrangements	Balance sheet total
Assets	£m	£m	£m	£m	£m	£m	£m	£m	£m
Derivatives	177,576	(15,573)	162,003	(129,800)	(20,289)	(5,692)	6,222	2	162,005
Reverse repos	37,682	(13,740)	23,942	(96)	—	(23,846)	—	5,715	29,657
Loans and advances to banks	1,200	(9)	1,191	—	—	—	1,191	8,904	10,095
Loans to customers	2,113	(760)	1,353	(274)	—	—	1,079	23,367	24,720
Settlement balances	88	(55)	33	—	—	—	33	1,607	1,640
	218,659	(30,137)	188,522	(130,170)	(20,289)	(29,538)	8,525	39,595	228,117
Liabilities									
Derivatives	171,059	(16,042)	155,017	(129,800)	(18,028)	(3,952)	3,237	81	155,098
Repos	24,345	(13,740)	10,605	(96)	—	(10,509)	—	2,305	12,910
Deposits by banks	883	(9)	874	—	—	—	874	15,073	15,947
Customer accounts	8,876	(291)	8,585	(274)	—	—	8,311	17,959	26,544
Settlement balances	177	(55)	122	—	—	—	122	1,289	1,411
	205,340	(30,137)	175,203	(130,170)	(18,028)	(14,461)	12,544	36,707	211,910
2016									
Assets									
Derivatives	299,268	(51,080)	248,188	(199,906)	(28,666)	(8,338)	11,278	3,288	251,476
Reverse repos	43,797	(17,253)	26,544	(439)	—	(26,103)	2	3,711	30,255
Loans to customers	600	(600)	—	—	—	—	—	138,783	138,783
Settlement balances	206	(24)	182	—	—	—	182	4,525	4,707
	343,871	(68,957)	274,914	(200,345)	(28,666)	(34,441)	11,462	150,307	425,221
Liabilities									
Derivatives	288,842	(50,574)	238,268	(199,906)	(20,404)	(11,048)	6,910	2,630	240,898
Repos	34,210	(17,253)	16,957	(439)	—	(16,518)	—	2,322	19,279
Customer accounts	1,106	(1,106)	—	—	—	—	—	126,434	126,434
Settlement balances	28	(24)	4	—	—	—	4	2,770	2,774
	324,186	(68,957)	255,229	(200,345)	(20,404)	(27,566)	6,914	134,156	389,385

Loans and deposits on the balance sheet include cash collateral given or taken against the derivative portfolio. Where offset is available but not recognised under IFRS, this is reflected in the cash collateral column.

9 Financial instruments - valuation

Valuation of financial instruments carried at fair value

Control environment

Common valuation policies, procedures, frameworks and models apply across the RBS Group. Therefore, for the most part, discussions on these aspects below reflect those in the RBS Group as relevant for businesses in the Group.

The Group's control environment for the determination of the fair value of financial instruments includes formalised protocols for the review and validation of fair values independent of the businesses entering into the transactions. There are specific controls to ensure consistent pricing policies and procedures, incorporating disciplined price verification. The Group ensures that appropriate attention is given to bespoke transactions, structured products, illiquid products and other instruments which are difficult to price.

Independent price verification (IPV)

IPV is a key element of the control environment. Valuations are first performed by the business which entered into the transaction. Such valuations may be directly from available prices, or may be derived using a model and variable model inputs. These valuations are reviewed, and if necessary amended, by a team independent of those trading the financial instruments, in the light of available pricing evidence.

IPV differences are classified according to the quality of independent market observables into IPV quality bands linked to the fair value hierarchy principles, as laid out in IFRS 13 'Fair Value Measurement'. These differences are classified into fair value levels 1, 2 and 3 (with the valuation uncertainty risk increasing as the levels rise from 1 to 3) and then further classified into high, medium, low and indicative depending on the quality of the independent data available to validate the prices. Valuations are revised if they are outside agreed thresholds.

Governance framework

IPV takes place at least each month end date, for all fair value positions. The IPV control includes formalised reporting and escalation of any valuation differences in breach of established thresholds. The Pricing Unit determines IPV policy, monitors adherence to that policy and performs additional independent reviews of highly subjective valuation issues.

The Modelled Product Review Committee sets the policy for model documentation, testing and review, and prioritises models with significant exposure being reviewed by the RBS Group Pricing Model Risk team. The NatWest Markets Valuation Committee is made up of valuation specialists and senior business representatives from various functions and oversee pricing, reserving and valuations issues. This committee meets monthly to review and ratify any methodology changes. The Executive Valuation Committee meets quarterly to address key material and subjective valuation issues, to review items escalated by the NatWest Markets Valuation Committee and to discuss other relevant matters including prudential valuation.

Valuation hierarchy

Initial classification of a financial instrument is carried out by the Product Control team following the principles in IFRS 13. They base their judgment on information gathered during the IPV process for instruments which include the sourcing of independent prices and model inputs. The quality and completeness of the information gathered in the IPV process gives an indication as to the liquidity and valuation uncertainty of an instrument.

These initial classifications are reviewed and challenged by the Pricing Unit and are also subject to senior management review. Particular attention is paid to instruments crossing from one level to another, new instrument classes or products, instruments that are generating significant profit and loss and instruments where valuation uncertainty is high.

Valuation techniques

The Group derives fair value of its instruments differently depending on whether the instrument is a non-modelled or a modelled product.

Non-modelled products

Non-modelled products are valued directly from a price input typically on a position by position basis and include cash, equities and most debt securities.

Modelled products

Modelled products valued using a pricing model range in complexity from comparatively vanilla products such as interest rate swaps and options (e.g. interest rate caps and floors) through to more complex derivatives. The valuation of modelled products requires an appropriate model and inputs into this model. Sometimes models are also used to derive inputs (e.g. to construct volatility surfaces). The Group uses a number of modelling methodologies.

Inputs to valuation models

Values between and beyond available data points are obtained by interpolation and extrapolation. When utilising valuation techniques, the fair value can be significantly affected by the choice of valuation model and by underlying assumptions concerning factors such as the amounts and timing of cash flows, discount rates and credit risk. The principal inputs to these valuation techniques are as follows:

- Bond prices - quoted prices are generally available for government bonds, certain corporate securities and some mortgage-related products.
- Credit spreads - where available, these are derived from prices of credit default swaps or other credit based instruments, such as debt securities. For others, credit spreads are obtained from pricing services. For counterparty credit spreads, adjustments are made to market prices (or parameters) when the creditworthiness of the counterparty differs from that of the assumed counterparty in the market price (or parameters).
- Interest rates - these are principally benchmark interest rates such as the London Interbank Offered Rate (LIBOR), Overnight Index Swaps (OIS) rate and other quoted interest rates in the swap, bond and futures markets.
- Foreign currency exchange rates - there are observable prices both for spot and forward contracts and futures in the world's major currencies.

9 Financial instruments - valuation continued

Inputs to valuation models

- Equity and equity index prices - quoted prices are generally readily available for equity shares listed on the world's major stock exchanges and for major indices on such shares.
- Commodity prices - many commodities are actively traded in spot and forward contracts and futures on exchanges in London, New York and other commercial centres.
- Price volatilities and correlations - volatility is a measure of the tendency of a price to change with time. Correlation measures the degree which two or more prices or other variables are observed to move together.
- Prepayment rates - the fair value of a financial instrument that can be prepaid by the issuer or borrower differs from that of an instrument that cannot be prepaid. In valuing prepayable instruments that are not quoted in active markets, the Group considers the value of the prepayment option.
- Recovery rates/loss given default - these are used as an input to valuation models and reserves for asset-backed securities and other credit products as an indicator of severity of losses on default. Recovery rates are primarily sourced from market data providers or inferred from observable credit spreads.

Consensus pricing

The Group uses consensus prices for the IPV of some instruments. The consensus service encompasses the equity, interest rate, currency, commodity, credit, property, fund and bond markets, providing comprehensive matrices of vanilla prices and a wide selection of exotic products. NatWest Markets contribute to consensus pricing services where there is a significant interest either from a positional point of view or to test models for future business use. Data sourced from consensus pricing services are used for a combination of control processes including direct price testing, evidence of observability and model testing. In practice this means that the Group submits prices for all material positions for which a service is available. Data from consensus services are subject to the same level of quality review as other inputs used for IPV process.

In order to determine a reliable fair value, where appropriate, management applies valuation adjustments to the pricing information gathered from the above sources. The sources of independent data are reviewed for quality and are applied in the IPV processes using a formalised input quality hierarchy. These adjustments reflect the Group's assessment of factors that market participants would consider in setting a price. Furthermore, on an ongoing basis, the Group assesses the appropriateness of any model used. To the extent that the price determined by internal models does not represent the fair value of the instrument, for instance in highly stressed market conditions, the Group makes adjustments to the model valuation to calibrate to other available pricing sources.

Where unobservable inputs are used, the Group may determine a range of possible valuations derived from differing stress scenarios to determine the sensitivity associated with the valuation. When establishing the fair value of a financial instrument using a valuation technique, the Group considers adjustments to the modelled price which market participants would make when pricing that instrument. Such adjustments include the credit quality of the counterparty and adjustments to compensate for model limitations.

Valuation reserves

When valuing financial instruments in the trading book, adjustments are made to mid-market valuations to cover bid-offer spread, liquidity and credit risk. A breakdown of valuation adjustments is provided below.

Credit valuation adjustments (CVA)

CVA represents an estimate of the adjustment to fair value that a market participant would make to incorporate the counterparty credit risk inherent in derivative exposures. CVA is actively managed by a credit and market risk hedging process, and therefore movements in CVA are partially offset by trading revenue on the hedges.

The CVA is calculated on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the credit risk.

Where a positive exposure exists to a counterparty that is considered to be close to default, the CVA is calculated by applying expected losses to the current level of exposure. Otherwise, expected losses are applied to estimated potential future positive exposures which are modelled to reflect the volatility of the market factors which drive the exposures and the correlation between those factors.

Expected losses are determined from market implied probabilities of default and internally assessed recovery levels. The probability of default is calculated with reference to observable credit spreads and observable recovery levels. For counterparties where observable data do not exist, the probability of default is determined from the credit spreads and recovery levels of similarly rated entities.

Bid-offer, liquidity and other reserves

Fair value positions are adjusted to bid (long positions) or offer (short positions) levels, by marking individual cash positions directly to bid or offer or by taking bid-offer reserves calculated on a portfolio basis for derivatives exposures. The bid-offer approach is based on current market spreads and standard market bucketing of risk.

Bid-offer adjustments for each risk factor (including delta (the degree to which the price of an instrument changes in response to a change in the price of the underlying), vega (the degree to which the price of an instrument changes in response to the volatility in the price of the underlying), correlation (the degree to which prices of different instruments move together)) are determined by aggregating similar risk exposures arising on different products. Additional basis bid-offer reserves are taken where these are charged in the market.

Bid-offer spreads vary by maturity and risk type to reflect different spreads in the market. For positions where there is no observable quote, the bid-offer spreads are widened in comparison to proxies to reflect reduced liquidity or observability.

9 Financial instruments - valuation continued

Bid-offer methodologies may also incorporate liquidity triggers whereby wider spreads are applied to risks above pre-defined thresholds.

As permitted by IFRS 13, netting is applied on a portfolio basis to reflect the value at which the Group believes it could exit the portfolio, rather than the sum of exit costs for each of the portfolio's individual trades. This is applied where the asset and liability positions are managed as a portfolio for risk and reporting purposes.

Vanilla risk on exotic products is typically reserved as part of the overall portfolio based calculation e.g. delta and vega risk on exotic products are included within the delta and vega bid-offer calculations.

Product related risks such as correlation risk, attract specific bid-offer reserves. Additional reserves are provided for exotic products to ensure overall reserves match market close-out costs. These market close-out costs inherently incorporate risk decay and cross-effects (taking into account how changes in one risk factor may affect other inputs rather than treating all risk factors independently) that are unlikely to be adequately reflected in a static hedge based on vanilla instruments. Where there is limited bid-offer information for a product, the pricing approach and risk management strategy are taken into account when assessing the reserve.

Reserves are also held in relation to fair value funding costs that are not within the scope of FVA, potential losses arising from receivables where there is a counterparty dispute and certain uncollateralised derivatives after the pricing impact of a significant novation in 2017 was incorporated into transactions of a similar nature.

The discount rates applied to derivative cash flows in determining fair value reflect any underlying collateral agreements. Collateralised derivatives are generally discounted at the relevant OIS-related rates at an individual trade level. Reserves are held to the extent that the discount rates applied do not reflect all of the terms of the collateral agreements.

Funding valuation adjustment (FVA)

FVA represents an estimate of the adjustment to fair value that a market participant would make to incorporate funding costs and benefits that arise in relation to uncollateralised derivative exposures.

Funding levels are applied to estimated potential future exposures, the modelling of which is consistent with the approach used in the calculation of CVA. The counterparty contingent nature of the exposures is reflected in the calculation.

Amounts deferred on initial recognition

On initial recognition of financial assets and liabilities valued using valuation techniques incorporating information other than observable market data, any difference between the transaction price and that derived from the valuation technique is deferred. Such amounts are recognised in profit or loss over the life of the transaction; when market data becomes observable; or when the transaction matures or is closed out as appropriate. At 31 December 2017, net gains of £55 million (2016 - £71 million) were carried forward. During the year, net gains of £64 million (2016 - £27 million) were deferred and £80 million (2016 - £47 million) were recognised in the income statement.

Own credit

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

For issued debt this adjustment is based on debt issuance spreads above average inter-bank rates (at a range of tenors). Secondary senior debt issuance spreads are used in the calculation of the own credit adjustment applied to senior debt.

The fair value of the Group's derivative financial liabilities is also adjusted to reflect the Group's own credit risk through debit valuation adjustments (DVA). Expected gains are applied to estimated potential future negativ25
e exposures, the modelling of which is consistent with the approach used in the calculation of CVA. Expected gains are determined from market implied probabilities of default and recovery levels. FVA is considered the primary adjustment applied to derivative liabilities. The extent to which DVA and FVA overlap is eliminated from DVA.

The own credit adjustment does not alter cash flows, is not used for performance management, is disregarded for regulatory capital reporting processes and will reverse over time provided the liability is not repaid at a premium or a discount.

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

9 Financial instruments - valuation continued

Valuation reserves

The following table shows the breakdown of valuation reserves.

	2017 £m	2016 £m
Funding valuation adjustments (FVA)	438	930
Credit valuation adjustments (CVA)	342	599
Bid-offer reserves	286	333
Product and deal specific	843	607
Valuation reserves	1,909	2,469

Own credit

The own credit adjustments (OCA) recorded on held-for-trading (HFT) and designated as at fair value through profit or loss (DFV) debt securities in issue, subordinated liabilities and derivative liabilities are set out below. The cumulative adjustments below represent reductions/(increases) to the balance sheet liability amounts for those instruments that form part of continuing operations.

	Debt securities in issue (2)		Subordinated liabilities		
Cumulative own credit adjustment (1)	HFT £m	DFV £m	DFV £m	Derivatives £m	Total £m
2017	(47)	(37)	—	—	(84)
2016	(34)	(6)	45	74	79

Carrying values of underlying liabilities	£bn	£bn	£bn
2017	1.1	3.3	—
2016	1.6	4.5	0.4

Notes:
(1) The OCA does not alter cash flows and is not used for performance management.
(2) Includes wholesale and retail note issuances.
(3) The reserve movement between periods will not equate to the reported profit or loss or other comprehensive income related to own credit. RBS has early adopted the provisions within IFRS 9 Financial Instruments in respect of the presentation of gains and losses on financial liabilities designated at fair value through profit and loss from 1 January 2017. The balance sheet reserve is stated by converting underlying currency balances at spot rates for each period, whereas the income statement includes intra-period foreign exchange sell-offs.
(4) The cumulative adjustment for debt securities in issue is opposite to that for subordinated liabilities: debt securities in issue were issued relatively recently at wider than current spreads, whilst many of the subordinated liabilities were issued before the financial crisis at significantly tighter spreads.

Key points

- Excluding the impact of instruments now reflected in disposal groups, the cumulative OCA decrease during the year was mainly due to the tightening of spreads on Group issuance. The OCA on senior debt is determined by reference to secondary debt issuance spreads, which tightened by 52 basis points at the five year level to 10 basis points at 31 December 2017 (31 December 2016 – 62 basis points).
- OCA in respect of subordinated debt instruments form part of disposal groups for the year ended 31 December 2017, and are reflected as nil in the table above.
- Group five year CDS credit spreads tightened to 75 basis points at 31 December 2017 (31 December 2016 – 125 basis points).
- DVA in respect of derivative liabilities has reduced to nil following the tightening of spreads in 2017, such that adjustments overlap with FVA and are thus eliminated from DVA.

9 Financial instruments: carried at fair value - valuation hierarchy

The following tables show financial instruments carried at fair value on the Group's balance sheet by valuation hierarchy - level 1, level 2 and level 3.

	2017						2016					
					Level 3 sensitivity (5)						Level 3 sensitivity (5)	
	Level 1 £bn	Level 2 £bn	Level 3 £bn	Total £bn	Favourable £m	Unfavourable (£m)	Level 1 £bn	Level 2 £bn	Level 3 £bn	Total £bn	Favourable £m	Unfavourable (£m)
Assets												
Loans and advances	—	58.5	0.1	58.6	—	—	—	61.7	0.6	62.3	50	(50)
Debt securities	20.0	7.2	0.8	28.0	30	(10)	53.8	8.3	0.8	62.9	70	(20)
- of which AFS	0.2	0.3	—	0.5	—	—	35.1	3.2	0.1	38.4	20	(10)
Equity shares	—	—	0.1	0.1	—	—	0.1	0.1	0.2	0.4	20	(30)
- of which AFS	—	—	—	—	—	—	—	—	0.2	0.2	10	(20)
Derivatives	—	157.5	1.7	159.2	160	(160)	—	245.0	2.8	247.8	210	(210)
	20.0	223.2	2.7	245.9	190	(170)	53.9	315.1	4.4	373.4	350	(310)
Proportion	8.1%	90.8%	1.1%	100%			14.4%	84.4%	1.2%	100%		
Liabilities												
Deposits	—	52.1	0.2	52.3	20	(20)	—	62.3	0.3	62.6	—	(10)
Debt securities in issue	—	4.1	0.3	4.4	10	(10)	—	5.5	0.6	6.1	40	(40)
Short positions	23.7	4.8	—	28.5	—	—	19.7	2.4	—	22.1	—	—
Derivatives	—	151.8	1.6	153.4	90	(90)	—	235.6	2.0	237.6	120	(120)
Subordinated liabilities	—	—	—	—	—	—	—	0.4	—	0.4	—	—
	23.7	212.8	2.1	238.6	120	(120)	19.7	306.2	2.9	328.8	160	(170)
Proportion	9.9%	89.2%	0.9%	100%			6.0%	93.1%	0.9%	100%		
Analysis of assets and liabilities of disposal groups (1)												
Assets	37.0	7.3	0.5	44.8	20	(30)						
Liabilities	—	2.9	—	2.9	—	—						

Notes:

(1) Prior year not material.

(2) Level 1: valued using unadjusted quoted prices in active markets, for identical financial instruments. Examples include G10 government securities, listed equity shares, certain exchange-traded derivatives and certain US agency securities.

Level 2: valued using techniques based significantly on observable market data. Instruments in this category are valued using:
(a) quoted prices for similar instruments or identical instruments in markets which are not considered to be active; or
(b) valuation techniques where all the inputs that have a significant effect on the valuations are directly or indirectly based on observable market data.

Level 2 instruments included non-G10 government securities, most government agency securities, investment-grade corporate bonds, certain mortgage products, most bank loans, repos and reverse repos, less liquid listed equities, state and municipal obligations, most notes issued, and certain money market securities and loan commitments and most OTC derivatives.

Level 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. Level 3 instruments primarily include cash instruments which trade infrequently, certain syndicated and commercial mortgage loans, certain emerging markets instruments, unlisted equity shares, certain residual interests in securitisations, asset-backed products and less liquid debt securities, certain structured debt securities in issue, and OTC derivatives where valuation depends upon unobservable inputs such as certain credit and exotic derivatives. No gain or loss is recognised on the initial recognition of a financial instrument valued using a technique incorporating significant unobservable data.

(3) Transfers between levels are deemed to have occurred at the beginning of the quarter in which the instruments were transferred. There were no significant transfers between level 1 and level 2.

(4) For an analysis of debt securities (by issuer, measurement, classification and analysis of asset backed securities) and derivatives (by type of contract) refer to Capital and risk management – Credit risk.

(5) The determination of an instrument's level cannot be made at a global product level as a single product type can be in more than one level. For example, a single name corporate credit default swap could be in Level 2 or Level 3 depending on whether the reference counterparty's obligations are liquid or illiquid.

(6) Sensitivity represents the favourable and unfavourable effect on the income statement or the statement of comprehensive income due to reasonably possible changes to valuations using reasonably possible alternative inputs in RBS's valuation techniques or models. Level 3 sensitivities are calculated on a trade or low level portfolio basis and hence these aggregated figures do not reflect the correlation between some of the sensitivities. In particular, for some portfolios, the sensitivities may be negatively correlated where a downward movement in one asset would produce an upward movement in another, but due to the additive presentation above, this correlation cannot be shown.

9 Financial instruments: valuation techniques

The table below shows a breakdown of valuation techniques and the ranges for those unobservable inputs used in valuation models and techniques that have a material impact on the valuation of Level 3 financial instruments.

	Level 3 (£bn)				Range	
Financial instruments	Assets	Liabilities	Valuation technique	Unobservable inputs	Low	High
Loans and advances	0.1					
			Price-based	Price	0%	100.53%
Debt securities	0.8					
			Price-based	Price	0	369.81 GBP
Equity shares	0.1					
			Price-based	Price	0.164	585,066 GBP
			Valuation	Fund-NAV	80%	120%
Customer accounts		0.2				
			DCF based on recoveries	Correlation	(29%)	86.05%
				Interest rate delta	(0.38%)	2.61%
Debt securities in issue		0.3				
			Price-based	Price	56.77 JPY	148.68 EUR
			Valuation	Fund NAV	0.202	977.24 GBP
Derivatives	1.7	1.6				
Credit	0.2	0.1	DCF based on recoveries	Credit spreads	0.1 bps	500 bps
			Option pricing model	Correlation	(50%)	80%
				Volatility	38%	80%
				Upfront points	0%	99%
				Recovery rate	10%	40%
Interest and foreign exchange contracts	1.4	1.4	Option pricing model	Correlation	(75%)	100%
				Volatility	0%	292%
Equity	0.1	0.1	Option pricing model	Correlation	(57%)	95%
				Forward	146%	189%
				Volatility	7%	11%
Disposal groups	0.5					
			Price-based	Price	99.94%	101.84%
			Valuation	Discount factor	9%	13%

Notes:
(1) The table above excludes unobservable inputs where the impact on valuation is not significant. Movements in the underlying input may have a favourable or unfavourable impact on the valuation depending on the particular terms of the contract and the exposure. For example, an increase in the credit spread of a bond would be favourable for the issuer but unfavourable for the note holder. Whilst the Group indicates where it considers that there are significant relationships between the inputs, their inter-relationships will be affected by macro economic factors including interest rates, foreign exchange rates or equity index levels.
(2) Credit spreads and discount margins: credit spreads and margins express the return required over a benchmark rate or index to compensate for the credit risk associated with a cash instrument. A higher credit spread would indicate that the underlying instrument has more credit risk associated with it. Consequently, investors require a higher yield to compensate for the higher risk. The discount rate comprises credit spread or margin plus the benchmark rate; it is used to value future cash flows.
(3) Price and yield: there may be a range of prices used to value an instrument that may be a direct comparison of one instrument or portfolio with another or, movements in a more liquid instrument may be used to indicate the movement in the value of a less liquid instrument. The comparison may also be indirect in that adjustments are made to the price to reflect differences between the pricing source and the instrument being valued, for example different maturity, credit quality, seniority or expected pay-outs. Similarly to price, an instrument's yield may be compared with other instruments' yields either directly or indirectly.
(4) Recovery rate: reflects market expectations about the return of principal for a debt instrument or other obligations after a credit event or on liquidation. Recovery rates tend to move conversely to credit spreads.
(5) Valuation: for private equity investments, risk may be measured by beta, estimated by looking at past prices of similar stocks and from valuation statements where valuations are usually derived from earnings measures such as EBITDA or net asset value.
(6) Correlation: measures the degree by which two prices or other variables are observed to move together. If they move in the same direction there is positive correlation; if they move in opposite directions there is negative correlation. Correlations typically include relationships between: default probabilities of assets in a basket (a group of separate assets), exchange rates, interest rates and other financial variables.
(7) Volatility: a measure of the tendency of a price to change with time.
(8) Interest rate delta: these ranges represent the low/high marks on the relevant discounting curve.
(9) Upfront points: where CDS contracts are standardised, the inherent spread of the trade may exceed the standard premium paid or received under the contract. Upfront points will compensate for the difference between the standard premium and the actual premium at the start of the contract.
(10) The Group does not have any material liabilities measured at fair value that are issued with an inseparable third party credit enhancement.

9 Financial instruments - valuation continued

The Level 3 sensitivities on the previous page are calculated at a trade or low level portfolio basis. They are not calculated on an overall portfolio basis and therefore do not reflect the likely potential uncertainty on the portfolio as a whole. The figures are aggregated and do not reflect the correlated nature of some of the sensitivities. In particular, for some of the portfolios the sensitivities may be negatively correlated where a downwards movement in one asset would produce an upwards movement in another, but due to the additive presentation of the above figures this correlation cannot be displayed. The actual potential downside sensitivity of the total portfolio may be less than the non-correlated sum of the additive figures as shown in the above table.

Areas of judgement

Whilst the business has simplified, the diverse range of products historically traded by the Group results in a wide range of instruments that are classified into Level 3 of the hierarchy. Whilst the majority of these instruments naturally fall into a particular level, for some products an element of judgment is required. The majority of the Group's financial instruments carried at fair value are classified as Level 2: inputs are observable either directly (i.e. as a price) or indirectly (i.e. derived from prices).

Active and inactive markets

A key input in the decision making process for the allocation of assets to a particular level is market activity. In general, the degree of valuation uncertainty depends on the degree of liquidity of an input.

Where markets are liquid, little judgment is required. However, when the information regarding the liquidity in a particular market is not clear, a judgment may need to be made. This can be more difficult as assessing the liquidity of a market is not always straightforward. For an equity traded on an exchange, daily volumes of trading can be seen, but for an over-the-counter (OTC) derivative assessing the liquidity of the market with no central exchange is more difficult.

A key related matter is where a market moves from liquid to illiquid or vice versa. Where this change is considered to be temporary, the classification is not changed. For example, if there is little market trading in a product on a reporting date but at the previous reporting date and during the intervening period the market has been considered to be liquid, the instrument will continue to be classified in the same level in the hierarchy. This is to provide consistency so that transfers between levels are driven by genuine changes in market liquidity and do not reflect short term or seasonal effects. Material movements between levels are reviewed quarterly.

The breadth and depth of the IPV data allows for a rules based quality assessment to be made of market activity, liquidity and pricing uncertainty, which assists with the process of allocation to an appropriate level. Where suitable independent pricing information is not readily available, the quality assessment will result in the instrument being assessed as Level 3.

Modelled products

For modelled products the market convention is to quote these trades through the model inputs or parameters as opposed to a cash price equivalent. A mark-to-market is derived from the use of the independent market inputs calculated using the Group's model.

The decision to classify a modelled instrument as Level 2 or 3 will be dependent upon the product/model combination, the currency, the maturity, the observability and quality of input parameters and other factors. All these must be assessed to classify the asset.

If an input fails the observability or quality tests then the instrument is considered to be in Level 3 unless the input can be shown to have an insignificant effect on the overall valuation of the product.

The majority of derivative instruments for example vanilla interest rate swaps, foreign exchange swaps and liquid single name credit derivatives are classified as Level 2 as they are vanilla products valued using observable inputs. The valuation uncertainty on these is considered to be low and both input and output testing may be available.

Non-modelled products

Non-modelled products are generally quoted on a price basis and can therefore be considered for each of the three levels. This is determined by the market activity, liquidity and valuation uncertainty of the instruments which is in turn measured from the availability of independent data used by the IPV process to allocate positions to IPV quality levels.

The availability and quality of independent pricing information are considered during the classification process. An assessment is made regarding the quality of the independent information. For example, where consensus prices are used for non-modelled products, a key assessment of the quality of a price is the depth of the number of prices used to provide the consensus price. If the depth of contributors falls below a set hurdle rate, the instrument is considered to be Level 3. This hurdle rate is that used in the IPV process to determine the IPV quality rating. However, where an instrument is generally considered to be illiquid, but regular quotes from market participants exist, these instruments may be classified as Level 2 depending on frequency of quotes, other available pricing and whether the quotes are used as part of the IPV process or not.

For some instruments with a wide number of available price sources, there may be differing quality of available information and there may be a wide range of prices from different sources. In these situations the highest quality source is used to determine the classification of the asset. For example, a tradable quote would be considered a better source than a consensus price.

9 Financial instruments: Level 3 portfolios and sensitively methodologies

Reasonably plausible alternative assumptions of unobservable inputs are determined based on specified target level of certainty of 90%. The assessments recognise different favourable and unfavourable valuation movements where appropriate. Each unobservable input within a product is considered separately and sensitivity is reported on an additive basis.

Alternative assumptions are determined with reference to all available evidence including consideration of the following: quality of independent pricing information taking into account consistency between different sources, variation over time, perceived tradability or otherwise of available quotes; consensus service dispersion ranges; volume of trading activity and market bias (e.g. one-way inventory); day 1 profit or loss arising on new trades; number and nature of market participants; market conditions; modelling consistency in the market; size and nature of risk; length of holding of position; and market intelligence.

Other considerations

Whilst certain inputs used to calculate CVA, FVA and own credit adjustments are not based on observable market data, the uncertainty of the inputs is not considered to have a significant effect on the net valuation of the related derivative portfolios and issued debt. The classification of the derivative portfolios and issued debt is not determined by the observability of these inputs, and any related sensitivity does not form part of the Level 3 sensitivities presented.

Movement in Level 3 portfolios

	2017				2016			
	FVTPL assets (2)	AFS assets	Total assets	Total liabilities	FVTPL assets (2)	AFS assets	Total assets	Total liabilities
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January	4,050	342	4,392	2,943	3,008	682	3,690	2,622
Amount recorded in the income statement (1)	(639)	79	(560)	(405)	(135)	(9)	(144)	(13)
Amount recorded in the statement of comprehensive income	—	6	6	—	—	76	76	—
Level 3 transfers in	668	275	943	504	2,036	27	2,063	1,400
Level 3 transfers out	(1,016)	(3)	(1,019)	(607)	(928)	(113)	(1,041)	(995)
Transfer to disposal groups	(89)	(439)	(528)	(32)	—	—	—	—
Issuances	371	—	371	—	3	—	3	35
Purchases	1,789	17	1,806	412	1,300	42	1,342	521
Settlements	(161)	—	(161)	(434)	(678)	—	(678)	(596)
Sales	(2,274)	(222)	(2,496)	(323)	(604)	(370)	(974)	(87)
Foreign exchange and other adjustments	(17)	(2)	(19)	5	48	7	55	56
At 31 December	2,682	53	2,735	2,063	4,050	342	4,392	2,943
Amounts recorded in the income statement in respect of balances held at year end								
- unrealised	(24)	4	(20)	598	162	—	162	49
- realised	276	—	276	(100)	319	(4)	315	(35)

Notes:
(1) Net losses on HFT instruments of £159 million (2016 - £77 million) were recorded in income from trading activities in continuing operations. Net losses on other instruments of £45 million (2016 - £43 million) were recorded in other operating income and interest income as appropriate in continuing operations. Net losses in HFT instruments of £2 million (2016 - £25 million losses) were recorded in discontinued operations. Net gains on other instruments of £51 million (2016 - £14 million gains) were recorded in discontinued operations.
(2) Fair value through profit or loss comprises held-for-trading predominantly and designated at fair value through profit or loss.

9 Financial instruments: fair value of financial instruments not carried at fair value

The following table shows the carrying value and fair value of financial instruments carried at amortised cost on the balance sheet.

	Group						Bank					
	Items where fair value approximates carrying value	Carrying value	Fair value	Fair value hierarchy level			Items where fair value approximates carrying value	Carrying value	Fair value	Fair value hierarchy level		
2017	£bn	£bn	£bn	Level 1 £bn	Level 2 £bn	Level 3 £bn	£bn	£bn	£bn	Level 1 £bn	Level 2 £bn	Level 3 £bn
Financial assets												
Cash and balances at central banks	0.2						0.1					
Loans and advances to banks	—	0.4	0.4	—	0.2	0.2	—	1.9	2.1	—	—	2.1
Loans and advances to customers		9.6	9.6	—	1.2	8.4		10.4	10.4	—	0.7	9.7
Debt securities		2.6	2.6	—	1.5	1.1		3.3	3.3	—	1.5	1.8
Settlement balances	2.5						1.6					
Financial liabilities												
Deposits by banks	0.1	0.5	0.4	—	—	0.4	0.1	2.4	2.6	—	—	2.6
Customer accounts	1.0	2.3	2.2	—	—	2.2	0.8	4.4	4.4	—	—	4.4
Debt securities in issue		8.0	8.3	—	5.9	2.4		8.0	8.3	—	5.9	2.4
Settlement balances	2.8						1.4					
Notes in circulation	—						—					
Subordinated liabilities		—	—	—	—	—		—	—	—	—	—

	Group						Bank					
	Items where fair value approximates carrying value	Carrying value	Fair value	Fair value hierarchy level			Items where fair value approximates carrying value	Carrying value	Fair value	Fair value hierarchy level		
2016	£bn	£bn	£bn	Level 1 £bn	Level 2 £bn	Level 3 £bn	£bn	£bn	£bn	Level 1 £bn	Level 2 £bn	Level 3 £bn
Financial assets												
Cash and balances at central banks	73.8						70.6					
Loans and advances to banks	0.8	11.5	11.5	—	3.2	8.3	0.3	24.0	24.9	—	6.3	18.6
Loans and advances to customers		300.8	299.3	—	0.9	298.4		121.8	119.5	—	14.7	104.8
Debt securities		8.7	8.8	5.0	0.3	3.5		10.5	10.7	5.0	1.4	4.3
Settlement balances	5.6						4.7					
Financial liabilities												
Deposits by banks	4.4	10.9	11.1	—	7.1	4.0	3.8	111.1	111.8	—	24.1	87.7
Customer accounts	285.7	53.0	53.1	—	10.9	42.2	77.9	31.7	32.0	—	5.4	26.6
Debt securities in issue		14.3	14.7	—	10.2	4.5		12.8	13.5	—	10.2	3.3
Settlement balances	3.6						2.8					
Notes in circulation (1)	2.0						1.3					
Subordinated liabilities		19.1	19.7	—	17.0	2.7		17.5	18.3	—	15.7	2.6

Note:
(1) Included in Accruals and other liabilities.

9 Financial instruments: fair value of financial instruments not carried at fair value continued

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Quoted market values are used where available; otherwise, fair values have been estimated based on discounted expected future cash flows and other valuation techniques. These techniques involve uncertainties and require assumptions and judgments covering prepayments, credit risk and discount rates. Furthermore there is a wide range of potential valuation techniques. Changes in these assumptions would significantly affect estimated fair values. The fair values reported would not necessarily be realised in an immediate sale or settlement.

The assumptions and methodologies underlying the calculation of fair values of financial instruments at the balance sheet date are as follows:

Short-term financial instruments

For certain short-term financial instruments: cash and balances at central banks, items in the course of collection from other banks, settlement balances, items in the course of transmission to other banks, customer demand deposits and notes in circulation, carrying value is a reasonable approximation of fair value.

Loans and advances to banks and customers

In estimating the fair value of loans and advances to banks and customers measured at amortised cost, the Group's loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans. Two principal methods are used to estimate fair value:

(a) Contractual cash flows are discounted using a market discount rate that incorporates the current spread for the borrower or where this is not observable, the spread for borrowers of a similar credit standing. This method is used for portfolios where counterparties have external ratings: institutional and corporate lending in NatWest Markets.

(b) Expected cash flows (unadjusted for credit losses) are discounted at the current offer rate for the same or similar products. This approach is adopted for lending portfolios in UK PBB, Ulster Bank RoI, Commercial Banking (SME loans) and Private Banking in order to reflect the homogeneous nature of these portfolios which are included in assets of disposal groups.

For certain portfolios where there are very few or no recent transactions, such as Ulster Bank RoI's portfolio of lifetime tracker mortgages, a bespoke approach is used.

Debt securities

The majority of debt securities are valued using quoted prices in active markets, or using quoted prices for similar assets in active markets. Fair values of the rest are determined using discounted cash flow valuation techniques.

Deposits by banks and customer accounts

Fair values of deposits are estimated using discounted cash flow valuation techniques.

Debt securities in issue and subordinated liabilities

Fair values are determined using quoted prices for similar liabilities where available or by reference to valuation techniques, adjusting for own credit spreads where appropriate.

10 Financial instruments - maturity analysis

Remaining maturity

The following table shows the residual maturity of financial instruments, based on contractual date of maturity.

	Group					
	2017			2016		
	Less than 12 months £m	More than 12 months £m	Total £m	Less than 12 months £m	More than 12 months £m	Total £m
Assets						
Cash and balances at central banks	153	—	153	73,813	—	73,813
Loans and advances to banks	19,222	40	19,262	30,405	90	30,495
Loans and advances to customers	45,327	4,047	49,374	113,087	231,868	344,955
Debt securities	9,195	21,344	30,539	18,664	52,988	71,652
Equity shares	—	87	87	—	445	445
Settlement balances	2,512	—	2,512	5,557	—	5,557
Derivatives	32,247	127,031	159,278	61,898	185,846	247,744
Liabilities						
Deposits by banks	17,080	13	17,093	34,004	6,549	40,553
Customer accounts	38,187	916	39,103	371,811	4,254	376,065
Debt securities in issue	4,577	7,785	12,362	5,853	14,509	20,362
Settlement balances and short positions	4,912	26,433	31,345	5,004	20,713	25,717
Derivatives	32,163	121,167	153,330	60,931	176,646	237,577
Subordinated liabilities	—	—	—	1,072	18,443	19,515

	Bank					
	2017			2016		
	Less than 12 months £m	More than 12 months £m	Total £m	Less than 12 months £m	More than 12 months £m	Total £m
Assets						
Cash and balances at central banks	93	—	93	70,615	—	70,615
Loans and advances to banks	17,137	1,677	18,814	34,045	4,973	39,018
Loans and advances to customers	40,685	4,973	45,658	77,645	82,546	160,191
Debt securities	8,573	18,761	27,334	18,521	49,148	67,669
Equity shares	—	50	50	—	298	298
Settlement balances	1,640	—	1,640	4,707	—	4,707
Derivatives	32,322	129,683	162,005	61,975	189,501	251,476
Liabilities						
Deposits by banks	16,032	2,272	18,304	119,183	20,105	139,288
Customer accounts	34,072	3,025	37,097	136,554	5,664	142,218
Debt securities in issue	4,577	7,785	12,362	5,853	13,028	18,881
Settlement balances and short positions	3,216	24,402	27,618	3,608	16,756	20,364
Derivatives	32,336	122,762	155,098	61,549	179,349	240,898
Subordinated liabilities	—	—	—	1,055	16,815	17,870

10 Financial instruments - maturity analysis

On balance sheet liabilities

The tables below show the timing of cash outflows to settle financial liabilities, prepared on the following basis:

Financial liabilities are included at the earliest date on which the counterparty can require repayment regardless of whether or not such early repayment results in a penalty. If repayment is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the liability is included at the earliest possible date that the conditions could be fulfilled without considering the probability of the conditions being met. For example, if a structured note automatically prepays when an equity index exceeds a certain level, the cash outflow will be included in the less than three months' period whatever the level of the index at the year end. The settlement date of debt securities issued by certain securitisation vehicles consolidated by the Group depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date.

Liabilities with a contractual maturity of greater than 20 years - the principal amounts of financial liabilities that are repayable after 20 years or where the counterparty has no right to repayment of the principal, are excluded from the table along with interest payments after 20 years.

Held-for-trading liabilities - held-for-trading liabilities of £235.3 billion (2016 - £322.4 billion) for the Group and £230 billion (2016 - £317 billion) for the bank, have been excluded from the tables.

	Group					
2017	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Deposits by banks	564	13	—	—	—	—
Customers accounts	2,958	201	98	7	2	2
Debt securities in issue	1,871	617	904	307	236	—
Derivatives held for hedging	—	1	2	1	3	3
Subordinated liabilities	—	—	—	—	—	—
Settlement balances and other liabilities	2,821	—	—	—	—	—
	8,214	832	1,004	315	241	5
Guarantees and commitments - notional amount						
Guarantees (1, 2)	3,164	—	—	—	—	—
Commitments (3)	119,444	—	—	—	—	—
	122,608	—	—	—	—	—
2016						
Deposits by banks	8,800	33	1,285	5,050	78	79
Customers accounts	318,780	19,233	2,158	147	8	30
Debt securities in issue	1,768	3,883	5,333	5,037	2,455	798
Derivatives held for hedging	210	395	1,234	515	782	854
Subordinated liabilities	1,076	942	4,086	2,900	11,124	5,112
Settlement balances and other liabilities	5,669	—	—	—	—	—
	336,303	24,486	14,096	13,649	14,447	6,873
Guarantees and commitments - notional amount						
Guarantees (1,2)	3,560	—	—	—	—	—
Commitments (3)	134,259	—	—	—	—	—
	137,819	—	—	—	—	—

Notes:

(1) The Group is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Group expects most guarantees it provides to expire unused.

(2) Guarantees exclude the Asset Protection Scheme related financial guarantee contract of £142 million (2016 - £248 million) between the bank and a fellow subsidiary.

(3) The Group has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Group does not expect all facilities to be drawn, and some may lapse before drawdown.

10 Financial instruments - maturity analysis continued

	Bank					
	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years
2017	£m	£m	£m	£m	£m	£m
Deposits by banks	843	22	724	537	396	—
Customers accounts	2,856	308	799	482	530	233
Debt securities in issue	1,871	617	904	307	236	—
Derivatives held for hedging	—	1	2	1	3	3
Subordinated liabilities	—	—	—	—	—	—
Settlement balances and other liabilities	1,423	—	—	—	—	—
	6,993	948	2,429	1,327	1,165	236
Guarantees and commitments - notional amount						
Guarantees (1, 2)	2,339	—	—	—	—	—
Commitments (3)	66,397	—	—	—	—	—
	68,736	—	—	—	—	—
2016						
Deposits by banks	92,629	3,154	6,214	10,902	3,510	79
Customers accounts	88,953	16,125	2,298	905	1,245	392
Debt securities in issue	1,748	3,823	5,190	4,914	2,211	203
Derivatives held for hedging	170	325	970	394	557	593
Subordinated liabilities	1,048	878	3,933	2,462	10,861	4,559
Settlement balances and other liabilities	4,050	—	—	—	—	—
	188,598	24,305	18,605	19,577	18,384	5,826
Guarantees and commitments - notional amount						
Guarantees (1,2)	2,322	—	—	—	—	—
Commitments (3)	80,747	—	—	—	—	—
	83,069	—	—	—	—	—

Notes:
(1) The bank is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The bank expects most guarantees it provides to expire unused.
(2) Guarantees exclude the Asset Protection Scheme related financial guarantee contract of £142 million (2016 - £248 million) between the bank and a fellow subsidiary.
(3) The bank has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The bank does not expect all facilities to be drawn, and some may lapse before drawdown.

11 Financial assets - impairments

The following tables show the movement in the provision for impairment losses on loans and advances.

	Group				
	Individually assessed £m	Collectively assessed £m	Latent £m	2017 £m	2016 £m
At 1 January	1,341	2,659	396	4,396	7,052
Currency translation and other adjustments	(40)	9	3	(28)	493
Transfers from fellow subsidiaries	9	—	—	9	—
Disposal	(5)	—	—	(5)	—
Amounts written-off	(447)	(757)	—	(1,204)	(3,665)
Recoveries of amounts previously written-off	29	127	—	156	113
Charges to income statement					
- continuing operations	(57)	(2)	(16)	(75)	(123)
- discontinued operations	288	317	3	608	649
Unwind of discount (recognised in interest income)					
- continuing operations	—	—	—	—	(4)
- discontinued operations	(24)	(62)	—	(86)	(108)
At 31 December (1)	1,094	2,291	386	3,771	4,407
of which					
- disposal groups	976	2,273	381	3,630	11

	Bank				
	Individually assessed £m	Collectively assessed £m	Latent £m	2017 £m	2016 £m
At 1 January	1,011	430	117	1,558	1,572
Currency translation and other adjustments	(35)	2	—	(33)	119
Transfers from fellow subsidiaries	15	—	—	15	—
Disposals	(5)	—	—	(5)	—
Amounts written-off	(322)	(182)	—	(504)	(689)
Recoveries of amounts previously written-off	12	57	—	69	49
Charges to the income statement					
- continued operations	(56)	(1)	(16)	(73)	(73)
- discontinued operations	195	42	(2)	235	615
Unwind of discount (recognised in interest income)					
- continuing operations	—	—	—	—	(1)
- discontinued operations	(19)	(10)	—	(29)	(34)
At 31 December (1)	796	338	99	1,233	1,558
of which					
- disposal groups	638	337	94	1,069	—

Notes:
(1) There were no amounts relating to loans and advances to banks (2016 - nil).
(2) The table above excludes impairments relating to securities.

	Group		
Impairment releases to the income statement - continuing operations	2017 £m	2016 £m	2015 £m
Loans and advances to customers	(75)	(123)	(146)
Loans and advances to banks	—	—	(3)
	(75)	(123)	(149)
Debt securities	—	(7)	(4)
Total	(75)	(130)	(153)

For further information on balances within disposal groups, refer to Analysis of selected financial data pre and post disposal groups table on pages 15 and 16.

11 Financial assets - impairments continued

	Group 2017 £m	2016 £m	2015 £m
Gross income not recognised but which would have been recognised under the original terms of the impaired loans - continuing operations			
Domestic	—	4	—
Foreign	7	54	3
	7	58	3
Interest on impaired loans included in net interest income - continuing operations			
Domestic	—	4	(4)
	—	4	(4)

There was £299 million gross income (2016 - £307 million, 2015 - £431 million) in discontinued operations that was not recognised but which would have been recognised under the original terms of the impaired loan

There was £86 million (2016 - £108 million, 2015 - £148 million) interest on impaired loans included in net interest income in discontinued operations

Financial and non-financial assets recognised on the balance sheet, obtained during the year by taking possession of collateral or calling on other credit enhancements, were £30 million (2016 - £30 million) for the Group and £10 million (2016 - £9 million) for the Group. As at 31 December 2017, this is entirely within Disposal groups.

In general, the Group seeks to dispose of property and other assets not readily convertible into cash, obtained by taking possession of collateral, as rapidly as the market for the individual asset permits.

Loans and advances to customers impairment charge in relation to discontinued operations was £608 million (2016 - £647 million; 2015 - £685 million).

For further information on balances within disposal groups, refer to Analysis of selected financial data pre and post disposal groups table on pages 15 and 16.

12 Derivatives

Companies in the Group transact derivatives as principal either as a trading activity or to manage balance sheet foreign exchange, interest rate and credit risk.

The Group enters into fair value hedges, cash flow hedges and hedges of net investments in foreign operations. The majority of the Group's interest rate hedges relate to the management of the Group's non-trading interest rate risk. The Group manages this risk within approved limits. Residual risk positions are hedged with derivatives principally interest rate swaps. Suitable larger financial instruments are fair value hedged; the remaining exposure, where possible, is hedged by derivatives documented as cash flow hedges and qualifying for hedge accounting. The majority of the Group's fair value hedges involve interest rate swaps hedging the interest rate risk in recognised financial assets and financial liabilities. Cash flow hedges relate to exposures to the variability in future interest payments and receipts on forecast transactions and on recognised financial assets and financial liabilities. The Group hedges its net investments in foreign operations with currency borrowings and forward foreign exchange contracts.

For cash flow hedge relationships of interest rate risk, the hedged items are actual and forecast variable interest rate cash flows arising from financial assets and financial liabilities with interest rates linked to LIBOR, EURIBOR or the Bank of England Official Bank Rate. The financial assets are customer loans and the financial liabilities are customer deposits and LIBOR linked medium-term notes and other issued securities. At 31 December 2017, variable rate financial assets of £91 billion (2016 - £81 billion) for the Group and £41 billion (2016 - £47 billion) for the bank, and variable rate financial liabilities of £69 billion (2016 - £55 billion) for the Group and £23 billion (2016 - £31 billion) for the bank were hedged in such cash flow hedge relationships. All cash flow hedges are in discontinued operations.

For cash flow hedging relationships, the initial and ongoing effectiveness is assessed by comparing movements in the fair value of the expected highly probable forecast interest cash flows with movements in the fair value of the expected changes in cash flows from the hedging interest rate swap. Hedge effectiveness is measured on a cumulative basis over a time period management feels is appropriate The method of calculating hedge ineffectiveness is the hypothetical derivative method.

For fair value hedge relationships of interest rate risk, the hedged items are typically government bonds, large corporate fixed rate loans, fixed rate finance leases, fixed rate medium-term notes or preference shares classified as debt. At 31 December 2017, fixed rate financial assets of £35 billion (2016 - £28 billion) for the Group and £33 billion (2016 - £26 billion) for the bank, and fixed rate financial liabilities of £11 billion (2016 - £14 billion) for the Group and £11 billion (2016 - £13 billion) for the bank were hedged by interest rate swaps in fair value hedge relationships. Most fair value hedges are in discontinued operations.

The initial and ongoing hedge effectiveness of fair value hedge relationships is assessed on a cumulative basis by comparing movements in the fair value of the hedged item attributable to the hedged risk with changes in the fair value of the hedging interest rate swap over a time period management feels is appropriate

12 Derivatives continued

The following table shows the notional amounts and fair values of the Group's derivatives.

	Group					
	2017			2016		
	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m
Exchange rate contracts						
Spot, forwards and futures	1,894	19,254	19,103	2,275	35,875	34,044
Currency swaps	652	11,048	13,433	833	22,214	25,296
Options purchased	419	8,765	-	670	17,486	—
Options written	440	-	8,975	683	—	18,109
Interest rate contracts						
Interest rate swaps	7,822	97,651	89,998	11,532	139,596	127,890
Options purchased	1,162	21,734	-	1,519	31,457	—
Options written	1,032	-	21,026	1,182	—	31,324
Futures and forwards	1,738	145	110	2,403	63	36
Credit derivatives	39	530	559	42	682	557
Equity and commodity contracts	3	151	126	20	371	321
		159,278	153,330		247,744	237,577

	Group			
	2017		2016	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Amounts above include:				
Due from/to holding company	—	—	255	373
Due from/to fellow subsidiaries	362	486	1,051	855

Included in the table above are derivatives held for hedging purposes as follows:

	Group			
	2017		2016	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedging				
Interest rate contracts	—	10	1,199	2,440
Cash flow hedging				
Interest rate contracts	—	—	3,079	1,419
Exchange rate contracts	—	—	21	—
Net investment hedging				
Exchange rate contracts	—	—	66	3

Hedge ineffectiveness recognised in other operating income in continuing operations comprised:

	2017 £m	2016 £m	2015 £m
Fair value hedging			
Gains on the hedged items attributable to the hedged risk	(4)	25	(5)
Losses on the hedging instruments	4	(31)	6
Fair value hedging ineffectiveness	—	(6)	1

Note:
(1) Hedge ineffectiveness recognised in other operating income in discontinued operations was £29 million credit in 2017 (2016 - £1 million debit; 2015 – £38 million credit).

12 Derivatives continued

	Bank					
	2017			2016		
	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m
Exchange rate contracts						
Spot, forwards and futures	1,899	19,318	19,166	2,283	35,991	34,192
Currency swaps	654	11,071	13,487	839	22,353	25,759
Options purchased	418	8,759	—	670	17,473	—
Options written	440	—	8,985	683	—	18,123
Interest rate contracts						
Interest rate swaps	7,978	100,318	91,586	11,598	143,125	130,487
Options purchased	1,166	21,712	—	1,519	31,429	—
Options written	1,037	—	21,027	1,183	—	31,331
Futures and forwards	1,733	145	110	2,399	63	36
Credit derivatives	39	531	558	44	682	557
Equity and commodity contracts	3	151	179	20	360	413
		162,005	155,098		251,476	240,898

	Bank			
	2017		2016	
Amounts above include:	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Due from/to holding company	—	—	256	373
Due from/to fellow subsidiaries	3,374	2,264	1,050	855
Due from/to subsidiaries	313	202	4,838	3,808

Included in the table above are derivatives held for hedging purposes as follows:

	Bank			
	2017		2016	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedging				
Exchange rate contracts	—	—	6	—
Interest rate contracts	—	10	1,084	1,868
Cash flow hedging				
Interest rate contracts	—	—	1,562	1,031
Exchange rate contracts	—	—	21	—
Net investment hedging				
Exchange rate contracts	—	—	17	2

There are no cash flow hedges for continuing operations. For discontinued operations, in both the Group and the bank substantially all of the forecast receivable hedged cash flows occur within 5 years (2016 - 5 years) and substantially all forecast payable cash flows occur within 10 years (2016 – 10 years); the income statement is impacted over the same periods.
For further information on balances within disposal groups refer to Analysis of selected financial data pre and post disposal groups table on pages 15 and 16.

13 Debt securities

	Group							
	Central and local government				Other financial			Of which
	UK	US	Other	Banks	institutions	Corporate	Total	ABS (1)
2017	£m	£m	£m	£m	£m	£m	£m	£m
Held-for-trading	3,514	3,667	14,736	1,844	2,746	974	27,481	870
Available-for-sale	—	160	309	—	2	4	475	2
Loans and receivables	—	—	—	—	2,441	142	2,583	2,441
	3,514	3,827	15,045	1,844	5,189	1,120	30,539	3,313
Available-for-sale								
Gross unrealised gains	—	—	—	—	1	—	1	1
2016								
Held-for-trading	2,615	4,133	14,087	818	2,299	549	24,501	886
Available-for-sale	10,581	6,953	15,137	1,748	3,990	5	38,414	2,263
Loans and receivables	—	—	—	—	3,774	194	3,968	3,814
Held-to-maturity	4,769	—	—	—	—	—	4,769	—
	17,965	11,086	29,224	2,566	10,063	748	71,652	6,963
Available-for-sale								
Gross unrealised gains	768	56	503	8	93	2	1,430	75
Gross unrealised losses	(16)	(123)	(13)	(1)	(43)	(2)	(198)	(32)

Note:
(1) Includes covered bonds, asset-backed securities issued by US federal agencies and government sponsored entities.

Gross gains of £35 million (2016 - £74 million) and gross losses of £1 million (2016 - nil) were realised on the sale of available-for-sale securities in continuing operations.

Gross gains of £52 million (2016 - £15 million) and gross losses of £8 million (2016 - £19 million) were realised on the sale of available-for-sale securities in discontinued operations.

	Bank							
	Central and local government				Other financial			Of which
	UK	US	Other	Banks	institutions	Corporate	Total	ABS (1)
2017	£m	£m	£m	£m	£m	£m	£m	£m
Held-for-trading	3,514	277	14,735	1,776	2,332	931	23,565	870
Available-for-sale	—	160	308	—	2	—	470	2
Loans and receivables	—	—	—	—	3,157	142	3,299	2,441
	3,514	437	15,043	1,776	5,491	1,073	27,334	3,313
Available-for-sale								
Gross unrealised gains	—	—	—	—	1	—	1	1
2016								
Held-for-trading	2,615	673	14,087	721	1,858	548	20,502	878
Available-for-sale	10,581	6,953	13,445	1,393	4,284	—	36,656	2,179
Loans and receivables	—	—	—	—	5,548	194	5,742	5,588
Held-to-maturity	4,769	—	—	—	—	—	4,769	—
	17,965	7,626	27,532	2,114	11,690	742	67,669	8,645
Available-for-sale								
Gross unrealised gains	768	56	499	7	88	—	1,418	74
Gross unrealised losses	(16)	(123)	(12)	(1)	(38)	—	(190)	(32)

Note:
(1) Includes covered bonds, asset-backed securities issued by US federal agencies and government sponsored entities.

For further information on balances within disposal groups refer to Analysis of selected financial data pre and post disposal groups table on pages 15 and 16.

14 Equity shares

	Group					
	2017			2016		
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Held-for-trading	7	18	25	106	22	128
Designated as at fair value through profit or loss	—	6	6	3	85	88
Available-for-sale	7	49	56	13	216	229
	14	73	87	122	323	445
Available-for-sale						
Gross unrealised gains	5	4	9	7	47	54
Gross unrealised losses	—	(1)	(1)	—	(1)	(1)

	Bank					
	2017			2016		
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Held-for-trading	7	17	24	106	15	121
Available-for-sale	2	24	26	7	170	177
	9	41	50	113	185	298
Available-for-sale						
Gross unrealised gains	2	3	5	4	42	46

Gross gains of £46 million (2016 - £30 million) and gross losses of nil (2016 – £9 million) were realised on the sale of available-for-sale equity shares in continuing operations. Gross gains of £42 million (2016 - £29 million) and gross losses of nil (2016 - nil) were realised on the sale of available-for-sale equity shares in discontinued operations.

Dividend income from available-for-sale equity shares in continuing operations was £4 million (2016 - £6 million) and in discontinued operations was nil (2016 - £3 million).

Unquoted equity investments whose fair value cannot be reliably measured are carried at cost and classified as available-for-sale financial assets.

15 Investments in Group undertakings

Investments in Group undertakings are carried at cost less impairment. Movements during the year were as follows:

	Bank	
	2017 £m	2016 £m
At 1 January	35,169	34,482
Currency translation and other adjustments	7	73
Additional investments	32,648	1,304
Disposals	(33,253)	(152)
(Impairment)/write back of investments	(1,073)	53
Transfer to disposal groups	(33,002)	(591)
At 31 December	496	35,169

The impairment charge in 2017 mainly relates to the bank's investment in RBSG International Holdings Limited (RBSIH).

On 1 January 2017, the company exchanged its shareholdings in National Westminster Bank Plc (NatWest) and Adam & Company Group PLC for additional shares in its wholly-owned subsidiary NatWest Holdings Limited. The control over National Westminster Bank Plc and Adam & Company Group PLC is retained through NatWest Holdings Limited.

The principal subsidiary undertakings of the bank are shown below. Their capital consists of ordinary and preference shares, which are unlisted with the exception of certain preference shares issued by NatWest. All of the subsidiary undertakings are owned either by the bank, or directly or indirectly through intermediate holding companies and are included in the Group's consolidated financial statements and have an accounting reference date of 31 December.

	Nature of business	Country of incorporation and principal area of operation
Within continuing operations:		
RBS Securities Inc. (1)	Broker dealer	US
Within discontinued operations:		
National Westminster Bank Plc (1,2)	Banking	Great Britain
Coutts & Company (1, 3)	Private Banking	Great Britain
Ulster Bank Ireland Designated Activity Company (1)	Banking	Republic of Ireland

Notes:
(1) Shares are not directly held by the bank.
(2) The bank does not hold any of the NatWest preference shares in issue.
(3) Coutts & Company is incorporated with unlimited liability. Its registered office is 440 Strand, London WC2R 0QS.

Full information on all related undertakings is included in Note 41.

16 Intangible assets

As at 31 December 2017 intangible assets of £6,232 million for Group and £551 million for bank are included in assets of disposal groups. The net book value of intangible assets for 2016 was £6,469 million for Group, of which £304 million was included within disposal groups and £521 million for bank. Included within intangible assets is goodwill of £5,249 million (2016 - £5,549 million) for Group and £85 million (2016 - £85 million) for bank.

The annual review at 31 December 2017 indicated no impairment to goodwill based on value in use derived from management's five year forecasts (2016: no impairment).

The carrying value of goodwill and the amount by which it is exceeded by the recoverable amount are set out below by reportable segment, along with the key assumptions applied in calculating the recoverable amount and sensitivities to changes in those assumptions.

		Assumptions			Consequential impact of 1% adverse movement in		Consequential impact of 5% adverse movement in		Break even
	Goodwill	Terminal growth rate	Pre-tax discount rate	Recoverable amount exceeded carrying value	Discount rate	Terminal growth rate	forecast Income	forecast Cost	discount rate
At 31 December 2017	£bn	%	%	£bn	£bn	£bn	£bn	£bn	%
UK Personal & Business Banking (1)	3.4	2.0	13.1	9.7	(1.8)	(1.2)	(1.3)	(0.6)	21.6
Commercial Banking	1.9	2.0	12.9	1.3	(1.2)	(0.8)	(0.7)	(0.4)	13.9
31 December 2016									
UK Personal & Business Banking	3.4	2.5	12.8	14.6	(2.3)	(1.5)	(1.2)	(0.6)	27.0
Commercial Banking	1.9	2.5	12.9	2.1	(1.2)	(0.8)	(0.7)	(0.4)	14.7
RBS International (1)	0.3	2.5	10.9	0.2	(0.3)	(0.2)	(0.1)	—	11.7

Note:

(1) NatWest Holdings Limited is classed as a disposal group at 31 December 2017. RBSG International Holdings Limited (RBSIH) (which wholly own RBSI) was classified as a disposal group at 31 December 2016.

17 Property, plant and equipment

	Group			
2017	Property £m	Equipment £m	Operating lease assets £m	Total £m
Cost or valuation				
At 1 January	5,184	2,366	1,313	8,863
Transfers to disposal groups	(5,135)	(2,082)	(1,061)	(8,278)
Currency translation and other adjustments	(31)	(11)	(1)	(43)
Additions	764	145	199	1,108
Disposals and write-off of fully depreciated assets	(325)	(201)	(447)	(973)
At 31 December	457	217	3	677
Accumulated impairment, depreciation and amortisation				
At 1 January	2,037	1,702	588	4,327
Transfers to disposal groups	(1,753)	(1,482)	(463)	(3,698)
Currency translation and other adjustments	(35)	(10)	(2)	(47)
Disposals and write-off of fully depreciated assets	(224)	(155)	(265)	(644)
Charge for the year	278	159	143	580
At 31 December	303	214	1	518
Net book value at 31 December	154	3	2	159
2016				
Cost or valuation				
At 1 January	4,855	2,268	1,556	8,679
Transfers to disposal groups	(25)	(90)	—	(115)
Currency translation and other adjustments	288	109	25	422
Additions	395	279	228	902
Disposals and write-off of fully depreciated assets	(329)	(200)	(496)	(1,025)
At 31 December	5,184	2,366	1,313	8,863
Accumulated impairment, depreciation and amortisation				
At 1 January	1,907	1,643	676	4,226
Transfers to disposal groups	(6)	(71)	—	(77)
Currency translation and other adjustments	122	95	9	226
Disposals and write-off of fully depreciated assets	(217)	(152)	(250)	(619)
Charge for the year	231	187	153	571
At 31 December	2,037	1,702	588	4,327
Net book value at 31 December	3,147	664	725	4,536

17 Property, plant and equipment

2017	Bank Property £m	Equipment £m	Total £m
Cost or valuation			
At 1 January	1,768	1,804	3,572
Transfers to disposal groups	(1,731)	(1,744)	(3,475)
Currency translation and other adjustments	(14)	2	(12)
Additions	56	122	178
Disposals and write-off of fully depreciated assets	(70)	(176)	(246)
At 31 December	9	8	17
Accumulated impairment, depreciation and amortisation			
At 1 January	765	1,284	2,049
Transfers to disposal groups	(806)	(1,282)	(2,088)
Currency translation and other adjustments	(7)	2	(5)
Disposals and write-off of fully depreciated assets	(50)	(134)	(184)
Charge for the year	102	138	240
At 31 December	4	8	12
Net book value at 31 December	5	—	5
2016			
Cost or valuation			
At 1 January	1,869	1,735	3,604
Currency translation and other adjustments	(228)	8	(220)
Additions	303	205	508
Disposals and write-off of fully depreciated assets	(176)	(144)	(320)
At 31 December	1,768	1,804	3,572
Accumulated impairment, depreciation and amortisation			
At 1 January	758	1,234	1,992
Currency translation and other adjustments	6	9	15
Disposals and write-off of fully depreciated assets	(150)	(119)	(269)
Charge for the year	151	160	311
At 31 December	765	1,284	2,049
Net book value at 31 December	1,003	520	1,523

18 Prepayments, accrued income and other assets

	Group 2017 £m	Group 2016 £m	Bank 2017 £m	Bank 2016 £m
Prepayments	12	343	6	238
Accrued income	17	367	12	170
Tax recoverable	262	40	262	23
Pension schemes in net surplus (see Note 4)	290	267	290	264
Interests in associates	2	390	1	68
Other assets	246	881	20	800
	829	2,288	591	1,563

19 Discontinued operations and assets and liabilities of disposal groups

As part of implementing the legislation following the recommendations of the Independent Commission on Banking, the transfer of the Group's Personal & Business Banking (PBB), Commercial & Private Banking (CPB) and certain parts of Central items and NatWest Markets due to be included in the ring-fenced bank, to subsidiaries of NatWest Holdings, is planned for Q2 2018. It will be followed by a transfer of NatWest Holdings to RBSG. Accordingly, all of the activities to be undertaken by NatWest Holdings and its subsidiaries are classified as disposal groups at 31 December 2017 and presented as discontinued operations, with comparatives re-presented.

On 1 January 2017 The Royal Bank of Scotland International (Holdings) Limited (RBSI Holdings) was sold to The Royal Bank of Scotland Group plc, the immediate parent of the Group. Accordingly, RBSI Holdings was classified as a disposal group at 31 December 2016 and presented as a discontinued operation.

The Group sold the final tranche of its interest in Citizens Financial Group, Inc. (Citizens) in October 2015. Consequently, Citizens was classified as a disposal group at 31 December 2014 and presented as a discontinued operation until October 2015. From 3 August 2015, until the final tranche was sold in October 2015, Citizens was an associated undertaking. The gain on disposal in 2015 comprised £249 million on the derecognition of assets and liabilities, and £1,001 million in respect of reserves reclassified in accordance with IFRS.

(a) Profit/(loss) from discontinued operations, net of tax

	Group			Bank		
NatWest Holdings (1)	2017 £m	2016 £m	2015 £m	2017 £m	2016 £m	2015 £m
Interest income	10,528	10,658	10,677	4,130	4,657	5,078
Interest expense	(2,131)	(2,467)	(2,574)	(1,808)	(2,522)	(2,579)
Net interest income	8,397	8,191	8,103	2,322	2,135	2,499
Other income	1,953	2,865	2,532	2,072	4,290	3,402
Total income	10,350	11,056	10,635	4,394	6,425	5,901
Operating expenses	(7,729)	(9,757)	(9,473)	(4,812)	(6,021)	(4,529)
Profit/(loss) before impairment losses	2,621	1,299	1,162	(418)	404	1,372
Impairment (losses)/releases	(608)	(659)	685	(235)	(619)	2
Operating profit/(loss) before tax	2,013	640	1,847	(653)	(215)	1,374
Tax (charge)/credit	(821)	(919)	(406)	143	(316)	(84)
Profit/(loss) from discontinued operations net of tax	1,192	(279)	1,441	(510)	(531)	1,290
RBSI Holdings, Citizens and other (2)	2017 £m	2016 £m	2015 £m	2017 £m	2016 £m	2015 £m
Total income	—	275	3,246	—	—	—
Operating expenses	—	(130)	(1,311)	—	—	—
Profit before impairment losses	—	145	1,935	—	—	—
Impairment losses	—	(2)	(104)	—	—	—
Operating profit before tax	—	143	1,831	—	—	—
Tax charge	—	(26)	(235)	—	—	—
Profit from discontinued operations, net of tax	—	117	1,596	—	—	—

Note:
(1) Other comprehensive loss from discontinued operations for the year ended 31 December 2017 was £270 million (2016 – loss £325 million; 2015 – loss £1,697 million).
(2) 2016 profit from discontinued operations relates to RBSI Holdings (2015 - £58 million RBSI Holdings, £1,538 million Citizens).

(b) Cash flows attributable to discontinued operations

Included within the Group's cash flows are the following amounts attributable to discontinued operations.

	2017 £m	2016 £m	2015 £m
Net cash flows from operating activities	30,520	10,597	21,503
Net cash flows from investing activities	(4,745)	(3,764)	(5,479)
Net cash flows from financing activities	(10,046)	(11,789)	(3,667)
Net increase/(decrease) in cash and cash equivalents	16,550	(171)	13,108

19 Discontinued operations and assets and liabilities of disposal groups continued

(c) Assets and liabilities of disposal groups

	Group		Bank	
	2017 £m	2016 £m	2017 £m	2016 £m
Assets				
Cash and balances at central banks	97,625	62	61,532	—
Loans and advances to banks	11,299	31	21,889	—
Loans and advances to customers	291,599	7,891	102,816	—
Debt securities and equity shares	47,965	—	44,491	—
Investments in group undertakings	—	—	33,002	591
Derivatives	1,966	15	2,174	—
Intangible assets	6,232	304	551	—
Settlement balances	16	—	4	—
Property, plant and equipment (1)	4,041	38	1,046	—
Deferred tax	1,585	—	356	—
Other assets	1,550	25	1,177	—
Assets of disposal groups	463,878	8,366	269,038	591
Liabilities				
Deposits by banks	54,141	1	109,493	—
Customer accounts	349,619	23,272	94,843	—
Debt securities in issue	8,963	—	8,567	—
Derivatives	1,651	9	2,435	—
Settlement balances	36	—	21	—
Provisions for liabilities and charges	3,576	17	2,046	—
Accruals and other liabilities	4,819	84	2,258	—
Deferred tax	274	8	—	—
Subordinated liabilities	9,753	—	8,364	—
Liabilities of disposal groups	432,832	23,391	228,027	—

Note:

(1) A loss of £539 million (Bank - £341 million) has been provided for to recognise property, plant and equipments at the lower of fair value and carrying value.

At 31 December 2017 disposal groups primarily comprise of the net assets of the business due to be transferred to NatWest Holdings in Q2 2018 at book value; cost to sell are expected to be immaterial. Of the Group's cash flow hedge reserve at 31 December 2017, £205 million was attributable to the disposal groups. The cash flows remain highly probable in the context of a business combination under common control. Disposal groups at 31 December 2016 primarily comprise the net assets of RBSI Holdings, which in January 2017 was sold to The Royal Bank of Scotland Group plc at its book value; costs to sell were immaterial.

20 Short positions

	Group		Bank	
	2017 £m	2016 £m	2017 £m	2016 £m
Debt securities				
- Government	26,381	20,978	24,203	16,586
- Other issuers	2,145	1,095	2,003	1,001
Equity shares	1	3	1	3
	28,527	22,076	26,207	17,590

Note:
(1) All short positions are classified as held-for-trading.

21 Provisions for liabilities and charges

Provisions for liabilities and charges	Group					
	Payment protection insurance (1) £m	Other customer redress £m	Residential mortgage backed securities (2) £m	Litigation and other regulatory(3) £m	Property and other (4) (5) £m	Total (6) £m
At 1 January 2017	1,252	1,041	6,752	1,057	1,738	11,840
Disposals	—	(64)	—	—	(7)	(71)
Acquisition of business	—	53	—	—	13	66
Currency translation and other movements	—	4	(541)	(33)	52	(518)
Charge to income statement	175	228	714	228	995	2,340
Releases to income statement	—	(53)	(50)	(155)	(205)	(463)
Provisions utilised	(375)	(384)	(3,632)	(580)	(668)	(5,639)
At 31 December 2017	1,052	825	3,243	517	1,918	7,555

Provisions for liabilities and charges	Bank					
	Payment protection insurance (1) £m	Other customer redress £m	Residential mortgage backed securities (2) £m	Litigation and other regulatory(3) £m	Property and other (4) (5) £m	Total (6) £m
At 1 January 2017	497	271	1,786	908	1,422	4,884
Disposals	—	—	—	—	(8)	(8)
Acquisition of business	—	—	—	1	14	15
Currency translation and other movements	—	—	(155)	(9)	(2)	(166)
Charge to income statement	75	51	305	175	897	1,503
Releases to income statement	(4)	(28)	(191)	(152)	(137)	(512)
Provisions utilised	(150)	(115)	(185)	(531)	(459)	(1,440)
At 31 December 2017	418	179	1,560	392	1,727	4,276

Notes:

(1) To reflect the increased volume of complaints following the FCA's introduction of an August 2019 timebar as outlined in FCA announcement CP17/3, and the introduction of new Plevin (unfair commission) complaint handling rules, the Group increased its provision for PPI by £175m in 2017 (2016 - £601 million, 2015 - £600 million, 2014 - £650 million) bringing the cumulative charge to £5.1 billion, of which £3.7 billion (74%) in redress and £0.4 billion in administrative expenses had been paid by 31 December 2017. Of the £5.1 billion cumulative charge, £4.6 billion relates to redress and £0.5 billion to administrative expenses.

The principal assumptions underlying the Group's provision in respect of PPI sales are: assessment of the total number of complaints that the Group will receive before 29 August 2019; the proportion of these that will result in redress; and the average cost of such redress. The number of complaints has been estimated from an analysis of the Group's portfolio of PPI policies sold by vintage and by product. Estimates of the percentage of policyholders that will lodge complaints (the take up rate) and of the number of these that will be upheld (the uphold rate) have been established based on recent experience, guidance in FCA policy statements and the expected rate of responses from proactive customer contact. The average redress assumption is based on recent experience and FCA calculation rules.

21 Provisions for liabilities and charges continued

The table below shows the sensitivity of the provision to changes in the principal assumptions (all other assumptions remaining the same).

Assumptions	Actual to date	Future expected	Sensitivity: Change in assumption %	Sensitivity: Consequential change in provision £m
Customer initiated complaints (1)	2,386k	429k	+/-5	+/-30
Uphold rate (2)	90%	94%	+/-1	+/-6
Average redress (3)	£1,681	£1,476	+/-5	+/-30
Processing costs per claim (4)	£160	£142	+/- £20	+/-3

Notes:
(1) Claims received directly by the Group to date, including those received via CMCs and Plevin (commission) only. Excluding those for proactive mailings and where no PPI policy exists.
(2) Average uphold rate per customer initiated claims received directly by the Group to end of timebar for both PPI (mis-sale) and Plevin (commission), excluding those for which no PPI policy exists.
(3) Average redress for PPI (mis-sale) and Plevin (commission) pay-outs.
(4) Processing costs per claim on a valid complaints basis, includes direct staff costs and associated overhead - excluding FOS fees.

Interest that will be payable on successful complaints has been included in the provision as has the estimated cost to the Group of administering the redress process. There are uncertainties as to the eventual cost of redress which will depend on actual complaint volumes, take up and uphold rates and average redress costs. Assumptions related to these are inherently uncertain and the ultimate financial impact may be different from the amount provided. We continue to monitor the position closely and refresh the underlying assumptions.

Background information in relation to PPI claims is given in Note 29.

(2) In the US, the Group is subject to civil litigation and various investigations relating to its issuance and underwriting of US mortgage-backed securities (RMBS). An additional charge of US$650 million (£492 million) was taken in Q4 2017 in connection with these matters, resulting in a year to date charge of US$971 million (£714 million). Detailed descriptions of the Group’s legal proceedings and discussion of the associated uncertainties are given in Note 29.

In July 2017, the RBS Group reached a settlement with the Federal Housing Finance Agency (FHFA) as conservator of Fannie Mae and Freddie Mac, to resolve claims by FHFA in relation to the RBS Group’s issuance and underwriting of approximately US$32 billion (£25 billion) of RMBS in the US. As part of the settlement, the FHFA's outstanding litigation against the RBS Group relating to those securities was withdrawn.

Under the settlement, the RBS Group paid FHFA US$5.5 billion (£4.2 billion), of which US$754 million (£581 million) was reimbursed to the RBS Group under indemnification agreements with third parties. The cost to the RBS Group (net of the indemnity mentioned above) of US$4.75 billion (£3.65 billion) was largely covered by then-existing provisions but an incremental charge of US$196 million (£151 million) was recorded in Q2 2017 in relation to the settlement.

(3) The Group is party to certain legal proceedings and regulatory investigations and continues to co-operate with a number of regulators. All such matters are periodically reassessed with the assistance of external professional advisers, where appropriate, to determine the likelihood of the Group incurring a liability and to evaluate the extent to which a reliable estimate of any liability can be made. Details of these investigations and a discussion of the nature of the associated uncertainties are given in Note 29.

(4) The Group recognised a £750 million provision in 2016 as a consequence of the announcement that HM Treasury is seeking a revised package of remedies that would conclude its remaining State Aid commitments. An additional charge of £50 million was taken in Q2 2017 following further revisions to the package, taking the total provision to £800 million.

(5) The majority of property provisions relate to vacant leasehold property and comprise the present value of the shortfall between rentals payable and rentals receivable from sub-letting. In addition to the £800 million provision taken as an estimate of the cost of completing the Group’s State Aid divestment commitments as referred to in (4), other provisions include restructuring provisions of £478 million principally in relation to termination benefits.

(6) As at 31 December 2017 the Group provisions for liabilities and charges included within liabilities of disposal groups are £3,576 million, Bank includes £2,046 million. Of the Group's net charge to income statement above £1,236 million relates to continuing operations and £641 million relates to discontinued operations. Of the bank's net charge to income statement, above £721 million relates to continuing operations and £270 million relates to discontinued operations.

22 Accruals and other liabilities

	Group 2017 £m	Group 2016 £m	Bank 2017 £m	Bank 2016 £m
Notes in circulation	—	2,028	—	1,276
Current tax	140	346	30	250
Accruals	471	1,266	336	668
Deferred income	35	437	34	268
Other liabilities	105	2,052	79	807
Retirement benefit liabilities (see Note 4)	54	321	52	65
	805	6,450	531	3,334

23 Deferred tax

	Group 2017 £m	Group 2016 £m	Bank 2017 £m	Bank 2016 £m
Deferred tax asset	(166)	(1,798)	(165)	(272)
- disposal groups	(1,585)	—	(356)	—
	(1,751)	(1,798)	(521)	(272)
Deferred tax liability	128	525	100	—
- disposal groups	274	—	—	—
	402	525	100	—
Net deferred tax asset	(1,349)	(1,273)	(421)	(272)

Net deferred tax asset comprised:

	Group										
	Pension £m	Accelerated capital allowances £m	Provisions £m	Deferred gains £m	Fair value of financial instruments £m	Available-for-sale financial assets £m	Cash flow hedging £m	Share schemes £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2016	(857)	241	(327)	50	(4)	89	243	(23)	(1,331)	26	(1,893)
Acquisitions and disposals of subsidiaries	(6)	(62)	—	3	—	5	—	—	—	1	(59)
Charge/(credit) to income statement											
- continuing operations	11	104	55	(2)	2	—	(10)	—	280	30	470
- discontinued operations	(50)	44	(63)	(2)	24	(24)	(132)	13	37	(29)	(182)
Charge/(credit) to other comprehensive income	240	—	—	—	—	(8)	158	—	—	—	390
Currency translations and other adjustments	(4)	32	—	—	—	—	—	—	(36)	9	1
At 1 January 2017	(666)	359	(335)	49	22	62	259	(10)	(1,050)	37	(1,273)
Acquisitions and disposals of subsidiaries	5	(26)	—	—	—	—	—	—	—	—	(21)
Charge/(credit) to income statement											
- continuing operations	4	(148)	14	(4)	7	—	16	6	57	(31)	(79)
- discontinued operations	(1)	22	44	1	(214)	—	84	(6)	64	5	(1)
Charge/(credit) to other comprehensive income	276	—	—	(19)	—	29	(227)	—	—	—	59
Currency translations and other adjustments	(5)	(16)	(2)	3	—	—	—	1	(10)	(5)	(34)
At 31 December 2017	(387)	191	(279)	30	(185)	91	132	(9)	(939)	6	(1,349)
of which											
- disposal groups	(476)	164	(271)	24	(170)	91	122	13	(814)	6	(1,311)

23 Deferred tax continued

	Pension £m	Accelerated capital allowances £m	Provisions £m	Deferred gains £m	Fair value on financial instruments £m	Bank Available-for-sale financial assets £m	Cash flow hedging £m	Share schemes £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2016	18	(409)	(259)	31	—	58	144	(23)	(462)	—	(902)
Charge/(credit) to income statement											
- continuing operations	11	—	54	—	—	—	(5)	—	280	31	371
- discontinued operations	—	300	(56)	(6)	—	—	—	13	—	—	251
Charge/(credit) to other comprehensive income	21	—	—	—	—	2	(15)	—	—	—	8
Currency translations and other adjustments	—	—	—	(1)	—	—	—	—	—	1	—
At 1 January 2017	50	(109)	(261)	24	—	60	124	(10)	(182)	32	(272)
Charge/(credit) to income statement											
- continuing operations	4	—	14	6	—	—	—	—	57	(31)	50
- discontinued operations	—	74	24	(2)	(213)	—	(17)	—	—	6	(128)
Charge/(credit) to other comprehensive income	35	—	—	(18)	—	30	(113)	—	—	—	(66)
Currency translations and other adjustments	—	—	—	—	—	—	—	1	—	(6)	(5)
At 31 December 2017	89	(35)	(223)	10	(213)	90	(6)	(9)	(125)	1	(421)
of which											
- disposal groups	—	(35)	(215)	10	(213)	90	(6)	13	—	—	(356)

23 Deferred tax continued

Deferred tax assets in respect of unused tax losses are recognised if the losses can be used to offset probable future taxable profits after taking into account the expected reversal of other temporary differences. Recognised deferred tax assets in respect of tax losses are analysed below.

	2017 £m	2016 £m
UK tax losses carried forward		
- The Royal Bank of Scotland plc	125	182
- National Westminster Bank Plc	541	605
- Ulster Bank Limited	14	14
	680	801
Overseas tax losses carried forward		
- Ulster Bank Ireland DAC	259	249
	939	1,050

UK tax losses

Under UK tax rules, tax losses can be carried forward indefinitely. In periods from 1 April 2015, the Finance Act 2015 limits the offset of losses carried forward by UK banks to 50% of profits. In periods from 1 April 2016, the Finance Act 2016 further limits the offset of losses carried forward by UK banks to 25% of profits. The main rate of UK Corporation Tax reduced from 20% to 19% from 1 April 2017 and will reduce to 17% from 1 April 2020. Under the Finance (No 2) Act 2015, tax losses arising prior to 1 January 2016 are given credit in future periods at the main rate of UK corporation tax, excluding the Banking Surcharge rate (8%) introduced by the Act. Deferred tax assets and liabilities at 31 December 2017 take into account the reduced rates in respect of tax losses and non-banking temporary differences and where appropriate, the banking surcharge inclusive rate in respect of other banking temporary differences.

The Royal Bank of Scotland plc – The Royal Bank of Scotland plc expects that the balance of recognised deferred tax asset at 31 December 2017 of £125 million in respect of tax losses amounting to c. £700 million will be substantially recovered by the end of 2022. Since 2012 RBS has reported mixed levels of taxable profits and losses because core banking profitability was offset by a series of restructuring plans as the group reshaped to meet commercial and regulatory demands. In total, £10,247 million of losses have not been recognised in the deferred tax balance at 31 December 2017; such losses will be available to offset 25% of future taxable profits in excess of those forecast in the closing deferred tax asset.

National Westminster Bank Plc – A deferred tax asset of £541 million has been recognised in respect of total losses of £3,092 million. The losses arose principally as a result of significant impairment and conduct charges between 2009 and 2012 during challenging economic conditions in the UK banking sector. National Westminster Bank plc returned to tax profitability during 2015 and expects the deferred tax asset to be substantially consumed by future taxable profits by the end of 2024. A reduction in annual profits by £120 million would extend the recovery of the deferred tax asset by one year.

Overseas tax losses

Ulster Bank Ireland DAC – A deferred tax asset of £259 million has been recognised in respect of losses of £2,071 million of total tax losses of £8,596 million carried forward at 31 December 2017. The losses arose principally as a result of significant impairment charges between 2008 and 2013 during challenging economic conditions in the Republic of Ireland; subsequent movements reflect £:€ exchange differences. Ulster Bank Ireland DAC returned to profitability during 2014 and expects the deferred tax asset to be substantially consumed by future taxable profits by the end of 2024.

Unrecognised deferred tax

Deferred tax assets of £4,705 million (2016 - £5,728 million; 2015 - £4,364 million) have not been recognised in respect of tax losses and other temporary differences carried forward of £23,444 million (2016 - £24,373 million; 2015 - £19,499 million) in jurisdictions where doubt exists over the availability of future taxable profits. Of these losses and other temporary differences, £6,578 million expire after five years. The balance of tax losses and other temporary differences carried forward has no expiry date.

Deferred tax liabilities of £255 million (2016 - £258 million; 2015 - £256 million) have not been recognised in respect of retained earnings of overseas subsidiaries and held-over gains on the incorporation of overseas branches. Retained earnings of overseas subsidiaries are expected to be reinvested indefinitely or remitted to the UK free from further taxation. No taxation is expected to arise in the foreseeable future in respect of held-over gains. Dividends received from overseas are largely exempt from UK tax.

24 Subordinated liabilities

Certain preference shares issues are classified as liabilities; these securities remain subject to the capital maintenance rules of the Companies Act 2006.

The following tables analyse the remaining contracted maturity of subordinated liabilities by the final redemption date and by the next call date. At 31 December 2017 £9,753 million for group and £8,364 million for bank is included in liabilities for disposal groups.

	Group		Bank	
	2017 £m	2016 £m	2017 £m	2016 £m
Dated loan capital	—	11,429	—	11,045
Undated loan capital	—	4,538	—	3,631
Preference shares	—	3,548	—	3,194
	—	19,515	—	17,870

25 Share capital and reserves

	Allotted, called up and fully paid	
	2017 £m	2016 £m
Ordinary shares of £1	6,609	6,609

	Allotted, called up and fully paid	
Number of shares - millions	2017	2016
Ordinary shares of £1	6,609	6,609
Non-cumulative preference shares of US$0.01	56	56

Ordinary shares

No ordinary shares were issued during 2017 or 2016.

The bank did not pay an ordinary dividend in 2017 or 2016.

Reserves

At 31 December 2017, the merger reserve comprises the premium on shares issued to acquire NatWest less goodwill amortisation charged under previous GAAP. No share premium was recorded in the Bank financial statements through the operation of the merger relief provisions of the Companies Act 1985.

UK law prescribes that only reserves of the bank are taken into account for the purpose of making distributions and the permissible applications of the share premium account.

The Group optimises capital efficiency by maintaining reserves in subsidiaries, including regulated entities. Certain preference shares and subordinated debt are also included within regulatory capital. The remittance of reserves to the parent or the redemption of shares or subordinated capital by regulated entities may be subject to maintaining the capital resources required by the relevant regulator.

26 Structured entities

A structured entity (SE) is an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example, when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose, they do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions. As well as being a key element of securitisations, SEs are also used in fund management activities to segregate custodial duties from the fund management advice.

Consolidated structured entities

Securitisations

In a securitisation, assets, or interests in a pool of assets, are transferred generally to a SE which then issues liabilities to third party investors. The majority of securitisations are supported through liquidity facilities or other credit enhancements. The Group arranges securitisations to facilitate client transactions and undertakes own asset securitisations to sell or to fund portfolios of financial assets. The Group also acts as an underwriter and depositor in securitisation transactions in both client and proprietary transactions.

The Group's involvement in client securitisations takes a number of forms. It may: sponsor or administer a securitisation programme; provide liquidity facilities or programme-wide credit enhancement; and purchase securities issued by the vehicle.

Own asset securitisations

In own-asset securitisations, the pool of assets held by the SE is either originated by the Group, or (in the case of whole loan programmes) purchased from third parties.

The table below analyses the asset categories for those own-asset securitisations where the transferred assets continue to be recorded on the Group's balance sheet.

	Group							
	2017				2016			
		Debt securities in issue				Debt securities in issue		
Asset type	Assets £m	Held by third parties £m	Held by the Group (1) £m	Total £m	Assets £m	Held by third parties £m	Held by the Group (1) £m	Total £m
Mortgages								
- UK	—	—	—	—	1,475	—	1,774	1,774
- Irish	—	—	—	—	7,054	1,180	6,621	7,801
- US	—	—	—	—	301	301	—	301
	—	—	—	—	8,830	1,481	8,395	9,876
Cash deposits	4				965			
	4				9,795			

Note:
(1) Debt securities retained by the Group may be pledged with central banks.

Commercial paper conduits

The Group consolidates a number of asset-backed commercial paper (ABCP) conduits. A conduit is an SE 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 by further commercial paper issuance, repayment of assets or funding from liquidity facilities. Commercial paper is typically short-dated, usually up to three months. At 31 December 2017, assets held by the conduits were nil (2016 - £0.1 billion). At 31 December 2016 the conduits were funded entirely by the Group.

Covered bond programme

Certain loans and advances to customers have been assigned to bankruptcy remote limited liability partnership to provide security for issues of debt securities by the Group. The Group retains all of the risks and rewards of these loans. The partnerships are consolidated, the loans retained on the Group's balance sheet and the related covered bonds included within debt securities in issue. At 31 December 2017, there were no mortgages providing security for debt securities in issue (2016: mortgages - £8,621 million, bonds - £3,935 million).

26 Structured entities continued

Unconsolidated structured entities

The Group's interests in unconsolidated structured entities are analysed below.

2017	Asset backed securitisation vehicles £m	Investment funds and other £m	Total £m
Held-for-trading			
Loans and advances to customers	371	95	466
Debt securities	504	32	536
Derivatives assets	660	117	777
Derivatives liabilities	(559)	(131)	(690)
Total	976	113	1,089
Other than held-for-trading			
Loans and advances to customers	1,043	71	1,114
Debt securities	2,255	141	2,396
Total	3,298	212	3,510
Liquidity facilities/loan commitments	2,115	399	2,514
Guarantees	229	5	234
Maximum exposure	6,618	729	7,347

2016	£m	£m	£m
Held-for-trading			
Loans and advances to customers	579	40	619
Debt securities	618	28	646
Equity shares	—	93	93
Derivatives assets	317	77	394
Derivatives liabilities	(506)	(101)	(607)
Total	1,008	137	1,145
Other than held-for-trading			
Loans and advances to customers	1,339	871	2,210
Debt securities	4,702	146	4,848
Total	6,041	1,017	7,058
Liquidity facilities/loan commitments	1,397	757	2,154
Guarantees	55	6	61
Maximum exposure	8,501	1,917	10,418

Notes:
(1) Net income arising from interests in unconsolidated structured entities includes interest receivable, trading income as a result of changes in fair value, foreign exchange gains/losses and other income less impairments.
(2) A sponsored entity is a structured entity, established by the Group where the Group provides liquidity and/or credit enhancements or provides ongoing services to the entity. The Group can act as sponsor for its own or for customers' transactions.
(3) In 2017, no assets were transferred into sponsored structured entities (2016 - nil) which are not consolidated by the Group and to which the Group held no interest at 31 December 2017. Income arising from sponsored entities where no interest was held at year end was gains of £10 million (2016 - gains £21 million).

27 Asset transfers

Under IAS 39 a financial asset is transferred if the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. Following a transfer the financial asset will be derecognised; not derecognised and retained in full on the Group's balance sheet; or continue to be recognised on the balance sheet to the extent of the Group's continuing involvement.

Transfers that do not qualify for derecognition

Securities repurchase agreements and lending transactions

The Group enters into securities repurchase agreements and securities lending transactions under which it transfers securities in accordance with normal market practice.

Generally, the agreements require additional collateral to be provided if the value of the securities falls below a predetermined level. Under standard terms for repurchase transactions in the UK and US markets, the recipient of collateral has an unrestricted right to sell or repledge it, subject to returning equivalent securities on settlement of the transaction.

Securities sold under repurchase transactions are not derecognised if the Group retains substantially all the risks and rewards of ownership. The fair value (and carrying value) of securities transferred under such repurchase transactions included on the balance sheet, are set out below. All of these securities could be sold or repledged by the holder.

	Group		Bank	
Assets subject to securities repurchase agreements or security lending transactions	2017 £m	2016 £m	2017 £m	2016 £m
Debt securities (1)	7,538	18,107	7,538	15,206

Note:
(1) Associated liabilities were £7,483 million for both the Group and Bank (2016 – Group: £12,951 million, Bank: £10,060 million).

Assets pledged as collateral

The Group pledges collateral with its counterparties in respect of derivative liabilities and bank and other borrowings.

	Group		Bank	
Assets pledged against liabilities	2017 £m	2016 £m	2017 £m	2016 £m
Loans and advances to banks	6,842	7,352	6,842	6,985
Loans and advances to customers	14,671	29,657	14,671	28,118
Securities	15,175	20,152	13,173	19,937
	36,688	57,161	34,686	55,040
Liabilities secured by assets				
Deposits by banks	—	5,514	—	5,001
Derivatives	22,912	26,437	22,912	26,402
	22,912	31,951	22,912	31,403

28 Capital resources

Under Capital Requirements Regulation (CRR), regulators within the European Union monitor capital on a legal entity basis, with local transitional arrangements on the phasing in of end-point CRR. The capital resources based on the relevant transitional basis for the bank.

	2017 £m	2016 £m
Shareholders' equity (excluding non-controlling interests)		
Shareholders' equity	44,522	45,876
Regulatory adjustments and deductions		
Own credit	10	(152)
Defined benefit pension fund adjustment	(196)	(198)
Cash flow hedging reserve	49	(261)
Deferred tax assets	(50)	(47)
Prudential valuation adjustments	(471)	(524)
Goodwill and other intangible assets	—	(521)
Expected losses less impairments	(579)	(642)
Instruments of financial sector entities where the institution has a significant investment	(22,539)	(20,433)
Other regulatory adjustments	(577)	235
	(24,353)	(22,543)
CET1 capital	20,169	23,333
Additional Tier 1 (AT1) capital		
Qualifying instruments and related share premium subject to phase out	1,877	2,993
Tier 2 deductions		
Instruments of financial sector entities where the institution has a significant investment	(80)	(1,034)
Tier 1 capital	21,966	25,292
Qualifying Tier 2 capital		
Qualifying instruments and related share premium	4,353	12,161
Tier 2 deductions		
Instruments of financial sector entities where the institution has a significant investment	(719)	(3,302)
Tier 2 capital	3,634	8,859
Total regulatory capital	25,600	34,151

In the management of capital resources, the Group is governed by the RBS Group's policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the RBS Group has regard to the supervisory requirements of the PRA. The PRA uses capital ratios as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks); by international agreement, the Pillar 1 capital ratios, excluding capital buffers, should be not less than 8% with a Common Equity Tier 1 component of not less than 4.5%. The Group has complied with the PRA's capital requirements throughout the year.

A number of subsidiaries and sub-groups within the Group, principally banking entities, are subject to various individual regulatory capital requirements in the UK and overseas. Furthermore, the payment of dividends by subsidiaries and the ability of members of the RBS Group to lend money to other members of the RBS Group may be subject to restrictions such as local regulatory or legal requirements, the availability of reserves and financial and operating performance.

The RBS Group NatWest Markets segment's net assets as at 31 December 2017 are broadly similar to the target consolidated net assets of the Company after the completion of the ring-fence transfer schemes and capital reduction to be carried out during 2018. In July 2018 the company intends to reduce its equity capital base and reorganise its debt funding to be commensurate with its activities as an investment bank. Notwithstanding these capital changes the company is targeting a strong capital base with a CET1 of around 14% and a total capital ratio of around 28% by 2020.

Notes on the accounts

29 Memorandum items

Contingent liabilities and commitments

The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December 2017. Although the Group is exposed to credit risk in the event of non-performance of the obligations undertaken by customers, the amounts shown do not, and are not intended to, provide any indication of the Group's expectation of future losses.

	Group		Bank	
	2017 £m	2016 £m	2017 £m	2016 £m
Contingent liabilities and commitments				
Guarantees and assets pledged as collateral security	3,306	3,808	2,481	2,570
Other contingent liabilities	3,381	4,141	2,274	2,904
Standby facilities, credit lines and other commitments	123,157	138,579	69,558	84,608
	129,844	146,528	74,313	90,082

Note:
(1) In the normal course of business, the Bank guarantees specified third party liabilities of certain subsidiaries; it also gives undertakings that individual subsidiaries will fulfil their obligations to third parties under contractual or other arrangements.

Banking commitments and contingent obligations, which have been entered into on behalf of customers and for which there are corresponding obligations from customers, are not included in assets and liabilities. The Group's maximum exposure to credit loss, in the event of its obligation crystallising and all counterclaims, collateral or security proving valueless, is represented by the contractual nominal amount of these instruments included in the table above. These commitments and contingent obligations are subject to the Group's normal credit approval processes.

Guarantees - the Group gives guarantees on behalf of customers. A financial guarantee represents an irrevocable undertaking that the Group will meet a customer's specified obligations to a third party if the customer fails to do so. The maximum amount that the Group could be required to pay under a guarantee is its principal amount as in the table above. The Group expects most guarantees it provides to expire unused.

Other contingent liabilities - these include standby letters of credit, supporting customer debt issues and contingent liabilities relating to customer trading activities such as those arising from performance and customs bonds, warranties and indemnities.

Standby facilities and credit lines - under a loan commitment the Group agrees to make funds available to a customer in the future. Loan commitments, which are usually for a specified term may be unconditionally cancellable or may persist, provided all conditions in the loan facility are satisfied or waived. Commitments to lend include commercial standby facilities and credit lines, liquidity facilities to commercial paper conduits and unutilised overdraft facilities.

Other commitments - these include documentary credits, which are commercial letters of credit providing for payment by the Group to a named beneficiary against presentation of specified documents, forward asset purchases, forward deposits placed and undrawn note issuance and revolving underwriting facilities, and other short-term trade related transactions.

Capital Support Deed

The Bank, together with other members of the RBS Group, is party to a Capital Support Deed (CSD). Under the terms of the CSD, the Bank may be required, if compatible with its legal obligations, to make distributions on, or repurchase or redeem, its ordinary shares. The amount of this obligation is limited to the Bank's capital resources in excess of the capital and financial resources needed to meet its regulatory requirements. The Bank may also be obliged to make onward distribution to its ordinary shareholders of dividends or other capital distributions received from subsidiaries that are party to the CSD. The CSD also provides that, in certain circumstances, funding received by the Bank from other parties to the CSD becomes immediately repayable, such repayment being limited to the Bank's available resources.

29 Memorandum items continued

Contractual obligations for future expenditure not provided for in the accounts
The following table shows contractual obligations for future expenditure not provided for in the accounts at the year end. The decrease in the year is due to the business due to the transfer to disposal groups of the business due to be undertaken by NatWest Holdings and subsidiaries.

	Group		Bank	
	2017 £m	2016 £m	2017 £m	2016 £m
Operating leases				
Minimum rentals payable under non-cancellable leases (1)				
- within 1 year	4	246	3	126
- after 1 year but within 5 years	2	786	2	454
- after 5 years	—	1,775	—	1,205
	6	2,807	5	1,785
Capital expenditure on property, plant and equipment	—	21	—	19
Contracts to purchase goods or services (2)	—	598	—	467
	6	3,426	5	2,271

Notes:
(1) Predominantly property leases.
(2) Of which due within 1 year: Group - nil (2016 - £231 million) and Bank - nil (2016 - £201 million).

Trustee and other fiduciary activities
In its capacity as trustee or other fiduciary role, the Group may hold or place assets on behalf of individuals, trusts, companies, pension schemes and others. The assets and their income are not included in the Group's financial statements. The Group earned fee income of £1 million from continuing operations (2016 - £196 million; 2015 - £272 million) from these activities.

The Financial Services Compensation Scheme
The Financial Services Compensation Scheme (FSCS), the UK's statutory fund of last resort for customers of authorised financial services firms, pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the industry. In relation to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year (which runs from 1 April to 31 March), subject to annual maxima set by the Prudential Regulation Authority. In addition, the FSCS has the power to raise levies on a firm that has ceased to participate in the scheme and is in the process of ceasing to be authorised for the costs that it would have been liable to pay had the FSCS made a levy in the financial year it ceased to be a participant in the scheme.

The FSCS has borrowed from HM Treasury to fund compensation costs associated with the failure of Bradford & Bingley, Heritable Bank, Kaupthing Singer & Friedlander, Landsbanki 'Icesave' and London Scottish Bank plc. The interest rate on these borrowings is subject to a floor being the higher of 12 month LIBOR plus 100 basis points or the relevant gilt rate for the equivalent cost of borrowing from HMT. The FSCS and HM Treasury have agreed that the period of these loans will reflect the expected timetable for recoveries from the estates of Bradford & Bingley and the other failed banks. The FSCS will levy the deposit taking sector for its share of the balance of the principal outstanding for the non-Bradford & Bingley loan prior to the FSCS loan facility with HMT expiring in March 2016. The interest element levied on the industry in 2016/17 scheme year was £202 million (£337 million in the 2016/17 scheme year).

The Group has accrued £2 million for its share of estimated FSCS levies.

29 Memorandum items continued

Litigation, investigations and reviews

RBS plc and certain members of the RBS Group are party to legal proceedings and the subject of investigation and other regulatory and governmental action ("Matters") in the United Kingdom (UK), the United States (US), the European Union (EU) and other jurisdictions.

The RBS Group recognises a provision for a liability in relation to these Matters when it is probable that an outflow of economic benefits will be required to settle an obligation resulting from past events, and a reliable estimate can be made of the amount of the obligation. While the outcome of these Matters is inherently uncertain, the directors believe that, based on the information available to them, appropriate provisions have been made in respect of the Matters as at 31 December 2017 (refer to Note 21). To support the move towards a ring-fenced structure, the business due to be transferred to the ring-fenced bank in 2018 is classified as disposal groups at 31 December 2017 and presented as discontinued operations. Accordingly a number of the matters and related provisions discussed below relate to business presented in disposal groups.

In many proceedings and investigations, it is not possible to determine whether any loss is probable or to estimate reliably the amount of any loss, either as a direct consequence of the relevant proceedings and investigations or as a result of adverse impacts or restrictions on the RBS Group's reputation, businesses and operations. Numerous legal and factual issues may need to be resolved, including through potentially lengthy discovery and document production exercises and determination of important factual matters, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a liability can reasonably be estimated for any claim. The RBS Group cannot predict if, how, or when such claims will be resolved or what the eventual settlement, damages, fine, penalty or other relief, if any, may be, particularly for claims that are at an early stage in their development or where claimants seek substantial or indeterminate damages.

In respect of certain matters described below, we have established a provision and in certain of those matters, we have indicated that we have established a provision. The RBS Group generally does not disclose information about the establishment or existence of a provision for a particular matter where disclosure of the information can be expected to prejudice seriously the RBS Group's position in the matter.

There are situations where the RBS Group may pursue an approach that in some instances leads to a settlement agreement. This may occur in order to avoid the expense, management distraction or reputational implications of continuing to contest liability, or in order to take account of the risks inherent in defending claims or investigations even for those matters for which the RBS Group believes it has credible defences and should prevail on the merits.

The uncertainties inherent in all such matters affect the amount and timing of any potential outflows for both matters with respect to which provisions have been established and other contingent liabilities.

The future outflow of resources in respect of any matter may ultimately prove to be substantially greater than or less than the aggregate provision that the RBS Group has recognised. Where (and as far as) liability cannot be reasonably estimated, no provision has been recognised.

Other than those discussed below, no member of the Group is or has been involved in governmental, legal or regulatory proceedings (including those which are pending or threatened) that are expected to be material, individually or in aggregate. The RBS Group expects that in future periods additional provisions, settlement amounts, and customer redress payments will be necessary, in amounts that are expected to be substantial in some instances.

For a discussion of certain risks associated with the Group's litigation, investigations and reviews, see the Risk Factor relating to legal, regulatory and governmental actions and investigations set out on page 190.

Litigation

UK 2008 rights issue shareholder litigation

Between March and July 2013, claims were issued in the High Court of Justice of England and Wales by sets of current and former shareholders, against RBSG (and in one of those claims, also against certain former individual officers and directors) alleging that untrue and misleading statements and/or improper omissions, in breach of the Financial Services and Markets Act 2000, were made in connection with the rights issue announced by the RBS Group on 22 April 2008. These and other similar threatened claims were consolidated by the Court via a Group Litigation Order. Since then, further High Court claims have been issued against RBS under the Group Litigation Order. Prior to the settlement described below, the aggregate value of the shares subscribed for at 200 pence per share by all of the then claimant shareholders was approximately £4 billion.

In December 2016 the RBS Group concluded full and final settlements with four of the five shareholder groups representing 78 per cent of the claims by value. Further full and final settlements, without any admission of liability, were reached and the RBS Group has now concluded the action with over 98 per cent of the claimants.

The aggregate settlement figure available to claimants is £900 million, for which a previously established provision is in place, and is subject to validation of claims.

The Court directed that any claimant choosing not to enter the settlement should, by 28 July 2017, issue an application to restore the proceedings. No such application was made.

Litigation, investigations and reviews continued

Residential mortgage-backed securities (RMBS) litigation in the US

RBS Group companies have been named as defendants in their various roles as issuer, depositor and/or underwriter in a number of claims in the US that relate to the securitisation and securities underwriting businesses. These cases include actions by individual purchasers of securities and a purported class action suit.

In general, plaintiffs in these actions claim that certain disclosures made in connection with the relevant offerings of RMBS contained materially false or misleading statements and/or omissions regarding the underwriting standards pursuant to which the mortgage loans underlying the securities were issued.

RBS Securities Inc. remains a defendant in a lawsuit relating to RMBS issued by Nomura Holding America Inc. (Nomura) and subsidiaries, filed by the US Federal Housing Finance Agency (FHFA) as conservator for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). In May 2015, following a trial, the United States District Court for the Southern District of New York issued a written decision in favour of FHFA, finding, as relevant to the RBS Group, that the offering documents for four Nomura-issued RMBS for which RBS Securities Inc. served as an underwriter contained materially misleading statements about the mortgage loans that backed the securitisations. Nomura and the RBS Group appealed. On 28 September 2017, the court's judgment against Nomura and RBS Securities Inc. was affirmed by the United States Court of Appeals for the Second Circuit.

RBS Securities Inc. estimates that its net exposure under the court's judgment is approximately US$318 million, which consists of the difference between the amount of the judgment against RBS Securities Inc. (US$636 million) and the estimated market value of the four RMBS that FHFA would return to RBS Securities Inc. pursuant to the judgment, plus the costs and attorney's fees that will be due to FHFA if the judgment is upheld. The estimated net exposure in this matter is covered by an existing provision. The judgment is stayed pending defendants' request for review by the United States Supreme Court, though post-judgment interest on the judgment amount will accrue while that request and any further review is pending. RBS Securities Inc. intends to pursue a contractual claim for indemnification against Nomura with respect to any losses it suffers as a result of this matter.

RBS Group companies are also defendants in a purported RMBS class action entitled New Jersey Carpenters Health Fund v. Novastar Mortgage Inc. et al., which remains pending in the United States District Court for the Southern District of New York. The RBS Group has settled this matter for US$55.3 million, which has been paid into escrow pending court approval of the settlement.

In addition to the above, the remaining RMBS lawsuits against RBS Group companies consist of cases filed by the Federal Home Loan Banks of Boston and Seattle and the Federal Deposit Insurance Corporation that together involve the issuance of less than US$1 billion of RMBS issued primarily from 2005 to 2007.

As at 31 December 2017, the total aggregate of provisions in relation to certain of the RMBS litigation matters (described immediately above) and RMBS and other securitised products investigations (set out under "Investigations and reviews" on page 160) was £3.2 billion (US$4.4 billion). The duration and outcome of these investigations and litigation matters remain uncertain, including in respect of whether settlements for all or any of such matters may be reached.

The RBS Group continues to caution that, in connection with RMBS litigation matters and RMBS investigations taken as a whole, further substantial provisions and costs may be recognised and, depending on the final outcomes, other adverse consequences may occur.

London Interbank Offered Rate (LIBOR) and other rates litigation

Certain members of the Group have been named as defendants in a number of class actions and individual claims filed in the US with respect to the setting of LIBOR and certain other benchmark interest rates. The complaints are substantially similar and allege that certain members of the Group and other panel banks individually and collectively violated various federal laws, including the US commodities and antitrust laws, and state statutory and common law, as well as contracts, by manipulating LIBOR and prices of LIBOR-based derivatives in various markets through various means.

Most of the USD LIBOR-related actions in which RBS Group companies are defendants, including all purported class actions relating to USD LIBOR, were transferred to a coordinated proceeding in the United States District Court for the Southern District of New York.

In the coordinated proceeding, consolidated class action complaints were filed on behalf of (1) exchange-based purchaser plaintiffs, (2) over-the-counter purchaser plaintiffs, and (3) corporate debt purchaser plaintiffs. Over 35 other USD LIBOR-related actions naming the RBS Group as a defendant, including purported class actions on behalf of lenders and mortgage borrowers, were also made part of the coordinated proceeding.

In a series of orders issued in 2013 and 2014, the district court overseeing the coordinated USD proceeding dismissed class plaintiffs' antitrust claims and claims under RICO (Racketeer Influenced and Corrupt Organizations Act), but declined to dismiss (a) certain Commodity Exchange Act claims on behalf of persons who transacted in Eurodollar futures contracts and options on futures contracts on the Chicago Mercantile Exchange (on the theory that defendants' alleged persistent suppression of USD LIBOR caused loss to plaintiffs), and (b) certain contract and unjust enrichment claims on behalf of over-the-counter purchaser plaintiffs who transacted directly with a defendant. On 23 May 2016, the district court's dismissal of plaintiffs' antitrust claims was vacated by the United States Court of Appeals for the Second Circuit, which held that plaintiffs have adequately pled antitrust injury and an antitrust conspiracy, but remanded to the lower court for further consideration on the question of whether plaintiffs possess the requisite antitrust standing to proceed with antitrust claims.

Litigation, investigations and reviews continued

In a decision issued in December 2016, the district court held that it lacks personal jurisdiction over the RBS Group with respect to certain claims asserted in the coordinated proceeding. Following that decision, the RBS Group has been dismissed from each of the USD LIBOR-related class actions in the coordinated proceeding, subject to appeal, although certain non-class cases on behalf of particular plaintiffs remain pending.

On 10 July 2017, the US Federal Deposit Insurance Corporation (FDIC), on behalf of 39 failed US banks, served a claim in the High Court of Justice of England and Wales against the RBS Group, other LIBOR panel banks and the British Bankers' Association, alleging collusion with respect to the setting of USD LIBOR. The action alleges that the defendants breached English and European competition law as well as asserting common law claims of fraud under US law. The FDIC previously asserted many of the same US law USD LIBOR-related claims against the RBS Group and others in a lawsuit pending in the United States District Court for the Southern District of New York, though most of the claims in that case have been dismissed as a result of a series of rulings by that court. The RBS Group's defence to the High Court claim was filed on 24 November 2017.

Certain members of the Group have also been named as defendants in two class actions relating to JPY LIBOR and Euroyen TIBOR, both pending before the same judge in the United States District Court for the Southern District of New York. In the first case, relating to Euroyen TIBOR futures contracts, the court dismissed plaintiffs' antitrust claims in March 2014, but declined to dismiss their claims under the Commodity Exchange Act for price manipulation, which are proceeding in the discovery phase. In the second case, relating to other derivatives allegedly tied to JPY LIBOR and Euroyen TIBOR, the court dismissed the case on 10 March 2017 on the ground that the plaintiffs lack standing. Plaintiffs have commenced an appeal of that decision.

Certain members of the Group have also been named as defendants in class actions relating to (i) Euribor, (ii) Swiss Franc LIBOR (iii) Pound sterling LIBOR, (iv) the Singapore Interbank Offered Rate and Singapore Swap Offer Rate, and (v) the Australian Bank Bill Swap Reference Rate, all of which are pending before other judges in the United States District Court for the Southern District of New York. On 21 February 2017, the court in the action relating to Euribor dismissed all claims alleged against the RBS Group for lack of personal jurisdiction. On 18 August 2017, the court in the action relating to the Singapore Interbank Offered Rate and Singapore Swap Offer Rate dismissed all claims against the RBS Group for lack of personal jurisdiction; however, the court allowed the plaintiffs to replead their complaint, and defendants' renewed motion to dismiss the amended complaint is pending. On 25 September 2017, the court in the action relating to Swiss Franc LIBOR dismissed all claims against all defendants on various grounds; however, the court held that it has personal jurisdiction over RBS and allowed the plaintiffs to replead their complaint, and defendants' renewed motion to dismiss the amended complaint is pending.

The other matters described in this paragraph (relating to Pound Sterling LIBOR and the Australian Bank Bill Swap Reference Rate) are subject to motions to dismiss that are currently pending.

Details of UK litigation claims in relation to the sale of interest rate hedging products (IRHPs) involving LIBOR-related allegations are set out under "Interest rate hedging products litigation" on page 162. Details of LIBOR investigations involving the RBS Group are set out under ''Investigations and reviews'' on page 161.

ISDAFIX antitrust litigation

Beginning in September 2014, The Royal Bank of Scotland plc (RBS plc) and a number of other financial institutions were named as defendants in several purported class action complaints (subsequently consolidated into one complaint) in the United States District Court for the Southern District of New York alleging manipulation of USD ISDAFIX rates In 2015, RBS plc reached an agreement to settle this matter for US$50 million, and that settlement received preliminary approval from the Court in May 2016. The settlement amount has been paid into escrow pending the final court approval of the settlement.

FX antitrust litigation

In 2015, Group companies settled a consolidated antitrust class action (the "consolidated action"), pending in the United States District Court for the Southern District of New York, asserting claims on behalf of persons who entered into (a) over-the-counter foreign exchange (FX) spot transactions, forwards, swaps, futures, options or other FX transactions the trading or settlement of which is related in any way to FX rates, or (b) exchange-traded FX instruments. Following the Court's preliminary approval of the settlement in December 2015, the RBS Group paid the total settlement amount (US$255 million) into escrow pending final court approval of the settlement.

On 24 March 2017, the court dismissed a second FX-related antitrust class action, holding that the alleged class of "consumers and end-user businesses" lacked standing to pursue antitrust claims. The plaintiffs in that case have since filed an amended complaint. The defendants made a renewed motion to dismiss the complaint but the court denied that motion on 3 August 2017. As a result, the discovery phase has commenced. The RBS Group and the other defendants are seeking reconsideration of the court's decision regarding standing or, in the alternative, permission to take an immediate appeal to the United States Court of Appeals for the Second Circuit.

A third FX-related class action, asserting Employee Retirement Income Security Act claims on behalf of employee benefit plans that engaged in FX transactions, including claims based on alleged non-collusive FX-related conduct, was dismissed in September 2016 on the ground that the plaintiffs failed to plead that the defendants had ERISA-based fiduciary duties to the plaintiffs. The plaintiffs' appeal of this dismissal remains pending.

Litigation, investigations and reviews continued

Beginning in September 2016, several additional class action complaints were filed in the United States District Court for the Southern District of New York asserting claims on behalf of "indirect purchasers" of FX instruments.

The plaintiffs define "indirect purchasers" as persons who were indirectly affected by FX instruments that others entered into directly with defendant banks or on exchanges. The consolidated amended complaint for these matters alleges that certain RBS Group companies and other defendant banks caused damages to the "indirect purchasers" by conspiring to restrain trade in the FX spot market. The plaintiffs have asserted claims under federal and state antitrust laws. The RBS Group and the other defendants have filed a motion to dismiss, which remains pending.

On 12 July 2017, Alpari (US) LLC (Alpari) filed a class action complaint against RBS Group companies in the United States District Court for the Southern District of New York. The complaint alleges that the RBS Group breached contracts with Alpari and other counterparties by rejecting FX orders placed over electronic trading platforms through the application of a function referred to as "Last Look", and that the rejected orders were later filled at prices less favourable to putative class members. The complaint contains claims for breach of contract and unjust enrichment. The RBS Group has filed a motion to compel arbitration of Alpari's claims or, in the alternative, to dismiss those claims for improper venue.

In September 2015, certain members of the Group, as well as a number of other financial institutions, were named as defendants in two class actions filed in Ontario and Quebec on behalf of persons in Canada who entered into foreign exchange transactions or who invested in funds that entered into foreign exchange transactions, alleging that the defendants violated the Canadian Competition Act by conspiring to manipulate the prices of currency trades. The RBS Group settled the matters for approximately CAD 13 million. The settlement amount has been paid and the settlement has received final court approval.

Certain other foreign exchange transaction related claims have been or may be threatened against the RBS Group in other jurisdictions. The RBS Group cannot predict whether any of these claims will be pursued, but expects that several may.

US Treasury securities antitrust litigation

Beginning in July 2015, numerous class action antitrust complaints were filed in US federal courts against a number of primary dealers of US Treasury securities, including RBS Securities Inc.. The consolidated amended complaint for these matters, pending in the United States District Court for the Southern District of New York, alleges that RBS Securities Inc. and the other defendants rigged the US Treasury securities auction bidding process to deflate prices at which they bought such securities and colluded to increase the prices at which they sold such securities to plaintiffs.

The complaint asserts claims under the US antitrust laws on behalf of persons who transacted in US Treasury securities or derivatives based on such instruments, including futures and options. The defendants anticipate filing a motion to dismiss the operative complaint in this matter.

Swaps antitrust litigation

Beginning in November 2015, RBS plc and other members of the Group, as well as a number of other interest rate swap dealers, were named as defendants in a number of class action antitrust complaints filed in the United States District Court for the Southern District of New York and the United States District Court for the Northern District of Illinois. The complaints, filed on behalf of persons who entered into interest rate swaps with the defendants, allege that the defendants violated the US antitrust laws by restraining competition in the market for interest rate swaps through various means and thereby caused inflated bid-ask spreads for interest rate swaps, to the alleged detriment of the plaintiff class.

In addition, two complaints containing similar allegations of collusion were filed in United States District Court for the Southern District of New York on behalf of TeraExchange and Javelin, who allege that they would have successfully established exchange-like trading of interest rate swaps if the defendant dealers had not unlawfully conspired to prevent that from happening through boycotts and other means, in violation of the U.S. antitrust laws. In June 2016, all of these matters were transferred to the United States District Court for the Southern District of New York for coordinated or consolidated pretrial proceedings.

In July 2017, the Court overseeing the above matters dismissed all claims against RBS Group companies relating to the 2008 - 2012 time period, but declined to dismiss certain antitrust and unjust enrichment claims covering the 2013 - 2016 time period. Discovery is ongoing.

On 8 June 2017, TeraExchange filed another complaint against the RBS Group and others in the United States District Court for the Southern District of New York, this time relating to credit default swaps instead of interest rate swaps. TeraExchange alleges it would have established exchange-like trading of credit default swap if the defendant dealers had not engaged in an unlawful antitrust conspiracy. The RBS Group has filed a motion to dismiss the complaint in this matter.

Madoff

In December 2010, Irving Picard, as trustee for the bankruptcy estates of Bernard L. Madoff and Bernard L. Madoff Investment Securities LLC., filed a clawback claim against The Royal Bank of Scotland N.V. (RBS N.V.) in the New York bankruptcy court. In the operative complaint, filed in August 2012, the trustee seeks to recover US$75.8 million in redemptions that RBS N.V. allegedly received from certain Madoff feeder funds and US$162.1 million that RBS N.V. allegedly received from its swap counterparties at a time when RBS N.V. allegedly 'knew or should have known of Madoff's possible fraud'.

Litigation, investigations and reviews continued

The trustee alleges that those transfers were preferences or fraudulent conveyances under the US bankruptcy code and New York law and he asserts the purported right to claw them back for the benefit of Madoff's estate. RBS N.V. made a motion to dismiss in this case on the ground that many of the transfers at issue were extraterritorial to the United States and therefore not subject to the fraudulent conveyance statute upon which the trustee's claim is based, but the bankruptcy court denied that motion in November 2016.

RBS N.V. sought leave to appeal, but this was denied on 3 October 2017. A further claim by the trustee against RBS N.V., for clawback of an additional US$21.8 million, was filed in October 2011. With respect to that claim, the bankruptcy court granted RBS N.V.'s motion to dismiss on extraterritorial grounds, and the trustee has commenced an appeal of that decision.

Thornburg adversary proceeding

RBS Securities Inc. and certain other RBS Group companies, as well as several other financial institutions, are defendants in an adversary proceeding filed in the US bankruptcy court in Maryland by the trustee for TMST, Inc. (formerly known as Thornburg Mortgage, Inc.). The trustee seeks recovery of transfers made under certain restructuring agreements as, among other things, avoidable fraudulent and preferential conveyances and transfers. In September 2014, the Court largely denied the defendants' motion to dismiss this matter and, as a result, discovery is ongoing.

Interest rate hedging products litigation

The RBS Group is dealing with a large number of active litigation claims in relation to the sale of interest rate hedging products (IRHPs). In general claimants allege that the relevant interest rate hedging products were mis-sold to them, with some also alleging the RBS Group made misrepresentations in relation to LIBOR. Claims have been brought by customers who were considered under the UK Financial Conduct Authority (FCA) redress programme, as well as customers who were outside of the scope of that programme, which was closed to new entrants on 31 March 2015. The RBS Group encouraged those customers that were eligible to seek redress under the FCA redress programme to participate in that programme. The RBS Group remains exposed to potential claims from customers who were either ineligible to be considered for redress or who are dissatisfied with their redress offers.

Property Alliance Group (PAG) v The Royal Bank of Scotland plc was the leading case before the English High Court involving both IRHP mis-selling and LIBOR misconduct allegations. The amount claimed was £34.8 million and the trial ended in October 2016. In December 2016 the Court dismissed all of PAG's claims. PAG appealed that decision, and the appeal hearing closed on 8 February 2018. The judgment is awaited. The decision (subject to the appeal by PAG) may have significance to other similar LIBOR-related cases currently pending in the English courts, some of which involve substantial amounts.

The case of London Bridge Holdings Ltd and others v RBS plc remains stayed pending the outcome of the PAG appeal. The sum claimed in that case is £446.7 million.

In addition to claims alleging that IRHPs were mis-sold, the RBS Group has received a number of claims involving allegations that it breached a legal duty of care in its conduct of the FCA redress programme. These claims have been brought by customers who are dissatisfied with redress offers made to them through the FCA redress programme. The claims followed a preliminary decision against another UK bank. The RBS Group has since been successful in opposing an application by a customer to amend its pleadings to include similar claims against RBS, on the basis that the bank does not owe a legal duty of care to customers in carrying out the FCA review. An appeal of that decision was dismissed in July 2017 and permission to further appeal was refused by the UK Supreme Court in December 2017.

Tax dispute

HMRC issued a tax assessment in 2012 against the RBS Group for approximately £86 million regarding a value-added-tax ("VAT") matter in relation to the trading of European Union Allowances ("EUAs") by an RBS Group joint venture subsidiary in 2009. The RBS Group has commenced legal proceedings before the First-tier Tribunal (Tax), a specialist tax tribunal, challenging the assessment (the "Tax Dispute"). In the event that the assessment is upheld, interest and costs would be payable, and a penalty of up to 100 per cent of the VAT held to have been legitimately denied by HMRC could also be levied. Separately, the RBS Group is a named defendant in proceedings before the High Court brought in 2015 by ten companies (all in liquidation) (the "Liquidated Companies") and their respective liquidators (together, "the Claimants"). The Liquidated Companies previously traded in EUAs in 2009 and are alleged to be defaulting traders within (or otherwise connected to) the EUA supply chains forming the subject of the Tax Dispute. The Claimants are claiming approximately £80 million plus interest and costs by alleging that RBS dishonestly assisted the directors of the Liquidated Companies in the breach of their statutory duties and/or knowingly participated in the carrying on of the business of the Liquidated Companies with intent to defraud creditors. The trial in that matter is currently scheduled to start in June 2018.

Weiss v. National Westminster Bank Plc (NatWest)

NatWest is defending a lawsuit filed by a number of US nationals (or their estates, survivors, or heirs) who were victims of terrorist attacks in Israel. The plaintiffs allege that NatWest is liable for damages arising from those attacks pursuant to the US Anti-Terrorism Act because NatWest previously maintained bank accounts and transferred funds for the Palestine Relief & Development Fund, an organisation which plaintiffs allege solicited funds for Hamas, the alleged perpetrator of the attacks.

In March 2013, the trial court (the United States District Court for the Eastern District of New York) granted summary judgment in favour of NatWest on the issue of scienter, but in September 2014, that summary judgment ruling was vacated by the United States Court of Appeals for the Second Circuit.

Litigation, investigations and reviews continued

The appeals court returned the case to the trial court for consideration of NatWest's other asserted grounds for summary judgment and, if necessary, for trial. In March 2016, the trial court denied a motion by NatWest to dismiss the case in which NatWest had argued that the court lacked personal jurisdiction over NatWest. NatWest has since asserted other grounds for summary judgment that the trial court has not previously ruled upon. On 5 October 2017, the United States District Court for the Eastern District of New York dismissed claims against NatWest with respect to two terrorist attacks, but denied NatWest's summary judgment motion with respect to claims arising from 16 other attacks. No trial date has been set.

Anti-Terrorism Act litigation against RBS N.V.

RBS N.V. and certain other financial institutions (HSBC, Barclays, Standard Chartered, Credit Suisse, Bank Saderat, and Commerzbank) are defendants in an action first commenced in the United States District Court for the Eastern District of New York in November 2014 by a number of US nationals (or their estates, survivors, or heirs), most of whom are or were US military personnel, who were killed or injured in more than 90 attacks in Iraq between 2004 and 2011.

The attacks were allegedly perpetrated by Hezbollah and certain Iraqi terror cells allegedly funded by the Islamic Republic of Iran.

According to the plaintiffs' allegations, RBS N.V. and the other defendants are liable for damages arising from the attacks because they allegedly conspired with Iran and certain Iranian banks to assist Iran in transferring money to Hezbollah and the Iraqi terror cells, in violation of the US Anti-Terrorism Act, by agreeing to engage in "stripping" of transactions initiated by the Iranian banks so that the Iranian nexus to the transactions would not be detected. Since commencing this matter, the plaintiffs have amended the complaint twice. The second amended complaint is subject to a motion to dismiss that defendants filed in September 2016.

In November 2016, additional plaintiffs commenced a second action in the United States District Court for the Southern District of Illinois against the same defendants (including RBS N.V.), as well as Deutsche Bank. The allegations were substantially similar to the allegations contained in the complaint described above. The plaintiffs were a number of US military personnel (or their estates, survivors, or heirs) who were killed or injured in 21 attacks in Iraq between 2006 and 2011. In April 2017, this case was transferred to the United States District Court for the Eastern District of New York. On 3 October 2017, the plaintiffs in this second case, instead of responding to defendants' motion to dismiss, voluntarily dismissed their claims without prejudice to re-filing at a later date.

On 9 November 2017, a third action was commenced by an additional group of plaintiffs in the United States District Court for the Southern District of New York, against the same defendants as the November 2016 action (including RBS N.V.), as well as RBS plc. The allegations are substantially similar to the allegations contained in the complaints described above and concern 55 attacks in Iraq between 2003 and 2011. The defendants anticipate filing a motion to dismiss the claims in this case.

Investigations and reviews

The RBS Group's businesses and financial condition can be affected by the actions of various governmental and regulatory authorities in the UK, the US, the EU and elsewhere. The RBS Group has engaged, and will continue to engage, in discussions with relevant governmental and regulatory authorities, including in the UK, the US, the EU and elsewhere, on an ongoing and regular basis, and in response to informal and formal inquiries or investigations, regarding operational, systems and control evaluations and issues including those related to compliance with applicable laws and regulations, including consumer protection, business conduct, competition/anti-trust, anti-bribery, anti-money laundering and sanctions regimes.

The NatWest Markets segment in particular has been providing information regarding a variety of matters, including, for example, the setting of benchmark rates and related derivatives trading, conduct in the foreign exchange market, and various issues relating to the issuance, underwriting, and sales and trading of fixed-income securities, including structured products and government securities.

Any matters discussed or identified during such discussions and inquiries may result in, among other things, further inquiry or investigation, other action being taken by governmental and regulatory authorities, increased costs being incurred by the RBS Group, remediation of systems and controls, public or private censure, restriction of the RBS Group's business activities and/or fines. Any of the events or circumstances mentioned in this paragraph or below could have a material adverse effect on the RBS Group, its business, authorisations and licences, reputation, results of operations or the price of securities issued by it.

The RBS Group is co-operating fully with the investigations and reviews described below.

RMBS and other securitised products investigations

In the US, the RBS Group is involved in reviews, investigations and proceedings (both formal and informal) by federal and state governmental law enforcement and other agencies and self-regulatory organisations, including the US Department of Justice (DOJ) and several state attorneys general, including those mentioned below, relating to, among other things, issuance, underwriting and trading in RMBS and other mortgage-backed securities and collateralised debt obligations (CDOs).

These ongoing matters include, among others, active investigations by the DOJ, relating primarily to due diligence on and disclosure related to loans purchased for, or otherwise included in, securitisations and related disclosures.

As at 31 December 2017, the total aggregate of provisions in relation to certain of the RMBS investigations and RMBS litigation matters (set out under "Litigation" on page 156) was £3.2 billion (US$4.4 billion).

Litigation, investigations and reviews continued

The RBS Group continues to cooperate with the DOJ and with certain state attorneys general in their investigations of RMBS matters. The duration, timing for resolution and outcome of these investigations and RMBS litigation matters remain uncertain, including in respect of whether settlements for all or any of such matters may be reached.

Further substantial provisions and costs may be recognised and, depending on the final outcome, other adverse consequences may occur as described above and in the Risk Factor relating to legal, regulatory and governmental actions and investigations set out on page 190.

In December 2017, RBS Financial Products Inc. agreed to pay US$125 million to settle the RMBS investigation of the California Attorney General. Payment has been made from a previously established provision. Ongoing investigations into the same or similar issues by certain other state attorneys general are at various stages. RBS is in advanced discussions with the New York Attorney General to resolve its investigation, although there is no certainty that any settlement will be reached.

On 26 October 2017, the United States Attorney for the District of Connecticut (USAO) announced that it had entered into a Non-Prosecution Agreement (NPA) with RBS Securities Inc. in connection with alleged misrepresentations to counterparties relating to secondary trading in various forms of asset-backed securities. The NPA, which recognises RBS Securities Inc.'s timely self-reporting and cooperation, required RBS Securities Inc. to pay a penalty of US$35 million, reimburse customers at least US$9.1 million, and continue to cooperate with the investigation. These amounts were covered by provisions existing at the time of settlement. As part of the NPA, the USAO has agreed not to file criminal charges against RBS Securities Inc. relating to certain conduct and information described in the NPA if RBS Securities Inc. complies with the NPA during its one-year term. In March and December 2015, two former RBS Securities Inc. traders entered guilty pleas in the United States District Court for the District of Connecticut, each to one count of conspiracy to commit securities fraud while employed at RBS Securities Inc..

US mortgages - loan repurchase matters

The RBS Group's NatWest Markets business in North America was a purchaser of non-agency residential mortgages in the secondary market, and an issuer and underwriter of non-agency RMBS.

In issuing RMBS, NatWest Markets in some circumstances made representations and warranties regarding the characteristics of the underlying loans. As a result, NatWest Markets may be, or may have been, contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of such representations and warranties. Depending on the extent to which such loan repurchase related claims are pursued against and not rebutted by NatWest Markets on timeliness or other grounds, the aggregate potential impact on the RBS Group, if any, may be material.

LIBOR and other trading rates

From February 2013 to December 2016, the RBS Group entered into settlements with various governmental authorities in relation to investigations into submissions, communications and procedures around the setting of LIBOR and other interest rates and interest rate trading, which, among other things, required the RBS Group to pay significant penalties. As part of these resolutions, the RBS Group made certain undertakings regarding benchmark interest rates, including the undertakings contained in its February 2013 resolution with the Commodity Futures Trading Commission (CFTC).

The RBS Group continues to co-operate with investigations and requests for information by various other governmental and regulatory authorities, including in the UK, US and APAC.

On 3 February 2017, it was announced that the RBS Group and the CFTC entered into a civil settlement resolving the CFTC's investigation of ISDAFIX and related trading activities. As part of the settlement, the RBS Group has paid a penalty of US$85 million and agreed to certain undertakings.

Foreign exchange related investigations

In November 2014, RBS plc reached a settlement with the FCA and the CFTC in relation to investigations into failings in RBSG's FX businesses within its NatWest Markets segment. RBS plc agreed to pay penalties of £217 million to the FCA and US$290 million to the CFTC to resolve the investigations. The fines were paid in November 2014.

In May 2015, RBS plc announced that it had reached settlements with the DOJ and the Board of Governors of the Federal Reserve System (Federal Reserve) in relation to investigations into its FX business within its NatWest Markets segment. RBS plc paid a penalty of US$274 million to the Federal Reserve and agreed to pay a penalty of US$395 million to the DOJ to resolve the investigations.

As part of its plea agreement with the DOJ, RBS plc pled guilty in the United States District Court for the District of Connecticut to a one-count information charging an antitrust conspiracy. RBS plc admitted that it knowingly, through one of its euro/US dollar currency traders, joined and participated in a conspiracy to eliminate competition in the purchase and sale of the euro/US dollar currency pair exchanged in the FX spot market.

The charged conspiracy occurred between as early as December 2007 to at least April 2010. On 5 January 2017, the United States District Court for the District of Connecticut imposed a sentence on RBS plc consisting of the US$395 million criminal fine previously agreed with the DOJ and a term of probation, which among other things, prohibits RBS plc from committing another crime in violation of US law or engaging in the FX trading practices that form the basis for the charged crime and requires RBS plc to implement a compliance program designed to prevent and detect the unlawful conduct at issue and to strengthen its compliance and internal controls as required by other regulators (including the FCA and the CFTC). A violation of the terms of probation could lead to the imposition of additional penalties. Subsequent to the sentencing, RBS plc paid the criminal fine, which had been covered by an existing provision.

Litigation, investigations and reviews continued

RBS plc and RBS Securities Inc. have also entered into a cease and desist order with the Federal Reserve relating to FX and other designated market activities (the FX Order). In the FX Order, which is publicly available and will remain in effect until terminated by the Federal Reserve, RBS plc and RBS Securities Inc. agreed to take certain remedial actions with respect to FX activities and certain other designated market activities, including the creation of an enhanced written internal controls and compliance program, an improved compliance risk management program, and an enhanced internal audit program. RBS plc and RBS Securities Inc. are obligated to implement and comply with these programs as approved by the Federal Reserve, and are also required to conduct, on an annual basis, a review of applicable compliance policies and procedures and a risk-focused sampling of key controls.

The RBS Group is co-operating with investigations and responding to inquiries from other governmental and regulatory (including competition) authorities on similar issues relating to failings in its FX business within its NatWest Markets segment. The timing and amount of financial penalties with respect to any further settlements and related litigation risks and collateral consequences remain uncertain and may well be material.

FCA review of the RBS Group's treatment of SMEs

In November 2013, a report by Lawrence Tomlinson, entrepreneur in residence at the UK Government's Department for Business Innovation and Skills, was published ("Tomlinson Report"). The Tomlinson Report was critical of the RBS Group's treatment of SMEs.

The Tomlinson Report was passed to the PRA and FCA. Shortly thereafter, the FCA appointed an independent Skilled Person under section 166 of the Financial Services and Markets Act to review the allegations in the Tomlinson Report. The Skilled Person's review was focused on the RBS Group's UK small and medium sized business customers with credit exposures of up to £20 million whose relationship was managed within the RBS Group's Global Restructuring Group or within similar units within the RBS Group's Corporate Banking Division that were focused on customers in financial difficulties. In the period 2008 to 2013 the RBS Group was one of the leading providers of credit to the UK SME sector.

Separately, in November 2013, the RBS Group instructed the law firm Clifford Chance to conduct an independent review of the principal allegation made in the Tomlinson Report: the RBS Group was alleged to be culpable of systematic and institutional behaviour in artificially distressing otherwise viable businesses and, through that, putting businesses into insolvency. Clifford Chance published its report on 17 April 2014 and, while it made certain recommendations to enhance customer experience and transparency of pricing, it concluded that there was no evidence to support the principal allegation.

A separate independent review of the principal allegation, led by Mason Hayes & Curran, Solicitors, was conducted in the Republic of Ireland. The report was published in December 2014 and found no evidence to support the principal allegation.

The Skilled Person review focused on the allegations made in the Tomlinson Report and certain observations made by Sir Andrew Large in his 2013 Independent Lending Review, and was broader in scope than the reviews undertaken by Clifford Chance and Mason, Hayes & Curran which are referred to above. The Skilled Person delivered the draft findings from its review to the FCA in March 2016. The RBS Group was then given the opportunity to consider and respond to those draft findings before the Skilled Person delivered its final report to the FCA during September 2016.

In November 2016, the FCA published an update on its review. In response, the RBS Group announced redress steps for SME customers in the UK and the Republic of Ireland that were in GRG between 2008 and 2013. These steps were (i) an automatic refund of certain complex fees; and (ii) a new complaints process, overseen by an Independent Third Party. They were developed with the involvement of the FCA, which agreed that they were appropriate steps for the RBS Group to take.

The RBS Group estimates the costs associated with the complaints review process and the automatic refund of complex fees to be approximately £400 million, which was recognised as a provision in 2016. This includes operational costs together with the cost of refunded complex fees and the additional estimated redress costs arising from the complaints process. Of the £400 million provision, £150 million had been utilised by 31 December 2017.

On 23 October 2017, the FCA published an interim report incorporating a summary of the Skilled Person's report which stated that, further to the general investigation announced in November 2016, the FCA had decided to carry out a more focused investigation. The FCA published its final summary of the Skilled Person's report on 28 November 2017. The UK House of Commons Treasury Select Committee, seeking to rely on Parliamentary powers, published the full version of the Skilled Person's report on 20 February 2018.

Interest rate hedging products (IRHP) redress programme

From 2013, the RBS Group and other banks undertook a redress exercise and past business review in relation to the sale of interest rate hedging products to some small and medium sized businesses classified as retail clients or private customers under FSA rules. This exercise was scrutinised by an independent reviewer, KPMG (appointed as a Skilled Person under section 166 of the Financial Services and Markets Act), and overseen by the FCA.

RBS Group provisions in relation to the above redress exercises total £1.47 billion for these matters, virtually all of which had been utilised at 31 December 2017.

Judicial Review of Skilled Person's role in IRHP review

The RBS Group has been named as an interested party in a number of claims for judicial review of KPMG's decisions as Skilled Person in the RBS Group's previously disclosed IRHP redress programme. This follows a similar claim from a customer of another UK bank, also against KPMG.

Litigation, investigations and reviews continued

All of these claims were stayed pending the outcome of the other bank's case. The trial in that case was heard in January 2016. The court decided in favour of KPMG, finding that (1) KPMG is not a body amenable to judicial review in respect of its role as Skilled Person in this matter; and (2) that there was no unfairness by the other bank in the procedure adopted. The claimant has been granted permission to appeal that decision, and the appeal hearing is expected to take place on 23 and 24 May 2018.

The majority of the claims that name the RBS Group as an interested party have been discontinued but there are still several cases which remain stayed pending the outcome of the appeal in the other bank's case. If the appeal court finds that a section 166-appointed Skilled Person is susceptible to judicial review, these remaining claims against the RBS Group may then proceed to full hearing to assess the fairness of KPMG's role in the redress programme in those particular cases. If deemed unfair, this could have a consequential impact on the reasonableness of the methodology applied to reviewed and settled IRHP files generally. As there remains some uncertainty, it is not practicable reliably to estimate the impact of this matter, if any, on the RBS Group which may be material.

Investment advice review

In February 2013, the FSA announced the results of a mystery shopping review it undertook into the investment advice offered by banks and building societies to retail clients. As a result of that review the FSA announced that firms involved were cooperative and agreed to take immediate action. The RBS Group was one of the firms involved.

The action required included a review of the training provided to advisers, considering whether changes were necessary to both advice processes and controls for new business, and undertaking a past business review to identify any historic poor advice (and where breaches of regulatory requirements are identified, to put this right for customers).

Subsequent to the FSA announcing the results of its mystery shopping review, the FCA required the RBS Group to carry out a past business review and customer contact exercise on a sample of historic customers that received investment advice on certain lump sum products through the UK Financial Planning channel of the UK Personal & Business Banking (UK PBB) segment of the RBS Group, which includes RBS plc and NatWest, during the period from March 2012 until December 2012.

This review was conducted under section 166 of the Financial Services and Markets Act, under which a Skilled Person was appointed to carry out the exercise. Redress has been paid to certain customers in this sample group. Following discussions with the FCA after issue of the draft section 166 report, the RBS Group agreed with the FCA that it would carry out a wider review/remediation exercise relating to certain investment, insurance and pension sales from 1 January 2011 to 1 April 2015. The project regarding review/remediation of sales between 1 January 2011 and 1 April 2015 was due to finish at the end of 2017 but this deadline is being extended with completion anticipated by the end of Q1 2018. This is to allow completion of outstanding remediation activity that was impacted by customer responses, and to receive information from third party providers, in addition to concluding small cohorts of work that were postponed until the additional scope was agreed.

In addition, discussions are ongoing with FCA with regard to extending the scope of the review/remediation exercise to include the period from 1 January 2010 to 31 December 2010, with a formal decision expected during Q1 2018. It is not currently anticipated that any extension of scope will require an additional provision to be taken.

In addition, the RBS Group agreed with the FCA that it would carry out a remediation exercise, for a specific customer segment who were sold a particular structured product, in response to concerns raised by the FCA with regard to (a) the target market for the product and (b) how the product may have been described to customers by certain advisers. Redress has been paid to certain customers who took out the structured product.

RBS Group provisions in relation to investment advice total £201 million to date for these matters, of which £102 million had been utilised as at 31 December 2017.

Packaged accounts

As a result of an uplift in packaged current account complaints, the RBS Group proactively put in place dedicated resources in 2013 to investigate and resolve complaints on an individual basis. The RBS Group has made gross provisions totalling £409 million to date for this matter.

The FCA conducted a thematic review of packaged bank accounts across the UK from October 2014 to April 2016, the results of which were published in October 2016. The RBS Group continues to take into consideration and, where relevant, address the findings from this review.

FCA investigation into the RBS Group plc's compliance with the Money Laundering Regulations 2007

On 21 July 2017, the FCA notified the RBS Group that it was undertaking an investigation into RBS plc's compliance with the Money Laundering Regulations 2007 in relation to certain customers. Following amendment to the scope of the investigation, there are currently three areas under review: (1) compliance with Money Laundering Regulations in respect of Money Service Business customers; (2) compliance with the Terrorism Act 2000 in relation to sanctions screening; and (3) the Suspicious Transactions regime in relation to the events surrounding a particular customer. The investigations in all three areas are assessing both criminal and civil culpability. The RBS Group is cooperating with the investigations.

Multilateral interchange fees

In September 2014, the Court of Justice upheld earlier decisions by the EU Commission and the General Court that MasterCard's multilateral interchange fee (MIF) arrangements for cross border payment card transactions with MasterCard and Maestro branded consumer credit and debit cards in the EEA are in breach of competition law.

Separately, in April 2013, the EC announced it was opening a new investigation into interchange fees payable in respect of payments made in the EEA by MasterCard cardholders from non-EEA countries. On 3 August 2017, the EC announced it had also sent Visa a Supplementary Statement of Objections. The EC investigations are ongoing.

Litigation, investigations and reviews continued

In June 2015, a regulation on interchange fees for card payments entered into force. The regulation requires the capping of both cross-border and domestic MIF rates for debit and credit consumer cards. The regulation also sets out other reforms including to the Honour All Cards Rule which require merchants to accept all cards with the same level of MIF but not cards with different MIF levels.

In May 2015, the Competition & Markets Authority (CMA) announced that it had closed the investigations into domestic interchange fees on the grounds of administrative priorities.

Whilst there are no recent developments on the above to report, there remains uncertainty around the outcomes of the ongoing EC investigation, and the impact of the regulation, and they may have a material adverse effect on the structure and operation of four party card payment schemes in general and, therefore, on the RBS Group's business in this sector.

Payment Protection Insurance (PPI)

Since 2011, the RBS Group has been implementing the FCA's policy statement for the handling of complaints about the mis-selling of PPI (Policy Statement 10/12).

In August 2017, the FCA's new rules and guidance on PPI complaints handling (Policy Statement (17/3) came into force. The Policy Statement introduced new so called 'Plevin' rules, under which customers may be eligible for redress if the bank earned a high level of commission from the sale of PPI, but did not disclose this detail at the point of sale. The Policy Statement also introduced a two year PPI deadline, due to expire in August 2019, before which new PPI complaints must be made. The RBS Group is implementing the Policy Statement.

The RBS Group has made provisions totalling £5.1 billion to date for PPI claims, including an additional provision of £175 million in 2017. Of the £5.1 billion cumulative provision, £4.1 billion had been utilised by 31 December 2017.

UK retail banking

In November 2014, the CMA announced its decision to proceed with a market investigation reference (MIR) into retail banking, which would cover personal current account (PCA) and SME banking. On 9 August 2016, the CMA published its final report. The CMA concluded that there are a number of competition concerns in the provision of PCAs, business current accounts and SME lending, particularly around low levels of customers searching and switching, resulting in banks not being put under enough competitive pressure, and new products and new banks not attracting customers quickly enough. The final report set out remedies to address these concerns. These included remedies making it easier for customers to compare products, ensure customers benefit from technological advantages around open banking, improve the current account switching service and provide PCA overdraft customers with greater control over their charges along with additional measures targeted at SME customers.

On 2 February 2017 the CMA published the Retail Banking Market Investigation Order 2017 (the "Order"), which is the primary legal framework setting out the obligations for the implementation of the majority of remedies, including an implementation deadline for each. Other remedies are to be delivered via undertakings signed by Bacs and recommendations to be taken forward by other regulators (including the FCA).

On 19 December 2017 the CMA published directions for the RBS Group and four other banks, which set out revised implementation dates for the delivery of certain obligations relating to open banking under the Order. On 29 January 2018 the CMA published separate directions for RBS, which set out revised implementation dates for the delivery of certain obligations requiring PCA overdraft alerts to be sent to customers under the Order.

At this stage there remains uncertainty around the financial impact of the remedies once implemented, and so it is not practicable to estimate the potential impact on the RBS Group, which may be material.

FCA Investment and Corporate Banking Market Study

In February 2015, the FCA launched a market study into investment and corporate banking. In October 2016 the FCA published its final report. It found that whilst many clients feel well served by primary capital market services there were some areas where improvements could be made to encourage competition, particularly for smaller clients. It set out a package of remedies, including prohibiting the use of restrictive contractual clauses and ending league table misrepresentation by asking league table providers to review their recognition criteria. The prohibition on restrictive contractual clauses took effect from 3 January 2018.

Some uncertainty remains around the financial impact of the remedies once implemented and so it is not practicable reliably to estimate the potential impact on the RBS Group. However, at this stage, this impact is not expected to be material.

FCA Asset Management Market Study

In November 2015, the FCA announced that a market study would be undertaken into asset management. In November 2016, the FCA published the interim report which indicated that price competition is weak and expressed concerns around the lack of transparency on the objectives, and appropriate benchmarks, for reporting fund performance. On 28 June 2017, the FCA published the final report which was broadly in line with the interim report and sets out an extensive package of remedies which include providing further protection to investors and driving competitive pressure on asset managers.

Some uncertainty remains around the financial impact of the remedies once implemented and so it is not practicable reliably to estimate the potential impact on the RBS Group. However, at this stage, this impact is not expected to be material.

Litigation, investigations and reviews continued

FCA Mortgages Market Study

In December 2016, the FCA launched a market study into the provision of mortgages. The FCA is expected to publish an interim report in Spring 2018 with the final report expected in Q4 2018.

At this stage, as there is considerable uncertainty around the outcome of this market study, it is not practicable reliably to estimate the aggregate impact, if any, on the RBS Group which may be material.

FCA Strategic Review of Retail Banking Models

On 11 May 2017 the FCA announced a two phase strategic review of retail banking models. The FCA will use the review to understand how these models operate, including how 'free if in credit' banking is paid for and the impact of changes such as increased use of digital channels and reduced branch usage.

Phase 1 will allow the FCA to enhance its understanding of existing models and how these impact competition and conduct. Phase 2 will evaluate the impacts of economic, technological, social and regulatory factors on these models. A project update is expected in Q2 2018 outlining the FCA's preliminary conclusions from Phase 1.

At this early stage, as there is considerable uncertainty around the outcome of this review, it is not practicable reliably to estimate the aggregate impact, if any, on the RBS Group, which in due course may be material.

Governance and risk management consent order

In July 2011, the RBS Group agreed with the Board of Governors of the Federal Reserve System, the New York State Banking Department, the Connecticut Department of Banking, and the Illinois Department of Financial and Professional Regulation to enter into a consent Cease and Desist Order (Governance Order) (which is publicly available) to address deficiencies related to governance, risk management and compliance systems and controls in the US branches of RBS plc and RBS N.V. branches (the US Branches).

In the Governance Order, the RBS Group agreed to create the following written plans or programmes:

Key points

- a plan to strengthen board and senior management oversight of the corporate governance, management, risk management, and operations of the RBS Group's US operations on an enterprise-wide and business line basis;
- an enterprise-wide risk management programme for the RBS Group's US operations;
- a plan to oversee compliance by the RBS Group's US operations with all applicable US laws, rules, regulations, and supervisory guidance;
- a Bank Secrecy Act/anti-money laundering compliance programme for the US Branches on a consolidated basis;
- a plan to improve the US Branches' compliance with all applicable provisions of the Bank Secrecy Act and its rules and regulations as well as the requirements of Regulation K of the Federal Reserve;
- a customer due diligence programme designed to ensure reasonably the identification and timely, accurate, and complete reporting by the US Branches of all known or suspected violations of law or suspicious transactions to law enforcement and supervisory authorities, as required by applicable suspicious activity reporting laws and regulations; and
- a plan designed to enhance the US Branches' compliance with Office of Foreign Assets Control (OFAC) requirements.

The Governance Order identified specific items to be addressed, considered, and included in each proposed plan or programme. The RBS Group also agreed in the Governance Order to adopt and implement the plans and programmes after approval by the regulators, to comply fully with the plans and programmes thereafter, and to submit to the regulators periodic written progress reports regarding compliance with the Governance Order.

The RBS Group has created, submitted, and adopted plans and/or programmes to address each of the areas identified above. In connection with the RBS Group's efforts to implement these plans and programmes, it has, among other things, made investments in technology, hired and trained additional personnel, and revised compliance, risk management, and other policies and procedures for the RBS Group's US operations. The RBS Group continues to test the effectiveness of the remediation efforts it has undertaken to ensure they are sustainable and meet regulators' expectations. Furthermore, the RBS Group continues to work closely with the regulators in its efforts to fulfil its obligations under the Governance Order, which will remain in effect until terminated by the regulators.

The RBS Group may be subject to formal and informal supervisory actions and may be required by its US banking supervisors to take further actions and implement additional remedial measures with respect to these and additional matters. The RBS Group's activities in the US may be subject to significant limitations and/or conditions.

Litigation, investigations and reviews continued

US dollar processing consent order

In December 2013 the RBS Group and RBS plc agreed a settlement with the Federal Reserve, the New York State Department of Financial Services (DFS), and the Office of Foreign Assets Control (OFAC) with respect to RBS plc's historical compliance with US economic sanction regulations outside the US. As part of the settlement, the RBS Group and RBS plc entered into a consent Cease and Desist Order with the Federal Reserve (US Dollar Processing Order), which remains in effect until terminated by the Federal Reserve. The US Dollar Processing Order (which is publicly available) indicated, among other things, that the RBS Group and RBS plc lacked adequate risk management and legal review policies and procedures to ensure that activities conducted outside the US comply with applicable OFAC regulations.

The RBS Group agreed to create an OFAC compliance programme to ensure compliance with OFAC regulations by the RBS Group's global business lines outside the US, and to adopt, implement, and comply with the programme. Prior to and in connection with the US Dollar Processing Order, the RBS Group has made investments in technology, hired and trained personnel, and revised compliance, risk management, and other policies and procedures.

Under the US Dollar Processing Order (as part of the OFAC compliance programme) the RBS Group was required to appoint an independent consultant to conduct an annual review of OFAC compliance policies and procedures and their implementation and an appropriate risk-focused sampling of US dollar payments.

The RBS Group appointed the independent consultant and their reports were submitted to the authorities in June 2015. The independent consultant review examined a significant number of sanctions alerts and no reportable issues were identified.

Pursuant to the US Dollar Processing Order, the authorities requested a second annual review to be conducted by an independent consultant. The second review was conducted by the independent consultant and reports were submitted to the authorities in September 2016. In line with the first review, and following examination of a significant number of sanctions alerts, the independent consultant did not identify any reportable issues. The authorities have requested a third annual review to be conducted and independent consultant reports are expected to be issued during Q1 2018. In addition, pursuant to requirements of the US Dollar Processing Order, the RBS Group has provided the required written submissions, including quarterly updates, in a timely manner, and RBS continues to participate in a constructive dialogue with the authorities.

US/Swiss tax programme

In August 2013, the DOJ announced a programme for Swiss banks (the Programme) which provides Swiss banks with an opportunity to obtain resolution, through non-prosecution agreements or non-target letters, of the DOJ's investigations of the role that Swiss banks played in concealing the assets of US tax payers in offshore accounts (US related accounts). In December 2013, Coutts & Co Ltd., a member of the Group incorporated in Switzerland, notified the DOJ that it intended to participate in the Programme.

As required by the Programme, Coutts & Co Ltd. subsequently conducted a review of its US related accounts and presented the results of the review to the DOJ. In December 2015, Coutts & Co Ltd. entered into a non-prosecution agreement (the NPA) in which Coutts & Co Ltd. paid a US$78.5 million penalty and acknowledged responsibility for certain conduct set forth in a statement of facts accompanying the agreement. Under the NPA, which has a term of four years, Coutts & Co Ltd. is required, among other things, to provide certain information, cooperate with DOJ's investigations, and commit no U.S. federal offences. If Coutts & Co Ltd. abides by the NPA, the DOJ will not prosecute it for certain tax-related and monetary transaction offences in connection with US related accounts.

Enforcement proceedings and investigations in relation to Coutts & Co Ltd

The Swiss Financial Market Supervisory Authority (FINMA) has been taking enforcement proceedings against Coutts & Co Ltd, a member of RBS incorporated in Switzerland, with regard to certain client accounts held with Coutts & Co Ltd relating to allegations in connection with the Malaysian sovereign wealth fund 1MDB. On 2 February 2017, FINMA announced that Coutts & Co Ltd had breached money laundering regulations by failing to carry out adequate background checks into business relationships and transactions associated with 1MDB. FINMA accordingly required Coutts & Co Ltd to disgorge profits of CHF 6.5 million. FINMA is currently investigating three individuals in connection with 1MDB.

In addition, Coutts & Co Ltd is cooperating with investigations and enquiries from authorities in other jurisdictions in relation to the same subject matter. In this context, the Monetary Authority of Singapore (MAS)'s supervisory examination of Coutts & Co Ltd's Singapore branch revealed breaches of anti-money laundering requirements. MAS imposed on Coutts & Co Ltd financial penalties amounting to SGD 2.4 million in December 2016.

The outcomes of other proceedings, investigations and enquiries are uncertain but may include financial consequences and/or regulatory sanctions.

Regulator requests concerning certain historic Russian transactions

Media coverage in 2017 highlighted an alleged money laundering scheme involving Russian entities between 2010 and 2014. Allegedly certain European banks, including the RBS Group and 16 other UK based financial institutions, and certain US banks, were involved in processing certain transactions associated with this scheme. The RBS Group has responded to requests for information from the FCA, PRA and regulators in other jurisdictions.

Litigation, investigations and reviews continued

Review and investigation of treatment of tracker mortgage customers in Ulster Bank Ireland DAC (formerly Ulster Bank Ireland Limited)

In December 2015, the Central Bank of Ireland (CBI) announced that it had written to a number of lenders requiring them to put in place a robust plan and framework to review the treatment of customers who have been sold mortgages with a tracker interest rate or with a tracker interest rate entitlement. The CBI stated that the intended purpose of the review was to identify any cases where customers' contractual rights under the terms of their mortgage agreements were not fully honoured, or where lenders did not fully comply with various regulatory requirements and standards regarding disclosure and transparency for customers. The CBI has required Ulster Bank Ireland DAC (UBI DAC), a member of RBS, incorporated in the Republic of Ireland, to participate in this review and UBI DAC is co-operating with the CBI in this regard. UBI DAC submitted its phase 2 report to the CBI on 31 March 2017, identifying impacted customers. The redress and compensation phase (phase 3) commenced in Q4 2017.

RBS has made provisions totalling €298 million (£248 million) to date for this matter, including an additional provision of €87 million (£76 million) in 2017. Of the €298 million (£248 million) cumulative provision, €75 million (£64 million) had been utilised by 31 December 2017.

Separately, in April 2016, the CBI notified UBI DAC that it was also commencing an investigation under its Administrative Sanctions Procedure into suspected breaches of the Consumer Protection Code 2006 during the period 4 August 2006 to 30 June 2008 in relation to certain customers who switched from tracker mortgages to fixed rate mortgages. This investigation is ongoing and UBI DAC continues to co-operate with the CBI.

As part of an internal review of the wider retail and commercial loan portfolios extending from the tracker mortgage examination programme, UBI DAC identified further legacy business issues. A programme is ongoing to identify and remediate impacted customers and a charge of €101 million (£89 million) has been recognised in 2017 based on expected remediation and project costs in relation to these items.

30 Net cash flow from operating activities

	Group			Bank		
	2017 £m	2016 £m	2015 £m	2017 £m	2016 £m	2015 £m
Operating loss before tax - continuing operations	(1,396)	(4,372)	(5,081)	(641)	(2,721)	(2,825)
Profit/(loss) before tax - discontinued operations	2,013	783	3,678	(653)	(215)	1,374
Increase/(decrease) in prepayments and accrued income	697	(52)	411	397	(32)	325
Interest on subordinated liabilities	318	1,228	1,267	44	1,175	1,285
Decrease in accruals and deferred income	(1,182)	(543)	(829)	(554)	(477)	(550)
Impairment losses/(recoveries)	533	531	(734)	158	558	(260)
Loans and advances written-off net of recoveries	(1,048)	(3,552)	(8,778)	(435)	(640)	(1,492)
Unwind of discount on impairment losses	(86)	(112)	(144)	(29)	(35)	(47)
(Profit)/loss on sale of property, plant and equipment	(75)	(15)	(88)	(7)	3	(24)
(Profit)/loss on sale of subsidiaries and associates	(167)	(38)	(1,092)	(145)	(198)	30
Profit on sale of securities	(145)	(120)	(40)	(152)	(89)	(40)
Charge for defined benefit pension schemes	302	259	521	271	165	20
Pension scheme curtailments or settlements loss/(gain)	65	2	(65)	69	2	(8)
Cash contribution to defined benefit pension schemes	(621)	(4,783)	(1,059)	(251)	(200)	(32)
Other provisions charged net of releases	1,877	6,323	4,470	991	3,728	1,326
Other provisions utilised	(5,639)	(2,643)	(2,159)	(1,440)	(870)	(1,097)
Depreciation and amortisation	802	775	1,173	403	465	548
Loss on redemption of own debt	789	90	263	789	90	—
Loss on reclassification to disposal groups	539	—	273	341	—	—
Write down of goodwill and other intangible assets	28	159	1,331	28	141	725
Write down of investment in subsidiaries	—	—	—	1,073	(53)	6,045
Elimination of foreign exchange differences	116	(6,416)	(1,476)	(268)	(7,496)	(170)
Other non-cash items	(1,490)	260	(1,276)	(170)	135	(445)
Net cash (outflow)/inflow from trading activities	(3,770)	(12,236)	(9,434)	(181)	(6,564)	4,688
Increase/(decrease) in loans and advances to banks and customers	9,796	(13,036)	57,211	120,815	7,411	65,905
(Decrease)/increase in securities	(1,612)	16,375	13,330	42,896	14,716	8,624
(Decrease)/increase in other assets	(121,108)	815	(1,813)	(234,644)	(16)	330
Increase in derivative assets	86,567	15,353	91,499	89,538	14,125	94,224
Changes in operating assets	(26,357)	19,507	160,227	18,605	36,236	169,083
Increase/(decrease) in deposits by banks and customers	43,293	23,211	(38,175)	(226,195)	(4,488)	(58,740)
Decrease in debt securities in issue	(8,000)	(5,494)	(16,455)	(6,519)	(4,532)	(13,382)
Increase/(decrease) in other liabilities	11,229	(111)	3,158	215,683	(169)	810
Decrease in derivative liabilities	(82,670)	(17,990)	(95,235)	(85,874)	(16,474)	(97,375)
Increase/(decrease) in settlement balances and short positions	8,740	68	(2,733)	10,321	(1,246)	596
Changes in operating liabilities	(27,408)	(316)	(149,440)	(92,584)	(26,909)	(168,091)
Income taxes (paid)/received	(546)	14	(231)	(197)	335	(192)
Net cash (outflow)/inflow from operating activities	(58,081)	6,969	1,122	(74,357)	3,098	5,488

31 Analysis of the net investment in business interests and intangible assets

Acquisitions and disposals	Group 2017 £m	Group 2016 £m	Group 2015 £m	Bank 2017 £m	Bank 2016 £m	Bank 2015 £m
Fair value given for businesses acquired	(131)	(87)	(59)	—	—	—
Value recognised for business transferred from fellow subsidiary	(438)	—	—	(318)	—	(2)
Non-cash consideration on acquisition	—	—	—	32,546	—	—
Additional and new investments in Group undertakings	—	—	—	(32,648)	(1,304)	(856)
Net outflow of cash in respect of acquisitions	(569)	(87)	(59)	(420)	(1,304)	(858)
Other assets sold	2,712	(506)	(2,301)	663	—	(2,630)
Repayment of investments	—	—	—	—	—	193
Disposal of investments in Group undertakings	—	—	—	33,253	152	—
Non-cash consideration on disposal	(16)	(5)	—	(32,563)	—	—
Profit/(loss) on disposal	167	38	1,092	145	198	(30)
Net cash and cash equivalents disposed	—	55	1,923	—	—	—
Net inflow/(outflow) of cash in respect of disposals	2,863	(418)	714	1,498	350	(2,467)
Dividends received from associates	—	9	11	—	—	—
Cash expenditure on intangible assets	(382)	(480)	(613)	(366)	(470)	(612)
Net (outflow)/inflow	1,912	(976)	53	712	(1,424)	(3,937)

Note:
(1) Includes cash proceeds of £1,628 million in 2015 relating to the disposal of the controlling interest in Citizens.

32 Interest received and paid

	Group 2017 £m	Group 2016 £m	Group 2015 £m	Bank 2017 £m	Bank 2016 £m	Bank 2015 £m
Interest received	10,694	11,280	11,589	4,445	5,165	5,579
Interest paid	(2,631)	(2,865)	(3,699)	(2,479)	(3,018)	(3,800)
	8,063	8,415	7,890	1,966	2,147	1,779

33 Analysis of changes in financing during the year

Group	Share capital, share premium and merger reserve 2017 £m	2016 £m	2015 £m	Subordinated liabilities 2017 £m	2016 £m	2015 £m
At 1 January	44,297	44,281	44,250	19,515	27,030	30,469
Redemption of subordinated liabilities				(9,624)	(10,556)	(2,279)
Net cash outflow from financing	—	—	—	(9,624)	(10,556)	(2,279)
Currency translation and other adjustments	—	16	31	(9,891)	3,041	(1,160)
At 31 December	44,297	44,297	44,281	—	19,515	27,030

Bank	Share capital, share premium and merger reserve 2017 £m	2016 £m	2015 £m	Subordinated liabilities 2017 £m	2016 £m	2015 £m
At 1 January	33,416	33,400	33,369	17,870	25,534	27,480
Redemption of subordinated liabilities				(9,431)	(10,535)	(1,894)
Net cash outflow from financing	—	—	—	(9,431)	(10,535)	(1,894)
Currency translation and other adjustments	—	16	31	(8,439)	2,871	(52)
At 31 December	33,416	33,416	33,400	—	17,870	25,534

34 Analysis of cash and cash equivalents

	Group (1)			Bank (2)		
	2017 £m	2016 £m	2015 £m	2017 £m	2016 £m	2015 £m
At 1 January						
- cash	87,694	92,981	90,191	85,730	92,821	82,975
- cash equivalents	10,333	9,094	17,117	13,343	13,792	18,395
	98,027	102,075	107,308	99,073	106,613	101,370
Net cash (outflow)/inflow	(72,344)	(4,048)	(5,233)	(86,015)	(7,540)	5,243
At 31 December	25,683	98,027	102,075	13,058	99,073	106,613
Comprising:						
Cash and balances at central banks	153	73,813	78,999	93	70,615	76,904
Treasury bills and debt securities	170	358	1,445	427	315	1,179
Loans and advances to banks	25,360	23,856	21,631	12,538	28,143	28,530
Cash and cash equivalents	25,683	98,027	102,075	13,058	99,073	106,613

Notes:
(1) Includes cash collateral posted with bank counterparties in respect of derivative liabilities of £6,883 million (2016 - £6,653 million, 2015 - £11,046 million).
(2) Includes cash collateral posted with bank counterparties in respect of derivative liabilities of £6,883 million (2016 - £6,653 million, 2015 - £10,843 million).

Certain members of the Group are required by law or regulation to maintain balances with the central banks in the jurisdictions in which they operate. These balances are set out below.

	2017	2016	2015
Bank of England	£0.6bn	£0.5bn	£0.5bn
De Nederlandsche Bank	—	—	€0.2bn

35 Segmental analysis

(a) Reportable segments

Segmental reorganisation and business transfers

The Group continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. To support this, and in preparation for the UK ring-fencing regime the previously reported operating segments were realigned in Q4 2017 and a number of business transfers completed.

Segmental reorganisation

the previously reported operating segments are now realigned and comparatives have been re-presented as follows:

- The former Capital Resolution reported operating segment has been integrated into the NatWest Markets reportable segment, with the exception of the costs in relation to the retail mortgage backed securities (RMBS) claims, which have been transferred to the Central & Other items reportable segment.

Business transfers

on 1 October 2017 the following changes were made to the Group's businesses, which impact its financial reporting but where comparatives have not been re-presented:

- Shipping and other activities, which were formerly in Capital Resolution, were transferred from NatWest Markets to Commercial Banking business which is classified as disposal groups at 31 December 2017.
- Commercial Banking whole business securitisations and relevant financial institutions (RFI) were transferred to NatWest Markets during December 2017. RFIs are prohibited from being within the ring-fence due to their nature and exposure to global financial markets, the move is in preparation for the implementation of the UK ring-fencing regime.

Disposal groups and discontinued operations

NatWest Holdings Limited (NatWest Holdings)

The transfer of the Group's Personal & Business Banking (PBB) (including the former Williams & Glyn segment), Commercial & Private Banking (CPB) and certain parts of Central items and NatWest Markets, due to be included in the ring-fenced bank, to subsidiaries of NatWest Holdings, is planned for Q2 2018. It will be followed by a transfer of NatWest Holdings to RBSG. Accordingly, all of the activities to be undertaken by NatWest Holdings and its subsidiaries are classified as disposal groups at 31 December 2017 and presented as discontinued operations, with comparatives re-presented. UK Personal and Business banking, Ulster Bank ROI, Commercial Banking and Private Banking are no longer reportable segments.

RBS International

The Royal Bank of Scotland International (Holdings) Limited (RBSI Holdings), which was mainly reported in the RBS International reporting segment, was sold to RBSG on 1 January 2017 in preparation for ring-fencing. RBSI Holdings was classified as a disposal group at 31 December 2016 and its assets and liabilities presented in aggregate in accordance with IFRS 5. RBS International is no longer a reportable segment.

Reportable operating segments

Following the changes in relation to the segmental reorganisation and the transfers to disposal groups, the reportable operating segments are as follows:

NatWest Markets, offers its customers global market access, providing them with trading, risk management and financing solutions through its trading and sales operations in London, Singapore and Stamford and sales offices in Dublin, Hong Kong and Tokyo; and

Central items & other includes balances in relation to legacy litigation issues and disposal groups in the relevant periods.

35 Segmental analysis continued

2017	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses £m	Depreciation and amortisation £m	Impairment releases £m	Operating loss £m
NatWest Markets	215	825	1,040	(1,914)	49	79	(746)
Central items & other	(167)	38	(129)	(521)	—	—	(650)
Total	48	863	911	(2,435)	49	79	(1,396)
2016*							
NatWest Markets	306	1,059	1,365	(2,257)	(2)	130	(764)
Central items & other	(209)	(89)	(298)	(3,310)	—	—	(3,608)
Total	97	970	1,067	(5,567)	(2)	130	(4,372)
2015*							
NatWest Markets	499	1,384	1,883	(4,439)	(18)	153	(2,421)
Central items & other	(320)	(259)	(579)	(2,081)	—	—	(2,660)
Total	179	1,125	1,304	(6,520)	(18)	153	(5,081)

	2017			2016*			2015*		
Total revenue	External £m	Inter segment £m	Total £m	External £m	Inter segment £m	Total £m	External £m	Inter segment £m	Total £m
NatWest Markets	1,368	637	2,005	1,649	1,183	2,832	2,540	2,646	5,186
Central items & other	40	(637)	(597)	(81)	(1,183)	(1,264)	(275)	(2,646)	(2,921)
Total	1,408	—	1,408	1,568	—	1,568	2,265	—	2,265

	2017			2016*			2015*		
Total income	External £m	Inter segment £m	Total £m	External £m	Inter segment £m	Total £m	External £m	Inter segment £m	Total £m
NatWest Markets	1,070	(30)	1,040	1,360	5	1,365	1,942	(59)	1,883
Central items & other	(159)	30	(129)	(293)	(5)	(298)	(638)	59	(579)
Total	911	—	911	1,067	—	1,067	1,304	—	1,304

	2017			2016*			2015*		
	Assets £m	Liabilities £m	Cost to acquire fixed assets and intangible assets £m	Assets £m	Liabilities £m	Cost to acquire fixed assets and intangible assets £m	Assets £m	Liabilities £m	Cost to acquire fixed assets and intangible assets £m
NatWest Markets	262,432	248,427	4	357,743	340,976	6	401,623	380,696	13
Central items & other	463,805	442,550	1,585	440,071	421,019	1,376	410,568	389,588	1,435
Total	726,237	690,977	1,589	797,814	761,995	1,382	812,191	770,284	1,448

* Re-presented to reflect the segmental reorganisation. See page 173 for further details.

35 Segmental analysis continued

(b) Geographical segments

The geographical analysis in the tables below has been compiled on the basis of location of office where the transactions are recorded.

2017	UK £m	USA £m	Europe £m	Rest of the World £m	Total £m
Total revenue	1,096	179	19	114	1,408
Net interest income	27	1	7	13	48
Net fees and commissions	(150)	96	7	54	7
Income from trading activities	647	83	—	7	737
Other operating income	79	16	—	24	119
Total income	603	196	14	98	911
Operating (loss)/profit before tax	(1,296)	(6)	(89)	(5)	(1,396)
Total assets	658,540	38,536	27,457	1,704	726,237
Of which assets held for sale	432,478	3,554	27,189	657	463,878
Total liabilities	633,389	36,655	19,839	1,094	690,977
Of which liabilities held for sale	412,491	484	19,807	50	432,832
Net assets attributable to equity shareholders and non-controlling interests	25,151	1,881	7,618	610	35,260
Contingent liabilities and commitments	126,185	78	3,559	22	129,844
Cost to acquire property, plant and equipment and intangible assets	1,568	1	10	10	1,589
2016					
Total revenue	1,018	205	196	149	1,568
Net interest income	59	25	5	8	97
Net fees and commissions	(94)	9	77	56	48
Income from trading activities	767	159	27	14	967
Other operating income	(34)	(48)	31	6	(45)
Total income	698	145	140	84	1,067
Operating (loss)/profit before tax	(2,936)	(1,538)	96	6	(4,372)
Total assets	718,795	44,512	30,321	4,186	797,814
Of which assets held for sale	7,999	—	367	—	8,366
Total liabilities	689,015	44,612	24,784	3,584	761,995
Of which liabilities held for sale	21,329	—	2,062	—	23,391
Net assets attributable to equity shareholders and non-controlling interests	29,780	(100)	5,537	602	35,819
Contingent liabilities and commitments	142,150	639	3,738	1	146,528
Cost to acquire property, plant and equipment and intangible assets	1,314	3	54	11	1,382
2015					
Total revenue	964	321	572	408	2,265
Net interest income	(71)	75	112	63	179
Net fees and commissions	28	136	193	42	399
Income from trading activities	966	34	73	(12)	1,061
Other operating income	(210)	(77)	(10)	(39)	(336)
Total income	714	168	368	54	1,304
Operating (loss)/profit before tax	(1,700)	(3,392)	149	(138)	(5,081)
Total assets	677,248	77,955	38,258	18,730	812,191
Of which assets held for sale	—	15	1,251	2,220	3,486
Total liabilities	644,067	76,618	31,268	18,331	770,284
Of which liabilities held for sale	—	16	418	2,546	2,980
Net assets attributable to equity shareholders and non-controlling interests	33,181	1,337	6,990	399	41,907
Contingent liabilities and commitments	128,478	9,729	11,148	692	150,047
Cost to acquire property, plant and equipment and intangible assets	1,330	70	21	27	1,448

36 Directors' and key management remuneration

The directors of the Bank are also directors of the holding company and are remunerated for their services to the RBS Group as a whole. The remuneration of the directors is disclosed in the Report and Accounts of the RBS Group.

Directors' remuneration	2017 £000	2016 £000
Non-executive directors emoluments	1,747	1,466
Chairman and executive directors emoluments	5,299	5,801
	7,046	7,267
Amounts receivable under long-term incentive plans and share option plans	1,225	993
	8,271	8,260

No directors accrued benefits under defined benefit schemes or money purchase schemes during 2017 and 2016.

The executive directors may participate in the company's long-term incentive plans, executive share option and sharesave schemes and details of their interests in the company's shares arising from their participation are given in the Directors' remuneration report in the Report and Accounts of the RBS Group. Details of the remuneration received by each director is also given in the Directors' remuneration report in the 2017 Annual Report and Accounts of the RBS Group.

Compensation of key management

The aggregate remuneration of directors and other members of key management during the year, borne by the RBS Group, was as follows:

	2017 £000	2016 £000
Short-term benefits	19,019	20,350
Post-employment benefits	434	471
Share-based payments	3,558	2,606
	23,011	23,427

Key management comprises members of the RBS Group Executive Committee.

37 Transactions with directors and key management

(a) At 31 December 2017, amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions, as defined in UK legislation, in the Group, were £24,376 in respect of loans to six persons who were directors of the Bank at any time during the financial period.

(b) For the purposes of IAS 24 'Related Party Disclosures', key management comprise directors of the Bank and members of the RBS Group Executive Committee. The captions in the Group's primary financial statements include the following amounts attributable, in aggregate, to key management:

	2017 £000	2016 £000
Loans and advances to customers	3,942	4,127
Customer accounts	23,619	17,045

Key management have banking relationships with Group entities which are entered into in the normal course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with other persons of a similar standing or, where applicable, with other employees. These transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Key management had no reportable transactions or balances with the holding company.

38 Related parties

UK Government

On 1 December 2008, the UK Government through HM Treasury became the ultimate controlling party of The Royal Bank of Scotland Group plc. The UK Government's shareholding is managed by UK Financial Investments Limited, a company wholly owned by the UK Government. As a result, the UK Government and UK Government controlled bodies became related parties of the Group. During 2015, all of the B shares held by the UK Government were converted into ordinary shares of £1 each.

The Group enters into transactions with many of these bodies on an arm's length basis. Transactions include the payment of: taxes principally UK corporation tax (see Note 6) and value added tax; national insurance contributions; local authority rates; and regulatory fees and levies (including the bank levy and FSCS levies (see Note 29); together with banking transactions such as loans and deposits undertaken in the normal course of banker-customer relationships.

Bank of England facilities

The Group may participate in a number of schemes operated by the Bank of England in the normal course of business.

Members of the Group that are UK authorised institutions are required to maintain non-interest bearing (cash ratio) deposits with the Bank of England amounting to 0.18% of their average eligible liabilities in excess of £600 million. They also have access to Bank of England reserve accounts: sterling current accounts that earn interest at the Bank of England Rate.

Other related parties

(a) In their roles as providers of finance, Group companies provide development and other types of capital support to businesses. These investments are made in the normal course of business and on arm's length terms. In some instances, the investment may extend to ownership or control over 20% or more of the voting rights of the investee company. However, these investments are not considered to give rise to transactions of a materiality requiring disclosure under IAS 24.

(b) The Group recharges The Royal Bank of Scotland Group Pension Fund with the cost of administration services incurred by it. The amounts involved are not material to the Group.

(c) In accordance with IAS 24, transactions or balances between Group entities that have been eliminated on consolidation are not reported.

(d) The captions in the primary financial statements of the parent company include amounts attributable to subsidiaries. These amounts have been disclosed in aggregate in the relevant notes to the financial statements.

The table below discloses items included in income and operating expenses on transactions between the Group and fellow subsidiaries of the RBS Group.

	2017 £m	2016 £m	2015 £m
Interest receivable	1	—	43
Interest payable	(7)	(1)	(19)
Fees and commissions receivable	1	1	—
Fees and commissions payable	—	—	(2)
Continuing operations	(5)	—	22
Discontinued operations	(1,031)	(950)	(974)

39 Ultimate holding company

The Group's ultimate holding company is The Royal Bank of Scotland Group plc which is incorporated in Great Britain and registered in Scotland. As at 31 December 2017, The Royal Bank of Scotland Group plc heads the largest group in which the Group is consolidated. Copies of the consolidated accounts may be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, PO Box 1000, Edinburgh EH12 1HQ.

Following placing and open offers by The Royal Bank of Scotland Group plc in December 2008 and April 2009, the UK Government, through HM Treasury, currently holds 70.5% of the issued ordinary share capital of the holding company and is therefore the Group's ultimate controlling party.

40 Post balance sheet events

There have been no other significant events between 31 December 2017 and the date of approval of these accounts which would require a change to or additional disclosure in the accounts.

41 Related undertakings

Group legal entities and activities at 31 December 2017

In accordance with the Companies Act 2006, the Bank's related undertakings and the accounting treatment for each are listed below. All undertakings are wholly-owned by the Bank or subsidiaries of the Bank and are consolidated by reason of contractual control (Section 1162(2) CA 2006), unless otherwise indicated. Group interest refers to ordinary shares of equal values and voting rights unless further analysis is provided in the notes. Activities are classified in accordance with Annex I to the Capital Requirements Directive ("CRD IV") and the definitions in Article 4 of the Capital Requirements Regulation. All other requirements of the Capital Requirements (country-by-country) Reporting Regulations 2013 will be published on the RBS Group's website.

The following table details active related undertakings incorporated in the UK which are 100% owned by the Group and fully consolidated for accounting purposes.

Entity name	Activity (2)	Reg Acc (3)	Address
280 Bishopsgate Finance Ltd	INV	FC	250 Bishopsgate, London, EC2M 4RB, England
Adam & Company Group PLC	BF	FC	25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Adam & Company Investment Management Ltd	BF	FC	25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Adam & Company PLC	CI	FC	25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Caledonian Sleepers Rail Leasing Ltd	BF	FC	1 Princes Street, London, EC2R 8PB, England
Care Homes 1 Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
Care Homes 2 Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
Care Homes 3 Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
Care Homes Holdings Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
Churchill Management Ltd	BF	FC	1 Princes Street, London, EC2R 8PB, England
Coutts & Company	BF	FC	440 Strand, London, WC2R 0QS, England
Coutts Finance Company	BF	FC	440 Strand, London, WC2R 0QS, England
Desertlands Entertainment Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Digi Ventures Ltd	OTH	FC	250 Bishopsgate, London, EC2M 4AA, England
Distant Planet Productions Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Esme Loans Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
Euro Sales Finance Plc	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
G L Trains Ltd	BF	FC	1 Princes Street, London, EC2R 8PB, England
Gatehouse Way Developments Ltd	INV	PC	1 Princes Street, London, EC2R 8PB, England
Heartlands (Central) Ltd	BF	DE	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Helena Productions Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
KUC (Public Houses) Ltd	BF	DE	1 Princes Street, London, EC2R 8PB, England
KUC Properties Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Land Options (West) Ltd	INV	DE	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Leckhampton Finance Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard & Ulster Ltd	BF	FC	11-16 Donegall Square East, Belfast, BT1 5HD, Northern Ireland
Lombard Business Finance Ltd	BF	FC	280 Bishopsgate, London, EC2M 4RB, England
Lombard Business Leasing Ltd	BF	FC	280 Bishopsgate, London, EC2M 4RB, England
Lombard Charterhire Ltd	BF	FC	280 Bishopsgate, London, EC2M 4RB, England
Lombard Corporate Finance (10) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (11) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (13) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (14) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (15) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (6) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (7) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (December 1) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (December 3) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (June 2) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Discount Ltd	BF	FC	280 Bishopsgate, London, EC2M 4RB, England
Lombard Finance Ltd	BF	FC	280 Bishopsgate, London, EC2M 4RB, England
Lombard Industrial Leasing Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Initial Leasing Ltd	BF	FC	280 Bishopsgate, London, EC2M 4RB, England

For notes to this table refer to page 187.

41 Related undertakings continued

Entity name	Activity (2)	Reg Acc (3)	Address
Lombard Lease Finance Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Leasing Company Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Leasing Contracts Ltd	BF	FC	1 Princes Street, London, EC2R 8PB, England
Lombard Lessors Ltd	BF	FC	280 Bishopsgate, London, EC2M 4RB, England
Lombard Maritime Ltd	BF	FC	280 Bishopsgate, London, EC2M 4RB, England
Lombard North Central Leasing Ltd	BF	FC	280 Bishopsgate, London, EC2M 4RB, England
Lombard North Central PLC	BF	FC	280 Bishopsgate, London, EC2M 4RB, England
Lombard Property Facilities Ltd	BF	FC	1 Princes Street, London, EC2R 8PB, England
Lombard Technology Services Ltd	BF	FC	280 Bishopsgate, London, EC2M 4RB, England
Nanny McPhee Productions Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
National Westminster Bank Plc	CI	FC	135 Bishopsgate, London, EC2M 4AA, England
National Westminster Home Loans Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
National Westminster Properties No. 1 Ltd	SC	FC	250 Bishopsgate, London, EC2M 4AA, England
NatWest Capital Finance Ltd	BF	FC	1 Princes Street, London, EC2R 8PB, England
NatWest Corporate Investments	BF	DE	250 Bishopsgate, London, EC2M 4AA, England
NatWest Holdings Ltd	INV	FC	280 Bishopsgate, London, EC2M 4RB, England
NatWest Machinery Leasing Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
NatWest Property Investments Ltd	INV	FC	250 Bishopsgate, London, EC2M 4AA, England
NatWest Ventures Investments Ltd	BF	DE	250 Bishopsgate, London, EC2M 4AA, England
Nevis Derivatives No. 3 LLP	BF	FC	35 Great St Helen's, London, EC3A 6AP, England
Northern Isles Ferries Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
P of A Productions Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Patalex II Productions Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Patalex III Productions Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Patalex IV Productions Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Patalex Productions Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Patalex V Productions Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Pittville Leasing Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Premier Audit Company Ltd	BF	DE	250 Bishopsgate, London, EC2M 4AA, England
Premier Place Finance Ltd	INV	FC	250 Bishopsgate, London, EC2M 4RB, England
Price Productions Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Priority Sites Investments Ltd	BF	DE	250 Bishopsgate, London, EC2M 4AA, England
Priority Sites Ltd	INV	FC	250 Bishopsgate, London, EC2M 4AA, England
Property Venture Partners Ltd	INV	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
R.B. Capital Leasing Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
R.B. Equipment Leasing Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
R.B. Leasing (April) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
R.B. Leasing (December) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
R.B. Leasing (March) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
R.B. Leasing (September) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
R.B. Leasing Company Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
R.B. Quadrangle Leasing Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
R.B.S. Special Investments Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
RB Investments 2 Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
RB Investments 3 Ltd	OTH	FC	250 Bishopsgate, London, EC2M 4AA, England
RBDC Administrator Ltd	SC	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RBS Asset Finance Europe Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBS Asset Management (ACD) Ltd	BF	FC	440 Strand, London, WC2R 0QS, England
RBS Asset Management Holdings	BF	FC	440 Strand, London, WC2R 0QS, England
RBS Asset Management Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
RBS Collective Investment Funds Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RBS Investment Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RBS Invoice Finance (Holdings) Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England

For notes to this table refer to page 187.

41 Related undertakings continued

Entity name	Activity (2)	Reg Acc (3)	Address
RBS Invoice Finance Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
RBS Mezzanine Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RBS Property Developments Ltd	INV	FC	36 St Andrew Square, Edinburgh, EH2 2YB, Scotland
RBS Property Ventures Investments Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RBS Secured Funding LLP	BF	FC	35 Great St Helen's, London, EC3A 6AP, England
RBS SME Investments Ltd	BF	FC	1 Princes Street, London, EC2R 8PB, England
RBSG Collective Investments Holdings Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RBSG International Holdings Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RBSM Capital Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RBSSAF (11) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (12) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (2) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (25) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (4) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (6) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (7) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (8) Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Riossi Ltd	BF	FC	280 Bishopsgate, London, EC2M 4RB, England
RoboScot Equity Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RoboScot Ventures Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Royal Bank Investments Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Royal Bank Invoice Finance Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
Royal Bank Leasing Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Royal Bank of Scotland (Industrial Leasing) Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Royal Bank Ventures Investments Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Royal Scot Leasing Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RoyScot Financial Services Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
RoyScot Trust plc	BF	FC	280 Bishopsgate, London, EC2M 4RB, England
Safetosign Ltd	SC	FC	250 Bishopsgate, London, EC2M 4RB, England
Sandford Leasing Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Springwell Street Developments (No 1) Ltd	INV	FC	280 Bishopsgate, London, EC2M 4RB, England
Style Financial Services Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
The One Account Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
The Royal Bank of Scotland Group Independent Financial Services Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
The Royal Bank of Scotland Invoice Discounting Ltd	BF	FC	250 Bishopsgate, London, EC2M 4AA, England
Theobald Film Productions LLP	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Total Capital Finance Ltd	BF	DE	1 Princes Street, London, EC2R 8PB, England
Ulster Bank Commercial Services (NI) Ltd	BF	FC	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland
Ulster Bank Ltd	CI	FC	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland
Ulster Bank Pension Trustees Ltd	TR	FC	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland
Voyager Leasing Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Walton Lake Developments Ltd	INV	DE	1 Princes Street, London, EC2R 8PB, England
West Register (Hotels Number 1) Ltd	INV	DE	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
West Register (Hotels Number 3) Ltd	INV	DE	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
West Register (Land) Ltd	INV	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
West Register (Project Developments) Ltd	INV	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
West Register (Property Investments) Ltd	BF	DE	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
West Register (Realisations) Ltd	INV	DE	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
West Register Hotels (Holdings) Ltd	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Winchcombe Finance Ltd	BF	FC	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England

For notes to this table refer to page 187.

41 Related undertakings continued

The following table details active related undertakings incorporated outside the UK which are 100% owned by the Group and fully consolidated for accounting purposes.

Country (1)	Entity name	Activity (2)	Reg Acc (3)	Address
Bermuda	R.B. Leasing BDA One Ltd	BF	FC	22 Victoria Street, Hamilton, HM12
Brazil	RBS Assessoria Ltda	SC	FC	Rua Boa Vista, Sao Paulo, SP 01014-907
Cayman Islands	Coutts General Partner (Cayman) V Ltd	BF	FC	Maples Corporate Services Limited, P.O. Box 309, 121 South Church Street, George Town, Grand Cayman, KY1-1104
Denmark	Airside Properties ASP Denmark AS	BF	FC	c/o Visma Services, Lyskaer 3 CD, Herlev, 104 40
Denmark	Airside Properties Denmark AS	BF	FC	c/o Visma Services, Lyskaer 3 CD, Herlev, 104 40
Denmark	Kastrup Commuter K/S	BF	FC	c/o Visma Services, Lyskaer 3 CD, Herlev, 104 40
Denmark	Kastrup Hangar 5 K/S	BF	FC	c/o Visma Services, Lyskaer 3 CD, Herlev, 104 40
Denmark	Kastrup V & L Building K/S	BF	FC	c/o Visma Services, Lyskaer 3 CD, Herlev, 104 40
Finland	Artul Kiinteistöt Oy	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Fab Ekenäs Formanshagen 4	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Forssa Liikekiinteistöt Oy	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Kiinteistö Oy Pennalan Johtotie 2	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Espoon Entresse II	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Espoon Niittysillantie 5	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Helsingin Mechelininkatu 1	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Helsingin Osmontie 34	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Helsingin Panuntie 11	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Helsingin Panuntie 6	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Iisalmen Kihlavirta	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Jämsän Keskushovi	BF	FC	Södra esplanaden, 12 c/o Nordisk Renting Oy, FI-00130, Helsinki
Finland	Koy Kokkolan Kaarlenportti Fab	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Kouvolan Oikeus ja Poliisitalo	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Lohjan Huonekalutalo	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Millennium	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Nummelan Portti	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Nuolialan päiväkoti	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Päiväläisentie 1-6	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Peltolantie 27	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Raision Kihlakulma	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Ravattulan Kauppakeskus	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Tapiolan Louhi	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Koy Vapaalan Service-Center	BF	DE	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Finland	Nordisk Renting OY	BF	FC	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki
Germany	RBS Deutschland Holdings GmbH	BF	FC	Junghofstrasse 22, Frankfurt am Main, D-60311
Guernsey	Morar ICC Insurance Ltd	BF	DE	PO Box 384, The Albany, South Esplanade, St Peter Port, GY1 4NF
Guernsey	RBS Employment (Guernsey) Ltd	SC	FC	1 Le Marchant Street, St. Peter Port, GY1 1LF
Hong Kong	RBS Securities Japan Ltd	BF	FC	Level 54, Hopewell Centre, 183 Queen's Road East
India	RBS Services India Private Ltd	SC	FC	DLF Cyber City, Tower C, DLF Phase III, Haryana, 122 002
Isle of Man	Lombard Manx Leasing Ltd	BF	FC	Royal Bank House, 2 Victoria Street, Douglas, IM1 2LN
Isle of Man	Lombard Manx Ltd	BF	FC	Royal Bank House, 2 Victoria Street, Douglas, IM1 2LN
Italy	Fondo Sallustio	BF	DE	Via Vittorio Alfieri 1, Conegliano, 31015

For notes to this table refer to page 187.

41 Related undertakings continued

Country (1)	Entity name	Activity (2)	Reg Acc (3)	Address
Jersey	Lombard Finance (CI) Ltd	BF	FC	Royal Bank House, 71 Bath Street, St Helier, JE4 8PJ
Netherlands	National Westminster International Holdings B.V.	BF	FC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Netherlands	RBS Netherlands Holdings B.V.	BF	FC	Gustav Mahlerlaan 350, Amsterdam, 1082 ME
Norway	BD Lagerhus AS	BF	FC	c/o Nordisk Renting AS, 9 Estaje, Klingenberggata 7, NO-0161, Oslo
Norway	Eiendomsselskapet Apteno Larvik AS	BF	FC	c/o Nordisk Renting AS, 9 Estaje, Klingenberggata 7, NO-0161, Oslo
Norway	Hatros 1 AS	BF	FC	c/o Nordisk Renting AS, 9 Estaje, Klingenberggata 7, NO-0161, Oslo
Norway	Nordisk Renting AS	BF	FC	c/o Nordisk Renting AS, 9 Estaje, Klingenberggata 7, NO-0161, Oslo
Norway	Ringdalveien 20 AS	BF	FC	c/o Nordisk Renting AS, 9 Estaje, Klingenberggata 7, NO-0161, Oslo
Poland	RBS Bank (Polska) S.A.	CI	FC	Wisniowy Business Park, ul 1-go Sierpnia 8a, Warsaw 02-134
Poland	RBS Polish Financial Advisory Services sp. z o.o.	BF	FC	Wisniowy Business Park, ul 1-go Sierpnia 8a, Warsaw 02-134
RoI	Easycash (Ireland) Ltd	BF	FC	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	First Active Insurances Services Ltd	BF	DE	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	First Active Investments No. 4 Ltd	BF	FC	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	First Active Ltd	BF	FC	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	Hume Street Nominees Ltd	BF	FC	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	Lombard Ireland Group Holdings Unlimited Company	BF	FC	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	Lombard Ireland Ltd	BF	FC	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	Norgay Property Ltd	BF	FC	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	RBS Asset Management (Dublin) Ltd	BF	FC	Guild House, Guild Street, IFSC, D01 K2C5, Dublin 1
RoI	The RBS Group Ireland Retirement Savings Trustee Ltd	TR	FC	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	Ulster Bank (Ireland) Holdings Unlimited Company	INV	FC	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	Ulster Bank Commercial Services Ltd	BF	FC	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	Ulster Bank Dublin Trust Company Unlimited Company	TR	DE	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	Ulster Bank Holdings (ROI) Ltd	BF	FC	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	Ulster Bank Ireland Designated Activity Company	CI	FC	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	Ulster Bank Pension Trustees (RI) Ltd	TR	FC	Ulster Bank Group Centre, George's Quay, Dublin 2
RoI	Walter Property Ltd	BF	FC	Ulster Bank Group Centre, George's Quay, Dublin 2
Sweden	Airside Properties AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Arkivborgen KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Backsmedjan KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Bil Fastigheter i Sverige AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Bilfastighet i Täby AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Braheberget KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Brödmagasinet KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Eurohill 4 KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighet Kallebäck 2:4 i Göteborg AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighets AB Flöjten i Norrköping	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighets AB Hammarbyvagnen	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighets AB Kabisten 1	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighets AB Stockmakaren	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighets AB Xalam	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighets Aktiebolaget Sambiblioteket	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighetsbolaget Holma i Höör AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Forskningshöjden KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Förvaltningsbolaget Dalkyrkan KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Förvaltningsbolaget Predio 3 KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Gredelinen KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Grinnhagen KB	BF	PC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Horrsta 4:38 KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm

For notes for this table refer to page 187.

41 Related undertakings continued

Country (1)	Entity name	Activity (2)	Reg Acc (3)	Address
Sweden	IR Fastighets AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	IR IndustriRenting AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Kallebäck Institutfastigheter AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	KB Eurohill	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	KB IR Gamlestaden	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	KB Lagermannen	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	KB Likriktaren	BF	DE	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Läkten 1 KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	LerumsKrysset KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Limstagården KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Mjälgen KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Mons AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Mons Investment AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Nordisk Renting AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Nordisk Renting Kapital AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Nordisk Specialinvest AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Nordiska Strategifastigheter Holding AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Pyrrhula 6,7 AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	SFK Kommunfastigheter AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Sjöklockan KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Skinnarängen KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Solbänken KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Strand European Holdings AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Svenskt Fastighetskapital AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Svenskt Energikapital AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Svenskt Fastighetskapital Holding AB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Tingsbrogården KB	BF	FC	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Tygverkstaden 1 KB	BF	DE	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Switzerland	Coutts & Co Ltd	BF	FC	Lerchenstrasse 18, Zurich, CH 8022
Switzerland	Coutts & Co Trustees (Suisse) S.A.	BF	FC	c/o Regus Rue du Rhône Sàrl, Geneva, CH-1204
Switzerland	RBS Services (Switzerland) Ltd	SC	FC	Lerchenstrasse 18, Zurich, CH 8022
USA	Candlelight Acquisition LLC	BF	FC	2711 Centerville Road, Suite 400, Wilmington, Delaware, DE 19808
USA	Financial Asset Securities Corp.	BF	PC	2711 Centerville Road, Suite 400, Wilmington, Delaware, DE 19808
USA	Greenwich Capital Derivatives, Inc.	BF	PC	2711 Centerville Road, Suite 400, Wilmington, Delaware, DE 19808
USA	NatWest Group Holdings Corporation	BF	FC	2711 Centerville Road, Suite 400, Wilmington, Delaware, DE 19808
USA	Random Properties Acquisition Corp. III	INV	PC	2711 Centerville Road, Suite 400, Wilmington, Delaware, DE 19808
USA	Random Properties Acquisition Corp. IV	INV	DE	2711 Centerville Road, Suite 400, Wilmington, Delaware, DE 19808
USA	RBS Acceptance Inc.	CI	FC	2711 Centerville Road, Suite 400, Wilmington, Delaware, DE 19808
USA	RBS Americas Property Corp.	SC	FC	2711 Centerville Road, Suite 400, Wilmington, Delaware, DE 19808
USA	RBS Commercial Funding Inc.	BF	FC	2711 Centerville Road, Suite 400, Wilmington, Delaware, DE 19808
USA	RBS Equity Corporation	BF	FC	340 Madison Avenue, New York, 10173
USA	RBS Financial Products Inc.	BF	FC	2711 Centerville Road, Suite 400, Wilmington, Delaware, DE 19808
USA	RBS Holdings USA Inc.	BF	FC	2711 Centerville Road, Suite 400, Wilmington, Delaware, DE 19808
USA	RBS Securities Inc.	BF	FC	2711 Centerville Road, Suite 400, Wilmington, Delaware, DE 19808

For notes for this table refer to page 187.

41 Related undertakings continued

The following table details active related undertakings incorporated in the UK where the Group ownership is less than 100%.

Entity name	Activity (2)	Accouting Treatment (4)	Reg Acc (3)	Group interest %	Address	Notes
Aspire Oil Services Ltd	BF	EAA	FC	27	Union Plaza 6th Floor, 1 Union Wynd, Aberdeen, AB10 1DQ, Scotland	
BGF Group Ltd	BF	EAA	PC	24	13-15 York Buildings, London, WC2N 6JU, England	
GWNW City Developments Ltd	BF	EAJV	FC	50	Gate House, Turnpike Road, High Wycombe, Buckinghamshire, HP12 3NR, England	
Hamsard 3120 Ltd	BF	IA	FC	40	Sycamore Road, Eastwood Trading Estate, Rotherham, South Yorkshire, S65 1EN, England	(6)
Higher Broughton (GP) Ltd	BF	EAA	PC	51	Floor 3, 1 St Ann Street, Manchester, M2 7LR, England	
Higher Broughton Partnership LP	BF	EAA	FC	51	Cornwall Buildings, 45-51 Newhall Street, Birmingham, West Midlands, B3 3QR, England	
Isobel AssetCo Ltd	BF	FC	FC	75	40 Berkeley Square, London, W1J 5AL, England	
Isobel EquityCo Ltd	BF	FC	FC	75	40 Berkeley Square, London, W1J 5AL, England	
Isobel Finance HoldCo No2 Ltd	BF	FC	FC	0	35 Great St Helen's, London, EC3A 6AP, England	
Isobel HoldCo Ltd	BF	FC	FC	75	40 Berkeley Square, London, W1J 5AL, England	
Isobel Intermediate HoldCo Ltd	BF	FC	DE	75	40 Berkeley Square, London, W1J 5AL, England	
Isobel Loan Capital Ltd	BF	FC	FC	75	40 Berkeley Square, London, W1J 5AL, England	
Isobel Mezzanine Borrower Ltd	BF	FC	FC	75	40 Berkeley Square, London, W1J 5AL, England	
Jaguar Cars Finance Ltd	BF	FC	FC	50	280 Bishopsgate, London, EC2M 4RB, England	
JCB Finance (Leasing) Ltd	BF	FC	FC	75	The Mill, High Street, Rocester, ST14 5JW, England	
JCB Finance Ltd	BF	FC	FC	75	The Mill, High Street, Rocester, ST14 5JW, England	
Land Options (East) Ltd	BF	EAJV	FC	50	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland	
Landpower Leasing Ltd	BF	FC	FC	75	The Mill, High Street, Rocester, ST14 5JW, England	
London Rail Leasing Ltd	BF	EAJV	PC	50	99 Queen Victoria Street, London, EC4V 4EH, England	
Lyalvale Property Ltd	INV	IA	FC	31	Lyalvale Express Ltd, Express Estate, Fisherwick, Nr Whittington, Lichfield, WS13 8XA, England	
RBS Covered Bonds (LM) Ltd	BF	IA	FC	20	35 Great St Helen's, London, EC3A 6AP, England	
RBS Covered Bonds LLP	BF	FC	DE	73	1 Princes Street, London, EC2R 8BP, England	
RBS Secured Funding (LM) Ltd	BF	FC	FC	20	c/o SFM Corporate Services Ltd, 35 Great St Helens, London, EC3A 6AP, England	(7)
RBS Sempra Commodities LLP	BF	FC	FC	51	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland	
Wealdland Ltd	OTH	EAA	FC	29	10 Norwich Street, London, EC4A 1BD, England	

The following table details active related undertakings incorporated outside the UK where the Group ownership is less than 100%

Country (1)	Entity name	Activity (2)	Accouting Treatment (4)	Reg Acc (3)	Group interest %	Address	Notes
Cayman Islands	Lunar Funding VIII Ltd	BF	FC	FC	0	Boundary Hall, Cricket Square, 171 Elgin Avenue, George Town, Grand Cayman, KY1-1104	
Cyprus	Pharos Estates Ltd	OTH	EAA	DE	49	24 Demostheni Severi, 1st Floor, Nicosia, 1080	
Guernsey	MSE Holdings Ltd	INV	IA	FC	37	c/o Gentoo Fund Services Ltd, Mill Court, La Charrotiere, St Peter Port, GY1 3GG	(6)
Jersey	Nightingale Securities 2017-1 Ltd	BF	FC	DE	0	44 Esplanade, St Helier, JE4 9WG	
Luxembourg	Solar Energy Capital Europe SARL	BF	EAJV	FC	33	46 Avenue J.F. Kennedy, Luxembourg-Kirchberg, L-1855	
Netherlands	Tulip Asset Purchase Company B.V.	BF	FC	FC	0	Claude Debussylaan 24, Amsterdam, 1082 MD	
Poland	Wiśniowy Management sp. z o.o.	SC	EAA	FC	25	Ilzecka 26 Street, Warsaw, 02-135	
RoI	Celtic Residential Irish Mortgage Securitisation No 14 DAC	BF	FC	DE	0	5 Harbourmaster Place, Dublin 1	
RoI	Celtic Residential Irish Mortgage Securitisation No 15 DAC	BF	FC	FC	0	5 Harbourmaster Place, Dublin 1	
RoI	Cesium Structured Funding Ltd	BF	FC	FC	0	5 Harbourmaster Place, Dublin 1	
RoI	The Drive4Growth Company Ltd	OTH	IA	FC	20	c/o Denis Crowley & Co, Chartered Accountants, Unit 6 Riverside Grove, Riverstick, Cork	

For notes for this table refer to page 187.

41 Related undertakings continued

Country (1)	Entity name	Activity (2)	Accouting Treatment (4)	Reg Acc (3)	Group interest %	Address	Notes
Sweden	Förvaltningsbolaget Klöverbacken Skola KB	BF	FC	FC	51	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm	
Sweden	Optimus KB	BF	FC	PC	51	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm	
Sweden	Stora Kvarnen KB	BF	FC	FC	51	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm	
USA	Sempra Energy Trading LLC	BF	FC	DE	51	251 Little Falls Drive, Wilmington, Delaware, DE 19808	
USA	Thames Asset Global Securitization No.1 Inc.	BF	FC	DE	0	114 West 47th Street, New York, 10036	

The following table details an active related undertakings which is 100% owned by the Group but is not consolidated for accounting purposes(6).

Country (1)	Entity Name	Activity (2)	Reg Acc (3)	Address	Notes
USA	West Granite Homes Inc.	INV	FC	Bellevue Parkway, Suite 210, Wilmington, Delaware, DE 19809	(9)

The following tables detail related undertakings that are not active.

Actively being dissolved

Country (1)	Entity name	Accounting Treatment (4)	Reg Acc (3)	Group interest %	Address	Notes
Cayman Islands	Equator Investments (Cayman) Ltd	FC	FC	100	Maples Corporate Services Limited, P.O. Box 309, 121 South Church Street, George Town, Grand Cayman, KY1-1104	
Germany	West Register Prime Holding GmbH i. L.	FC	FC	100	Emil-Riedl-Weg 6, Pullach i.Isartal, D-82049	
Jersey	Arran Cards Loan Note Issuer No.1 Ltd	FC	DE	0	44 Esplanade, St Helier, JE49WG	
Jersey	Arran Cards Loan Note Issuer No.1 Ltd	FC	DE	0	44 Esplanade, St Helier, JE49WG	
Jersey	Mulcaster Street Nominees Ltd	FC	FC	100	Royal Bank House, 71 Bath Street, St Helier, JE4 8PJ	
Netherlands	Exfin Capital B.V.	FC	FC	0	Amsteldijk 166, Amsterdam, 1082 MD	
RoI	Celtic Residential Irish Mortgage Securitisation No 09 plc	FC	FC	0	Riverside One, Sir John Rogersons Quay, Dublin 2	
RoI	Celtic Residential Irish Mortgage Securitisation No 10 plc	FC	FC	0	5 Harbourmaster Place, Dublin 1	
RoI	Celtic Residential Irish Mortgage Securitisation No 11 plc	FC	FC	0	5 Harbourmaster Place, Dublin 1	
RoI	Celtic Residential Irish Mortgage Securitisation No 12 DAC	FC	DE	0	5 Harbourmaster Place, Dublin 1	
RoI	Celtic Residential Irish Mortgage Securitisation No 16 DAC	FC	FC	0	5 Harbourmaster Place, Dublin 1	
RoI	First Active Holdings Ltd	FC	FC	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
RoI	First Active Investments No. 3 Ltd	FC	FC	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
RoI	First Active Treasury Ltd	FC	FC	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
RoI	Qulpic Ltd	FC	FC	67	70 Sir John Rogerson's Quay, Dublin 2	
RoI	The Royal Bank of Scotland Finance (Ireland)	FC	FC	100	24/26 City Quay, Dublin 2	
RoI	UB SIG (ROI) Ltd	FC	DE	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
RoI	Ulster Bank Group Treasury Ltd	FC	FC	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
RoI	Ulster Bank Wealth Unlimited Company	FC	FC	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
RoI	West Register (RoI) Property Ltd	FC	DE	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
RoI	Zrko Ltd	FC	DE	67	70 Sir John Rogerson's Quay, Dublin 2	
UK	Arran Cards Funding plc	FC	FC	0	35 Great St Helen's, London, EC3A 6AP, England	
UK	Arran Residential Mortgages Funding 2010-1 plc	FC	FC	0	35 Great St Helen's, London, EC3A 6AP, England	
UK	Arran Residential Mortgages Funding 2011-1 plc	FC	DE	0	35 Great St Helen's, London, EC3A 6AP, England	
UK	Arran Residential Mortgages Funding 2011-2 plc	FC	DE	0	35 Great St Helen's, London, EC3A 6AP, England	
UK	Attlee Personal Loans Plc	FC	FC	0	35 Great St Helens, London, EC3A 6AP	
UK	Bevan Loan Interest Purchaser Plc	FC	FC	0	35 Great St Helens, London, EC3A 6AP	
UK	Cala Campus Ltd	EAJV	DE	50	Ledingham Chalmers, Johnstone House, 52-54 Rose Street, Aberdeen, AB10 1HA, Scotland	
UK	CNW Group Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England	

For notes for this table refer to page 187.

41 Related undertakings continued

Country (1)	Entity name	Accounting Treatment (4)	Reg Acc (3)	Group interest %	Address	Notes
UK	Dixon Motors Developments Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England	
UK	Emperor Holdings Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England	
UK	Farming and Agricultural Finance Ltd	FC	FC	100	280 Bishopsgate, London, EC2M 4RB, England	
UK	Funding For Equity Release Securitisation Transaction (No.4) Ltd	FC	FC	0	Wilmington Trust SP Services (London) Ltd, Third Floor, 1 Kings Arms Yard, London, EC2R 7AF, England	
UK	Funding For Equity Release Securitisation Transaction (No.5) Ltd	FC	DE	0	Wilmington Trust SP Services (London) Ltd, Third Floor, 1 Kings Arms Yard, London, EC2R 7AF, England	
UK	Greenock Funding No 5 Plc	FC	DE	0	35 Great St Helen's, London, EC3A 6AP, England	
UK	Greenwich NatWest Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England	
UK	KUC Holdings Ltd	FC	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland	
UK	Latam Directors Ltd	NC	FC	100	Quartermile Two, 2 Lister Square, Edinburgh, Midlothian, EH3 9GL, Scotland	
UK	Lombard Corporate Finance (3) Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England	
UK	Lombard Venture Finance Ltd	FC	FC	100	280 Bishopsgate, London, EC2M 4RB, England	
UK	NatWest (HMHP) Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England	
UK	NatWest Finance Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England	
UK	NatWest Nominees Ltd	FC	DE	100	1 Princes Street, London, EC2R 8PB, England	
UK	Nevis Derivatives No. 2 LLP	FC	FC	100	35 Great St Helen's, London, EC3A 6AP, England	
UK	Nevis Derivatives No.1 LLP	FC	FC	100	35 Great St Helen's, London, EC3A 6AP, England	
UK	Northants Developments Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England	
UK	Property Ventures (B&M) Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England	
UK	RBDC Investments Ltd	FC	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland	
UK	RBEF Ltd	FC	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland	
UK	RBS Argonaut Ltd	FC	PC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland	
UK	RBS Sempra Products Ltd	FC	FC	51	Suite 1, 3rd Floor 11-12 St James's Square, London, SW1Y 4LB, England	
UK	RBS Special Opportunities General Partner (England) Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England	
UK	RBS Special Opportunities General Partner (Scotland) II Ltd	FC	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland	
UK	RBS Special Opportunities General Partner (Scotland) Ltd	FC	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland	
UK	RBS Specialised Property Investments Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England	
UK	RoboScot (64) Ltd	FC	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland	
UK	RoboScot DevCap Ltd	FC	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland	
UK	Royal Bank Development Capital Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England	
UK	Royal Bank Project Investments Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England	
UK	Royal Bank Ventures Ltd	FC	DE	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland	
UK	RoyScot Ltd	FC	FC	100	280 Bishopsgate, London, EC2M 4RB, England	
UK	STAR 1 Special Partner Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England	
UK	The National Bank Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England	
UK	Thrapston Triangle Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England	
UK	West Register (Hotels Number 2) Ltd	FC	DE	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland	
UK	West Register (Northern Ireland) Property Ltd	FC	DE	100	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland	
UK	West Register (Residential Property Investments) Ltd	FC	DE	100	250 Bishopsgate, London, EC2M 4AA, England	
UK	Williams & Glyn's Trust Company Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England	
UK	WR (NI) Property Investments Ltd	FC	DE	100	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland	
UK	WR (NI) Property Realisations Ltd	FC	DE	100	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland	

For notes for this table refer to page 187.

41 Related undertakings continued

Dormant

Country (1)	Entity name	Accounting treatment (4)	Reg Acc (3)	Group interest %	Address
Denmark	Nordisk Renting A/S	FC	FC	100	c/o Adv Jan-Erik Svensson, HC Andersens Boulevard 12, Kopenhaum V, 1553
Jersey	RBS Cards Securitisation Funding Ltd	FC	DE	100	Royal Bank House, 71 Bath Street, St Helier, JE4 8PJ
Sweden	Nordisk Renting Facilities Management AB	FC	FC	100	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Nordisk Renting HB	FC	FC	100	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
UK	Adam & Company (Nominees) Ltd	FC	FC	100	25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
UK	British Overseas Bank Nominees Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England
UK	Buchanan Holdings Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England
UK	Coutts Group	FC	FC	100	1 Princes Street, London, EC2R 8PB, England
UK	Dixon Vehicle Sales Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England
UK	Dunfly Trustee Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England
UK	FIT Nominee 2 Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England
UK	FIT Nominee Ltd	FC	PC	100	250 Bishopsgate, London, EC2M 4AA, England
UK	Freehold Managers (Nominees) Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England
UK	Glyns Nominees Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England
UK	HPUT A Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4RB, England
UK	HPUT B Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4RB, England
UK	JCB Finance Pension Ltd	FC	FC	88	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland
UK	Lombard Bank	FC	FC	100	Lee House, Baird Road, Enfield, Middlesex, EN1 1SJ, England
UK	Marigold Nominees Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England
UK	N.C. Head Office Nominees Ltd	FC	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
UK	National Westminster Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England
UK	NatWest Aerospace Trust Company Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England
UK	NatWest FIS Nominees Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England
UK	NatWest Invoice Finance Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England
UK	NatWest PEP Nominees Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England
UK	NatWest Security Trustee Company Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England
UK	Nextlinks Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4RB, England
UK	Project & Export Finance (Nominees) Ltd	FC	DE	100	1 Princes Street, London, EC2R 8PB, England
UK	R.B.S. Property (Greenock) Ltd	FC	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
UK	RB Investments 5 Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England
UK	RBS CIF Trustee Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England
UK	RBS Investment Executive Ltd	NC	DE	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
UK	RBS Pension Trustee Ltd	NC	FC	100	1 Princes Street, London, EC2R 8PB, England
UK	RBS Retirement Savings Trustee Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England
UK	RBS Secretarial Services Ltd	FC	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
UK	RBS Trustees Ltd	FC	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
UK	RBSG Collective Investments Nominees Ltd	FC	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
UK	RoyScot Leasing Ltd	FC	FC	100	280 Bishopsgate, London, EC2M 4RB, England
UK	Sixty Seven Nominees Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England
UK	Strand Nominees Ltd	FC	FC	100	440 Strand, London, WC2R 0QS, England
UK	Syndicate Nominees Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England
UK	TDS Nominee Company Ltd	FC	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
UK	The Royal Bank of Scotland (1727) Ltd	FC	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
UK	W.G.T.C.Nominees Ltd	FC	FC	100	250 Bishopsgate, London, EC2M 4AA, England
UK	Williams & Glyn's Bank Ltd	FC	FC	100	1 Princes Street, London, EC2R 8PB, England

For notes for this table refer to page 187.

41 Related undertakings continued

In Administration

Country (1)	Entity name	Activity (2)	Accounting treatment (4)	Reg Acc (3)	Group interest %	Address
UK	Adam & Company Second General Partner Ltd	BF	IA	PC	50	FRP Advisory LLP, Apex 3 95 Haymarket Terrace, Edinburgh, EH12 5HD Scotland

Notes:
(1) Country:
RoI – Republic of Ireland
UK – United Kingdom
USA – United States of America
(2) Activity:
BF - Banking and Financial institution
CI - Credit institution
INV - Investment (shares or property) holding company
SC - Service company
TR - Trustee
OTH – Other
(3) Regulatory Accounting treatment::
DE - Deconsolidated (for non financial or insurance undertakings)
FC - Full consolidation
PC - Pro-rata consolidation (based on percentage equity held by RBSG)
(4) Accounting treatment::
EAA - Equity accounting - Associate
EAJV - Equity accounting - Joint Venture
FC - Fully consolidated
IA - Investment Accounting
NC - Not consolidated
(5) The Group is interested in 25% of the voting rights
(6) The Group is interested in none of the voting rights
(7) Related undertaking consolidated because the Group controls the company by virtue of contractual agreements
(8) Related undertaking not consolidated as it is not controlled by the Group.
(9) Related undertaking owned for the benefit of Group pension schemes.

Group overseas branches

The company's related undertakings have overseas branches in the following countries.

Subsidiary	Geographic location of branches
Coutts & Co Ltd	Hong Kong
National Westminster Bank Plc	Finland, France, Germany, Italy, Jersey, Netherlands, Norway, Spain, Sweden
RBS Securities Japan Ltd	Japan
The Royal Bank of Scotland plc	Canada, Germany, Hong Kong, RoI, Jersey, Poland, Singapore, Turkey, United Arab Emirates
Ulster Bank Ireland DAC	UK

Additional information

Financial summary

The Group's financial statements are prepared in accordance with IFRS. Selected data under IFRS for each of the last five years are presented below.

Summary consolidated income statement	2017 £m	2016 £m	2015 £m	2014 £m	2013 £m
Net interest income	48	97	179	276	(322)
Non-interest income	863	970	1,125	2,888	4,124
Total income	911	1,067	1,304	3,164	3,802
Operating expenses	(2,386)	(5,569)	(6,538)	(3,264)	(6,471)
Loss before impairment releases/(losses)	(1,475)	(4,502)	(5,234)	(100)	(2,669)
Impairment releases/(losses)	79	130	153	194	(2,238)
Operating (loss)/profit before tax	(1,396)	(4,372)	(5,081)	94	(4,907)
Tax credit/(charge)	160	(229)	458	(1,797)	(43)
Loss from continuing operations	(1,236)	(4,601)	(4,623)	(1,703)	(4,950)
Profit/(loss) from discontinued operations, net of tax	1,192	(162)	3,037	(1,413)	(2,314)
(Loss)/profit for the year	(44)	(4,763)	(1,586)	(3,116)	(7,264)
Attributable to:					
Non-controlling interests	5	4	320	57	(13)
Preference shareholders	—	23	44	61	58
Ordinary shareholders	(49)	(4,790)	(1,950)	(3,234)	(7,309)
	(44)	(4,763)	(1,586)	(3,116)	(7,264)

Summary consolidated balance sheet	2017 £m	2016 £m	2015 £m	2014 £m	2013 £m
Loans and advances	68,636	375,450	364,799	421,530	505,583
Debt securities and equity shares	30,626	72,097	81,096	89,477	108,974
Derivatives and settlement balances	161,790	253,301	267,191	359,292	295,037
Other assets	465,185	96,966	99,105	175,083	110,284
Total assets	726,237	797,814	812,191	1,045,382	1,019,878
Owners' equity	35,203	35,757	41,853	45,303	48,702
Non-controlling interests	57	62	54	2,385	79
Subordinated liabilities	—	19,515	27,030	30,469	33,134
Deposits	56,196	416,618	416,168	458,849	537,467
Derivatives, settlement balances and short positions	184,675	263,294	279,739	378,309	319,382
Other liabilities	450,106	62,568	47,347	130,067	81,114
Total liabilities and equity	726,237	797,814	812,191	1,045,382	1,019,878

Financial summary continued

Other contractual cash obligations

The table below summarises the Group's other contractual cash obligations by payment date.

	Group					
2017	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Operating leases	1	3	2	—	—	—
Contractual obligations to purchase goods or services	—	—	—	—	—	—
	1	3	2	—	—	—
2016						
Operating leases	64	182	425	361	684	1,091
Contractual obligations to purchase goods or services	64	168	266	93	7	—
	128	350	691	454	691	1,091

	Bank					
2017	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Operating leases	1	2	2	—	—	—
Contractual obligations to purchase goods or services	—	—	—	—	—	—
	1	2	2	—	—	—
2016						
Operating leases	33	93	237	217	474	731
Contractual obligations to purchase goods or services	54	146	215	45	7	—
	87	239	452	262	481	731

Cross border exposures

Cross border exposures are loans and advances including finance leases and instalment credit receivables and other monetary assets, such as debt securities and net derivatives, including non-local currency claims of overseas offices on local residents.

The Group monitors the geographical breakdown of these exposures based on the country of domicile of the borrower or guarantor of ultimate risk. Cross border exposures exclude exposures to local residents in local currencies.

The table below sets out the Group's cross border exposures greater than 0.5% of the Group's total assets. None of these countries have experienced repayment difficulties that have required restructuring of outstanding debt.

2017	Government £m	Banks £m	Other £m	Total £m	Short positions £m	Net of short positions £m
United States	8,697	4,482	7,941	21,120	2,607	18,513
France	4,721	11,739	2,316	18,776	3,324	15,452
Japan	7,533	4,878	194	12,605	15	12,590
Netherlands	1,897	798	4,948	7,643	986	6,657
Germany	7,643	5,819	2,162	15,624	9,957	5,667
2016						
United States	7,677	6,004	8,117	21,798	5,099	16,699
France	4,275	7,045	1,996	13,316	2,392	10,924
Japan	8,291	5,438	375	14,104	1	14,103
Netherlands	2,809	450	6,675	9,934	1,061	8,873
Germany	8,868	4,836	2,138	15,842	4,207	11,635
2015						
United States	10,971	3,528	8,895	23,394	287	23,107
France	6,221	10,794	2,626	19,641	1,778	17,863
Japan	7,172	2,442	211	9,825	—	9,825
Netherlands	3,820	984	7,097	11,901	786	11,115
Germany	9,574	4,211	1,565	15,350	3,272	12,078

Risk factors

Set out below are certain risk factors that could adversely affect the Group's future results, its financial condition and prospects and cause them to be materially different from what is expected. The Group is currently the principal operating subsidiary of The Royal Bank of Scotland Group plc ('RBSG' and, together with its subsidiaries, the RBS Group'). Throughout 2018, the Group will go through a period of significant corporate change as it implements its UK ring-fencing compliant structure. Following the effective date of the first Ring-Fencing Transfer Scheme in April 2018, the Bank will be renamed 'NatWest Markets Plc' and will primarily comprise the current core NatWest Markets franchise serving UK and Western European corporate customers and global financial institutions. NatWest Markets Plc will services its customers through its trading and sales operations in London, Singapore and Stamford and sales offices in Dublin, Hong Kong and Tokyo (See – Report of the Directors on page 61). Accordingly, there will be changes to the risks to which the Group and its business are or will be exposed during this period and certain of the risks below will be more or less significant to NatWest Markets Plc following the implementation of the Group's UK ring-fencing compliant structure. In addition, a number of the risk factors described below which relate to RBSG and the RBS Group will also be applicable to the Bank and the Group and the occurrence of any such risks could have a material adverse effect on the Group's business, reputation, results of operations, financial condition, cash flows or future prospects. The factors discussed below and elsewhere in this report should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties facing the Group.

The viability of the Bank (to be renamed as NatWest Markets Plc) depends on its ability to access sources of liquidity and funding. If the Bank is unable to raise adequate funds in the capital markets, its liquidity position could be adversely affected which may require unencumbered assets to be liquidated or it may result in higher funding costs which may impact the Group's margins and profitability.

The Group currently relies on retail and wholesale deposits to meet a considerable portion of its funding. Pursuant to the first Ring-Fencing Transfer Scheme in April 2018, the majority of retail and wholesale deposits will transfer to and be held by Adam & Company PLC (to be renamed The Royal Bank of Scotland plc) requiring the Group to diversify its sources of funding and capital.

The implementation of the UK ring-fencing regime will also impact the Group's funding strategy which is currently managed centrally by the RBS Group insofar as the Group also depends on intragroup funding arrangements entered into with other RBS Group entities. As a result of the implementation of the UK ring-fencing regime, such arrangements may no longer, or only to a limited extent, be permitted if they are provided to the Group by an entity in the RFB once a ring-fence compliant structure is established. As a result the cost of funding may increase for certain Group entities, including the Bank, which will be required to manage their own funding and liquidity strategy.

The Bank will be required to access the debt capital markets with issuance plans for £2-4 billion in senior unsecured funding in 2018. This will require frequent access to the global capital markets and entails execution risk. Should its access to the global capital markets be limited or if it is not able to access markets at all or on acceptable terms, or if it is not able to reduce its risk weighted assets (RWAs) in line with assumptions in its funding plans, it may experience a shortfall in its funding requirements which would have a material adverse impact on the Group.

The market view of bank credit risk has changed radically as a result of the financial crisis and banks perceived by the market to be riskier have had to issue debt at significantly higher costs. Although conditions have improved, there have been recent periods where corporate and financial institution counterparties have reduced their credit exposures to banks and other financial institutions, limiting the availability of these sources of funding. The ability of the Bank of England to resolve the RBS Group in an orderly manner may also increase investors' perception of risk and hence affect the availability and cost of funding for the RBS Group and the Group. Any uncertainty relating to the credit risk of financial institutions generally or the Group in particular may lead to reductions in levels of interbank lending or may restrict the Group's access to traditional sources of funding or increase the costs or collateral requirements for accessing such funding.

In addition, the RBS Group is subject to certain regulatory requirements with respect to liquidity coverage, including a liquidity coverage ratio set by the PRA in the UK. This requirement was phased in at 90% from 1 January 2017 and increased to 100% in January 2018 (as required by the Capital Requirements Regulation). The PRA may also impose additional liquidity requirements on the RBS Group to reflect risks not captured in the liquidity coverage ratio by way of Pillar 2 add-ons, which may increase and/or decrease from time to time and require the RBS Group to obtain additional funding or diversify its sources of funding. Current proposals by the Financial Stability Board ('FSB') and the European Commission also seek to introduce certain liquidity requirements for financial institutions, including the introduction of a net stable funding ratio (NSFR). Under the European Commission November 2016 proposals, the NSFR would be calculated as the ratio of an institution's available stable funding relative to the required stable funding it needs over a one-year horizon.

The NSFR would be expressed as a percentage and set at a minimum level of 100%, which indicates that an institution holds sufficient stable funding to meet its funding needs during a one-year period under both normal and stressed conditions. If an institution's NSFR were to fall below the 100% level, the institution would be required to take the measures laid down in the CRD IV Regulation for a timely restoration to the minimum level. Competent authorities would assess the reasons for non-compliance with the NSFR requirement before deciding on any potential supervisory measures.

Risk factors continued

These proposals are currently being considered and negotiated among the European Commission, the European Parliament and the European Council and, in light of Brexit, there is considerable uncertainty as to the extent to which such rules will apply to the RBS Group.

If the RBS Group or the Group are unable to raise sufficient funds through deposits or in the capital markets, the liquidity position of the RBS Group or the Group could be adversely affected and they might be unable to meet deposit withdrawals on demand or at their contractual maturity, to repay borrowings as they mature, to meet their obligations under committed financing facilities, to comply with regulatory funding requirements, to undertake certain capital and/or debt management activities or to fund new loans, investments and businesses. The RBS Group or the Group may need to liquidate unencumbered assets to meet their liabilities, including disposals of assets not previously identified for disposal to reduce their funding commitments. In a time of reduced liquidity, the RBS Group or the Group may be unable to sell some of their assets, may be unable to maintain the run-down and sale of certain legacy portfolios, or may need to sell assets at depressed prices, which in either case could have a material adverse effect on the Group's financial condition and results of operations.

The RBS Group and the Group are subject to a number of legal, regulatory and governmental actions and investigations. Unfavourable outcomes in such actions and investigations could have a material adverse effect on the Group's operations, operating results, reputation, financial position and future prospects

The RBS Group's and the Group's operations remain diverse and complex and they operate in legal and regulatory environments that expose them to potentially significant legal and regulatory actions, including litigation claims and proceedings and civil and criminal regulatory and governmental investigations, and other regulatory risk. The RBS Group and the Group have settled a number of legal and regulatory actions over the past several years but the RBS Group and the Group continue to be, and may in the future be, involved in a number of legal and regulatory actions in the US, the UK, Europe and other jurisdictions.

The legal and regulatory actions specifically referred to below are, in the RBS Group's view, the most significant legal and regulatory actions to which the RBS Group, including the Group, are currently exposed. However, the RBS Group and the Group are also subject to a number of additional claims, proceedings and investigations, the adverse resolution of which may also have a material adverse impact on the Group and which include ongoing reviews, investigations and proceedings (both formal and informal) by governmental law enforcement and other agencies and litigation proceedings (including class action litigation), relating to, among other matters, the offering of securities, including residential mortgage-backed securities (RMBS), conduct in the foreign exchange market, the setting of benchmark rates such as LIBOR and related derivatives trading, the issuance, underwriting, and sales and trading of fixed-income securities (including government securities), product mis-selling, customer mistreatment, anti-money laundering, sanctions, antitrust and various other compliance issues.

See 'Litigation, investigations and reviews' of note 29 on the consolidated accounts on pages 156 to 168 for details for these matters. The RBS Group and the Group continue to cooperate with governmental and regulatory authorities in relation to ongoing informal and formal inquiries or investigations regarding these and other matters.

Legal and regulatory actions are subject to many uncertainties, and their outcomes, including the timing, amount of fines or settlements or the form of any settlements, which may be material, are often difficult to predict, particularly in the early stages of a case or investigation. It is expected that the RBS Group, including the Group will continue to have a material exposure to legal and regulatory actions relating to legacy issues in the medium term.

RMBS

In the US, ongoing matters include certain matters relating to legacy RMBS activities including investigations by the U.S. Department of Justice (DOJ) and several state attorneys general and various civil claims. A further provision of $650 million (£492 million) was recorded by the RBS Group in Q4 2017 in relation to the RBS Group's various RMBS investigations and litigation matters, taking the charge for the year to $971 million (£714 million). Total aggregate provisions at 31 December 2017 were $4.4 billion (£3.2 billion).

The duration and outcome of the DOJ's investigations and other RMBS matters remain uncertain, including in respect of whether settlements for all or any such matters may be reached and any timing thereof. Further substantial provisions and costs may be recognised.

Global Restructuring Group

As announced on 8 November 2016, the RBS Group has taken steps, including automatic refunds of certain complex fees and a complaints process, overseen by an independent third party for small and medium entity (SME) customers in the UK and the Republic of Ireland that were in its Global Restructuring Group (GRG) between 2008 and 2013. This complaints review process and the automatic refund of complex fees was developed with the involvement of the Financial Conduct Authority (FCA). The RBS Group booked a provision of £400 million in Q4 2016, based on its estimates of the costs associated with the complaints review process and the automatic refund of complex fees for SME customers in GRG. On 23 October 2017, the FCA published an interim report incorporating a summary of the Skilled Person's report which stated that, further to the general investigation announced in November 2016, the FCA had decided to carry out a more focused investigation. The FCA published its final summary of the Skilled Person's report on 28 November 2017. The UK House of Commons Treasury Select Committee, seeking to rely on Parliamentary powers, published the full version of the Skilled Person's report on 20 February 2018. The FCA investigation is ongoing and fines or additional redress commitments may be accepted by or imposed upon the RBS Group as a result of this or any subsequent investigation or enquiry, notwithstanding the steps the RBS Group has already taken.

Risk factors continued

Payment protection insurance

To date, the RBS Group has made provisions totaling £5.1 billion with respect to payment protection insurance (PPI), including an additional provision of £175 million in 2017. Of the £5.1 billion cumulative provision, £4.1 billion has been utilised by 31 December 2017. In August 2017, the FCA's new rules and guidance on PPI complaints handling (Policy Statement (17/3)) came into force. The Policy Statement introduced new so called 'Plevin' rules, under which customers may be eligible for redress if the bank earned a high level of commission from the sale of PPI, but did not disclose this detail at the point of sale. The Policy Statement also introduced a two year PPI deadline, due to expire in August 2019, before which new PPI complaints must be made. The RBS Group is implementing the Policy Statement.

The number of claims received and the cost of the redress of such claims may materially exceed the RBS Group's estimates and may entail additional material provisions and reputational harm.

Settlements, resolutions and outcomes in relation to ongoing legal or regulatory actions may result in material financial fines or penalties, non-monetary penalties, restrictions upon or revocation of regulatory permissions and licenses and other collateral consequences and may prejudice both contractual and legal rights otherwise available to the Group. The costs of resolving these legal and regulatory actions could individually or in aggregate prove to be substantial and monetary penalties and other outcomes could be materially in excess of provisions, if any, made by the Group. New provisions or increases in existing provisions relating to existing or future legal or regulatory actions may be substantial and may have a material adverse effect on the Group's financial condition and results of operations as well as its reputation.

The outcome of on-going claims against the RBS Group and the Group may give rise to additional legal claims being asserted against the Group. Adverse outcomes or resolution of current or future legal or regulatory actions could result in restrictions or limitations on the Group's operations, adversely impact the implementation of the RBS Group's current transformation programme as well as the Group's capital position and its ability to meet regulatory capital adequacy requirements. The remediation programmes or commitments which the RBS Group or the Group have agreed to in connection with past settlements or investigations, could require significant financial costs and personnel investment for the Group and may result in changes in its operations or product offerings, and failure to comply with undertakings made by the Group to its regulators may result in additional measures or penalties being taken against the Group.

The Group has been, and will remain, in a period of major business transformation and structural change through to at least 2019 as it implements its own transformation programme and seeks to comply with UK ring-fencing and recovery and resolution requirements as well as the Alternative Remedies Package. Additional structural changes to the Group's operations will also be required as a result of Brexit. These various transformation and restructuring activities are required to occur concurrently, which carries significant execution and operational risks, and the Group may not be a viable, competitive and profitable bank as a result.

Since early 2015, the RBS Group and the Group have been implementing a major restructuring and transformation programme, articulated around a strategy focused on the growth of strategic operations in Personal & Business Banking (PBB) and Commercial & Private Banking (CPB) and the further restructuring of the NatWest Markets franchise, to focus mainly on UK and Western European corporate and financial institutions.

Part of the focus of this transformation programme is to downsize and simplify the Group, reduce underlying costs and strengthen its overall capital position. The transformation programme also aims to improve customer experience and employee engagement, update its operational and technological capabilities, strengthen governance and control frameworks and better position the Group to operate in compliance with the UK ring-fencing regime by 1 January 2019. Together, these initiatives are referred to as the Group's 'transformation programme'.

This transformation programme, including the restructuring of its NatWest Markets franchise, is being completed at the same time as the RBS Group is going through a period of very significant structural reform to implement the requirements of the UK ring-fencing regime and the requirements of the bank recovery and resolution framework. It is complex and entails significant costs and operational, legal and execution risks. See 'Implementation of the ring-fencing regime in the UK which began in 2015 and must be completed before 1 January 2019 will result in material structural changes to the RBS Group and the Group's business, including with respect to the perimeter of the Group's activities and the assets, liabilities and businesses that it holds. The steps required to implement the UK ring-fencing regime are complex and entail significant costs and operational, legal and execution risks, which risks may be exacerbated by the Group's other ongoing restructuring efforts. The implementation of ring-fencing will fundamentally reshape the Group's business and operations.' The RBS Group is concurrently seeking to implement the Alternative Remedies Package. See 'The cost of implementing the Alternative Remedies Package regarding the business previously described as Williams & Glyn could be more onerous than anticipated and any failure to comply with the terms of the Alternative Remedies Package could result in the imposition of additional measures or limitations on the RBS Group's and the Group's operations.'

Risk factors continued

Due to changes in the macro-economic and political and regulatory environment in which it operates, in particular as a result of Brexit, the Group has been required to reconsider certain aspects of its current restructuring and transformation programme. In anticipation of Brexit the Group has announced that it will be re-purposing the RBS Group's Dutch subsidiary, The Royal Bank of Scotland N.V. ('RBS N.V.') for the NatWest Market franchise's European business and further structural changes to Group's Western European operations may also be required, including in response to proposed changes to the European prudential regulatory framework for banks and investment banks. These proposals may result in additional prudential or structural requirements being imposed on financial institutions based outside the EU wishing to provide financial services within the EU and may apply to the Group once the UK has formally exited the EU. The ability of the RBS Group to successfully re-purpose and utilise RBS N.V. as the platform for the NatWest Market franchise's European business following Brexit is subject to numerous uncertainties, including those relating to Brexit negotiations. See 'The Group is subject to political risks, including economic, regulatory and political uncertainty arising from the referendum on the UK's membership of the European Union which could adversely impact the Group's business, results of operations, financial condition and prospects.'

One proposal made by the European Commission would impose a requirement for any bank established outside the EU, which has an asset base within the EU exceeding a certain size and has two or more institutions within the EU, to establish a single intermediate parent undertaking ('IPU') in the European Union under which all EU entities within that group will operate.

The RBS Group is currently taking steps to plan for how these proposals, if adopted as currently proposed, may impact the RBS Group and its current plans to implement the UK ring-fencing regime (which will come into force on 1 January 2019 ahead of any IPU being required). The impact of these proposals could be material given the expectation that the Group would continue to carry out operations in the EU. This could result in material additional capital requirements and could have adverse tax implications.

The scale and scope of the changes currently being implemented present material operational, people and financial risks to the Group. The Group's transformation programme and structural reform agenda comprise a large number of concurrent actions and initiatives, any of which could fail to be implemented due to operational or execution issues. Implementation of such actions and initiatives is expected to result in significant costs, which could be materially higher than currently contemplated, including due to material uncertainties and factors outside of the Group's control. Furthermore it requires the implementation and application of robust governance and controls frameworks and there is no guarantee that the Group will be successful in doing so.

The planning and execution of the various restructuring and transformation activities is disruptive and will continue to divert management resources from the conduct of the Group's operations and development of its business. Any additional restructuring and transformation of the Group's activities would increase these risks and could result in further material restructuring and transformation costs, jeopardise the delivery and implementation of a number of other significant change projects, impact the Group's product offering or business model or adversely impact the Group's ability to deliver its strategy and meet its targets and guidance, each of which could have a material adverse impact on the Group's results of operations, financial condition and prospects.

There can be no certainty that the Group will be able to successfully complete its transformation programme and programmes for mandatory structural reform, nor that the restructured Group will be a viable, competitive or profitable banking business.

The Group's ability to meet the targets and expectations which accompany its own and the RBS Group's transformation programme, including with respect to its cost reduction programme and its return to profitability and the timing thereof, are subject to various internal and external risks and are based on a number of key assumptions and judgments any of which may prove to be inaccurate.

As part of RBS Group's and the Group's transformation programme, a number of financial, capital, operational and diversity targets and expectations have been set by management for the RBS Group and the Group, both for the short term and throughout the transformation and restructuring period. These include (but are not limited to) expectations relating to the RBS Group's and the Group's return to profitability and the timing thereof, one-off costs incurred in connection with material litigation and conduct matters and the timing thereof, expected growth rates in income, customer loans and advances and volumes and underlying drivers and trends, cost:income ratio targets, expectations with respect to reductions in operating costs, including remediation costs, expectations relating to restructuring or transformation costs and charges as well as impairment charges, disposal losses, CET1 ratio targets and expectations regarding funding plans and requirements, expectations with respect to reductions in risk-weighted assets and the timing thereof, expectations with respect to employees engagement and diversity targets.

Risk factors continued

The successful implementation of the transformation programme and the ability to meet associated targets and expectations, are subject to various internal and external factors and risks, including those described in this risk factor, the other risk factors included in this section and the disclosure included in the rest of this document. These include, but are not limited to, market, regulatory, economic and political uncertainties, developments relating to litigation, governmental actions and investigations and regulatory matters, operational risks, risks relating to the RBS Group's and the Group's business models and strategies and delays or difficulties in implementing the transformation programme, including the restructuring and funding of the NatWest Markets franchise, the implementation of the UK ring-fencing regime and compliance with the Alternative Remedies Package obligations. A number of factors may also impact the RBS Group's ability to maintain its current CET1 ratio target at 13% throughout the restructuring period, including conduct related costs, pension or legacy charges, accounting impairments, including as a result of the implementation of IFRS 9, or limited organic capital generation through profits. In addition, the run-down of risk-weighted assets may be accompanied by the recognition of disposal losses which may be higher than anticipated, including due to a degraded economic environment.

The RBS Group's and the Group's ability to meet cost:income ratio targets and the planned reductions in annual underlying costs (excluding restructuring and conduct-related charges) may also be impacted, and the focus on meeting cost reduction targets may result in limited investment in other areas which could affect the RBS Group's or the Group's long-term product offering or competitive position.

More generally, the targets and expectations which accompany the transformation programme are based on management plans, projections and models and are subject to a number of key assumptions and judgments any of which may prove to be inaccurate. Among others, the targets and expectations set as part of the transformation programme assume that the RBS Group and the Group will be successful in implementing their business models and strategies in executing the transformation programme and in reducing the complexity of their businesses and infrastructure, at the same time that they will be implementing significant structural changes to comply with the regulatory environment and that they will implement and maintain robust control environments and effective cultures, including with respect to risk management.

In addition, the plans to deliver a UK ring-fencing compliant structure across franchises and functions may impact the concurrent transformation programme, which could result in delays to the transformation programme portfolio deliveries which in turn could result in delayed benefits therefrom. See 'The Group has been, and will remain, in a period of major business transformation and structural change through to at least 2019 as it implements its own transformation programme and seeks to comply with UK ring-fencing and recovery and resolution requirements as well as the Alternative Remedies Package. Additional structural changes to the Group's operations will also be required as a result of Brexit.

These various transformation and restructuring activities are required to occur concurrently, which carries significant execution and operational risks, and the Group may not be a viable, competitive and profitable bank as a result.'

On completion of the implementation of the transformation programme, the further restructuring of the NatWest Markets franchise and the UK ring-fencing regime, previously anticipated levels of Group revenue and profitability may not be achieved in the timescale envisaged or at any time, due to the changed nature of the Group's business model and revised scope of the Group's business. An adverse macroeconomic environment, including sustained low interest rates, political and regulatory uncertainty, market competition for margins and/or heightened litigation costs may also pose significant headwinds to the profitability of the Group.

As a result, there can be no certainty that the implementation of the transformation programme will prove to be a successful strategy, that the RBS Group or the Group will meet its targets and expectations during the restructuring period or that the restructured RBS Group (including the Group) will be a viable, competitive or profitable banking business.

Implementation of the ring-fencing regime in the UK which began in 2015 and must be completed before 1 January 2019 will result in material structural changes to the RBS Group and the Group's business, including with respect to the perimeter of the Group's activities and the assets, liabilities and businesses that it holds. The steps required to implement the UK ring-fencing regime are complex and entail significant costs and operational, legal and execution risks, which risks may be exacerbated by the Group's other ongoing restructuring efforts. The implementation of ring-fencing will fundamentally reshape the Group's business and operations.

The requirement for large UK banks taking deposits to 'ring-fence' retail banking operations was introduced under the UK Financial Services (Banking Reform) Act 2013 (the 'Banking Reform Act 2013') and adopted through secondary legislation (the 'UK ring-fencing regime'). These reforms form part of a broader range of structural reforms of the banking industry seeking to improve the resilience and resolvability of banks and which range from structural reforms (including ring-fencing) to the implementation of a new recovery and resolution framework (which in the UK will incorporate elements of the ring-fencing regime). See 'RBSG and its subsidiaries, including the Bank, are subject to an evolving framework on recovery and resolution, the impact of which remains uncertain, and which may result in additional compliance challenges and costs.'

By the end of 2018, the RBS Group intends to have placed the majority of its UK and Western European banking business in ring-fenced banking entities organised as a sub-group ('RFB') under an intermediate holding company named NatWest Holdings Limited, which will ultimately be a direct subsidiary of RBSG and will own National Westminster Bank Plc, Adam & Company PLC (to be renamed The Royal Bank of Scotland plc) and Ulster Bank Ireland DAC (Ulster Bank). As a result, National Westminster Bank Plc will no longer be a subsidiary of the Bank. The Bank and the RBS International businesses will sit outside the RFB.

Risk factors continued

As part of this restructuring, the majority of existing personal, private, business and commercial customers of the Bank is expected to be transferred to the RFB during the second quarter of 2018, specifically to Adam & Company PLC, which will be renamed The Royal Bank of Scotland plc. Certain assets and liabilities (including the covered bond programme, certain hedging positions and parts of the liquid asset portfolio) will also be transferred to National Westminster Bank Plc. At the same time, the Bank (which will sit outside the RFB) will be renamed NatWest Markets Plc to bring its legal name in line with the rebranding of the NatWest Markets franchise which was initiated in December 2016, and will continue to operate the NatWest Markets franchise as a direct subsidiary of RBSG. The transfer, as described above, will be effected principally by utilising a legal scheme entitled a 'Ring-Fencing Transfer Scheme' under Part VII of the Financial Services and Markets Act 2000. The implementation of such a scheme is subject to, amongst other considerations, regulatory approval and the sanction of the Court of Session in Scotland, Edinburgh (the 'Court'). A hearing to seek the Court's approval of the scheme is expected to be held on 22 March 2018. The approval of the scheme by the Prudential Regulation Authority ('PRA') is expected to be confirmed shortly before that hearing date. If the scheme is duly approved by the Court at the hearing expected to be held on 22 March 2018, it is expected that the scheme will be implemented with effect from 30 April 2018 or any later date which the RBS Group may agree with the PRA and the Financial Conduct Authority ('FCA'). It remains possible that the court process described above may result in amendments being required to be made to the RBS Group's current plan and that this may result in delays in the implementation of the UK ring-fencing compliant structure, additional costs and/or changes to the RBS Group's and the Group's business.

In addition, during the second half of 2018, it is proposed that NatWest Holdings Limited, being the parent of the future ring-fenced sub-group (which together with other entities is intended to include National Westminster Bank Plc, Adam & Company PLC (to be renamed The Royal Bank of Scotland plc) and Ulster Bank Ireland DAC), will become a direct subsidiary of RBSG. This is expected to occur through a capital reduction of The Royal Bank of Scotland plc (to be renamed NatWest Markets Plc), which will be satisfied by the transfer of the shares in NatWest Holdings Limited currently held by The Royal Bank of Scotland plc to RBSG, which will occur via a further and separate court process, which is subject to the relevant Court and regulatory approvals. It is possible that the court process described above may result in amendments being required to be made to the RBS Group's current plan and that this may result in delays in the implementation of the UK ring-fencing compliant structure, additional costs and/or changes to the RBS Group's and the Group's business.

During the course of 2018, it is proposed that the RBS Group will seek to implement a second, smaller ring-fencing transfer scheme as part of its strategy to implement its future ring-fencing compliant structure, which is proposed to transfer certain assets from National Westminster Bank Plc to the Bank (by then renamed to NatWest Markets Plc). Such a scheme would be subject to the same reviews and approvals as described above in connection with the first scheme.

As a result of the implementation of the changes described above, there will be a material impact on the composition of the Group's assets and liabilities and the businesses it operates and will require a significant legal and organisational restructuring of the RBS Group and the Group and the transfer of large numbers of assets, liabilities, obligations, customers and employees between legal entities within the RBS Group. As the Bank is currently the principal operating subsidiary of RBSG and holds a significant share of the RBS Group's assets and businesses, such changes, in conjunction with the concurrent restructuring of the NatWest Markets franchise, will result in a significant reduction of the perimeter of the Group's activities as well as the assets held by the Group as such businesses and assets will be divested or transferred to other entities within the RBS Group, which may adversely impact its security holders. The RBS Group's final ring-fenced legal structure and the actions being taken to achieve it, remain subject to, amongst other factors, additional regulatory, board and other approvals. In particular, transfers of assets and liabilities by way of a Ring-Fencing Transfer Scheme, as described above, must be reviewed and reported on by an Independent Skilled Person appointed by the RBS Group with the prior approval of the PRA (having consulted with the FCA). The reports of the Skilled Person are made public and form part of the court process described above.

The implementation of these changes involves a number of risks related to both the revised RBS Group and Group structures and also the process of transition to such new structures. Those risks include the following:

- As a result of ring-fencing, the Bank will have fewer customers as certain customers will be moved from the Group to RFB entities, and certain customers will also be required to deal with both the RFB and other RBS Group entities outside the RFB (including the Bank), in order to obtain the full range of products and services or to take any affirmative steps in connection with the reorganisation. The Group is unable to predict how some customers may react to these and other required changes.
- As a result of ring-fencing, subject to certain exceptions, the Group will no longer be able to undertake retail or protected activities, including the accepting of European Economic Area retail deposits which must be carried out exclusively within the RFB. This will require the transfer of certain of the current Group's activities to the RFB, leading to a loss of revenue and assets for the Group. Such changes will alter the scope of the Group's activities. Such adjustments to the Group's activities and any related loss of customers may have a material adverse effect on the Group's business, financial condition and results of operations.

Risk factors continued

- As part of the establishment of the RFB, the RFB will need to operate independently from other RBS Group entities outside the RFB, including the Bank, and as a result, amendments will need to be made to the RBS Group's existing corporate governance structure to ensure the RFB is independent of the Bank. This new structure, which will also require the approval of the PRA, may result in divergences between the various governance bodies within the RBS Group and create operational challenges. In particular, capital and funding requirements of the Bank and other RBS Group entities outside the RFB will increasingly be managed at the level of the Group as a result of these increasingly independent governance structures and this may have an impact on the availability and cost of funding for the Group.
- The implementation of the UK ring-fencing regime will significantly impact the management of the RBS Group's treasury operations, including internal and external funding arrangements. The changes required may adversely impact the assessment made by credit rating agencies, creditors and other stakeholders of the credit strength of the Bank on a standalone basis and may heighten the cost of capital and funding for the Bank and its subsidiaries. The ability of the Bank to meet funding and capital prudential requirements may be dependent on obtaining adequate credit ratings. There can be no guarantee that such a credit rating will be obtained by the Bank. The Group currently receives capital and funding support from RBS Group entities, including those which will ultimately be transferred to the RFB and which may no longer, or only to a limited extent, provide capital and funding support to the Group once a ring-fence compliant structure is established. Restrictions or changes imposed on the ability of the RBS Group to provide intra-group funding, capital or other support directly or indirectly to the Bank or its subsidiaries, may result in funding or capital pressures and liquidity stress for the Bank or its subsidiaries.
- The Group currently receives certain services from, and provides other services to, entities within the RBS Group and has access to the infrastructure of the RBS Group which the Group currently requires in order to operate its business. In order to comply with the requirements of the UK ring-fencing regime, the RBS Group will need to revise its operations infrastructure so as to comply with the shared services, independence and resolvability requirements set out in the UK ring-fencing legislation and rules, including in areas such as information technology (IT) infrastructure, human resources and critical service providers which may involve associated execution risk and may result in increased costs. Arrangements between the RFB and other RBS Group entities outside the RFB, including the Bank and its subsidiaries, will also need to be reviewed in light of these requirements and the requirement that all such transactions take place on an arm's-length basis, which may result in increased operational costs for the Group if it duplicates certain infrastructure that, following implementation are run from inside the RFB or rely on third party providers for the provision of such services or infrastructure.
- Once the UK ring-fencing regime is implemented, reliance on intragroup exemptions in relation to the limits of risk-weighted assets and large exposures will not be possible between the RFB and other RBS Group entities outside the RFB (including the Bank) and may result in risk-weighted assets inflation for the Bank and/or the RBS Group.
- From 2026 it will not be possible for the Group or other entities outside the RFB to participate in the same defined benefit pension scheme as RFB entities or their wholly-owned subsidiaries. As a result, it will be necessary to restructure the RBS Group's defined benefit pension scheme (including The Royal Bank of Scotland Group Pension Fund ('Main scheme') in which the Group currently participates). This restructuring will be such that either the Group or the RFB entities leave the current scheme. The costs of separation may be material and may trigger certain legal and regulatory obligations including possibly increased contributions. Such restructuring may also result in additional or increased cash contributions in the event the pension trustees determine that the employer covenant has been weakened as a result of such separation. See 'The Group is subject to pension risks and may be required to make additional contributions to cover pension funding deficits as a result of degraded economic conditions, any devaluation in the asset portfolio held by the pension trustee, or as a result of the restructuring of its pension schemes in relation to the implementation of the UK ring-fencing regime.'
- The restructuring and planned transfers may also result in accounting consequences for the Bank. Although a number of transfers will be made at book value between fully owned RBS Group entities, certain transfers will be made at fair value which may result in a profit or loss being recognised by the Bank. In addition, transfers of assets that have related hedging arrangements may result in adverse operational, financial or accounting consequences if the transfer is not consistent with the unaffected continuation of such hedging arrangements.
- In addition, the proposed transfers may have tax costs, or may impact the tax attributes of the Bank and the ability to transfer tax losses.

The steps required to implement the UK ring-fencing regime within the RBS Group (including with respect to the Group) to comply with the relevant rules and regulations are complex and require an extended period of time to plan, execute and implement and entail significant costs and operational, legal and execution risks, which risks may be exacerbated by the RBS Group's other ongoing restructuring efforts (many of which impact or will impact the Group). External or internal factors including new and developing legal requirements relating to the regulatory framework for the banking industry and the evolving regulatory and economic landscape resulting from Brexit, as well as further political developments or changes to the RBS Group's current strategy, may require the RBS Group to further restructure its operations (including certain Group operations in the UK and Western Europe) and may in turn require further changes to be made to the RBS Group's ring-fencing plans (including the planned structure of the RBS Group post implementation).

Risk factors continued

The completion of ring-fencing will substantially reconfigure the way RBSG holds its businesses and the legal entities within the RBS Group, including fundamentally reshaping the Group. There is no certainty that the RBS Group will be able to complete the legal restructuring and migration of customers' assets and liabilities by the 1 January 2019 deadline or in accordance with future rules and the consequences of non-compliance are currently uncertain. Conducting the RBS Group's operations in accordance with the new rules may result in additional costs (transitional and recurring) following implementation and impact the RBS Group's and/or the Group's profitability. As a result, the implementation of the UK ring-fencing regime could have a material adverse effect on the Group's reputation, results of operations, financial condition and prospects.

In July 2018 the RBS Group plans to reorganise the capital structure of the Bank by way of a Court approved capital reduction. While the impact on the Bank's capital will depend on number of factors, including the potential resolution of outstanding litigation and conduct matters, the reduction is expected to be a material change to the Bank's absolute level of capital.

Following the transfer of certain assets and liabilities out of the Bank (to be renamed NatWest Markets Plc) to Adam & Company PLC (to be renamed The Royal Bank of Scotland plc) at the end of April 2018 pursuant to the proposed first Ring-Fencing Transfer Scheme, in July 2018 the RBS Group plans to reorganise the capital structure of the Bank by way of a Court approved capital reduction. As part of that Court process, the Bank's shareholding in NatWest Holdings Limited, as the parent of the RFB, will be distributed to RBSG thereby separating the RFB from the remainder of the RBS Group's activities. The capital reduction will be a material change to the Bank's absolute level of equity while establishing it with capital intended to be commensurate with its ongoing activities. The extent of the reduction will depend on number of factors, including the potential resolution of outstanding litigation and conduct matters.

The Group's capital requirements and needs could vary significantly over time, including as a result of the changes to the Group's business following the implementation of the ring-fencing regime and may also be affected by general economic conditions, industry trends, performance and many other factors not within the Group's control and the Group may be required to raise additional capital.

The Group's borrowing costs, its access to the debt capital markets and its sources of liquidity depend significantly on its and the RBS Group's credit ratings and, to a lesser extent, on the UK sovereign ratings.

The credit ratings of RBSG, the Bank and other RBS Group entities directly affect the cost of funding and capital instruments issued by those entities, as well as secondary market liquidity in those instruments. The implementation of ring-fencing is expected to change the funding strategy of the RBS Group and the Group.

A number of UK and other European financial institutions, including RBSG, the Bank and other RBS Group entities, have been downgraded multiple times in recent years in connection with rating methodology changes and credit rating agencies' revised outlook relating to regulatory developments, macroeconomic trends and a financial institution's capital position and financial prospects.

The senior unsecured long-term and short-term credit ratings of RBSG and the Bank are investment grade by Moody's, S&P and Fitch. The outlook for RBSG is currently stable for S&P, Fitch and Moody's and the outlook for the Bank is currently stable for S&P and Fitch and under review for downgrade for Moody's. This outlook is consistent with previous statements made by Moody's that the implementation of the ring-fencing regime is likely to lead to downgrades in the ratings of the Bank. Moody's has not given an indication of the extent of the potential downgrade. Therefore, there is a risk that any such downgrade could be one or more notches.

Rating agencies regularly review the RBSG and RBS Group entity credit ratings, including those of RBSG, the Bank and other RBS Group entities, and their ratings of long-term debt are based on a number of factors, such as the RBS Group's financial strength as well as factors not within the Group's control, including political developments, conditions affecting the financial services industry generally and other macroeconomic and political developments, including in light of the outcome of the negotiations relating to the form and timing of Brexit. In addition, the rating agencies may further review the RBSG, the Bank and other RBS Group entity ratings, as a result of the implementation of the UK ring-fencing regime and related reorganisation as well as pension and litigation/regulatory investigation risk, including potential fines relating to investigations relating to legacy conduct issues. A challenging macroeconomic environment, a delayed return to satisfactory profitability and greater market uncertainty could negatively impact the RBS Group's (and in particular, the Bank's) credit ratings and potentially lead to ratings downgrades which could adversely impact the RBS Group's (and in particular, the Bank's) ability to fund, and the cost of that funding, if any. As a result, the Bank's ability to access capital markets on acceptable terms and hence the ability to raise the amount of funding required, and the RBS Group's ability to meet its regulatory requirements and targets, including those relating to loss-absorbing instruments to be issued by the RBS Group, could be affected. See 'Implementation of the ring-fencing regime in the UK which began in 2015 and must be completed before 1 January 2019 will result in material structural changes to the RBS Group and the Group's business, including with respect to the perimeter of the Group's activities and the assets, liabilities and businesses that it holds. The steps required to implement the UK ring-fencing regime are complex and entail significant costs and operational, legal and execution risks, which risks may be exacerbated by the Group's other ongoing restructuring efforts. The implementation of ring-fencing will fundamentally reshape the Group's business and operations.

Risk factors continued

Any reductions in the long-term or short-term credit ratings of RBSG and, in particular, the Bank, including downgrades below investment grade, could adversely affect the Group's issuance capacity in the financial markets, increase the funding and borrowing costs of the Group and, in particular, the Bank, require the Group and, in particular, the Bank, to replace funding lost due to the downgrade, which may include the loss of customer deposits and may limit the Group's and, in particular, the Bank's access to capital and money markets and trigger additional collateral or other requirements in derivatives contracts and other secured funding arrangements or the need to amend such arrangements, limit the range of counterparties and clients willing to enter into transactions with the Group and, in particular, the Bank, and adversely affect its competitive position, all of which could have a material adverse impact on the Group's earnings, and in particular, the Bank's cash flow and financial condition.

At 31 December 2017, a simultaneous one-notch long-term and associated short-term downgrade in the credit rating of RBS plc by the three main ratings agencies would have required RBS plc to post estimated additional collateral of £1.4 billion, without taking account of mitigating action by management. Individual credit ratings of RBS plc, RBS N.V., RBS International, RBS Securities Inc., National Westminster Bank Plc, Ulster Bank Ltd, Ulster Bank Ireland DAC and Adam & Company PLC are also important to the RBS Group when competing in certain markets such as corporate deposits and over-the-counter derivatives. As discussed above, the success of the implementation of the UK ring-fencing regime and the restructuring of the Group, is in part dependent upon the Bank (to be renamed NatWest Markets Plc) maintaining a sustainable investment grade credit rating and being able to satisfy their funding needs. A failure to maintain such a rating, or any subsequent downgrades may threaten the ability of the Bank or other entities outside of the RFB to satisfy their funding needs.

The major credit rating agencies downgraded and changed their outlook to negative on the UK's sovereign credit rating in June 2016 and September 2017 following the UK's decision to leave the EU. Any further downgrade in the UK Government's credit ratings could adversely affect the credit ratings of RBS Group entities (including the Bank) and may result in the effects noted above. Further political developments, including in relation to the UK's exit from the EU or the outcome of any further Scottish referendum could negatively impact the credit ratings of the UK Government and result in a downgrade of the credit ratings of RBSG, the Bank and other RBS Group entities.

The Group is subject to political risks, including economic, regulatory and political uncertainty arising from the referendum on the UK's membership of the European Union which could adversely impact the Group's business, results of operations, financial condition and prospects.

In a referendum held in the UK on 23 June 2016 (the 'EU Referendum'), a majority voted for the UK to leave the European Union ('EU'). On 29 March 2017 the UK Government triggered the exit process contemplated under Article 50 of the Treaty on European Union.

This provides for a maximum two year period of negotiation to determine the terms of the UK's exit from the EU (also known as 'Brexit') and set the framework for the UK's new relationship with the EU.

After this period its EU membership and all associated treaties will cease to apply, unless some form of transitional agreement encompassing those associated treaties is agreed or there is unanimous agreement by the European Council with the UK to extend the negotiation period defined under Article 50. There is no certainty that negotiations relating to the terms of the UK's relationship with the EU will be completed within the two-year period designated by Article 50. Such negotiations may well extend beyond 29 March 2019, into any transitional period, the terms and duration of which are currently uncertain. Furthermore, the government has introduced the European Union (Withdrawal) Bill (the 'Withdrawal Bill') to the UK Parliament, which aims to repeal the European Communities Act of 1972 and to transpose EU law relevant to the UK into national law upon Brexit. However, the precise terms of the Withdrawal Bill, if enacted by the UK Parliament, are uncertain and it remains unclear how the Withdrawal Bill will impact the legal and regulatory landscape in the UK after it becomes effective. In addition, it is possible (although of low likelihood) that a disorderly termination of the Article 50 process could occur, resulting in the UK leaving the EU before 29 March 2019. The consequences of such an early termination of the Article 50 process are uncertain and adverse impacts could crystallise rapidly should this occur.

This prevailing uncertainty relates to the timing of Brexit, as well as to the negotiation and form of the UK's relationships with the EU, with other multilateral organisations and with individual countries at the time of exit and beyond. The timing of, and process for, such negotiations and the resulting terms of the UK's future economic, trading and legal relationships with both the EU and other counterparties could impact the RBS Group's and the Group's financial condition, results of operations and prospects. The direct and indirect effects of Brexit are expected to affect many aspects of the RBS Group's and the Group's business and operating environment, including as described elsewhere in these risk factors, and may be material.

The longer term effects of Brexit on the RBS Group's and the Group's operating environment are difficult to predict, and are subject to wider global macro-economic trends and events, but may significantly impact the RBS Group and the Group and their customers and counterparties who are themselves dependent on trading with the EU or personnel from the EU and may result in periodic financial volatility and slower economic growth, in the UK in particular, but also in Republic of Ireland, Europe and potentially the global economy. Until the bilateral and multilateral trading and economic relationships between the UK, the EU, members of the World Trade Organisation and other key trading partners are agreed, implemented and settled, the longer-term effects of this uncertainty are likely to endure and their severity increase in the absence of such agreements.

Risk factors continued

There is related uncertainty as to the respective legal and regulatory arrangements under which the RBS Group and its subsidiaries (including the Group) will operate when the UK is no longer a member of the EU. The RBS Group and its counterparties may no longer be able to rely on the EU passporting framework for financial services and could be required to apply for authorisation in multiple jurisdictions in the EU. The cost and timing of that authorisation process is uncertain.

The RBS Group has already announced plans to re-purpose its Dutch banking subsidiary, RBS N.V., to conduct the NatWest Market franchise's European business and further changes to the RBS Group's business operations may be required. The ability of the Bank (to be renamed NatWest Markets Plc) to utilise RBS N.V. as a platform for its European business is subject to uncertainty and there is no guarantee that the use of such platform will be successful. The RBS Group is also monitoring proposed amendments to the prudential framework for non-EU banks operating within in the EU. These and any other restructuring or commercial actions as well as new or amended rules, could have a significant impact on the RBS Group's operations and/or legal entity structure, including attendant restructuring costs, capital requirements and tax implications and as a result adversely impact the RBS Group's and the Group's profitability, business model and product offering. These impacts would potentially be greater in the event of a disorderly termination of the Article 50 process and early Brexit. See 'The Group has been, and will remain, in a period of major business transformation and structural change through to at least 2019 as it implements its own transformation programme and seeks to comply with UK ring-fencing and recovery and resolution requirements as well as the Alternative Remedies Package. Additional structural changes to the Group's operations will also be required as a result of Brexit. These various transformation and restructuring activities are required to occur concurrently, which carries significant execution and operational risks, and the Group may not be a viable, competitive and profitable bank as a result.'

The RBS Group and the Group face additional political uncertainty as to how the Scottish parliamentary process may impact the negotiations relating to Brexit. RBSG and the Bank are each headquartered and incorporated in Scotland. Any changes to Scotland's relationship with the UK or the EU (as an indirect result of Brexit or other developments) would impact the environment in which the RBS Group and its subsidiaries (including the Group) operate, and may require further changes to be made to the RBS Group's or the Group's structure, independently or in conjunction with other mandatory or strategic structural and organisational changes and as a result could adversely impact the RBS Group and the Group.

The Group is currently subject to increased political risks as a result of the UK Government's majority ownership stake in RBSG. The UK Government in its November 2017 Autumn Budget indicated its intention to recommence the process for the privatisation of RBSG before the end of 2018-2019, although there can be no certainty as to the commencement of any sell-downs or the timing or extent thereof.

See 'HM Treasury (or UKFI on its behalf) may be able to exercise a significant degree of influence over the RBS Group, including indirectly on the Group, and any further offer or sale of its interests may affect the price of securities issued by the RBS Group.' Were there to be a change of UK government as a result of a general election, the Group may face new risks as a result of a change in government policy. In its 2017 manifesto, for example, the Labour Party announced its intention to launch a consultation on breaking up the RBS Group to create new local public banks, a move that could impact the Group.

In addition to the political risks described above, the RBS Group remains exposed to risks arising out of geopolitical events, such as the imposition of trade barriers, the implementation of exchange controls and other measures taken by sovereign governments that can hinder economic or financial activity levels.

Operational risks are inherent in the Group's businesses and these risks are heightened as the Group implements its transformation programme, including significant cost reductions, the UK ring-fencing regime and implementation of the Alternative Remedies Package, against the backdrop of legal and regulatory changes.

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events, including legal risks. The Group has complex and diverse operations and operational risks or losses can result from a number of internal or external factors, including:

- internal and external fraud and theft from the RBS Group or the Group, including cybercrime;
- compromise of the confidentiality, integrity, or availability of the RBS Group's or the Group's data, systems and services;
- failure to identify or maintain the RBS Group's or the Group's key data within the limits of their agreed risk appetite;
- failure to provide adequate data, or the inability to correctly interpret poor quality data;
- failure of the RBS Group's or the Group's technology services due to loss of data, systems or data centre failure as a result of the Group's actions or actions outside the Group's control, or failure by third parties to restore services;
- failure to appropriately or accurately manage the RBS Group's or the Group's operations, transactions or security;
- incorrect specification of models used by the RBS Group or the Group or implementing or using such models incorrectly;
- failure to effectively execute or deliver the transformation programme;
- failure to attract, retain or engage staff;
- insufficient resources to deliver change and business-as-usual activity;

Risk factors continued

- decreasing employee engagement or failure by the RBS Group or the Group to embed new ways of working and values; or
- incomplete, inaccurate or untimely statutory, regulatory or management reporting.

Operational risks for the Group are and will continue to be heightened as a result of the number of initiatives being concurrently implemented by the Group, in particular the implementation of the Group's transformation programme, its cost-reduction programme, the implementation of the UK ring-fencing regime and implementation of the Alternative Remedies Package. Individually, these initiatives carry significant execution and delivery risk and such risks are heightened as their implementation is often highly correlated and dependent on the successful implementation of interdependent initiatives.

These initiatives are being delivered against the backdrop of ongoing cost challenges and increasing legal and regulatory uncertainty and will put significant pressure on the Group's ability to maintain effective internal controls and governance frameworks. Although the Group has implemented risk controls and loss mitigation actions and significant resources and planning have been devoted to mitigate operational risk, 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. Ineffective management of such risks could have a material adverse effect on the Group's business, financial condition and results of operations.

The Group's operations are highly dependent on its and the RBS Group's IT systems. A failure of its or the RBS Group's IT systems, including as a result of the lack of or untimely investments, could adversely affect its operations, competitive position and investor and customer confidence and expose the RBS Group or the Group to regulatory sanctions.

The RBS Group's and the Group's operations are dependent on the ability to process a very large number of transactions efficiently and accurately while complying with applicable laws and regulations where it does business. The proper functioning of the RBS Group's and the Group's payment systems, financial and sanctions controls, risk management, credit analysis and reporting, accounting, customer service and other IT systems, as well as the communication networks between its branches and main data processing centres, are critical to the RBS Group's and the Group's operations.

The vulnerabilities of the RBS Group's and the Group's IT systems are in part due to their complexity, which is attributable to overlapping multiple dated systems that result from the RBS Group's historical acquisitions and insufficient investment prior to 2013 to keep the IT applications and infrastructure up-to-date. Within a complex IT estate, the risk of disruption due to end-of-life hardware and software may create challenges in recovering from system breakdowns. In 2017, the Group made progress to remediate or replace out of date systems, reducing the overall risk of disruption.

However, some risk remains, and will require continued focus and investment on an on-going basis to limit any IT failures which may adversely affect the RBS Group's or the Group's relationship with their customers and their reputation, and which may also lead to regulatory investigations and redress.

The RBS Group's and the Group's regulators in the UK, continue to actively monitor progress being made by banks in the UK to modernise, manage and secure their IT infrastructure and environment, in order to prevent future failures affecting customers. Any critical system failure, any prolonged loss of service availability or any material breach of data security could cause serious damage to the RBS Group's or the Group's ability to provide service to their customers, which could result in significant compensation costs or fines resulting from regulatory investigations and could breach regulations under which the RBS Group and the Group operate.

In particular, failures or breaches resulting in the loss or publication of confidential customer data could cause long-term damage to the RBS Group's and/or the Group's reputation, business and brands, which could undermine its ability to attract and keep customers.

The RBS Group and the Group currently are implementing a number of complex change initiatives, including their transformation programme, the UK ring-fencing regime and the restructuring of the NatWest Markets franchise. A failure to safely and timely implement one or several of these initiatives could lead to disruptions of the RBS Group's or the Group's IT infrastructure or loss or publication of confidential customer data and in turn could cause long-term damage to the RBS Group's and the Group's reputation, brands, results of operations and financial position. In addition, recent or future regulatory changes, such as the EU General Data Protection Regulation and the CMA's Open Banking standard, increase the risks relating to the RBS Group's and the Group's ability to comply with rules that impact its IT infrastructure. Any non-compliance with such regulations could result in regulatory proceedings or the imposition of fines or penalties and consequently could have a material adverse effect on the RBS Group's and the Group's business, reputation, financial condition and future prospects.

The RBS Group has made, and will continue to make, considerable investments in its (including the Group's) IT systems and technology to further simplify, upgrade and improve its capabilities to make them more cost-effective and improve controls, procedures, strengthen cyber security defences, enhance the digital services provided to bank customers and improve the RBS Group's and the Group's competitive position, which is designed to reduce the potential for system failures which adversely affect their relationship with their customers and reputation, which may lead to regulatory investigations and redress. However, the RBS Group's and Group's current focus on cost-saving measures, as part of their transformation programme, may impact the resources available to implement further improvements to the RBS Group's and the Group's IT infrastructure and technology or limit the resources available for investments in technological developments and/or innovation.

Risk factors continued

Should such investment and rationalisation initiatives fail to achieve the expected results, or prove to be insufficient, it could have a material adverse impact on the Group's operations, its ability to retain or grow its customer business or its competitive position and could negatively impact the Group's financial position.

The RBS Group and the Group are exposed to cyberattacks and a failure to prevent or defend against such attacks and, provide, as appropriate, notification of them, could have a material adverse effect on the Group's operations, results of operations or reputation.

The RBS Group and the Group are subject to regular cybersecurity attacks and related threats, which have targeted financial institutions, corporates, governments and other institutions across all industries. The RBS Group and the Group are increasingly reliant on technology which is vulnerable to attacks and these attacks continue to increase in frequency, sophistication and severity and could have a material adverse effect on the Group's operations, customers and reputation.

The RBS Group and the Group rely on the effectiveness of their internal policies, controls, procedures and capabilities to protect the confidentiality, integrity and availability of information held on their computer systems, networks and devices, and also on the computer systems, networks and devices of third parties with whom the RBS Group and the Group interact. In connection with the implementation of the UK ring-fencing regime, certain systems, networks or devices may be migrated from the Bank level to the entities within the RFB, which may cause disruption or impact the effectiveness of such systems, networks or devices.

The RBS Group and the Group take appropriate measures to prevent, detect and minimise attacks that could disrupt the delivery of critical business processes to their customers. Because financial institutions such as the Group operate with complex legacy infrastructure, they may be even more susceptible to attack due to the increased number of potential entry points and weaknesses. In addition, the increasing sophistication of cyber criminals may increase the risk of a security breach of the RBS Group's and the Group's systems and as security threats continue to evolve the RBS Group and the Group may be required to invest additional resources to modify the security of their systems, which could have a material adverse effect on the RBS Group's and the Group's results of operations.

Failure to protect the Group's operations from cyberattacks or to continuously review and update current processes and controls in response to new or existing threats could result in the loss of customer data or other sensitive information as well as instances of denial of service for the Group's customers and staff.

The RBS Group and the Group's systems, and those of third parties suppliers, are often subject to cyberattacks which have to date been immaterial to the RBS Group's and the Group's operations. In 2017, the RBS Group experienced 11 distributed denial of service (DDOS) attacks against customer-facing websites, one of which caused minimal customer impacts for a short period of time.

This represents a decrease from 26 attacks against the RBS Group in 2016, but a recent surge of activity in the fourth quarter of 2017 points towards an increasing trend of such attacks into 2018. The Group's DDOS mitigation controls have recently been strengthened and will continue to be strengthened further in 2018. However, there can be no assurance that those and the RBS Group and the Group's other strategies to defend against cyberattacks, including future DDOS attacks, will be successful and avoid the potential adverse effects of cyberattacks on the RBS Group or the Group.

The Bank of England, the FCA and HM Treasury in the UK and regulators in the US and in Europe continue to recognise cybersecurity as a systemic risk to the financial sector and have highlighted the need for financial institutions to improve resilience to cyberattacks and provide timely notification of them, as appropriate. The RBS Group expects greater regulatory engagement, supervision and enforcement on cybersecurity in the future. The RBS Group and the Group continue to participate in initiatives led by the Bank of England and other regulators designed to share best practice and to test how major firms respond to significant cyberattacks.

The outputs of this collaboration along with other regulatory and industry-led initiatives are continually incorporated into the RBS Group's and the Group's on-going IT priorities and improvement measures. However, the Group continues to expect that it and the RBS Group will be targeted regularly in the future but there can be no certainty that the Group will not be materially impacted by a future attack.

Any failure in the RBS Group's or the Group's cybersecurity policies, procedures or controls, could lead to the Group suffering financial losses, reputational damage, a loss of customers, additional costs (including costs of notification of consumers, credit monitoring or card reissuance), regulatory investigations or sanctions being imposed and could have a material adverse effect on the Group's results of operations, financial condition or future prospects.

The Group's business and results of operations may be adversely affected by increasing competitive pressures and technology disruption in the markets in which it operates.

The markets for UK financial services, and the other markets within which the Group operates, are very competitive, and management expects such competition to continue or intensify in response to customer behaviour, technological changes (including the growth of digital banking), competitor behaviour, new entrants to the market (including non-traditional financial services providers such as large retail or technology conglomerates), new lending models (such as peer-to-peer lending), industry trends resulting in increased disaggregation or unbundling of financial services or conversely the re-intermediation of traditional banking services, and the impact of regulatory actions and other factors. In particular, developments in the financial sector resulting from new banking, lending and payment solutions offered by rapidly evolving incumbents, challengers and new entrants, in particular with respect to payment services and products, and the introduction of disruptive technology may impede the Group's ability to grow or retain its market share and impact its revenues and profitability, particularly in its key UK retail banking segment.

Risk factors continued

These trends may be catalysed by various regulatory and competition policy interventions, particularly as a result of the Open Banking initiative and other remedies imposed by the Competition and Markets Authority (CMA) which are designed to further promote competition within retail banking.

Increasingly many of the products and services offered by the Group are, and will become, technology intensive and the Group's ability to develop such services has become increasingly important to retaining and growing the Group's customer business in the UK.

There can be no certainty that the Group's investment in its IT capability intended to address the material increase in customer use of online and mobile technology for banking will be successful or that it will allow the Group to continue to grow such services in the future. Certain of the Group's current or future competitors may have more efficient operations, including better IT systems allowing them to implement innovative technologies for delivering services to their customers.

Furthermore, the Group's competitors may be better able to attract and retain customers and key employees and may have access to lower cost funding and/or be able to attract deposits on more favourable terms than the Group. Although the Group invests in new technologies and participates in industry and research led initiatives aimed at developing new technologies, such investments may be insufficient, especially given the RBS Group's focus on its cost savings targets, which may limit additional investment in areas such as financial innovation and therefore could affect the Group's offering of innovative products and its competitive position.

The Group may also fail to identify future opportunities or derive benefits from disruptive technologies in the context of rapid technological innovation, changing customer behaviour and growing regulatory demands, including the UK initiative on Open Banking (PSD2), resulting in increased competition from both traditional banking businesses as well as new providers of financial services, including technology companies with strong brand recognition, that may be able to develop financial services at a lower cost base. If the Group is unable to offer competitive, attractive and innovative products that are also profitable, it will lose market share, incur losses on some or all of its activities and lose opportunities for growth.

For example, companies in the financial services industry are increasingly using artificial intelligence and/or automated processes to enhance their output and performance. As part of this broader trend, the RBS Group is in the early stages of automating certain of its solutions and interactions within its customer-facing businesses. Such developments may result in unintended consequences or conduct risk for the RBS Group and the Group if such new processes, including the algorithms used, are not carefully tested and integrated into the RBS Group's and the Group's current solutions. In addition to such reputational risks, the development of automated solutions will require investment in technology and will likely result in increased costs for the RBS Group and the Group.

In addition, recent and future disposals and restructurings by the Group relating to the implementation of non-customer facing elements of the transformation programme and the UK ring-fencing regime, or required by the Group's regulators, as well as constraints imposed on the Group's ability to compensate its employees at the same level as its competitors, may also have an impact on its ability to compete effectively. Intensified competition from incumbents, challengers and new entrants in the Group's core markets could lead to greater pressure on the Group to maintain returns and may lead to unsustainable growth decisions. These and other changes in the Group's competitive environment could have a material adverse effect on the Group's business, margins, profitability, financial condition and prospects.

The Group is reliant on the RBS Group for capital, liquidity and funding support and expects to continue to be reliant, at least during its transition to becoming a standalone sub-group to comply with the UK ring-fencing requirements.

The Group currently receives capital, liquidity and funding support from the RBS Group, including from RBS Group entities which will ultimately be situated inside of the RFB.

Although the Group is transitioning to becoming a standalone sub-group of the RBS Group that will be independent of the RFB to operate in compliance with the UK ring-fencing regime by 1 January 2019, the Group is expected to continue to rely on the RBS Group for capital, liquidity and funding support, at least during the transition period and such reliance may be necessary for a longer period.

The Group will likely be required to hold securities that are compliant with the minimum requirements for own funds and eligible liabilities ('MREL') on an internal basis and in compliance with the capital requirements for a 'material subsidiary' as set forth by the Bank of England. RBSG is the only entity that is able to issue MREL securities externally. As a result, the Group's ability to meet its internal MREL is substantially reliant on RBSG's ability to issue sufficient amounts of external MREL securities and downstream the proceeds to the Group. If RBSG is unable to issue adequate levels of MREL securities such that it is unable to downstream sufficient amounts to the Group, this could lead to a failure of the Group to meet its own individual internal MREL requirements as well as the internal MREL requirements of subsidiaries within the Group. See 'Failure by the RBS Group or the Group to comply with regulatory capital, funding, liquidity and leverage requirements may result in intervention by their regulators and loss of investor confidence, and may have a material adverse effect on the Group's results of operations, financial condition and reputation and may result in distribution restrictions and adversely impact existing shareholders.' and 'As a result of extensive reforms being implemented relating to the resolution of financial institutions within the UK, the EU and globally, material additional requirements will arise to ensure that financial institutions maintain sufficient loss-absorbing capacity. Such changes to the funding and regulatory capital framework may require the RBS Group to meet higher capital levels than anticipated within the RBS Group's strategic plans and affect the RBS Group's and the Group's funding costs.'

Risk factors continued

In addition, the RBS Group has historically held and managed its liquidity portfolio centrally, via a single liquidity sub-group ('UK DoLSub') comprising the RBS Group's five licensed deposit-taking UK banks: The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Co and Adam & Company PLC. Following the legal entity restructuring in response to the UK government's ring-fencing legislation, the Bank will separately hold and manage its own liquidity portfolio. It will therefore cease to form part of the UK DoLSub at a point in time in the second half of 2018 (subject to regulatory agreement). As a result of the Bank (to be renamed NatWest Markets Plc) leaving the UK DoLSub, the Bank's liquidity position could be adversely affected, which may require unencumbered assets to be liquidated or may result in higher funding costs which may impact the Group's margins and profitability. See 'The viability of Bank (to be renamed as NatWest Markets Plc) depends on its ability to access sources of liquidity and funding. If the Bank is unable to raise adequate funds in the capital markets, its liquidity position could be adversely affected which may require unencumbered assets to be liquidated or it may result in higher funding costs which may impact the Group's margins and profitability.'

The planned transfers of a substantial part of the Group's operations will result in a loss of customers and related revenue as the majority of existing personal, private, business and commercial customers will be moved into the RFB. The Group's funding and liquidity needs will be particularly challenging during this time, in particular if the RBS Group is not able to successfully complete its transformation programme and if the Group is not able to adapt its business models following the implementation of the ring-fencing regime to become a viable, competitive and profitable banking business. See 'Implementation of the ring-fencing regime in the UK which began in 2015 and must be completed before 1 January 2019 will result in material structural changes to the RBS Group and the Group's business, including with respect to the perimeter of the Group's activities and the assets, liabilities and businesses that it holds. The steps required to implement the UK ring-fencing regime are complex and entail significant costs and operational, legal and execution risks, which risks may be exacerbated by the Group's other ongoing restructuring efforts. The implementation of ring-fencing will fundamentally reshape the Group's business and operations.'

In addition, the Group currently also receives capital, liquidity and funding support from RBS Group entities which will ultimately be transferred to the RFB and which may no longer, or only to a limited extent, provide capital and funding support to the Group once a ring-fence compliant structure is established. The reduction or cessation of the ability of the RBS Group to provide capital injections, liquidity or other financial support directly or indirectly to the Group may result in funding or capital pressures and liquidity stress for the Group and may have a material adverse effect on the operations, financial condition and results of operations of the Group. See 'The Group's borrowing costs, its access to the debt capital markets and its sources of liquidity depend significantly on its and the RBS Group's credit ratings and, to a lesser extent, on the UK sovereign ratings.' and 'The viability of Bank (to be renamed as NatWest Markets Plc) depends on its ability to access sources of liquidity and funding. If the Bank is unable to raise adequate funds in the capital markets, its liquidity position could be adversely affected which may require unencumbered assets to be liquidated or it may result in higher funding costs which may impact the Group's margins and profitability.'

The Group's business performance and financial position could be adversely affected if its or the RBS Group's capital is not managed effectively or if it or the RBS Group is unable to meet their prudential regulatory requirements, including their capital targets. Effective management of the RBS Group's and the Group's capital is critical to their ability to operate their businesses, comply with regulatory obligations, pursue their transformation programmes and current strategies resume dividend payments on RBSG ordinary shares, maintain discretionary payments and pursue their strategic opportunities.

The RBS Group and the Bank (on a standalone basis) are required by regulators in the UK, the EU and other jurisdictions in which they undertake regulated activities to maintain adequate capital resources. Adequate capital also gives the RBS Group and the Bank financial flexibility in the face of continuing turbulence and uncertainty in the global economy and specifically in their core UK and European markets.

The RBS Group currently targets a CET1 ratio at or above 13% throughout the period until completion of its restructuring. On the PRA transitional basis, the RBS Group's and the Bank's CET1 ratio were 15.9% and 14.7%, respectively, at 31 December 2017, compared with 13.4% and 13.1%, respectively, at 31 December 2016.

The RBS Group's target capital ratio for the RBS Group and the RBS Group entities, including the Bank, is based on its expected regulatory requirements and internal modelling, including stress scenarios. However, the ability of the RBS Group or the Bank to achieve such targets depends on a number of factors, including the implementation of the RBS Group's and the Bank's transformation programme and any of the factors described below. A shortage of capital, which could in turn affect the Group's capital ratio, could arise from:

- a depletion of the RBS Group's or the Bank's capital resources through increased costs or liabilities (including pension, conduct and litigation costs), reduced profits or increased losses (which would in turn impact retained earnings), sustained periods of low or lower interest rates, reduced asset values resulting in write-downs, impairments or accounting charges;
- reduced upstreaming of dividends from the RBS Group's subsidiaries as a result of the Bank of England's approach to setting MREL within groups, requiring sub-groups, such as the Group, to hold internal MREL resources sufficient to match both their own individual MREL as well as the internal MREL of the subsidiaries constituting the sub-group;

Risk factors continued

- an increase in the amount of capital that is required to meet the Bank's regulatory requirements, including as a result of changes to the actual level of risk faced by the RBS Group or the Group, factors influencing the RBS Group's regulator's determination of the firm-specific Pillar 2B buffer applicable to the RBS Group (PRA buffer), changes in the minimum levels of capital or liquidity required by legislation or by the regulatory authorities or the calibration of capital or leverage buffers applicable to the RBS Group or the Bank, including countercyclical buffers, increases in risk-weighted assets or in the risk weighting of existing asset classes, or an increase in the RBS Group's view of any management buffer it needs, taking account of, for example, the capital levels or capital targets of the RBS Group's peer banks and criteria set by the credit rating agencies;
- the implementation of the RBS Group's transformation programme, including in response to implementation of the UK ring-fencing regime, means certain intragroup funding arrangements will be limited and may no longer be permitted and the RBS Group entities, including the Bank, may need to increasingly manage funding and liquidity at an individual RBS Group or Group entity level, which could result in the RBS Group and the Bank being required to maintain higher levels of capital in order to meet their regulatory requirements than would otherwise be the case, as may be the case if the Bank of England were to identify impediments to the RBS Group's resolvability resulting from new funding and liquidity management strategies. In addition, once the UK ring-fencing regime is implemented, reliance on intragroup exemptions in relation to large exposures and liquidity will not be possible between the RFB and other RBS Group entities outside the RFB (including the Bank) and may result in risk-weighted assets inflation.

In addition, the RBS Group's capital requirements, determined either as a result of regulatory requirements, including in light of the implementation of the UK ring-fencing regime and the establishment of the RFB or management targets, may impact the level of capital required to be held by the Group and as part of its capital management strategy, the RBS Group may decide to impose higher capital levels to be held by the Bank.

The RBS Group's and the Bank's current capital strategy is based on the expected accumulation of additional capital through the accrual of profits over time and/or through the planned reduction of its risk-weighted assets through disposals, natural attrition and other capital management initiatives.

Further losses or a failure to meet profitability targets or reduce risk-weighted assets in accordance with or within the timeline contemplated by the RBS Group's capital plan, a depletion of its or the Bank's capital resources, earnings and capital volatility resulting from the implementation of IFRS 9 as of 1 January 2018, or an increase in the amount of capital they need to hold (including as a result of the reasons described above), would adversely impact the RBS Group's or the Bank's ability to meet their capital targets or requirements and achieve their capital strategy during the restructuring period.

If the RBS Group or the Bank are determined to have a shortage of capital, including as a result of any of the circumstances described above, the RBS Group and the Bank may suffer a loss of confidence in the market with the result that access to liquidity and funding may become constrained or more expensive or may result in the RBS Group or the Bank being subject to regulatory interventions and sanctions. The RBS Group's regulators may also request that the RBS Group carry out certain capital management actions, which may impact the Group, or, in an extreme scenario, this may also trigger the implementation of the RBS Group's recovery plans. Such actions may, in turn, affect, among other things, the RBS Group's and/or the Group's product offering, ability to operate their businesses, comply with their regulatory obligations, pursue their transformation programme and current strategies, resume dividend payments on RBSG ordinary shares, maintain discretionary payments on capital instruments and pursue strategic opportunities, affecting the underlying profitability of the RBS Group and the Group and future growth potential.

If, in response to such shortage, certain regulatory capital instruments are converted into equity or the RBS Group raises additional capital through the issuance of share capital or regulatory capital instruments, existing RBSG shareholders may experience a dilution of their holdings. The success of such issuances will also be dependent on favourable market conditions and the RBS Group may not be able to raise the amount of capital required or on satisfactory terms. Separately, the RBS Group may address a shortage of capital by taking action to reduce leverage and/or risk-weighted assets, by modifying the RBS Group's legal entity structure or by asset or business disposals. Such actions may affect the underlying profitability of the RBS Group and the Group.

Failure by the RBS Group or the Group to comply with regulatory capital, funding, liquidity and leverage requirements may result in intervention by their regulators and loss of investor confidence, and may have a material adverse effect on the Group's results of operations, financial condition and reputation and may result in distribution restrictions and adversely impact existing shareholders.
The RBS Group and, where applicable, RBS Group entities (including the Group and the Bank, are subject to extensive regulatory supervision in relation to the levels and quality of capital it is required to hold in connection with its business, including as a result of the transposition of the Basel Committee on Banking Supervision's regulatory capital framework (Basel III) in Europe by a Directive and Regulation (collectively known as CRD IV).

In addition, the RBS Group is currently identified as a global systemically important bank (G-SIB) by the FSB and is therefore subject to more intensive oversight and supervision by its regulators as well as additional capital requirements, although the RBS Group belongs to the last 'bucket' of the FSB G-SIB list and is therefore subject to the lowest level of additional loss-absorbing capacity requirements.

Risk factors continued

Each business within the RBS Group is subject to performance metrics which factor in underlying regulatory capital requirements for the RBS Group and the Bank to ensure that business capital targets and generation are aligned to the RBS Group's overall risk appetite.

Under CRD IV, the RBS Group is required, on a consolidated basis, to hold at all times a minimum amount of regulatory capital calculated as a percentage of risk-weighted assets (Pillar 1 requirement). CRD IV also introduced a number of new capital buffers that are in addition to the Pillar 1 and Pillar 2A requirements (as described below) that must be met with CET1 capital.

The combination of the capital conservation buffer (which, subject to transitional provisions, will be set at 2.5% from 2019), the countercyclical capital buffer (of up to 2.5% which is currently set at 1.0%, with binding effect from 28 November 2018 by the FPC for UK banks) and the higher of (depending on the institution) the systemic risk buffer, the global systemically important institutions buffer (G-SIB Buffer) and the other systemically important institutions buffer, is referred to as the 'combined buffer requirement'.

These rules entered into force on 1 May 2014 for the countercyclical capital buffer and on 1 January 2016 for the capital conservation buffer and the G-SIB Buffer. The G-SIB Buffer is currently set at 1.0% for the RBS Group (from 1 January 2017), and is being phased in over the period to 1 January 2019. The systemic risk buffer will be applicable from 1 January 2019.

The Bank of England's Financial Policy Committee (the FPC) was responsible for setting the framework for the systemic risk buffer and the PRA adopted in December 2016 a final statement of policy implementing the FPC's framework. In early 2019, the PRA is expected to determine which institutions the systemic risk buffer should apply to, and if so, how large the buffer should be up to a maximum of 3% of a firm's risk-weighted assets. The systemic risk buffer will apply to ring-fenced entities only and not all entities within a banking group. The systemic risk buffer is part of the UK framework for identifying and setting higher capital buffers for domestic systemically important banks (D-SIBs), which are groups that, upon distress or failure, could have an important impact on their domestic financial systems.

In addition, national supervisory authorities may add extra capital requirements (the Pillar 2A requirements) to cover risks that they believe are not covered or insufficiently covered by Pillar 1 requirements. The RBS Group's current Pillar 2A requirement has been set by the PRA at an equivalent of 4.0% of risk-weighted assets.

The PRA has also introduced a firm-specific PRA buffer, which is a forward-looking requirement set annually and based on various factors including firm-specific stress test results and is to be met with CET1 capital (in addition to any CET1 capital used to meet any Pillar 1 or Pillar 2A requirements).

Where appropriate, the PRA may require an increase in an institution's PRA buffer to reflect additional capital required to be held to mitigate the risk of additional losses that could be incurred as a result of risk management and governance weaknesses, including with respect to the effectiveness of the internal stress testing framework and control environment. UK banks are required to meet the higher of the combined buffer requirement or PRA buffer requirement. The FPC and PRA have expressed concerns around potential systemic risk associated with recent increases in UK consumer lending and the impact of consumer credit losses on banks' resilience in a stress scenario, which the PRA has indicated that it will consider when setting capital buffers for individual banks.

In addition to capital requirements and buffers, the regulatory framework adopted under CRD IV, as transposed in the UK, sets out minimum leverage ratio requirements for financial institutions. These include a minimum leverage requirement of 3.25% which applies to major UK banks, as recalibrated in October 2017 in accordance with the FPC's recommendation to the PRA. In addition, the UK leverage ratio framework provides for: (i) an additional leverage ratio to be met by G-SIBs and ring-fenced institutions to be calibrated at 35% of the relevant firm's capital G-SIB Buffer or systemic risk buffer and which is being phased in from 2016 (currently set at 0.75% from 1 January 2018) and (ii) a countercyclical leverage ratio buffer for all firms subject to the minimum leverage ratio requirements which is calibrated at 35% of a firm's countercyclical capital buffer. Further changes may be made to the current leverage ratio framework as a result of future regulatory reforms, including the FSB proposals and proposed amendments to the CRD IV proposed by the European Commission in November 2016.

Most of the capital requirements which apply or will apply to the RBS Group or to the Group (directly or indirectly as a result of RBS Group internal capital management) will need to be met in whole or in part with CET1 capital.

CET1 capital broadly comprises retained earnings and equity instruments, including ordinary shares. As a result, the RBS Group's ability meet applicable CET1 capital requirements is dependent on organic generation of CET1 through sustained profitability and/or the RBS Group's ability to issue ordinary shares, and there is no guarantee that the RBS Group may be able to generate CET1 capital through either of these alternatives.

The amount of regulatory capital required to meet the RBS Group's and the Bank's regulatory capital requirements (and any additional management buffer), is determined by reference to the amount of risk-weighted assets held by the RBS Group and the Bank. The models and methodologies used to calculate applicable risk-weightings are a combination of individual models, subject to regulatory permissions, and more standardised approaches. The rules are applicable to the calculation of the RBS Group's and the Bank's risk-weighted assets are subject to regulatory changes which may impact the levels of regulatory capital required to be met by the RBS Group and the Bank.

Risk factors continued

On 7 December 2017, the Basel Committee on Banking Supervision published revised standards intended to finalise the Basel III post-crisis regulatory reforms. The revised standards include the following elements: (i) a revised standardised approach for credit risk, which will improve the robustness and risk sensitivity of the existing approach; (ii) revisions to the internal ratings-based approach for credit risk, where the use of the most advanced internally modelled approaches for low-default portfolios will be limited; (iii) revisions to the credit valuation adjustment (CVA) framework, including the removal of the internally modelled approach and the introduction of a revised standardised approach; (iv) a revised standardised approach for operational risk, which will replace the existing standardised approaches and the advanced measurement approaches; (v) revisions to the measurement of the leverage ratio and a leverage ratio buffer for global systemically important banks (G-SIBs), which will take the form of a Tier 1 capital buffer set at 50% of a G-SIB's risk-weighted capital buffer; and (vi) an aggregate output floor, which will ensure that banks' risk-weighted assets (RWAs) generated by internal models are no lower than 72.5% of RWAs as calculated by the Basel III framework's standardised approaches.

The revised Basel III standards will take effect from 1 January 2022 and will be phased in over five years. Although the revised Basel III standards must be implemented through legislation in the EU and UK, and precise estimates of their impact would be premature at this time, the revised standards may result in higher levels of risk-weighted assets and therefore higher levels of capital, and in particular CET1 capital, required to be held by the RBS Group or the Group under Pillar 1 requirements. Such requirements would be separate from any further capital overlays required to be held as part of the PRA's determination of the RBS Group's Pillar 2A or PRA buffer requirements with respect to such exposures.

In the UK, the PRA also set revised expectations to the calculation of risk-weighted capital requirements in relation to residential mortgage portfolios which firms are expected to meet by the end of 2020. To this effect, firms should also submit amended models for regulatory approval.

Although the above provides an overview of the capital and leverage requirements currently applicable to the RBS Group and the Bank, such requirements are subject to ongoing amendments and revisions, including as a result of final rules and recommendations adopted by the FSB or by European or UK regulators. In particular, on 23 November 2016, the European Commission published a comprehensive package of reforms including proposed amendments to CRD IV and the EU Bank Recovery and Resolution Directive (the BRRD). Although such proposals are currently being considered and discussed among the European Commission, the European Parliament and the European Council and their final form and the timetable for their implementation are not known, such amendments may result in increased or more stringent requirements applying to the RBS Group or its subsidiaries (including the Bank).

This uncertainty is compounded by Brexit which may result in further changes to the prudential and regulatory framework applicable to the RBS Group and the Bank.

If the RBS Group is unable to raise the requisite amount of regulatory capital (including loss absorbing capital in the form of MREL), or if the RBS Group or the Bank otherwise fail to meet regulatory capital and leverage requirements, they may be exposed to increased regulatory supervision or sanctions, loss of investor confidence, and restrictions on distributions or they may be required to reduce further the amount of their risk-weighted assets or total assets and engage in the disposal of core and other non-core businesses, including businesses within the Group, which may not occur on a timely basis or achieve prices which would otherwise be attractive to the RBS Group or the Group.

This may also result in write-down or the conversion into equity of certain regulatory capital instruments issued by the RBS Group or the issue of additional equity by the RBS Group, each of which could result in the dilution of the RBS Group's existing shareholders. A breach of the RBS Group's or the Bank's applicable capital or leverage requirements may also trigger the application of the RBS Group's recovery plan to remediate a deficient capital position.

Any of these developments, including the failure by the RBS Group to meet its regulatory capital and leverage requirements, may have a material adverse impact on the Group's capital position, operations, reputation or prospects.

As a result of extensive reforms being implemented relating to the resolution of financial institutions within the UK, the EU and globally, material additional requirements will arise to ensure that financial institutions maintain sufficient loss-absorbing capacity. Such changes to the funding and regulatory capital framework may require the RBS Group to meet higher capital levels than anticipated within the RBS Group's strategic plans and affect the RBS Group's and the Group's funding costs.

In addition to the prudential requirements applicable under CRD IV, the BRRD introduces, among other things, a requirement for banks to maintain at all times a sufficient aggregate amount of own funds and 'eligible liabilities' (that is, liabilities that can absorb loss and assist in recapitalising a firm in accordance with a predetermined resolution strategy), known as MREL), designed to ensure that the resolution of a financial institution may be carried out, without public funds being exposed to the risk of loss and in a way which ensures the continuity of critical economic functions, maintains financial stability and protects depositors.

In November 2015, the FSB published a final term sheet setting out its total loss-absorbing capacity ('TLAC') standards for G-SIBs. The EBA was mandated to assess the implementation of MREL in the EU and the consistency of MREL with the final TLAC standards and published an interim report setting out the conclusions of its review in July 2016 and its final report in December 2016.

Risk factors continued

On the basis of the EBA's work and its own assessment of CRD IV and the BRRD, the European Commission published in November 2016 a comprehensive set of proposals, seeking to make certain amendments to the existing MREL framework. In particular, the proposals make a number of amendments to the MREL requirements under the BRRD, in part in order to transpose the FSB's final TLAC term sheet.

The UK government is required to transpose the BRRD's provisions relating to MREL into law through further secondary legislation. In November 2016, the Bank of England published its final rules setting out its approach to setting MREL for UK banks. These final rules (which were adopted on the basis of the current MREL framework in force in the EU) do not take into account the European Commission's most recent proposals with respect to MREL and differ in a number of respects. In addition, rules relating to a number of specific issues under the framework remain to be implemented. These include internal MREL requirements, in respect of which the FSB published guiding principles in July 2017. The Bank of England published a consultation paper in October 2017 but has not yet published a final statement of policy on its approach to setting internal MREL. The Bank of England has also stated that it expects to set out policy proposals for MREL cross-holdings and disclosure requirements once there is greater clarity as to the timing and final content of related EU proposals.

The Bank of England is responsible for setting the MREL requirements for each UK bank, building society and certain investment firms in consultation with the PRA and the FCA, and such requirement will be set depending on the resolution strategy of the financial institution. In its final rules, the Bank of England has set out a staggered compliance timeline for UK banks, including with respect to those requirements applicable to G-SIBs (including the RBS Group).

Under the revised timeline, G-SIBs will be expected to (i) meet the minimum requirements set out in the FSB's TLAC term sheet from 1 January 2019 (i.e. the higher of 16% of risk-weighted assets or 6% of leverage exposures), and (ii) meet the full MREL requirements to be phased in from 1 January 2020, with the full requirements applicable from 2 January 2022 (i.e. for G-SIBs two times Pillar 1 plus Pillar 2A or the higher of two times the applicable leverage ratio requirement or 6.75% of leverage exposures). MREL requirements are expected to be set on consolidated, sub-consolidated and individual bases, and are in addition to regulatory capital requirements (so that there can be no double counting of instruments qualifying for capital requirements).

For institutions, including the RBS Group, for which bail-in is the required resolution strategy and which are structured to permit single point of entry resolution due to their size and systemic importance, the Bank of England has indicated that in order to qualify as MREL, eligible liabilities must be issued by the resolution entity (i.e. the holding company for the RBS Group) and be structurally subordinated to operating and excluded liabilities (which include insured deposits, short-term debt, derivatives, structured notes and tax liabilities).

The final rules set out a number of liabilities which cannot qualify as MREL and are therefore 'excluded liabilities'. As a result, senior unsecured issuances by RBSG will need to be subordinated to the excluded liabilities described above.

The proceeds from such issuances will be transferred to material operating subsidiaries (as identified using criteria set in the Bank of England's final rules on internal MREL) in the form of capital or another form of subordinated claim. In this way, MREL resources will be 'structurally subordinated' to senior liabilities of operating companies, allowing losses from operating companies to be transferred to the holding company and - if necessary - for resolution to occur at the holding company level, without placing the operating companies into a resolution process. The TLAC standard requires that the total amount of excluded liabilities on RBSG's balance sheet does not exceed 5% of its external TLAC (i.e. the eligible liabilities RBSG has issued to investors which meet the TLAC requirements) and the Bank of England has adopted this criterion in its final rules. If the RBS Group were to fail to comply with this 'clean balance sheet' requirement, it could disqualify otherwise eligible liabilities from counting towards MREL and result in the RBS Group breaching its MREL requirements.

The purpose of internal MREL requirements is to provide for loss-absorbing capacity to be appropriately distributed within a banking group and to provide the mechanism by which losses can be transferred from operating companies to the resolution entity. The Bank of England proposes to set internal MREL requirements above capital requirements for each 'material subsidiary' of a banking group. The Bank of England will formally determine which entities within the group represent material subsidiaries, with reference to indicative criteria including such subsidiary's contribution to the RBS Group's risk-weighted assets and operating income.

It will also set the internal MREL requirement, calibrated to be between 75% and 90% of the external MREL requirement that would otherwise apply to a material subsidiary were it a resolution entity in its own right. Such requirements must be met with internal MREL resources which are subordinated to the operating liabilities of the material subsidiary issuing them and must be capable of being written down or converted to equity via a contractual trigger. These liabilities, issued to other group entities (typically the issuing entity's immediate parent), must be priced on an arm's-length basis. The impact of these requirements on the RBS Group and the Group, the cost of servicing these liabilities and the implications for the RBS Group's and the Group's funding plans cannot be assessed with certainty until the Bank of England's proposed internal MREL policy is finalised and final rules are published.

Compliance with these and other future changes to capital adequacy and loss-absorbency requirements in the EU and the UK by the relevant deadline will require the RBS Group to restructure its balance sheet and issue additional capital and other instruments compliant with the rules, which may be costly, whilst certain existing Tier 1 and Tier 2 securities and other senior, unsecured instruments issued by the RBS Group will cease to count towards the RBS Group's loss-absorbing capacity for the purposes of meeting MREL/TLAC requirements.

Risk factors continued

The RBS Group's resolution authority can impose an MREL requirement over and above the regulatory minima and potentially higher than the RBS Group's peers, if it has concerns regarding the resolvability of the RBS Group.

As a result, the RBS Group may be required to issue additional loss-absorbing instruments in the form of CET1 capital or subordinated or senior unsecured debt instruments and may see an increased risk of a breach of the RBS Group's combined buffer requirement triggering the restrictions relating to the MDA described above.

There remain some areas of uncertainty regarding the implementation of outstanding regulatory requirements in the UK, the EU and globally, and the final requirements to which the RBS Group will be subject, and the RBS Group may therefore need to revise its capital plan accordingly.

The Group's businesses and performance can be negatively affected by actual or perceived economic conditions in the UK and globally and other global risks, including risks arising out of geopolitical events and political developments and the Group will be increasingly impacted by developments in the UK as its operations become increasingly concentrated in the UK.

Actual or perceived difficult global economic conditions can create challenging economic and market conditions and a difficult operating environment for the Group's businesses and its customers and counterparties. As part of its revised strategy, the RBS Group has been refocusing its business in the UK, the ROI and Western Europe and, accordingly is more exposed to the economic conditions of the British economy as well as the Eurozone. In particular, the longer term effects of Brexit are difficult to predict and are subject to wider global macro-economic trends, but may include periods of financial market volatility and slower economic growth, in the UK in particular, but also in the ROI, Europe and the global economy, at least in the short to medium term.

See 'The Group is subject to political risks, including economic, regulatory and political uncertainty arising from the referendum on the UK's membership of the European Union which could adversely impact the Group's business, results of operations, financial condition and prospects.' and 'The Group has been, and will remain, in a period of major business transformation and structural change through to at least 2019 as it implements its own transformation programme and seeks to comply with UK ring-fencing and recovery and resolution requirements as well as the Alternative Remedies Package. Additional structural changes to the Group's operations will also be required as a result of Brexit. These various transformation and restructuring activities are required to occur concurrently, which carries significant execution and operational risks, and the Group may not be a viable, competitive and profitable bank as a result.'

The outlook for the global economy over the medium-term remains uncertain due to a number of factors including political instability, an extended period of low inflation and low interest rates, although monetary policy has begun the process of normalisation in some countries.

The normalisation of monetary policy in the USA may affect some emerging market economies which may raise their domestic interest rates in order to avoid capital outflows, with negative effects on growth and trade. Such conditions could be worsened by a number of factors including political uncertainty or macro-economic deterioration in the Eurozone or the US, increased instability in the global financial system and concerns relating to further financial shocks or contagion, volatility in the value of the pound sterling, new or extended economic sanctions, volatility in commodity prices or concerns regarding sovereign debt. In particular, concerns relating to emerging markets, including lower economic growth or recession, concerns relating to the Chinese economy and financial markets, reduced global trade in emerging market economies to which the Group is exposed or increased financing needs as existing debt matures, may give rise to further instability and financial market volatility.

Any of the above developments could impact the Group directly by resulting in credit losses and indirectly by further impacting global economic growth and financial markets.

Developments relating to current economic conditions, including those discussed above, could have a material adverse effect on the Group's business, financial condition, results of operations and prospects. Any such developments may also adversely impact the financial position of the Group's pension schemes, which may result in the Group being required to make additional contributions. See 'The Group is subject to pension risks and may be required to make additional contributions to cover pension funding deficits as a result of degraded economic conditions, any devaluation in the asset portfolio held by the pension trustee, or as a result of the restructuring of its pension schemes in relation to the implementation of the UK ring-fencing regime.'

In addition, the Group is exposed to risks arising out of geopolitical events or political developments, such as trade barriers, exchange controls, sanctions and other measures taken by sovereign governments that can hinder economic or financial activity levels.

Furthermore, unfavourable political, military or diplomatic events, including secession movements or the exit of other Member States from the EU, armed conflict, pandemics, state and privately sponsored cyber and terrorist acts or threats, and the responses to them by governments, could also adversely affect economic activity and have an adverse effect upon the Group's business, financial condition and results of operations.

Risk factors continued

The financial performance of the RBS Group has been, and may continue to be, materially affected by customer and counterparty credit quality and deterioration in credit quality could arise due to prevailing economic and market conditions and legal and regulatory developments.

The RBS Group has exposure to many different industries, customers and counterparties, and risks arising from actual or perceived changes in credit quality and the recoverability of monies due from borrowers and other counterparties are inherent in a wide range of the Group's businesses. In particular, the Group has significant exposure to certain individual customers and other counterparties in weaker business sectors and geographic markets and also has concentrated country exposure in the UK, the US and across the rest of Europe principally Germany, the Netherlands, Ireland and France.

At 31 December 2017, the RBS Group's current exposure in the UK was £363.0 billion, in the US was £18.4 billion and in Western Europe (excluding the UK) was £60.0 billion); and within certain business sectors, namely personal and financial institutions (at 31 December 2016, personal lending amounted to £176.6 billion, and lending to banks and other financial institutions was £37.8 billion.

Provisions held on loans in default have decreased in recent years due to asset sales and the portfolio run-down in Ulster Bank Ireland DAC and the NatWest Markets franchise's legacy portfolios. If the risk profile of these loans were to increase, including as a result of a degradation of economic or market conditions, this could result in an increase in the cost of risk and the Group may be required to make additional provisions, which in turn would reduce earnings and impact the Group's profitability. The Group's lending strategy or processes may also fail to identify or anticipate weaknesses or risks in a particular sector, market or borrower category, which may result in an increase in default rates, which may, in turn, impact the Group's profitability. Any adverse impact on the credit quality of the Group's customers and other counterparties, coupled with a decline in collateral values, could lead to a reduction in recoverability and value of the Group's assets and higher levels of impairment allowances, which could have an adverse effect on the Group's operations, financial position or prospects.

The credit quality of the Group's borrowers and its other counterparties is impacted by prevailing economic and market conditions and by the legal and regulatory landscape in their respective markets. Credit quality has improved in certain of the Group's core markets, in particular the UK and Ireland, as these economies have improved. However, a further deterioration in economic and market conditions or changes to legal or regulatory landscapes could worsen borrower and counterparty credit quality and also impact the Group's ability to enforce contractual security rights. In particular, developments relating to Brexit may adversely impact credit quality in the UK.

In addition, as the RBS Group continues to implement its strategy and further reduces its scale and global footprint, the Group's relative exposure to the UK and to certain sectors and asset classes in the UK will continue to increase as its business becomes more concentrated in the UK as a result of the reduction in the number of jurisdictions outside of the UK in which it operates. The level of UK household indebtedness remains high and the ability of some households to service their debts could be challenged by a period of higher unemployment. Highly indebted households are particularly vulnerable to shocks, such as falls in incomes or increases in interest rates, which threaten their ability to service their debts.

In particular, in the UK the Group is at risk from downturns in the UK economy and volatility in property prices in both the residential and commercial sectors. With UK home loans currently representing the most significant portion of the Group's total loans and advances to the retail sector, the Group has a large exposure to adverse developments in the UK residential property sector. In the UK commercial real estate market, activity has improved against 2016 but may be short-lived given continued political uncertainty and progress of negotiations relating to the form and timing of Brexit. There is a risk of further adjustment given the reliance of the UK commercial real estate market in recent years on inflows of foreign capital and, in some segments, stretched property valuations. As a result, the continued house price weakness, particularly in London and the South East of the UK, would be likely to lead to higher impairment and negative capital impact as loss given default rate increases. In addition, reduced affordability of residential and commercial property in the UK, for example, as a result of higher interest rates, inflation or increased unemployment, could also lead to higher impairments on loans held by the Group being recognised.

The Group also remains exposed to certain counterparties operating in certain industries which have been under pressure in recent years and any further deterioration in the outlook the credit quality of these counterparties may require the Group to make additional provisions, which in turn would reduce earnings and impact the Group's profitability.

In addition, the Group's credit risk is exacerbated when the collateral it holds cannot be realised as a result of market conditions or regulatory intervention or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due to the Group, which is most likely to occur during periods of illiquidity and depressed asset valuations, such as those experienced in recent years. This has particularly been the case with respect to large parts of the Group's commercial real estate portfolio. Any such deteriorations in the Group's recoveries on defaulting loans could have an adverse effect on the Group's results of operations and financial condition.

Concerns about, or a default by, one financial institution could lead to significant liquidity problems and losses or defaults by other financial institutions, as the commercial and financial soundness of many financial institutions may be closely related as a result of credit, trading, clearing and other relationships. Even the perceived lack of creditworthiness of, or questions about, a counterparty may lead to market-wide liquidity problems and losses for, or defaults by, the RBS Group and/or the Group.

Risk factors continued

This systemic risk may also adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with which the Group interacts on a daily basis.

The effectiveness of recent prudential reforms designed to contain systemic risk in the EU and the UK is yet to be tested. Counterparty risk within the financial system or failures of the Group's financial counterparties could have a material adverse effect on the Group's access to liquidity or could result in losses which could have a material adverse effect on the Group's financial condition, results of operations and prospects.

The trends and risks affecting borrower and counterparty credit quality have caused, and in the future may cause, the Group to experience further and accelerated impairment charges, increased repurchase demands, higher costs, additional write-downs and losses for the Group and an inability to engage in routine funding transactions.

The Group is subject to pension risks and will be required to make additional contributions as a result of the restructuring of its pension schemes in relation to the implementation of the UK ring-fencing regime. In addition, the Group expects to make additional contributions to cover pension funding deficits if there are degraded economic conditions or if there is any devaluation in the asset portfolio held by the pension trustee.

The Group maintains a number of defined benefit pension schemes for certain former and current employees. The UK ring-fencing regime will require significant changes to the structure of the Group's existing defined benefit pension schemes because, from 2026 it will not be possible for the Group or other entities outside the RFB to participate in the same defined pension benefit scheme as RFB entities or their wholly-owned subsidiaries. As a result, RFB entities cannot be liable for debts to pension schemes that might arise as a result of the failure of an entity that is not a RFB or wholly owned subsidiary thereof after 1 January 2026. The restructuring of the RBS Group and its defined benefit pension scheme to implement the UK ring-fencing regime could also affect assessments of the RBS Group's pension scheme deficits or result in the pension scheme trustees considering that the employer covenant has been weakened and result in further additional material contributions being required.

The RBS Group is developing a strategy to meet these requirements. This will require the agreement of the pension scheme trustee. The RBS Group's intention is for the Main Scheme to be supported by the RFB. Discussions with the pension scheme trustee are ongoing and will be influenced by the RBS Group's overall ring-fence strategy and its pension funding and investment strategies.

If agreement is not reached with the pension trustee, alternative options less favourable to the RBS Group or the Group may need to be developed to meet the requirements of the pension regulations.

The costs associated with the restructuring of the Group's existing defined benefit pension schemes could be material and could result in higher levels of additional contributions than those described above and currently agreed with the pension trustee which could have a material adverse effect on the Group's results of operations, financial position and prospects.

Pension risk also includes the risk that the assets of the RBS Group's various defined benefit pension schemes, including those in which the Group participates, do not fully match the timing and amount of the schemes' liabilities, as a result of which the RBS Group and/or the Group are required or chooses to make additional contributions to address deficits that may emerge. Risk arises from the schemes because the value of the asset portfolios may be less than expected, or may have reduced in value relative to the pension liabilities it supports, and because there may be greater than expected increases in the estimated value of the schemes' liabilities and additional future contributions to the schemes may be required. Pension regulations may also change in a manner adverse to the RBS Group or the Group.

The value of pension scheme liabilities varies with changes to long-term interest rates (including prolonged periods of low interest rates as is currently the case), inflation, monetary policy, pensionable salaries and the longevity of scheme members, as well as changes in applicable legislation.

Given economic and financial market difficulties and volatility, the low interest rate environment and the risk that such conditions may occur again over the near and medium term, some of the RBS Group's pension schemes have experienced increased pension deficits.

The last triennial valuation of the Main scheme, which covers certain of the Group's current or former employees and to which the Group contributes, had an effective date of 31 December 2015. This valuation was concluded with the acceleration of the nominal value of all committed contributions in respect of past service (£4.2 billion), which was paid in the first quarter of 2016. The next triennial period valuation will take place in the fourth quarter of 2018 and the Main scheme pension trustee agreed that it would not seek a new valuation prior to that date, except where a material change arises. The 2018 triennial valuation is expected to result in a significant increase in the regular annual contributions in respect of the ongoing accrual of benefits. Notwithstanding the 2016 accelerated payment and any additional contributions that may be required beforehand as a result of a material change, the RBS Group expects to have to agree to additional contributions, to which the Group may be required to contribute over and above the existing committed past service contributions, as a result of the next triennial valuation. Under current legislation, such agreement would need to be reached no later than the first quarter of 2020. The cost of such additional contributions could be material and any additional contributions that are committed to the Main scheme following new actuarial valuations would trigger the recognition of a significant additional liability on the balance sheet of the Group and/or an increase in any pension surplus derecognised, which in turn could have a material adverse effect on the Group's results of operations, financial position and prospects.

Risk factors continued

Pension risk and changes to the RBS Group's funding of its pension schemes may have a significant impact on the RBS Group's and/or the Group's capital position.

The RBS Group's capital position is influenced by pension risk in several respects: Pillar 1 capital is impacted by the requirement that net pension assets are deducted from capital and that actuarial gains/losses impact reserves and, by extension, CET1 capital; Pillar 2A requirements result in the RBS Group being required to carry a capital add-on to absorb stress on the pension fund and finally the risk of additional contributions to the RBS Group's pension fund is taken into account in the Group's capital framework plan. Changes to the RBS Group's capital position or capital requirements relating to pension risks, are then reflected in the capital which the Group is required to hold, in line with the RBS Group's capital strategy which requires Group entities, including the Group, to maintain adequate capital at all times. In addition, an increase in the pension risk to which the Group is exposed may result in increased regulatory capital requirements applicable to the Group.

The RBS Group believes that the accelerated payment to the RBS Group's Main scheme pension fund made in the first quarter of 2016 improved the RBS Group's and the Group's capital planning and resilience through the period to 2019 and provided the Main Scheme pension trustee with more flexibility over its investment strategy. This payment has resulted in a reduction in prevailing Pillar 2A add-on. However, subsequent contributions required in connection with the 2018 triennial valuation, or otherwise, may adversely impact the RBS Group's and the Group's capital position.

As the RBS Group is unable to recognise any accounting surplus due to constraints under IFRIC 14, any contributions made which increase the accounting surplus, or contributions committed to which would increase the accounting surplus when paid, would have a corresponding negative impact on the RBS Group's capital position.

As a result, if any of these assumptions proves inaccurate, the RBS Group's capital position may significantly deteriorate and fall below the minimum capital requirements applicable to the RBS Group or RBS Group entities (including the Bank), and in turn result in increased regulatory supervision or sanctions, restrictions on discretionary distributions or loss of investor confidence, which could individually or in aggregate have a material adverse effect on the RBS Group's and/or the Group's results of operations, financial prospects or reputation.

The impact of the Group's pension obligations on its results and operations are also dependent on the regulatory environment in which it operates. There is a risk that changes in prudential regulation, pension regulation and accounting standards, or a lack of coordination between such sets of rules, may make it more challenging for the RBS Group to manage its pension obligations resulting in an adverse impact on the RBS Group's CET1 capital.

The Group's businesses are exposed to the effect of movements in currency rates, which could have a material adverse effect on the results of operations, financial condition or prospects of the Group.

The Group's foreign exchange exposure arises from structural foreign exchange risk, including capital deployed in the Group's foreign subsidiaries, branches and joint arrangements, and non-trading foreign exchange risk, including customer transactions and profits and losses that are in a currency other than the functional currency of the transacting entity.

The Group maintains policies and procedures to ensure the impact of exposures to fluctuations in currency rates are minimised. Nevertheless, changes in currency rates, particularly in the sterling-US dollar and euro-sterling exchange rates, affect the value of assets, liabilities, income and expenses denominated in foreign currencies and the reported earnings of the Group's non-UK subsidiaries and may affect the Group's reported consolidated financial condition or its income from foreign exchange dealing.

Changes in foreign exchange rates may result from the decisions of the Bank of England, ECB, the US Federal Reserve and from political or global market events outside the Group's control and lead to sharp and sudden variations in foreign exchange rates, such as those seen in the sterling/US dollar exchange rates since the occurrence of the EU Referendum. Throughout 2017, ongoing UK negotiations to exit the EU have, amongst other factors, resulted in continued volatility in the sterling exchange rate relative to other major currencies. Continued or increasing volatility in currency rates can materially affect the Group's results of operations, financial condition or prospects.

Continued low interest rates have significantly affected and will continue to affect the Group's business and results of operations. A continued period of low interest rates, and yield curves and spreads may affect net interest income, the effect of which may be heightened during periods of liquidity stress.

Interest rate and foreign exchange risks, discussed below, are significant for the Group. Monetary policy has been highly accommodative in recent years, including as a result of certain policies implemented by the Bank of England and HM Treasury such as the Term Funding Scheme, which have helped to support demand at a time of very pronounced fiscal tightening and balance sheet repair. In the UK, the Bank of England lowered interest rates to 0.25% in August 2016 and raised them to 0.5% in November 2017. However, there remains considerable uncertainty as to whether or when the Bank of England and other central banks will further increase interest rates. While the ECB has been conducting a quantitative easing programme since January 2015 designed to improve confidence in the Eurozone and encourage more private bank lending, there remains considerable uncertainty as to whether such measures have been or will be sufficient or successful and the extension of this programme until the end of September 2018 (or beyond) may put additional pressure on margins.

Risk factors continued

Continued sustained low or negative interest rates or any divergences in monetary policy approach between the Bank of England and other major central banks could put further pressure on the Group's interest margins and adversely affect the Group's profitability and prospects. A continued period of low interest rates and yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs, the effect of which may be heightened during periods of liquidity stress.

Conversely while increases in interest rates may support the Group's income, sharp increases in interest rates could lead to generally weaker than expected growth, or even contracting GDP, reduced business confidence, higher levels of unemployment or underemployment, adverse changes to levels of inflation, potentially higher interest rates and falling property prices in the markets in which the Group operates. In turn, this could cause stress in the loan portfolio of the Group, particularly in relation to non-investment grade lending or real estate loans and consequently to an increase in delinquency rates and default rates among customers, leading to the possibility of the Group incurring higher impairment charges. Similar risks result from the exceptionally low levels of inflation in developed economies, which in Europe particularly could deteriorate into sustained deflation if policy measures prove ineffective. Reduced monetary stimulus and the actions and commercial soundness of other financial institutions have the potential to impact market liquidity.

The cost of implementing the Alternative Remedies Package regarding the business previously described as Williams & Glyn could be more onerous than anticipated and any failure to comply with the terms of the Alternative Remedies Package could result in the imposition of additional measures or limitations on the RBS Group's and the Group's operations.

On 18 September 2017, the RBS Group received confirmation that an alternative remedies package announced on 26 July 2017 ('Alternative Remedies Package'), regarding the business previously described as Williams & Glyn, had been formally approved by the European Commission ('EC') in the form proposed.

The Alternative Remedies Package replaced the existing requirement to divest the business previously described as Williams & Glyn by 31 December 2017. The Alternative Remedies Package focusses on the following two remedies to promote competition in the market for banking services to small and medium-sized enterprises ('SMEs') in the UK: (i) a £425 million capability and innovation fund that will grant funding to a range of eligible competitors in the UK banking and financial technology sectors; and (ii) a £275 million incentivised switching scheme which will provide funding for eligible bodies to help them incentivise SME customers of the business previously described as Williams & Glyn to switch their primary accounts and loans from the RBS Group, paid in the form of 'dowries' to business current accounts at the receiving bank.

The RBS Group has also agreed to set aside up to a further £75 million in funding to cover certain costs customers may incur as a result of switching under the incentivised switching scheme. In addition, under the terms of the Alternative Remedies Package, should the uptake within the incentivised switching scheme not be sufficient, RBSG may be required to make a further contribution, capped at £50 million.

An independent body ('Independent Body') is in the process of being established to administer the Alternative Remedies Package. However, the implementation of the Alternative Remedies Package including but not limited to the funding commitments and financial incentives envisaged to be provided under the plan. Implementation of the Alternative Remedies Package could also divert resources from the RBS Group's and the Group's operations and jeopardise the delivery and implementation of other significant plans and initiatives. In addition, under the terms of the Alternative Remedies Package, the Independent Body can require the RBS Group to modify certain aspects of the RBS Group's execution of the incentivised switching scheme, which could increase the cost of implementation. Furthermore, should the uptake within the incentivised switching scheme not be sufficient, the Independent Body can extend the duration of the scheme by up to twelve months and can compel the RBS Group to extend the customer base to which the scheme applies which may result in prolonged periods of disruption to a wider portion of the Group's business.

As a direct consequence of the incentivised switching scheme, the Group will lose existing customers and deposits, which in turn will have adverse impacts on the Group's business and associated revenues and margins. Furthermore, the capability and innovation fund is intended to benefit eligible competitors and negatively impact the Group's competitive position.

To support the incentivised switching initiative, upon request by an eligible bank, the RBS Group has also agreed to grant those customers which have switched to eligible banks under the incentivised switching scheme access to its branch network for cash and cheque handling services, which may result in reputational and financial exposure for the Group and impact customer service quality for the Group's own customers with consequent competitive, financial and reputational implications. The implementation of the incentivised switching scheme is also dependent on the engagement of the eligible banks with the incentivised switching scheme and the application of the eligible banks to and approval by the Independent Body. The incentivised transfer of SME customers to third party banks places reliance on those third parties to achieve satisfactory customer outcomes which could give rise to reputational damage if these are not forthcoming.

A failure to comply with the terms of the Alternative Remedies Package could result in the imposition of additional measures or limitations on the RBS Group's and the Group's operations, additional supervision by the RBS Group's regulators, and loss of investor or customer confidence, any of which could have a material adverse impact on the RBS Group and the Group. Delays in execution may also impact the RBS Group's and the Group's ability to carry out their transformation programme, including the implementation of cost saving initiatives and mandatory regulatory requirements.

Risk factors continued

Such risks will increase in line with any delays.

The Group's earnings and financial condition have been, and its future earnings and financial condition may continue to be, materially affected by depressed asset valuations resulting from poor market conditions.

The Group's businesses and performance are affected by financial market conditions. The performance and volatility of financial markets affect bond and equity prices and have caused, and may in the future cause, changes in the value of the Group's investment and trading portfolios. Financial markets have recently experienced and may in the near term experience significant volatility, including as a result of concerns about Brexit, political and financial developments in the US and in Europe, including as a result of general elections, geopolitical developments and developments relating to trade agreements volatility and instability in the Chinese and global stock markets, expectations relating to or actions taken by central banks with respect to monetary policy, and weakening fundamentals of the Chinese economy, resulting in further short-term changes in the valuation of certain of the Group's assets. Uncertainty about potential fines for past misconduct and concerns about the longer-term viability of business models have also weighed heavily on the valuations of some financial institutions in Europe and in the UK, including the RBS Group.

Any further deterioration in economic and financial market conditions or weak economic growth could require the RBS Group to recognise further significant write-downs and realise increased impairment charges, all of which may have a material adverse effect on its financial condition, results of operations and capital ratios. As part of their transformation programme, the RBS Group and the Group are executing the run-down and sale of certain legacy portfolios and assets. Deteriorating market conditions could extend the time line to achieve this.

Moreover, market volatility and illiquidity (and the assumptions, judgements and estimates in relation to such matters that may change over time and may ultimately not turn out to be accurate) make it difficult to value certain of the Group's exposures. Valuations in future periods reflecting, among other things, the then-prevailing market conditions and changes in the credit ratings of certain of the Group's assets may result in significant changes in the fair values of the Group's exposures, such as credit market exposures, and the value ultimately realised by the Group may be materially different from the current or estimated fair value. As part of its ongoing derivatives operations, the Group also faces significant basis, volatility and correlation risks, the occurrence of which are also impacted by the factors noted above.

In addition, for accounting purposes, the Group carries some of its issued debt, such as debt securities, at the current market price on its balance sheet. Factors affecting the current market price for such debt, such as the credit spreads of the Group, may result in a change to the fair value of such debt, which is recognised in the income statement as a profit or loss.

The Group's businesses are subject to substantial regulation and oversight. Significant regulatory developments and increased scrutiny by the Group's key regulators has had and is likely to continue to increase compliance and conduct risks and could have a material adverse effect on how the Group conducts its business and on its results of operations and financial condition.

The Group is subject to extensive laws, regulations, corporate governance requirements, administrative actions and policies in each jurisdiction in which it operates. Many of these have been introduced or amended recently and are subject to further material changes. Among others, the implementation and strengthening of the prudential and recovery and resolution framework applicable to financial institutions in the UK, the EU and the US, and future amendments to such rules, are considerably affecting the regulatory landscape in which the Group operates and will operate in the future, including as a result of the adoption of rules relating to the UK ring-fencing regime, severe restrictions on proprietary trading, CRD IV and the BRRD and certain other measures. Increased regulatory focus in certain areas, including conduct, consumer protection regimes, anti-money laundering, anti-tax evasion, payment systems, and antiterrorism laws and regulations, have resulted in the Group facing greater regulation and scrutiny in the UK, the US and other countries in which it operates.

Recent regulatory changes, proposed or future developments and heightened levels of public and regulatory scrutiny in the UK, Europe and the US have resulted in increased capital, funding and liquidity requirements, changes in the competitive landscape, changes in other regulatory requirements and increased operating costs, and have impacted, and will continue to impact, product offerings and business models.

Such changes may also result in an increased number of regulatory investigations and proceedings and have increased the risks relating to the Group's ability to comply with the applicable body of rules and regulations in the manner and within the time frames required.

Such risks are currently exacerbated by Brexit and the unprecedented degree of uncertainty as to the respective legal and regulatory frameworks in which the RBS Group and the Group will operate when the UK is no longer a member of the EU. For example, current proposed changes to the European prudential regulatory framework for banks and investment banks may result in additional prudential or structural requirements being imposed on financial institutions based outside the EU wishing to provide financial services within the EU (which may apply to the Group once the UK has formally exited the EU). See 'The Group has been, and will remain, in a period of major business transformation and structural change through to at least 2019 as it implements its own transformation programme and seeks to comply with UK ring-fencing and recovery and resolution requirements as well as the Alternative Remedies Package. Additional structural changes to the Group's operations will also be required as a result of Brexit. These various transformation and restructuring activities are required to occur concurrently, which carries significant execution and operational risks, and the Group may not be a viable, competitive and profitable bank as a result'.

Risk factors continued

In addition, the RBS Group and its counterparties may no longer be able to rely on the European passporting framework for financial services and could be required to apply for authorisation in multiple European jurisdictions, the costs, timing and viability of which is uncertain.

Any of these developments (including failures to comply with new rules and regulations) could have a significant impact on how the Group conduct its business, its authorisations and licenses, the products and services it offers, its reputation and the value of its assets, the Group's operations or legal entity structure, including attendant restructuring costs and consequently have a material adverse effect on its business, funding costs, results of operations, financial condition and prospects.

Areas in which, and examples of where, governmental policies, regulatory and accounting changes and increased public and regulatory scrutiny could have an adverse impact (some of which could be material) on the Group include, but are not limited to, those set out above as well as the following:

- amendments to the framework or requirements relating to the quality and quantity of regulatory capital as well as liquidity and leverage requirements, either on a solo, consolidated or subgroup level (and taking into account the new legal structure of the RBS Group and the Group following the implementation of the UK ring-fencing regime), including amendments to the rules relating to the calculation of risk-weighted assets and reliance on internal models and credit ratings as well as rules affecting the eligibility of deferred tax assets;
- the design and implementation of national or supranational mandated recovery, resolution or insolvency regimes or the implementation of additional or conflicting loss-absorption requirements, including those mandated under UK rules, BRRD, MREL or by the FSB's recommendations on TLAC;
- new or amended regulations or taxes that reduce profits attributable to shareholders which may diminish, or restrict, the accumulation of the distributable reserves or distributable items necessary to make distributions or coupon payments or limit the circumstances in which such distributions may be made or the extent thereof;
- the monetary, fiscal, interest rate and other policies of central banks and other governmental or regulatory bodies;
- further investigations, proceedings or fines either against the RBS Group or the Group in isolation or together with other large financial institutions with respect to market conduct wrongdoing;
- the imposition of government-imposed requirements and/or related fines and sanctions with respect to lending to the UK SME market and larger commercial and corporate entities;
- increased regulatory scrutiny with respect to mortgage lending, including through the implementation of the FCA's UK mortgages market study and other initiatives led by the Bank of England or European regulators;
- concerns expressed by the FPC and PRA around potential systemic risk associated with recent increases in UK consumer lending and the impact of consumer credit losses on banks' resilience in a stress scenario, which the PRA has indicated that it will consider when setting capital buffers for individual banks;
- additional rules and regulatory initiatives and review relating to customer protection, including the FCA's Treating Customers Fairly regime and increased focus by regulators on how institutions conduct business, particularly with regard to the delivery of fair outcomes for customers and orderly/transparent markets;
- the imposition of additional restrictions on the Group's ability to compensate its senior management and other employees and increased responsibility and liability rules applicable to senior and key employees;
- rules and regulations relating to, and enforcement of, anti-corruption, anti-bribery, anti-money laundering, anti-terrorism, sanctions, anti-tax evasion or other similar regimes;
- investigations into facilitation of tax evasion or avoidance or the creation of new civil or criminal offences relating thereto;
- rules relating to foreign ownership, expropriation, nationalisation and confiscation of assets;
- changes to financial reporting standards (including accounting standards or guidance) and guidance or the timing of their implementation;
- changes to risk aggregation and reporting standards;
- changes to corporate governance requirements, senior manager responsibility, corporate structures and conduct of business rules;
- competition reviews and investigations relating to the retail banking sector in the UK, including with respect to SME banking and PCAs;
- financial market infrastructure reforms establishing new rules applying to investment services, short selling, market abuse, derivatives markets and investment funds, including the European Market Infrastructure Regulation and the Markets in Financial Instruments Directive and Regulation in the EU and the Dodd Frank Wall Street Reform Consumer Protection Act of 2010 in the US;
- increased regulatory scrutiny with respect to UK payment systems by the Payments Systems Regulator and the FCA, including in relation to banks' policies and procedures for handling push payment scams;
- increased attention to competition and innovation in UK payment systems and developments relating to the UK initiative on Open Banking and the European directive on payment services;
- new or increased regulations relating to customer data and privacy protection, including the EU General Data Protection Regulation ('GDPR');
- restrictions on proprietary trading and similar activities within a commercial bank and/or a group;

Risk factors continued

- the introduction of, and changes to, taxes, levies or fees applicable to the RBS Group's or the Group's operations, such as the imposition of a financial transaction tax, changes in tax rates, increases in the bank corporation tax surcharge in the UK, restrictions on the tax deductibility of interest payments or further restrictions imposed on the treatment of carry-forward tax losses that reduce the value of deferred tax assets and require increased payments of tax;
- the regulation or endorsement of credit ratings used in the EU (whether issued by agencies in European member states or in other countries, such as the US);
- the Markets in Financial Instruments Directive ('MiFID') regulating the provision of 'investment services and activities' in relation to a range of customer-related areas and the revised directive ('MiFID II') and new regulation (Markets in Financial Instruments Regulation or 'MiFIR') replacing and changing MiFID to include expanded supervisory powers that include the ability to ban specific products, services and practices;
- the European Commission's proposal to impose a requirement for any bank established outside the EU, which has an asset base of a certain size and has two or more institutions within the EU, to establish a single intermediate parent undertaking ('IPU') in the European Union, under which all EU entities within that group would operate; and
- other requirements or policies affecting the Group and its profitability or product offering, including through the imposition of increased compliance obligations or obligations which may lead to restrictions on business growth, product offerings, or pricing.

Changes in laws, rules or regulations, or in their interpretation or enforcement, or the implementation of new laws, rules or regulations, including contradictory laws, rules or regulations by key regulators in different jurisdictions, or failure by the RBS Group or the Group to comply with such laws, rules and regulations, may have a material adverse effect on the Group's business, financial condition and results of operations. In addition, uncertainty and lack of international regulatory coordination as enhanced supervisory standards are developed and implemented may adversely affect the Group's ability to engage in effective business, capital and risk management planning.

The RBS Group and the Group rely on valuation, capital and stress test models to conduct their business, assess their risk exposure and anticipate capital and funding requirements. Failure of these models to provide accurate results or accurately reflect changes in the micro-and macroeconomic environment in which the Group operates or findings of deficiencies by the Group's regulators resulting in increased regulatory capital requirements could have a material adverse effect on the Group's business, capital and results.

Given the complexity of the RBS Group and the Group's business, strategy and capital requirements, the Group relies on analytical models to manage its business, assess the value of its assets and its risk exposure and anticipate capital and funding requirements, including with stress testing. The Group's valuation, capital and stress test models and the parameters and assumptions on which they are based, need to be periodically reviewed and updated to maximise their accuracy.

Failure of these models to accurately reflect changes in the environment in which the Group operates or to be updated in line with the changes in the RBS Group's or the Group's business model or operations, or the failure to properly input any such changes could have an adverse impact on the modelled results or could fail to accurately capture the Group's risk exposure or the risk profile of the Group's financial instruments or result in the RBS Group being required to hold additional capital as a function of the PRA buffer. For example, as the Group implements its transformation programme, including the restructuring and funding of its NatWest Markets franchise, the implementation of the UK ring-fencing regime any impacted models would need to be correctly identified and adapted in line with the implementation process. The Group also uses valuation models that rely on market data inputs. If incorrect market data is input into a valuation model, it may result in incorrect valuations or valuations different to those which were predicted and used by the Group in its forecasts or decision making. Internal stress test models may also rely on different, less severe, assumptions or take into account different data points than those defined by the Group's regulators.

Some of the analytical models used by the Group are predictive in nature. In addition, a number of internal models used by the Group are designed, managed and analysed by the RBS Group and may not appropriately capture risks and exposures relating to the Group's portfolios. Some of the Group's internal models are subject to periodic review by its regulators and, if found deficient, the Group may be required to make changes to such models or may be precluded from using any such models, which could result in an additional capital requirement which could have a material impact on the Group's capital position.

Risk factors continued

The Group could face adverse consequences as a result of decisions which may lead to actions by management based on models that are poorly developed, implemented or used, or as a result of the modelled outcome being misunderstood or such information being used for purposes for which it was not designed. Risks arising from the use of models could have a material adverse effect on the Group's business, financial condition and results of operations, minimum capital requirements and reputation.

The RBS Group is subject to stress tests mandated by its regulators in the UK and in Europe which may result in additional capital requirements or management actions which, in turn, may impact the RBS Group's and/or the Group's financial condition, results of operations and investor confidence or result in restrictions on distributions.

The RBS Group is subject to annual stress tests by its regulator in the UK and also subject to stress tests by the European regulators with respect to RBSG, RBS N.V. and Ulster Bank Ireland DAC. Stress tests provide an estimate of the amount of capital banks might deplete in a hypothetical stress scenario. In addition, if the stress tests reveal that a bank's existing regulatory capital buffers are not sufficient to absorb the impact of the stress, it is possible that it will need to take action to strengthen its capital position.

There is a strong expectation that the PRA would require a bank to take action if, at any point during the stress, a bank were projected to breach any of its minimum CET1 capital or leverage ratio requirements. However, if a bank is projected to fail to meet its systemic buffers, it will still be expected to strengthen its capital position over time but the supervisory response is expected to be less intensive than if it were projected to breach its minimum capital requirements. The PRA will also use the annual stress test results to inform its determination of whether individual banks' current capital positions are adequate or need strengthening. For some banks, their individual stress-test results might imply that the capital conservation buffer and countercyclical rates set for all banks is not consistent with the impact of the stress on them. In that case, the PRA can increase regulatory capital buffers for individual banks by adjusting their PRA buffers.

Under the 2017 Bank of England stress tests, which were based on the balance sheet of the RBS Group for the year ended 31 December 2016, the RBS Group's capital position before the impact of strategic management actions that the PRA judged could realistically be taken in the stress scenario remained below its CET1 capital hurdle rate and above its Tier 1 leverage hurdle rate. After the impact of strategic management actions the Group's capital position would have remained above its CET1 capital hurdle rate, but the PRA judged that RBSG did not meet its systemic reference point in this scenario. Given the steps RBSG had already taken to strengthen its capital position during 2017, the PRA did not require the RBS Group to submit a revised capital plan.

Failure by the RBS Group to meet the thresholds set as part of the stress tests carried out by its regulators in the UK and elsewhere may result in the RBS Group's regulators requiring the RBS Group to generate additional capital, increased supervision and/or regulatory sanctions, restrictions on capital distributions and loss of investor confidence, which may impact the Group's financial condition, results of operations and prospects.

The Group's operations entail inherent reputational risk, i.e., the risk of brand damage and/or financial loss due to a failure to meet stakeholders' expectations of the Group's conduct, performance and business profile.

Brand damage can be detrimental to the business of the Group in a number of ways, including its ability to build or sustain business relationships with customers, low staff morale, regulatory censure or reduced access to, or an increase in the cost of, funding. In particular, negative public opinion resulting from the actual or perceived manner in which the Group or any other member of the RBS Group conducts or modifies its business activities and operations, including as a result of the transformation programme or other restructuring efforts, speculative or inaccurate media coverage, financial performance, ongoing investigations and proceedings and the settlement of any such investigations and proceedings, IT failures or cyber-attacks resulting in the loss or publication of confidential customer data or other sensitive information, the level of direct and indirect government support, or the actual or perceived strength or practices in the banking and financial industry may adversely affect the Group's ability to keep and attract customers and, in particular, corporate and retail depositors.

Modern technologies, in particular online social networks and other broadcast tools which facilitate communication with large audiences in short time frames and with minimal costs, may also significantly enhance and accelerate the impact of damaging information and allegations.

Although the RBS Group has implemented a Reputational Risk Policy across customer-facing businesses (including those of the Group) to improve the identification, assessment and management of customers, transactions, products and issues which represent a reputational risk, the Group cannot ensure that it will be successful in avoiding damage to its business from reputational risk, which could result in a material adverse effect on the Group's business, financial condition, results of operations and prospects.

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Its results in future periods may be affected by changes to applicable accounting rules and standards.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses.

Risk factors continued

Due to the inherent uncertainty in making estimates, results reported in future periods may reflect amounts which differ from those estimates. Estimates, judgements and assumptions take into account historical experience and other factors, including market practice and expectations of future events that are believed to be reasonable under the circumstances.

The accounting policies deemed critical to the Group's results and financial position, based upon materiality and significant judgements and estimates, include goodwill, provisions for liabilities, deferred tax, loan impairment provisions, fair value of financial instruments, which are discussed in detail in 'Critical accounting policies and key sources of estimation uncertainty' on pages 96 to 98. IFRS Standards and Interpretations that have been issued by the International Accounting Standards Board (the IASB) but which have not yet been adopted by the Group are discussed in 'Accounting developments' on pages 98 to 100. Changes in accounting standards or guidance by accounting bodies or in the timing of their implementation, whether mandatory or as a result of recommended disclosure relating to the future implementation of such standards could result in the Group having to recognise additional liabilities on its balance sheet, or in further write-downs or impairments and could also significantly impact the financial results, condition and prospects of the Group.

In July 2014, the IASB published a new accounting standard for financial instruments (IFRS 9) effective for annual periods beginning on or after 1 January 2018. It introduced a new framework for the recognition and measurement of credit impairment, based on expected credit losses, rather than the incurred loss model currently applied under IAS 39. The inclusion of loss allowances with respect to all financial assets that are not recorded at fair value tend to result in an increase in overall impairment balances when compared with the previous basis of measurement under IAS 39. The Group expects IFRS 9 to increase earnings and capital volatility in 2018 and beyond.

The valuation of financial instruments, including derivatives, measured at fair value can be subjective, in particular where models are used which include unobservable inputs. Generally, to establish the fair value of these instruments, the Group relies on quoted market prices or, where the market for a financial instrument is not sufficiently active, internal valuation models that utilise observable market data. In certain circumstances, the data for individual financial instruments or classes of financial instruments utilised by such valuation models may not be available or may become unavailable due to prevailing market conditions. In such circumstances, the Group's internal valuation models require the Group to make assumptions, judgements and estimates to establish fair value, which are complex and often relate to matters that are inherently uncertain. Resulting changes in the fair values of the financial instruments has had and could continue to have a material adverse effect on the Group's earnings, financial condition and capital position.

The Group is exposed to conduct risk which may adversely impact the Group or its employees and may result in conduct having a detrimental impact on the Group's customers or counterparties.

In recent years, the RBS Group, including the Group, has sought to refocus its culture on serving the needs of its customers and continues to redesign many of its systems and processes to promote this focus and strategy. However, the Group is exposed to various forms of conduct risk in its operations. These include business and strategic planning that does not adequately reflect the RBS Group's customers' needs, ineffective management and monitoring of products and distribution, actions taken that may not conform to their customer-centric focus, outsourcing of customer service and product delivery via third parties that do not have appropriate levels of control, oversight and culture, the possibility of alleged mis-selling of financial products or the mishandling of complaints related to the sale of such product, or poor governance of incentives and rewards. Some of these risks have materialised in the past and ineffective management and oversight of conduct issues may result in customers being poorly or unfairly treated and may in the future lead to further remediation and regulatory intervention/enforcement.

The Group's businesses are also exposed to risks from employee misconduct including non-compliance with policies and regulatory rules, negligence or fraud (including financial crimes), any of which could result in regulatory fines or sanctions and serious reputational or financial harm to the RBS Group and the Group. In recent years, a number of multinational financial institutions, including entities within the RBS Group, have suffered material losses due to the actions of employees, including, for example, in connection with the foreign exchange and LIBOR investigations the Group may not succeed in protecting itself from such conduct in the future. It is not always possible to timely detect or deter employee misconduct and the precautions the RBS Group takes to detect and prevent this activity may not always be effective.

The RBS Group and the Group have implemented a number of policies and allocated new resources in order to help mitigate against these risks. The RBS Group and the Group have also prioritised initiatives to reinforce good conduct in their engagement with the markets in which they operate, together with the development of preventative and detective controls in order to positively influence behaviour.

The RBS Group's and the Group's transformation programme is also intended to improve the control environment. Nonetheless, no assurance can be given that the RBS Group's and the Group's strategy and the control framework will be effective and that conduct and financial crime issues will not have an adverse effect on the Group's results of operations, financial condition or prospects.

Risk factors continued

The Group may be adversely impacted if its or the RBS Group's risk management is not effective and there may be significant challenges in maintaining the effectiveness of the Group's risk management framework as a result of the number of strategic and restructuring initiatives being carried out by the RBS Group simultaneously.

The management of risk is an integral part of all of the Group's activities. Risk management includes the definition and monitoring of the RBS Group's risk appetite and reporting of the RBS Group's and the Group's exposure to uncertainty and the consequent adverse effect on profitability or financial condition arising from different sources of uncertainty and risks as described throughout these risk factors.

Ineffective risk management may arise from a wide variety of events and behaviours, including lack of transparency or incomplete risk reporting, unidentified conflicts or misaligned incentives, lack of accountability control and governance, lack of consistency in risk monitoring and management or insufficient challenges or assurance processes.

Failure to manage risks effectively could adversely impact the RBS Group's and/or the Group's reputation or their relationship with their customers, shareholders or other stakeholders, which in turn could have a significant effect on the Group's business prospects, financial condition and results of operations.

Risk management is also strongly related to the use and effectiveness of internal stress tests and models. See 'The RBS Group and the Group rely on valuation, capital and stress test models to conduct their business, assess their risk exposure and anticipate capital and funding requirements. Failure of these models to provide accurate results or accurately reflect changes in the micro-and macroeconomic environment in which the Group operates or findings of deficiencies by the Group's regulators resulting in increased regulatory capital requirements could have a material adverse effect on the Group's business, capital and results.'

A failure by the Group to embed a strong risk culture across the organisation could adversely affect the ability of the RBS Group and the Group to achieve their strategic objectives.

In response to weaknesses identified in previous years, the RBS Group is currently seeking to embed a strong risk culture within the RBS Group (including the Group) based on a robust risk appetite and governance framework.

A key component of this approach is the three lines of defence model designed to identify, manage and mitigate risk across all levels of the organisation. This framework has been implemented and improvements continue and will continue to be made to clarify and improve the three lines of defence and internal risk responsibilities and resources, including in response to feedback from regulators. Notwithstanding the RBS Group's efforts, changing an organisation's risk culture requires significant time, investment and leadership, and such efforts may not insulate the RBS Group or the Group from future instances of misconduct.

A failure by any of these three lines to carry out their responsibilities or to effectively embed this culture could have a material adverse effect on the RBS Group and/or the Group through an inability to achieve their strategic objectives for their customers, employees and wider stakeholders.

As a result of the commercial and regulatory environment in which it operates, the Group may be unable to attract or retain senior management (including members of the board) and other skilled personnel of the appropriate qualification and competence. The Group may also suffer if it does not maintain good employee relations.

The Group's current and future success depend on its ability to attract, retain and remunerate highly skilled and qualified personnel, including senior management (which includes directors and other key employees), in a highly competitive labour market. This cannot be guaranteed, particularly in light of heightened regulatory oversight of banks and the increasing scrutiny of, and (in some cases) restrictions placed upon, employee compensation arrangements, in particular those of banks in receipt of Government support (such as the RBS Group), which may place the Group at a competitive disadvantage. In addition, the market for skilled personnel is increasingly competitive, thereby raising the cost of hiring, training and retaining skilled personnel.

Certain of the Group's directors as well as members of its executive committee and certain other senior managers and employees are also subject to the new responsibility regime introduced under the Banking Reform Act 2013 which introduces clearer accountability rules for those within the new regime. The senior managers' regime and certification regime took effect on 7 March 2016, whilst the conduct rules were applied to the wider employee population from 7 March 2017, with the exception of some transitional provisions. The new regulatory regime may contribute to reduce the pool of candidates for key management and non-executive roles, including non-executive directors with the right skills, knowledge and experience, or increase the number of departures of existing employees, given concerns over the allocation of responsibilities introduced by the new rules.
In addition, in order to ensure the independence of the RFB as part of the implementation of the UK ring-fencing regime, the RBS Group will be required to recruit new independent directors and senior members of management to sit on the boards of directors and board committees of the RFB and other RBS Group entities, and there may be a limited pool of competent candidates from which such appointments can be made.
The RBS Group's evolving strategy has led to the departure of a large number of experienced and capable employees, including Group employees. The restructuring relating to the ongoing implementation of the transformation programme and related cost-reduction targets may cause experienced staff members to leave and prospective staff members not to join the RBS Group, including the Group. The lack of continuity of senior management and the loss of important personnel coordinating certain or several aspects of the RBS Group's restructuring (including those which impact the Group) could have an adverse impact on the Group's business and future success.

Risk factors continued

The failure to attract or retain a sufficient number of appropriately skilled personnel to manage the complex restructuring required to implement the UK ring-fencing regime and the RBS Group's and the Group's strategies could prevent the Group from successfully maintaining its current standards of operation, implementing its strategy and meeting regulatory commitments. This could have a material adverse effect on the Group's business, financial condition and results of operations.

In addition, many of the Group's employees in the UK and other jurisdictions in which the Group operates are represented by employee representative bodies, including trade unions. Engagement with its employees and such bodies is important to the Group and a breakdown of these relationships could adversely affect the Group's business, reputation and results.

HM Treasury (or UKFI on its behalf) may be able to exercise a significant degree of influence over the RBS Group, including indirectly on the Group, and any further offer or sale of its interests may affect the price of securities issued by the RBS Group.

On 6 August 2015, the UK Government made its first sale of RBSG ordinary shares since its original investment in 2009 and sold approximately 5.4% of its stake in RBSG. Following this initial sale, the UK Government exercised its conversion rights under the B Shares on 14 October 2015 which resulted in HM Treasury holding 72.88% of the ordinary share capital of RBSG, and which entity owns all of the Bank's share capital. The UK Government, through HM Treasury, held 70.5% of the issued ordinary share capital of the RBS Group as of 31 December 2017. The UK Government in its November 2017 Autumn Budget indicated its intention to recommence the process for the privatisation of the RBS Group before the end of 2018-2019 and to carry out over the forecast period a programme of sales of RBSG ordinary shares expected to sell down approximately two thirds of HM Treasury's current shareholding in the RBS Group, although there can be no certainty as to the commencement of any sell-downs or the timing or extent thereof.

Any offers or sale, or expectations relating to the timing thereof, of a substantial number of ordinary shares by HM Treasury, could negatively affect prevailing market prices for the outstanding ordinary shares of RBSG and other securities issued by the RBS Group and lead to a period of increased price volatility for the RBS Group's securities. In addition, UKFI manages HM Treasury's shareholder relationship with the RBS Group and, although HM Treasury has indicated that it intends to respect the commercial decisions of the RBS Group and that the RBS Group entities (including the Bank) will continue to have their own independent board of directors and management team determining their own strategies, its position as a majority shareholder (and UKFI's position as manager of this shareholding) means that HM Treasury or UKFI might be able to exercise a significant degree of influence over, among other things, the election of directors and appointment of senior management, the RBS Group's capital strategy, dividend policy, remuneration policy or the conduct of any RBS Group entities, including the Bank.

The manner in which HM Treasury or UKFI exercises HM Treasury's rights as majority shareholder could give rise to conflicts between the interests of HM Treasury and the interests of other shareholders. The Board of RBSG has a duty to promote the success of the RBS Group for the benefit of its members as a whole.

The Group operates in markets that are subject to intense scrutiny by the competition authorities and its business and results of operations could be materially affected by competition decisions and other regulatory interventions.

The competitive landscape for banks and other financial institutions in the UK, the rest of Europe and the US is changing rapidly. Recent regulatory and legal changes have and may continue to result in new market participants and changed competitive dynamics in certain key areas, such as in retail and SME banking in the UK where the introduction of new entrants is being actively encouraged by the UK Government. The competitive landscape in the UK is also likely to be affected by the UK Government's implementation of the UK ring-fencing regime and other customer protection measures introduced by the Banking Reform Act 2013. The implementation of these reforms may result in the consolidation of newly separated businesses or assets of certain financial institutions with those of other parties to realise new synergies or protect their competitive position and is likely to increase competitive pressures on the Group.

The UK retail banking sector has been subjected to intense scrutiny by the UK competition authorities and by other bodies, including the FCA, in recent years, including with a number of reviews/inquiries being carried out, including market reviews conducted by the CMA and its predecessor the Office of Fair Trading regarding SME banking and personal banking products and services, the Independent Commission on Banking and the Parliamentary Commission on Banking Standards. These reviews raised significant concerns about the effectiveness of competition in the retail banking sector.

The CMA's Retail Banking Market Investigation report sets out measures primarily intended to make it easier for consumers and businesses to compare PCA and SME bank products, increase the transparency of price comparison between banks and amend PCA overdraft charging. The CMA is working with HM Treasury and other regulators to implement these remedies which are likely to impose additional compliance requirements on the RBS Group and the Group and could, in aggregate, adversely impact the Group's competitive position, product offering and revenues.

Adverse findings resulting from current or future competition investigations may result in the imposition of reforms or remedies which may impact the competitive landscape in which the RBS Group or the Group operate or result in restrictions on mergers and consolidations within the UK financial sector.

The impact of any such developments in the UK will become more significant as the Group's business becomes increasingly concentrated in the UK retail sector.

Risk factors continued

These and other changes to the competitive framework in which the Group operates could have a material adverse effect on the Group's business, margins, profitability, financial condition and prospects.

RBSG and its subsidiaries, including the Bank, are subject to an evolving framework on recovery and resolution, the impact of which remains uncertain, and which may result in additional compliance challenges and costs.

In the EU, the UK and the US, regulators have implemented or are in the process of implementing recovery and resolution regimes designed to prevent the failure of financial institutions and resolution tools to ensure the timely and orderly resolution of financial institutions without use of public funds. These initiatives have been complemented by a broader set of initiatives to improve the resilience of financial institutions and reduce systemic risk, including the UK ring-fencing regime, the introduction of certain prudential requirements and powers under CRD IV, and certain other measures introduced under the BRRD, including the requirements relating to loss absorbing capacity.

The BRRD, which was implemented in the UK from January 2015, provides a framework for the recovery and resolution of credit institutions and investment firms, their subsidiaries and certain holding companies in the EU, and the tools and powers introduced under the BRRD include preparatory and preventive measures, early supervisory intervention powers and resolution tools.

Implementation of certain provisions of the BRRD remains subject to secondary rulemaking as well as a review by the European Parliament and the European Commission of certain topics mandated by the BRRD. In November 2016, as a result of this review, the European Commission published a package of proposals seeking to introduce certain amendments to CRD IV and the BRRD. These proposals are now subject to further discussions and negotiations among the European institutions and it is not possible to anticipate their final content. Further amendments to the BRRD or the implementing rules in the EU or the UK may also be necessary to ensure continued consistency with the FSB recommendations on key attributes of national resolution regimes and resolution planning for G-SIBs, including with respect to TLAC and MREL requirements.

In light of these potential developments as well as the impact of Brexit, there remains uncertainty as to the rules which may apply to the RBS Group going forward.

In addition, banks headquartered in countries which are members of the Eurozone are now subject to the European banking union framework. In November 2014, the ECB assumed direct supervisory responsibility for RBS N.V. and Ulster Bank Ireland DAC under the Single Supervisory Mechanism (SSM). As a result of the above, there remains uncertainty as to how the relevant resolution regimes in force in the UK, the Eurozone and other jurisdictions, would interact in the event of a resolution of the RBS Group, although it remains clear that the Bank of England, as UK resolution authority, would be responsible for resolution of the RBS Group overall (consistent with the RBS Group's single point of entry bail-in resolution strategy, as determined by the Bank of England)

The BRRD requires national resolution funds to raise 'ex ante' contributions on banks and investment firms in proportion to their liabilities and risk profiles and allow them to raise additional 'ex post' funding contributions in the event the ex-ante contributions do not cover the losses, costs or other expenses incurred by use of the resolution fund. Although receipts from the UK bank levy are currently being used to meet the ex-ante and ex post funding requirements, the RBS Group may be required to make additional contributions in the future. In addition, RBS Group entities in countries subject to the European banking union are required to pay supervisory fees towards the funding of the SSM as well as contributions to the single resolution fund.

The recovery and resolution regime implementing the BRRD in the UK places compliance and reporting obligations on the RBS Group and the Group. These compliance and reporting obligations may result in increased costs, including as a result of the RBS Group's mandatory participation in resolution funds, and heightened compliance risks, and the RBS Group may not be in a position to comply with all such requirements within the prescribed deadlines or at all. In addition to the costs associated with the issuance of MREL-eligible debt securities and compliance with internal MREL requirements, further changes may be required for the RBS Group and the Group to enhance their resolvability, in particular due to regulatory requirements relating to operational continuity and valuations capabilities in resolution.

In July 2016, the PRA adopted a new framework requiring financial institutions to ensure the continuity of critical shared services (provided by entities within the group or external providers) to facilitate recovery action, orderly resolution and post-resolution restructuring, which will apply from 1 January 2019.

The application of such rules to the RBS Group requires the RBS Group to restructure certain of its activities relating to the provision of services from one legal entity to another within the RBS Group, may limit the RBS Group's ability to outsource certain functions and/or may result in increased costs resulting from the requirement to ensure the financial and operational resilience and independent governance of such critical services. Any such developments could have a material adverse impact on the Group.

In August 2017, the Bank of England published a consultation paper setting out its preliminary views on the valuation capabilities that firms should have in place prior to resolution. The Bank of England has not yet published a final statement of policy in this area. Achieving compliance with the expectations set out in any such statement of policy, once finalised, may require changes to the RBS Group's existing valuation processes and/or the development of additional capabilities, infrastructure and processes. The RBS Group may incur costs in complying with such obligations, which costs may increase if the Bank of England determined that the RBS Group's valuation capabilities constitute an impediment to resolution and subsequently exercised its statutory power to direct the RBS Group to take measures to address such impediment.

Risk factors continued

In addition, compliance by the RBS Group with this recovery and resolution framework has required and is expected to continue to require significant work and engagement with the RBS Group's regulators, including in order for the RBS Group to continue to submit to the PRA an annual recovery plan assessed as meeting regulatory requirements and to be assessed as resolvable by the Bank of England. The outcome of this regulatory dialogue may impact the operations or structure of the RBS Group or the Group, or otherwise result in increased costs, including as a result of the Bank of England's power under section 3A of the Banking Act to direct institutions to address impediments to resolvability.

The RBS Group may become subject to the application of stabilisation or resolution powers in certain significant stress situations, which may result in various actions being taken in relation to the RBS Group and any securities of the RBS Group, including the Group, including the write-off, write-down or conversion of securities issued by the RBS Group or the Group.

The Banking Act 2009, as amended to implement the BRRD (Banking Act) confers substantial powers on relevant UK authorities designed to enable them to take a range of actions in relation to UK banks or investment firms and certain of their affiliates in the event a bank or investment firm in the same group is considered to be failing or likely to fail. Under the Banking Act, wide powers are granted to the Bank of England (as the relevant resolution authority), as appropriate as part of a special resolution regime (the SRR). These powers enable the Bank of England to implement resolution measures with respect to a UK bank or investment firm and certain of its affiliates (including, for example, RBSG) (each a relevant entity) in circumstances in which the relevant UK resolution authorities are satisfied that the resolution conditions are met. Under the applicable regulatory framework and pursuant to guidance issued by the Bank of England, governmental financial support, if any is provided, would only be used as a last resort measure where a serious threat to financial stability cannot be avoided by other measures (such as the stabilisation options described below, including the UK bail-in power) and subject to the limitations set out in the Banking Act.

Several stabilisation options and tools are available to the Bank of England under the SRR, where a resolution has been triggered.

In addition, the Bank of England may commence special administration or liquidation procedures specifically applicable to banks. Where stabilisation options are used which rely on the use of public funds, such funds can only be used once there has been a contribution to loss absorption and recapitalisation of at least 8% of the total liabilities of the institution under resolution. The Bank of England has indicated that among these options, the UK bail-in tool (as described further below) would apply in the event a resolution of the RBS Group were triggered.

Further, the Banking Act grants broad powers to the Bank of England, the application of which may adversely affect contractual arrangements and which include the ability to (i) modify or cancel contractual arrangements to which an entity in resolution is party, in certain circumstances; (ii) suspend or override the enforcement provisions or termination rights that might be invoked by counterparties facing an entity in resolution, as a result of the exercise of the resolution powers; and (iii) disapply or modify laws in the UK (with possible retrospective effect) to enable the powers under the Banking Act to be used effectively.

The stabilisation options are intended to be applied prior to the point at which any insolvency proceedings with respect to the relevant entity would otherwise have been initiated. Accordingly, the stabilisation options may be exercised if the relevant UK resolution authority: (i) is satisfied that a UK bank or investment firm is failing, or is likely to fail; (ii) determines that it is not reasonably likely that (ignoring the stabilisation powers) action will be taken by or in respect of a UK bank or investment firm that will result in condition (i) above ceasing to be met; (iii) considers the exercise of the stabilisation powers to be necessary, having regard to certain public interest considerations (such as the stability of the UK financial system, public confidence in the UK banking system and the protection of depositors, being some of the special resolution objectives) and (iv) considers that the special resolution objectives would not be met to the same extent by the winding-up of the UK bank or investment firm.

In the event that the Bank of England seeks to exercise its powers in relation to a UK banking group company (such as RBSG), the relevant UK resolution authority has to be satisfied that (A) the conditions set out in (i) to (iv) above are met in respect of a UK bank or investment firm in the same banking group (or, in respect of an EEA or third country credit institution or investment firm in the same banking group, the relevant EEA or third country resolution authority is satisfied that the conditions for resolution applicable in its jurisdiction are met) and (B) certain criteria are met, such as the exercise of the powers in relation to such UK banking group company being necessary having regard to public interest considerations.

The use of different stabilisation powers is also subject to further 'specific conditions' that vary according to the relevant stabilisation power being used. Although the SRR sets out the pre-conditions for determining whether an institution is failing or likely to fail, it is uncertain how the relevant UK resolution authority would assess such conditions in any particular pre-insolvency scenario affecting RBSG and/or other members of the RBS Group (including the Bank) and in deciding whether to exercise a resolution power.

There has been no application of the SRR powers in the UK to a large financial institution, such as RBSG, to date, which could provide an indication of the relevant UK resolution authority's approach to the exercise of the resolution powers, and even if such examples existed, they may not be indicative of how such powers would be applied to RBSG.

Risk factors continued

Therefore, holders of shares and other securities issued by RBS Group entities may not be able to anticipate a potential exercise of any such powers.

The UK bail-in tool is one of the powers available to the Bank of England under the SRR and was introduced under the Banking Reform Act 2013. The UK government amended the provisions of the Banking Act to ensure the consistency of these provisions with the bail-in provisions under the BRRD, which amendments came into effect on 1 January 2015. The UK bail-in tool includes both a power to write-down or convert capital instruments and triggered at the point of non-viability of a financial institution and a bail-in tool applicable to eligible liabilities (including senior unsecured debt securities issued by the RBS Group) and available in resolution.

The capital instruments write-down and conversion power may be exercised independently of, or in combination with, the exercise of a resolution tool, and it allows resolution authorities to cancel all or a portion of the principal amount of capital instruments and/or convert such capital instruments into common equity Tier 1 instruments when an institution is no longer viable. The point of non-viability for such purposes is the point at which the Bank of England or the PRA determines that the institution meets certain conditions under the Banking Act, for example if the institution will no longer be viable unless the relevant capital instruments are written down or extraordinary public support is provided, and without such support the appropriate authority determines that the institution would no longer be viable. The Bank of England may exercise the power to write down or convert capital instruments without any further exercise of resolution tools, as may be the case where the write-down or conversion of capital instruments is sufficient to restore an institution to viability.

Where the conditions for resolution exist and it is determined that a stabilisation power may be exercised, the Bank of England may use the bail-in tool (in combination with other resolution tools under the Banking Act) to, among other things, cancel or reduce all or a portion of the principal amount of, or interest on, certain unsecured liabilities of a failing financial institution and/or convert certain debt claims into another security, including ordinary shares of the surviving entity.

In addition, the Bank of England may use the bail-in tool to, among other things, replace or substitute the issuer as obligor in respect of debt instruments, modify the terms of debt instruments (including altering the maturity (if any) and/or the amount of interest payable and/or imposing a temporary suspension on payments) and discontinue the listing and admission to trading of financial instruments. The exercise of the bail-in tool will be determined by the Bank of England which will have discretion to determine whether the institution has reached a point of non-viability or whether the conditions for resolution are met, by application of the relevant provisions of the Banking Act, and involves decisions being taken by the PRA and the Bank of England, in consultation with the FCA and HM Treasury. As a result, it will be difficult to predict when, if at all, the exercise of the bail-in power may occur.

The potential impact of these powers and their prospective use may include increased volatility in the market price of shares and other securities issued by RBS Group entities, as well as increased difficulties for RBSG or other RBS Group entities in issuing securities in the capital markets and increased costs of raising such funds.

If these powers were to be exercised (or there is an increased risk of exercise) in respect of the RBS Group or any entity within the RBS Group (including the Bank), such exercise could result in a material adverse effect on the rights or interests of RBSG shareholders which would likely be extinguished or very heavily diluted. Holders of debt securities (which may include holders of RBSG senior unsecured debt), may see the conversion of part (or all) of their claims into equity or written down in part or written off entirely. In accordance with the rules of the Special Resolution Regime, the losses imposed on holders of equity and debt instruments through the exercise of bail-in powers would be subject to the ‘no creditor worse off’ safeguard, which requires losses (net of any compensation received) not to exceed those which would be realised in an insolvency counterfactual.

Although the above represents the risks associated with the UK bail-in power currently in force in the UK and applicable to the RBS Group, changes to the scope of, or conditions for the exercise of the UK bail-in power may be introduced as a result of further political or regulatory developments. For example, the application of these powers to internally-issued MREL instruments, issued by one group entity and held solely by its parent entity, is currently being consulted on by the Bank of England. In addition, further political, legal or strategic developments may lead to structural changes to the RBS Group, including at the holding company level. Notwithstanding any such changes, the RBS Group expects that its securities would remain subject to the exercise of a form of bail-in power, either pursuant to the provisions of the Banking Act, the BRRD or otherwise.

The value or effectiveness of any credit protection that the Group has purchased depends on the value of the underlying assets and the financial condition of the insurers and counterparties.

The Group has some remaining credit exposure arising from over-the-counter derivative contracts, mainly credit default swaps (CDSs), and other credit derivatives, each of which are carried at fair value.

The fair value of these CDSs, as well as the Group’s exposure to the risk of default by the underlying counterparties, depends on the valuation and the perceived credit risk of the instrument against which protection has been bought. Many market counterparties have been adversely affected by their exposure to residential mortgage-linked and corporate credit products, whether synthetic or otherwise, and their actual and perceived creditworthiness may deteriorate rapidly. If the financial condition of these counterparties or their actual or perceived creditworthiness deteriorates, the Group may record further credit valuation adjustments on the credit protection bought from these counterparties under the CDSs. The Group also recognises any fluctuations in the fair value of other credit derivatives.

Risk factors continued

Any such adjustments or fair value changes may have a material adverse impact on the Group's financial condition and results of operations.

In the UK and in other jurisdictions, the RBS Group and the Group are 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 UK, the Financial Services Compensation Scheme ('FSCS') was established under the Financial Services and Markets Act 2000 and is the UK's statutory fund of last resort for customers of authorised financial services firms. The FSCS pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising levies on the industry, including the RBS Group and the Group. In relation to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits.

In the event that the FSCS needs to raise additional and unexpected funding, is required to raise funds more frequently or significantly increases the levies to be paid by authorised firms, the associated costs to the RBS Group or the Group may have an adverse impact on the RBS Group's and/or the Group's results of operations and financial condition.

To the extent that other jurisdictions where the RBS Group operates have introduced or plan to introduce similar compensation, contributory or reimbursement schemes, the RBS Group and the Group may make further provisions and may incur additional costs and liabilities, which may have an adverse impact on the Group's financial condition and results of operations.

The Group intends to execute the run-down and/or the sale of certain portfolios and assets. Failure by the Group to do so on commercially favourable terms could have a material adverse effect on the Group's operations, operating results, financial position and reputation.

The Group's ability to execute the run-down and/or sale of certain portfolios and assets and the price achieved for such disposals will be dependent on prevailing economic and market conditions.

As a result, there is no assurance that the Group will be able to sell or run down these portfolios or assets either on favourable economic terms to the Group or at all or that it may do so within the intended timetable. Material tax or other contingent liabilities could arise on the disposal or run-down of assets and there is no assurance that any conditions precedent agreed will be satisfied, or consents and approvals required will be obtained in a timely manner or at all. The Group may be exposed to deteriorations in the portfolios or assets being sold between the announcement of the disposal and its completion, which period may span many months.

In addition, the Group may be exposed to certain risks, including risks arising out of ongoing liabilities and obligations, breaches of covenants, representations and warranties, indemnity claims, transitional services arrangements and redundancy or other transaction-related costs, and counterparty risk in respect of buyers of assets being sold.

The occurrence of any of the risks described above could have a material adverse effect on the Group's business, results of operations, financial condition and capital position and consequently may have the potential to impact the competitive position of part or all of the Group's business.

The Group's results could be adversely affected in the event of goodwill impairment.

The Group capitalises goodwill, which is calculated as the excess of the cost of an acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Acquired goodwill is recognised initially at cost and subsequently at cost less any accumulated impairment losses. As required by IFRS Standards, the Group tests goodwill for impairment annually, or more frequently when events or circumstances indicate that it might be impaired. An impairment test involves comparing the recoverable amount (the higher of the value in use and fair value less cost to sell) of an individual cash generating unit with its carrying value. At 31 December 2017, the Group carried goodwill of £5.2 billion on its balance sheet. The value in use and fair value 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, but it has no effect on the Group's regulatory capital position. Further impairments of the Group's goodwill could have an adverse effect on the Group's results and financial condition.

Changes in tax legislation or failure to generate future taxable profits may impact the recoverability of certain deferred tax assets recognised by the Group.

In accordance with IFRS Standards, the Group has recognised deferred tax assets on losses available to relieve future profits from tax only to the extent it is probable that they will be recovered. The deferred tax assets are quantified on the basis of current tax legislation and accounting standards and are subject to change in respect of the future rates of tax or the rules for computing taxable profits and offsetting allowable losses.

Failure to generate sufficient future taxable profits or further changes in tax legislation (including rates of tax) or accounting standards may reduce the recoverable amount of the recognised deferred tax assets. Changes to the treatment of deferred tax assets may impact the Group's capital, for example by reducing further the Group's ability to recognise deferred tax assets.

The implementation of the rules relating to the UK ring-fencing regime and the resulting restructuring of the Group may further restrict the Group's ability to recognise tax deferred tax assets in respect of brought forward losses.

Abbreviations and acronyms

ABS	Asset-backed securities
AFS	Available-for-sale
ALCo	Asset and Liability Management Committee
AQ	Asset quality
AT1	Additional Tier 1
BCBS	Basel Committee on Banking Supervision
BoE	Bank of England
C&RA	Conduct & Regulatory Affairs
CDO	Collateralised debt obligation
CDS	Credit default swap
CEC	Control Environment Certification
CET1	Common equity tier 1
CFG	Citizens Financial Group Inc.
CIB	Corporate & Institutional Banking
CLO	Collateralised loan obligation
CMBS	Commercial mortgage-backed securities
CPB	Commercial & Private Banking
CRD	Capital Requirements Directive
CRE	Commercial real estate
CVA	Credit valuation adjustment
DFV	Designated as at fair value through profit or loss
DVA	Debit valuation adjustment
EAD	Exposure at default
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
ECL	Expected credit losses
EMEA	Europe, the Middle East and Africa
ERF	Executive Risk Forum
EU	European Union
FCA	Financial Conduct Authority
FI	Financial institution
FSA	Financial Services Authority
FSB	Financial Stability Board
FSCS	Financial Services Compensation Scheme
FVTPL	Fair value through profit or loss
GDP	Gross domestic product
GSIB	Global systemically important bank
HFT	Held-for-trading
HMT	HM Treasury
HTM	Held-to-maturity
IAS	International Accounting Standards
IASB	International Accounting Standards Board
ICAAP	Internal Capital Adequacy Assessment Process

IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IPV	Independent price verification
IRC	Incremental risk charge
IRHP	Interest rate hedging product
L-SREP	Liquidity Supervisory Review and Evaluation Process
LAR	Loans and receivables
LCR	Liquidity coverage ratio
LIBOR	London Interbank Offered Rate
LGD	Loss given default
LTI	Long term incentive awards
LTV	Loan-to-value
MDA	Maximum distributable amount
MREL	Minimum requirement for own funds and eligible liabilities
NI	Northern Ireland
NSFR	Net stable funding ratio
NTIRR	Non-traded interest rate risk
NWM	NatWest Markets
PBB	Personal & Business Banking
PD	Probability of default
PPI	Payment Protection Insurance
PRA	Prudential Regulation Authority
RBSG	The Royal Bank of Scotland Group plc
RCR	RBS Capital Resolution
REIL	Risk elements in lending
RFB	Ring-fenced Banking
RFS	RFS Holdings B.V.
RMBS	Residential mortgage-backed securities
RNIV	Risks not In VaR
ROI	Republic of Ireland
RoW	Rest of the World
RWA	Risk-weighted asset
SE	Structured entity
SEC	US Securities and Exchange Commission
SME	Small and medium-sized enterprise
SVaR	Stressed value-at-risk
TLAC	Total loss absorbing capacity
UBI DAC	Ulster Bank Ireland Designated Activity Company
UK	United Kingdom
UKFI	UK Financial Investments Limited
US/USA	United States of America
VaR	Value-at-risk

In the Report and Accounts, and unless specified otherwise, the terms 'the Royal Bank', 'RBS plc' or 'the Bank' mean The Royal Bank of Scotland plc, the 'Group' means the Bank and its subsidiaries, 'RBSG' or the 'holding company' mean The Royal Bank of Scotland Group plc' and 'RBS Group' means the holding company and its subsidiaries, and 'NatWest' means National Westminster Bank Plc.

The Bank publishes its financial statements in pounds sterling ('£' or 'sterling'). The abbreviations '£m' and '£bn' represent millions and thousands of millions of pounds sterling, respectively, and references to 'pence' represent pence in the United Kingdom ('UK'). Reference to 'dollars' or '$' are to United States of America ('US') dollars. The abbreviations '$m' and '$bn' represent millions and thousands of millions of dollars, respectively, and references to 'cents' represent cents in the US. The abbreviation '€' represents the 'euro', and the abbreviations '€m' and '€bn' represent millions and thousands of millions of euros, respectively

Glossary of terms

Arrears - the aggregate of contractual payments due on a debt that have not been met by the borrower. A loan or other financial asset is said to be 'in arrears' when payments have not been made.

Asset-backed commercial paper (ABCP) - a form of asset-backed security generally issued by a commercial paper conduit.

Asset-backed securities (ABS) - securities that represent interests in specific portfolios of assets. They are issued by a structured entity following a securitisation. The underlying portfolios commonly comprise residential or commercial mortgages but can include any class of asset that yields predictable cash flows. Payments on the securities depend primarily on the cash flows generated by the assets in the underlying pool and other rights designed to assure timely payment, such as guarantees or other credit enhancements. Collateralised debt obligations, collateralised loan obligations, commercial mortgage backed securities and residential mortgage backed securities are all types of ABS.

Asset quality (AQ) band - probability of default banding for all counterparties on a scale of 1 to 10.

Assets under management - assets managed by the Group on behalf of clients.

Back-testing - statistical techniques that assess the performance of a model, and how that model would have performed had it been applied in the past.

Basel II - the capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the 'International Convergence of Capital Measurement and Capital Standards'.

Basel III - in December 2010, the Basel Committee on Banking Supervision issued final rules: 'Basel III: A global regulatory framework for more resilient banks and banking systems' and 'Basel III: International framework for liquidity risk measurement, standards and monitoring'.

Basis point - one hundredth of a per cent i.e. 0.01 per cent. 100 basis points is 1 per cent. Used when quoting movements in interest rates or yields on securities.

Buy-to-let mortgages - mortgages to customers for the purchase of residential property as a rental investment.

Capital requirements regulation (CRR) - refer to CRD IV.

Central counterparty (CCP) - an intermediary between a buyer and a seller (generally a clearing house).

Certificates of deposit (CDs) - bearer negotiable instruments acknowledging the receipt of a fixed term deposit at a specified interest rate.

Collateralised debt obligations (CDOs) - asset-backed securities for which the underlying asset portfolios are debt obligations: either bonds (collateralised bond obligations) or loans (collateralised loan obligations) or both. The credit exposure underlying synthetic CDOs derives from credit default swaps. The CDOs issued by an individual vehicle are usually divided in different tranches: senior tranches (rated AAA), mezzanine tranches (AA to BB), and equity tranches (unrated). Losses are borne first by the equity securities, next by the junior securities, and finally by the senior securities; junior tranches offer higher coupons (interest payments) to compensate for their increased risk.

Collateralised loan obligations (CLOs) - asset-backed securities for which the underlying asset portfolios are loans, often leveraged loans.

Collectively assessed loan impairment provisions - impairment loss provisions in respect of impaired loans, such as credit cards or personal loans, that are below individual assessment thresholds. Such provisions are established on a portfolio basis, taking account of the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends.

Commercial mortgage backed securities (CMBS) - asset-backed securities for which the underlying asset portfolios are loans secured on commercial real estate.

Commercial paper (CP) - unsecured obligations issued by a corporate or a bank directly or secured obligations (asset-backed CP), often issued through a commercial paper conduit, to fund working capital. Maturities typically range from two to 270 days. However, the depth and reliability of some CP markets means that issuers can repeatedly roll over CP issuance and effectively achieve longer term funding. CP is issued in a wide range of denominations and can be either discounted or interest-bearing.

Commercial paper conduit - a structured entity 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 liquidity drawings.

Commercial real estate - freehold and leasehold properties used for business activities. Commercial real estate includes office buildings, industrial property, medical centres, hotels, retail stores, shopping centres, agricultural land and buildings, warehouses, garages etc.

Common Equity Tier 1 capital - the highest quality form of regulatory capital under Basel III comprising common shares issued and related share premium, retained earnings and other reserves excluding reserves which are restricted or not immediately available, less specified regulatory adjustments.

Contractual maturity - the date in the terms of a financial instrument on which the last payment or receipt under the contract is due for settlement.

Glossary of terms

Cost:income ratio - operating expenses as a percentage of total income.

Counterparty credit risk - the risk that a counterparty defaults before the maturity of a derivative or sale and repurchase contract. In contrast to non-counterparty credit risk, the exposure to counterparty credit risk varies by reference to a market factor (e.g. interest rate, exchange rate, asset price).

Coverage ratio - impairment provisions as a percentage of impaired loans.

Covered bonds - debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds.

CRD IV - the European Union has implemented the Basel III capital proposals through the CRR and the CRD, collectively known as CRD IV. CRD IV was implemented on 1 January 2014. The EBA's technical standards are still to be finalised through adoption by the European Commission and implemented within the UK.

Credit default swap (CDS) - a contract where the protection seller receives premium or interest-related payments in return for contracting to make payments to the protection buyer upon a defined credit event in relation to a reference financial asset or portfolio of financial assets. Credit events usually include bankruptcy, payment default and rating downgrades.

Credit derivative product company (CDPC) - a structured entity that sells credit protection under credit default swaps or certain approved forms of insurance policies. CDPCs are similar to monoline insurers. However, unlike monoline insurers, they are not regulated as insurers.

Credit derivatives - contractual agreements that provide protection against a credit event on one or more reference entities or financial assets. The nature of a credit event is established by the protection buyer and protection seller at the inception of a transaction, and such events include bankruptcy, insolvency or failure to meet payment obligations when due. The buyer of the credit derivative pays a periodic fee in return for a payment by the protection seller upon the occurrence of a credit event. Credit derivatives include credit default swaps, total return swaps and credit swap options.

Credit enhancements - techniques that improve the credit standing of financial obligations; generally those issued by a structured entity in a securitisation. External credit enhancements include financial guarantees and letters of credit from third party providers. Internal enhancements include excess spread - the difference between the interest rate received on the underlying portfolio and the coupon on the issued securities; and over-collateralisation – at inception, the value of the underlying portfolio is greater than the securities issued.

Credit grade - a rating that represents an assessment of the creditworthiness of a customer. It is a point on a scale representing the probability of default of a customer.

Credit risk - the risk of financial loss due to the failure of a customer, or counterparty, to meet its obligation to settle outstanding amounts.

Credit risk mitigation - reducing the credit risk of an exposure by application of techniques such as netting, collateral, guarantees and credit derivatives.

Credit valuation adjustment (CVA) - the CVA is the difference between the risk-free value of a portfolio of trades and its market value, taking into account the counterparty's risk of default. It represents the market value of counterparty credit risk, or an estimate of the adjustment to fair value that a market participant would make to reflect the creditworthiness of its counterparty.

Currency swap - an arrangement in which two parties exchange specific principal amounts of different currencies at inception and subsequently interest payments on the principal amounts. Often, one party will pay a fixed rate of interest, while the other will pay a floating rate (though there are also fixed-fixed and floating-floating currency swaps). At the maturity of the swap, the principal amounts are usually re-exchanged.

Customer accounts - money deposited with the Group by counterparties other than banks and classified as liabilities. They include demand, savings and time deposits; securities sold under repurchase agreements; and other short term deposits. Deposits received from banks are classified as deposits by banks.

Debit valuation adjustment (DVA) - an adjustment made in valuing OTC derivative liabilities to reflect the entity's own credit risk.

Debt securities - transferable instruments creating or acknowledging indebtedness. They include debentures, bonds, certificates of deposit, notes and commercial paper. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue, such as the right to receive certain information. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured or unsecured.

Debt securities in issue - unsubordinated debt securities issued by the Group. They include commercial paper, certificates of deposit, bonds and medium-term notes.

Deferred tax asset - income taxes recoverable in future periods as a result of deductible temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in tax deductible amounts in future periods) and the carry-forward of tax losses and unused tax credits.

Deferred tax liability - income taxes payable in future periods as a result of taxable temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in taxable amounts in future periods).

Defined benefit obligation - the present value of expected future payments required to settle the obligations of a defined benefit plan resulting from employee service.

Glossary of terms

Defined benefit plan/scheme - pension or other post-retirement benefit plan other than a defined contribution plan.

Defined contribution plan/scheme - pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.

Deposits by banks - money deposited with the Group by banks and recorded as liabilities. They include money-market deposits, securities sold under repurchase agreements, federal funds purchased and other short term deposits. Deposits received from customers are recorded as customer accounts.

Derivative - a contract or agreement whose value changes with changes in an underlying variable such as interest rates, foreign exchange rates, share prices or indices and which requires no initial investment or an initial investment that is smaller than would be required for other types of contracts with a similar response to market factors. The principal types of derivatives are: swaps, forwards, futures and options.

Discontinued operation - a component of the Group that either has been disposed of or is classified as held for sale. A discontinued operation is either: a separate major line of business or geographical area of operations or part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or a subsidiary acquired exclusively with a view to resale.

Economic capital - an internal measure of the capital required by the Group to support the risks to which it is exposed.

Economic profit - the difference between the return on shareholders funds and the cost of that capital. Economic profit is usually expressed as a percentage.

Effective interest rate method - the effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees payable or receivable that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows.

Encumbrance - an interest in an asset held by another party. Encumbrance usually restricts the asset's transferability until the encumbrance is removed.

Equity risk - the risk of changes in the market price of the equities or equity instruments arising from positions, either long or short, in equities or equity-based financial instruments.

Eurozone - the 19 European Union countries that have adopted the euro: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

Expected credit loss (ECL, an IFRS 9 accounting measure) – generally is the weighted average of credit losses; for collectively assessed portfolios it is the product of the exposure, probability of default at the reporting date and the lifetime loss given default. At initial recognition of a financial asset, an allowance is made for the 12 month expected credit loss, using the probability of default in the first 12 months only. On a significant increase in credit risk, the expected credit loss is increased to the lifetime probability of default. ECL is applied to exposures to all financial assets and contractual facilities whose performance is not recognised at fair value in the income statement.

Expected loss (EL, a regulatory measure) – is the product of the regulatory credit exposure, the probability of default over the next 12 months, averaged through an economic cycle, and the downturn loss given default. It is applied to exposures whether performance is recognised in income or reserves. Credit exposures include all financial assets, customer facilities and are subject to regulatory overlays.

Exposure - a claim, contingent claim or position which carries a risk of financial loss.

Exposure at default (EAD) - an estimate of the extent to which the bank will be exposed under a specific facility, in the event of the default of a counterparty.

FICO score - a credit score calculated using proprietary software developed by the Fair Isaac Corporation in the US from a consumer's credit profile. The scores range between 300 and 850 and are used in credit decisions made by banks and other providers of credit.

Financial Conduct Authority (FCA) - the statutory body responsible for conduct of business regulation and supervision of UK authorised firms from 1 April 2013. The FCA also has responsibility for the prudential regulation of firms that do not fall within the PRA's scope.

Financial Services Compensation Scheme (FSCS) - the UK's statutory fund of last resort for customers of authorised financial services firms. It pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the financial services industry.

First/second lien - a lien is a charge such as a mortgage held by one party, over property owned by a second party, as security for payment of some debt, obligation, or duty owed by that second party. The holder of a first lien takes precedence over all other encumbrances on that property i.e. second and subsequent liens.

Forbearance - forbearance takes place when a concession is made on the contractual terms of a loan in response to a customer's financial difficulties.

Forward contract - a contract to buy (or sell) a specified amount of a physical or financial commodity, at an agreed price, at an agreed future date.

Futures contract - a contract which provides for the future delivery (or acceptance of delivery) of some type of financial instrument or commodity under terms established at the outset. Futures differ from forward contracts in that they are standardised and traded on recognised exchanges and rarely result in actual delivery; most contracts are closed out prior to maturity by acquisition of an offsetting position.

G10 - the Group of Ten comprises the eleven industrial countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States) that have agreed to participate in the International Monetary Fund's (IMF's) General Arrangements to Borrow.

Government Sponsored Enterprises (GSEs) - a group of financial services corporations created by the US Congress. Their function is to improve the efficiency of capital markets and to overcome statutory and other market imperfections which otherwise prevent funds from moving easily from suppliers of funds to areas of high loan demand. They include the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association.

Gross yield - the interest rate earned on average interest-earning assets i.e. interest income divided by average interest-earning assets.

Haircut - a downward adjustment to collateral value to reflect its nature and any currency or maturity mismatches between the collateral and the exposure it secures.

Hedge funds - pooled investment vehicles that are not widely available to the public; their assets are managed by professional asset managers who participate in the performance of the fund.

Impaired loans - all loans for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans.

Impairment allowance - refer to Loan impairment provisions.

Impairment losses - (a) for impaired financial assets measured at amortised cost, impairment losses - the difference between carrying value and the present value of estimated future cash flows discounted at the asset's original effective interest rate - are recognised in profit or loss and the carrying amount of the financial asset reduced by establishing a provision (allowance) (b) for impaired available-for-sale financial assets, the cumulative loss that had been recognised directly in equity is removed from equity and recognised in profit or loss as an impairment loss.

Individual liquidity guidance (ILG) - guidance from the PRA on a firm's required quantity of liquidity resources and funding profile.

Individually assessed loan impairment provisions - impairment loss provisions for individually significant impaired loans assessed on a case-by-case basis, taking into account the financial condition of the counterparty and any guarantor and the realisable value of any collateral held.

Interest rate swap - a contract under which two counterparties agree to exchange periodic interest payments on a predetermined monetary principal, the notional amount.

Interest spread - the difference between the gross yield and the interest rate paid on average interest-bearing liabilities.

Internal Capital Adequacy Assessment Process (ICAAP) - the Group's own assessment, as part of Basel III requirements, of its risks, how it intends to mitigate those risks and how much current and future capital is necessary having considered other mitigating factors.

Internal funding of trading business - the internal funding of the trading book comprises net banking book financial liabilities that fund financial assets in the Group's trading portfolios. Interest payable on these financial liabilities is charged to the trading book.

Internal Liquidity Adequacy Assessment Process (ILAAP) an ongoing exercise as part of the PRA's regulatory framework to comply with best practice and regulatory standards for liquidity management.

International Accounting Standards Board (IASB) - the independent standard-setting body of the IFRS Foundation. Its members are responsible for the development and publication of International Financial Reporting Standards (IFRSs) and for approving Interpretations of IFRS as developed by the IFRS Interpretations Committee.

International Swaps and Derivatives Association (ISDA) master agreement - a standardised contract developed by ISDA for bilateral derivatives transactions. The contract grants legal rights of set-off for derivative transactions with the same counterparty.

Investment grade - generally represents a risk profile similar to a rating of BBB-/Baa3 or better, as defined by independent rating agencies.

Key management - members of the RBS Group Executive Committee.

L-SREP - An annual Liquidity Supervisory Review and Evaluation Process with the PRA, that involves a comprehensive review of the RBS ILAAP, liquidity policies and risk management framework.

Latent loss provisions - loan impairment provisions held against impairments in the performing loan portfolio that have been incurred as a result of events occurring before the balance sheet date but which have not been identified at the balance sheet date.

Level 1 - level 1 fair value measurements are derived from quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

Level 2 - level 2 fair value measurements use inputs, other than quoted prices included within level 1, that are observable for the asset or liability, either directly or indirectly.

Level 3 - level 3 fair value measurements use one or more unobservable inputs for the asset or liability.

Glossary of terms

Leverage ratio - a measure prescribed under Basel III. It is the ratio of Tier 1 capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives, and generally follow the accounting measure of exposure.

Liquidity and funding risk - the risk that the Group is unable to meet its financial liabilities when they fall due.

Liquidity coverage ratio (LCR) - the ratio of the stock of high quality liquid assets to expected net cash outflows over the following 30 days. High quality liquid assets should be unencumbered, liquid in markets during a time of stress and, ideally, central bank eligible.

Loan:deposit ratio - the ratio of loans and advances to customers net of provision for impairment losses and excluding reverse repurchase agreements to customer deposits excluding repurchase agreements.

Loan impairment provisions - loan impairment provisions are established to recognise incurred impairment losses on a portfolio of loans classified as loans and receivables and carried at amortised cost. It has three components: individually assessed loan impairment provisions, collectively assessed loan impairment provisions and latent loss provisions.

Loan-to-value ratio - the amount of a secured loan as a percentage of the appraised value of the security e.g. the outstanding amount of a mortgage loan as a percentage of the property's value.

London Interbank Offered Rate (LIBOR) - the benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.

Loss given default (LGD) - an estimate of the amount that will not be recovered by the Group in the event of default, plus the cost of debt collection activities and the delay in cash recovery.

Market risk - the risk of loss arising from fluctuations in interest rates, credit spreads, foreign currency rates, equity prices, commodity prices and other risk-related factors such as market volatilities that may lead to a reduction in earnings, economic value or both.

Master netting agreement - an agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.

Maximum distributable amount (MDA) - a restriction on distributions which may be made by a bank which does not meet the combined buffer requirements as set out in the PRA Supervisory Statement SS6/14 'Implementing CRD IV: capital buffers'.

Medium term notes (MTNs) - debt securities usually with a maturity of five to ten years, but the term may be less than one year or as long as 50 years. They can be issued on a fixed or floating coupon basis or with an exotic coupon; with a fixed maturity date (non-callable) or with embedded call or put options or early repayment triggers. MTNs are generally issued as senior unsecured debt.

Minimum requirement for own funds and eligible liabilities (MREL) – Tier 1 and Tier 2 capital plus specific loss absorbing instruments, including senior notes, that may be used to cover certain gone concern requirements in the EU.

Monoline insurers (monolines) - entities that specialise in providing credit protection against the notional and interest cash flows due to the holders of debt instruments in the event of default. This protection is typically in the form of derivatives such as credit default swaps.

Model Risk Management - performs independent model validation for material models where necessary.

Mortgage-backed securities - asset-backed securities for which the underlying asset portfolios are loans secured on property. See Residential mortgage backed securities and Commercial mortgage backed securities.

Mortgage servicing rights - the rights of a mortgage servicer to collect mortgage payments and forward them, after deducting a fee, to the mortgage lender.

Net interest income - the difference between interest receivable on financial assets classified as loans and receivables or available-for-sale and interest payable on financial liabilities carried at amortised cost.

Net interest margin - net interest income as a percentage of average interest-earning assets.

Net stable funding ratio (NSFR) - the ratio of available stable funding to required stable funding over a one year time horizon, assuming a stressed scenario. Available stable funding includes items such as equity capital, preferred stock with a maturity of over one year and liabilities with an assessed maturity of over one year.

Non-performing loans - loans classified as Risk elements in lending and potential problem loans. They have a 100% probability of default and have been assigned an AQ10 internal credit grade.

Operational risk - the risk of loss resulting from inadequate or failed processes, people, systems or from external events.

Option - an option is a contract that gives the holder the right but not the obligation to buy (or sell) a specified amount of an underlying physical or financial commodity, at a specific price, at an agreed date or over an agreed period. Options can be exchange-traded or traded over-the-counter.

Over-the-counter (OTC) derivatives - derivatives with tailored terms and conditions negotiated bilaterally, in contrast to exchange traded derivatives that have standardised terms and conditions.

Own credit adjustment (OCA) - the effect of the Group's own credit standing on the fair value of financial liabilities.

Past due - a financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.

Pillar 1 - the part of CRD IV that sets out the process by which regulatory capital requirements should be calculated for credit, market and operational risk.

Pillar 2 - Pillar 2 is intended to ensure that firms have adequate capital to support all the relevant risks in their business and is divided into capital held against risks not captured or not fully captured by the Pillar 1 regulations (Pillar 2A) and risks to which a firm may become exposed over a forward-looking planning horizon (Pillar 2B). Capital held under Pillar 2A, in addition to the Pillar 1 requirements, is the minimum level of regulatory capital a bank should maintain at all times to cover adequately the risks to which it is or might be exposed, and to comply with the overall financial adequacy rules. Pillar 2B is a capital buffer which helps to ensure that a bank can continue to meet minimum requirements during a stressed period, and is determined by the PRA evaluating the risks to which the firm may become exposed (e.g. due to changes to the economic environment) during the supervisory review and evaluation process. All firms will be subject to a PRA buffer assessment and the PRA will set a PRA buffer only if it judges that the CRD IV buffers are inadequate for a particular firm given its vulnerability in a stress scenario, or where the PRA has identified risk management and governance failings, which the CRD IV buffers are not intended to address.

Pillar 3 - the part of CRD IV that sets out the information banks must disclose about their risks, the amount of capital required to absorb them, and their approach to risk management. The aim is to strengthen market discipline.

Potential future exposure - is a measure of counterparty risk/credit risk. It is calculated by evaluating existing trades done against the possible market prices in future during the lifetime of the transactions.

Potential problem loans (PPL) - loans for which an impairment event has taken place but no impairment loss is expected. This category is used for advances which are not past due 90 days or revolving credit facilities where identification as 90 days overdue is not feasible.

PRA Rule Book - contains provisions made by the PRA that apply to PRA authorised firms. Within 'Banking and Investment Rules', the Capital Requirements firms' section applies to the Group.

Private equity - equity investments in operating companies not quoted on a public exchange. Capital for private equity investment is raised from retail or institutional investors and used to fund investment strategies such as leveraged buyouts, venture capital, growth capital, distressed investments and mezzanine capital.

Probability of default (PD) - the likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon.

Prudential Regulation Authority (PRA) - the statutory body responsible for the prudential supervision of banks, building societies, insurers and a small number of significant investment firms in the UK. The PRA is a subsidiary of the Bank of England.

Regulatory capital - the amount of capital that the Group holds, determined in accordance with rules established by the PRA for the consolidated Group and by local regulators for individual Group companies.

Repurchase agreement (Repo) - refer to Sale and repurchase agreements.

Residential mortgage - a loan to purchase a residential property where the property forms collateral for the loan. The borrower gives the lender a lien against the property and the lender can foreclose on the property if the borrower does not repay the loan per the agreed terms. Also known as a home loan.

Residential mortgage backed securities (RMBS) - asset-backed securities for which the underlying asset portfolios are residential mortgages. RBS Group RMBS classifications, including prime, non-conforming and sub-prime, reflect the characteristics of the underlying mortgage portfolios. RMBS are classified as prime RMBS where the loans have low default risk and are made to borrowers with good credit records and reliable payment histories and there is full documentation. Non-conforming RMBS include US Alt-A RMBS, together with RMBS in jurisdictions other than the US where the underlying mortgages are not classified as either prime or sub-prime. Classification of RMBS as subprime or Alt-A is based on Fair Isaac Corporation (FICO) scores, level of documentation and loan-to-value ratios of the underlying mortgage loans. US RMBS are classified as sub-prime if the mortgage portfolio comprises loans with FICO scores between 500 and 650 with full or limited documentation. Mortgages in Alt-A RMBS portfolios have FICO scores of 640 to 720, limited documentation and an original LTV of 70% to 100%. In other jurisdictions, RMBS are classified as sub-prime if the mortgage portfolio comprises loans with one or more high risk characteristics such as: unreliable or poor payment histories; high loan-to-value ratios; high debt-to-income ratio; the loan is not secured on the borrower's primary residence; or a history of delinquencies or late payments on the loan.

Retail loans - loans made to individuals rather than institutions. The loans may be for car purchases, home purchases, medical care, home repair, holidays and other consumer uses.

Return on equity - profit attributable to ordinary shareholders divided by average shareholders' equity as a percentage.

Reverse repurchase agreement (Reverse repo) - refer to Sale and repurchase agreements.

Risk appetite - an expression of the maximum level of risk that the Group is prepared to accept to deliver its business objectives.

Risk asset ratio (RAR) - total regulatory capital as a percentage of risk-weighted assets.

Risk elements in lending (REIL) - impaired loans and accruing loans which are contractually overdue 90 days or more as to principal or interest.

Risk-weighted assets (RWAs) - assets adjusted for their associated risks using weightings established in accordance with the CRD IV as implemented by the PRA. Certain assets are not weighted but deducted from capital.

Sale and repurchase agreements - in a sale and repurchase agreement one party, the seller, sells a financial asset to another party, the buyer, at the same time the seller agrees to reacquire and the buyer to resell the asset at a later date. From the seller's perspective such agreements are repurchase agreements (repos) and from the buyer's reverse repurchase agreements (reverse repos).

Securitisation - a process by which assets or cash flows are transformed into transferable securities. The underlying assets or cash flows are transferred by the originator or an intermediary, typically an investment bank, to a structured entity which issues securities to investors. Asset securitisations involve issuing debt securities (asset-backed securities) that are backed by the cash flows of income-generating assets (ranging from credit card receivables to residential mortgage loans).

Settlement balances - payables and receivables that result from purchases and sales of financial instruments recognised on trade date. Asset settlement balances are amounts owed to the Group in respect of sales and liability settlement balances are amounts owed by the Group in respect of purchases.

Sovereign exposures - exposures to governments, ministries, departments of governments and central banks.

Standardised approach - a method used to calculate credit risk capital requirements under Pillar 1. In this approach the risk weights used in the capital calculation are determined by regulators. For operational risk, capital requirements are determined by multiplying three years' historical gross income by a percentage determined by the regulator. The percentage ranges from 12 to 18%, depending on the type of underlying business being considered.

Standstill - is an agreement, usually for a specified period of time, not to enforce the lender's rights as a result of a customer breaching the terms and conditions of their facilities. This is a concession to the customer. A standstill is most commonly used in a complex restructuring of a company's debts, where a group of creditors agree to delay enforcement action to give the company time to gather information and formulate a strategy with a view to establishing a formal restructuring.

Stress testing - a technique used to evaluate the potential effects on an institution's financial condition of an exceptional but plausible event and/or movement in a set of financial variables.

Stressed value-at-risk (SVaR) - a VaR measure using historical data from a one year period of stressed market conditions. For the purposes of calculating regulatory SVaR, a time horizon of ten trading days is assumed at a confidence level of 99%. Refer also to Value-at-risk below.

Structured credit portfolio (SCP) - a portfolio of certain illiquid assets - principally CDO super senior positions, negative basis trades and monoline exposures.

Structured entity (SE) - an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose, they do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions.

Structured notes - securities that pay a return linked to the value or level of a specified asset or index. Structured notes can be linked to equities, interest rates, funds, commodities and foreign currency.

Subordinated liabilities - liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.

Super senior CDO - the most senior class of instrument issued by a CDO vehicle. They benefit from the subordination of all other instruments, including AAA rated securities, issued by the CDO vehicle.

Tier 1 capital - a component of regulatory capital, comprising Common Equity Tier 1 and Additional Tier 1. Additional Tier 1 capital includes eligible non-common equity capital securities and any related share premium. Under Basel II, Tier 1 capital comprises Core Tier 1 capital plus other Tier 1 securities in issue, less certain regulatory deductions.

Tier 2 capital - qualifying subordinated debt and other Tier 2 securities in issue, eligible collective impairment allowances less certain regulatory deductions.

Total loss absorbing capacity (TLAC) - a Financial Stability Board requirement for global systemically important banks to have a sufficient amount of specific types of liabilities which can be used to absorb losses and recapitalise a bank in resolution. The implementation of the TLAC requirements is being discussed within local regulators.

Unaudited - financial information that has not been subjected to the audit procedures undertaken by the Group's auditors to enable them to express an opinion on the Group's financial statements.

US Federal Agencies - are independent bodies established by the US Government for specific purposes such as the management of natural resources, financial oversight or national security. A number of agencies, including, the Government National Mortgage Association, issue or guarantee publicly traded debt securities.

Value-at-risk (VaR) - a technique that produces estimates of the potential loss in the market value of a portfolio over a specified time period at a given confidence level.

Wholesale funding - wholesale funding comprises Deposits by banks, Debt securities in issue and Subordinated liabilities.

Write-down - a reduction in the carrying value of an asset to record a decline in its fair value or value in use.

Forward-looking statements

Cautionary statement regarding forward-looking statements
Certain sections in this document contain ‘forward-looking statements’ as that term is defined in the United States Private Securities Litigation Reform Act of 1995, such as statements that include the words ‘expect’, ‘estimate’, ‘project’, ‘anticipate’, ‘commit’, ‘believe’, ‘should’, ‘intend’, ‘plan’, ‘could’, ‘probability’, ‘risk’, ‘Value-at-Risk (VaR)’, ‘target’, ‘goal’, ‘objective’, ‘may’, ‘endeavour’, ‘outlook’, ‘optimistic’, ‘prospects’ and similar expressions or variations on these expressions.

In particular, this document includes forward-looking statements relating, but not limited to: future profitability and performance, including financial performance targets such as return on tangible equity; cost savings and targets, including cost:income ratios; litigation and government and regulatory investigations, including the timing and financial and other impacts thereof; structural reform and the implementation of the UK ring-fencing regime; the implementation of RBSG’s transformation programme, including the restructuring of the NatWest Markets franchise; the satisfaction of RBSG’s residual EU State Aid obligations; the continuation of RBSG’s and the Group’s balance sheet reduction programme, including the reduction of risk-weighted assets (RWAs) and the timing thereof; capital and strategic plans and targets; capital, liquidity and leverage ratios and requirements, including CET1 Ratio, RWA equivalents (RWAe), Pillar 2 and other regulatory buffer requirements, minimum requirement for own funds and eligible liabilities, and other funding plans; funding and credit risk profile; capitalisation; portfolios; net interest margin; customer loan and income growth; the level and extent of future impairments and write-downs, including with respect to goodwill; restructuring and remediation costs and charges; future pension contributions; and RBSG’s and the Group’s exposure to political risks, operational risk, conduct risk, cyber and IT risk and credit rating risk and to various types of market risks, including as interest rate risk, foreign exchange rate risk and commodity and equity price risk; customer experience including our Net Promotor Score (NPS); employee engagement and gender balance in leadership positions.

Limitations inherent to forward-looking statements
These statements are based on current plans, estimates, targets and projections, and are subject to significant inherent risks, uncertainties and other factors, both external and relating to the RBS Group and the Group’s strategy or operations, which may result in the Group being unable to achieve the current targets, predictions, expectations and other anticipated outcomes expressed or implied by such forward-looking statements. In addition certain of these disclosures are dependent on choices relying on key model characteristics and assumptions and are subject to various limitations, including assumptions and estimates made by management. By their nature, certain of these disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated. Accordingly, undue reliance should not be placed on these statements.

Forward-looking statements speak only as of the date we make them and we expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the RBSG’s or the Group’s expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Important factors that could affect the actual outcome of the forward-looking statements
We caution you that a large number of important factors could adversely affect our results or our ability to implement our strategy, cause us to fail to meet our targets, predictions, expectations and other anticipated outcomes or affect the accuracy of forward-looking statements we describe in this document including in the risk factors set out in the Group’s 2017 Annual Report and other risk factors and uncertainties discussed in this document.

These include the significant risks for RBSG and the Group presented by: the Bank’s ability to access sources of liquidity and funding; the outcomes of the legal, regulatory and governmental actions and investigations that RBSG and the Group are or may be subject to and any resulting material adverse effect on RBSG and the Group of unfavourable outcomes and the timing thereof (including where resolved by settlement); economic, regulatory and political risks, including as may result from the uncertainty arising from Brexit and from the outcome of general elections in the UK and changes in government policies; RBSG’s ability to satisfy its residual EU State Aid obligations and the timing thereof; RBSG’s ability to successfully implement the significant and complex restructuring required to be undertaken in order to implement the UK ring fencing regime and related costs; RBSG’s ability to successfully implement the various initiatives that are comprised in its restructuring and transformation programme, particularly the proposed further restructuring of the NatWest Markets franchise, the balance sheet reduction programme and its significant cost-saving initiatives and whether RBSG and the Group will be a viable, competitive, customer focused and profitable bank especially after its restructuring and the implementation of the UK ring-fencing regime; the reorganisation of the Bank by way of a capital reduction; the dependence of the Group’s operations on its and RBS Group’s IT systems; the exposure of RBSG and the Group to cyber-attacks and their ability to defend against such attacks; the Group’s reliance on the RBS Group for capital, liquidity and funding support; RBSG’s and the Group’s ability to achieve their capital, funding, liquidity and leverage requirements or targets which will depend in part on RBSG and the Group’s success in reducing the size of their business and future profitability as well as developments which may impact its CET1 capital including additional litigation or conduct costs, additional pension contributions, further impairments or accounting changes; ineffective management of capital or changes to regulatory requirements relating to capital adequacy and liquidity or failure to pass mandatory stress tests; RBSG’s and the Group’s ability to access sufficient sources of capital, liquidity and funding when required; changes in the credit ratings of RBSG, the Bank or the UK government; declining revenues resulting from lower customer retention and revenue generation in light of RBSG’s and the Group’s strategic refocus on the UK; as well as increasing competition from new incumbents and disruptive technologies.

In addition, there are other risks and uncertainties that could adversely affect our results, ability to implement our strategy, cause us to fail to meet our targets or the accuracy of forward-looking statements in this document. These include operational risks that are inherent to the Group’s business and will increase as a result of RBSG’s and the Group’s significant restructuring and transformation initiatives being concurrently implemented; the potential negative impact on RBSG’s and the Group’s business of global economic and financial market conditions and other global risks, including risks arising out of geopolitical events and political developments; the impact of a prolonged period of low interest rates or unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices; basis, volatility and correlation risks; the extent of future write-downs and impairment charges caused by depressed asset valuations; deteriorations in borrower and counterparty credit quality; heightened regulatory and governmental scrutiny (including by competition authorities) and the increasingly regulated environment in which RBSG and the Group operate as well as divergences in regulatory requirements in the jurisdictions in which RBSG and the Group operate; the risks relating to RBSG’s or the Group’s IT systems or a failure to protect themselves and their customers against cyber threats, reputational risks; risks relating to increased pension liabilities and the impact of pension risk on RBSG’s and the Group’s capital positions; risks relating to the failure to embed and maintain a robust conduct and risk culture across the organisation or if their risk management framework is ineffective; the Group’s ability to attract and retain qualified personnel; limitations on, or additional requirements imposed on, the Group’s activities as a result of HM Treasury’s investment in RBSG; the value and effectiveness of any credit protection purchased by the Group; risks relating to the reliance on valuation, capital and stress test models and any inaccuracies resulting therefrom or failure to accurately reflect changes in the micro and macroeconomic environment in which the Group operates, risks relating to changes in applicable accounting policies or rules which may impact the preparation of RBSG’s and the Group’s financial statements or adversely impact their capital positions; the impact of the recovery and resolution framework and other prudential rules to which RBSG and the Group are subject; the application of stabilisation or resolution powers in significant stress situations; contribution to relevant compensation schemes; the execution of the run-down and/or sale of certain portfolios and assets; the recoverability of deferred tax assets by the Group; and the success of RBSG and the Group in managing the risks involved in the foregoing.

The forward-looking statements contained in this document speak only as at the date hereof, and RBSG and the Group do not assume or undertake any obligation or responsibility to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The information, statements and opinions contained in this document do not constitute a public offer under any applicable legislation or an offer to sell or solicit of any offer to buy any securities or financial instruments or any advice or recommendation with respect to such securities or other financial instruments.

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