**Company Registered Number: R0000733**

# ULSTER BANK LIMITED

## REPORT OF THE DIRECTORS AND FINANCIAL STATEMENTS

**31 December 2013**

**Ulster Bank Group Secretariat**
**Ulster Bank Limited**
**11-16 Donegall Square East**
**Belfast**
**BT1 5UB**

# ULSTER BANK LIMITED

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# ULSTER BANK LIMITED

## BOARD OF DIRECTORS AND SECRETARIES

| | |
|---|---|
| **DIRECTORS:** | S Bell<br>J Brown<br>C Campbell<br>N Hamilton<br>A McLaughlin<br>C M Mills<br>P Nolan (Chairman)<br>D O'Shea<br>R Quinlan<br>B Rosewell<br>P Stanley |
| **REGISTERED OFFICE:** | 11–16 Donegall Square East<br>Belfast<br>BT1 5UB |
| **SECRETARIES:** | R Bergin<br>S Anderson (Joint secretary)<br>E Dignam (Deputy secretary) |
| **AUDITORS:** | Deloitte & Touche<br>Chartered Accountants & Statutory Audit Firm<br>Deloitte and Touche House<br>Earlsfort Terrace<br>Dublin 2 |

# ULSTER BANK LIMITED

## STRATEGIC REPORT

The directors of Ulster Bank Limited ("the Bank") present their report, together with audited financial statements of the Bank and its subsidiaries (together "the Group" or "Ulster Bank Group") for the year ended 31 December 2013. The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union (EU).

### Principal activities

The Group's principal operating entities are leading retail and commercial banks in Northern Ireland and the Republic of Ireland, operating under the Ulster Bank brand. The Group provides a comprehensive range of financial services through both its Retail Banking and Corporate Banking divisions. Retail Banking provides loan and deposit products through a network of branches and direct channels, including telephony, the internet and mobile apps. Corporate Banking provides services to business and corporate customers, including small and medium enterprises.

### Business review

In November 2013 The Royal Bank of Scotland Group ("the RBS Group"), of which the Ulster Bank Group is a subsidiary, announced its intention to establish the RBS Capital Resolution Group ("RCR") from January 2014. RCR will manage the accelerated reduction in non-performing, capital intensive assets from the balance sheet. This will ultimately strengthen the capital position of the RBS Group, speed up the recovery in its core businesses and accelerate the path to privatisation.

RCR will manage a portfolio of Ulster Bank Group loans and advances. These assets will remain on the Ulster Bank Group balance sheet with the intention that 85% of the RCR assets will be managed down by specialist teams, through a range of strategies, by the end of 2016. A portfolio of c. £8 billion of assets was identified for management by RCR. Realising these assets over a shorter timeframe will reduce the value that the Ulster Bank Group can expect to recover and therefore additional impairments of £2,818m have been recognised on these assets in December 2013. This brings the total Ulster Bank Group impairment charge for the year to £4,794m (2012: £2,340m).

Whilst elevated levels of impairment continued to materially impact Ulster Bank Group's performance in 2013, the impairment charge excluding the impact of RCR fell by 16% to £1,976m (2012: £2,340m). This is most evident in the Retail Banking division with the 2013 impairment charge falling by 63% to £258m (2012: £698m) as a result of stabilising house prices combined with improved collections and recoveries activity. Effective customer engagement by the Group through collections and recoveries and better engagement from customers have resulted in a continued reduction in the percentage of mortgage customers more than 90 days in arrears to 12.1% (2012: 13.2%).

A modest return to economic growth in both the Republic of Ireland and Northern Ireland in the latter stages of 2013 is encouraging. There have been positive trends reported in residential property prices, the rate of unemployment and overall economic activity in both markets, particularly in the Republic of Ireland. The directors believe that these positive economic indicators, along with the strategies being implemented will lead to improved future results.

The Group's objective is to become a customer centric, sustainable, "really good bank" whilst dealing with its legacy issues. To achieve the goal of becoming a "really good bank" the Group is implementing changes to simplify its operating model, leveraging RBS Group capabilities and programmes and targeting sectors in which it has a competitive advantage. The Group is committed to reshaping distribution, driving deposit growth, improving margins and fees while optimising its capital position. It is proactively tackling a variety of legacy issues, managing risk and benefitting from the commitment and engagement of its staff. In addition to RCR, measures employed to effectively deal with the Group's legacy issues include developing its collections and recoveries and asset management capabilities.

The Group has established a set of key performance indicators (KPIs) to track its progress towards its objectives:

| | **2013** | 2012 |
|---|---|---|
| Loan:deposit ratio(1) | **129%** | 155% |
| Net interest margin | **1.19%** | 1.29% |
| Cost:income ratio | **63%** | 74% |
| Transactions through digital channels | **51%** | 43% |

(1) The loan:deposit ratio is calculated using the Group's net loans to customers

The loan:deposit ratio improved during the year due principally to the effect of increased impairments, driven by the implementation of RCR.

The drivers of the changes in net interest margin and the cost:income ratio are discussed further in the financial performance section of this report.

**STRATEGIC REPORT**

**Business review (continued)**

In 2013 the Group launched the Think Outside The Bank programme to roll out to its staff the Group's values of serving customers, working together, doing the right thing and thinking long term. The programme has resulted in an enhanced focus on the customer across all aspects of the Group's operations. The impact of the renewed focus on customer service can be seen in the Group's improved net promoter score, which measures how likely the Group's customers are to recommend it to friends and colleagues. The Group's Republic of Ireland business is the top ranked bank for net promoter score in that market

As part of the Group's strategy of reshaping distribution a significantly enhanced mobile app was launched in 2013 with a multi-channel marketing campaign which has contributed to an 8% increase in transactions now being carried out through digital channels.

In November 2013 the RBS Group also announced that it was initiating a review of all of its on-going businesses, the results of which will be announced in conjunction with the RBS Group full year results on 27 February 2014. The review is considering three areas: what the RBS Group can do to meet more of its customers' needs; the RBS Group's IT systems and the organisation of the RBS Group. Ulster Bank Group is part of the review and its directors and executives are actively engaged with RBS Group senior management in contributing to the outcome.

*Financial performance*

The Group's financial performance is presented in the Consolidated Income Statement on page 9.

The Group's total loss after tax for the year ended 31 December 2013 increased to £4,193m (2012: restated £2,204m) mainly as a result of the increase in the impairment charge from £2,340m to £4,794m, as noted previously.

Net interest income decreased by 7% due to the reduction in the loan book and an increase in the non-performing loans, this was partially mitigated by actions taken on deposits pricing.

Non-interest income increased from £260m to £493m as a result of a £239m gain on the buy back of externally issued debt and £38m as a result of an interest rate swap hedging the basis risk on the Republic of Ireland tracker mortgage book. These were offset by a £28m movement in the credit value adjustment, a charge linked to the Group's customer credit risk on derivatives.

Operating expenses increased by 2% year on year as a result of one-off costs associated with legacy issues, specifically interest rate hedging products ("IRHP") and payment protection insurance ("PPI") redress and administration costs and the impact of mandatory change programmes, including Single European Payments Area, and an increase in the recharge of central RBS Group costs to Ulster Bank Ireland Group. These were offset by the reduction in costs arising from the 2012 technology incident which severely impacted the Ulster Bank Group.

At the year end the total assets of the Group were £40,182m (2012: restated £44,650m, 2011: restated £48,917m).

The Group and Bank financial statements have been restated as a result of a change in accounting standards affecting how the Group accounts for its defined benefits pension schemes. IAS 19 'Employee Benefits' (revised) was implemented from 1 January 2013, the most significant impact of which on the Group's reporting is the requirement to discontinue the 'corridor approach' to accounting for actuarial gains and losses. The impact of the change in accounting policy is detailed in Note 34 to the financial statements.

*Risk management*

The major risks associated with the Group's businesses are market, liquidity, credit, regulatory, reputational, conduct, operational and sovereign risk, with the principal risk associated with the Group's business being credit risk. The Group has established a comprehensive framework for managing these risks, which is continually evolving as the Group's business activities change in response to market, credit, product, regulatory and other developments. The Group is also exposed to risks from its defined benefit pension schemes. The Group's policies for managing each of these risks and its exposure thereto are detailed in Note 23 to the financial statements.

The Group's future performance and results could be materially different from expected results depending on the outcome of certain potential risks and uncertainties, particularly credit risk.

*Accounting policies*

The reported results of the Group are 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 judgements are included in the Accounting policies on pages 21 to 23.

**STRATEGIC REPORT**

**Business review (continued)**

*Outlook*

The directors note the most recent releases of economic data for Ulster Bank Group's external markets have been positive. The latest Central Statistics Office reports show annual economic growth of 1.7% in the Republic of Ireland, a 6.4% annual increase in residential property prices and a reduction in the rate of unemployment to 12.4% (from 13.9% at the end of 2012). The recovery has been slower in Northern Ireland but the more recent indicators are again positive. According to the Northern Ireland Composite Economic Index the economy grew 1.2% year on year and the Department of Employment, Trade and Industry reported a marginal 0.6% reduction in the rate of unemployment to 7.3%. The 2013 Quarter 4 Northern Ireland Housing Executive / University of Ulster quarterly house price index reported a quarterly increase of 2.4% in average house prices.

The directors believe that these positive economic indicators, along with the actions being taken to build a really good bank, focussed on the customer while dealing with legacy issues should lead to improved future results for the Group. They consider the Group and the Bank to be in a stable financial position and confirm that it has adequate resources, with on-going support from RBS Group, to continue in business for the foreseeable future. Accordingly they continue to adopt the going concern basis in preparing the financial statements.

**Share capital**

Details of share capital can be found in Note 20 to the financial statements.

**Directors' indemnities**

In terms of Section 236 of the Companies Act 2006, all directors have been granted Qualifying Third Party Indemnity Provisions by the RBS Group.

**Staff involvement**

The Group values the input of its employees and actively seeks opportunities to engage with staff at all levels. The annual survey of employee opinions, known as Our View, provides valuable data to decision makers across the Group in support of improving employee engagement and satisfaction.

Employees across the Group continued to give generously, both financially and through volunteering, to many community and other worthy causes. Such giving is encouraged by the Group through its use of matched funding and staff charity funds which support worthy causes at local, national and international level.

The Group is represented on the European Employee Communication Council which facilitates dialogue amongst employee representatives in the European Economic Area.

**Employment of disabled persons**

The Group's policy is that disabled persons are considered for employment and subsequent training, career development and promotion based on merit. If members of staff become disabled, it is the Group's policy, wherever possible, to retain them in their existing jobs or to re-deploy them in suitable alternative duties.

**Diversity**

The attainment of an effective equal opportunities policy is a natural and integral part of good management practice. Key elements of policy are an intention to develop and treat people fairly and create an environment within which staff can develop to their full potential. It is the Group's policy to comply with the relevant provisions of legislation and have regard to Codes of Practice affecting employment practices. Through the Managing Diversity Programme, the Group aims to value and engage individual difference and maximise inclusion to create a positive experience for its people and customers.

The Group's commitment to diversity underpins its desire to be the financial services provider of choice for customers and to be the employer of choice. The Group will recruit, retain, develop and promote people based solely on merit regardless of their gender, disability, political opinion, race, religious belief or any other characteristics.

**Safety, health and wellbeing**

The Group recognises that people are key to the success of its business. The Group's vision is for its employees, peers and communities to recognise that the Group's pride and performance in safety, health and wellbeing adds value to them and to the Group's business. Industry leading expertise, innovative tools, products and services and a practical approach to implementation are combined to ensure improved performance continues to be delivered.

During 2013, the Group continued to focus on compliance, governance and managing risk across both jurisdictions in which it operates. Opportunities to improve the efficiency and effectiveness of safety, health and wellbeing management policies and services were monitored and, where relevant, implemented.

**STRATEGIC REPORT**

**Political donations**

During the year the Group made no political donations in the UK or the EU (2012: £nil).

**Going concern**

The Group's business activities, together with the factors likely to affect its future development, performance and position, including potential risks and uncertainties, are set out in the Business review on pages 2 to 4.

The financial position of the Group, its cash flows, liquidity position, capital and funding sources are set out in the financial statements. Notes 8, 23 and 24 to the financial statements include the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to market, credit and liquidity risks.

The Group is part of the RBS Group and receives ongoing capital, funding and liquidity resources which, coupled with other sources of funding and liquidity, enable the Group to meet its obligations as they fall due. Other sources of funding and liquidity include retail, wholesale and central bank liquidity facilities.

The directors are satisfied that the Group will continue to receive support from the RBS Group by way of capital, funding and liquidity facilities. After considering the Group's financial outlook and related funding and capital needs, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

**Investments in Group undertakings**

The investments in Group undertakings are shown in Note 12. The financial performance of these companies is included in the Group's financial statements and all have an accounting reference date of 31 December.

**Dividends**

The directors do not recommend the payment of a dividend on ordinary shares (2012: £nil).

**Post balance sheet events**

There have been no significant events between the year end and the date of approval of the financial statements which would require a change or additional disclosure or amendment in the financial statements.

By order of the Board:

Robert Bergin
Secretary
11-16 Donegall Square East
Belfast
BT1 5UB

20 February 2014

Ulster Bank Limited is registered in Northern Ireland No. R0000733

# ULSTER BANK LIMITED

## REPORT OF THE DIRECTORS

### Directors and secretaries

The names of the current members of the Board of Directors are shown on page 1 and brief biographical details are shown on pages 101 and 102. From 1 January 2013 to date the following changes have taken place:

| | Appointed | Resigned |
|---|---|---|
| **Directors** | | |
| R Quinlan | 3 April 2013 | |
| P Stanley | 6 August 2013 | |
| T Bowen | | 28 February 2013 |
| E Gleeson | | 28 February 2013 |
| I Webb | | 28 February 2013 |
| S Dorgan | | 21 June 2013 |
| **Secretary** | | |
| R Curran | | 1 July 2013 |
| S Anderson | 26 September 2013 | |

In accordance with the Articles of Association, the directors are not required to retire by rotation.

### 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 steps he/she ought to have taken as a director in order 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 2006.

### Auditors

The auditors Deloitte & Touche have indicated their willingness to continue in office as auditors.

By order of the Board:

Robert Bergin
Secretary
11-16 Donegall Square East
Belfast
BT1 5UB

20 February 2014

Ulster Bank Limited is registered in Northern Ireland No. R0000733

## STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the financial statements in accordance with applicable laws and regulation. Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare Group and Bank financial statements in accordance with IFRS as adopted by the EU. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Bank and of the profit or loss for that period. In preparing these financial statements, the directors are required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the Group and Bank's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Bank and enable them to ensure that the financial statements comply with the Companies Act 2006. They are responsible for safeguarding the assets of the Group and Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors confirm that these financial statements comply with the aforementioned requirements.

By order of the Board:

Robert Bergin
Secretary
11-16 Donegall Square East
Belfast
BT1 5UB

20 February 2014

Ulster Bank Limited is registered in Northern Ireland No. R0000733

## INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF ULSTER BANK LIMITED

We have audited the financial statements of Ulster Bank Limited for the year ended 31 December 2013 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Group and Bank Balance Sheets, the Group and Bank Statements of Changes in Equity, the Group and Bank Cash Flow Statements, the accounting policies and the related notes 1 to 34. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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.

**Respective responsibilities of directors and auditors**
As explained more fully in the Statement of Directors' Responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

**Scope of the audit of the financial statements**
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Bank's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

**Opinion on financial statements**
In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Bank's affairs as at 31 December 2013 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Bank's 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.

**Opinion on other matter prescribed by the Companies Act 2006**
In our opinion the information given in the Strategic Report and the Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements.

**Matters on which we are required to report by exception**
We have nothing to report in respect of the following matters where 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's financial statements 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.

Martin Reilly
for and on behalf of Deloitte & Touche
Chartered Accountants and Statutory Auditor
Dublin
26 February 2014

# ULSTER BANK LIMITED

**CONSOLIDATED INCOME STATEMENT** *for the year ended 31 December 2013*

| | | Group | | |
|---|---|---|---|---|
| | Note | **2013** **£m** | Restated 2012[1] £m | Restated 2011[1] £m |
| Interest receivable | | **999** | 1,194 | 1,478 |
| Interest payable | | **(350)** | (499) | (638) |
| **Net interest income** | 1 | **649** | 695 | 840 |
| Fees and commission receivable | | **154** | 156 | 145 |
| Fees and commission payable | | **(8)** | (9) | (6) |
| Income from trading activities | | **97** | 94 | 42 |
| Gain on redemption of own debt | | **239** | - | 255 |
| Other operating income | | **11** | 19 | 10 |
| **Non-interest income** | 2 | **493** | 260 | 446 |
| **Total income** | | **1,142** | 955 | 1,286 |
| **Operating expenses** | 3 | **(722)** | (706) | (649) |
| **Operating profit before impairment losses** | | **420** | 249 | 637 |
| Impairment loss on loans and advances | 9 | **(4,794)** | (2,340) | (3,718) |
| **Operating loss before tax** | | **(4,374)** | (2,091) | (3,081) |
| Tax credit/(charge) | 6 | **181** | (113) | 257 |
| **Loss for the year** | | **(4,193)** | (2,204) | (2,824) |
| **Attributable to:** | | | | |
| Non-controlling interests | | **-** | - | 8 |
| Ordinary shareholders | | **(4,193)** | (2,204) | (2,832) |
| | | **(4,193)** | (2,204) | (2,824) |

[1] For details of the restatement refer to page 94.

The accompanying accounting policies and notes form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 20 February 2014 and signed on its behalf by:

| | | |
|---|---|---|
| Philip Nolan | James Brown | Paul Stanley |
| Chairman | Group Chief Executive | Chief Financial Officer |

Ulster Bank Limited is registered in Northern Ireland No. R0000733

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME** *for the year ended 31 December 2013*

| | Group | | |
|---|---|---|---|
| | **2013** **£m** | Restated 2012[1] £m | Restated 2011[1] £m |
| **Loss for the year** | **(4,193)** | (2,204) | (2,824) |
| **Items that will not be reclassified subsequently to profit or loss:** | | | |
| Actuarial losses on defined benefit plans and other movements | **(12)** | (195) | (41) |
| **Items that will be reclassified subsequently to profit or loss:** | | | |
| Fair value gains on available-for-sale financial assets | **-** | - | 2 |
| Exchange differences on translation of foreign operations | **185** | (146) | (241) |
| Income tax on items that do qualify for reclassification | **-** | - | (1) |
| **Other comprehensive income/(loss) after tax** | **173** | (341) | (281) |
| **Total comprehensive loss for the year** | **(4,020)** | (2,545) | (3,105) |
| **Attributable to:** | | | |
| Non-controlling interests | **11** | (13) | (7) |
| Ordinary shareholders | **(4,031)** | (2,532) | (3,098) |
| | **(4,020)** | (2,545) | (3,105) |

[1] For details of the restatement refer to page 94.

The accompanying accounting policies and notes form an integral part of these financial statements.

**BALANCE SHEETS** *as at 31 December 2013*

| | | Group | | | Bank | | |
|---|---|---|---|---|---|---|---|
| | | | Restated | Restated | | Restated | Restated |
| | | **2013** | 2012[(1)] | 2011[(1)] | **2013** | 2012[(1)] | 2011[(1)] |
| | Note | **£m** | £m | £m | **£m** | £m | £m |
| **Assets** | | | | | | | |
| Cash and balances at central banks | 8 | **867** | 725 | 749 | **624** | 545 | 522 |
| Loans and advances to banks | 8 | **9,752** | 8,190 | 7,331 | **7,236** | 7,054 | 6,757 |
| Loans and advances to customers | 8 | **28,263** | 34,406 | 38,945 | **4,930** | 6,020 | 6,453 |
| Debt securities | 8,10 | **9** | 26 | 98 | **9** | 26 | 71 |
| Equity shares | 8,11 | **9** | 7 | 5 | **-** | - | - |
| Investments in Group undertakings | 8,12 | **-** | - | - | **3,110** | 2,544 | 3,488 |
| Derivatives | 8,15 | **561** | 724 | 997 | **16** | 37 | 87 |
| Property, plant and equipment | 8,14 | **333** | 341 | 349 | **56** | 64 | 81 |
| Prepayments, accrued income and other assets | 8,16 | **236** | 123 | 155 | **194** | 88 | 150 |
| Retirement benefit assets | 4,8 | **77** | 33 | 3 | **77** | 33 | 3 |
| Deferred taxation | 8,18 | **75** | 75 | 285 | **1** | 2 | 2 |
| **Total assets** | | **40,182** | 44,650 | 48,917 | **16,253** | 16,413 | 17,614 |
| | | | | | | | |
| **Liabilities** | | | | | | | |
| Deposits by banks | 8 | **8,661** | 7,895 | 12,830 | **4,485** | 4,540 | 4,365 |
| Customer accounts | 8 | **22,298** | 23,070 | 22,348 | **6,818** | 7,154 | 7,487 |
| Debt securities in issue | 8 | **1,908** | 3,254 | 3,530 | **9** | 2 | 38 |
| Derivatives | 8,15 | **744** | 992 | 1,352 | **47** | 78 | 84 |
| Accruals, deferred income and other liabilities | 8,17 | **1,008** | 909 | 871 | **735** | 668 | 641 |
| Retirement benefit liabilities | 4,8 | **232** | 213 | 36 | **-** | - | - |
| Deferred taxation | 8,18 | **24** | 19 | 13 | **21** | 15 | 10 |
| Subordinated liabilities | 8,19 | **1,175** | 1,157 | 1,183 | **956** | 939 | 961 |
| **Total liabilities** | | **36,050** | 37,509 | 42,163 | **13,071** | 13,396 | 13,586 |
| | | | | | | | |
| **Equity** | | | | | | | |
| Non-controlling interests | | **517** | 500 | 512 | **-** | - | - |
| **Shareholders' equity:** | | | | | | | |
| Called up share capital | 20 | **1,505** | 1,505 | 1,505 | **1,505** | 1,505 | 1,505 |
| Reserves | | **2,110** | 5,136 | 4,737 | **1,677** | 1,512 | 2,523 |
| **Total equity** | 8 | **4,132** | 7,141 | 6,754 | **3,182** | 3,017 | 4,028 |
| | | | | | | | |
| **Total liabilities and equity** | | **40,182** | 44,650 | 48,917 | **16,253** | 16,413 | 17,614 |

[(1)] For details of the restatement refer to page 94.

The accompanying accounting policies and notes form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 20 February 2014 and signed on its behalf by:

| | | |
|---|---|---|
| Philip Nolan | James Brown | Paul Stanley |
| Chairman | Group Chief Executive | Chief Financial Officer |

Ulster Bank Limited is registered in Northern Ireland No. R0000733

**STATEMENTS OF CHANGES IN EQUITY** *for the year ended 31 December 2013*

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | | Restated | Restated | | Restated | Restated |
| | **2013** | 2012[1] | 2011[1] | **2013** | 2012[1] | 2011[1] |
| | **£m** | £m | £m | **£m** | £m | £m |
| **Called up share capital** | | | | | | |
| At 1 January and 31 December | **1,505** | 1,505 | 1,505 | **1,505** | 1,505 | 1,505 |
| **Share premium account** | | | | | | |
| At 1 January and 31 December | **907** | 907 | 907 | **907** | 907 | 907 |
| **Available-for-sale reserve** | | | | | | |
| At 1 January | **-** | - | (1) | **-** | - | (5) |
| Unrealised gains/(losses) in the year | **5** | 1 | (2) | **-** | 1 | 1 |
| Realised losses in the year | **-** | (1) | - | **-** | - | - |
| Exchange (losses)/gains in the year | **(5)** | - | 4 | **-** | - | 5 |
| Taxation | **-** | - | (1) | **-** | (1) | (1) |
| At 31 December | **-** | - | - | **-** | - | - |
| **Foreign exchange reserve** | | | | | | |
| At 1 January | **(169)** | (36) | 190 | **(260)** | (260) | (260) |
| Retranslation of net assets | **174** | (133) | (226) | **-** | - | - |
| At 31 December | **5** | (169) | (36) | **(260)** | (260) | (260) |
| **Retained earnings** | | | | | | |
| At 1 January | **(9,109)** | (6,710) | (3,837) | **(12,642)** | (8,700) | (4,678) |
| Actuarial (losses)/gains on defined benefit plans and other movements | **(12)** | (195) | (41) | **10** | 3 | (19) |
| Loss attributable to ordinary shareholders | **(4,193)** | (2,204) | (2,832) | **(850)** | (3,945) | (4,003) |
| At 31 December | **(13,314)** | (9,109) | (6,710) | **(13,482)** | (12,642) | (8,700) |
| **Capital contribution** | | | | | | |
| At 1 January | **13,507** | 10,576 | 5,918 | **13,507** | 10,576 | 5,918 |
| Capital contribution | **1,005** | 2,931 | 4,658 | **1,005** | 2,931 | 4,658 |
| At 31 December | **14,512** | 13,507 | 10,576 | **14,512** | 13,507 | 10,576 |
| **Shareholders' equity at 31 December** | **3,615** | 6,641 | 6,242 | **3,182** | 3,017 | 4,028 |
| **Non-controlling interests** | | | | | | |
| At 1 January | **500** | 512 | 558 | **-** | - | - |
| Increase/(decrease) in loan classed as equity | **6** | 1 | (39) | **-** | - | - |
| Currency translation and other adjustments | **11** | (13) | (15) | **-** | - | - |
| Gain attributable to non-controlling interests | **-** | - | 8 | **-** | - | - |
| At 31 December | **517** | 500 | 512 | **-** | - | - |
| **Total equity at 31 December** | **4,132** | 7,141 | 6,754 | **3,182** | 3,017 | 4,028 |

Total comprehensive loss recognised in the Statement of Changes in Equity is attributable as follows:

| | | | | | | |
|---|---|---|---|---|---|---|
| Non-controlling interests | **11** | (13) | (7) | **-** | - | - |
| Ordinary shareholders | **(4,031)** | (2,532) | (3,098) | **(841)** | (3,942) | (4,017) |
| | **(4,020)** | (2,545) | (3,105) | **(841)** | (3,942) | (4,017) |

[1] For details of the restatement refer to page 94.

The accompanying accounting policies and notes form an integral part of these financial statements.

## ULSTER BANK LIMITED

**CASH FLOW STATEMENTS** *for the year ended 31 December 2013*

| | | Group | | | Bank | | |
|---|---|---|---|---|---|---|---|
| | Note | **2013 £m** | 2012 £m | Restated 2011[(1)] £m | **2013 £m** | Restated 2012[(1)] £m | Restated 2011[(1)] £m |
| **Operating activities** | | | | | | | |
| Operating loss before tax | | **(4,374)** | (2,091) | (3,081) | **(1,026)** | (4,036) | (4,169) |
| Adjustments for: | | | | | | | |
| Depreciation, amortisation and impairment of property, plant and equipment | | **43** | 43 | 30 | **12** | 17 | 10 |
| Interest on subordinated liabilities | | **26** | 27 | 34 | **15** | 13 | 19 |
| Gain on redemption of own debt | | **(239)** | - | (255) | **-** | - | - |
| Charge for defined benefit pension schemes | | **32** | 26 | 33 | **6** | 11 | 10 |
| Cash contribution to defined benefit pension schemes | | **(73)** | (77) | (75) | **(39)** | (40) | (39) |
| Loan impairment provisions net of recoveries | | **4,085** | 2,128 | 3,544 | **581** | 256 | 737 |
| Impairment of investments in Group undertakings | | **-** | - | - | **277** | 3,663 | 3,518 |
| Elimination of foreign exchange differences | | **242** | (194) | (411) | **(13)** | (9) | (7) |
| Other non-cash items | | **(110)** | (244) | (292) | **(75)** | (33) | (51) |
| **Net cash flows (used in)/from trading activities** | 26 | **(368)** | (382) | (473) | **(262)** | (158) | 28 |
| Changes in operating assets and liabilities | | **1,819** | (1,764) | (1,857) | **185** | 211 | (2,076) |
| **Net cash flows from operating activities before tax** | | **1,451** | (2,146) | (2,330) | **(77)** | 53 | (2,048) |
| Income taxes received | | **88** | 124 | 182 | **86** | 155 | 137 |
| **Net cash flows from/(used in) operating activities** | 26 | **1,539** | (2,022) | (2,148) | **9** | 208 | (1,911) |
| **Investing activities** | | | | | | | |
| Sale and maturity of securities | | **17** | 73 | 281 | **17** | 47 | 128 |
| Purchase of equity shares | | **-** | (2) | (3) | **-** | - | - |
| Sale of equity shares | | **-** | - | 1 | **-** | - | - |
| Purchase of property, plant and equipment | | **(10)** | (11) | (60) | **(4)** | (2) | (1) |
| Sale of property, plant and equipment | | **-** | 3 | 8 | **-** | 2 | - |
| Investment in subsidiary undertakings | | **-** | - | - | **(834)** | (2,730) | (4,068) |
| **Net cash flows (used in)/from investing activities** | | **7** | 63 | 227 | **(821)** | (2,683) | (3,941) |
| **Financing activities** | | | | | | | |
| Purchase of own debt | | **(1,040)** | - | (1,116) | **-** | - | - |
| Capital contribution | | **1,005** | 2,931 | 4,658 | **1,005** | 2,931 | 4,658 |
| Interest on subordinated liabilities | | **(26)** | (27) | (34) | **(15)** | (13) | (19) |
| **Net cash flows from financing activities** | | **(61)** | 2,904 | 3,508 | **990** | 2,918 | 4,639 |
| **Effect of exchange rate changes on cash and cash equivalents** | | **61** | (117) | (70) | **21** | (2) | - |
| **Net increase/(decrease) in cash and cash equivalents** | | **1,546** | 828 | 1,517 | **199** | 441 | (1,213) |
| Cash and cash equivalents 1 January | 29 | **6,525** | 5,697 | 4,180 | **3,404** | 2,963 | 4,176 |
| **Cash and cash equivalents 31 December** | 29 | **8,071** | 6,525 | 5,697 | **3,603** | 3,404 | 2,963 |

(1) For details of the restatement refer to page 94.

The accompanying accounting policies and notes form an integral part of these financial statements.

## ACCOUNTING POLICIES

### 1. Presentation of financial statements

The consolidated financial statements are prepared on a going concern basis and in accordance with IFRS issued by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB, as adopted by the EU. The Group and Bank's financial statements are presented in accordance with the Companies Act 2006.

The Bank is incorporated and registered in Northern Ireland. The Group and Bank's financial statements are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: held-for-trading financial assets and financial liabilities, financial assets and financial liabilities that are designated at fair value through profit or loss, available-for-sale financial assets and investment property. Recognised financial assets and financial liabilities in fair value hedges are adjusted for changes in fair value in respect of the risk that is hedged.

### 2. Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank (Ulster Bank Limited) and entities (including certain special purpose entities) that are controlled by the Bank (its subsidiaries). Control exists where the Group has the power to govern the financial and operating policies of the entity so as to obtain benefit from its activities; generally conferred by holding a majority of voting rights.

On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated financial statements at their fair value. Any excess of the cost (the fair value of assets given, liabilities incurred or assumed and equity instruments issued by the Group plus any directly attributable costs) of an acquisition over the fair value of the net assets acquired is recognised as goodwill. The interest of non-controlling shareholders is stated at their share of the fair value of the subsidiary's net assets.

The results of subsidiaries acquired are included in the consolidated income statement from the date control passes until the Group ceases to control them through a sale or significant change in circumstances. Changes in interest that do not result in a loss of control are recognised in equity. Total comprehensive income of subsidiaries is attributed to the owners of the Group and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

All intra-group balances, transactions, income and expenses are eliminated on consolidation. The consolidated financial statements are prepared using 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 at fair value through profit or loss is 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.

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 through profit or loss together with dividends, interest receivable and interest payable.

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 through profit or loss over the life of the facility otherwise they are deferred and included in the effective interest rate on the advance.

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 income comprises income received for payment services including cheques cashed and direct debits. 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 charged.

**ACCOUNTING POLICIES**

**3. Revenue recognition (continued)**

*Card related services*: fees from credit 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; and

- Annual fees payable by credit card holders: these are deferred and taken to profit or loss over the period of the service i.e. 12 months.

*Insurance brokerage*: this is made up of fees and commissions received from the agency sale of insurance. Commission on the sale of an insurance contract is earned at the inception of the policy as the insurance has been arranged and placed. However, provision is made where commission is refundable in the event of policy cancellation in line with estimated cancellations.

*Investment management fees*: 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 an expense as the related revenue is recognised.

*Fees and commissions payable*: fees and commissions are payable in respect of services provided by third party intermediaries. These are charged through profit or loss over the life of the underlying product.

**4. Pensions and other post-retirement benefits**

The Group provides post-retirement benefits in the form of pensions to eligible employees.

For defined benefit schemes, scheme liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate that reflects the current rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities. Scheme assets are measured at their fair value. Past service costs are recognised immediately to the extent that benefits have vested; otherwise they are amortised over the period until the benefits become vested.

Contributions to defined contribution pension schemes are recognised in the income statement when payable.

**5. Intangible assets and goodwill**

Intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and accumulated impairment losses. The intangible assets of the Group and Bank are fully impaired.

**6. Property, plant and equipment**

Items of property, plant and equipment (except investment properties – see accounting policy 8) are stated at cost less accumulated depreciation and accumulated impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they 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. Land is not depreciated. Estimated useful lives are as follows:

| | |
|---|---|
| Freehold and long leasehold buildings | 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 with the effect of any changes in estimate accounted for on a prospective basis.

**ACCOUNTING POLICIES**

**7. Impairment of property, plant and equipment**

At each reporting date, the Group assesses whether there is any indication that the value of its property, plant and equipment is impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss, if any. 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. The recoverable amount of an asset 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 reflected in the estimation of future cash flows. If the recoverable amount of a 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 property, plant and equipment is recognised as it arises provided the increased carrying value does not exceed that which it would have been had no impairment loss been recognised.

**8. Investment properties**

Investment property, which is property held to earn rentals and/or for capital appreciation (including property under construction for such purposes), is measured initially at its cost, including transaction costs. Subsequent to initial recognition, investment property is measured at fair value. Fair value is based on current prices for similar properties in the same location and condition using internal valuation models based on yield comparables and any available recent market transactions taking cognisance of the principles of the Royal Institute of Chartered Surveyors (RICS) valuation methodology.

Fair value of the investment properties is determined on at least an annual basis by officers of the Group. A selection of properties may be valued by external appointed surveyors from time to time as the commercial need arises. Gains and losses arising from changes in the fair value of investment property are included in profit or loss in the period in which they arise.

Rental income from investment property is recognised on a straight line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income.

**9. Foreign currencies**

The Group's consolidated financial statements are presented in Sterling, which is the functional currency of the Bank.

Transactions in foreign currencies are translated into Sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into Sterling at the rates of exchange ruling at the balance sheet date. Foreign exchange differences arising on translation are reported in income from trading activities. Non-monetary items denominated in foreign currencies that are stated at fair value are translated into Sterling at foreign exchange rates ruling at the dates the values were 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 included in the available-for-sale reserve in equity 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 translation of foreign operations are recognised directly in equity and included in profit or loss on its disposal.

**10. 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 banks and 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 credited to the income statement on a receivable basis over the term of the lease. Operating lease assets are included within property, plant and equipment and depreciated over their useful lives (see accounting policy 6). Operating lease rentals receivable are included in other operating income.

*As lessee*
Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease.

**11. Provisions and contingent liabilities**

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.

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 obligations under it 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.

**12. Taxation**

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 income or in 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 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.

**13. Financial assets**

On initial recognition financial assets are classified into held for-trading; designated as at fair value through profit or loss; loans and receivables or available-for-sale. Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date; all other regular way purchases are recognised on trade date

*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. Gains and losses on held-for-trading financial assets are recognised in profit or loss 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 on financial assets that are designated as at fair value through profit or loss are recognised in profit or loss as they arise.

The Group has designated financial assets as at fair value through profit or loss principally where the assets are economically hedged by derivatives and fair value designation eliminates the measurement inconsistency that would arise if the assets were carried at amortised cost or classified as available-for-sale.

*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.

### 13. Financial assets (continued)

*Available-for-sale* - 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 monetary available-for-sale financial assets denominated in a foreign currency are recognised in profit or loss together with interest calculated using the effective interest method (see accounting policy 3). Other changes in the fair value of available-for-sale financial assets and any related tax are reported in a separate component of shareholders' equity until disposal, when the cumulative gain or loss is recognised in profit or loss.

*Fair value* - fair value for a net open position in a financial asset that is quoted in an active market is the closing market price times the number of units of the instrument held. Fair values for financial assets not quoted in an active market are determined using appropriate valuation techniques including discounting future cash flows, option pricing models and other methods that are consistent with accepted economic methodologies for pricing financial assets.

### 14. 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 available-for-sale or loans and receivables is impaired. A financial asset or portfolio 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 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 original 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 properties, the exchange is accounted for as the sale of the loan and the acquisition of equity securities or investment properties. 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 assessment of impairment, 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 current 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 original effective 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 portfolios that are collectively assessed for impairment, the timing of write off principally reflects historic recovery experience for each portfolio. 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 will be prompted by bankruptcy, insolvency, restructuring and similar events. 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 significant or prolonged decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss is removed from equity and recognised in profit or loss. The loss is measured as the difference between the acquisition cost 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.

**ACCOUNTING POLICIES**

**15. Financial liabilities**

On initial recognition financial liabilities are classified into held-for-trading; designated as at fair value through profit or loss; or amortised cost.

*Held-for-trading* - a financial liability is classified as held-for-trading if it is incurred principally for the 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. Gains and losses on financial liabilities that are designated as at fair value through profit or loss are recognised in profit or loss as they arise.

The principal category of financial liabilities designated as at fair value through profit or loss is 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* - Fair value for a net open position in a financial liability that is quoted in an active market is the closing market price times the number of units of the instrument held or issued. Fair values for financial liabilities not quoted in an active market are determined using appropriate valuation techniques including discounting future cash flows, option pricing models and other methods that are consistent with accepted economic methodologies for pricing financial liabilities. Valuation adjustments are made when fair valuing financial liabilities to reflect the Group's own credit standing.

**16. Derecognition**

A financial asset is derecognised 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 rights 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. If substantially all the risks and rewards have been retained, the asset remains on the balance sheet. If substantially all of the risks and rewards have been transferred, the asset is derecognised. If substantially all the risks and rewards have been neither retained nor transferred, the Group assess whether or not it has retained control of the asset. If it has not retained control, the asset is derecognised. Where the Group has retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement.

A financial liability is removed from the balance sheet when the obligation is discharged, or 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 discounted present value of the cash flows under the new terms with the discounted present value of the remaining cash flows of the original debt issue.

**17. 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 deposit. Securities acquired in reverse sale and repurchase transactions 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 is recorded in Loans and advances to banks or Loans and advances to customers as appropriate.

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 received or given 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.

## ACCOUNTING POLICIES

### 18. Netting

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when, and only when, the Group 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. Where it does not intend to settle the amounts net or simultaneously the assets and liabilities concerned are presented gross.

### 19. Capital instruments

The Group classifies a financial instrument that it issues as a financial asset, financial liability or an equity instrument in accordance with the substance of the contractual arrangement. An instrument is classified 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. An instrument is classified 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.

### 20. Derivatives and hedging

Derivative financial instruments are initially recognised, and subsequently measured, at fair value. Derivative fair values are determined from quoted prices in active markets where available. Where there is no active market for an instrument, fair value is derived from prices for the derivative's components using appropriate pricing or valuation models. Credit valuation adjustments are made when valuing derivative financial assets to incorporate counterparty credit risk. The Group does not apply debt valuation adjustments.

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.

The Group enters into hedges of changes in the fair value of a recognised asset or liability or firm commitment (fair value hedges). 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 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 hedged relationship.

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. The fair value of the hedging instrument and the associated hedged item were immaterial as at 31 December 2013 and 2012.

### 21. Share-based payments

The RBS Group awards options over shares to its employees under various share option schemes. IFRS 2 'Share-based Payment' is applied by the RBS Group to grants made under these schemes. The RBS Group recognises an expense for these transactions with its employees based on the fair value on the date the options are granted. It includes the cost of these awards in determining any recharges of employee costs it makes to subsidiaries in the Group.

### 22. Cash and cash equivalents

In the Cash Flow Statement, cash and cash equivalents comprise cash and demand deposits with banks 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.

### 23. Investments in Group undertakings

The Bank's investments in its subsidiaries are stated at cost less any accumulated impairment losses.

## ACCOUNTING POLICIES

### Critical accounting policies and key sources of accounting judgements

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, International Accounting Standard (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 light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's Framework for the Preparation and Presentation of financial statements.

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.

### 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. A loan is impaired when there is objective evidence that events since the loan was granted have affected expected cash flows from the loan. 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.

At 31 December 2013, the Group's gross loans and advances to customers totalled £43,029m (2012: £45,180m, 2011: £47,996m) and customer loan impairment provisions amounted to £14,766m (2012: £10,774m, 2011: £9,051m).

There are three components to the Group's loan impairment provisions: individual, collective and latent.

*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* - impaired loans that are below individual assessment thresholds are collectively assessed. 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 smaller commercial loans, credit card receivables and other personal advances including mortgages. 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 component* – this consists of loan losses that have been incurred but have not been separately identified at the balance sheet date. 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 that 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.

### Forbearance

The forbearance policies are the main response to managing mortgage customers in financial difficulty and are deployed through the Group's forbearance initiative. Forbearance is applied to secured retail products where temporary relief is offered through the renegotiation of the original contract, although on terms not generally available on a commercial basis. This may include offering contract revision by various means including reduced repayment, interest only arrangements, negative amortisation, payment moratorium, term extension, lifetime reduced repayment and/or interest rate reduction; these forbearance arrangements are subject to heightened monitoring.

Forbearance offered by the Group on loans where an impairment loss provision has been previously recognised will result in such loans retaining their classification as non-performing. Where the customer met the loan terms prior to modification and there is a realistic expectation that the customer will adhere to forbearance terms, these loans are classified as performing loans. In recognising their credit risk profile, they carry a provision incorporating an expectation that some customers will fail to comply with the terms of the forbearance together with the associated loss rate.

## ACCOUNTING POLICIES

### Critical accounting policies and key sources of accounting judgements (continued)

**Impairment of investment in Group undertakings**

The fair value of investments in Group undertakings is calculated using a model based on expected future profits plus future equity requirements. A discounted terminal value is added to the discounted expected future profits to provide the fair value of the subsidiary. If the fair value of the subsidiary 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.

**Valuation of investment property**

Investment property, which is property held to earn rentals and/or for capital appreciation (including property under construction for such purposes), is measured initially at its cost, including transaction costs. Subsequent to initial recognition, investment property is measured at fair value. Fair value is based on current prices for similar properties in the same location and condition using internal valuation models based on yield comparables and any available recent market transactions taking cognisance of the principles of the RICS valuation methodology.

Fair value of the investment properties is determined on at least an annual basis by officers of the Group. A selection of properties may be valued by external appointed surveyors from time to time as the commercial need arises. Gains and losses arising from changes in the fair value of investment property are included in profit or loss in the period in which they arise.

**Deferred tax**

The Group makes provision for deferred tax on short-term and other temporary differences where tax recognition occurs at a different time from accounting recognition. Net deferred tax assets of £51m were recognised as at 31 December 2013 (2012: restated £56m, 2011: restated £272m). Deferred tax assets of £1,369m (2012: £886m, 2011: £494m) have not been recognised in respect of tax losses carried forward where doubt exists over the availability of future taxable profits.

The Group has recognised deferred tax assets in respect of losses and short-term temporary differences. Deferred tax assets are recognised in respect of unused tax losses to the extent that it is probable that there will be future taxable profits against which the losses can be utilised. Current management business projections indicate that sufficient future taxable income will be available against which to offset the recognised deferred tax asset within 5 years (2012: 7 years). While business projections may support an asset write back, the asset has been retained at the 2012 level in recognition of uncertainty pending completion of the Group's Strategic review. The Group's cumulative losses are principally attributable to the continuing unparalleled market conditions.

**Pensions**

There are three defined benefit pension schemes in operation within the Group: Ulster Bank Pension Scheme, Ulster Bank Pension Scheme (Republic of Ireland) and First Active Pension Scheme. The assets of defined benefit schemes are measured at their fair value at the balance sheet date. Scheme liabilities are measured using the projected unit method, which takes account of projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. These cash flows are discounted at an interest rate based on the yields of high-quality corporate bonds of appropriate duration, with high-quality almost universally understood to mean AA-rated. The choice of discount rate is a source of estimation uncertainty, due to a lack of appropriate Euro-denominated AA-rated bonds of equivalent duration to the pension schemes' liabilities.

The approach used is to fit a yield curve to an appropriate dataset of AA bonds, and derive the discount rate from that curve. To increase the number of reference bonds available at the end of the reporting period, equivalent AA yields were extrapolated for longer dated A and AAA rated bonds by applying a credit spread adjustment to their actual yields. These were then included in the dataset used to create the yield curve.

In determining the value of scheme liabilities, financial and demographic assumptions are made as to price inflation, pension increases, earnings growth and employee life expectancy. A range of assumptions could be adopted in valuing the schemes' liabilities. Different assumptions could significantly alter the amount of the surplus or deficit recognised in the balance sheet and the pension cost charged to the income statement. The assumptions adopted for the Group's pension schemes are set out in Note 4 to the financial statements together with sensitivities of the balance sheet and income statement to changes in those assumptions.

The Group has reduced the allowance made for future discretionary increases to pensions in payment, in light of recent experience.

The Group applied IAS 19 revised from 1 January 2013. The revised standard requires: the immediate recognition of all actuarial gains and losses; interest cost to be calculated on the net pension liability or asset at the long-term bond rate, such that an expected rate of return will no longer be applied to assets; and all past service costs to be recognised immediately when a scheme is curtailed or amended. Implementation of IAS 19 revised resulted in the net pension asset of £82m becoming a net pension liability of £180m as at 31 December 2012. The loss after tax was lower by £1m for the period ended 31 December 2012. Prior periods have been restated accordingly (see Note 34).

## ACCOUNTING POLICIES

### Critical accounting policies and key sources of accounting judgements (continued)

### Fair value – financial instruments

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. On the balance sheet, financial assets carried at fair value are included within debt securities, equity shares and derivatives as appropriate. Financial liabilities carried at fair value are included within deposits by banks, customer accounts and derivatives. Derivative assets and derivative liabilities are shown separately on the face of the balance sheets. Gains or losses arising from changes in fair value of financial instruments classified as held-for-trading or designated as at fair value through profit or loss are included in the income statement. Unrealised gains and losses on available-for-sale financial assets are recognised directly in equity unless an impairment loss is recognised. The carrying value of a financial asset or a financial liability carried at cost or amortised cost that is the hedged item in a qualifying hedge relationship is adjusted by the gain or loss attributable to the hedged risk.

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. Fair values are determined by reference to observable market prices where available and reliable. Where representative market prices for an instrument are not available or are unreliable because of poor liquidity, the fair value is derived from prices for its components using appropriate pricing or valuation models that are based on independently sourced market parameters, including interest rate yield curves, option volatilities and currency rates. Financial assets carried at fair value include government and corporate debt securities, reverse repos, loans, corporate equity shares and derivatives. Financial liabilities carried at fair value include deposits, repos, debt securities issued and derivatives. Fair value for a substantial proportion of these instruments is based on observable market prices or derived from observable market parameters. Where observable prices are not available, fair value is based on appropriate valuation techniques or management estimates.

The Group's derivative products include swaps, forwards, futures and options. Exchange traded instruments are valued using quoted prices. The fair value of over-the-counter instruments is derived from pricing models which take account of contract terms, including maturity, as well as quoted market parameters such as interest rates and volatilities. Most of the Group's pricing models do not entail material subjectivity because the methodologies utilised do not incorporate significant judgement and the parameters included in the models can be calibrated to actively quoted market prices. Values established from pricing models are adjusted for credit risk, liquidity risk and future operational costs.

A negligible proportion of the Group's trading derivatives are valued directly from quoted prices, the remaining majority being valued using appropriate valuation techniques. The fair value of substantially all securities positions carried at fair value is determined directly from quoted prices. Fair value for a net open position in a financial instrument in an active market is the number of units of the instrument held times the closing market price. In determining the fair value of derivative financial instruments gross long and short positions measured at current mid market prices are adjusted by bid-offer reserves calculated on a portfolio basis. Credit valuation adjustments are made when valuing derivative financial assets to incorporate counterparty credit risk. Valuation adjustments are made when fair valuing financial liabilities 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.

More details about the Group's valuation methodologies of the fair value of financial instruments valued using techniques where at least one significant input is unobservable are given in Note 8.

### Provisions for liabilities

As set out in Note 17, at 31 December 2013 the Group recognised provisions for liabilities in respect of Interest Rate Hedging Products and Payment Protection Insurance. 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. The provisions are management's best estimate of the anticipated costs of redress and related administration expenses. As at 31 December 2013 the Group is experiencing take up rates of 69% in relation to PPI claims and is upholding 91% of these.

### Accounting developments

A number of IFRSs and amendments to IFRS were in issue at 31 December 2013 that had effective dates of 1 January 2014 or later.

International Financial Reporting Interpretations Committee 21 'Levies' (IFRIC 21) was issued in May 2013. This interpretation provides guidance on accounting for the liability to pay a government imposed levy. IFRIC 21 is effective for annual periods beginning on or after 1 January 2014. Implementation of IFRIC 21 will not have a material effect on the Group's financial statements.

## ACCOUNTING POLICIES

### Accounting developments (continued)

IAS 36 'Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)' was issued in May 2013. The amendments align IAS 36's disclosure requirements about recoverable amounts with the IASB's original intentions. They are effective for annual periods beginning on or after 1 January 2014. Implementation of the amendments to IAS 36 is not expected to have a material effect on the Group's financial statements.

IAS 39 'Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)' was issued in June 2013. The amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria. They are effective for annual periods beginning on or after 1 January 2014. Implementation of the amendments to IAS 39 will not have a material effect on the Group's financial statements.

IAS 19 'Defined Benefit Plans: Employee Contributions' was issued in November 2013. This amendment distinguishes the accounting for employee contributions that are related to service from those that are independent of service. It is effective for annual periods beginning on or after 1 July 2014. The amendment is not expected to have a material effect on the Group's financial statements.

Annual Improvements to IFRS 2010 - 2012 and 2011 - 2013 cycles were issued in December 2013. There are a number of minor changes to IFRS that will not have a material effect on the Group's financial statements. All amendments are effective for annual periods beginning on or after 1 July 2014.

In November 2009, the IASB issued IFRS 9 'Financial Instruments' simplifying the classification and measurement requirements in IAS 39 in respect of financial assets. The standard reduces the measurement categories for financial assets to two: fair value and amortised cost. A financial asset is classified on the basis of the entity's business model for managing the financial asset and the contractual cash flow characteristics of the financial asset. Only assets with contractual terms that give rise to cash flows on specified dates that are solely payments of principal and interest on principal and which are held within a business model whose objective is to hold assets in order to collect contractual cash flows are classified as amortised cost. All other financial assets are measured at fair value. Changes in the value of financial assets measured at fair value are generally taken to profit or loss.

In October 2010, IFRS 9 was updated to include requirements in respect of the classification and measurement of liabilities. These do not differ markedly from those in IAS 39 except for the treatment of changes in the fair value of financial liabilities that are designated as at fair value through profit or loss attributable to own credit; these must be presented in other comprehensive income.

In December 2011, the IASB issued amendments to IFRS 9 and to IFRS 7 'Financial Instruments: Disclosures' delaying the effective date of IFRS 9 to annual periods beginning on or after 1 January 2015 and introducing revised transitional arrangements including additional transition disclosures. If an entity implements IFRS 9 in 2012 the amendments permit it either to restate comparative periods or to provide the additional disclosures. Additional transition disclosures must be given if implementation takes place after 2012.

IFRS 9 makes major changes to the framework for the classification and measurement of financial instruments and will have a significant effect on the Group's financial statements. The Group is assessing the effect of IFRS 9 which will depend on the results of IASB's reconsideration of IFRS 9's classification and measurement requirements and the outcome of the other phases in the development of IFRS 9.

**NOTES TO THE FINANCIAL STATEMENTS** *for the year ended 31 December 2013*

## 1. Net interest income

| | Group | | |
|---|---|---|---|
| | **2013** | 2012 | 2011 |
| | **£m** | £m | £m |
| Loans and advances to customers | **930** | 1,088 | 1,355 |
| Loans and advances to banks | **67** | 104 | 116 |
| Debt securities | **2** | 2 | 7 |
| Interest receivable | **999** | 1,194 | 1,478 |
| Customer accounts | **(270)** | (327) | (347) |
| Deposits by banks | **(41)** | (113) | (193) |
| Debt securities in issue | **(13)** | (32) | (64) |
| Subordinated liabilities | **(26)** | (27) | (34) |
| Interest payable | **(350)** | (499) | (638) |
| Net interest income | **649** | 695 | 840 |

Included within net interest income is £210m (2012: £248m, 2011: £253m) of interest on impaired loans.

## 2. Non-interest income

| | Group | | |
|---|---|---|---|
| | **2013** | 2012 | 2011 |
| | **£m** | £m | £m |
| Fees and commission receivable | **154** | 156 | 145 |
| Fees and commission payable | **(8)** | (9) | (6) |
| Income from trading activities (1): | | | |
| Foreign exchange | **40** | 31 | 42 |
| Interest rates | **57** | 63 | - |
| Gain on redemption of own debt (2) | **239** | - | 255 |
| Other operating income | **11** | 19 | 10 |
| Non-interest income | **493** | 260 | 446 |

(1) The analysis of trading income is based on how the business is organised and the underlying risks managed.

Trading income comprises gains and losses on financial instruments held-for-trading, both realised and unrealised, interest income and dividends and the related funding costs.

i) Foreign exchange: spot foreign exchange contracts, currency swaps and options, emerging markets and related hedges and funding.

ii) Interest rates: interest rate swaps, forward foreign exchange contracts, forward rate agreements, interest rate options, interest rate futures and related hedges and funding.

(2) During the year ended 31 December 2013 the Group bought back certain externally issued mortgage securitisation bonds at a discount to par and realised a gain of £239m (2012: £nil, 2011: £255m).

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### 3. Operating expenses

| | Group | | |
|---|---|---|---|
| | | | Restated |
| | **2013** | 2012 | 2011 |
| | **£m** | £m | £m |
| Wages, salaries and other staff costs | **248** | 251 | 270 |
| Social security costs | **23** | 27 | 26 |
| Pension costs: | | | |
| - defined benefit schemes (see Note 4) | **32** | 26 | 33 |
| - defined contribution schemes (see Note 4) | **4** | 3 | 2 |
| Restructure costs | **14** | 26 | 5 |
| Staff costs | **321** | 333 | 336 |
| Premises and equipment | **121** | 103 | 140 |
| Administration | **237** | 227 | 143 |
| Other expenses | **358** | 330 | 283 |
| Property, plant and equipment depreciation (see Note 14) | **24** | 26 | 30 |
| Impairment of property, plant and equipment (see Note 14) | **19** | 17 | - |
| Depreciation, amortisation and impairment | **43** | 43 | 30 |
| | **722** | 706 | 649 |

Included within operating expenses for the year is £15m in respect of mandatory change programmes, including Single European Payments Area (SEPA) (2012: £3m, 2011: £nil).

Included within the operating expenses for the year ended 31 December 2012 are staff costs of £7m and other expenses of £77m which were incurred as a result of the technology incident that impacted the Group during 2012 (2013: £nil, 2011: £nil).

The average number of persons employed by the Group during the year, excluding temporary staff was 5,484 (2012: 5,671, 2011: 5,725). The average number of temporary employees during 2013 was 347 (2012: 295, 2011: 217). The number of persons employed by the Group at 31 December, excluding temporary staff, was as follows:

| | Group | | |
|---|---|---|---|
| | **2013** | 2012 | 2011 |
| **Employee numbers** | **Number** | Number | Number |
| Retail banking | **2,164** | 2,203 | 2,366 |
| Corporate banking | **892** | 974 | 1,460 |
| Other | **2,321** | 2,413 | 1,926 |
| | **5,377** | 5,590 | 5,752 |

| | Group | | |
|---|---|---|---|
| | **2013** | 2012 | 2011 |
| **Auditors' remuneration** | **£'000** | £'000 | £'000 |
| Statutory audit work | **908** | 944 | 924 |
| Non audit work: | | | |
| - Other services pursuant to legislation | **9** | 9 | 9 |
| | **917** | 953 | 933 |

In 2012, £85k of the total statutory audit work balance relates to services provided in relation to the technology incident. Other than the amounts disclosed above, no additional remuneration was payable to the auditors for any other services.

Auditor's remuneration is disclosed exclusive of VAT.

**Bank levy**

The UK bank levy was charged at a rate of 0.13% on chargeable liabilities in excess of £20 billion (2012: 0.088%, 2011: average 0.075%). Levy costs in respect of the Bank will be borne by the RBS Group for 2013.

**4. Pension costs**

The Group operates the following defined benefit pension schemes, the assets of which are independent of the Group's finances:

**Name of schemes**
Ulster Bank Pension Scheme
Ulster Bank Pension Scheme (Republic of Ireland)
First Active Pension Scheme

The Ulster Bank Pension Scheme operates under UK trust law and is managed and administered on behalf of its members in accordance with the terms of the trust deed, the scheme rules and UK legislation (principally the Pension Schemes Act 1993, the Pensions Act 1995 and the Pensions Act 2004). 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. Pension fund trustees are required to: prepare a statement of funding principles; obtain regular actuarial valuations and reports; put in place a recovery plan addressing any funding shortfall; and send regular summary funding statements to members of the scheme.

The Ulster Bank Pension Scheme corporate Trustee is Ulster Bank Pension Trustees Limited (“UBPTL”) a wholly owned subsidiary of Ulster Bank Limited. UBPTL is the legal owner of the scheme assets which are held separately from the assets of the Group. The board of UBPTL comprises 3 trustee directors nominated by members selected from eligible active staff and pensioner members who apply and 6 appointed by the Group. The board is responsible for operating the scheme in line with its formal rules and pensions law. It has a duty to act in the best interests of all scheme members, including pensioners and those who are no longer employed by the Group, but who still have benefits in the scheme.

The Group’s main pension scheme in the Republic of Ireland, the Ulster Bank Pension Scheme (Republic of Ireland) (“UBPSRI”), operates under Republic of Ireland trust law and is managed and administered on behalf of its members in accordance with the terms of the trust deed; the scheme rules; and Republic of Ireland legislation (principally the Pension Schemes Act 1990). Under Republic of Ireland legislation a defined benefit pension scheme is required to build up and maintain enough funds to pay members their pension entitlements should the scheme be wound up. Pension fund trustees are required to obtain regular actuarial valuations and reports, put in place a recovery plan addressing any funding shortfall and submit that plan to the Irish Pensions Board for approval.

The corporate Trustee of the UBPSRI is Ulster Bank Pension Trustees R.I. Limited (“UBPTRIL”), a wholly owned subsidiary of Ulster Bank Holdings (ROI) Limited. UBPTRIL is the legal owner of the scheme assets which are held separately from the assets of the Group. The board of UBPTRIL comprises 3 trustee directors nominated by the unions and 6 appointed by the Group. The board is responsible for operating the scheme in line with its formal rules and pensions law. It has a duty to act in the best interests of all scheme members, including pensioners and those who are no longer employed by the Group, but who still have benefits in the scheme.

Similar governance principles to those outlined above relating to UBPSRI apply to the First Active Pension Scheme in the Republic of Ireland.

The schemes were closed to new entrants in 2009, when a new defined contribution scheme was launched.

Employees make contributions at varying levels depending on which scheme they are a member of and when they joined the scheme. In addition, employees may make voluntary contributions to secure additional benefits on a money-purchase basis.

The Group also makes contributions to a small number of RBS Group Pension Schemes, the costs of which are accounted for as defined contributions. The Group made contributions of £3,673k to its own defined contribution schemes in 2013 (2012: £3,252k, 2011: £2,345k). The Bank made contributions of £796k to its own defined contribution schemes in 2013 (2012: £541k, 2011: £453k).

Interim valuations of the Group’s schemes were prepared to 31 December 2013 by independent actuaries, using the following assumptions:

| | Group | | |
|---|---|---|---|
| **Principal actuarial assumptions at 31 December** | **2013** | 2012 | 2011 |
| Discount rate | **3.80% - 4.65%** | 4.10% - 4.50% | 5.00% - 5.75% |
| Rate of increase in salaries | **1.75% - 3.30%** | 1.75% - 3.90% | 1.75% |
| Rate of increase in pensions in payment | **0.00% - 2.30%** | 1.00% - 2.00% | 1.50% - 2.10% |
| Inflation assumption | **2.00% - 3.30%** | 2.00% - 2.90% | 2.00% - 3.00% |

**4. Pension costs (continued)**

**Discount rate**
The Sterling and Euro yield curves are 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. 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 issuance size, quality of pricing and the exclusion of outliers. Judgement is also required in determining the shape of the yield curve at long durations. For the Sterling curve, a constant credit spread relative to gilts is assumed while for the Euro curve rates at longer durations are derived by extrapolating yields on “A” and “AAA” corporate bonds to derive equivalent AA yields.

| | Group | | |
|---|---|---|---|
| **Major classes of plan assets as a percentage of total plan assets** | **2013** | 2012 | 2011 |
| **Quoted assets** | | | |
| Quoted equities | **35%** | 41% | 42% |
| Index-linked bonds | **6%** | 11% | 16% |
| Government fixed interest bonds | **1%** | 1% | 2% |
| Corporate and other bonds | **22%** | 18% | 15% |
| | | | |
| **Unquoted assets** | | | |
| Private equity | **1%** | - | - |
| Hedge funds | **5%** | 18% | 8% |
| Real estate | **5%** | 4% | 5% |
| Derivatives | **1%** | 1% | - |
| Cash and other assets | **24%** | 6% | 12% |

| | Bank | | |
|---|---|---|---|
| **Principal actuarial assumptions at 31 December** | **2013** | 2012 | 2011 |
| Discount rate | **4.65%** | 4.50% | 5.00% |
| Rate of increase in salaries | **1.75% - 3.30%** | 3.90% | 1.75% |
| Rate of increase in pensions in payment | **1.15% - 2.30%** | 1.00% | 1.50% - 2.10% |
| Inflation assumption | **3.30%** | 2.90% | 3.00% |

| | Bank | | |
|---|---|---|---|
| **Major classes of plan assets as a percentage of total plan assets** | **2013** | 2012 | 2011 |
| **Quoted assets** | | | |
| Quoted equities | **36%** | 38% | 38% |
| Index-linked bonds | **13%** | 16% | 19% |
| Government fixed interest bonds | **-** | - | - |
| Corporate and other bonds | **17%** | 17% | 15% |
| | | | |
| **Unquoted assets** | | | |
| Private equity | **1%** | - | - |
| Hedge funds | **9%** | 13% | 9% |
| Real estate | **6%** | 4% | 5% |
| Cash and other assets | **18%** | 12% | 14% |

| | Group and Bank | | |
|---|---|---|---|
| **Post-retirement mortality assumptions (Main scheme)** | **2013** | 2012 | 2011 |
| Longevity at age 70 for current pensioners (years) | | | |
| Males | **17.5** | 17.3 | 17.1 |
| Females | **18.9** | 18.7 | 18.6 |
| | | | |
| Longevity at age 63 for future pensioners (years) | | | |
| Males | **24.1** | 23.9 | 23.7 |
| Females | **25.6** | 25.5 | 25.4 |

These post-retirement mortality assumptions are derived from standard mortality tables used by the scheme actuary to value the liabilities for the main scheme.

**4. Pension costs (continued)**

| **Group (all schemes)**<br>**Changes in value of net pension asset/(liability)** | **Fair value of plan assets £m** | **Present value of defined benefit obligations £m** | **Net pension asset/(liability) £m** |
|---|---|---|---|
| **At 1 January 2013** | 1,331 | (1,511) | **(180)** |
| Currency translation and other adjustments | 14 | (18) | **(4)** |
| *Income statement:* | | | |
| Expected return | 59 | - | **59** |
| Interest cost | - | (65) | **(65)** |
| Current service cost | - | (39) | **(39)** |
| Contributions by other scheme members | - | 3 | **3** |
| Past service cost | - | 10 | **10** |
| | 59 | (91) | **(32)** |
| *Statement of comprehensive income:* | | | |
| Actuarial gains and losses due to experience gains | 20 | 53 | **73** |
| Actuarial gains and losses due to changes in financial assumptions | - | (71) | **(71)** |
| Actuarial gains and losses due to changes in demographic assumptions | - | (14) | **(14)** |
| Contributions by employer | 73 | - | **73** |
| Contributions by other scheme members | 3 | (3) | **-** |
| Contributions by plan participants | 3 | (3) | **-** |
| Benefits paid | (38) | 38 | **-** |
| Expenses included in service cost | (2) | 2 | **-** |
| **At 31 December 2013** | 1,463 | (1,618) | **(155)** |

| **Group (all schemes)**<br>Restated changes in value of net pension asset/(liability) | Fair value of plan assets £m | Present value of defined benefit obligations £m | Net pension asset/(liability) £m |
|---|---|---|---|
| **At 1 January 2012** | 1,162 | (1,195) | (33) |
| Currency translation and other adjustments | 7 | (7) | - |
| *Income statement:* | | | |
| Expected return | 62 | - | 62 |
| Interest cost | - | (62) | (62) |
| Current service cost | - | (28) | (28) |
| Past service cost | - | 2 | 2 |
| | 62 | (88) | (26) |
| *Statement of comprehensive income:* | | | |
| Actuarial gains and losses due to experience gains and losses | 55 | 31 | 86 |
| Actuarial gains and losses due to changes in financial assumptions | - | (260) | (260) |
| Actuarial gains and losses due to changes in demographic assumptions | - | (24) | (24) |
| Contributions by employer | 77 | - | 77 |
| Contributions by plan participants | 4 | (4) | - |
| Benefits paid | (35) | 35 | - |
| Expenses included in service cost | (1) | 1 | - |
| **At 31 December 2012** | 1,331 | (1,511) | (180) |

| **Net pension deficit comprises** | **2013 £m** | Restated 2012 £m | Restated 2011 £m |
|---|---|---|---|
| Net assets of schemes in surplus | **77** | 33 | 3 |
| Net liabilities of schemes in deficit | **(232)** | (213) | (36) |
| | **(155)** | (180) | (33) |

**4. Pension costs (continued)**

Of the expense for the year, £32m (2012: restated £26m) has been included in the income statement within staff costs (see Note 3). Cumulative actuarial losses of £12m (2012: restated £198m) have been recognised in the statement of comprehensive income. The past service gain of £10m (2012: £2m) relates to the pension levy.

The Group expects to contribute £76m to its defined benefit pension schemes in 2014.

The weighted average duration of the Group's defined benefit obligation is 22 years.

| **Bank**<br>**Changes in value of net pension asset/(liability)** | **Fair value of plan assets £m** | **Present value of defined benefit obligations £m** | **Net pension asset/(liability) £m** |
|---|---|---|---|
| **At 1 January 2013** | 649 | (616) | **33** |
| *Income statement:* | | | |
| Expected return | 30 | - | **30** |
| Interest cost | - | (27) | **(27)** |
| Current service cost | - | (12) | **(12)** |
| Contributions by other scheme members | - | 3 | **3** |
| | 30 | (36) | **(6)** |
| *Statement of comprehensive income:* | | | |
| Actuarial gains and losses due to experience gains and losses | 28 | 7 | **35** |
| Actuarial gains and losses due to changes in financial assumptions | - | (10) | **(10)** |
| Actuarial gains and losses due to changes in demographic assumptions | - | (14) | **(14)** |
| Contributions by employer | 39 | - | **39** |
| Contributions by other scheme members | 3 | (3) | **-** |
| Contributions by plan participants | 1 | (1) | **-** |
| Benefits paid | (18) | 18 | **-** |
| Expenses included in service cost | (1) | 1 | **-** |
| **At 31 December 2013** | 731 | (654) | **77** |

| **Bank**<br>Restated changes in value of net pension asset/(liability) | Fair value of plan assets £m | Present value of defined benefit obligations £m | Net pension asset/(liability) £m |
|---|---|---|---|
| **At 1 January 2012** | 555 | (552) | 3 |
| Currency translation and other adjustments | 22 | (22) | - |
| *Income statement:* | | | |
| Expected return | 28 | - | 28 |
| Interest cost | - | (27) | (27) |
| Current service cost | - | (12) | (12) |
| | 28 | (39) | (11) |
| *Statement of comprehensive income:* | | | |
| Actuarial gains and losses due to experience gains and losses | 22 | 28 | 50 |
| Actuarial gains and losses due to changes in financial assumptions | - | (25) | (25) |
| Actuarial gains and losses due to changes in demographic assumptions | - | (24) | (24) |
| Contributions by employer | 40 | - | 40 |
| Contributions by plan participants | 1 | (1) | - |
| Benefits paid | (18) | 18 | - |
| Expenses included in service cost | (1) | 1 | - |
| **At 31 December 2012** | 649 | (616) | 33 |

Of the expense for the year, £6m (2012: restated £11m) has been included in the income statement within staff costs.

The Bank expects to contribute £40m to its defined benefit pension scheme in 2014.

**4. Pension costs (continued)**

| **History of defined benefit schemes (Group)** | **2013 £m** | Restated 2012 £m | Restated 2011 £m | Restated 2010 £m | Restated 2009 £m |
|---|---|---|---|---|---|
| Present value of defined benefit obligations | **(1,618)** | (1,511) | (1,195) | (1,179) | (1,272) |
| Fair value of plan assets | **1,463** | 1,331 | 1,162 | 1,146 | 1,012 |
| Net deficit | **(155)** | (180) | (33) | (33) | (260) |
| Experience gains/(losses) on plan liabilities | **53** | 31 | 12 | 137 | (184) |
| Experience gains/(losses) on plan assets | **20** | 55 | (70) | 53 | 92 |
| Actual return on pension scheme assets | **79** | 117 | (6) | 100 | 130 |

| **History of defined benefit schemes (Bank)** | **2013 £m** | Restated 2012 £m | Restated 2011 £m | Restated 2010 £m | Restated 2009 £m |
|---|---|---|---|---|---|
| Present value of defined benefit obligations | **(654)** | (616) | (552) | (527) | (557) |
| Fair value of plan assets | **731** | 649 | 555 | 525 | 458 |
| Net surplus/(deficit) | **77** | 33 | 3 | (2) | (99) |
| Experience gains/(losses) on plan liabilities | **7** | 28 | 5 | 54 | (137) |
| Experience gains/(losses) on plan assets | **28** | 22 | (21) | 28 | 30 |
| Actual return on pension scheme assets | **58** | 50 | 8 | 53 | 55 |

The table below sets out the sensitivities of the pension cost for the year and the present value of defined benefit obligations at the balance sheet dates to a change in the principal actuarial assumptions:

| | **Group** | | | | | |
|---|---|---|---|---|---|---|
| | (Decrease)/increase in pension cost for the year | | | (Decrease)/increase in obligation at 31 December | | |
| | **2013 £m** | Restated 2012 £m | Restated 2011 £m | **2013 £m** | Restated 2012 £m | Restated 2011 £m |
| 0.25% increase in the discount rate | **(6)** | (5) | (6) | **(84)** | (77) | (60) |
| 0.25% increase in inflation | **4** | 3 | 3 | **61** | 82 | 63 |
| 0.25% additional rate of increase in pensions in payment | **3** | 3 | 3 | **50** | 47 | 38 |
| 0.25% additional rate of increase in deferred pensions | **-** | - | - | **16** | 9 | 8 |
| 0.25% additional rate of increase in salaries | **3** | 2 | 2 | **21** | 24 | 17 |
| Longevity increase of 1 year | **2** | 2 | 2 | **37** | 30 | 24 |

| | **Bank** | | | | | |
|---|---|---|---|---|---|---|
| | (Decrease)/increase in pension cost for the year | | | (Decrease)/increase in obligation at 31 December | | |
| | **2013 £m** | 2012 £m | 2011 £m | **2013 £m** | 2012 £m | 2011 £m |
| 0.25% increase in the discount rate | **(2)** | (2) | (2) | **(30)** | (29) | (28) |
| 0.25% increase in inflation | **1** | 1 | 2 | **21** | 30 | 29 |
| 0.25% additional rate of increase in pensions in payment | **1** | 1 | 1 | **21** | 19 | 19 |
| 0.25% additional rate of increase in deferred pensions | **-** | - | - | **6** | 3 | 3 |
| 0.25% additional rate of increase in salaries | **1** | 1 | 1 | **6** | 8 | 7 |
| Longevity increase of 1 year | **1** | 1 | 1 | **13** | 12 | 11 |

### 4. Pension costs (continued)

In the Republic of Ireland, the Finance (No.2) Act 2011 introduced a levy at the rate of 0.6% per annum for each of the next four years, 2011 to 2014. In October 2013, the Government introduced an additional levy of 0.15% of the Scheme's assets which is payable in 2014 and 2015. The Act states that payment is due by 25 September each year. The levy is payable on all of a scheme's assets (other than "excluded assets"). During 2013, an amount of £4.2m (excluding Additional Voluntary Contributions) was deducted from the asset value of the Group's two Republic of Ireland pension schemes within the statutory deadlines (2012: £3.6m).

### 5. Emoluments of directors

| | **2013** | 2012 |
|---|---|---|
| | **£** | £ |
| Emoluments for the provision of directors' services: | | |
| Non-executive directors - emoluments | **335,085** | 346,319 |
| Chairman and executive directors | | |
| - Emoluments | **1,654,028** | 1,724,916 |
| - Pension contributions | **-** | 57,638 |
| Total emoluments received | **1,989,113** | 2,128,873 |

Two of the non-executive directors of the Bank, Andrew McLaughlin and Christopher Campbell, are employed by The Royal Bank of Scotland plc and are remunerated for their services to the RBS Group as a whole.

No retirement benefits are accruing to directors under either defined contribution or defined benefit schemes at year end (2012: none).

Performance related bonuses are awarded on the basis of measuring annual performance against certain specified financial targets, which include both corporate performance objectives and key strategic objectives.

During the year there were no emoluments in respect of compensation payments for loss of office (2012: £nil).

During the year the highest paid director received emoluments of £701,857 (2012: £744,792). The highest paid director did not exercise any share options during the year.

The executive directors may also participate in the RBS Group's executive share option and sharesave schemes.

### 6. Taxation

| | | **Group** | |
|---|---|---|---|
| | | Restated | Restated |
| | **2013** | 2012 | 2011 |
| **Current taxation:** | **£m** | £m | £m |
| *United Kingdom Corporation Tax at 23.25% (2012: 24.5%, 2011: 26.5%)* | | | |
| Credit for the year | **185** | 98 | 180 |
| (Under)/over provision in respect of prior periods | **(4)** | (11) | 12 |
| | **181** | 87 | 192 |
| *Overseas Tax at 12.5% (2012: 12.5%, 2011: 12.5%)* | | | |
| Credit for the year | **3** | 3 | - |
| Over provision in respect of prior periods | **2** | 5 | 4 |
| Total current taxation | **186** | 95 | 196 |
| **Deferred taxation:** | | | |
| (Charge)/credit for the year | **(11)** | (10) | 54 |
| Over/(under) provision in respect of prior periods | **6** | (198) | 7 |
| Total deferred taxation | **(5)** | (208) | 61 |
| **Tax credit/(charge) for the year** | **181** | (113) | 257 |

### 6. Taxation (continued)

The actual tax credit/(charge) differs from the expected tax credit computed by applying the standard rate of UK Corporation Tax of 23.25% (2012: 24.5%, 2011: 26.5%) as follows:

| | **2013 £m** | Restated 2012 £m | Restated 2011 £m |
|---|---|---|---|
| **Operating loss before tax** | **(4,374)** | (2,091) | (3,081) |
| **Expected tax credit** | **1,017** | 512 | 816 |
| *Factors affecting the credit for the year:* | | | |
| Tax arising at rates other than the standard rate of tax | **(413)** | (201) | (349) |
| Non-deductible items | **(2)** | (4) | (9) |
| Other temporary differences | **52** | (8) | 29 |
| De-recognition of a deferred tax asset | **-** | (203) | - |
| Unrecognised losses | **(477)** | (208) | (253) |
| Adjustments to tax credit in respect of prior periods | **4** | (1) | 23 |
| **Actual tax credit/(charge) for the year** | **181** | (113) | 257 |

The effective tax rate for the year was 4.1% (2012 restated: (5.4%), 2011 restated: 8.3%).

### 7. Loss dealt with in the financial statements of the Bank

In accordance with the exemption contained within Section 408(3) of the Companies Act 2006 the primary financial statements of the Bank do not include an Income Statement or Statement of Comprehensive Income. The Bank's loss after tax for the year ended 31 December 2013 is £850m (2012: restated £3,945m, 2011: restated £4,004m), which includes write downs of investments in Group undertakings which eliminate on consolidation in the results of the Group.

### 8. Financial instruments

The following tables analyse the financial assets and financial liabilities in accordance with the categories of financial instruments in accordance with IAS 39 'Financial Instruments: Recognition and Measurement'. Assets and liabilities outside the scope of IAS 39 are shown separately.

| | Group | | | | | | |
|---|---|---|---|---|---|---|---|
| **2013** | Held-for-trading £m | Designated as at fair value through profit or loss £m | Available-for-sale £m | Loans and receivables £m | Other (amortised cost) £m | Non financial assets/ liabilities £m | Total £m |
| **Assets** | | | | | | | |
| Cash and balances at central banks(1) | - | - | - | 867 | - | - | **867** |
| Loans and advances to banks (2) | - | - | - | 9,752 | - | - | **9,752** |
| Loans and advances to customers(3) | - | - | - | 28,263 | - | - | **28,263** |
| Debt securities | - | - | 9 | - | - | - | **9** |
| Equity shares | - | 2 | 7 | - | - | - | **9** |
| Derivatives | 561 | - | - | - | - | - | **561** |
| Property, plant and equipment | - | - | - | - | - | 333 | **333** |
| Prepayments, accrued income and other assets | - | - | - | - | - | 236 | **236** |
| Retirement benefit asset | - | - | - | - | - | 77 | **77** |
| Deferred taxation | - | - | - | - | - | 75 | **75** |
| | 561 | 2 | 16 | 38,882 | - | 721 | **40,182** |
| **Liabilities** | | | | | | | |
| Deposits by banks (4) | 42 | - | - | - | 8,619 | - | **8,661** |
| Customer accounts (5) | - | 2,174 | - | - | 20,124 | - | **22,298** |
| Debt securities in issue (6) | - | - | - | - | 1,908 | - | **1,908** |
| Derivatives | 744 | - | - | - | - | - | **744** |
| Accruals, deferred income and other liabilities | - | - | - | - | - | 1,008 | **1,008** |
| Retirement benefit liabilities | - | - | - | - | - | 232 | **232** |
| Deferred taxation | - | - | - | - | - | 24 | **24** |
| Subordinated liabilities | - | - | - | - | 1,175 | - | **1,175** |
| | 786 | 2,174 | - | - | 31,826 | 1,264 | **36,050** |
| Equity | | | | | | | **4,132** |
| | | | | | | | **40,182** |

For notes relating to this table refer to page 35.

**8. Financial instruments (continued)**

| | Group | | | | | | |
|---|---|---|---|---|---|---|---|
| Restated 2012 | Held-for-trading £m | Designated as at fair value through profit or loss £m | Available-for-sale £m | Loans and receivables £m | Other (amortised cost) £m | Non financial assets/ liabilities £m | Total £m |
| **Assets** | | | | | | | |
| Cash and balances at central banks (1) | - | - | - | 725 | - | - | 725 |
| Loans and advances to banks (2) | 13 | - | - | 8,177 | - | - | 8,190 |
| Loans and advances to customers (3) | - | 25 | - | 34,381 | - | - | 34,406 |
| Debt securities | - | - | 26 | - | - | - | 26 |
| Equity shares | - | - | 7 | - | - | - | 7 |
| Derivatives | 724 | - | - | - | - | - | 724 |
| Property, plant and equipment | - | - | - | - | - | 341 | 341 |
| Prepayments, accrued income and other assets | - | - | - | - | - | 123 | 123 |
| Retirement benefit asset | - | - | - | - | - | 33 | 33 |
| Deferred taxation | - | - | - | - | - | 75 | 75 |
| | 737 | 25 | 33 | 43,283 | - | 572 | 44,650 |
| **Liabilities** | | | | | | | |
| Deposits by banks (4) | 58 | - | - | - | 7,837 | - | 7,895 |
| Customer accounts (5) | 4 | 2,069 | - | - | 20,997 | - | 23,070 |
| Debt securities in issue (6) | - | - | - | - | 3,254 | - | 3,254 |
| Derivatives | 992 | - | - | - | - | - | 992 |
| Accruals, deferred income and other liabilities | - | - | - | - | - | 909 | 909 |
| Retirement benefit liabilities | - | - | - | - | - | 213 | 213 |
| Deferred taxation | - | - | - | - | - | 19 | 19 |
| Subordinated liabilities | - | - | - | - | 1,157 | - | 1,157 |
| | 1,054 | 2,069 | - | - | 33,245 | 1,141 | 37,509 |
| Equity | | | | | | | 7,141 |
| | | | | | | | 44,650 |

| | Group | | | | | | |
|---|---|---|---|---|---|---|---|
| Restated 2011 | Held-for-trading £m | Designated as at fair value through profit or loss £m | Available-for-sale £m | Loans and receivables £m | Other (amortised cost) £m | Non financial assets/ liabilities £m | Total £m |
| **Assets** | | | | | | | |
| Cash and balances at central banks (1) | - | - | - | 749 | - | - | 749 |
| Loans and advances to banks (2) | 21 | - | - | 7,310 | - | - | 7,331 |
| Loans and advances to customers (3) | - | 32 | - | 38,913 | - | - | 38,945 |
| Debt securities | - | - | 98 | - | - | - | 98 |
| Equity shares | - | - | 5 | - | - | - | 5 |
| Derivatives | 997 | - | - | - | - | - | 997 |
| Property, plant and equipment | - | - | - | - | - | 349 | 349 |
| Prepayments, accrued income and other assets | - | - | - | - | - | 155 | 155 |
| Retirement benefit asset | - | - | - | - | - | 3 | 3 |
| Deferred taxation | - | - | - | - | - | 285 | 285 |
| | 1,018 | 32 | 103 | 46,972 | - | 792 | 48,917 |
| **Liabilities** | | | | | | | |
| Deposits by banks (4) | 59 | - | - | - | 12,771 | - | 12,830 |
| Customer accounts (5) | 17 | 1,790 | - | - | 20,541 | - | 22,348 |
| Debt securities in issue (6) | - | - | - | - | 3,530 | - | 3,530 |
| Derivatives | 1,352 | - | - | - | - | - | 1,352 |
| Accruals, deferred income and other liabilities | - | | - | - | - | 871 | 871 |
| Retirement benefit liabilities | - | - | - | - | - | 36 | 36 |
| Deferred taxation | - | - | - | - | - | 13 | 13 |
| Subordinated liabilities | - | - | - | - | 1,183 | - | 1,183 |
| | 1,428 | 1,790 | - | - | 38,025 | 920 | 42,163 |
| Equity | | | | | | | 6,754 |
| | | | | | | | 48,917 |

For notes relating to the tables above refer to page 35.

## 8. Financial instruments (continued)

(1) Cash and balances at central banks includes Bank of England notes held in respect of notes in circulation in Northern Ireland.
(2) Includes items in the course of collection from other banks of £126m (2012: £187m, 2011: £198m).
(3) The Group has advances secured on residential properties subject to non–recourse funding. Under IAS 39, these securitised mortgages qualify for full recognition on the balance sheet at 31 December 2013. As at 31 December 2013 £9,308m (2012: £10,587m, 2011: £11,709m) are included in loans and advances to customers. Included within Loans and advances to customers is £1m (2012 and 2011: £nil) of gross loans subject to enforceable offset arrangements. No netting has taken place therefore the net effective Balance Sheet value is equal to the gross amount.
(4) Includes repurchase agreements of £1,874m (2012: £1,875m, 2011: £1,381m) and items in the course of transmission to other banks of £273m (2012: £250m, 2011: £159m). Included within Deposits by banks are gross amounts relating to reverse repurchase agreements totalling £1,193m (2012: £593m, 2011: nil) which are subject to enforceable offset arrangements. No netting has taken place therefore the net effective Balance Sheet value is equal to the gross amounts.
(5) The carrying amount of other customer accounts designated as at fair value through profit or loss is £3m less (2012: £61m less, 2011: £65m less) than the principal amount.
(6) Comprises bonds and medium term notes of £1,890m (2012: £3,217m, 2011: £3,472m) and certificates of deposit and other commercial paper of £18m (2012: £37m, 2011: £58m)

| | Bank | | | | | | |
|---|---|---|---|---|---|---|---|
| **2013** | Held-for-trading £m | Designated as at fair value through profit or loss £m | Available-for-sale £m | Loans and receivables £m | Other (amortised cost) £m | Non financial assets/ liabilities £m | Total £m |
| **Assets** | | | | | | | |
| Cash and balances at central banks | - | - | - | 624 | - | - | **624** |
| Loans and advances to banks (1) | - | - | - | 7,236 | - | - | **7,236** |
| Loans and advances to customers | - | - | - | 4,930 | - | - | **4,930** |
| Debt securities | - | - | 9 | - | - | - | **9** |
| Investments in Group undertakings | - | - | - | - | - | 3,110 | **3,110** |
| Derivatives | 16 | - | - | - | - | - | **16** |
| Property, plant and equipment | - | - | - | - | - | 56 | **56** |
| Prepayments, accrued income and other assets | - | - | - | - | - | 194 | **194** |
| Retirement benefit assets | - | - | - | - | - | 77 | **77** |
| Deferred taxation | - | - | - | - | - | 1 | **1** |
| | 16 | - | 9 | 12,790 | - | 3,438 | **16,253** |
| **Liabilities** | | | | | | | |
| Deposits by banks (2) | - | - | - | - | 4,485 | - | **4,485** |
| Customer accounts (3) | - | 312 | - | - | 6,506 | - | **6,818** |
| Debt securities in issue | - | - | - | - | 9 | - | **9** |
| Derivatives | 47 | - | - | - | - | - | **47** |
| Accruals, deferred income and other liabilities | - | - | - | - | - | 735 | **735** |
| Deferred taxation | - | - | - | - | - | 21 | **21** |
| Subordinated liabilities | - | - | - | - | 956 | - | **956** |
| | 47 | 312 | - | - | 11,956 | 756 | **13,071** |
| Equity | | | | | | | **3,182** |
| | | | | | | | **16,253** |

For notes relating to this table refer to page 36.

**NOTES TO THE FINANCIAL STATEMENTS** *for the year ended 31 December 2013*

## 8. Financial instruments (continued)

| Restated 2012 | Bank Held-for-trading £m | Designated as at fair value through profit or loss £m | Available-for-sale £m | Loans and receivables £m | Other (amortised cost) £m | Non financial assets/ liabilities £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances at central banks | - | - | - | 545 | - | - | 545 |
| Loans and advances to banks (1) | - | - | - | 7,054 | - | - | 7,054 |
| Loans and advances to customers | - | - | - | 6,020 | - | - | 6,020 |
| Debt securities | - | - | 26 | - | - | - | 26 |
| Investments in Group undertakings | - | - | - | - | - | 2,544 | 2,544 |
| Derivatives | 37 | - | - | - | - | - | 37 |
| Property, plant and equipment | - | - | - | - | - | 64 | 64 |
| Prepayments, accrued income and other assets | - | - | - | - | - | 88 | 88 |
| Retirement benefit assets | - | - | - | - | - | 33 | 33 |
| Deferred taxation | - | - | - | - | - | 2 | 2 |
| | 37 | - | 26 | 13,619 | - | 2,731 | 16,413 |
| **Liabilities** | | | | | | | |
| Deposits by banks (2) | - | - | - | - | 4,540 | - | 4,540 |
| Customer accounts (3) | 3 | 379 | - | - | 6,772 | - | 7,154 |
| Debt securities in issue | - | - | - | - | 2 | - | 2 |
| Derivatives | 78 | - | - | - | - | - | 78 |
| Accruals, deferred income and other liabilities | - | - | - | - | - | 668 | 668 |
| Deferred taxation | | | | | | 15 | 15 |
| Subordinated liabilities | - | - | - | - | 939 | - | 939 |
| | 81 | 379 | - | - | 12,253 | 683 | 13,396 |
| Equity | | | | | | | 3,017 |
| | | | | | | | 16,413 |

| Restated 2011 | Bank Held-for-trading £m | Designated as at fair value through profit or loss £m | Available-for-sale £m | Loans and receivables £m | Other (amortised cost) £m | Non financial assets/ liabilities £m | Total £m |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances at central banks | - | - | - | 522 | - | - | 522 |
| Loans and advances to banks (1) | - | - | - | 6,757 | - | - | 6,757 |
| Loans and advances to customers | - | - | - | 6,453 | - | - | 6,453 |
| Debt securities | - | - | 71 | - | - | - | 71 |
| Investments in Group undertakings | - | - | - | - | - | 3,488 | 3,488 |
| Derivatives | 87 | - | - | - | - | - | 87 |
| Property, plant and equipment | - | - | - | - | - | 81 | 81 |
| Prepayments, accrued income and other assets | - | - | - | - | - | 150 | 150 |
| Retirement benefit assets | - | - | - | - | - | 3 | 3 |
| Deferred taxation | | | | | | 2 | 2 |
| | 87 | - | 71 | 13,732 | - | 3,724 | 17,614 |
| **Liabilities** | | | | | | | |
| Deposits by banks (2) | - | - | - | - | 4,365 | - | 4,365 |
| Customer accounts (3) | 10 | 466 | - | - | 7,011 | - | 7,487 |
| Debt securities in issue | - | - | - | - | 38 | - | 38 |
| Derivatives | 84 | - | - | - | - | - | 84 |
| Accruals, deferred income and other liabilities | - | - | - | - | - | 641 | 641 |
| Deferred taxation | | | | | | 10 | 10 |
| Subordinated liabilities | - | - | - | - | 961 | - | 961 |
| | 94 | 466 | - | - | 12,375 | 651 | 13,586 |
| Equity | | | | | | | 4,028 |
| | | | | | | | 17,614 |

(1) Includes items in the course of collection from other banks of £54m (2012: £60m, 2011: £74m).
(2) Includes items in the course of transmission to other banks of £27m (2012: £33m, 2011: £40m).
(3) The carrying amount of other customer accounts designated as at fair value through profit or loss is £30m less (2012: £1m less, 2011: £7m less) than the principal amount.

**8. Financial instruments (continued)**

The following tables show the financial instruments carried at fair value by valuation method:

| | Group | | | |
|---|---|---|---|---|
| | **Level 1(1)** | **Level 2(2)** | **Level 3(3)** | **Total** |
| **2013** | **£m** | **£m** | **£m** | **£m** |
| **Assets** | | | | |
| Debt securities | **-** | **9** | **-** | **9** |
| Equity shares | **2** | **-** | **7** | **9** |
| Derivatives(4) | **-** | **561** | **-** | **561** |
| **Total** | **2** | **570** | **7** | **579** |
| **Liabilities** | | | | |
| Deposits by banks | **-** | **42** | **-** | **42** |
| Deposits by customers | **-** | **2,174** | **-** | **2,174** |
| Derivatives(5) | **-** | **744** | **-** | **744** |
| **Total** | **-** | **2,960** | **-** | **2,960** |

| | Group | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| 2012 | £m | £m | £m | £m |
| **Assets** | | | | |
| Loans and advances to banks | - | 13 | - | 13 |
| Loans and advances to customers | - | 25 | - | 25 |
| Debt securities | - | 26 | - | 26 |
| Equity shares (6) | - | - | 7 | 7 |
| Derivatives(4) | - | 724 | - | 724 |
| **Total** | - | 788 | 7 | 795 |
| **Liabilities** | | | | |
| Deposits by banks | - | 58 | - | 58 |
| Deposits by customers | - | 2,073 | - | 2,073 |
| Derivatives(5) | - | 992 | - | 992 |
| **Total** | - | 3,123 | - | 3,123 |

| | Group | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| 2011 | £m | £m | £m | £m |
| **Assets** | | | | |
| Loans and advances to banks | - | 21 | - | 21 |
| Loans and advances to customers | - | 32 | - | 32 |
| Debt securities | 27 | 71 | - | 98 |
| Equity shares (7) | - | - | 5 | 5 |
| Derivatives(4) | - | 997 | - | 997 |
| **Total** | 27 | 1,121 | 5 | 1,153 |
| **Liabilities** | | | | |
| Deposits by banks | - | 59 | - | 59 |
| Deposits by customers | - | 1,807 | - | 1,807 |
| Derivatives(5) | - | 1,352 | - | 1,352 |
| **Total** | - | 3,218 | - | 3,218 |

For notes relating to the tables above refer to page 38.

**8. Financial instruments (continued)**

| | Bank | | | |
|---|---|---|---|---|
| **2013** | **Level 1(1) £m** | **Level 2(2) £m** | **Level 3(3) £m** | **Total £m** |
| **Assets** | | | | |
| Debt securities | **-** | **9** | **-** | **9** |
| Derivatives | **-** | **16** | **-** | **16** |
| **Total** | **-** | **25** | **-** | **25** |
| | | | | |
| **Liabilities** | | | | |
| Deposits by customers | **-** | **312** | **-** | **312** |
| Derivatives | **-** | **47** | **-** | **47** |
| **Total** | **-** | **359** | **-** | **359** |

| | Bank | | | |
|---|---|---|---|---|
| 2012 | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
| **Assets** | | | | |
| Debt securities | - | 26 | - | 26 |
| Derivatives | - | 37 | - | 37 |
| **Total** | - | 63 | - | 63 |
| | | | | |
| **Liabilities** | | | | |
| Deposits by customers | - | 382 | - | 382 |
| Derivatives | - | 78 | - | 78 |
| **Total** | - | 460 | - | 460 |

| | Bank | | | |
|---|---|---|---|---|
| 2011 | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
| **Assets** | | | | |
| Debt securities | - | 71 | - | 71 |
| Derivatives(4) | - | 87 | - | 87 |
| **Total** | - | 158 | - | 158 |
| | | | | |
| **Liabilities** | | | | |
| Deposits by customers | - | 476 | - | 476 |
| Derivatives(5) | - | 84 | - | 84 |
| **Total** | - | 560 | - | 560 |

(1) Valued using unadjusted quoted prices in active markets for identical financial instruments. This category includes listed equity shares and government securities.

(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 valuation are directly or indirectly based on observable market data.

   The type of instruments that trade in markets that are not considered to be active, but are based on quoted market prices, broker dealer quotations or alternative pricing sources with reasonable levels of price transparency and those instruments valued using techniques include most government agency securities, investment-grade corporate bonds, certain mortgage products, certain bank and bridge loans, repos and reverse repos, less liquid equities, state and municipal obligations, most physical commodities and certain money market securities and loan commitments and most OTC derivatives.

(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. Where inputs can be observed from market data without undue cost and effort, the observed input is used. Otherwise, the Group determines a reasonable level for the input.

   Financial instruments included within Level 3 of the fair value hierarchy primarily consist of cash instruments which trade infrequently, certain syndicated and commercial mortgage loans, unlisted equity shares, certain residual interests in securitisations, super senior tranches of high grade and mezzanine collateralised debt obligations (CDO's), and other mortgage-based 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.

(4) For the year ending 31 December 2011 the Group reclassified £528m (Bank: £82m) of derivative assets from level 1 to level 2 to better reflect the valuation method used for derivative assets.

(5) For the year ending 31 December 2011 the Group reclassified £947m (Bank: £83m) of derivative liabilities from level 1 to level 2 to better reflect the valuation method used for derivative liabilities.

(6) For the year ending 31 December 2012 the Group reclassified £7m (Bank: £nil) of equity shares from level 2 to level 3 to better reflect the valuation method used.

(7) For the year ending 31 December 2011 the Group reclassified £5m (Bank: £nil) of equity shares from level 2 to level 3 to better reflect the valuation method used.

## 8. Financial instruments (continued)

### Level 3 portfolio movement tables

| | Group | | |
|---|---|---|---|
| | | Reclassified | Reclassified |
| | **2013** | 2012 | 2011 |
| **Equity shares** | **£m** | £m | £m |
| At 1 January | **7** | 5 | 4 |
| Additions | **4** | 3 | 3 |
| Disposals | **(4)** | (1) | (1) |
| Impairment | **-** | - | (1) |
| At 31 December | **7** | 7 | 5 |

The following tables show the carrying values and the fair values of financial instruments on the balance sheet carried at amortised cost: All assets and liabilities carried at amortised cost on the balance sheet fall within level 3 of the valuation methodologies, as set out on page 38.

| | Group | | | | | |
|---|---|---|---|---|---|---|
| | **2013 Carrying value £m** | **2013 Fair value £m** | 2012 Carrying value £m | 2012 Fair value £m | 2011 Carrying value £m | 2011 Fair value £m |
| **Financial assets** | | | | | | |
| Cash and balances at central banks | **867** | **867** | 725 | 725 | 749 | 749 |
| Loans and advances to banks | | | | | | |
| Loans and receivables | **9,752** | **9,752** | 8,177 | 8,177 | 7,310 | 7,310 |
| Loans and advances to customers | | | | | | |
| Loans and receivables | **28,263** | **22,643** | 34,381 | 27,807 | 38,913 | 30,260 |
| **Financial liabilities** | | | | | | |
| Deposits by banks | **8,619** | **8,619** | 7,837 | 7,837 | 12,771 | 12,771 |
| Customer accounts | **20,124** | **20,175** | 20,997 | 21,093 | 20,541 | 20,658 |
| Debt securities in issue | **1,908** | **1,575** | 3,254 | 2,160 | 3,530 | 2,130 |
| Subordinated liabilities | **1,175** | **1,175** | 1,157 | 1,157 | 1,183 | 1,197 |

**8. Financial instruments (continued)**

| | Bank | | | | | |
|---|---|---|---|---|---|---|
| | **2013 Carrying value £m** | **2013 Fair value £m** | 2012 Carrying value £m | 2012 Fair value £m | 2011 Carrying value £m | 2011 Fair value £m |
| **Financial assets** | | | | | | |
| Cash and balances at central banks | **624** | **624** | 545 | 545 | 522 | 522 |
| Loans and advances to banks | | | | | | |
| Loans and receivables | **7,236** | **7,236** | 7,054 | 7,054 | 6,757 | 6,757 |
| Loans and advances to customers | | | | | | |
| Loans and receivables | **4,930** | **4,496** | 6,020 | 5,417 | 6,453 | 4,921 |
| **Financial liabilities** | | | | | | |
| Deposits by banks | **4,485** | **4,485** | 4,540 | 4,540 | 4,365 | 4,365 |
| Customer accounts | **6,506** | **6,508** | 6,772 | 6,781 | 7,011 | 7,021 |
| Debt securities in issue | **9** | **9** | 2 | 2 | 38 | 38 |
| Subordinated liabilities | **956** | **956** | 939 | 939 | 961 | 961 |

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.

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. As a wide range of valuation techniques are available, it may be inappropriate to compare the Group's fair value information to independent markets or other financial institutions' fair values.

The assumptions and methodologies underlying the calculation of fair values of financial instruments at the balance sheet date are set out below:

The fair value of financial instruments that are of short maturity (3 months or less) approximates their carrying value. This applies mainly to 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 and demand deposits.

The Group uses a number of methodologies to determine the fair values of financial instruments for which observable prices in active markets for identical instruments are not available. These techniques include: relative value methodologies based on observable prices for similar instruments; present value approaches where future cash flows from the asset or liability are estimated and then discounted using a risk-adjusted interest rate; option pricing models (such as Black-Scholes or binomial option pricing models) and simulation models such as Monte-Carlo.

The principal inputs to these valuation techniques are listed below. 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.

- 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.
- Interest rates - these are principally benchmark interest rates such as the London Inter-Bank Offered Rate (LIBOR) and quoted interest rates in the swap, bond and futures markets.
- Foreign currency exchange rates - there are observable markets both for spot and forward contracts and futures in the world's major currencies.

**8. Financial instruments (continued)**

**Loans and advances to banks and customers**
Fair value is estimated by grouping loans into homogeneous portfolios and applying a discount rate to the cash flows. The discount rate is based on the market rate applicable at the balance sheet date for a similar portfolio with similar maturity and credit risk characteristics. Where no similar market rates are available, values have been estimated based on expected future cash flows and other valuation techniques which involve uncertainties and require assumptions and judgements covering credit risk and observable market data.

**Debt securities**
Fair values are determined using quoted prices where available or by reference to quoted prices of similar instruments.

**Deposits by banks and customer accounts**
The 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 where available or by reference to valuation techniques, adjusting for own credit spreads where appropriate.

**Remaining maturity**

| | **Group** | | |
|---|---|---|---|
| **2013** | **Less than 12 months £m** | **More than 12 months £m** | **Total £m** |
| **Assets** | | | |
| Cash and balances at central banks | **867** | **-** | **867** |
| Loans and advances to banks | **7,682** | **2,070** | **9,752** |
| Loans and advances to customers | **6,193** | **22,070** | **28,263** |
| Debt securities | **-** | **9** | **9** |
| Equity shares | **-** | **9** | **9** |
| Derivatives | **78** | **483** | **561** |
| **Liabilities** | | | |
| Deposits by banks | **6,651** | **2,010** | **8,661** |
| Customer accounts | **20,121** | **2,177** | **22,298** |
| Debt securities in issue | **13** | **1,895** | **1,908** |
| Derivatives | **59** | **685** | **744** |
| Subordinated liabilities | **81** | **1,094** | **1,175** |

| | **Group** | | |
|---|---|---|---|
| 2012 | Less than 12 months £m | More than 12 months £m | Total £m |
| **Assets** | | | |
| Cash and balances at central banks | 725 | - | 725 |
| Loans and advances to banks | 6,104 | 2,086 | 8,190 |
| Loans and advances to customers | 8,679 | 25,727 | 34,406 |
| Debt securities | - | 26 | 26 |
| Equity shares | - | 7 | 7 |
| Derivatives | 84 | 640 | 724 |
| **Liabilities** | | | |
| Deposits by banks | 5,013 | 2,882 | 7,895 |
| Customer accounts | 20,868 | 2,202 | 23,070 |
| Debt securities in issue | 32 | 3,222 | 3,254 |
| Derivatives | 67 | 925 | 992 |
| Subordinated liabilities | 63 | 1,094 | 1,157 |

**8. Financial instruments (continued)**

| | Group | | |
|---|---|---|---|
| 2011 | Less than 12 months £m | More than 12 months £m | Total £m |
| **Assets** | | | |
| Cash and balances at central banks | 749 | - | 749 |
| Loans and advances to banks | 5,438 | 1,893 | 7,331 |
| Loans and advances to customers | 8,769 | 30,176 | 38,945 |
| Debt securities | 15 | 83 | 98 |
| Equity shares | - | 5 | 5 |
| Derivatives(1) | 193 | 804 | 997 |
| | | | |
| **Liabilities** | | | |
| Deposits by banks | 11,100 | 1,730 | 12,830 |
| Customer accounts | 19,813 | 2,535 | 22,348 |
| Debt securities in issue | 44 | 3,486 | 3,530 |
| Derivatives(2) | 134 | 1,218 | 1,352 |
| Subordinated liabilities | - | 1,183 | 1,183 |

| | Bank | | |
|---|---|---|---|
| **2013** | **Less than 12 months £m** | **More than 12 months £m** | **Total £m** |
| **Assets** | | | |
| Cash and balances at central banks | **624** | **-** | **624** |
| Loans and advances to banks | **4,737** | **2,499** | **7,236** |
| Loans and advances to customers | **1,702** | **3,228** | **4,930** |
| Debt securities | **-** | **9** | **9** |
| Derivatives | **12** | **4** | **16** |
| | | | |
| **Liabilities** | | | |
| Deposits by banks | **3,683** | **802** | **4,485** |
| Customer accounts | **6,503** | **315** | **6,818** |
| Debt securities in issue | **5** | **4** | **9** |
| Derivatives | **8** | **39** | **47** |
| Subordinated liabilities | **20** | **936** | **956** |

| | Bank | | |
|---|---|---|---|
| 2012 | Less than 12 months £m | More than 12 months £m | Total £m |
| **Assets** | | | |
| Cash and balances at central banks | 545 | - | 545 |
| Loans and advances to banks | 4,548 | 2,506 | 7,054 |
| Loans and advances to customers | 2,481 | 3,539 | 6,020 |
| Debt securities | - | 26 | 26 |
| Derivatives | 22 | 15 | 37 |
| | | | |
| **Liabilities** | | | |
| Deposits by banks | 2,803 | 1,737 | 4,540 |
| Customer accounts | 6,664 | 490 | 7,154 |
| Debt securities in issue | - | 2 | 2 |
| Derivatives | 15 | 63 | 78 |
| Subordinated liabilities | - | 939 | 939 |

For notes relating to the tables above refer to page 43.

**8. Financial instruments (continued)**

| 2011 | Bank<br>Less than 12 months £m | <br>More than 12 months £m | <br>Total £m |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances at central banks | 522 | - | 522 |
| Loans and advances to banks | 4,289 | 2,468 | 6,757 |
| Loans and advances to customers | 2,531 | 3,922 | 6,453 |
| Debt securities | 6 | 65 | 71 |
| Derivatives(1) | 26 | 61 | 87 |
| | | | |
| **Liabilities** | | | |
| Deposits by banks | 2,672 | 1,693 | 4,365 |
| Customer accounts | 6,404 | 1,083 | 7,487 |
| Debt securities in issue | 38 | - | 38 |
| Derivatives(2) | 19 | 65 | 84 |
| Subordinated liabilities | - | 961 | 961 |

(1) For the year ending 31 December 2011 the Group reclassified £364m (Bank: £31m) of derivative assets from less than 12 months to more than 12 months to better reflect the remaining maturity of derivative assets.
(2) For the year ending 31 December 2011 the Group reclassified £847m (Bank: £65m) of derivative liabilities from less than 12 months to more than 12 months to better reflect the remaining maturity of derivative liabilities.

## 9. Financial assets – impairments

The following table shows the movement in the provision for impairment losses for loans and advances.

| | Group<br>Individually assessed £m | <br>Collectively assessed £m | <br>Latent £m | <br>Total £m |
|---|---|---|---|---|
| At 1 January 2013 | **7,691** | **2,272** | **811** | **10,774** |
| Currency translation and other adjustments | **70** | **35** | **12** | **117** |
| Amounts written-off [1] | **(617)** | **(92)** | **-** | **(709)** |
| Charged to the income statement | **4,083** | **601** | **110** | **4,794** |
| Unwind of discount | **(168)** | **(42)** | **-** | **(210)** |
| At 31 December 2013[2] | **11,059** | **2,774** | **933** | **14,766** |

| | Group<br>Individually assessed £m | <br>Collectively assessed £m | <br>Latent £m | <br>Total £m |
|---|---|---|---|---|
| At 1 January 2012 | 7,157 | 1,312 | 582 | 9,051 |
| Currency translation and other adjustments | (122) | (23) | (12) | (157) |
| Transfer | (275) | 275 | - | - |
| Amounts written-off [1] | (149) | (63) | - | (212) |
| Charged to the income statement | 1,297 | 802 | 241 | 2,340 |
| Unwind of discount | (217) | (31) | - | (248) |
| At 31 December 2012[2] | 7,691 | 2,272 | 811 | 10,774 |

| | Group<br>Individually assessed £m | <br>Collectively assessed £m | <br>Latent £m | <br>Total £m |
|---|---|---|---|---|
| At 1 January 2011 | 4,616 | 753 | 609 | 5,978 |
| Currency translation and other adjustments | (164) | (38) | (16) | (218) |
| Amounts written-off [1] | (131) | (43) | - | (174) |
| Charged/(credited) to the income statement | 3,062 | 667 | (11) | 3,718 |
| Unwind of discount | (226) | (27) | - | (253) |
| At 31 December 2011[2] | 7,157 | 1,312 | 582 | 9,051 |

For notes relating to the tables above refer to page 44.

**9. Financial assets – impairments (continued)**

| | Bank | | | |
|---|---|---|---|---|
| | **Individually assessed £m** | **Collectively assessed £m** | **Latent £m** | **Total £m** |
| At 1 January 2013 | **1,650** | **302** | **80** | **2,032** |
| Other adjustments | **(5)** | **-** | **(1)** | **(6)** |
| Amounts written-off [(1)] | **(146)** | **(29)** | **-** | **(175)** |
| Charged/(credited) to the income statement | **661** | **98** | **(3)** | **756** |
| Unwind of discount | **(25)** | **(5)** | **-** | **(30)** |
| At 31 December 2013[(2)] | **2,135** | **366** | **76** | **2,577** |

| | Bank | | | |
|---|---|---|---|---|
| | Individually assessed £m | Collectively assessed £m | Latent £m | Total £m |
| At 1 January 2012 | 1,589 | 161 | 71 | 1,821 |
| Other adjustments | 2 | - | - | 2 |
| Transfer | (101) | 101 | - | - |
| Amounts written-off [(1)] | (83) | (24) | - | (107) |
| Charged to the income statement | 287 | 67 | 9 | 363 |
| Unwind of discount | (44) | (3) | - | (47) |
| At 31 December 2012[(2)] | 1,650 | 302 | 80 | 2,032 |

| | Bank | | | |
|---|---|---|---|---|
| | Individually assessed £m | Collectively assessed £m | Latent £m | Total £m |
| At 1 January 2011 | 886 | 122 | 126 | 1,134 |
| Amounts written-off [(1)] | (3) | (16) | - | (19) |
| Charged/(credited) to the income statement | 754 | 57 | (55) | 756 |
| Unwind of discount | (48) | (2) | - | (50) |
| At 31 December 2011[(2)] | 1,589 | 161 | 71 | 1,821 |

(1) Amounts written off do not include any loans and advances to banks.
(2) Impairment losses at 31 December 2013, 31 December 2012 and 31 December 2011 do not include any loans and advances to banks.

**Loan impairment**

The Group considers financial assets to be impaired when there is no longer a reasonable prospect of receiving the contractual cash flows in accordance with the contract and the net present value of any security is less than the outstanding amount.

At 31 December 2013, the Group's non-accrual loans and loans past due 90 days amounted to £19,438m (2012: £18,850m, 2011: £17,134m) and £3,245m (2012: £3,162m, 2011: £3,243m) for the Bank. Not all of the loans past 90 days are considered to be impaired, for the loans that are considered impaired, provisions were held in the Group of £13,833m (2012: £9,963m, 2011: £8,469m) and £2,501m (2012: £1,952m, 2011: £1,750m) were held in the Bank.

The following table shows analysis of impaired financial assets:

| | **2013** | | | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|---|---|---|
| **Group** | **Cost £m** | **Provision £m** | **Net book value £m** | Cost £m | Provision £m | Net book value £m | Cost £m | Provision £m | Net book value £m |
| **Impaired financial assets** | | | | | | | | | |
| Loans and advances to customers | **19,212** | **(13,833)** | **5,379** | 18,219 | (9,963) | 8,256 | 16,763 | (8,469) | 8,294 |

| | **2013** | | | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|---|---|---|
| **Bank** | **Cost £m** | **Provision £m** | **Net book value £m** | Cost £m | Provision £m | Net book value £m | Cost £m | Provision £m | Net book value £m |
| **Impaired financial assets** | | | | | | | | | |
| Loans and advances to customers | **3,184** | **(2,501)** | **683** | 3,114 | (1,952) | 1,162 | 3,131 | (1,750) | 1,381 |

**9. Financial assets – impairments (continued)**

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | **2013 £m** | 2012 £m | 2011 £m | **2013 £m** | 2012 £m | 2011 £m |
| Impaired financial assets – individually assessed: | | | | | | |
| Loans and advances to customers | **11,059** | 7,691 | 7,157 | **2,135** | 1,650 | 1,589 |

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | **2013 £m** | 2012 £m | 2011 £m | **2013 £m** | 2012 £m | 2011 £m |
| Gross income not recognised but which would have been recognised under the original terms of non–accrual and restructured loans: | | | | | | |
| United Kingdom | **366** | 279 | 185 | **366** | 279 | 185 |
| Republic of Ireland | **1,616** | 1,273 | 853 | **-** | - | - |
| Other | **-** | - | - | **-** | - | - |
| | **1,982** | 1,552 | 1,038 | **366** | 279 | 185 |

The following assets were past due at the balance sheet date but not considered impaired:

| **Group** | **Past due 1–29 days £m** | **Past due 30–59 days £m** | **Past due 60–89 days £m** | **Past due more than 90 days £m** | **Total £m** |
|---|---|---|---|---|---|
| **2013** | | | | | |
| Loans and advances to customers | **856** | **427** | **393** | **226** | **1,902** |
| 2012 | | | | | |
| Loans and advances to customers | 1,260 | 539 | 370 | 631 | 2,800 |
| 2011 | | | | | |
| Loans and advances to customers | 1,390 | 570 | 414 | 371 | 2,745 |

| **Bank** | **Past due 1–29 days £m** | **Past due 30–59 days £m** | **Past due 60–89 days £m** | **Past due more than 90 days £m** | **Total £m** |
|---|---|---|---|---|---|
| **2013** | | | | | |
| Loans and advances to customers | **71** | **19** | **9** | **61** | **160** |
| 2012 | | | | | |
| Loans and advances to customers | 90 | 30 | 14 | 48 | 182 |
| 2011 | | | | | |
| Loans and advances to customers | 113 | 23 | 10 | 112 | 258 |

The Group holds collateral in respect of certain loans and advances to banks and to customers that are past due or impaired. Such collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade receivables; and guarantees of lending from parties other than the borrower.

The following table shows financial and non-financial assets, recognised on the Group and Bank's balance sheets, obtained during the year by taking possession of collateral or calling on other credit enhancements:

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | **2013 £m** | 2012 £m | 2011 £m | **2013 £m** | 2012 £m | 2011 £m |
| Residential property | **-** | 36 | 22 | **-** | 7 | 5 |
| Other property | **13** | 32 | 49 | **-** | - | - |
| | **13** | 68 | 71 | **-** | 7 | 5 |

**10. Debt securities**

| | Group | | | |
|---|---|---|---|---|
| **2013** | **Other central and local government £m** | **Bank and building society £m** | **Mortgage backed securities £m** | **Total £m** |
| Available-for-sale | **-** | **-** | **9** | **9** |
| Gross unrealised gains | **-** | **-** | **-** | **-** |
| Gross unrealised losses | **-** | **-** | **-** | **-** |
| 2012 | | | | |
| Available-for-sale | - | - | 26 | 26 |
| Gross unrealised gains | - | - | - | - |
| Gross unrealised losses | - | - | - | - |
| 2011 | | | | |
| Available-for-sale | 27 | 6 | 65 | 98 |
| Gross unrealised gains | 1 | - | - | 1 |
| Gross unrealised losses | - | - | (2) | (2) |

| | Bank | | | |
|---|---|---|---|---|
| **2013** | **Other central and local government £m** | **Bank and building society £m** | **Mortgage backed securities £m** | **Total £m** |
| Available-for-sale | **-** | **-** | **9** | **9** |
| Gross unrealised losses | **-** | **-** | **-** | **-** |
| 2012 | | | | |
| Available-for-sale | - | - | 26 | 26 |
| Gross unrealised losses | - | - | - | - |
| 2011 | | | | |
| Available-for-sale | - | 6 | 65 | 71 |
| Gross unrealised losses | - | - | (2) | (2) |

**11. Equity shares**

| | Group | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2013** | | | 2012 | | | 2011 | | |
| | **Listed £m** | **Unlisted £m** | **Total £m** | Listed £m | Unlisted £m | Total £m | Listed £m | Unlisted £m | Total £m |
| Designated as at fair value through profit or loss | **2** | **-** | **2** | - | - | - | - | - | - |
| Available-for-sale | **-** | **7** | **7** | - | 7 | 7 | - | 5 | 5 |
| | **2** | **7** | **9** | - | 7 | 7 | - | 5 | 5 |

As at 31 December 2013, the Bank held £88,686 unlisted equity shares (2012: £172,048, 2011: £154,549).

**12. Investments in Group undertakings**

Investments in Group undertakings are carried at cost less impairment. Movements during the year were as follows:

| | Bank | | |
|---|---|---|---|
| | **2013 £m** | 2012 £m | 2011 £m |
| At 1 January | **2,544** | 3,488 | 2,951 |
| Exchange adjustment | **9** | (11) | (13) |
| Additional investments in Group undertakings | **834** | 2,730 | 4,068 |
| Impairment in Ulster Bank (Ireland) Holdings | **(277)** | (3,663) | (3,518) |
| **At 31 December** | **3,110** | 2,544 | 3,488 |

The fair value of investments in Group undertakings is calculated using a model based on expected future profits plus future equity requirements. A terminal value is added to the discounted expected future profits to provide the fair value of the subsidiary. If the fair value of the subsidiary 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.

The principal related undertaking of the Bank is shown below. Its capital consists of ordinary shares which are unlisted. It is wholly owned by the Bank through intermediate holding companies.

| **Undertaking** | **Nature of business** | **Country of incorporation** |
|---|---|---|
| Ulster Bank Ireland Limited (1) | Banking services, corporate and investment banking, foreign exchange services | Republic of Ireland |

(1) Ulster Bank Ireland Limited and its subsidiaries also operate in the UK.

The above information is provided in relation to the principal related undertakings as permitted by Section 410(2) of the Companies Act 2006. Full information on all related undertakings will be included in the Annual Return filed with the UK Companies House. The financial performance of these companies is included in the Group's consolidated financial statements and all have an accounting reference date of 31 December.

There are a number of entities in which the Group holds less than half the voting rights which are consolidated when the substance of the relationship between the Group and the entity indicates that the entity is controlled by the Group. Such entities are deemed to be controlled by the Group when relationships with such entities give rise to benefits that are in substance no different from those that would arise were the entity a subsidiary.

The Group holds 23.75% of the issued ordinary share capital of Jury's Inn Holdings Limited, a holding company incorporated in Jersey, which has its registered office at Ogier House, The Esplanade, St Helier, Jersey, JE4 9WG. The Group have availed of the exemption under IAS 28 'Investments in associates and joint ventures' and measured the investment at fair value through profit and loss.

**13. Intangible assets**

Intangible assets comprising goodwill, computer software and other acquired intangibles were fully impaired as at 31 December 2013, 31 December 2012 and 31 December 2011. No further intangible assets were developed or acquired in the current or the previous year.

**14. Property, plant and equipment**

| **2013** | **Group** | | | | | |
|---|---|---|---|---|---|---|
| | **Investment properties £m** | **Freehold land and buildings £m** | **Leases of 50 years or more unexpired £m** | **Leases of 50 years or less unexpired £m** | **Computer and other equipment £m** | **Total £m** |
| Cost or valuation: | | | | | | |
| At 1 January 2013 | 145 | 147 | 42 | 80 | 237 | **651** |
| Currency translation and other adjustments | 3 | 2 | - | 2 | 2 | **9** |
| Additions | 16 | 2 | 1 | 3 | 1 | **23** |
| Disposals | (1) | (2) | - | (2) | (52) | **(57)** |
| Revaluation | 9 | - | - | - | - | **9** |
| At 31 December 2013 | 172 | 149 | 43 | 83 | 188 | **635** |
| | | | | | | |
| Accumulated impairment, depreciation and amortisation: | | | | | | |
| At 1 January 2013 | - | 77 | 20 | 30 | 183 | **310** |
| Currency translation and other adjustments | - | 1 | - | - | 2 | **3** |
| Disposals | - | (1) | - | (2) | (51) | **(54)** |
| Impairments | - | 15 | 3 | 1 | - | **19** |
| Depreciation charge for the year | - | 4 | 1 | 7 | 12 | **24** |
| At 31 December 2013 | - | 96 | 24 | 36 | 146 | **302** |
| | | | | | | |
| **Carrying amount at 31 December 2013** | **172** | **53** | **19** | **47** | **42** | **333** |

| 2012 | Group | | | | | |
|---|---|---|---|---|---|---|
| | Investment properties £m | Freehold land and buildings £m | Leases of 50 years or more unexpired £m | Leases of 50 years or less unexpired £m | Computer and other equipment £m | Total £m |
| Cost or valuation: | | | | | | |
| At 1 January 2012 | 111 | 151 | 42 | 80 | 235 | 619 |
| Currency translation and other adjustments | (2) | (3) | (1) | (2) | (3) | (11) |
| Additions | 42 | 1 | 1 | 4 | 5 | 53 |
| Disposals | - | (2) | - | (2) | - | (4) |
| Revaluation | (6) | - | - | - | - | (6) |
| At 31 December 2012 | 145 | 147 | 42 | 80 | 237 | 651 |
| | | | | | | |
| Accumulated impairment, depreciation and amortisation: | | | | | | |
| At 1 January 2012 | - | 57 | 18 | 24 | 171 | 270 |
| Currency translation and other adjustments | - | - | - | - | (2) | (2) |
| Disposals | - | - | - | (1) | - | (1) |
| Impairments | - | 16 | 1 | - | - | 17 |
| Depreciation charge for the year | - | 4 | 1 | 7 | 14 | 26 |
| At 31 December 2012 | - | 77 | 20 | 30 | 183 | 310 |
| | | | | | | |
| Carrying amount at 31 December 2012 | 145 | 70 | 22 | 50 | 54 | 341 |

**14. Property, plant and equipment (continued)**

| | Group | | | | | |
|---|---|---|---|---|---|---|
| 2011 | Investment properties £m | Freehold land and buildings £m | Leases of 50 years or more unexpired £m | Leases of 50 years or less unexpired £m | Computer and other equipment £m | Total £m |
| Cost or valuation: | | | | | | |
| At 1 January 2011 | 113 | 170 | 61 | 86 | 237 | 667 |
| Currency translation and other adjustments | (2) | (3) | (1) | (2) | (3) | (11) |
| Reclassifications | 11 | - | (11) | - | - | - |
| Additions | 56 | 1 | - | 1 | 2 | 60 |
| Disposals | - | (17) | (7) | (5) | (1) | (30) |
| Revaluation | (67) | - | - | - | - | (67) |
| At 31 December 2011 | 111 | 151 | 42 | 80 | 235 | 619 |
| | | | | | | |
| Accumulated depreciation and amortisation: | | | | | | |
| At 1 January 2011 | 3 | 71 | 13 | 22 | 158 | 267 |
| Currency translation and other adjustments | - | (1) | - | (1) | (3) | (5) |
| Reclassifications | (3) | - | 3 | - | - | - |
| Disposals | - | (17) | - | (5) | - | (22) |
| Depreciation charge for the year | - | 4 | 2 | 8 | 16 | 30 |
| At 31 December 2011 | - | 57 | 18 | 24 | 171 | 270 |
| | | | | | | |
| Carrying amount at 31 December 2011 | 111 | 94 | 24 | 56 | 64 | 349 |

There is no profit or loss on disposal of freehold land and buildings during the year (2012: £nil, 2011: £nil).

Rental income from investment properties totalled £11m in 2013 (2012: £7m, 2011 £6m). Direct operating expenses of £8m (2012: £4m, 2011: £2m) were incurred in relation to income generating investment properties. No direct operating expenses were incurred for investment properties not generating income (2012: £12m, 2011: £9m).

| | **Bank** | | | | |
|---|---|---|---|---|---|
| **2013** | **Freehold land and buildings £m** | **Leases of 50 years or more unexpired £m** | **Leases of 50 years or less unexpired £m** | **Computer and other equipment £m** | **Total £m** |
| Cost or valuation: | | | | | |
| At 1 January 2013 | 51 | 21 | 11 | 108 | **191** |
| Additions | 3 | 1 | - | - | **4** |
| Disposals | - | - | - | (24) | **(24)** |
| At 31 December 2013 | 54 | 22 | 11 | 84 | **171** |
| | | | | | |
| Accumulated impairment, depreciation and amortisation: | | | | | |
| At 1 January 2013 | 24 | 7 | 4 | 92 | **127** |
| Disposals | - | - | - | (24) | **(24)** |
| Impairments | 3 | 1 | - | - | **4** |
| Depreciation charge for the year | 1 | - | 1 | 6 | **8** |
| At 31 December 2013 | 28 | 8 | 5 | 74 | **115** |
| | | | | | |
| **Carrying amount at 31 December 2013** | **26** | **14** | **6** | **10** | **56** |

**14. Property, plant and equipment (continued)**

| | Bank | | | | |
|---|---|---|---|---|---|
| 2012 | Freehold land and buildings £m | Leases of 50 years or more unexpired £m | Leases of 50 years or less unexpired £m | Computer and other equipment £m | Total £m |
| Cost or valuation: | | | | | |
| At 1 January 2012 | 53 | 21 | 10 | 107 | 191 |
| Additions | - | - | 1 | 1 | 2 |
| Disposals | (2) | - | - | - | (2) |
| At 31 December 2012 | 51 | 21 | 11 | 108 | 191 |
| Accumulated impairment, depreciation and amortisation: | | | | | |
| At 1 January 2012 | 16 | 5 | 3 | 86 | 110 |
| Impairments | 7 | 1 | - | - | 8 |
| Depreciation charge for the year | 1 | 1 | 1 | 6 | 9 |
| At 31 December 2012 | 24 | 7 | 4 | 92 | 127 |
| Carrying amount at 31 December 2012 | 27 | 14 | 7 | 16 | 64 |

| | Bank | | | | |
|---|---|---|---|---|---|
| 2011 | Freehold land and buildings £m | Leases of 50 years or more unexpired £m | Leases of 50 years or less unexpired £m | Computer and other equipment £m | Total £m |
| Cost or valuation: | | | | | |
| At 1 January 2011 | 52 | 21 | 10 | 107 | 190 |
| Additions | 1 | - | - | - | 1 |
| At 31 December 2011 | 53 | 21 | 10 | 107 | 191 |
| Accumulated depreciation and amortisation: | | | | | |
| At 1 January 2011 | 15 | 5 | 2 | 78 | 100 |
| Depreciation charge for the year | 1 | - | 1 | 8 | 10 |
| At 31 December 2011 | 16 | 5 | 3 | 86 | 110 |
| Carrying amount at 31 December 2011 | 37 | 16 | 7 | 21 | 81 |

There was no profit on disposal of freehold land and buildings during the year (2012: £nil, 2011: £nil).

Investment properties are valued using techniques based on observable market data. This methodology falls within Level 2 of the valuation methods as set out in Note 8.

**NOTES TO THE FINANCIAL STATEMENTS** *for the year ended 31 December 2013*

## 15. 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.

| | **Group** | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2013** | | | 2012 | | | 2011 | | |
| | **Notional amounts £m** | **Assets £m** | **Liabilities £m** | Notional amounts £m | Assets £m | Liabilities £m | Notional amounts £m | Assets £m | Liabilities £m |
| **Over-the-counter derivatives** | | | | | | | | | |
| **Foreign exchange contracts:** | | | | | | | | | |
| Spot, forwards and futures | **1,789** | **24** | **28** | 1,866 | 12 | 17 | 4,134 | 128 | 73 |
| Currency swaps | **1,379** | **61** | **189** | 1,495 | 55 | 176 | 1,537 | 52 | 196 |
| **Interest rate contracts:** | | | | | | | | | |
| Interest rate swaps | **46,532** | **324** | **525** | 45,133 | 551 | 796 | 50,722 | 733 | 1,071 |
| Options purchased | **1,948** | **3** | **-** | 520 | 2 | - | 966 | 12 | - |
| Options written | **242** | **-** | **2** | 342 | - | 3 | 837 | - | 12 |
| **Equity and commodity contracts** | **1,961** | **149** | **-** | 1,930 | 104 | - | 1,672 | 72 | - |
| | **53,851** | **561** | **744** | 51,286 | 724 | 992 | 59,868 | 997 | 1,352 |

| | **Bank** | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2013** | | | 2012 | | | 2011 | | |
| | **Notional amounts £m** | **Assets £m** | **Liabilities £m** | Notional amounts £m | Assets £m | Liabilities £m | Notional amounts £m | Assets £m | Liabilities £m |
| **Over-the-counter derivatives** | | | | | | | | | |
| **Foreign exchange contracts:** | | | | | | | | | |
| Spot, forwards and futures | **216** | **3** | **3** | 152 | 1 | 1 | 220 | 4 | 4 |
| **Interest rate contracts:** | | | | | | | | | |
| Interest rate swaps | **3,357** | **13** | **44** | 4,718 | 36 | 77 | 2,821 | 54 | 80 |
| **Equity and commodity contracts** | **-** | **-** | **-** | - | - | - | 475 | 29 | - |
| | **3,573** | **16** | **47** | 4,870 | 37 | 78 | 3,516 | 87 | 84 |

## 16. Prepayments, accrued income and other assets

| | **Group** | | | **Bank** | | |
|---|---|---|---|---|---|---|
| | **2013 £m** | Restated 2012 £m | Restated 2011 £m | **2013 £m** | Restated 2012 £m | Restated 2011 £m |
| Prepayments | **12** | 16 | 19 | **3** | 6 | 6 |
| Accrued income | **12** | 11 | 13 | **3** | 3 | 4 |
| Other assets | **212** | 96 | 123 | **188** | 79 | 140 |
| | **236** | 123 | 155 | **194** | 88 | 150 |

## 17. Accruals, deferred income and other liabilities

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | **2013** | Restated 2012 | Restated 2011 | **2013** | Restated 2012 | Restated 2011 |
| | **£m** | £m | £m | **£m** | £m | £m |
| Notes in circulation | **635** | 578 | 552 | **635** | 578 | 552 |
| Accruals | **181** | 199 | 224 | **50** | 51 | 57 |
| Deferred income | **1** | 3 | 9 | **-** | 1 | 3 |
| Other liabilities | **191** | 129 | 86 | **50** | 38 | 29 |
| | **1,008** | 909 | 871 | **735** | 668 | 641 |

Provisions of £159m (2012: £114m, 2011: £82m) for the Group and £35m (2012: £41m, 2011: £27m) for the Bank are included in other liabilities.

The following amounts are included within provisions:

| | Group | | | | | |
|---|---|---|---|---|---|---|
| | **Property** | **Interest rate hedge products** | **PPI** | **Technology incident redress** | **Other** | **Total** |
| | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** |
| Provisions as at 1 January 2013 | 59 | 10 | 22 | 17 | 6 | 114 |
| Charge to the income statement | 18 | 50 | 40 | - | - | 108 |
| Utilised in year | (16) | - | (18) | (10) | (4) | (48) |
| Exchange movements | 1 | (1) | - | - | 2 | 2 |
| Release of provision | (9) | - | - | (7) | (1) | (17) |
| **Provisions as at 31 December 2013** | **53** | **59** | **44** | **-** | **3** | **159** |

| | Bank | | | | |
|---|---|---|---|---|---|
| | **Property** | **PPI** | **Technology incident redress** | **Other** | **Total** |
| | **£m** | **£m** | **£m** | **£m** | **£m** |
| Provisions as at 1 January 2013 | 13 | 13 | 10 | 5 | 41 |
| Charge to the income statement | 6 | 21 | - | - | 27 |
| Utilised in year | (4) | (7) | (6) | (3) | (20) |
| Release of provision | (9) | - | (4) | - | (13) |
| **Provisions as at 31 December 2013** | **6** | **27** | **-** | **2** | **35** |

**Property provisions**
The property provisions principally comprise provisions for onerous lease contracts. Provision is made for future rentals payable in respect of vacant leasehold property and for any shortfall where leased property is sub-let at a rental lower than the lease rentals payable by the Group.

**Interest rate hedge products**
In June 2012, following an industry wide review, the regulatory authority announced that the Group and other UK banks had agreed to:
- provide automatic fair and reasonable redress to non-sophisticated customers who were sold structured collars;
- review the sales of interest rate hedging products (other than caps or structured collars) to non-sophisticated customers to determine whether redress is due; and
- review the sale of caps to non-sophisticated customers to determine whether redress is due if a complaint is made by the customer during the review.

The Central Bank of Ireland (CBI) has requested that Ulster Bank Ireland Limited (which is not subject to the FCA review) and other Irish banks carry out a review of interest rate hedging products sold in the Republic of Ireland in the period 2001 to 2012. The Ulster Bank Ireland Limited review is being progressed in line with the RBS Group approach and within the infrastructure of the wider RBS Group project.

The Group has estimated its liability based on the regulatory authority’s guidance, an analysis of its portfolio of interest rate hedging products and the results of the pilot exercise.

**17. Accruals, deferred income and other liabilities (continued)**

**Interest rate hedge products (continued)**
As the redress and review exercise progresses it is likely that the level of the provision will change. There remain significant uncertainties over the number of transactions that will qualify for redress and the nature and cost of that redress.

**Technology incident redress**
The Group has experienced technology incidents that have had a negative impact on its customers. The costs associated with this have been substantially settled and no further significant costs are anticipated.

**Payment Protection Insurance (PPI)**
The PPI provision was established to reflect current experience of PPI complaints received. The eventual cost is dependent upon complaint volumes, uphold rates and average redress costs. Assumptions relating to these are inherently uncertain and the ultimate financial impact may be different from the amount provided. The Group will continue to monitor the position closely and refresh its assumptions as more information becomes available.

**18. Deferred taxation**

Provision for deferred taxation has been made as follows:

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | **2013** | Restated 2012 | Restated 2011 | **2013** | Restated 2012 | Restated 2011 |
| | **£m** | £m | £m | **£m** | £m | £m |
| Deferred tax asset | **75** | 75 | 285 | **1** | 2 | 2 |
| Deferred tax liability | **(24)** | (19) | (13) | **(21)** | (15) | (10) |
| **Net deferred tax** | **51** | 56 | 272 | **(20)** | (13) | (8) |

| | Group | | | | | | |
|---|---|---|---|---|---|---|---|
| | Pension | Accelerated capital allowances | Deferred gains | Fair value on financial instruments | Other | Tax losses | Total |
| Restated | £m | £m | £m | £m | £m | £m | £m |
| At 1 January 2011 | 4 | - | (15) | 1 | (3) | 226 | 213 |
| (Charge) / credit to income statement | (11) | 1 | 5 | - | - | 66 | 61 |
| Charge to equity directly | 6 | - | - | - | - | - | 6 |
| Other | - | - | 1 | - | - | (9) | (8) |
| At 1 January 2012 | (1) | 1 | (9) | 1 | (3) | 283 | 272 |
| (Charge) / credit to income statement | (7) | - | 2 | - | - | (203) | (208) |
| Charge to equity directly | - | - | - | - | - | - | - |
| Other | - | - | - | - | (1) | (7) | (8) |
| At 1 January 2013 | (8) | 1 | (7) | 1 | (4) | 73 | 56 |
| (Charge) / credit to income statement | (5) | (1) | 2 | (1) | - | - | (5) |
| Charge to equity directly | (2) | - | - | - | - | - | (2) |
| Other | - | - | - | - | 1 | 1 | 2 |
| **At 31 December 2013** | **(15)** | **-** | **(5)** | **-** | **(3)** | **74** | **51** |

Deferred tax assets are recognised depending on the availability of future taxable profits in excess of profits arising from the reversal of other temporary differences. While business projections may support a write back of the asset in respect of unused losses, the asset has been retained at the 2012 level in recognition of uncertainty pending completion of the Group's Strategic review. Current management business projections indicate that sufficient future taxable income will be available against which to offset the recognised deferred tax asset within 5 years (2012: 7 years). In jurisdictions where doubt exists over the availability of future taxable profits, deferred tax assets of £1,369m (2012: £886m, 2011: £494m) have not been recognised in respect of tax losses carried forward.

**18. Deferred taxation (continued)**

Deferred tax liabilities of £99m (2012: £113m, 2011: £132m) 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.

| | Bank |
|---|---|
| **Restated provisions for Deferred Tax** | **£m** |
| Balance at 1 January 2011 | (9) |
| Charge to income statement | (5) |
| Credit directly to equity | 6 |
| At 1 January 2012 | (8) |
| Charge to income statement | (5) |
| At 1 January 2013 | **(13)** |
| Charge to income statement | **(5)** |
| Charge directly to equity | **(2)** |
| **At 31 December 2013** | **(20)** |

In recent years the UK Government has steadily reduced the rate of UK corporation tax, with the latest rates substantively enacted in July 2013 now standing at 21% with effect from 1 April 2014 and 20% with effect from 1 April 2015. The closing deferred tax assets and liabilities have been calculated at 20% in accordance with the rates enacted at the balance sheet date.

**19. Subordinated liabilities**

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | **2013** | 2012 | 2011 | **2013** | 2012 | 2011 |
| | **£m** | £m | £m | **£m** | £m | £m |
| Dated loan capital | **940** | 923 | 944 | **856** | 841 | 861 |
| Undated loan capital | **100** | 98 | 100 | **100** | 98 | 100 |
| Dated subordinated bonds | **61** | 63 | 64 | **-** | - | - |
| Undated perpetual subordinated bonds | **74** | 73 | 75 | **-** | - | - |
| | **1,175** | 1,157 | 1,183 | **956** | 939 | 961 |

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | **2013** | 2012 | 2011 | **2013** | 2012 | 2011 |
| | **£m** | £m | £m | **£m** | £m | £m |
| **Dated loan capital:** | | | | | | |
| Repayable 2014 | | | | | | |
| – held by immediate parent company | **20** | 20 | 20 | **20** | 20 | 20 |
| Repayable 2015 | | | | | | |
| – held by immediate parent company | **20** | 20 | 20 | **20** | 20 | 20 |
| Repayable 2019 | | | | | | |
| – held by RBS plc | **100** | 100 | 100 | **100** | 100 | 100 |
| Euro loan capital repayable 2017 | | | | | | |
| – held by RBS plc | **334** | 326 | 335 | **333** | 326 | 335 |
| Euro loan capital repayable 2020 | | | | | | |
| – held by RBS plc | **150** | 147 | 151 | **150** | 147 | 151 |
| Euro loan capital repayable 2022 | | | | | | |
| – held by RBS plc | **316** | 310 | 318 | **233** | 228 | 235 |
| | **940** | 923 | 944 | **856** | 841 | 861 |
| **Undated loan capital:** | | | | | | |
| – held by RBS plc | **100** | 98 | 100 | **100** | 98 | 100 |
| | **100** | 98 | 100 | **100** | 98 | 100 |
| **Dated subordinated bonds** | | | | | | |
| £60m 6.375% subordinated bonds 2018 | **61** | 63 | 64 | **-** | - | - |
| | **61** | 63 | 64 | **-** | - | - |
| **Undated perpetual subordinated bonds** | | | | | | |
| €38m 11.375% perpetual tier two capital | **47** | 46 | 47 | **-** | - | - |
| £20m 11.75% perpetual tier two capital | **25** | 25 | 26 | **-** | - | - |
| £1.3m floating rate perpetual tier two capital | **2** | 2 | 2 | **-** | - | - |
| | **74** | 73 | 75 | **-** | - | - |
| **Total** | **1,175** | 1,157 | 1,183 | **956** | 939 | 961 |

### 19. Subordinated liabilities (continued)

**Dated loan capital**
Claims in respect of the Group's and the Bank's loan capital are subordinate to the claims of other creditors. None of the loan capital is secured.

Interest on the Sterling-denominated dated loan capital held by fellow subsidiary undertakings, the immediate parent company and the ultimate holding company are payable quarterly at a margin over London Interbank Offer rates. Interest on Euro-denominated loan capital is payable quarterly at a margin over Euro Interbank Offer rates.

Early repayment of the dated loan capital may take place at any time with a notice period of at least 30 days, subject to the prior agreement of the Financial Conduct Authority (FCA).

**Undated loan capital**
The Sterling loan stock, which is perpetual, is held by another company within the RBS Group and is repayable at the option of the Bank only with prior consent of the CBI.

**Dated subordinated bonds**
The Sterling fixed subordinated bonds mature on 4 April 2018 but are callable quarterly, on any interest payment date. The claims of the holders of the bonds are subordinate to the claims of all creditors of Ulster Bank Ireland Limited other than the holders of the perpetual subordinated bonds.

**Perpetual subordinated bonds**
The subordinated perpetual bonds were issued by First Active plc, in the Republic of Ireland, at par on conversion of First National Building Society to a public limited company pursuant to Section 107 of the Building Societies Act, 1989 to replace the issued fixed and floating rate permanent interest bearing shares of the Society. The claims of the holders of the bonds are subordinate to the claims of all creditors of Ulster Bank Ireland Limited.

### 20. Share capital

| | Group and Bank | | | | | |
|---|---|---|---|---|---|---|
| | Allotted, called up and fully paid | | | Authorised | | |
| | **2013** | 2012 | 2011 | **2013** | 2012 | 2011 |
| | **£m** | £m | £m | **£m** | £m | £m |
| *Equity shares:* | | | | | | |
| Ordinary shares of £1 | **1,208** | 1,208 | 1,208 | **2,000** | 2,000 | 2,000 |
| *Equity preference shares:* | | | | | | |
| Non–cumulative redeemable preference shares of €1 each | **297** | 297 | 297 | **346** | 346 | 346 |
| **Total share capital** | **1,505** | 1,505 | 1,505 | **2,346** | 2,346 | 2,346 |

| | Allotted, called up and fully paid | | | Authorised | | |
|---|---|---|---|---|---|---|
| | **2013** | 2012 | 2011 | **2013** | 2012 | 2011 |
| **Number of shares** | **Millions** | Millions | Millions | **Millions** | Millions | Millions |
| *Equity shares:* | | | | | | |
| Ordinary shares of £1 | **1,208** | 1,208 | 1,208 | **2,000** | 2,000 | 2,000 |
| *Equity Preference shares:* | | | | | | |
| Non–cumulative redeemable preference shares of €1 each | **450** | 450 | 450 | **500** | 500 | 500 |
| **Total share capital** | **1,658** | 1,658 | 1,658 | **2,500** | 2,500 | 2,500 |

The non-cumulative redeemable preference shares entitle the holders thereof to receive periodic non-cumulative cash dividends, at the discretion of the directors, at a specified floating rate payable out of distributable profits of the Bank. In a winding-up the holders of the preference shares have the right to repayment in priority to the holders of any other class of shares in the capital of the Bank. Any surplus assets available after repayment of the preference shares will be distributable to the holders of the £1 ordinary shares.

The non-cumulative redeemable preference shares do not confer on the holder a right to attend or vote at general meetings of the Bank unless the business of the meeting includes the consideration of a resolution for winding up of the Bank, reducing its share capital or varying any of the special rights attached to the preference shares.

Subject to the provisions of company law and to the consent of the FCA, the Bank shall have the right to redeem the preference shares at any time by notice to the holders provided that no such notice may be issued in respect of any preference share prior to the day following the fifth anniversary of the date of its allotment.

**21. Leases**

Amounts receivable under finance lease contracts and hire purchase agreements:

| | Group | | | | | |
|---|---|---|---|---|---|---|
| | **2013** | | | 2012 | | |
| Period in which receipt will occur: | **Gross amounts £m** | **Present value adjustments £m** | **Present value £m** | Gross amounts £m | Present value adjustments £m | Present value £m |
| Within 1 year | **59** | **(7)** | **52** | 67 | (7) | 60 |
| After 1 year but within 5 years | **71** | **(6)** | **65** | 84 | (6) | 78 |
| After 5 years | **-** | **-** | **-** | 1 | - | 1 |
| | **130** | **(13)** | **117** | 152 | (13) | 139 |

The Group provides asset finance to its customers through acting as a lessor. It purchases plant and equipment renting them to customers under lease arrangements that qualify as finance leases.

Minimum amounts payable under non–cancellable leases:

| | Group | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **2013** | | | | 2012 | | | |
| Period in which payment will occur: | **Within 1 year £m** | **After 1 year but within 5 years £m** | **After 5 years £m** | **Total £m** | Within 1 year £m | After 1 year but within 5 years £m | After 5 years £m | Total £m |
| *Operating lease obligations:* | | | | | | | | |
| Premises | **19** | **65** | **135** | **219** | 20 | 70 | 147 | 237 |
| Equipment | **1** | **1** | **-** | **2** | 2 | 1 | - | 3 |
| | **20** | **66** | **135** | **221** | 22 | 71 | 147 | 240 |

| | Bank | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **2013** | | | | 2012 | | | |
| Period in which payment will occur: | **Within 1 year £m** | **After 1 year but within 5 years £m** | **After 5 years £m** | **Total £m** | Within 1 year £m | After 1 year but within 5 years £m | After 5 years £m | Total £m |
| *Operating lease obligations:* | | | | | | | | |
| Premises | **1** | **3** | **88** | **92** | 2 | 4 | 88 | 94 |
| Equipment | **-** | **-** | **-** | **-** | 1 | - | - | 1 |
| | **1** | **3** | **88** | **92** | 3 | 4 | 88 | 95 |

| | Group | | Bank | |
|---|---|---|---|---|
| | **2013 £m** | 2012 £m | **2013 £m** | 2012 £m |
| **Amounts recognised as income and expense** | | | | |
| Operating lease payables – minimum payments | **22** | 22 | **3** | 3 |

### 22. Collateral and securitisations

**Securities repurchase agreements and lending transactions**

The Group enters into securities repurchase agreements and securities lending transactions under which it receives or transfers collateral in accordance with normal market practice. Generally, the agreements require additional collateral to be provided if the value of the securities fall below a predetermined level.

Under standard terms for repurchase transactions in the United Kingdom and Republic of Ireland, the recipient of collateral has an unrestricted right to sell or repledge it, subject to returning equivalent securities on settlement of the transaction.

The fair value (and carrying value) of securities transferred under repurchase transactions included within debt securities on the balance sheet were £nil (2012: £nil). Securities received as collateral under reverse repurchase agreements amounted to £nil (2012: £nil).

**Other collateral given**

| | Group | |
|---|---|---|
| | **2013** | 2012 |
| **Group assets charged as security for liabilities** | **£m** | £m |
| Loans and advances to customers | **10,479** | 13,089 |
| Investment properties | **-** | 1 |
| Derivatives | **-** | 8 |
| | **10,479** | 13,098 |

| | Group | |
|---|---|---|
| | **2013** | 2012 |
| **Liabilities secured by charges on assets** | **£m** | £m |
| Debt securities in issue | **1,890** | 3,217 |
| Deposits by banks | **1,889** | 1,884 |
| Derivatives | **25** | 26 |
| Other liabilities | **-** | 2 |
| | **3,804** | 5,129 |

Of the Group assets total above, £9.3 billion (2012: £11.3 billion) relates to securitisations.

Included in deposits by banks is Ulster Bank Ireland Limited's obligation to the CBI under the terms of a Mortgage Backed Promissory Note programme. These obligations are secured by way of a floating charge to the CBI over all its right, title, interest and benefit.

**Securitisations and other asset transfers**

The Group undertakes securitisations to fund specific portfolios of assets. In a securitisation, assets, or interests in a pool of assets, are transferred generally to a special purpose entity (SPE) which then issues liabilities to third party investors. SPEs are vehicles established for a specific, limited purpose, usually 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.

It is primarily the extent of risks and rewards assumed that determines whether these entities are consolidated in the Group's financial statements. The following section aims to address the significant exposures which arise from the Group's activities through specific types of SPEs.

The table below sets out the asset categories together with the carrying amounts of the assets and associated liabilities for those securitisations where substantially all the risks and rewards of the asset have been retained by the Group and continue to be presented in its balance sheet.

| | **2013** | | 2012 | |
|---|---|---|---|---|
| | **Assets** | **Liabilities** | Assets | Liabilities |
| | **£m** | **£m** | £m | £m |
| Residential mortgages | **9,308** | **1,890** | 10,587 | 3,217 |
| Corporate and commercial loans | **-** | **-** | 738 | - |

### 23. Risk management

The major risks associated with the Group's businesses are market, liquidity, credit, regulatory, reputational, conduct, operational and sovereign risk, with the principal risk associated with the Group's business being credit risk. The Group has established a comprehensive framework for managing these risks which is continually evolving as the Group's business activities change in response to market, credit, product and other developments. The Group is also exposed to risks from its defined benefit pension schemes.

The Group has established clear risk policies, including limits, reporting lines and control procedures. This framework is designed to provide tight control and is reviewed regularly by both Executive and Board committees.

**Market risk**

Market risk is defined as the risk of loss as a result of adverse changes in market factors. The risk factors include interest rates, foreign currency and equity prices together with related parameters such as market volatilities.

The principal market risks to which the Group is exposed are interest rate risk and foreign exchange risk. The RBS Group manages market risk within its trading and non-trading portfolios through a comprehensive market risk management framework. This framework includes limits based on, but not limited to Value at Risk ("VaR"), scenario analysis, position and sensitivity analysis. The Group in conjunction with the RBS Group Market Risk and Group Treasury annually agree sub limits based on the Group's approved market risk appetite.

At the RBS Group level, the risk appetite is expressed in the form of a combination of VaR, sensitivity and scenario limits. VaR is a technique that produces estimates of the potential change in the market value of a portfolio over a specified time horizon at given confidence levels. For internal risk management purposes, the Group's VaR assumes a time horizon of one trading day and confidence level of 99% as it is considered that this provides greater clarity in respect of more severe potential economic outcomes. The Group's VaR model is based on a historical simulation model utilising data from the previous two years' trading results.

The VaR disclosure is broken down into trading and non-trading, where trading VaR relates to the trading activities and non-trading reflects the VaR associated with reclassified assets, money market business and the management of internal funds flow within the Group's businesses.

The Group calculates VaR using historical simulation models but does not make any assumption about the nature or type of underlying loss distribution other than implied by history. The methodology uses the previous 500 trading days of market data and calculates both general market risk (the risk due to movement in general market benchmarks) and idiosyncratic market risk (the risk due to movements in the value of securities by reference to specific issuers). The Group VaR should be interpreted in light of the limitations of the methodology used as follows:

- Historical simulation VaR may not provide the best estimate of future market movements. It can only provide a prediction of the future based on events that occurred in the time series horizon. Therefore, events that are more severe than those in the historical data series cannot be predicted;
- VaR that uses a 99% confidence level does not reflect the extent of potential losses beyond that percentile;
- VaR that uses a one-day time horizon will not fully capture the profit or loss implications of positions that cannot be liquidated or hedged within one day; and
- The Group computes the VaR of trading portfolios and non-trading money markets portfolio at the close of business. Treasury Interest Rate Risk VaR is computed monthly.

A 'Risks not in VaR' framework has been developed to address those market risks not adequately captured by the market standard VaR methodology. Where risks are not included in the model, various non-VaR controls (for example, position monitoring, sensitivity limits, triggers or stress limits) are in place. These limitations mean that the Group cannot guarantee that losses will not exceed the VaR.

**(i) Trading portfolios**

The Group eliminates its market risk in these portfolios by entering into back-to-back positions with its ultimate parent company, The Royal Bank of Scotland Group plc.

**23. Risk management – market risk (continued)**

**(ii) Non-trading**
The principal market risks arising from the Group's non-trading activities are interest rate risk and currency risk. Non-trading risk is managed by Treasury, and arises from mismatches between the repricing of assets and liabilities in its wholesale markets, retail bank and corporate bank.

**Total VaR**
The short term markets and financing ("STMF") desk is responsible for raising funding in the international wholesale and repo markets and funding the corporate loan book.

The total VaR for the Group's dealing is presented in the table below:

| | **31 December 2013 £m** | **Maximum £m** | **Minimum £m** | **Average £m** |
|---|---|---|---|---|
| Value-at-Risk | **0.3** | **1.2** | **0.2** | **0.5** |

| | 31 December 2012 £m | Maximum £m | Minimum £m | Average £m |
|---|---|---|---|---|
| Value-at-Risk | 0.4 | 1.3 | 0.3 | 0.6 |

**Interest Rate VaR**
The Interest Rate VaR limit is a sub limit of the Total VaR limit and is monitored daily.

Interest Rate VaR is presented in the table below:

| | **31 December 2013 £m** | **Maximum £m** | **Minimum £m** | **Average £m** |
|---|---|---|---|---|
| Value-at-Risk | **0.3** | **1.2** | **0.2** | **0.5** |

| | 31 December 2012 £m | Maximum £m | Minimum £m | Average £m |
|---|---|---|---|---|
| Value-at-Risk | 0.4 | 1.3 | 0.3 | 0.7 |

**Treasury interest rate risk**
The Group's portfolio of non-trading financial instruments principally comprises retail and commercial banking loans and deposits, debt securities issued, capital and hedging instruments.

Non-trading interest rate risk is calculated on the basis of establishing the repricing behaviour of each asset, liability and off-balance sheet product. For many products, the actual interest rate repricing characteristics differ from the contractual repricing. In most cases, the repricing maturity is determined by the market interest rate that most closely fits the historical behaviour of the product interest rate. For example with non-interest bearing current accounts, the repricing maturity is determined by the stability of the portfolio. The repricing maturities used are approved by the Ulster Bank Asset and Liability Committee ("ALCO") at least annually. Key conventions are reviewed annually by ALCO. Short-term exposures are reviewed in terms of net interest income sensitivity over 12 months to a 1% parallel movement in interest rates. Risk is managed through arm's length cash transactions, bonds and derivatives, principally interest rate swaps.

A static maturity gap report is produced as at the month-end, in each functional currency based on the behaviouralised repricing for each product. It is Group policy to include in the gap report non-financial assets and liabilities, mainly property, plant and equipment and the Group's capital and reserves, spread over medium and longer term maturities. This report also includes hedge transactions, principally derivatives.

Any residual non-trading interest rate exposures are controlled by limiting repricing mismatches in the balance sheets. Potential exposures to interest rate movements in the medium to long term are measured and controlled using a version of the same VaR methodology that is used for the Group's trading portfolios but without discount factors. Net accrual income exposures are measured and controlled in terms of sensitivity over time to movements in interest rates.

Risk is managed within VaR limits approved by ALCO through the execution of cash and derivative instruments. Execution of the hedging is carried out by the relevant division through the Group's Treasury function. The residual risk position is reported to ALCO on a monthly basis.

Non-trading interest rate VaR is split between Euro and Sterling currency balances to which separate risk limits are applied. At 31 December 2013, Sterling VaR was calculated to be £169,000 (2012: £175,000). Euro VaR was calculated to be £260,000 (2012: £203,000).

**23. Risk management – market risk (continued)**

**Treasury interest rate risk (continued)**
Principal amounts only are included. Average balances are used for products where this is considered to provide a more accurate representation of the exposure. A separate ladder is produced for each material currency.

Option risk in the non-trading businesses principally occurs in certain fixed rate assets and liabilities. It arises where businesses undertake to provide funding to, or to accept deposits from, customers at a future date at a pre-determined fixed interest rate. Derivatives are used to manage the risk of interest rate movements from the date a commitment is made to a customer to the date the transaction closes. Option risk also arises where customers can repay fixed rate loans or withdraw fixed rate deposits prior to their maturity. In managing this risk, historic early repayment rates are taken into account.

The Group generally seeks to protect itself from early repayment risk through the imposition of contract breakage fees.

**Foreign exchange risk**
Foreign Exchange Risk in the Banking Book represents exposures to changes in the values of current holdings and future cash flows denominated in other currencies. Hedging instruments used to mitigate these risks include foreign currency options, currency swaps, futures, forwards and deposits. Foreign exchange risk results from the Group's investments in overseas subsidiaries, associates and branches in three principal forms:

- Structural foreign currency exposures that arise from net investment in overseas subsidiaries, associates and branches;
- Transactional/commercial foreign currency exposures that arise from mismatches in the currency balance sheet; and
- Foreign currency profit streams.

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

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

The table below sets out the Group's structural foreign currency exposures as at 31 December 2013:

| | **2013** | | | | | |
|---|---|---|---|---|---|---|
| | **Net assets of overseas investment £m** | **Minority interest £m** | **Net investments £m** | **Currency borrowings £m** | **Economic hedges £m** | **Structural foreign currency exposures £m** |
| Euro | **4,090** | **(26)** | **4,064** | **(416)** | **(1,660)** | **1,988** |

| | 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Net assets of overseas investment £m | Minority interest £m | Net investments £m | Currency borrowings £m | Economic hedges £m | Structural foreign currency exposures £m |
| Euro | 6,767 | (20) | 6,747 | (408) | (1,624) | 4,715 |

At 31 December 2013, a 5% strengthening of foreign currencies would result in a structural foreign currency gain of £99 million in equity (2012: £236m) and a 5% weakening of foreign currencies would result in a structural foreign currency loss of £99 million in equity (2012: £236m).

Changes in foreign exchange rates affect the Group's earnings and equity through differences on the retranslation of the net assets and related funding of overseas subsidiaries from the local functional currency to Sterling. Gains or losses on foreign currency investments in subsidiary and associated undertakings, net of any losses or gains on related foreign currency funding, are recognised in reserves. In 2013 exchange gains of £185m (2012 loss: £146m) have been charged to reserves.

**23. Risk management (continued)**

**Liquidity Risk**

Liquidity risk is the risk that the Group is unable to meet its financial obligations, including financing wholesale maturities or customer deposit withdrawals as and when they fall due. Liquidity risk is highly dependent on company specific characteristics such as the maturity profile and composition of the Group's asset and liabilities, the quality and marketable value of its liquidity buffer and broader market factors, such as wholesale market conditions alongside depositor and investor behaviour.

The Group has in place a comprehensive set of policies to manage liquidity risk that reflected best market practice and complies with prevailing regulatory strictures. These policies are designed to address three broad issues which ensure that:

- the Group maintains adequate liquidity resources to meet liabilities as and when they fall due;
- the Group maintains an adequate liquidity buffer appropriate to the business activities of the Group and their risk profile; and
- the Group has in place robust strategies, policies, systems and procedures for identifying, measuring, monitoring and managing liquidity risk.

At their simplest, these policies determine the sources of liquidity risk and the steps the Group can take when these risks exceed certain tolerances. These include, not only, when and how to use the Group's liquidity buffer but also what other adjustments to the Group's balance sheet could be undertaken to manage these risks back within Group appetite. These policies are reviewed at least annually, or sooner if the Group's own liquidity position changes, or if market conditions and/or regulatory rules warrant further amendment or refinement.

**Policy, framework and governance**
The Group has in place a robust and comprehensive set of policies and procedures for assessing, measuring and managing the liquidity risk within the Group. This ensures that the Group always maintains sufficient eligible and appropriate financial resources to meet its forward looking financial commitments as they fall due.

Guided by ALCO, the Bank's Board of directors are responsible for defining and approving the Group's liquidity policy and setting acceptable parameters and risk limits that align with the overall RBS Group standard and risk appetite. The Group's liquidity buffer is managed by the Treasury function which monitors and controls the Group's funding and liquidity position.

Similar provisions and requirements exist for each entity within the Group, whereby they must comply with both internal standards and local regulatory frameworks.

**Regulatory oversight**
The Group operates in both the United Kingdom and the Republic of Ireland and is subject to regulatory oversight in both jurisdictions. The Group's lead regulator is the FCA. The FCA implemented a new liquidity regime on 1 June 2010. The new rules provide a standardised approach applied to all UK banks. At the RBS Group level, the rules focus on the UK Defined Liquidity Group (a subset comprising the Group's five UK banks, The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Co and Adam & Co) and cover adequacy of liquidity resources, controls, stress testing and the Individual Liquidity Adequacy Assessment (ILAA). The ILAA informs the Group Board and the FCA of the assessment and quantification of the Group's liquidity risks and their mitigation, and how much current and future liquidity is required. In the Republic of Ireland, the Group's operations must meet liquidity requirements set out by the Central Bank of Ireland.

**Liquidity measurement and monitoring**
Liquidity risk is measured and assessed on a daily basis at the RBS Group level in compliance with requirements laid out by the FCA. The Group uses a set of internal metrics and analysis to assess liquidity risk.

The Group uses limits to manage and control the overall extent of liquidity risk within the balance sheet. Limits will focus on the aggregate amount and composition of particular sources of liabilities, asset liability mismatches and third party counterparty concentrations.

As further described herein, stress testing is used to help inform a broader understanding of liquidity risk as well as to model specific liquidity risk events; for example the secession of a country from the Euro.

**23. Risk management - liquidity risk (continued)**

**Liquidity measurement and monitoring (continued)**
The Group actively monitors a range of market and firm specific indicators on an ongoing basis which are designed to act as early warning indicators that liquidity stresses are emerging. Some of these indicators will be based upon actual performance of the business against pre-agreed limits, for example customer deposit outflows. Others will be based around general or specific market movements.

Liquidity risk performance reports are reviewed by ALCO. Any breach or material deterioration of these metrics will set in motion a series of actions and escalations.

The Group's liquidity risk framework is subject to internal oversight, challenge and governance both at Board level and via internal control functions such as Internal Audit. The Group is also subject to regulatory review and challenge.

**Stress testing**
In determining the adequacy of the Group's liquidity resources as part of the RBS Group UK Defined Liquidity Group, the Group evaluates its ability to survive when subjected to simulated stress conditions.

Simulated liquidity stress testing is regularly performed. Stress tests are designed to look at the impact of a variety of firm-specific and market-related scenarios on the adequacy of the Group's liquidity resources at various points in time. Stress tests can therefore be run on an ad hoc basis in response to the emergence of one of these risks.

Scenarios include assumptions about significant changes in key funding sources, external credit ratings, contingent uses of funding and political and economic conditions or events in particular countries. Stress scenarios are applied to both on-balance sheet instruments and off-balance sheet activities to provide a comprehensive view of potential cash flows.

In determining the adequacy of the Group's liquidity resources the Group focuses on the stressed outflows it could anticipate experiencing as a result of any stress scenario occurring. These outflows are measured as occurring over certain time periods which extend from any given day, out to two weeks or to as long as three months. The Group is expected to be able to withstand these stressed outflows through its own resources (principally the use of the liquidity buffer) over these time horizons without having to revert to extraordinary central bank or government assistance.

Stress tests are augmented from time to time to reflect firm specific or emerging market risks that could have a material impact on the Group's liquidity position.

The results of stress testing are an active part of management and strategy in balance sheet management and inform allocation, target and limit discussions. In short, limits in the business-as-usual environment are bounded by capacity to satisfy the Group's liquidity needs in the stress environments.

**Balance sheet composition**
The Group's balance sheet composition is a function of the broad array of product offerings and diverse markets served. The structural composition of the balance sheet is enhanced as needed through active management of both asset and liability portfolios. The objective of these activities is to optimise liquidity transformation in normal business environments, while ensuring adequate coverage of all cash requirements under extreme stress conditions.

The Group also accesses professional markets funding by way of public and private debt issuances on an unsecured and secured basis. These debt issuance programmes are spread across multiple currencies and maturities, to appeal to a broad range of investor types and preferences around the world. This market-based funding supplements the Group's structural liquidity needs and, in some cases, achieves certain capital objectives.

The Group is part of the RBS Group and receives ongoing capital, funding and liquidity resources which, coupled with other sources of funding and liquidity, enable the Group to meet its obligations as they fall due. Other sources of funding and liquidity include retail, wholesale and central bank liquidity facilities.

### 23. Risk management – liquidity risk (continued)

**Contractual maturity**

The tables below analyse the contractual undiscounted cash flows receivable and payable up to a period of twenty years including future receipts and payments of interest on the balance sheet items by contractual maturity. The balances in the tables below do not agree directly to the Group or Bank balance sheet as the tables include all cash flows relating to principal and future coupon payments presented on an undiscounted basis.

| | **Group** | | | | | |
|---|---|---|---|---|---|---|
| **2013** | **0–3 months £m** | **3–12 months £m** | **1–3 years £m** | **3–5 years £m** | **5–10 years £m** | **10–20 years £m** |
| **Assets by contractual maturity** | | | | | | |
| Cash and balances at central banks | 867 | - | - | - | - | - |
| Loans and advances to banks | 7,333 | 349 | 1,099 | 971 | - | - |
| Debt securities | - | - | - | - | - | - |
| Finance leases | 7 | 18 | 28 | 4 | - | - |
| Total maturing assets | 8,207 | 367 | 1,127 | 975 | - | - |
| Loans and advances to customers | 5,168 | 5,080 | 5,930 | 3,902 | 5,763 | 5,842 |
| **Total assets** | **13,375** | **5,447** | **7,057** | **4,877** | **5,763** | **5,842** |
| **Liabilities by contractual maturity** | | | | | | |
| Deposits by banks | 5,880 | 776 | 1,953 | 57 | 1 | - |
| Debt securities in issue | 53 | 126 | 289 | 246 | 466 | 519 |
| Subordinated liabilities | 23 | 9 | 44 | 415 | 716 | 68 |
| Other liabilities | 846 | - | - | - | - | - |
| Total maturing liabilities | 6,802 | 911 | 2,286 | 718 | 1,183 | 587 |
| Customer accounts | 16,706 | 3,188 | 1,238 | 1,034 | 191 | - |
| **Total liabilities** | **23,508** | **4,099** | **3,524** | **1,752** | **1,374** | **587** |
| Maturity gap | **(10,133)** | **1,348** | **3,533** | **3,125** | **4,389** | **5,255** |
| Cumulative maturity gap | **(10,133)** | **(8,785)** | **(5,252)** | **(2,127)** | **2,262** | **7,517** |

| | **Group** | | | | | |
|---|---|---|---|---|---|---|
| 2012 | 0–3 months £m | 3–12 months £m | 1–3 years £m | 3–5 years £m | 5–10 years £m | 10–20 years £m |
| **Assets by contractual maturity** | | | | | | |
| Cash and balances at central banks | 725 | - | - | - | - | - |
| Loans and advances to banks | 5,992 | 111 | 1,079 | 1,007 | - | - |
| Debt securities | - | - | - | - | 1 | 2 |
| Finance leases | 8 | 21 | 32 | 7 | 1 | - |
| Total maturing assets | 6,725 | 132 | 1,111 | 1,014 | 2 | 2 |
| Loans and advances to customers | 3,240 | 8,522 | 5,241 | 3,842 | 7,326 | 11,496 |
| **Total assets** | 9,965 | 8,654 | 6,352 | 4,856 | 7,328 | 11,498 |
| **Liabilities by contractual maturity** | | | | | | |
| Deposits by banks | 5,005 | 13 | 2,885 | 2 | 2 | - |
| Debt securities in issue | 85 | 204 | 440 | 371 | 709 | 806 |
| Subordinated liabilities | 3 | 71 | 60 | 20 | 1,030 | 77 |
| Other liabilities | 580 | 89 | - | - | - | - |
| Total maturing liabilities | 5,673 | 377 | 3,385 | 393 | 1,741 | 883 |
| Customer accounts | 16,267 | 4,742 | 1,500 | 559 | 160 | - |
| **Total liabilities** | 21,940 | 5,119 | 4,885 | 952 | 1,901 | 883 |
| Maturity gap | (11,975) | 3,535 | 1,467 | 3,904 | 5,427 | 10,615 |
| Cumulative maturity gap | (11,975) | (8,440) | (6,973) | (3,069) | 2,358 | 12,973 |

**23. Risk management – liquidity risk (continued)**

| | Bank | | | | | |
|---|---|---|---|---|---|---|
| **2013** | **0–3 months £m** | **3–12 months £m** | **1–3 years £m** | **3–5 years £m** | **5–10 years £m** | **10–20 years £m** |
| **Assets by contractual maturity** | | | | | | |
| Cash and balances at central banks | 624 | - | - | - | | |
| Loans and advances to banks | 4,387 | 350 | 1,099 | 971 | 429 | - |
| Debt securities | - | - | - | - | - | - |
| Total maturing assets | 5,011 | 350 | 1,099 | 971 | 429 | - |
| Loans and advances to customers | 1,384 | 829 | 846 | 775 | 847 | 865 |
| **Total assets** | **6,395** | **1,179** | **1,945** | **1,746** | **1,276** | **865** |
| | | | | | | |
| **Liabilities by contractual maturity** | | | | | | |
| Deposits by banks | 2,961 | 723 | 752 | 50 | - | - |
| Debt securities in issue | 3 | 3 | 4 | - | - | - |
| Subordinated liabilities | 20 | - | 20 | 333 | 583 | - |
| Other liabilities | 822 | - | - | - | - | - |
| Total maturing liabilities | 3,806 | 725 | 776 | 383 | 583 | - |
| Customer accounts | 5,536 | 687 | 328 | 258 | 10 | - |
| **Total liabilities** | **9,342** | **1,413** | **1,104** | **641** | **593** | **-** |
| | | | | | | |
| Maturity gap | **(2,947)** | **(234)** | **841** | **1,105** | **683** | **865** |
| Cumulative maturity gap | **(2,947)** | **(3,181)** | **(2,340)** | **(1,235)** | **(552)** | **313** |

| | Bank | | | | | |
|---|---|---|---|---|---|---|
| 2012 | 0–3 months £m | 3–12 months £m | 1–3 years £m | 3–5 years £m | 5–10 years £m | 10–20 years £m |
| **Assets by contractual maturity** | | | | | | |
| Cash and balances at central banks | 545 | - | - | - | - | - |
| Loans and advances to banks | 4,437 | 111 | 1,079 | 1,007 | 420 | - |
| Debt securities | - | - | - | - | 1 | 2 |
| Total maturing assets | 4,982 | 111 | 1,079 | 1,007 | 421 | 2 |
| Loans and advances to customers | 1,446 | 1,312 | 851 | 489 | 1,122 | 1,526 |
| **Total assets** | 6,428 | 1,423 | 1,930 | 1,496 | 1,543 | 1,528 |
| | | | | | | |
| **Liabilities by contractual maturity** | | | | | | |
| Deposits by banks | 2,801 | 2 | 1,737 | - | - | - |
| Debt securities in issue | - | - | 3 | - | - | - |
| Subordinated liabilities | - | - | 40 | - | 899 | - |
| Other liabilities | 574 | 80 | - | - | - | - |
| Total maturing liabilities | 3,375 | 82 | 1,780 | - | 899 | - |
| Customer accounts | 5,146 | 1,543 | 349 | 144 | 26 | - |
| **Total liabilities** | 8,521 | 1,625 | 2,129 | 144 | 925 | - |
| | | | | | | |
| Maturity gap | (2,093) | (202) | (199) | 1,352 | 618 | 1,528 |
| Cumulative maturity gap | (2,093) | (2,295) | (2,494) | (1,142) | (524) | 1,004 |

**23. Risk management – liquidity risk (continued)**

Other contractual cash obligations

| | Group | | | | | |
|---|---|---|---|---|---|---|
| **2013** | 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 | 5 | 15 | 36 | 30 | 31 | 18 |
| Contractual obligations to purchase goods or services | 1 | 2 | 3 | 6 | - | - |
| | **6** | **17** | **39** | **36** | **31** | **18** |

| | Group | | | | | |
|---|---|---|---|---|---|---|
| 2012 | 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 | 5 | 16 | 39 | 33 | 41 | 20 |
| Contractual obligations to purchase goods or services | 1 | 2 | 4 | - | - | - |
| | 6 | 18 | 43 | 33 | 41 | 20 |

| | Bank | | | | | |
|---|---|---|---|---|---|---|
| **2013** | 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 | 1 | 1 | 2 |
| Contractual obligations to purchase goods or services | - | 1 | 1 | 3 | - | - |
| | **-** | **2** | **3** | **4** | **1** | **2** |

| | Bank | | | | | |
|---|---|---|---|---|---|---|
| 2012 | 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 | 3 | 2 | 2 | 2 |
| Contractual obligations to purchase goods or services | - | 1 | 2 | - | - | - |
| | 1 | 3 | 5 | 2 | 2 | 2 |

Financial assets have been reflected in the time band of the latest date on which they could be repaid unless earlier repayment can be demanded by the Group; 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 the repayment of a financial asset or liability is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the asset is included in the latest date on which it can repay regardless of early repayment whereas 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 is automatically prepaid 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 in issue 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. As the repayment of assets and liabilities are linked, the repayment of assets in securitisations are shown on the earliest date that the asset can be prepaid as this is the basis used for liabilities.

The principal amounts of financial assets and liabilities that are repayable after 20 years or where the counterparty has no right to repayment of the principal are excluded from the table as are interest payments after 20 years.

**23. Risk management (continued)**

**Credit risk**

Credit risk is the risk of financial loss due to the failure of a customer to meet its obligation to settle outstanding amounts. The Group is exposed to credit risk as a result of a wide range of business activities. The most significant source of credit risk is direct credit risk to customers and banks, which arises from lending activities. The second most significant source is counterparty credit risk, which results from the Group's activities in the derivatives and security financing transaction markets.

The Group offers a number of lending products where it has an irrevocable obligation to provide credit facilities to a customer. Security can be obtained to mitigate the risk of loss in the form of physical collateral such as commercial real estate assets and residential housing, or financial collateral such as cash or bonds.

Derivatives and security financing transactions expose the Group to counterparty credit risk, which is the risk of loss arising from a failure of a customer to meet obligations which vary in value by reference to a market factor.

The Group holds debt securities with the intention of selling them resulting in exposure to market risk. However, it also holds some debt securities until maturity and is exposed to credit risk as a result.

The Group is exposed to credit risk from off balance sheet products such as trade finance activities and guarantees.

**Objectives, organisation and governance**
The existence of a strong credit risk management function is vital to support the ongoing profitability of the Group. The potential for loss through economic cycles is mitigated through the embedding of a robust credit risk culture within the business units and through a focus on the importance of sustainable lending practices. The credit risk management function is responsible for credit approval, concentration and credit risk control frameworks and acts as the ultimate authority for the approval of credit. This, together with strong independent oversight and challenge, enables the business to maintain a sound lending environment.

Responsibility for development of RBS Group-wide policies, credit risk frameworks, RBS Group-wide portfolio management and assessment of provision adequacy resides with the Group Credit Risk ("GCR") function under the management of the Ulster Bank Chief Risk Officer. Responsibility for application of these policies within the Group resides with the Ulster Bank Chief Risk Officer.

Ulster Bank Credit Risk ("UBCR") works together with GCR to ensure that the expressed risk appetite is met, within a clearly defined and managed control environment. UBCR operates under the management of the Ulster Bank Group Chief Risk Officer with matrix responsibility to the RBS Group Chief Risk Officer

Material aspects of the RBS Group's credit risk management framework, such as credit risk appetite and limits for portfolios of strategic significance, are considered and approved by the Executive Risk Forum ("ERF"). The ERF has delegated authority to the RBS Group Credit Risk Committee, a functional sub-committee of RBS Group Risk Committee, to act on credit risk matters. These include, but are not limited to, credit risk appetite and limits (within the overall risk appetite set by the Board and the ERF), credit risk strategy and frameworks, credit risk policy and the oversight of the credit profile across the RBS Group.

In the Group material sector concentrations are reviewed by the Executive Risk Committee while other sector limits are approved by the Concentration Risk Committee.

The Prudential Regulatory Authority (PRA) has highlighted the shortcomings of the Commercial Real Estate models used by all UK regulated entities. It has advised the Group to adopt the "Specialised Lending" approach to determine capital requirements. This approach was introduced during the year and is due to be fully embedded by the end of 2013.

The RBS Group Audit Committee ("GAC") provides oversight of the RBS Group's provision adequacy. The Group Chief Credit Officer ("GCCO") is accountable to the GAC for the adequacy of the Group's provisions, both individual and collective. The RBS Group Provisions Committee, which is chaired by either the RBS Group Chief Risk Officer ("GCRO") or the GCCO, approves recommendations from the divisional provisions committees. In Ulster Bank Group the equivalent roles are filled by the Ulster Bank Audit Committee and Provisions Committee.

**Credit risk management framework**
Risk appetite is set using specific quantitative targets under stress. Of particular relevance are the targets for earnings volatility and capital adequacy. The Group's credit risk framework has therefore been designed around the factors that influence the Group's ability to meet those targets. These include product and asset class, industry sector, single name and country concentrations. Any of these factors could generate higher earnings volatility under stress and, if not adequately controlled, could undermine capital adequacy. Tools such as stress testing and economic capital are used to measure credit risk volatility and develop links between Group risk appetite targets and the credit risk control framework. The framework is supported by a suite of policies that set out the risk parameters. The Group also manages its exposures to counterparty credit risk closely, using portfolio limits and specific tools to control more volatile or capital intensive business areas.

**23. Risk management – credit risk (continued)**

**Risk appetite and concentration risk management**
Risk appetite has been expressed by the Board through the setting of specific quantitative risk appetite targets under stress. Of particular relevance in the management of credit risk are the targets for earnings volatility and capital adequacy. The Group's credit risk framework has therefore been designed around the factors that influence the Group's ability to meet these targets. These include the limiting of excess credit risk concentrations which generate higher volatility under stress and, if not adequately controlled, can undermine capital adequacy.

The Group's credit concentration frameworks are designed to limit concentration by product/asset class, industry sector, customer or counterparty (i.e. single name) and country. The frameworks are supported by a suite of policies that set out the risk parameters within which business units may operate.

*Product/asset class concentration framework*
The Group manages certain lines of business where the nature of credit risk assumed could result in a concentration or a heightened risk in some other form. This will include specific credit risk types such as settlement, wrong-way risk and products such as long-dated derivatives and securitisation. These product and asset classes may require formal policies, expertise, tailored monitoring and reporting measures. In some cases, specific limits and thresholds are deployed to ensure that the credit risk inherent in these lines of business and products is adequately controlled. Product and asset classes are reviewed regularly. The reviews consider the risks inherent in each product or asset class, the risk controls applied, monitoring and reporting of the risk, the client base, and any emerging risks to ensure risk appetite remains appropriate.

*Sector concentration*
Exposures are assigned to, and reviewed in the context of, a defined set of industry sectors. Risk appetite and portfolio strategies are set either at the sector or sub-sector level, depending on where exposures may result in excessive concentration or where trends in both external factors and internal portfolio performance give cause for concern. Regular formal reviews are undertaken at Group or divisional level depending on materiality. Reviews may include an assessment of the Group's franchise in a particular sector, an analysis of the outlook, identification of key vulnerabilities and stress testing.

As a result of the reviews carried out in 2013, the Group further reduced its risk appetite in the corporate sectors of commercial real estate and retail.

*Single name concentration*
A single name concentration framework addresses the risk of outsized exposure to a borrower or borrower group. The framework includes elevated approval authority, additional reporting and monitoring, and the requirement for plans to address excess exposures.

A number of credit risk mitigation techniques are available to reduce single name concentrations. If the Group decides that its exposure is too high, it may decide to sell excess exposures. Alternatively, it may decide to take additional security or guarantees such as cash, bank or government guarantees or credit default swaps. Credit risk mitigants must be effective in terms of legal certainty and enforceability. In addition, maturity or expiry dates must be the same, or later, than the underlying obligations.

*Wholesale*
Four formal frameworks are used to manage wholesale credit concentration risk. The Group continually reassesses its frameworks to ensure that they remain appropriate for its varied business franchises, current economic conditions and to reflect further refinements in the Group's risk measurement models.

The credit risk function assesses, approves and manages the credit risk associated with a borrower or group of related borrowers.

The GCCO has established a framework of individual delegated authorities which requires at least two individuals to approve each credit decision, one from the business and one from the credit risk function. Both must hold appropriate delegated authority, granted through a framework set out in the Group Credit Risk Policy, which is dependent on their experience and expertise. Only a small number of senior executives hold the highest authority provided under the framework. While both parties are accountable for the quality of each decision taken, the credit risk approver holds ultimate sanctioning authority.

**23. Risk management – credit risk (continued)**

**Risk appetite and concentration risk management (continued)**
In all circumstances the risks associated with any proposal to provide, increase, review or change the terms or conditions of credit facilities must be assessed prior to a credit decision being made. Assessments of credit risk must, at a minimum, specifically address the following elements:

- Amount, terms, tenor, structure, conditions, purpose and appropriateness of all credit facilities;
- Compliance with applicable Group and/or divisional credit policies;
- The customer's ability to meet obligations based on an analysis of financial information and a review of payment and covenant compliance history;
- The source of repayment and the customer's risk profile, including sector analysis and sensitivity to economic and market developments, and credit risk mitigation;
- Refinancing risk - the risk of loss arising from the failure of a customer to settle an obligation on expiry of a facility through the drawdown of another credit facility provided by the Group or by another lender;
- Consideration of all other risks such as environmental, social and ethical, regulatory and reputational risks;
- Portfolio impact of the transaction including impact on any credit risk concentration limits or agreed divisional risk appetite;

At a minimum, credit relationships are reviewed and re-approved annually. The renewal process addresses: borrower performance, including reconfirmation or adjustment of risk parameter estimates; the adequacy of security; and compliance with terms and conditions. For certain counterparties, early warning indicators are also in place to detect deteriorating trends in limit utilisation or account performance, and to prompt additional oversight.

Since 2009, the Group has been managing its corporate exposures to reduce concentrations and align its appetite for future business to the Group's broader strategies for its large corporate franchises. The Group is continually reviewing its single name concentration framework to ensure that it remains appropriate for current economic conditions and in line with improvements in the Group's risk measurement models.

In 2012 the Group implemented further refinements to the single name exposure management controls that were already in place to be more closely aligned with market best practice and to allow the Group to differentiate more consistently between the different risk types.

Significant progress has been made in putting in place and embedding the necessary risk management frameworks to monitor and manage the risk inherent in the portfolios, as set out above. Notwithstanding this progress, it is noted that the overall credit risk profile of the balance sheet remains outside the desired risk appetite predominantly due to the need to address and rectify the impact on the balance sheet from the legacy portfolios. The announcement of the accelerated disposal of a significant portfolio of legacy wholesale assets represents an important step towards bringing the credit risk profile back within the desired appetite. Successful execution of this strategy over the coming three years will represent material progress in this regard.

**Country**
Country risk arises from sovereign events (for example, default or restructuring); economic events (for example, contagion of sovereign default to other parts of the economy or cyclical economic shock); political events (for example, convertibility restrictions and expropriation or nationalisation); and natural disaster or conflict. Such events have the potential to impact elements of the Group's credit portfolio that are directly or indirectly linked to the affected country and can also give rise to market, liquidity, operational and franchise risk related losses. Sovereign risk is discussed on page 83.

**Global Restructuring Group**
Global Restructuring Group ("GRG") manages the Group's wholesale problem debt portfolio in cases where its exposure to the customer exceeds £1 million. The primary function of GRG is to restore customers to an acceptable credit condition and minimise losses to the Group.

The common factor to all customers managed by GRG is that the Group's exposure is outside risk appetite. Customers transferred to GRG typically show symptoms of significant financial stress, such as cash flow pressures, or show evidence that the management team has limited experience of managing a business in difficulty. In addition, a business may be transferred to GRG if the Group has imperfect information available on which to make decisions.

GRG relationship managers use their skill, experience and judgement to support customers through these difficulties while seeking to minimise losses to protect the Group's capital.

**23. Risk management – credit risk (continued)**

**Global Restructuring Group (continued)**
When the relationship is transferred, GRG conducts a detailed assessment of the viability of the business as well as the ability of management to deal with the causes of financial stress. Following GRG's initial file assessment and wider due diligence, with input from independent experts (sector experts, accountants and surveyors), various options are presented to the customer. A strategy is then agreed for dealing with the distressed loan.

The objective is to find a mutually acceptable solution, including refinancing or exit if that is the customer's preferred option. If the business is not viable and a turnaround is not possible, insolvency may be one of the options.

**Retail collections and recoveries**
There are collections and recoveries functions in each of the consumer businesses. Their role is to provide support and assistance to customers who are currently experiencing difficulties meeting their financial obligations. Where possible, the aim of the collections and recoveries teams is to return the customer to a satisfactory position by working with them to restructure their finances. If this is not possible, the team has the objective of reducing the loss to the Group.

**Forbearance**
Within the Group's retail businesses forbearance generally occurs when the business, grants a permanent or temporary concession to a customer. Forbearance is granted following an assessment of the customer's individual circumstances and ability to pay.

Mortgage Arrears Resolution Strategies ("MARS") is a CBI sponsored initiative for all banks in the Republic of Ireland that aims to increase the level of engagement and options available to mortgage customers in financial difficulty. Ulster Bank Ireland Limited started to develop new MARS contact strategies and treatments in September 2011 and presented for approval to the Board in October 2012. The MARS strategies went live in December 2012.

*Identification of forbearance*
Customers who contact the bank directly because of financial difficulties, or who are already in payment arrears, may be granted forbearance. In the course of assisting customers, more than one forbearance treatment may be granted.

*Types of retail forbearance*
Forbearance options include, but are not limited to, payment concessions, capitalisations of arrears, term extensions and temporary conversions to interest only.

- Payment concessions - A temporary reduction in, or elimination of, the periodic (usually monthly) loan repayment is agreed with the customer. At the end of the concessionary period, forborne principal and accrued interest outstanding is scheduled for repayment over an agreed period.
- Capitalisation of arrears - The arrears are repaid over the remaining term of the mortgage and the customer returns to an up-to-date position. Capitalisation of arrears does not apply to FCA regulated mortgages, other than in exceptional cases where other forbearance options have been exhausted.
- Term extensions - The maturity date of the loan is extended.
- Interest Only Conversions - The customer converts from principal and interest repayment to interest only repayment on a temporary or permanent basis.

For unsecured portfolios, forbearance treatments entail reduced or deferred payments. Arrangements to facilitate the repayment of overdraft excesses or loan arrears can be agreed dependent on affordability. Where repayment arrangements are not affordable debt consolidation loans can be provided to customers in collections.

The mortgage arrears information for retail accounts in forbearance and related provisions are shown in the table below:

| | **2013** | | 2012 | |
|---|---|---|---|---|
| | **Balance** | **Provisions** | Balance | Provisions |
| **Arrears status and provisions** | **£m** | **£m** | £m | £m |
| No missed payments | **1,362** | **166** | 905 | 100 |
| 1-3 months in arrears | **631** | **76** | 537 | 60 |
| >3 months in arrears | **789** | **323** | 516 | 194 |
| Total | **2,782** | **565** | 1,958 | 354 |

**23. Risk management – credit risk (continued)**

**Forbearance (continued)**

*Types of retail forbearance (continued)*
The incidence of the main types of retail forbearance on the balance sheet as at 31 December 2013 is analysed below. Definitions are based on those used within the FCA forbearance guidelines. For a small proportion of mortgages, more than one forbearance type applies.

| | **2013** | 2012 |
|---|---|---|
| | **£m** | £m |
| Interest only | **512** | 924 |
| Term extensions – capital repayment & interest only | **325** | 183 |
| Payment concession/holidays | **1,567** | 762 |
| Capitalisation of arrears | **493** | 119 |
| Total | **2,897** | 1,988 |
| | | |
| % of total mortgage stock | **14.6** | 10.2 |

**Provisioning methodology**
If there is objective evidence that an impairment loss has been incurred, the amount of the 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 Group uses one of the following three different methods to assess the amount of provision required: individual; collective; and latent.

*Individually assessed provisions*
Loans and securities above a defined threshold deemed to be individually significant are assessed on a case-by-case basis. Assessments of future cash flows take into account the impact of any guarantees or collateral held. Projections of cash flow receipts are based on the Group's judgement and facts available at the time. Projected cash flows are reviewed on subsequent assessment dates as new information becomes available.

*Collectively assessed provisions*
Provisions on impaired credits below an agreed threshold are assessed on a portfolio basis, reflecting the homogeneous nature of the assets. The Group segments wholesale and retail portfolios according to product type, such as credit cards, personal loans and mortgages. The approach taken to assess impaired assets in provisioning differs from that taken in Collections and Recoveries.

The provision is determined based on a quantitative review of the relevant portfolio. It takes account of the level of arrears, the value of any security, and historical and projected cash recovery trends over the recovery period. The provision also incorporates any adjustments that may be deemed appropriate given current economic conditions. Such adjustments may be determined based on a review of the latest cash collections profile; and operational processes used in managing exposures.

*Latent loss provisions*
In the performing portfolio, provisions are held against losses incurred but not identified before the balance sheet date.

Latent loss provisions reflect probability of default ("PDs") and loss given default ("LGDs") as well as emergence periods. The emergence period is defined as the period between the occurrence of the impairment event and a loan being identified and reported as impaired.

Impairment charges have increased significantly from £2.34bn in 2012 to £4.79bn in 2013. The significant increase is attributed to the placing of c. £8bn of Ulster Bank's loans into the RBS Capital Resolution Group ("RCR"), which is designated for accelerated realisation. This has significantly shortened the amount of time the Group has before it can realise the underlying collateral on the affected loans, to a scenario where 55-70% of all RCR assets must be disposed of before the end of 2015 and 85% by the end of 2016. Disposing of these RCR assets over a shorter timeframe will reduce the value the Group can expect to recover, and will lead to accelerated and increased impairments.

**Provisioning for retail customers**
Provisions are assessed in accordance with the Group's provisioning policies which comply with IAS 39 'Financial Instruments: Recognition and Measurement'. For the non-performing population, a collective assessment is made. Within the performing book, latent loss provisions are held for those loans that are impaired but not yet identified.

**23. Risk management – credit risk (continued)**

**Provisioning for retail customers (continued)**
The majority of mortgage accounts subject to forbearance remain in the performing book but these accounts are identified and monitored separately from other performing accounts. They are subject to higher provisioning rates than the remainder of the performing book (currently approximately eight times higher). These rates are reviewed monthly. Once forbearance is granted, the account continues to be assessed separately for latent provisioning until the forbearance period expires. After that point, the account is no longer separately identified for latent provisioning. Non-performing mortgage accounts that have been granted forbearance carry the same provision rate as non-forborne accounts.

**Controls and assurance**
The Group's credit control and assurance framework comprises three key components: credit policy, policy compliance assurance and independent assurance.

The foundation is the RBS Group Credit Policy Standard, which as part of the Group Policy Framework ("GPF"), sets out the rules the Group's businesses must follow to ensure that credit risks are identified and effectively managed through the credit lifecycle. During 2012, a major revision of the RBS Group's key credit policies was completed. This revision has provided support in ensuring that the Group's control environment is appropriately aligned to the approved risk appetite, and provides a sound basis for the Group's independent audit and assurance activities across the credit risk function.

The second component is a policy assurance activity that GCR undertakes to provide the Group Chief Credit Officer with evidence of the effectiveness of the controls in place across the Group to manage credit risk. The results of these reviews are presented to the Group Credit Risk Committee on a regular basis in support of the self-certification that GCR is obliged to complete under the GPF.

Lastly, a strong independent assurance function is an important element of a sound control environment. During 2011, the RBS Group took the decision to strengthen its Credit Quality Assurance ("CQA") activities and moved all divisional CQA resources under the centralised management of GCR. The benefits of this action are already apparent in greater consistency of standards and cross-utilisation of resources, ensuring that subject matter experts bring their expertise to bear where relevant.

**Controls and assurance (continued)**
Reviews undertaken consistently address the four underlying risk pillars of: risk management, risk appetite, ratings and data integrity, and asset quality. Appropriate identification, escalation, remediation and related tracking of control breaches and improvements in operational processes are firmly embedded in the assurance process to ensure that divisions act upon review findings.

**Credit risk measurement**
Credit risk models are used throughout the Group to support the quantitative risk assessment element within the credit approval process, ongoing credit risk management, monitoring and reporting and portfolio analytics.

The Group is undertaking a significant programme of updates and improvements to its wholesale credit risk models, including the incorporation of more recent data and reflecting updated regulatory requirements applying to some aspects of wholesale Internal Ratings Based ("IRB") modelling. Material updates to certain models, notably those used in sovereign and financial institution asset classes, have been implemented and are reflected in measures of risk reported in the Group's disclosures. Further updates are planned. In addition, in accordance with the instruction from the FCA, the Group has begun to transition relevant commercial real estate assets to the slotting approach, under which modelled measures play no role in the determination of risk weighted assets and capital requirements.

The model updates are generally in segments of the portfolio where risk experience has remained limited even in recent periods and primarily result in increases to measures that still remain within ranges representing lower risk business relative to the Group's broader risk profile; in terms of probability of default models, for example, the changes occur largely within ranges equivalent to investment grade ratings.

Material aspects of these changes have been anticipated in risk frameworks and in other areas that are dependent on these measures, notably including the group's risk appetite framework. In some portfolios the anticipated impact on risk weighted assets has been realised, as part of a process defined with regulators, prior to introduction of the updated models.

These models assess the probability that a customer will fail to make full and timely repayment of its obligations. The probability of a customer failing to do so is measured over a one year period through the economic cycle, although certain retail scorecards use longer periods for business management purposes.

*Wholesale businesses* **-** As part of the credit assessment process, each counterparty is assigned an internal credit grade derived from a default probability. There are a number of different credit grading models in use across the Group, each of which considers risk characteristics particular to that type of customer. The credit grading models score a combination of quantitative inputs (for example, recent financial performance) and qualitative inputs (for example, management performance or sector outlook).

**23. Risk management – credit risk (continued)**

*Retail businesses* **-** Each customer account is separately scored using models based on the most material drivers of default. In general, scorecards are statistically derived using customer data. Customers are assigned a score, which in turn is mapped to a probability of default. The probabilities of default are used to support automated credit decision making and to group customers into risk pools for regulatory capital calculations.

**Exposure at default**
Facility usage models estimate the expected level of utilisation of a credit facility at the time of a borrower's default. For revolving and variable draw-down type products which are not fully drawn, the exposure at default ("EAD") will typically be higher than the current utilisation. The methodologies used in EAD modelling provide an estimate of potential exposure and recognise that customers may make more use of their existing credit facilities as they approach default.

Counterparty credit risk exposure measurement models are used for derivatives and other traded instruments, where the amount of credit risk exposure may be dependent upon one or more underlying market variables, such as interest or foreign exchange rates. These models drive internal credit risk management activities such as limit and excess management.

**Loss given default**
These models estimate the economic loss that may be experienced (the amount that cannot be recovered) by the Group on a credit facility in the event of default. The Group's loss given default models take into account both borrower and facility characteristics for unsecured or partially unsecured facilities, as well as the quality of any risk mitigation that may be in place for secured facilities, the cost of collections and a time discount factor for the delay in cash recovery.

**Credit risk assets**
In the tables and commentary below, exposure refers to credit risk assets, which consist of:

- *Lending* **-** Comprises gross loans and advances to: central and local governments; central banks, including cash balances; other banks and financial institutions, incorporating overdraft and other short-term credit lines; corporations, in large part loans and leases; and individuals, comprising mortgages, personal loans and credit card balances. Lending includes both impaired loans and those loans where an impairment event has taken place, but no impairment provision is recognised.
- *Derivatives* **-** Comprises the mark-to-market value of such contracts after the effect of enforceable netting agreements, but before the effect of collateral. In the event of a counterparty default, this is the amount due from the counterparty. Figures shown apply counterparty netting within the regulatory capital model used.
- *Contingent obligations* **-** Comprises primarily letters of credit and guarantees.

Credit risk assets exclude issuer risk (primarily debt securities) and reverse repurchase arrangements. They take account of legal netting arrangements that provide a right of legal set-off, but do not meet the offset criteria under IFRS.

*Asset quality*
Internal reporting and oversight of risk assets is principally differentiated by credit grades. Customers are assigned credit grades based on various credit grading models that reflect the key drivers of default for each customer type. All credit grades across the Group map to both a Group level asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures, used for internal management reporting across portfolios. Accordingly, measures of risk exposure may be readily aggregated and reported at increasing levels of granularity depending on stakeholder or business need.

The table below shows credit risk assets by asset quality (AQ) band:

| Asset Quality Grade | Minimum % | Maximum % |
|---|---|---|
| AQ1 | 0.000 | 0.034 |
| AQ2 | 0.034 | 0.048 |
| AQ3 | 0.048 | 0.095 |
| AQ4 | 0.095 | 0.381 |
| AQ5 | 0.381 | 1.076 |
| AQ6 | 1.076 | 2.153 |
| AQ7 | 2.153 | 6.089 |
| AQ8 | 6.089 | 17.222 |
| AQ9 | 17.222 | 100.000 |
| AQ10 | 100.000 | 100.000 |

**23. Risk management – credit risk (continued)**

The following table provides an analysis of the credit quality of third party financial assets by probability of default.

| | Group | | | | | |
|---|---|---|---|---|---|---|
| **2013** | **Cash and balances at central banks £m** | **Loans and advances to banks £m** | **Loans and advances to customers £m** | **Derivatives £m** | **Commitments £m** | **Contingent liabilities £m** |
| AQ1 | 624 | 9,543 | 142 | 358 | 238 | 34 |
| AQ2 | - | - | 29 | 69 | 208 | 75 |
| AQ3 | - | 18 | 73 | 2 | 37 | 48 |
| AQ4 | 243 | 189 | 837 | 57 | 697 | 47 |
| AQ5 | - | 2 | 2,022 | 6 | 719 | 55 |
| AQ6 | - | - | 4,060 | 5 | 673 | 56 |
| AQ7 | - | - | 5,701 | 8 | 415 | 50 |
| AQ8 | - | - | 767 | 18 | 131 | 9 |
| AQ9 | - | - | 8,284 | 38 | 56 | 3 |
| AQ10 | - | - | - | - | 460 | 71 |
| Accruing past due | - | - | 1,902 | - | - | - |
| Non-accrual | - | - | 19,212 | - | - | - |
| Impairment provisions | - | - | (14,766) | - | - | - |
| **Total** | **867** | **9,752** | **28,263** | **561** | **3,634** | **448** |

| | Group | | | | | |
|---|---|---|---|---|---|---|
| 2012 | Cash and balances at central banks £m | Loans and advances to banks £m | Loans and advances to customers £m | Derivatives £m | Commitments £m | Contingent liabilities £m |
| AQ1 | 545 | 8,039 | 293 | 404 | 168 | 1 |
| AQ2 | - | 3 | 17 | 43 | 165 | 47 |
| AQ3 | - | 4 | 81 | 39 | 40 | 35 |
| AQ4 | 180 | 142 | 794 | 43 | 896 | 123 |
| AQ5 | - | 2 | 893 | 5 | 523 | 29 |
| AQ6 | - | - | 4,548 | 2 | 608 | 59 |
| AQ7 | - | - | 9,918 | 6 | 423 | 60 |
| AQ8 | - | - | 2,222 | 67 | 155 | 45 |
| AQ9 | - | - | 5,395 | 115 | 80 | 15 |
| AQ10 | - | - | - | - | 354 | 82 |
| Accruing past due | - | - | 2,800 | - | - | - |
| Non-accrual | - | - | 18,219 | - | - | - |
| Impairment provisions | - | - | (10,774) | - | - | - |
| Total | 725 | 8,190 | 34,406 | 724 | 3,412 | 496 |

**23. Risk management – credit risk (continued)**

| | | | **Bank** | | | |
|---|---|---|---|---|---|---|
| **2013** | **Cash and balances at central banks £m** | **Loans and advances to banks £m** | **Loans and advances to customers £m** | **Derivatives £m** | **Commitments £m** | **Contingent liabilities £m** |
| AQ1 | 624 | 7,180 | 358 | 15 | 49 | - |
| AQ2 | - | - | 10 | - | 3 | - |
| AQ3 | - | 2 | 21 | - | 6 | 3 |
| AQ4 | - | 2 | 264 | - | 88 | 7 |
| AQ5 | - | - | 992 | 1 | 453 | 8 |
| AQ6 | - | - | 860 | - | 183 | 7 |
| AQ7 | - | - | 461 | - | 109 | 35 |
| AQ8 | - | - | 210 | - | 49 | 1 |
| AQ9 | - | - | 987 | - | 13 | 1 |
| AQ10 | - | - | - | - | 114 | 16 |
| Accruing past due | - | - | 160 | - | - | - |
| Non-accrual | - | - | 3,184 | - | - | - |
| Impairment provisions | - | 52 | (2,577) | - | - | - |
| **Total** | **624** | **7,236** | **4,930** | **16** | **1,067** | **78** |

| | | | **Bank** | | | |
|---|---|---|---|---|---|---|
| 2012 | Cash and balances at central banks £m | Loans and advances to banks £m | Loans and advances to customers £m | Derivatives £m | Commitments £m | Contingent liabilities £m |
| AQ1 | 545 | 6,963 | 254 | 34 | 43 | - |
| AQ2 | - | 2 | 3 | 3 | 8 | - |
| AQ3 | - | 1 | 14 | - | 21 | 3 |
| AQ4 | - | 87 | 148 | - | 161 | 10 |
| AQ5 | - | 1 | 154 | - | 321 | 5 |
| AQ6 | - | - | 816 | - | 207 | 10 |
| AQ7 | - | - | 1,777 | - | 118 | 10 |
| AQ8 | - | - | 426 | - | 45 | 2 |
| AQ9 | - | - | 1,164 | - | 29 | 7 |
| AQ10 | - | - | - | - | 61 | 20 |
| Accruing past due | - | - | 182 | - | - | - |
| Non-accrual | - | - | 3,114 | - | - | - |
| Impairment provisions | - | - | (2,032) | - | - | - |
| Total | 545 | 7,054 | 6,020 | 37 | 1,014 | 67 |

Loans and advances to customers, past due at balance sheet date but not considered impaired are shown in Note 9.

### 23. Risk management – credit risk (continued)

**Credit risk assets by industry and geography**

Industry analysis plays an important part in assessing the potential for concentration risk in the loan portfolio. Particular attention is given to industry sectors where the Group believes there is a high degree of risk or potential for volatility in the future. The table below analyses credit risk assets by industry sector and geography.

The tables below analyse financial assets by geographical region (based on location of transaction office) and sector.

| | Group | | | | |
|---|---|---|---|---|---|
| 2013 | Gross loans and advances to banks and customers £m | Debt securities and equity shares £m | Derivatives £m | Total £m | Netting and offset (1) £m |
| **UK** | | | | | |
| Central and local government | - | - | - | - | - |
| Manufacturing | 345 | - | 1 | 346 | 8 |
| Construction | 324 | - | - | 324 | 18 |
| Finance | 7,781 | 9 | 349 | 8,139 | - |
| Service industries and business activities | 870 | - | 1 | 871 | 49 |
| Agriculture, forestry and fishing | 267 | - | - | 267 | 54 |
| Property | 4,582 | - | - | 4,582 | 21 |
| Individuals | | - | - | | |
| Home mortgages | 2,256 | - | - | 2,256 | - |
| Other | 394 | - | - | 394 | - |
| Interest accruals | 10 | - | - | 10 | - |
| **Total UK** | **16,829** | **9** | **351** | **17,189** | **150** |
| **Republic of Ireland** | | | | | |
| Central and local government | 56 | - | - | 56 | - |
| Manufacturing | 756 | - | 17 | 773 | 8 |
| Construction | 452 | - | - | 452 | 20 |
| Finance | 426 | 7 | 72 | 505 | - |
| Service industries and business activities | 4,460 | 2 | 94 | 4,556 | 59 |
| Agriculture, forestry and fishing | 888 | - | 2 | 890 | 30 |
| Property | 11,304 | - | 25 | 11,329 | 5 |
| Individuals | | | | | |
| Home mortgages | 16,791 | - | - | 16,791 | - |
| Other | 783 | - | - | 783 | 1 |
| Interest accruals | 36 | - | - | 36 | - |
| **Total Republic of Ireland** | **35,952** | **9** | **210** | **36,171** | **123** |
| **Total** | | | | | |
| Central and local government | 56 | - | - | 56 | - |
| Manufacturing | 1,101 | - | 18 | 1,119 | 16 |
| Construction | 776 | - | - | 776 | 38 |
| Finance | 8,207 | 16 | 421 | 8,644 | - |
| Service industries and business activities | 5,330 | 2 | 95 | 5,427 | 108 |
| Agriculture, forestry and fishing | 1,155 | - | 2 | 1,157 | 84 |
| Property | 15,886 | - | 25 | 15,911 | 26 |
| Individuals | | | | | |
| Home mortgages | 19,047 | - | - | 19,047 | - |
| Other | 1,177 | - | - | 1,177 | 1 |
| Interest accruals | 46 | - | - | 46 | - |
| | **52,781** | **18** | **561** | **53,360** | **273** |

(1) This column shows the amount by which the Group's credit risk exposures is reduced through arrangements, such as master netting agreements, which give the Group a legal right to set–off the financial asset against a financial liability due to the same counterparty. In addition, the Group holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade receivables; and guarantees of lending from parties other than the borrower. The Group obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

**23. Risk management – credit risk (continued)**

| | Group | | | | |
|---|---|---|---|---|---|
| 2012 | Gross loans and advances to banks and customers £m | Debt securities and equity shares £m | Derivatives £m | Total £m | Netting and offset (1) £m |
| **UK** | | | | | |
| Central and local government | - | - | - | - | - |
| Manufacturing | 399 | - | 1 | 400 | 8 |
| Construction | 331 | - | - | 331 | 17 |
| Finance | 5,902 | 24 | 389 | 6,315 | - |
| Service industries and business activities | 871 | - | 16 | 887 | 48 |
| Agriculture, forestry and fishing | 295 | - | - | 295 | 54 |
| Property | 5,303 | - | 57 | 5,360 | 21 |
| Individuals | | | | | |
| Home mortgages | 2,298 | - | - | 2,298 | - |
| Other | 459 | - | - | 459 | - |
| Interest accruals | 9 | - | - | 9 | - |
| **Total UK** | 15,867 | 24 | 463 | 16,354 | 148 |
| **Republic of Ireland** | | | | | |
| Central and local government | 42 | - | - | 42 | - |
| Manufacturing | 771 | - | 17 | 788 | 9 |
| Construction | 514 | - | - | 514 | 21 |
| Finance | 429 | 9 | 96 | 534 | - |
| Service industries and business activities | 5,056 | - | 70 | 5,126 | 60 |
| Agriculture, forestry and fishing | 705 | - | 1 | 706 | 29 |
| Property | 12,092 | - | 77 | 12,169 | 5 |
| Individuals | | | | | |
| Home mortgages | 16,882 | - | - | 16,882 | 1 |
| Other | 983 | - | - | 983 | - |
| Interest accruals | 29 | - | - | 29 | - |
| **Total Republic of Ireland** | 37,503 | 9 | 261 | 37,773 | 125 |
| **Total** | | | | | |
| Central and local government | 42 | - | - | 42 | - |
| Manufacturing | 1,170 | - | 18 | 1,188 | 17 |
| Construction | 845 | - | - | 845 | 38 |
| Finance | 6,331 | 33 | 485 | 6,849 | - |
| Service industries and business activities | 5,927 | - | 86 | 6,013 | 108 |
| Agriculture, forestry and fishing | 1,000 | - | 1 | 1,001 | 83 |
| Property | 17,395 | - | 134 | 17,529 | 26 |
| Individuals | | | | | |
| Home mortgages | 19,180 | - | - | 19,180 | 1 |
| Other | 1,442 | - | - | 1,442 | - |
| Interest accruals | 38 | - | - | 38 | - |
| | 53,370 | 33 | 724 | 54,127 | 273 |

(1) This column shows the amount by which the Group's credit risk exposures is reduced through arrangements, such as master netting agreements, which give the Group a legal right to set–off the financial asset against a financial liability due to the same counterparty. In addition, the Group holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade receivables; and guarantees of lending from parties other than the borrower. The Group obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

## 23. Risk management – credit risk (continued)

| | Bank | | | | |
|---|---|---|---|---|---|
| **2013** | Gross loans and advances to banks and customers £m | Debt securities and equity shares £m | Derivatives £m | Total £m | Netting and offset [(1)] £m |
| **UK** | | | | | |
| Central and local government | - | - | - | - | - |
| Manufacturing | 279 | - | 1 | 280 | 8 |
| Construction | 320 | - | - | 320 | 18 |
| Finance | 7,583 | 9 | 14 | 7,606 | - |
| Service industries and business activities | 710 | - | 1 | 711 | 49 |
| Agriculture, forestry and fishing | 267 | - | - | 267 | 54 |
| Property | 2,987 | - | - | 2,987 | 21 |
| Individuals | | | | | |
| Home mortgages | 2,256 | - | - | 2,256 | - |
| Other | 334 | - | - | 334 | - |
| Interest accruals | 7 | - | - | 7 | - |
| **Total UK** | **14,743** | **9** | **16** | **14,768** | **150** |
| **Republic of Ireland** | | | | | |
| Central and local government | - | - | - | - | - |
| Manufacturing | - | - | - | - | - |
| Construction | - | - | - | - | - |
| Finance | - | - | - | - | - |
| Service industries and business activities | - | - | - | - | - |
| Agriculture, forestry and fishing | - | - | - | - | - |
| Property | - | - | - | - | - |
| Individuals | | | | | |
| Home mortgages | - | - | - | - | - |
| Other | - | - | - | - | - |
| Interest accruals | - | - | - | - | - |
| **Total Republic of Ireland** | **-** | **-** | **-** | **-** | **-** |
| **Total** | | | | | |
| Central and local government | - | - | - | - | - |
| Manufacturing | 279 | - | 1 | 280 | 8 |
| Construction | 320 | - | - | 320 | 18 |
| Finance | 7,583 | 9 | 14 | 7,606 | - |
| Service industries and business activities | 710 | - | 1 | 711 | 49 |
| Agriculture, forestry and fishing | 267 | - | - | 267 | 54 |
| Property | 2,987 | - | - | 2,987 | 21 |
| Individuals | | | | | |
| Home mortgages | 2,256 | - | - | 2,256 | - |
| Other | 334 | - | - | 334 | - |
| Interest accruals | 7 | - | - | 7 | - |
| | **14,743** | **9** | **16** | **14,768** | **150** |

(1) This column shows the amount by which the Bank's credit risk exposures is reduced through arrangements, such as master netting agreements, which give the Bank a legal right to set–off the financial asset against a financial liability due to the same counterparty. In addition, the Bank holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade receivables; and guarantees of lending from parties other than the borrower. The Bank obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

### 23. Risk management – credit risk (continued)

| | Bank | | | | |
|---|---|---|---|---|---|
| 2012 | Gross loans and advances to banks and customers £m | Debt securities and equity shares £m | Derivatives £m | Total £m | Netting and offset [(1)] £m |
| **UK** | | | | | |
| Central and local government | - | - | - | - | - |
| Manufacturing | 304 | - | - | 304 | 8 |
| Construction | 325 | - | - | 325 | 17 |
| Finance | 7,285 | 26 | 35 | 7,346 | - |
| Service industries and business activities | 746 | - | - | 746 | 48 |
| Agriculture, forestry and fishing | 295 | - | - | 295 | 54 |
| Property | 3,450 | - | - | 3,450 | 21 |
| Individuals | | | | | |
| Home mortgages | 2,298 | - | - | 2,298 | - |
| Other | 395 | - | - | 395 | - |
| Interest accruals | 8 | - | - | 8 | - |
| **Total UK** | 15,106 | 26 | 35 | 15,167 | 148 |
| **Republic of Ireland** | | | | | |
| Central and local government | - | - | - | - | - |
| Manufacturing | - | - | - | - | - |
| Construction | - | - | - | - | - |
| Finance | - | - | 2 | 2 | - |
| Service industries and business activities | - | - | - | - | - |
| Agriculture, forestry and fishing | - | - | - | - | - |
| Property | - | - | - | - | - |
| Individuals | | | | | |
| Home mortgages | - | - | - | - | - |
| Other | - | - | - | - | - |
| Interest accruals | - | - | - | - | - |
| **Total Republic of Ireland** | - | - | 2 | 2 | - |
| **Total** | | | | | |
| Central and local government | - | - | - | - | - |
| Manufacturing | 304 | - | - | 304 | 8 |
| Construction | 325 | - | - | 325 | 17 |
| Finance | 7,285 | 26 | 37 | 7,348 | - |
| Service industries and business activities | 746 | - | - | 746 | 48 |
| Agriculture, forestry and fishing | 295 | - | - | 295 | 54 |
| Property | 3,450 | - | - | 3,450 | 21 |
| Individuals | | | | | |
| Home mortgages | 2,298 | - | - | 2,298 | - |
| Other | 395 | - | - | 395 | - |
| Interest accruals | 8 | - | - | 8 | - |
| **Total** | 15,106 | 26 | 37 | 15,169 | 148 |

(1) This column shows the amount by which the Bank's credit risk exposures is reduced through arrangements, such as master netting agreements, which give the Bank a legal right to set–off the financial asset against a financial liability due to the same counterparty. In addition, the Bank holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade receivables; and guarantees of lending from parties other than the borrower. The Bank obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

**23. Risk management – credit risk (continued)**

**Credit risk mitigation**

*Approaches and methodologies*
The Group employs a number of structures and techniques to mitigate credit risk. Netting of debtor and creditor balances is undertaken in accordance with relevant regulatory and internal policies. Exposure on over-the-counter derivative and secured financing transactions is further mitigated by the exchange of financial collateral and the use of market standard documentation. Further mitigation may be undertaken in a range of transactions, from retail mortgage lending to large wholesale financing. This can include: structuring a security interest in a physical or financial asset; use of credit derivatives, including credit default swaps, credit-linked debt instruments and securitisation structures; and use of guarantees and similar instruments (for example, credit insurance) from related and third parties. Such techniques are used in the management of credit portfolios, typically to mitigate credit concentrations in relation to an individual obligor, a borrower group or a collection of related borrowers.

The use and approach to credit risk mitigation varies by product type, customer and business strategy. Minimum standards applied across the Group cover:

- The suitability of qualifying credit risk mitigation types and any conditions or restrictions applicable to those mitigants;
- The means by which legal certainty is to be established, including required documentation, supportive independent legal opinions and all necessary steps required to establish legal rights;
- Acceptable methodologies for initial and any subsequent valuations of collateral and the frequency with which collateral is to be revalued and the use of collateral haircuts;
- Actions to be taken in the event that the value of mitigation falls below required levels;
- Management of the risk of correlation between changes in the credit risk of the customer and the value of credit risk mitigation;
- Management of concentration risks, for example, by setting thresholds and controls on the acceptability of credit risk mitigants and on lines of business that are characterised by a specific collateral type or structure; and
- Collateral management to ensure that credit risk mitigation remains legally effective and enforceable.

*Secured portfolios*
Within its secured portfolios, the Group has recourse to various types of collateral and other credit enhancements to mitigate credit risk and reduce the loss to the Group arising from the failure of a customer to meet its obligations. These include: cash deposits; charges over residential and commercial property, debt securities and equity shares; and third-party guarantees. The existence of collateral may affect the pricing of a facility and its regulatory capital requirement.

When a collateralised financial asset becomes impaired, the impairment charge directly reflects the realisable value of collateral and any other credit enhancements.

*Corporate exposures*
The type of collateral taken by the Group's commercial and corporate businesses and the manner in which it is taken will vary according to the activity and assets of the customer.

- *Physical assets* - These include business assets such as stock, plant and machinery, vehicles, ships and aircraft. In general, physical assets qualify as collateral only if they can be unambiguously identified, located or traced, and segregated from uncharged assets. Assets are valued on a number of bases according to the type of security that is granted.
- *Real estate* - The Group takes collateral in the form of real estate, which includes residential and commercial properties. The loan amount will typically exceed the market value of the collateral at origination date. The market value is defined as the estimated amount for which the asset could be sold in an arms length transaction by a willing seller to a willing buyer.
- *Receivables* - When taking a charge over receivables, the Group assesses their nature and quality and the borrower's management and collection processes. The value of the receivables offered as collateral will typically be adjusted to exclude receivables that are past their due dates.

The security charges may be floating or fixed, with the type of security likely to impact: (i) the credit decision; and (ii) the potential loss upon default. In the case of a general charge such as a mortgage debenture, balance sheet information may be used as a proxy for market value if the information is deemed reliable.

The Group does not recognise certain asset classes as collateral: for example, short leasehold property and equity shares of the borrowing company. Collateral whose value is correlated to that of the obligor is assessed on a case-by-case basis and, where necessary, over-collateralisation may be required.

The Group uses industry standard loan and security documentation wherever possible. Non-standard documentation is typically prepared by external lawyers on a case-by-case basis. The Group's business and credit teams are supported by in-house specialist documentation teams.

**23. Risk management – credit risk (continued)**

**Credit risk mitigation (continued)**

*Corporate exposures (continued)*
The existence of collateral has an impact on provisioning. Where the Group no longer expects to recover the principal and interest due on a loan in full or in accordance with the original terms and conditions it is assessed for impairment. If exposures are secured, the current net realisable value of the collateral will be taken into account when assessing the need for a provision. No impairment provision is recognised in cases where all amounts due are expected to be settled in full on realisation of the security.

**Residential Mortgages**
The Group's residential mortgage portfolio totalled £19.0 billion at 31 December 2013, with 88% in the Republic of Ireland and 12% in Northern Ireland. At constant exchange rates, the portfolio decreased 1% from £19.2 billion at 31 December 2012 as a result of natural amortisation and limited growth due to low market demand.

The table below shows how the continued decrease in property values has affected the distribution of residential mortgages by loan-to-value ("LTV") (indexed). LTV is based upon gross loan amounts and, whilst including defaulted loans, does not take account of provisions made.

| | Group | |
|---|---|---|
| | **2013** | 2012 |
| **Residential mortgages – distribution by average LTV (1) indexed** | **%** | % |
| <=50% | **30.1** | 36.3 |
| >50% and <=60% | **6.5** | 5.6 |
| >60% and <=70% | **6.3** | 5.3 |
| >70% and <=80% | **6.3** | 5.3 |
| >80% and <=90% | **6.8** | 5.5 |
| >90% and <=100% | **6.4** | 5.5 |
| >100% | **37.6** | 36.5 |
| | | |
| Total portfolio average LTV at 31 December | **82.9** | 85.5 |
| Average LTV on new originations during the year | **69.0** | 69.4 |

(1) The above table uses unweighted LTV averages calculated by transaction volume.

The table below details residential mortgages three months or more in arrears (by volume):

| | Group | |
|---|---|---|
| | **2013** | 2012 |
| **Personal** | **%** | % |
| Mortgages | **12.1** | 13.2 |

**Collateral and other credit enhancements received**
The Group's financial performance continues to be overshadowed by the challenging economic climate in Ireland, with impairments remaining elevated in the wholesale bank as a result of limited liquidity in the economy which continues to depress the property market and domestic spending, resulting in a substantial proportion of the Commercial Real Estate portfolio in excess of 100% LTV. Additionally in Q4, the move to an accelerated recovery strategy for loans transferring to RCR due to the forecast reduction in asset value recovery arising from the deleverage strategy has resulted in substantial uplift in provisions at year end. Consequently, 71% (£10.1bn) (2012: 72% (£11.0bn) of the Commercial Real Estate portfolio is actively managed by Non Core, of which £9.8bn (2012: £10.1bn) is categorised Risk elements in Lending ("REiL") with a provision coverage of 85% (2012: 60%).

| | **2013** | | 2012 | |
|---|---|---|---|---|
| **Non-performing corporate loans (excluding commercial real estate)** | **Loans £m** | **Provisions £m** | Loans £m | Provisions £m |
| **Secured** | **3,075** | **2,266** | 428 | 226 |
| **Unsecured** | **299** | **220** | 3,063 | 1,720 |

The movement between secured and unsecured non-performing corporate loans between 2012 and 2013 is driven by increased provisioning resulting from RCR. As the assets have been impaired to spot market value they have become fully secured and only the overdrafts element of corporate lending remains unsecured.

**23. Risk management – credit risk (continued)**

**Credit risk mitigation (continued)**

**Retail exposures**

All borrowing applications, whether secured or not, are subject to appropriate credit risk underwriting processes including affordability assessments. Pricing is typically higher on unsecured than secured loans. For secured loans, pricing will typically vary by LTV: higher LTV products are typically subject to higher interest rates commensurate with the associated risk.

The value of a property intended to secure a mortgage is assessed during the loan underwriting process using industry standard methodologies. Property values supporting home equity lending reflect either an individual appraisal or valuations generated by statistically valid automated valuation models. Property values are updated each quarter using the relevant house price index (Nationwide House Price Index in Northern Ireland and Central Statistics Office Residential Property Price Index in the Republic of Ireland).

The existence of collateral has an impact on provisioning levels. Once a secured loan is classified as non-performing, the present realisable value of the underlying collateral and the costs associated with repossession are used to estimate the provision required.

The tables below shows period-end weighted LTVs for the Group's residential mortgage portfolio split between performing and non-performing.

| Non-performing residential mortgages by average loan to value (LTV) | 2013 £m | 2012 £m |
|---|---|---|
| <70% | 366 | 471 |
| >70% and <=90% | 288 | 294 |
| >90% and <=110% | 344 | 330 |
| >110% and <=130% | 461 | 397 |
| >130% | 1,775 | 1,764 |
| Total portfolio average by LTV | 130.0% | 132.2% |

| Performing residential mortgages by average loan to value (LTV) | 2013 £m | 2012 £m |
|---|---|---|
| <70% | 3,862 | 3,815 |
| >70% and <=90% | 2,325 | 2,019 |
| >90% and <=110% | 2,515 | 2,358 |
| >110% and <=130% | 2,509 | 2,412 |
| >130% | 4,586 | 5,301 |
| Total portfolio average by LTV | 102.7% | 107.7% |

Aside from the lending portfolios, the Group receives collateral and other credit enhancements on other financial assets on its balance sheet as detailed in the following table.

| | 2013 £m | 2012 £m |
|---|---|---|
| Derivative assets gross exposure | 25 | 26 |

**Regulatory risk**

Regulatory risk is the risk of material loss or liability, legal or reputational sanctions, or reputational damage, arising from the failure to comply with (or adequately plan for changes to) relevant official sector policy, laws, regulations, or major industry standards, in any location in which the Group operates.

The Group maintains well-established policies and supporting processes to ensure timely identification of, and effective responses to, changes in official sector requirements impacting the Group. RBS Group Regulatory Affairs underpin a range of other policies and processes that address on-going compliance with regulatory obligations.

The level of regulatory risk remained high during 2013, as policymakers and regulators continued to strengthen regulation and supervision in response to the events of 2007 and 2008.

**23. Risk management - regulatory risk (continued)**

**Risk management and mitigation**
The Group believes that maintaining a strong regulatory risk framework is fundamental to ensuring sustainable growth, rebuilding its reputation and maintaining stakeholder confidence. Key components of the framework are noted below:

- The early identification and effective management of changes in legislation and regulation as well as other requirements that may affect the Group are critical to the successful mitigation of regulatory risk.

- RBS Regulatory Affairs ensures all relevant parties are made aware of appropriate governance and reporting of all material regulatory reviews, investigations and upstream regulatory developments.

- There is timely communication of regulatory developments and follow-up engagement with client-facing businesses and functions, helping them identify and execute any required mitigating changes to strategy or business models.

Key regulatory policies are kept under annual review. Each incorporates a risk appetite statement, relevant benchmarking activity against peer banks and an end-to-end review and mapping of the upstream risk management process.

**Reputational risk**

Reputational risk is the risk of brand damage and/or financial loss due to a failure to meet stakeholders' expectations of the Group's conduct and performance. Stakeholders include customers, investors, rating agencies, employees, suppliers, government, politicians, regulators, special interest groups, consumer groups, media and the general public. Brand damage can be detrimental to the business in a number of ways, including an inability to build or sustain business relationships, low staff morale or reduced access to funding sources.

The Group has put the focus on serving customers well at the heart of its strategic objectives that, combined with a safe and sound bank, will build a culture and reputation in line with our stakeholder expectations. There are still legacy issues to work through, but dealing with them in an open and direct manner is a necessary part of the ability to move forward.

**Risk management and mitigation**
The Group's reputational risk management framework is aligned with its strategic objectives, its risk appetite and its focus on servicing customers. It is designed to embed, at different points of decision-making processes, a series of customer-related and reputational filters and controls that examine products, services and activities through the lens of sustainability, transparency and fairness.

The Board has ultimate responsibility for managing the Group's reputation, though all parts of the Group have responsibility for any reputational impact arising from their operations.

Several of the Group policies address key sources of reputational risk. These policies are implemented in accordance with the Group Policy Framework. The effectiveness of these policies is reported through the Control Environment Certification process semi-annually. Reputational aspects also form a core part of the RBS conduct risk framework, with a series of enhanced policies being developed in line with the Group's conduct risk appetite.

**Conduct risk**

Conduct risk is the risk that the conduct of the Group and its staff towards its customers, or within the markets in which it operates, leads to reputational damage and/or financial loss by breaching regulatory rules or laws, or failing to meet customers' or regulators' expectations of the Group. Activities through which conduct risk may arise include: personal account dealing; privacy and data protection; conflicts of interest; and product design.

Conduct risk exists at all stages of the Group's relationships with its customers and regulators, from the development of its business strategies, through to governance arrangements and post-sales processes. Specific activities from which conduct risk may arise include: product design, marketing and sales; complaint handling; staff training and competence; handling of confidential and non-public price sensitive information; anti-money laundering; sanctions adherence; and bribery and corruption.

Effective conduct risk management is not only a commercial imperative for the Group; customers, clients and counterparties demand it as a precursor to building trust. It also reflects the changing regulatory environment.

The Group's compliance function manages conduct risk facing the Group, including Anti-Money Laundering ("AML"); sanctions and terrorist financing; and anti-bribery and corruption. Mitigation of conduct risk is driven by the Group's business areas and the Accountable Executive is responsible for the design, implementation and maintenance of an effective management framework to enable consistent identification, assessment, management, monitoring and reporting of conduct risk.

**23. Risk management (continued)**

**Operational risk**

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

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

In 2013, the Group continued to make good progress in enhancing its operational risk framework and risk management capabilities.

The standards, which are incorporated in the Group Policy Framework, provide the direction for delivering effective operational risk management and are designed to allow the consistent identification, assessment, management, monitoring and reporting of operational risk across the Group.

Operational risk appetite, policy and frameworks are tabled regularly at the Executive Risk Committee to satisfy oversight responsibilities and, as appropriate, to other senior committees.

**Sovereign risk**

The Group's sovereign portfolio comprises central governments, central banks and sub-sovereigns such as local authorities, primarily in the Group's key markets in the UK and the Republic of Ireland. Exposure predominantly comprises cash balances placed with central banks such as the Bank of England, the Central Bank of Ireland and consequently the asset quality of this portfolio is high. Exposure to sovereigns fluctuates according to the Group's liquidity requirements and cash positions, which determine the level of cash placed with central banks.

**Pension risk**

The Group is exposed to risk from its defined benefit pension schemes to the extent that the assets of the schemes do not fully match the timing and amount of the schemes' liabilities. Pension scheme liabilities vary with changes to long-term interest rates, inflation, pensionable salaries and the longevity of scheme members as well as changes in legislation. Ultimate responsibility for the Group's pension schemes is separate from Group management. The Group is exposed to the risk that the market value of the schemes' assets, together with future returns and any additional future contributions could be considered insufficient to meet the liabilities as they fall due. In such circumstances, the Group could be obliged, or may choose, to make additional contributions to the schemes or be required to hold additional capital to mitigate such risk.

The Ulster Bank Pension Scheme (UBPS) and the Ulster Bank Pension Scheme (Republic of Ireland) (UBPSROI) are the largest of the schemes and the main sources of pension risk. They both operate under trust deeds under which the corporate trustees are wholly owned subsidiaries of the Group. Both trustee boards comprise six directors selected by the Group and three directors nominated by members.

The trustee boards are solely responsible for the investment of the schemes' assets which are held separately from the assets of the Group. The Group and the trustee board must agree on the investment principles and the funding plan.

In November 2009 both schemes were closed to new employees. In April 2010 the Group confirmed that it was making changes to the both of the schemes and the Group's other defined benefit scheme, the First Active Pension Scheme ("FAPS"). For some members, the Group has limited the amount by which pensionable salary would increase in future (the "pensionable salary cap") to 2% per annum (or CPI inflation, if lower). For those who decided not to accept terms which included the pensionable salary cap, and were not in the Provident Fund sections of the schemes, the Group agreed with the trustees of the schemes a reduction in the accrual rate from 60ths to 80ths for future service, in return for improvements in future funding of the schemes. In 2012 a further contract offer was made and this has reduced the number of employees who are subject to the lower accrual rate and increased the number subject to the pensionable earnings cap.

During 2013, new funding agreements were put in place for the UBPSROI and FAPS under the revised Minimum Funding Standard framework framework which came into place in 2013 in the Republic of Ireland. These have resulted in funding plans requiring contributions for UBPSROI of £14m p.a. until 2023 and for FAPS of £6m p.a. until 2020 (in both cases increasing in line with inflation each year). For both schemes contingent asset arrangements have been put in place to cover the Risk Reserve requirements arising under the Minimum Funding Standard framework.

A funding valuation for the UBPS is ongoing with an effective date of 31 December 2012 and is expected to be finalised by 31 March 2014. Under the terms of the deficit Recovery Plan from the previous valuation at 31 March 2010, the Bank agreed to pay contributions at the rate of £33m p.a. from 2010 to 2018 (increasing each year in line with inflation).

**23. Risk management (continued)**

**Pension risk (continued)**

Risk appetite and investment policy are agreed by the trustees with quantitative and qualitative input from the scheme actuaries and investment advisers. The trustees also consult with the Group to obtain its view on the appropriate level of risk within the pension funds. The Group independently monitors risk within its pension funds as part of the Internal Capital Adequacy Assessment Process.

The schemes are invested in diversified portfolios of quoted and private equity, government and corporate fixed-interest and index-linked bonds, and other assets including property, derivatives and hedge funds.

Pension risk is the risk to the Group caused by its contractual or other liabilities to, or with respect to, its pension schemes, whether established for its employees or for those of a related company or otherwise.

## 24. Capital resources

| | 2013 £m | 2012[(1)] £m | 2011[(1)] £m |
|---|---|---|---|
| *Shareholders' equity (excluding non-controlling interests)* | | | |
| Shareholders' equity per balance sheet | **3,615** | 6,894 | 6,301 |
| Preference shares – equity | **(959)** | (959) | (959) |
| | **2,656** | 5,935 | 5,342 |
| *Non-controlling interests* | | | |
| Non-controlling interests per balance sheet | **517** | 500 | 512 |
| Other adjustments to non-controlling interests for regulatory purposes | **(487)** | (477) | (489) |
| | **30** | 23 | 23 |
| *Regulatory adjustments and deductions* | | | |
| Defined benefit pension adjustment | **105** | (82) | (134) |
| 50% excess of expected losses over impairment provisions (net of tax) | **-** | (1,088) | (1,219) |
| | **105** | (1,170) | (1,353) |
| **Core tier 1 capital** | **2,791** | 4,788 | 4,012 |
| *Other tier 1 capital* | | | |
| Preference shares – equity | **1,446** | 1,436 | 1,448 |
| *Deductions* | | | |
| 50% of material holdings | **(14)** | - | - |
| Tax on excess of expected losses over impairment provisions | **-** | 353 | 439 |
| Excess of Tier 2 50:50 deduction | **-** | (314) | (494) |
| | **(14)** | 39 | (55) |
| **Total tier 1 capital** | **4,223** | 6,263 | 5,405 |
| *Qualifying tier 2 capital* | | | |
| Undated subordinated debt | **100** | 98 | 100 |
| Dated subordinated debt - net of amortisation | **972** | 1,029 | 1,060 |
| Collectively assessed impairment provisions | **-** | - | 4 |
| Surplus provisions | **175** | - | - |
| | **1,247** | 1,127 | 1,164 |
| *Tier 2 deductions* | | | |
| 50% of material holdings | **(14)** | - | - |
| 50% excess of expected losses over impairment provisions | **-** | (1,441) | (1,658) |
| Excess Tier 2 50:50 deduction to transfer to Tier 1 | **-** | 314 | 494 |
| | **(14)** | (1,127) | (1,164) |
| **Total tier 2 capital** | **1,233** | - | - |
| **Total regulatory capital** | **5,456** | 6,263 | 5,405 |
| **Key capital ratios** | **%** | % | % |
| Tier 1 | **13.1** | 15.2 | 12.9 |
| Total capital | **16.9** | 15.2 | 12.9 |
| **Risk weighted assets by risk** | | | |
| Credit risk | **29,500** | 37,400 | 38,300 |
| Counterparty risk | **400** | 1,500 | 1,100 |
| Market risk | **500** | 200 | 300 |
| Operational risk | **1,800** | 2,000 | 2,200 |
| **Total risk weighted assets** | **32,200** | 41,100 | 41,900 |

(1) The Group's capital resource position is reported as at a specific point in time. As such there is no restatement of the position at 31 December 2012 or 2011.

**24. Capital resources (continued)**

In the management of capital resources, the Group is governed by the Ulster Bank Group and the RBS Group policies which are 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 these policies the Group has regard to and has complied with the supervisory requirements of the PRA. The PRA uses Risk Asset Ratio ("RAR") as a measure of capital adequacy for banks, 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 RAR should not be less than 8% with a Tier 1 component of not less than 4%.

**25. 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 2013. 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 | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| | **£m** | £m | **£m** | £m |
| **Contingent liabilities**: | | | | |
| Guarantees and assets pledged as collateral security | **201** | 261 | **25** | 29 |
| Other contingent liabilities | **247** | 235 | **53** | 38 |
| | **448** | 496 | **78** | 67 |
| **Commitments:** | | | | |
| Documentary credits and other short-term trade related transactions | **5** | 9 | **3** | 2 |
| Commitments to lend: | | | | |
| - less than one year | **2,517** | 2,406 | **966** | 945 |
| - one year and over | **1,112** | 997 | **98** | 67 |
| | **3,634** | 3,412 | **1,067** | 1,014 |

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 non-performance by the other party and where all counterclaims, collateral or security proves valueless, is represented by the contractual nominal amount of these instruments included in the table. These commitments and contingent obligations are subject to the Group's normal credit approval processes and any potential loss is taken into account in assessing provisions for bad and doubtful debts in accordance with the Group's provisioning policy.

**Contingent liabilities**
*Guarantees* - the Group gives guarantees on behalf of customers. A financial guarantee represents an irrevocable undertaking that the Group will meet a customer's obligations to third parties 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 disclosed 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.

**Commitments**
*Commitments to lend* - 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, documentary credits and other short-term trade related transactions.

**25. Memorandum items - contingent liabilities and commitments (continued)**

The following table shows contractual obligations for future expenditure not provided for in the financial statements at the year end:

| | Group | | Bank | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| | **£m** | £m | **£m** | £m |
| **Property, plant and equipment** | | | | |
| Other capital expenditure | **-** | - | **-** | - |
| **Contracts to purchase goods or services** | **12** | 8 | **5** | 4 |
| | **12** | 8 | **5** | 4 |

**Litigation and investigations**

The Group is involved in litigation, investigations and reviews in the United Kingdom and the Republic of Ireland. Other than as set out below, the litigation involves claims by and against Group companies which arise in the ordinary course of business. No material adverse effect on the net assets of the Group is expected to arise from the ultimate resolution of these claims. The material litigation, investigations and reviews involving the Group are described below. These matters could, individually or in the aggregate, have a material adverse effect on the Group's consolidated net assets, operating results or cash flows in any particular period.

*Taggart litigation*

Two former shareholders of the Taggart group of companies have issued proceedings against the Group in Northern Ireland alleging that breach of contract and misrepresentation by the Group led to the administration of the group of companies and resulted in shareholder losses. The amount of the claim is c. £85m. The Group considers that it has substantial and credible legal and factual defences and will defend the claim vigorously.

*Interest rate hedging products*

In June 2012, following an industry wide review, the FSA announced that the RBS Group, including the Bank, and other UK banks had agreed to a redress exercise and past business review in relation to the sale of interest rate hedging products to some small and medium sized businesses who were classified as retail clients under FSA rules. On 31 January 2013, the FSA issued a report outlining the principles to which it wishes the RBS Group and other UK banks to adhere in conducting the review and redress exercise.

The RBS Group will provide fair and reasonable redress to non-sophisticated customers classified as retail clients, who were mis-sold interest rate hedging products. In relation to non-sophisticated customers classified as retail clients or private customers who were sold interest rate products other than interest rate caps on or after 1 December 2001 up to 29 June 2012, the RBS Group is required to (i) make redress to customers sold structured collars; and (ii) write to customers sold other interest rate hedging products offering a review of their sale and, if it is appropriate in the individual circumstances, the RBS Group will propose fair and reasonable redress on a case by case basis. Furthermore, non-sophisticated customers classified as retail clients or private customers who have purchased interest rate caps during the period on or after 1 December 2001 to 29 June 2012 will be entitled to approach the RBS Group and request a review.

The redress exercise and the past business review is being scrutinised by an independent reviewer, who will review and agree any redress, and will be overseen by the FCA.

In addition to the redress exercise that is being overseen by the FCA, the RBS Group is also dealing with a large number of active claims by customers that are eligible to be considered under the FCA redress program as well as customers who are outside of such scope due to their sophistication. The RBS Group is encouraging those customers that are eligible to seek redress under the redress scheme overseen by the FCA. To the extent that claims are brought, the RBS Group believes it has strong grounds for defending these claims.

In 2013 the regulatory focus in the Republic of Ireland also moved on to the sale of interest rate hedging products. Ulster Bank Ireland Limited (which is not subject to the FCA review) engaged with the CBI and is carrying out a review of interest rate hedging products sold in the Republic of Ireland in the period 2001 to 2012.

Ulster Bank Group has provided £59m (2012: £10m) in respect of this matter. As the actual amount that the Group will be required to pay, if any, will depend on the facts and circumstances of each case, there is no certainty as to the eventual costs of redress.

**25. Memorandum items - Litigation and investigations (continued)**

*Technology incident in June 2012*
On 19 June 2012 the RBS Group, including Ulster Bank Limited, was affected by a technology incident, as a result of which the processing of certain customer accounts and payments were subject to considerable delay. The cause of the incident has been investigated by independent external counsel with the assistance of third party advisors. The Group agreed to reimburse customers for any loss suffered as a result of the incident.

On 9 April 2013 the FCA announced that it had commenced an enforcement investigation into the incident. This is a joint investigation conducted by the FCA together with the Prudential Regulation Authority (PRA). The FCA and PRA will reach their conclusions in due course and will decide whether or not to initiate enforcement action following that investigation. While the outcomes of the FCA and PRA investigations will be separate, the regulators have indicated that they will endeavour to co-ordinate the timescales of their respective investigations. Separately the Central Bank of Ireland has initiated an investigation. The Group is co-operating fully with these investigations.

*Tomlinson Report*
On 25 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 Global Restructuring Group, a division of both RBS Group and Ulster Bank Group, with regard to the treatment of small to medium enterprises. The Tomlinson Report has been passed to the PRA and FCA. On 29 November 2013 the FCA announced that an independent skilled person will be appointed under Section 166 of the Financial Services and Markets Act to review the allegations in the report. On 17 January 2014, Promontory Financial Group and Mazars were appointed as the skilled person. The RBS Group will fully cooperate with the FCA in its investigation.

In response to the Tomlinson Report, RBS Group has instructed Clifford Chance to conduct an independent review of the principal allegation made in the Tomlinson Report: the Global Restructuring Group was alleged to be culpable of systemic and institutional behaviour in artificially distressing otherwise viable businesses and through that putting businesses into insolvency. Clifford chance is due to report during the first quarter of 2014. Ulster Bank Limited in Northern Ireland is within the scope of the FCA investigation and the Clifford Chance review.

Ulster Bank Ireland Limited has instructed Mason Hayes and Curran Solicitors in the Republic of Ireland to assist Clifford Chance in relation to its investigation of the principal allegations in the Tomlinson report in the Republic of Ireland

**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.

## 26. Net cash flow from operating activities

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | **2013** | 2012 | Restated 2011 | **2013** | Restated 2012 | Restated 2011 |
| | **£m** | £m | £m | **£m** | £m | £m |
| Operating loss before tax | **(4,374)** | (2,091) | (3,081) | **(1,026)** | (4,036) | (4,169) |
| Depreciation, amortisation and impairment of property, plant and equipment | **43** | 43 | 30 | **12** | 17 | 10 |
| Interest on subordinated liabilities | **26** | 27 | 34 | **15** | 13 | 19 |
| Gain on redemption of own debt | **(239)** | - | (255) | **-** | - | - |
| Charge for defined benefit pension schemes | **32** | 26 | 33 | **6** | 11 | 10 |
| Cash contribution to defined benefit pension schemes | **(73)** | (77) | (75) | **(39)** | (40) | (39) |
| Loan impairment provisions net of recoveries | **4,085** | 2,128 | 3,544 | **581** | 256 | 737 |
| Impairment of investments in Group undertakings | **-** | - | - | **277** | 3,663 | 3,518 |
| Elimination of foreign exchange differences | **242** | (194) | (411) | **(13)** | (9) | (7) |
| Other non-cash items | **(110)** | (244) | (292) | **(75)** | (33) | (51) |
| Net cash (outflow)/inflow from trading activities | **(368)** | (382) | (473) | **(262)** | (158) | 28 |
| | | | | | | |
| Decrease/(increase) in loans and advances to banks and customers | **1,986** | 2,782 | 3,492 | **535** | 348 | (3,271) |
| Increase in debt securities | **-** | (16) | (74) | **-** | (9) | (87) |
| (Increase)/decrease in other assets | **(15)** | 5 | 37 | **(9)** | 1 | 30 |
| Decrease/(increase) in derivative assets | **163** | 273 | (35) | **21** | 50 | 62 |
| Decrease in assets held for sale | **-** | - | 1 | **-** | - | - |
| Changes in operating assets | **2,134** | 3,044 | 3,421 | **547** | 390 | (3,266) |
| | | | | | | |
| (Decrease)/increase in deposits by banks and customers | **(6)** | (4,213) | (3,114) | **(391)** | (158) | 1,520 |
| (Decrease)/increase in debt securities in issue | **(67)** | (276) | (1,941) | **7** | (36) | (76) |
| (Decrease)/increase in other liabilities | **6** | 41 | (179) | **53** | 21 | (176) |
| Decrease in derivative liabilities | **(248)** | (360) | (44) | **(31)** | (6) | (78) |
| Changes in operating liabilities | **(315)** | (4,808) | (5,278) | **(362)** | (179) | 1,190 |
| | | | | | | |
| Total taxes received | **88** | 124 | 182 | **86** | 155 | 137 |
| Net cash inflow/(outflow) from operating activities | **1,539** | (2,022) | (2,148) | **9** | 208 | (1,911) |

## 27. Interest received and paid

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | **2013** | 2012 | 2011 | **2013** | 2012 | 2011 |
| | **£m** | £m | £m | **£m** | £m | £m |
| Interest received | **1,012** | 1,226 | 1,071 | **306** | 344 | 293 |
| Interest paid | **(417)** | (459) | (599) | **(160)** | (177) | (156) |
| | **595** | 767 | 472 | **146** | 167 | 137 |

### 28. Analysis of changes in financing during the year

| | Group | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Share capital and share premium** | | | **Capital contribution reserve** | | | **Subordinated liabilities** | | |
| | **2013 £m** | 2012 £m | 2011 £m | **2013 £m** | 2012 £m | 2011 £m | **2013 £m** | 2012 £m | 2011 £m |
| At 1 January | **2,412** | 2,412 | 2,412 | **13,507** | 10,576 | 5,918 | **1,157** | 1,183 | 1,215 |
| Net cash inflows from financing | **-** | - | - | **1,005** | 2,931 | 4,658 | **-** | - | - |
| Currency translation and other adjustments | **-** | - | - | **-** | - | - | **18** | (26) | (32) |
| **At 31 December** | **2,412** | 2,412 | 2,412 | **14,512** | 13,507 | 10,576 | **1,175** | 1,157 | 1,183 |

| | Bank | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Share capital and share premium** | | | **Capital contribution reserve** | | | **Subordinated liabilities** | | |
| | **2013 £m** | 2012 £m | 2011 £m | **2013 £m** | 2012 £m | 2011 £m | **2013 £m** | 2012 £m | 2011 £m |
| At 1 January | **2,412** | 2,412 | 2,412 | **13,507** | 10,576 | 5,918 | **939** | 961 | 986 |
| Net cash inflows from financing | **-** | - | - | **1,005** | 2,931 | 4,658 | **-** | - | - |
| Currency translation and other adjustments | **-** | - | - | **-** | - | - | **17** | (22) | (25) |
| **At 31 December** | **2,412** | 2,412 | 2,412 | **14,512** | 13,507 | 10,576 | **956** | 939 | 961 |

### 29. Analysis of cash and cash equivalents

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | **2013 £m** | 2012 £m | 2011 £m | **2013 £m** | 2012 £m | 2011 £m |
| At 1 January | | | | | | |
| Cash | **725** | 749 | 854 | **545** | 522 | 613 |
| Cash equivalents | **5,800** | 4,948 | 3,326 | **2,859** | 2,441 | 3,563 |
| | **6,525** | 5,697 | 4,180 | **3,404** | 2,963 | 4,176 |
| Net cash inflow/(outflow) | **1,485** | 945 | 1,587 | **178** | 443 | (1,213) |
| Effect of exchange rate changes on cash and cash equivalents | **61** | (117) | (70) | **21** | (2) | - |
| At 31 December | **8,071** | 6,525 | 5,697 | **3,603** | 3,404 | 2,963 |
| | | | | | | |
| Comprising: | | | | | | |
| Cash and balances at central banks | **867** | 725 | 749 | **624** | 545 | 522 |
| Loans and advances to banks and debt securities | **7,204** | 5,800 | 4,948 | **2,979** | 2,859 | 2,441 |

### 30. Divisional analysis

The Group operates in the financial services industry in the United Kingdom and the Republic of Ireland and provides an integrated service to its customers. The directors manage the Group primarily by class of business and present the divisional analysis on that basis. Divisions charge market prices for services rendered to other parts of the Group; funding charges between divisions are determined by Group Treasury, having regard to commercial demands.

The Group reports on a divisional basis as follows:

Retail Banking provides loan and deposit products through a network of branches and direct channels.

Corporate Banking provides services to business and corporate customers.

Both Retail Banking and Corporate Banking are supported by business services, finance, human resources and head office divisions.

Other is comprised of Non-Core and central functions. Non-Core consists of assets that the Group intends to run off or dispose of. Central functions comprise Group and corporate functions such as treasury, finance, risk management, legal, communications and human resources.

**30. Divisional analysis (continued)**

Divisional information by class of business and geographical area is set out below:

**Class of business**

| **2013** | Total income: Interest income £m | Total income: Non-interest income £m | Total income: Total £m | Operating expenses before depreciation £m | Depreciation and amortisation £m | Impairment losses £m | Operating loss before tax £m |
|---|---|---|---|---|---|---|---|
| Retail Banking | 290 | 118 | 408 | (150) | - | (258) | - |
| Corporate Banking | 178 | 117 | 295 | (123) | - | (1,528) | (1,356) |
| Other | 181 | 258 | 439 | (425) | (24) | (3,008) | (3,018) |
| **Total** | **649** | **493** | **1,142** | **(698)** | **(24)** | **(4,794)** | **(4,374)** |

**Class of business**

| Restated 2012 | Total income: Interest income £m | Total income: Non-interest income £m | Total income: Total £m | Operating expenses before depreciation £m | Depreciation and amortisation £m | Impairment losses £m | Operating loss before tax £m |
|---|---|---|---|---|---|---|---|
| Retail Banking | 284 | 76 | 360 | (157) | - | (699) | (496) |
| Corporate Banking | 240 | 120 | 360 | (112) | - | (665) | (417) |
| Other | 171 | 64 | 235 | (411) | (26) | (976) | (1,178) |
| Total | 695 | 260 | 955 | (680) | (26) | (2,340) | (2,091) |

**Class of business**

| Restated 2011 | Total income: Interest income £m | Total income: Non-interest income £m | Total income: Total £m | Operating expenses before depreciation £m | Depreciation and amortisation £m | Impairment losses £m | Operating loss before tax £m |
|---|---|---|---|---|---|---|---|
| Retail Banking | 337 | 91 | 428 | (114) | (1) | (626) | (313) |
| Corporate Banking | 321 | 113 | 434 | (98) | (1) | (758) | (423) |
| Other | 182 | 242 | 424 | (407) | (28) | (2,334) | (2,345) |
| Total | 840 | 446 | 1,286 | (619) | (30) | (3,718) | (3,081) |

| **Class of business** | **2013** | | Restated 2012 | | Restated 2011 | |
|---|---|---|---|---|---|---|
| | **Assets £m** | **Liabilities £m** | Assets £m | Liabilities £m | Assets £m | Liabilities £m |
| Retail Banking | **18,401** | **10,713** | 18,488 | 10,142 | 20,164 | 9,658 |
| Corporate Banking | **8,798** | **10,308** | 10,857 | 14,268 | 13,768 | 13,931 |
| Other | **12,983** | **15,029** | 15,305 | 13,099 | 14,985 | 18,574 |
| Total | **40,182** | **36,050** | 44,650 | 37,509 | 48,917 | 42,163 |

| **Geographical divisions** | **2013** | | | Restated 2012 | | | Restated 2011 | | |
|---|---|---|---|---|---|---|---|---|---|
| | **UK £m** | **ROI £m** | **Total £m** | UK £m | ROI £m | Total £m | UK £m | ROI £m | Total £m |
| Total Income | **274** | **868** | **1,142** | 137 | 818 | 955 | 234 | 1,052 | 1,286 |
| Operating loss before tax | **(1,410)** | **(2,964)** | **(4,374)** | (590) | (1,501) | (2,091) | (1,094) | (1,987) | (3,081) |
| Net Assets | **3,511** | **621** | **4,132** | 4,210 | 2,931 | 7,141 | 5,004 | 1,750 | 6,754 |
| Total Assets | **20,513** | **19,669** | **40,182** | 19,526 | 25,124 | 44,650 | 20,731 | 28,186 | 48,917 |

### 31. Transactions with directors

At 31 December 2013 the amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions in the Group, as defined in UK legislation, were £664,454 (2012: £705,045) in respect of loans to any persons who were directors at any time during the financial period.

### 32. Related parties

The Company's immediate parent company is National Westminster Bank Plc, which is incorporated in Great Britain.

The Bank's ultimate holding company, and the parent of the largest group into which the Company is consolidated, is The Royal Bank of Scotland Group plc which is incorporated in Great Britain and registered in Scotland. Copies of the accounts for The Royal Bank of Scotland Group plc can be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, Edinburgh, EH12 1HQ.

The smallest subgroup into which the Bank is consolidated has as its parent company National Westminster Bank Plc, a company incorporated in Great Britain. Copies of the accounts for this subgroup can be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, Edinburgh, EH12 1HQ.

**UK Government**

The UK Government through HM Treasury is the ultimate controlling party of The Royal Bank of Scotland Group plc. Its shareholding is managed by UK Financial Investments Limited, a company it wholly owns and as a result, the UK Government and UK Government controlled bodies are related parties of the Group.

**The Funding for Lending Scheme**

The Funding for Lending Scheme was launched in July 2012. Under the scheme UK banks and building societies are able to borrow UK treasury bills from the Bank of England in exchange for eligible collateral during the drawdown period (1 August 2012 to 31 January 2014). Borrowing is limited to 5% of the participant's stock of loans to the UK non-financial sector as at 30 June 2012, plus any expansion in lending from that date to the end of 2013. Eligible collateral comprises all collateral eligible for the Bank of England's discount window facility. The term of each transaction is four years from the date of drawdown. The price for borrowing UK treasury bills under the scheme depends on the participant's net lending to the UK non-financial sector between 30 June 2012 and the end of 2013. If lending is maintained or expanded over that period, the fee is 0.25% per year on the amount borrowed. If lending declines, the fee increases by 0.25% for each 1% fall in lending, up to a maximum fee of 1.5%. As at 31 December 2013, the total funds allocated under the scheme was £84 million (2012: £10 million).

**(a) Directors and key managers**

At 31 December 2013, amounts advanced by the Group were £664,454 in respect of loans to 8 persons who served as directors during the financial period.

The aggregate transactions between the Group and its directors, key managers, their close families and companies which they control were:

| | Number of directors | Number of key managers | Connected parties | Transaction £ |
|---|---|---|---|---|
| **Transactions during the year** | | | | |
| Loans made during the year: | | | | |
| – at a commercial rate | 2 | - | 1 | 52,476 |
| **Balances outstanding at the end of the year** | | | | |
| Loans: | | | | |
| – at a commercial rate | 8 | 6 | 15 | 10,459,893 |
| – at a preferential rate | - | 5 | 1 | 623,533 |
| Customer accounts: | | | | |
| – Savings | 9 | 13 | 47 | 12,211,421 |

### 32. Related parties (continued)

#### (b) Related party transactions

| | Group | | Bank | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| **Assets** | **£m** | £m | **£m** | £m |
| Loans and advances: | | | | |
| Parent companies | **9,161** | 7,557 | **6,855** | 6,654 |
| Key management | **2** | 3 | **-** | - |
| Other related parties, including fellow subsidiaries | **13** | 16 | **293** | 219 |
| | **9,176** | 7,576 | **7,148** | 6,873 |
| Derivatives: | | | | |
| Parent companies | **349** | 388 | **15** | 67 |
| **Total assets** | **9,525** | 7,964 | **7,163** | 6,940 |
| **Liabilities** | | | | |
| Deposits: | | | | |
| Parent companies | **6,253** | 5,543 | **4,456** | 4,503 |
| Key management | **3** | 5 | **-** | 1 |
| Other related parties, including fellow subsidiaries | **467** | 869 | **272** | 82 |
| | **6,723** | 6,417 | **4,728** | 4,586 |
| Subordinated loans: | | | | |
| Parent companies | **1,040** | 1,021 | **956** | 939 |
| Other related parties, including fellow subsidiaries | **135** | 136 | **-** | - |
| | **1,175** | 1,157 | **956** | 939 |
| Derivatives: | | | | |
| Parent companies | **696** | 926 | **47** | 77 |
| **Total liabilities** | **7,898** | 8,500 | **5,731** | 5,602 |

#### (c) Compensation of key management

The aggregate remuneration of directors and other members of key management during the year was as follows:

| | Group | |
|---|---|---|
| | **2013** | 2012 |
| | **£** | £ |
| Short term benefits | **4,653,539** | 4,560,754 |
| Termination benefit | **-** | - |
| Long term benefit | **385,136** | 956,269 |
| | **5,038,675** | 5,517,023 |

### 33. Post balance sheet events

There have been no significant events between the year end and the date of approval of the financial statements which would require a change or additional disclosure or amendment in the financial statements.

### 34. Restatement

The Group and Bank financial statements have been restated as a result of a change in accounting standards affecting how the Group accounts for its defined benefit pension schemes. IAS 19 'Employee Benefits' (revised) was implemented from 1 January 2013 and the most significant impact on the Group's reporting is the requirement to discontinue the 'corridor approach' to accounting for actuarial gains and losses. Prior to 1 January 2013, it was permissible to defer actuarial gains and losses if they did not exceed 10% of the fair value of the plan assets or the pension benefit obligation, whichever was the greater. The actuarial gain or loss could be amortised gradually over time into the income statement, this was known as the 'corridor approach'. Under IAS 19 (revised) the actuarial gains and losses are required to be immediately recognised in other comprehensive income.

Other requirements of IAS 19 include: interest cost to be calculated on the net pension liability or asset at the long-term bond rate; an expected rate of return will no longer be applied to assets; and all past service costs to be recognised immediately when a scheme is curtailed or amended.

The Group's and Bank's statements of comprehensive income, balance sheets and cash flow statements for 2012 and 2011 have been restated under the terms of IAS 19 (revised) to facilitate comparison with the 2013 financial performance. The resulting adjustments are detailed on pages 95 - 100.

**NOTES TO THE FINANCIAL STATEMENTS** *for the year ended 31 December 2013*

**34. Restatement (continued)**

**CONSOLIDATED INCOME STATEMENT** *for the year ended 31 December 2012*

| | Group | | |
|---|---|---|---|
| | Previously reported 2012 £m | Adjustment 2012 £m | Restated 2012 £m |
| Interest receivable | 1,194 | - | 1,194 |
| Interest payable | (499) | - | (499) |
| **Net interest income** | 695 | - | 695 |
| Fees and commission receivable | 156 | - | 156 |
| Fees and commission payable | (9) | - | (9) |
| Income from trading activities | 94 | - | 94 |
| Other operating income | 19 | - | 19 |
| **Non-interest income** | 260 | - | 260 |
| **Total income** | 955 | - | 955 |
| **Operating expenses** | (706) | - | (706) |
| **Operating profit before impairment losses** | 249 | - | 249 |
| Impairment loss on loans and advances | (2,340) | - | (2,340) |
| **Operating loss before tax** | (2,091) | - | (2,091) |
| Tax charge | (114) | 1 | (113) |
| **Loss for the year** | (2,205) | 1 | (2,204) |
| **Loss attributable to:** | | | |
| Non-controlling interests | - | - | - |
| Ordinary shareholders | (2,205) | 1 | (2,204) |
| | (2,205) | 1 | (2,204) |

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME** *for the year ended 31 December 2012*

| | Group | | |
|---|---|---|---|
| | Previously reported 2012 £m | Adjustment 2012 £m | Restated 2012 £m |
| **Loss for the year** | (2,205) | 1 | (2,204) |
| **Items that will not be reclassified subsequently to profit or loss:** | | | |
| Actuarial losses on defined benefit plans and other movements | - | (195) | (195) |
| **Items that will be reclassified subsequently to profit or loss:** | | | |
| Fair value gains on available-for-sale financial assets | - | - | - |
| Exchange differences on translation of foreign operations | (146) | - | (146) |
| Income tax on items that do qualify for reclassification | - | - | - |
| **Other comprehensive loss after tax** | (146) | (195) | (341) |
| **Total comprehensive loss for the year** | (2,351) | (194) | (2,545) |
| **Attributable to:** | | | |
| Non-controlling interests | (13) | - | (13) |
| Ordinary shareholders | (2,338) | (194) | (2,532) |
| | (2,351) | (194) | (2,545) |

**34. Restatement (continued)**

**BALANCE SHEETS** *as at 31 December 2012*

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | Previously reported 2012 £m | Adjustment 2012 £m | Restated 2012 £m | Previously reported 2012 £m | Adjustment 2012 £m | Restated 2012 £m |
| **Assets** | | | | | | |
| Cash and balances at central banks | 725 | - | 725 | 545 | - | 545 |
| Loans and advances to banks | 8,190 | - | 8,190 | 7,054 | - | 7,054 |
| Loans and advances to customers | 34,406 | - | 34,406 | 6,020 | - | 6,020 |
| Debt securities | 26 | - | 26 | 26 | - | 26 |
| Equity shares | 7 | - | 7 | - | - | - |
| Investments in Group undertakings | - | - | - | 2,544 | - | 2,544 |
| Derivatives | 724 | - | 724 | 37 | - | 37 |
| Property, plant and equipment | 341 | - | 341 | 64 | - | 64 |
| Prepayments, accrued income and other assets | 123 | - | 123 | 87 | 1 | 88 |
| Retirement benefit assets | 82 | (49) | 33 | 55 | (22) | 33 |
| Deferred taxation | 71 | 4 | 75 | 2 | - | 2 |
| **Total assets** | 44,695 | (45) | 44,650 | 16,434 | (21) | 16,413 |
| **Liabilities** | | | | | | |
| Deposits by banks | 7,895 | - | 7,895 | 4,540 | - | 4,540 |
| Customer accounts | 23,070 | - | 23,070 | 7,154 | - | 7,154 |
| Debt securities in issue | 3,254 | - | 3,254 | 2 | - | 2 |
| Derivatives | 992 | - | 992 | 78 | - | 78 |
| Accruals, deferred income and other liabilities | 910 | (1) | 909 | 668 | - | 668 |
| Retirement benefit liabilities | - | 213 | 213 | - | - | - |
| Deferred taxation | 23 | (4) | 19 | 20 | (5) | 15 |
| Subordinated liabilities | 1,157 | - | 1,157 | 939 | - | 939 |
| **Total liabilities** | 37,301 | 208 | 37,509 | 13,401 | (5) | 13,396 |
| **Equity** | | | | | | |
| Non-controlling interests | 500 | - | 500 | - | - | - |
| **Shareholders' equity:** | | | | | | |
| Called up share capital | 1,505 | - | 1,505 | 1,505 | - | 1,505 |
| Reserves | 5,389 | (253) | 5,136 | 1,528 | (16) | 1,512 |
| **Total equity** | 7,394 | (253) | 7,141 | 3,033 | (16) | 3,017 |
| **Total liabilities and equity** | 44,695 | (45) | 44,650 | 16,434 | (21) | 16,413 |

**34. Restatement (continued)**

**CASH FLOW STATEMENT** *for the year ended 31 December 2012*

| | Bank | | |
|---|---|---|---|
| | Previously reported 2012 £m | Adjustment 2012 £m | Restated 2012 £m |
| **Operating activities** | | | |
| Operating loss before tax | (4,032) | (4) | (4,036) |
| Adjustments for: | | | |
| Depreciation, amortisation and impairment | 17 | - | 17 |
| Interest on subordinated liabilities | 13 | - | 13 |
| Charge for defined benefit pension schemes | 7 | 4 | 11 |
| Cash contribution to defined benefit pension schemes | (40) | - | (40) |
| Loan impairment provisions net of recoveries | 256 | - | 256 |
| Impairment of investments in Group undertakings | 3,663 | - | 3,663 |
| Elimination of foreign exchange differences | (9) | - | (9) |
| Other non-cash items | (33) | - | (33) |
| **Net cash flows from trading activities** | (158) | - | (158) |
| Changes in operating assets and liabilities | 211 | - | 211 |
| **Net cash flows from operating activities before tax** | 53 | - | 53 |
| Income taxes received | 155 | - | 155 |
| **Net cash flows from operating activities** | 208 | - | 208 |
| **Investing activities** | | | |
| Sale and maturity of securities | 47 | - | 47 |
| Purchase of property, plant and equipment | (2) | - | (2) |
| Sale of property, plant and equipment | 2 | - | 2 |
| Investment in subsidiary undertakings | (2,730) | - | (2,730) |
| **Net cash flows from investing activities** | (2,683) | - | (2,683) |
| **Financing activities** | | | |
| Capital contribution | 2,931 | - | 2,931 |
| Interest on subordinated liabilities | (13) | - | (13) |
| **Net cash flows from financing activities** | 2,918 | - | 2,918 |
| **Effect of exchange rate changes on cash and cash equivalents** | (2) | - | (2) |
| **Net increase in cash and cash equivalents** | 441 | - | 441 |
| Cash and cash equivalents 1 January | 2,963 | - | 2,963 |
| **Cash and cash equivalents 31 December** | 3,404 | - | 3,404 |

**34. Restatement (continued)**

**CONSOLIDATED INCOME STATEMENT** *for the year ended 31 December 2011*

| | Group | | |
|---|---|---|---|
| | Previously reported 2011 £m | Adjustment 2011 £m | Restated 2011 £m |
| Interest receivable | 1,478 | - | 1,478 |
| Interest payable | (638) | - | (638) |
| **Net interest income** | 840 | - | 840 |
| Fees and commission receivable | 145 | - | 145 |
| Fees and commission payable | (6) | - | (6) |
| Income from trading activities | 42 | - | 42 |
| Gain on redemption of own debt | 255 | - | 255 |
| Other operating income | 10 | - | 10 |
| **Non-interest income** | 446 | - | 446 |
| **Total income** | 1,286 | - | 1,286 |
| **Operating expenses** | (640) | (9) | (649) |
| **Operating profit before impairment losses** | 646 | (9) | 637 |
| Impairment loss on loans and advances | (3,718) | - | (3,718) |
| **Operating loss before tax** | (3,072) | (9) | (3,081) |
| Tax credit | 260 | (3) | 257 |
| **Loss for the year** | (2,812) | (12) | (2,824) |
| **Profit/(loss) attributable to:** | | | |
| Non-controlling interests | 8 | - | 8 |
| Ordinary shareholders | (2,820) | (12) | (2,832) |
| | (2,812) | (12) | (2,824) |

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME** *for the year ended 31 December 2011*

| | Group | | |
|---|---|---|---|
| | Previously reported 2011 £m | Adjustment 2011 £m | Restated 2011 £m |
| **Loss for the year** | (2,812) | (12) | (2,824) |
| **Items that will not be reclassified subsequently to profit or loss:** | | | |
| Actuarial losses on defined benefit plans and other movements | (10) | (31) | (41) |
| **Items that will be reclassified subsequently to profit or loss:** | | | |
| Fair value gains on available-for-sale financial assets | 2 | - | 2 |
| Exchange differences on translation of foreign operations | (241) | - | (241) |
| Income tax on items that do qualify for reclassification | (1) | - | (1) |
| **Other comprehensive loss after tax** | (250) | (31) | (281) |
| **Total comprehensive loss for the year** | (3,062) | (43) | (3,105) |
| **Attributable to:** | | | |
| Non-controlling interests | (7) | - | (7) |
| Ordinary shareholders | (3,055) | (43) | (3,098) |
| | (3,062) | (43) | (3,105) |

### 34. Restatement (continued)

**BALANCE SHEETS** *as at 31 December 2011*

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | Previously reported 2011 £m | Adjustment 2011 £m | Restated 2011 £m | Previously reported 2011 £m | Adjustment 2011 £m | Restated 2011 £m |
| **Assets** | | | | | | |
| Cash and balances at central banks | 749 | - | 749 | 522 | - | 522 |
| Loans and advances to banks | 7,331 | - | 7,331 | 6,757 | - | 6,757 |
| Loans and advances to customers | 38,945 | - | 38,945 | 6,453 | - | 6,453 |
| Debt securities | 98 | - | 98 | 71 | - | 71 |
| Equity shares | 5 | - | 5 | - | - | - |
| Investments in Group undertakings | - | - | - | 3,488 | - | 3,488 |
| Derivatives | 997 | - | 997 | 87 | - | 87 |
| Property, plant and equipment | 349 | - | 349 | 81 | - | 81 |
| Prepayments, accrued income and other assets | 155 | - | 155 | 149 | 1 | 150 |
| Retirement benefit assets | 31 | (28) | 3 | 23 | (20) | 3 |
| Deferred taxation | 285 | - | 285 | 1 | 1 | 2 |
| **Total assets** | 48,945 | (28) | 48,917 | 17,632 | (18) | 17,614 |
| **Liabilities** | | | | | | |
| Deposits by banks | 12,830 | - | 12,830 | 4,365 | - | 4,365 |
| Customer accounts | 22,348 | - | 22,348 | 7,487 | - | 7,487 |
| Debt securities in issue | 3,530 | - | 3,530 | 38 | - | 38 |
| Derivatives | 1,352 | - | 1,352 | 84 | - | 84 |
| Accruals, deferred income and other liabilities | 871 | - | 871 | 639 | 2 | 641 |
| Retirement benefit liabilities | - | 36 | 36 | - | - | - |
| Deferred taxation | 18 | (5) | 13 | 15 | (5) | 10 |
| Subordinated liabilities | 1,183 | - | 1,183 | 961 | - | 961 |
| **Total liabilities** | 42,132 | 31 | 42,163 | 13,589 | (3) | 13,586 |
| **Equity** | | | | | | |
| Non-controlling interests | 512 | - | 512 | - | - | - |
| **Shareholders' equity:** | | | | | | |
| Called up share capital | 1,505 | - | 1,505 | 1,505 | - | 1,505 |
| Reserves | 4,796 | (59) | 4,737 | 2,538 | (15) | 2,523 |
| **Total equity** | 6,813 | (59) | 6,754 | 4,043 | (15) | 4,028 |
| **Total liabilities and equity** | 48,945 | (31) | 48,917 | 17,632 | (18) | 17,614 |

### 34. Restatement (continued)

**CASH FLOW STATEMENTS** *for the year ended 31 December 2011*

| | Group | | | Bank | | |
|---|---|---|---|---|---|---|
| | Previously reported 2011 £m | Adjustment 2011 £m | Restated 2011 £m | Previously reported 2011 £m | Adjustment 2011 £m | Restated 2011 £m |
| **Operating activities** | | | | | | |
| Operating loss before tax | (3,072) | (9) | (3,081) | (4,165) | (4) | (4,169) |
| Adjustments for: | | | | | | |
| Depreciation, amortisation and impairment | 30 | - | 30 | 10 | - | 10 |
| Interest on subordinated liabilities | 34 | - | 34 | 19 | - | 19 |
| Gain on redemption of own debt (1) | (255) | - | (255) | - | - | - |
| Charge for defined benefit pension schemes | 27 | 6 | 33 | 6 | 4 | 10 |
| Cash contribution to defined benefit pension schemes | (75) | - | (75) | (39) | - | (39) |
| Loan impairment provisions net of recoveries | 3,544 | - | 3,544 | 737 | - | 737 |
| Impairment of investments in Group undertakings | - | - | - | 3,518 | - | 3,518 |
| Elimination of foreign exchange differences | (411) | - | (411) | (7) | - | (7) |
| Other non-cash items | (295) | 3 | (292) | (51) | - | (51) |
| **Net cash flows from trading activities** | (473) | - | (473) | 28 | - | 28 |
| Changes in operating assets and liabilities (1) | (1,857) | - | (1,857) | (2,076) | - | (2,076) |
| **Net cash flows from operating activities before tax** | (2,330) | - | (2,330) | (2,048) | - | (2,048) |
| Income taxes received | 182 | - | 182 | 137 | - | 137 |
| **Net cash flows from operating activities** | (2,148) | - | (2,148) | (1,911) | - | (1,911) |
| **Investing activities** | | | | | | |
| Sale and maturity of securities | 281 | - | 281 | 128 | - | 128 |
| Purchase of equity shares | (3) | - | (3) | - | - | - |
| Sale of equity shares | 1 | - | 1 | - | - | - |
| Purchase of property, plant and equipment | (60) | - | (60) | (1) | - | (1) |
| Sale of property, plant and equipment | 8 | - | 8 | - | - | - |
| Investment in subsidiary undertakings | - | - | - | (4,068) | - | (4,068) |
| **Net cash flows from investing activities** | 227 | - | 227 | (3,941) | - | (3,941) |
| **Financing activities** | | | | | | |
| Purchase of own debt (1) | (1,116) | - | (1,116) | | | |
| Capital contribution | 4,658 | - | 4,658 | 4,658 | - | 4,658 |
| Interest on subordinated liabilities | (34) | - | (34) | (19) | - | (19) |
| **Net cash flows from financing activities** | 3,508 | - | 3,508 | 4,639 | - | 4,639 |
| **Effect of exchange rate changes on cash and cash equivalents** | (70) | - | (70) | - | - | - |
| **Net increase/(decrease) in cash and cash equivalents** | 1,517 | - | 1,517 | (1,213) | - | (1,213) |
| Cash and cash equivalents 1 January | 4,180 | - | 4,180 | 4,176 | - | 4,176 |
| **Cash and cash equivalents 31 December** | 5,697 | - | 5,697 | 2,963 | - | 2,963 |

(1) For the year ended 31 December 2011 the gain on purchase of own debt has been reclassified within the cash flow statement to better reflect the underlying nature of the cash flow.

## DIRECTORS AND EXECUTIVES

### Chairman

**Dr Philip Nolan (60)**

was educated at Queen's University Belfast where he graduated with a PhD in Geology. Beginning his career as a Geology Lecturer, he joined British Petroleum as a Geologist in 1981. He spent 15 years with the company before joining British Gas (BG) in 1996 where he subsequently became Chief Executive of Lattice Group, which de-merged from BG in 1999. He was Chief Executive Officer at Eircom Group from 2002 to 2006 and Chairman of Infinis Limited and Sepura plc from 2007 to 2010. He is currently Chairman of John Laing plc and Affinity Water. He is also a non-executive director of Providence Resources and EnQuest plc.

## EXECUTIVE DIRECTORS

### Group Chief Executive

**Jim Brown (53)**

was appointed Chief Executive Officer of Ulster Bank Group in April 2011. Prior to taking up his role in Ulster Bank, Jim was Chief Executive Officer for Retail and Commercial Markets in Asia and Middle East with responsibility for the RBS retail and commercial banking franchise in nine markets. He formerly worked in ABN AMRO holding a variety of senior positions including Head of Consumer Clients Asia and Country Manager for Taiwan. He also worked in Citibank holding various key positions in retail and commercial banking in Taiwan, Australia and New Zealand.

**Stephen Bell (49)**

was appointed Chief Risk Officer in March 2012. He joined us from PwC from where he was most recently seconded to the role of Chief Risk Officer at Allied Irish Banks plc in the aftermath of the substantial nationalisation of the bank. Prior to that he established and ran the Business Support & Recoveries operation for Barclays Western Europe, based in Madrid. Before that he was Strategy & Change Director at Royal & Sun Alliance. He joined R&SA from Transamerica Commercial Finance where he was Vice President & Managing Director, EMEA. Earlier in his career he was Chief Risk Officer in GE's Auto Financial Services business. He started his career with National & Provincial Building Society and over a 9 year period held a variety of senior risk and collections roles. He is a member of the Ulster Bank Executive Committee and all relevant sub-committees, the UBL and UBIL Boards, the UBL and UBIL Board Risk Committees and is a member of the RBS Group Risk Management Committee.

**Paul Stanley (50)**

joined Ulster Bank Group from AIB in August 2013. Previously he was the Acting Chief Financial Officer for AIB and a member of its Leadership Team from 2011. He joined AIB's Branch banking division in 1980 before moving to the Group's Financial Control department. He spent two years as a senior risk analyst in the Group's Capital Markets division, treasury operations, before he took up a three year role as Head of Treasury Finance and Risk in AIB's Poland Division (Bank Zachodni WBK) in 2000. He returned to Ireland in 2003 as Head of Asset Liability Management until he was appointed Group Financial Controller in 2010.

## NON-EXECUTIVE DIRECTORS

**Christopher Mills (66)**

retired as Group Chief Executive Officer of Ulster Carpet Mills where he played a leadership role since 1988. He began his career with Esso Petroleum, spending 18 years in a variety of management positions. He has been President of the Northern Ireland Chamber of Commerce, Chairman of Business in the Community and President of the European Carpet Manufacturers Association.

**Sir Nigel Hamilton (65)**

joined the Ulster Bank Board in April 2009, after retiring from his role as Head of the Northern Ireland Civil Service in July 2008. During his time as Head of the Northern Ireland Civil Service he was also Head of the Office of the First Minister and Deputy First Minister and Secretary to the Northern Ireland Executive. He is Chairman of New Irish Arts, Vice-President of TinyLife Northern Ireland, a member of the Council of Ulster Rugby and Chairman of the Northern Ireland Council of the Prince's Trust. He is also Vice Lord Lieutenant for the City and Borough of Belfast.

# ULSTER BANK LIMITED

## DIRECTORS AND EXECUTIVES

### NON-EXECUTIVE DIRECTORS

**Dr Andrew McLaughlin (45)**

is a member of the RBS Group's Management Committee holding the position of Director of Communications and Group Chief Economist. His overall experience as a senior RBS executive and his expertise in communications, reputation management and the economic field are particularly relevant to the Bank given the challenging banking and economic markets in which it operates. He is also Chairman of The Prince's Trust in Scotland and a member of its national Advisory Board.

**Christopher Campbell (55)**

joined RBS Group in August 2005 as Deputy General Counsel and Director, Group Legal and became Group General Counsel in May 2010. Prior to joining RBS Group, he was a partner for 18 years in Scotland's largest law firm, Dundas & Wilson, and was Managing Partner from 1996 until he joined RBS Group in 2005. In his role as Group General Counsel, Mr. Campbell has overall responsibility for advising the RBS Group Board and Executive Committee and for the provision of legal support to all of RBS's businesses globally. His responsibilities also include the Group Secretariat and Regulatory Affairs & Compliance functions. He is an Honorary Professor in Commercial Law at the University of Glasgow.

**Bridget Rosewell (62)**

is an economist with degrees from Oxford University, where she also taught until 1984. She has founded two economics consultancies, and is Chair of Volterra Partners. She has advised the Chancellor of the Exchequer, Treasury Select Committee and the Mayor of London. She has been responsible for the economic analysis of major infrastructure projects and is currently a Non-Executive Director of Network Rail and The Thames Estuary Research & Development Company Limited.

**Des O'Shea (57)**

was appointed to the Board of Ulster Bank in November 2012. He is also a Non-Executive Director of OJSC Orient Express Bank, a leading Russian Retail Bank and GTLK Europe Limited. In November 2011 he retired from GE Capital after 14 years during which he held a variety of senior roles including Chief Risk Officer, Chief Commercial Officer and Head of Mergers & Acquisitions for GE Money Europe which was GE Capital's largest and most profitable business in Europe. In the period 2008-2011 he was responsible for GE's investments and partnerships in banks in high growth emerging markets such as Turkey, Thailand, Taiwan, Central America and Colombia and served on the Boards of these Banks. He also led a major divestment programme for GE Capital Global Banking. In 1981 - 1991 Des worked for Ulster Investment Bank Limited in Corporate Banking and headed up its IFSC activities. He also worked with Woodchester Investments plc; Cambridge Group and Arthur Andersen. Des has a B.Comm Degree from UCC and is a Fellow of the Institute of Chartered Accountants in Ireland.

**Rosemary Quinlan (44)**

has an international banking career spanning twenty one years, where she has held senior executive roles with market leading banks including HSBC, Citigroup and ABN AMRO in Ireland, London, the USA and Amsterdam. Rosemary has experience across a broad range of banking products including: Transaction Banking, Corporate and Retail Banking, Fund Administration, Insurance and Mergers and Acquisitions. Rosemary was Deputy Country Chief Executive, HSBC Bank plc (Ireland) and Chief Executive of HSBC Securities Services (Ireland) from 2006 to 2011. Prior to joining HSBC, Rosemary worked with ABN AMRO from 2003 to 2006 where she managed the Transaction Banking business across Central and Eastern Europe, the Middle East and Africa. She also spent 10 years with Citigroup in London and the USA, holding a number of senior roles in Customer Relationship Management. Rosemary began her career with National Westminster Bank in London. She holds a Bachelor of Commerce degree from University College Cork and has completed the Chartered Director Programme with the Institute of Directors in Ireland.

**GROUP AUDIT COMMITTEE**
Des O'Shea, Chairman
Chris Campbell
Bridget Rosewell
Rosemary Quinlan

## ULSTER BANK LIMITED

### DIRECTORS AND EXECUTIVES

### DIVISIONAL HEADS

| | |
|---|---|
| S Bell | Chief Risk Officer |
| R Donnan | Managing Director, Retail Banking |
| E Cullen | Managing Director, Corporate & Institutional Banking |
| M Donnelly | Acting Head of Human Resources |
| E Graham | Managing Director, SME Banking and Head of NI |
| C Davis | Chief Operating Officer |
| R Bergin | Director Communications & Corporate Affairs |
| J McAdam | Head of Global Restructuring Group/Non-Core |
| P Stanley | Chief Finance Officer |

### COMPANY SECRETARIES

R Bergin
E Dignam (Deputy)
S Anderson (Joint secretary)

### HEAD OFFICE

11-16 Donegall Square East, Belfast, BT1 5UB