

Annual Report and Accounts

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Board of directors and secretary

Chairman

Howard Davies

Nominations (Chairman)

Executive directors

Ross McEwan

Ewen Stevenson

Independent non-executive directors

Sandy Crombie

Senior Independent Director

Remuneration (Chairman), Audit, Nominations

Alison Davis

Nominations, Remuneration, Sustainability

Morten Friis

Audit, Risk

Robert Gillespie

Nominations, Remuneration, Risk, Sustainability

Penny Hughes

Sustainability (Chairman), Risk

Brendan Nelson

Audit (Chairman), Nominations, Risk

Baroness Noakes

Risk (Chairman), Audit

Mike Rogers

Sustainability

Chief Governance Officer and Board Counsel

Aileen Taylor

Auditors

Deloitte LLP

Chartered Accountants and Statutory Auditor

Hill House

1 Little New Street

London EC4A 3TR

Registered office

135 Bishopsgate

London EC2M 3UR

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Head office

135 Bishopsgate

London EC2M 3UR

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National Westminster Bank Plc

Registered in England No. 929027

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

Presentation of information

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

Business structure

The Group continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. To support this and reflect the progress made the previously reported operating segments have been realigned as follows:

Personal & Business Banking (PBB) comprises two reportable segments, UK Personal & Business Banking (UK PBB) and Ulster Bank RoI. UK PBB serves individuals and mass affluent customers in the UK together with small businesses (generally up to £2 million turnover). UK PBB includes Ulster Bank customers in Northern Ireland. Ulster Bank RoI serves individuals and businesses in the Republic of Ireland (RoI).

Commercial & Private Banking (CPB) comprises two reportable segments, Commercial Banking and Private Banking. Commercial Banking serves commercial and corporate customers in the UK and Western Europe. Private Banking serves UK connected high net worth individuals.

Corporate & Institutional Banking (CIB) serves UK and Western European corporate customers, and global financial institutions, supported by trading and distribution platforms in the UK, US and Singapore.

Capital Resolution includes CIB Capital Resolution and the remainder of RBS Capital Resolution (RCR).

Central items & other includes corporate functions, such as treasury, finance, risk management, compliance, legal, communications and human resources. Central functions manages the Group's capital resources and Group-wide regulatory projects and provides services to the reportable segments.

Reporting changes

In line with RBS Group's strategy to be a simpler bank, reporting changes have been implemented in relation to the presentation of NatWest Group's results. Gain/(loss) on redemption of own debt and write down of goodwill previously reported as separate items after operating profit/(loss) are now being reported within operating profit/(loss). Comparatives have been restated accordingly.

Pensions accounting policy

As set out in 'Accounting policies' on page 99, the Group has revised its accounting policy for determining whether or not it has an unconditional right to a refund of surpluses in its employee pension funds. The change has been applied retrospectively and comparatives restated.

Top and emerging risks

Top and emerging risks

RBS Group employs a robust process for identifying and managing its top and emerging risks. Top risks are defined as scenarios that, while unlikely, may materialise, and which, if they did, would have a significant negative impact, such that RBS Group as a whole, or a particular business, could potentially fail to meet one or more of its strategic objectives. A number of scenarios attracted particular attention in 2015:

Macro-economic and other external risks

Risks related to the wider economy:

Like most other businesses, RBS Group remains vulnerable to changes in the external economic environment. Among potential scenarios considered, the following could have a material negative impact: a UK recession including large house price falls; vulnerabilities in emerging market economies, including China, resulting in contagion in RBS Group's core markets; global deflation; volatility in international markets linked to advanced economy interest rate increases or decreases; a resumption of the eurozone crisis, including a worsening of the situation in Greece; and major geopolitical instability. To mitigate these risks, RBS Group has strengthened its capital, liquidity and leverage positions. A number of higher-risk portfolios have been exited or reduced. Stress testing is used extensively to inform strategic planning and risk mitigation relating to these risks.

Risks related to the UK referendum on EU membership:

The referendum on the UK's membership of the EU during this parliament increases economic and operational uncertainty. The result may also give rise to further political uncertainty regarding Scottish independence. RBS Group actively monitors, and considers responses to, varying EU referendum outcomes to ensure that it is well prepared for all eventualities.

Risks related to the competitive environment:

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

An increase in obligations to support pension schemes:

If economic growth stagnates, and interest rates remain low, the value of pension scheme assets may not be adequate to fund pension scheme liabilities. The deficit in RBS Group pension schemes as determined by the most recent triennial valuations has increased, requiring RBS Group to increase its current and future cash contributions to the schemes. An acceleration of certain previously committed pension contributions in Q1 2016 will reduce this risk. Depending on the economic and monetary conditions and longevity of scheme members prevailing at that time, the deficit may increase at subsequent valuations.

Regulatory and legal risks

The impacts of past business conduct:

Future conduct and litigation charges could be substantial. RBS Group is involved in ongoing class action litigation, securitisation and mortgage-backed securities related litigation, investigations into foreign exchange trading and rate-setting activities, continuing LIBOR-related litigation and investigations, investigations into the treatment of small and medium-sized business customers in financial difficulty, anti-money laundering, sanctions, mis-selling (including mis-selling of payment protection insurance products), and other investigations. Settlements may result in additional financial penalties, non-monetary penalties or other consequences, which may be material. More detail on these issues can be found in the Litigation, Investigations and Reviews and Risk Factors sections. To prevent future conduct from resulting in similar impacts, RBS Group has embarked on a programme to embed a strong and comprehensive risk and compliance culture.

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

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

Operational and execution risks

Increased losses arising from a failure to execute major projects successfully:

The successful execution of major projects, including the transformation plan, the restructuring of CIB, the divestment of Williams & Glyn and the embedding of a strong and pervasive organisational and risk culture, are essential to meet RBS Group's strategic objectives. The separation and eventual divestment of Williams & Glyn is a complex process and as such entails significant operational and execution risk. The RBS Group remains committed to full divestment of Williams & Glyn by the end of 2017. These projects cover organisational structure, business strategy, information technology systems, operational processes and product offerings. RBS Group is working to implement change in line with its project plans while assessing the risks to implementation and taking steps to mitigate those risks where possible.

Impact of cyber attacks:

Cyber attacks are increasing in frequency and severity across the industry. RBS Group has participated in industry-wide cyber attack simulations in order to help test and develop defence planning. To mitigate the risks, a large-scale programme to improve user access controls is in progress, along with a number of other actions, including a reduction in the number of external websites, enhancement of anti-virus protections, and the implementation of a staff education programme on information protection.

Top and emerging risks

Inability to recruit or retain suitable staff:

RBS Group is undergoing significant organisational change, the result of a need to implement new business strategies and respond to a changing external environment. The pace of change, coupled with the associated uncertainty, may cause experienced staff to leave and prospective staff not to join. Although these risks concern all customer businesses, they particularly affect CIB. RBS Group has communicated expected changes in its organisational structure to members of staff, implementing plans aimed at minimising unexpected staff losses. It is also working to implement an enhanced recruitment strategy.

Failure of information technology systems:

RBS Group's information technology systems may be subject to failure. As such systems are complex, recovering from failure is challenging. To mitigate these risks, a major investment programme has significantly improved the resilience of the systems and more benefits are expected. Back-up system sustainability has improved, and a 'shadow bank' system, to provide basic services, if needed, has been created.

Full risk factors are discussed on pages 193 to 218.

Financial review

Financial summary

Summary consolidated income statement for the year ended 31 December 2015

	2015 £m	2014 £m	2013 £m
Net interest income	4,896	4,577	4,021
Fees and commissions receivable	2,133	2,439	2,600
Fees and commissions payable	(517)	(498)	(490)
Income from trading activities	14	77	726
Gain on redemption of own debt	—	—	239
Other operating income	10	682	268
Non-interest income	1,640	2,700	3,343
Total income	6,536	7,277	7,364
Operating expenses	(8,178)	(5,949)	(8,762)
(Loss)/profit before impairment releases/(losses)	(1,642)	1,328	(1,398)
Impairment releases/(losses)	728	1,249	(5,407)
Operating (loss)/profit before tax	(914)	2,577	(6,805)
Tax (charge)/credit	(292)	(844)	842
(Loss)/profit for the year	(1,206)	1,733	(5,963)
Non-controlling interest	1	—	—
(Loss)/profit attributable to ordinary shareholders	(1,205)	1,733	(5,963)

2015 compared with 2014

Operating (loss)/profit before tax

Operating loss before tax was £914 million compared with a profit of £2,577 million in 2014. This decrease reflects higher charges for litigation and conduct costs of £2,812 million compared with £1,007 million in 2014, lower net impairment releases of £728 million compared with £1,249 million in 2014 and a significant decrease in other non-interest income; this was partially offset by an increase in net interest income.

Net interest income

Net interest income increased by £319 million, 7% to £4,896 million compared with £4,577 million in 2014. The increase was principally due to improvements in UK PBB reflecting improvements in deposit margins and growth in the mortgage book.

Non-interest income

Non-interest income decreased by £1,060 million, 39% to £1,640 million, compared with £2,700 million in 2014, primarily due to a significant decrease in other operating income of £672 million to £10 million primarily reflecting losses on strategic disposals and a reduction in dividend income. Income from trading activities decreased by £63 million to £14 million principally from the reduced scale of activity in CIB. Net fees and commissions decreased by £325 million to £1,616 million reflecting reduced activity in CIB, reductions in Private Banking and lower card interchange fees in UK PBB.

Operating expenses

Operating expenses increased by £2,229 million, or 37%, to £8,178 million from £5,949 million in 2014. Operating expenses excluding restructuring costs and litigation and conduct costs declined by £278 million, or 6%, to £4,638 million (2014 - £4,916 million) mainly reflecting the benefits of cost savings initiatives.

Litigation and conduct costs were £2,812 million compared with £1,007 million in 2014, primarily relating to mortgage-backed securities litigation in the US of £2.1 billion. Other charges in 2015 include: provisions in relation to PPI costs of £359 million and Interest Rate Hedging Products redress of £85 million and other litigation and conduct provisions of £268 million.

Restructuring costs increased by £702 million to £728 million, compared with £26 million in 2014, primarily reflecting property and software write-downs in CIB.

Impairment releases/(losses)

Net impairment releases were £728 million in 2015 compared with £1,249 million in 2014. Net impairment releases were principally in Capital Resolution (£622 million) with disposal activity continuing and in Ulster Bank RoI (£141 million) as economic conditions in Ireland continue to improve.

Capital ratios

NatWest capital ratios at 31 December 2015 were 11.6% (Common Equity Tier 1), 11.6% (Tier 1) and 19.6% (Total). Ulster Bank Ireland Limited (UBIL) capital ratios at 31 December 2015 were 29.6% (Common Equity Tier 1), 29.6% (Tier 1) and 32.1% (Total).

Financial review

2014 compared with 2013

Operating (loss)/profit before tax

Operating profit before tax was £2,577 million compared with a loss of £6,805 million in 2013. This significant improvement reflects net impairment releases of £1,249 million compared with net losses of £5,407 million in 2013 and lower charges for litigation, conduct and redress costs, down £2,403 million to £1,007 million. This was partially offset by a decrease in non-interest income, reflecting lower income from trading activities.

Net interest income

Net interest income increased by £556 million, 14% to £4,577 million compared with £4,021 million in 2013. The increase was principally due to improvements in deposit margins in Personal & Business Banking (PBB) and Commercial & Private Banking (CPB).

Non-interest income

Non-interest income decreased by £643 million, 19% to £2,700 million compared with £3,343 million in 2013, primarily due to lower income from trading activities, down £649 million to £77 million in line with Corporate & Institutional Banking's (CIB's) smaller balance sheet and reduced risk profile, and the non-repeat of a gain on redemption of own debt of £239 million in 2013. This was partially offset by an increase in other operating income of £414 million to £682 million, which included dividend income of £234 million compared with £18 million in 2013.

Operating expenses

Operating expenses decreased by £2,813 million, or 32%, to £5,949 million from £8,762 million in 2013. Operating expenses excluding restructuring costs and litigation, conduct and redress costs declined £393 million, or 7% to £4,916 million (2013 - £5,309 million) mainly reflecting the benefits of cost savings initiatives.

Litigation, conduct and redress charges were £1,007 million compared with £3,410 million in 2013 which included a charge relating to regulatory and legal actions of £2,536 million primarily relating to mortgage-backed securities and securities related litigation. Charges in 2014 include: provisions relating to investment advice in retail and private banking (£156 million) and to packaged accounts (£112 million), and additional provisions in relation to PPI costs (£440 million) and Interest Rate Hedging Products redress (£166 million).

Impairment releases/(losses)

Net impairment releases were £1,249 million in 2014 compared with a net impairment charge of £5,407 million in the prior year, which included £3,249 million provisions relating to the creation of RCR. Net impairment releases were principally in Capital Resolution (£1,145 million) and in Ulster Bank Rol (£306 million) and reflected the improving Irish economic and property market conditions and proactive debt management.

Capital ratios

NatWest capital ratios at 31 December 2014 were 13.9% (Common Equity Tier 1), 14.0% (Tier 1) and 21.7% (Total). UBIL capital ratios at 31 December 2014 were 17.3% (Common Equity Tier 1), 17.3% (Tier 1) and 19.5% (Total).

Financial review

Analysis of results

Net interest income

	2015 £m	2014 £m	2013 £m
Interest receivable (1)	6,280	6,499	7,483
Interest payable	(1,384)	(1,922)	(3,462)
Net interest income	4,896	4,577	4,021

Yields, spreads and margins of the banking business

	%	%	%
Gross yield on interest-earning assets of the banking business (2)	2.37	2.37	2.72
Cost of interest-bearing liabilities of the banking business	(0.78)	(1.06)	(1.75)
Interest spread of the banking business (3)	1.59	1.31	0.97
Benefit from interest-free funds	0.26	0.36	0.49
Net interest margin of the banking business (4)	1.85	1.67	1.46

Gross yield (2)

- Group	2.37	2.37	2.72
- UK	2.54	2.59	2.89
- Overseas	1.45	1.33	1.95

Interest spread (3)

- Group	1.59	1.31	0.97
- UK	1.75	1.50	1.09
- Overseas	0.75	0.50	0.51

Net interest margin (4)

- Group	1.85	1.67	1.46
- UK	1.97	1.82	1.53
- Overseas	1.15	0.97	1.16

National Westminster Bank Plc base rate (average)

0.50	0.50	0.50
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London inter-bank three month offered rates (average)

- Sterling	0.57	0.54	0.52
- Eurodollar	0.32	0.23	0.24
- Euro	(0.02)	0.21	0.27

Notes:

(1) Interest income includes £196 million (2014 - £149 million; 2013 - £210 million) in respect of loan fees forming part of the effective interest rate of loans and receivables.

(2) Gross yield is the interest rate earned on average interest-earning assets of the banking business.

(3) Interest spread is the difference between the gross yield and the interest rate paid on average interest-bearing liabilities of the banking business.

(4) Net interest margin is net interest income of the banking business as a percentage of average interest-earning assets of the banking business.

(5) The analysis into UK and Overseas has been compiled on the basis of location of office.

(6) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.

(7) Interest income includes amounts (unwind of discount) recognised on impaired loans and receivables. The average balances of such loans are included in average loans and advances to banks and loans and advances to customers.

Financial review

Consolidated balance sheet at 31 December 2015

	2015 £m	2014* £m
Assets		
Cash and balances at central banks	1,690	2,709
Amounts due from holding company and fellow subsidiaries	99,403	103,272
Other loans and advances to banks	3,875	7,640
Loans and advances to banks	103,278	110,912
Amounts due from fellow subsidiaries	569	1,028
Other loans and advances to customers	176,263	168,138
Loans and advances to customers	176,832	169,166
Debt securities subject to repurchase agreements	3,740	8,583
Other debt securities	3,464	5,246
Debt securities	7,204	13,829
Equity shares	717	779
Settlement balances	2,138	2,050
Amounts due from holding company and fellow subsidiaries	1,724	2,672
Other derivatives	889	1,226
Derivatives	2,613	3,898
Intangible assets	517	848
Property, plant and equipment	1,031	1,591
Deferred tax	1,802	1,732
Prepayments, accrued income and other assets	1,297	1,686
Assets of disposal groups	3,311	—
Total assets	302,430	309,200
Liabilities		
Amounts due to holding company and fellow subsidiaries	17,609	20,128
Other deposits by banks	6,982	6,104
Deposits by banks	24,591	26,232
Amounts due to fellow subsidiaries	7,752	13,112
Other customer accounts	223,909	221,215
Customer accounts	231,661	234,327
Debt securities in issue	1,473	1,707
Settlement balances	2,461	2,143
Short positions	3,577	6,827
Amounts due to holding company	2,291	3,971
Other derivatives	379	487
Derivatives	2,670	4,458
Provisions, accruals and other liabilities	7,543	6,315
Retirement benefit liabilities	3,547	3,987
Amounts due to holding company	5,621	5,656
Other subordinated liabilities	1,395	1,780
Subordinated liabilities	7,016	7,436
Liabilities of disposal groups	2,724	—
Total liabilities	287,263	293,432
Non-controlling interests	346	394
Owners' equity	14,821	15,374
Total equity	15,167	15,768
Total liabilities and equity	302,430	309,200

* Restated - refer to page 99 for further details

Commentary on consolidated balance sheet

2015 compared with 2014

Total assets decreased by £6.8 billion, 2%, to £302.4 billion, primarily driven by a reduction in the scale of CIB's US trading business, partially offset by loan growth in UK PBB.

Loans and advances to banks decreased by £7.6 billion, 7%, to £103.3 billion. Other bank placings decreased by £3.8 billion, 49%, to £3.9 billion and amounts due from the holding company and fellow subsidiaries decreased by £3.9 billion, 4%, to £99.4 billion.

Loans and advances to customers increased by £7.7 billion, 5%, to £176.8 billion. Within this, amounts due from fellow subsidiaries were down £0.5 billion, 45%, to £0.6 billion. Customer lending increased by £8.1 billion, 5%, to £176.3 billion, primarily reflecting £11.7 billion net growth in mortgages lending in UK PBB, partially offset by a £1.4 billion reduction in Ulster Bank Rol's tracker mortgage portfolio and RCR loan disposals.

Debt securities decreased by £6.6 billion, 48%, to £7.2 billion as a result of reductions in held-for-trading government and financial institution securities in CIB.

Movements in the fair value of derivative assets, down £1.3 billion, 33%, to £2.6 billion, and liabilities, down £1.8 billion, 40% to £2.6 billion, were driven by a reduction in interest rate swap notionals as well as yield curve movements.

The increase in assets and liabilities of disposal groups from nil, up to £3.3 billion and £2.7 billion respectively, reflects the transfer of the international private banking business to disposal groups.

Deposits by banks decreased by £1.6 billion, 6%, to £24.6 billion, with decreases in amounts due to the holding company and fellow subsidiaries, down £2.5 billion, 13%, to £17.6 billion, offset by increases in other bank deposits, up £0.9 billion, 14%, to £7.0 billion.

Customer accounts decreased £2.7 billion, 1%, to £231.7 billion. Within this, amounts due to fellow subsidiaries decreased by £5.4 billion, 41%, to £7.8 billion. Other customer deposits were up £2.7 billion, 1%, at £223.9 billion, with the increase mainly in UK PBB and Commercial Banking.

Owner's equity decreased by £0.6 billion, 4%, to £14.8 billion, driven by the £1.2 billion attributable loss for the year, offset by capital contributions from the holding company of £0.8 billion.

Capital and risk management

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Financial review Capital and risk management

Three lines of defence

The three lines of defence model is used industry-wide for the management of risk. It provides a clear set of principles by which to implement a cohesive operating model, one that provides a framework for the articulation of accountabilities and responsibilities for managing risk across the organisation.

First line of defence - Management and supervision

The first line of defence includes customer franchises, Technology and Operations and support functions such as HR, Communications and Financial MI. Responsibilities include:

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

Second line of defence - Oversight and control

The second line of defence includes RBS Group Risk Management and Conduct & Regulatory Affairs (see below for further information), Legal, and the financial control aspects of Finance. Responsibilities include:

- Working with the businesses and functions to develop the risk and control policies, limits and tools for the business to use to discharge its responsibilities.

- Overseeing and challenging the management of risks and controls.
- Leading the articulation, design and development of risk culture and appetite.
- Analysing the aggregate risk profile and ensuring that risks are being managed to the desired level (risk appetite).
- Providing expert advice to the business on risk management.
- Providing senior executives with relevant management information and reports and escalating concerns where appropriate.
- Undertaking risk assurance (see below for more information).

Third line of defence - Internal Audit

Responsibilities include:

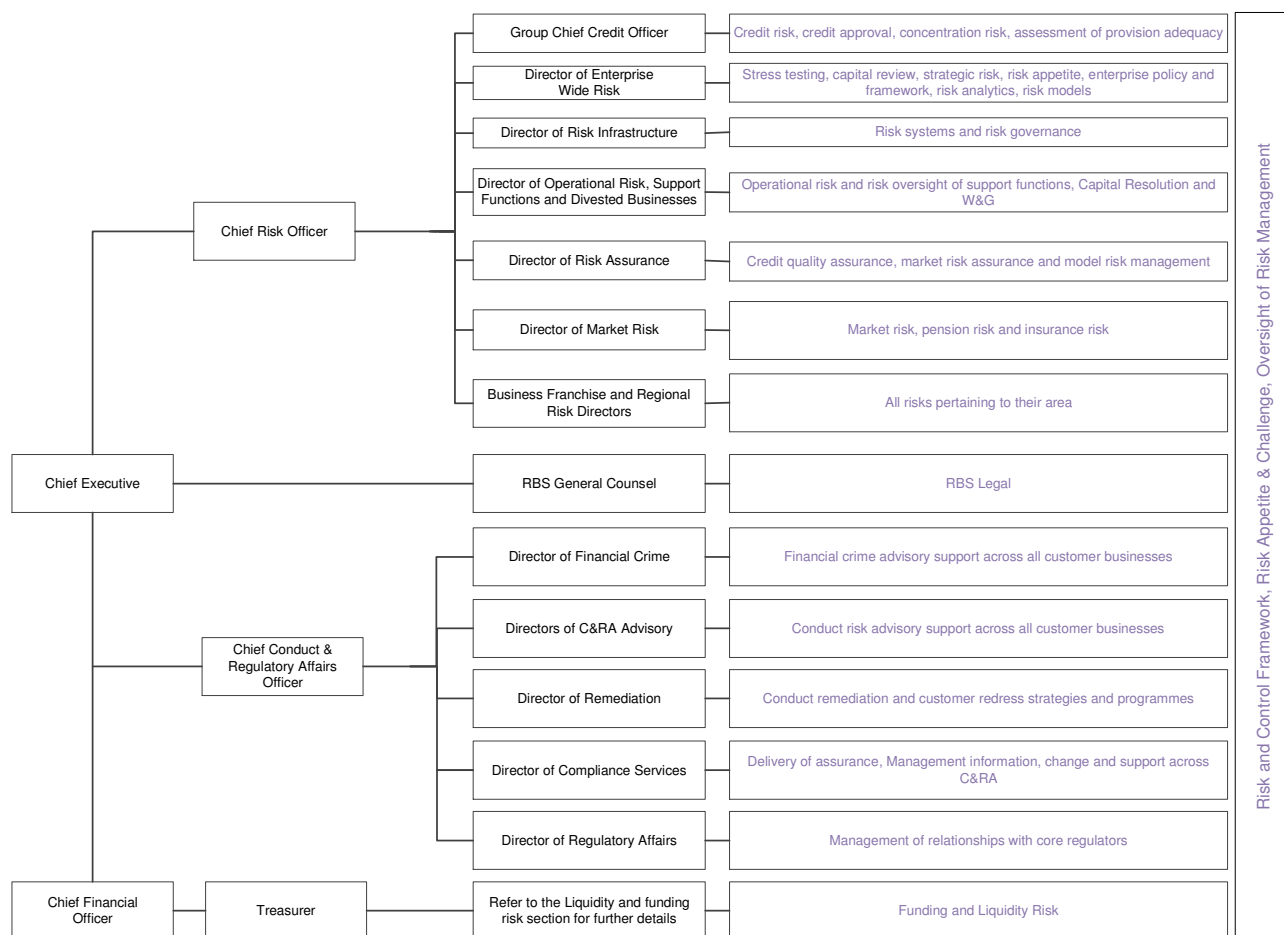
- Designing and delivering a risk-based audit plan to provide assurance on material risks and report on whether RBS is managing its material risks effectively.
- Monitoring, evaluating and reporting on the remediation of material risks across the RBS Group.
- Engaging with management and participating in key governance fora to provide perspectives, insights and challenge so as to influence the building of a sustainable bank.
- Advising the Group Audit Committee and executive management with respect to the Group's material risks and their associated controls.
- Reporting any matters which warrant escalation to the RBS Group Board, the Board Risk Committee, Group Audit Committee and the Executive Committee as appropriate.
- Providing independent assurance to the FCA, PRA, CBI and other key jurisdictional regulators on both specific risks and control themes.

Financial review Capital and risk management

Risk overview* continued

Management structure

RBS Group's management structure and the main elements of each role are set out below.



Notes:

(1) RBS Group Risk Management

The RBS Group Chief Risk Officer (CRO) leads RBS Group Risk Management. The CRO reports directly to the Chief Executive and has an indirect reporting line to the Chairman of the Board Risk Committee and a right of access to the committee's chairman.

RBS Group Risk Management is a function independent of the franchises, structured by risk discipline to facilitate the effective management of risk.

RBS Group Risk Management is organised into six functional areas: Credit Risk; Enterprise-Wide Risk; Risk Infrastructure; Operational Risk, Support Functions and Divested Businesses; Risk Assurance; and Market Risk. Directors of Risk are appointed for each of the franchises and for Services. This streamlined structure consolidates risk information, allowing for more efficient decision-making.

The directors of risk functions are responsible for RBS Group-wide risk appetite and standards within their respective disciplines and report to the CRO.

CROs are in place for certain jurisdictions and legal entities to meet local regulatory and governance requirements. They lead the risk management teams locally in support of functional risk heads where teams follow a functional operating model. The key CRO roles report directly to the RBS Group CRO.

Risk committees in the customer businesses and key functional risk committees oversee risk exposures arising from management and business activities and focus on ensuring that they are adequately monitored and controlled.

(2) Conduct & Regulatory Affairs

Conduct & Regulatory Affairs (C&RA) is led by the RBS Group's Chief Conduct & Regulatory Affairs Officer, who reports directly to the RBS Group Chief Executive and has an indirect reporting line to the Board Risk Committee and a right of access to the committee's chairman. It is responsible for providing oversight of conduct risk and regulatory risk at RBS Group, and does so by setting RBS Group-wide policy and standards, providing advice to each customer business, and ensuring that the mitigating controls are suitable. C&RA also provides leadership of the RBS Group's relationships with its regulators.

The functional heads (the Directors of Financial Crime, Advisory, Remediation, Compliance Services and Regulatory Affairs), report to the Chief Conduct & Regulatory Affairs Officer. Each is responsible, where appropriate, for the RBS Group-wide risk appetite and standards of their respective areas.

Financial review Capital and risk management

Risk assurance

Risk assurance is a second line of defence function in which most of the RBS Group's risk assurance activities are centralised. These primarily comprise credit risk and market risk quality assurance, controls assurance and Model Risk Management, each of which is described below.

Credit risk and market risk quality assurance: These teams provide assurance to both internal and external stakeholders including the Board, senior management, risk functions, franchises, Internal Audit and the regulators.

Credit risk and market risk quality assurance undertake reviews which assess various aspects of risk as appropriate: including: the quality of risk portfolios; the completeness, suitability, accuracy and timeliness of risk measurements; the quality of risk management practices; policy compliance; and adherence to risk appetite. This includes monitoring the Group's credit portfolios and market risk exposures to assist in early identification of emerging risks, as well as undertaking targeted reviews to examine specific concerns raised either by these teams or by their stakeholders.

The Risk Assurance Committee (RAC) provides governance to ensure a consistent and fair approach to all aspects of the review activities of credit and market risk assurance. Additionally, RAC monitors and validates the ongoing programme of reviews and tracks the remediation of review actions. The credit and market risk assurance teams also attend relevant committees run by the customer franchises and other risk functions to ensure strong communication channels are maintained.

Controls assurance: This team tests the adequacy and effectiveness of key controls relating to credit and market risk, including those within the scope of Section 404 of the US Sarbanes-Oxley Act of 2002. Since the team's creation in late 2014, testing has primarily covered key controls within CIB and CPB.

Model risk management

Model governance

Model governance follows a three lines of defence approach, with model developers having primary accountability and Model Risk Management (MRM) acting in a second-line-of-defence capacity.

MRM is responsible for setting policy, providing governance and insight for all of the Group's statistical, economic, financial or mathematical models and performing independent model validation where necessary. It works with individual businesses to set appropriate model standards, and monitor adherence to these, to ensure that models are developed and implemented appropriately and that their operational environment is fit for purpose.

Going forward, MRM will be responsible for defining and monitoring model risk appetite in conjunction with model developers, monitoring the model risk profile and reporting on the model population and escalating issues to senior management.

The general approach to MRM's independent model validation for risk and pricing models is detailed below. For more specific information relating to market risk models and pricing models, refer to page 84.

Models used within Risk

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

For more information on the use of models in the management of particular types of risk, notably credit and market risk, refer to the relevant section.

Independent model validation

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

A new model is typically introduced when an existing model is deemed no longer fit for purpose or when exposure to a new product requires a new approach to ensure that risks are appropriately quantified. Amendments are usually made when a weakness is identified during use of a model or following analysis either by the model developers or by MRM.

MRM's independent review comprises some or all of the following steps, as appropriate:

- Testing and challenging the logical and conceptual soundness of the methodology;
- Testing the assumptions underlying the model, where feasible, against actual behaviour. In its validation report, MRM will opine on the reasonableness and stability of the assumptions and specify which assumptions, if any, should be routinely monitored in production;
- Testing whether all key appropriate risks have been sufficiently captured;
- Checking the accuracy of calculations;
- Comparing outputs with results from alternative methods;
- Testing parameter selection and calibration;
- Ensuring model outputs are sufficiently conservative in areas where there is significant model uncertainty;
- Confirming the applicability of tests for accuracy and stability; recalculating and ensuring that results are robust; and
- Ensuring appropriate sensitivity analysis has been performed and documented.

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Financial review Capital and risk management

Risk overview* continued

Based on the review and findings from MRM, the RBS Group's model or risk committees with appropriate delegated authority consider whether a model can be approved for use and whether any conditions need to be imposed, including those relating to the remediation of material issues raised through the review process. Once approved through internal governance, the new or amended model is implemented. Models used for regulatory reporting may additionally require regulatory approval before implementation.

MRM reassesses the appropriateness of approved risk models on a periodic basis according to the approved Periodic Review Policy. Each periodic review begins with an initial assessment. A decision is then made by an internal model governance committee with appropriate delegated authority. Based on the initial assessment, the committee will decide to re-ratify a model based on the initial assessment or to carry out additional work prior to making a decision. In the initial assessment, MRM assesses changes since the last approval along the following dimensions, as appropriate: change in size/composition of the portfolio, market changes, model performance, model changes, status of any outstanding issues, scheduled activities including work carried over from previous reviews.

MRM also monitors the performance of RBS Group's portfolio of models. By engaging with the business and model users, MRM assesses whether models still capture underlying business rationale appropriately.

Risk culture and appetite

Risk culture

A strong risk culture, as part of a healthy organisational culture, is essential to the realisation of the RBS Group's ambition to build a truly customer-centric bank.

It seeks to create a strong risk culture that becomes part of the way people work and think. Such a culture should be supported by robust practices on risk identification, measurement and management, and on associated controls and governance. Risk competencies, mindsets and behaviours needed to support risk culture should be embedded across the organisation and made integral to performance reviews.

In 2015, significant steps were taken in measuring and benchmarking risk culture across all areas of the RBS Group. This has resulted in agreement on its target risk culture and initiatives needed to achieve it. While changing organisational culture will take time, risk culture objectives form a key part of individual performance objectives at all levels of the RBS Group.

The target risk culture is clearly aligned to the RBS Group's core values of "serving customers", "working together", "doing the right thing" and "thinking long term". They act as a clear starting point for a strong and effective risk culture.

Aligned to these values is the Code of Conduct. The Code provides guidance on expected behaviour and sets out the standards of conduct that support the values. It explains the effect of decisions that are taken and describes the principles that must be followed.

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

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

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

Each question is a prompt to think about the situation and how it fits with the Group's values. It ensures that employees can think through decisions that do not have a clear answer, guiding the judgements behind their decisions and actions.

If conduct falls short of the RBS Group's required standards, the accountability review process is used to assess how this should be reflected in pay outcomes for those individuals concerned. The RBS Group Performance and Remuneration Committee also consider risk performance and conduct when determining overall bonus pools. The Committee's decisions on pay aim to reinforce the need for good behaviours by all employees.

The RBS Group's policies require that risk behaviour assessment is incorporated into performance assessment and compensation processes for enhanced governance staff.

Risk-based key performance indicators

The RBS Group-wide remuneration policy requires remuneration to be aligned with, and to support, effective risk management. The policy ensures that the remuneration arrangements for all employees reflect the principles and standards prescribed by the UK Remuneration Code.

Training

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

The RBS Group offers a wide range of risk learning across the risk disciplines: Market Risk; Credit Risk; Operational Risk; Enterprise Risk; and Conduct and Regulatory Risk. This training can be mandatory, role specific or for personal development and includes technical and behavioural content.

Financial review Capital and risk management

There is mandatory learning that has to be completed by everyone and is focused on keeping employees, customers and the Group safe. This learning is accessed via the online learning system and is dependent on their role and business area. This makes it easy for employees to access and complete and allows monitoring at all levels to ensure completion.

Risk appetite

Risk appetite is the way in which the RBS Group expresses the level of risk it is willing to accept in order to achieve its strategic, business and financial objectives.

It is key to ensuring overall safety and soundness and in embedding a strong risk culture throughout the Group.

The RBS Group Board reviews and approves the risk appetite framework annually, establishing the level and types of risks the Group is able and willing to take in order to meet its:

- Strategic objectives - The strategic plan is built on the core foundations of serving customers well, building a sustainable risk profile and creating long-term value for its shareholders; and
- Wider obligations to stakeholders - If the Group is safe and sound and puts serving customers at the heart of its thinking, it will also perform well for its owners, employees, regulators and communities.

Risk appetite is set for material risks and is cascaded and embedded across the Group. It clearly informs, guides and empowers the businesses to execute their strategies within risk appetite.

Strategic risk appetite

The RBS Group's risk appetite framework is designed to ensure the Group remains safe and serves customers as well as its wider stakeholders.

The RBS Group Board has set out four key strategic risk appetite objectives, aligned with the strategic plan, which provide the boundaries within which the risk appetite for all material risks is set. The strategic risk appetite objectives are:

- **Maintain capital adequacy.** To ensure there is sufficient capital resources to meet regulatory requirements and to cover the potential for unexpected losses.
- **Deliver stable earnings growth.** To ensure that strategic growth is based around a longer-term risk-versus reward consideration, risk appetite is set at a level where the Group would remain profitable under severe stress.
- **Designed to ensure stable and efficient access to funding and liquidity.** To ensure that there is sufficient funding to meet its obligations, taking account of the constraint that some forms of funding may not be available when they are most needed.
- **Maintain stakeholder confidence.** To ensure that the Group is respected, valued and trusted by stakeholders (customers, employees, debt and equity investors, regulators and the wider community) to attain its strategic objectives, and establish and maintain an appropriate business culture and operational controls.

The strategic risk objectives are the bridge between the RBS Group-wide business strategy and the frameworks, limits and tolerances that are used to set risk appetite and manage risk in the business franchises on a day-to-day basis.

Risk appetite measures

Risk appetite starts with the strategic goals set by the RBS Board and is cascaded through key limits and risk tolerances that influence decision-making at all levels.

Risk appetite is set in a manner that:

- Is aligned to business and financial goals. The risk appetite framework ensures that risk is managed in a manner that aligns to and supports the attainment of business and financial objectives.
- Is meaningful to the business. Where possible risk appetite is expressed quantitatively and in a manner that can be cascaded meaningfully and unambiguously to the business. Risk control frameworks and limits set detailed tolerances and limits for managing risk (such as credit risk and market risk) on a day-to-day basis. These limits support, and are required to be consistent with, the strategic risk appetite.
- Considers performance under stress. The establishment and monitoring of risk appetite considers potential risk exposures and vulnerabilities under plausible stress conditions.

Effective processes exist for frequent reporting of the RBS Group's risks against agreed risk appetite to the RBS Group Board and senior management.

Risk appetite statements

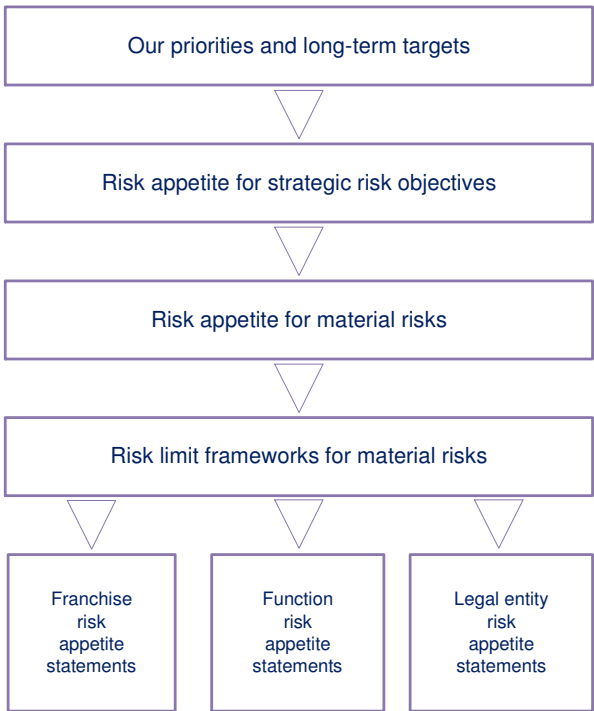
Risk appetite is set at RBS Group-wide level then cascaded and embedded across all businesses and support functions.

Each franchise, RBS Group-wide material risk owner, function and material legal entity is required to develop, own and manage a risk appetite statement that:

- Is aligned to strategic objectives and financial plans.
- Articulates the level of acceptable risk for all material risks.
- Sets out the escalation path to be followed in the event of a breach of risk appetite. The communication of risk appetite helps embed appropriate risk taking into the RBS Group's culture.

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Risk overview* continued



The communication of risk appetite helps embed appropriate risk taking into the RBS Group's culture.

Risk control frameworks and limits

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

The RBS Group Policy Framework directly supports the qualitative aspects of risk appetite, helping to rebuild and maintain stakeholder confidence the Group's risk control and governance. Its integrated approach is designed to ensure that appropriate controls, aligned to risk appetite, are set for each of the material risks it faces, with an effective assurance process put in place to monitor and report on performance. Risk appetite has its own policy within the RBS Group Policy Framework. This policy sets out clear roles and responsibilities to set, measure, cascade and report performance against risk appetite, and provides assurances that business is being conducted within approved risk limits and tolerances.

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Financial review Capital and risk management

Risk coverage

The main risk types faced by the Group are presented below. For further information, refer to pages 22 to 86.

Risk type	How the risk arises	2015 overview (1)
Capital adequacy risk	Capital adequacy risk arises from inefficient management of capital resources.	<p>The PRA monitors capital and leverage on a legal entity basis; the commentary below relates to NatWest, the most significant legal entity within the Group:</p> <ul style="list-style-type: none"> • The PRA transitional CET1 ratio decreased from 13.9% to 11.6%, reflecting the current year loss of £1.4 billion, including PPI provisions of £0.4 billion and the impairment of investments in US related subsidiaries of £1.6 billion. The loss on remeasurement of the retirement benefit schemes resulted in a CET1 capital reduction of £1.4 billion, which was partially offset by a capital injection of £800 million from RBS plc. • Modelled credit risk RWAs decreased by £1.5 billion, primarily Retail as a result of risk parameter improvements in PBB. • Standardised RWAs decreased by £6 billion, primarily reflecting a move from risk-weighting to capital deduction of significant investments in financial institutions, as part of phased in implementation of end-point CRR. • Leverage ratio was 4.7% at 31 December 2015.
Liquidity and funding risk	Liquidity and funding risk arise through the maturity transformation role that the Group performs and arises from day-to-day operations.	<ul style="list-style-type: none"> • The Group's liquidity portfolio, largely secondary liquidity comprising loans, was £48 billion (£45 billion within the UK group and £5 billion in UBIL) at 31 December 2015, an increase of £10 billion from 2014. The increase was due to higher mortgage loans available for discounting reflecting growth in UK PBB. • Third party customer loan:deposit ratio was broadly unchanged at 76% (2014 - 75%) as reductions in Capital Resolution were broadly offset by mortgage growth in UK PBB. Third party customer loans, increased by £5 billion to £167 billion, reflecting UK PBB lending growth, and third party customer deposits increased by £2 billion mainly within UK PBB and Commercial Banking.
Business risk	Business risk arises from exposure to, and the ability to assess the impact of, changes in the macro-environment, competition, business operations and technology.	<ul style="list-style-type: none"> • The Group reduced its business risk profile by implementing its strategic plan to shift the business mix towards the UK and the retail and commercial banking segments, with riskier activities in CIB and Capital Resolution curtailed via disposals and run-down. • The Group continued with its simplification agenda and cost reduction programme.

Note:

(1) Refer to page 220 for abbreviations and acronyms.

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Financial review Capital and risk management

Risk overview* continued

Risk type	How the risk arises	2015 overview
Reputational risk	Reputational risk can arise from the conduct of employees; activities of customers and the countries in which they operate; provision of products and transactions; as well as operations and infrastructure.	<ul style="list-style-type: none"> The importance of reputational risk was reinforced with the implementation of a Reputational Risk Policy across business franchises and functions to improve the identification, assessment and management of customers and issues that present a reputational risk. The most material threats to the Group's reputation continued to originate from historical and more recent conduct issues. As a result, the Group has been the subject of investigations and reviews by a number of its regulators, some of which have resulted in fines and public censure.
Conduct and regulatory risk	<p>Conduct risk arises if customers are not treated in line with their and other stakeholders' expectations. Conduct risk also arises if the Group does not take effective action to prevent fraud, bribery and money laundering.</p> <p>Regulatory risk arises from the Group's regulatory, business or operating environments and the Group's response to them</p>	<ul style="list-style-type: none"> Conduct and litigation costs were £2.8 billion in 2015 compared with £1.0 billion in 2014 and included additional provisions of £2.1 billion for historical investment banking activity in the US and £0.4 billion for PPI. The Group continued to remediate historical conduct issues, while also focusing its customer-facing businesses and support functions around the needs of its customers. A new Conduct Risk Appetite Framework was established. The RBS Group implemented programmes to prepare for ring-fencing and the UK's new individual accountability regime, as well as other future regulatory requirements; there was significant investment in anti-money laundering controls, governance and training.
Operational risk	Operational risk arises from a failure to manage operations, transactions and assets appropriately. It may arise from human error, an inability to deliver change on time or adequately, or the unavailability of technology services or the loss of customer data. Fraud and theft are sources of operational risk, as is the impact of natural and man-made disasters. It may also arise from a failure to take appropriate measures to protect assets or take account of changes in law.	<ul style="list-style-type: none"> The functional operating model for operational risk was embedded, with the aim of ensuring this is managed consistently across the Group. This supplemented work by the customer businesses to improve understanding of the operational risk profile and the actions required to mitigate risks outside of appetite. Following the major IT incident of 2012, there was further significant investment in upgrading core banking technology infrastructure and in improving a broad range of processes and tools. The threat to the security of the Group's information from cyber attacks continued to be closely monitored. During 2015 the RBS Group participated in industry-wide cyber attack simulations in order to help test and develop defence planning. Actions taken to mitigate the risk included a large-scale programme to improve user access controls, a reduction in the number of external websites, and enhanced protection against malware. RBS Group operational risk continued to oversee the execution of major projects, including the transformation plan, the restructuring of CIB and the divestment of Williams & Glyn. This ensured the associated risks were assessed and understood with mitigating activity in place wherever possible.

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Financial review Capital and risk management

Risk type	How the risk arises	2015 overview
Pension risk	The Group is exposed to pension risk through its defined benefit schemes and the variations in their value.	<ul style="list-style-type: none"> Following developments in pension accounting and reporting during 2015, the Group revised its policy for determining whether or not it has an unconditional right to a refund of any surpluses in its employee pension funds and also revised prior periods. The incremental impact of this, combined with the one-off accelerated payment made in March 2016, is anticipated to improve the Group's risk profile, capital planning, and resilience through the period to 2019. The accelerated payment is also expected to provide the main scheme trustee with more flexibility over investment strategy. Subject to PRA approval, the adverse CET1 capital impact resulting from the accounting policy change and the accelerated payment is expected to be partially offset by a reduction in CET1 capital requirements. Any such core capital offsets are likely to occur at the earliest from 1 January 2017, but they will depend on the PRA's assessment of the Group's CET1 capital position at that time.
Credit risk	Credit risk arises from lending and AFS debt securities. Counterparty credit risk results from derivatives and securities financing transaction activities.	<ul style="list-style-type: none"> The growth in UK PBB gross mortgage lending reflected the strategy to refocus the Group's business on the UK market, as well as improving economic conditions and increasing house prices in a continuing low interest environment. Asset quality improved due to continued focus on reducing risk concentrations and the reduction in exit portfolios driven by the RCR disposal strategy as well as improving economic and market conditions in the UK and Ireland. Credit quality remained stable, with risk elements in lending decreasing to £8.4 billion (4.8% of gross customer loans) at 31 December 2015, from £19.8 billion (11.2%) at 31 December 2014 and were covered by impairment provision by 64% or £5.4 billion (2014 - 70% or £13.9 billion). Credit metrics principally reflected Capital Resolution disposals and the impact of supportive economic conditions.
Market risk	<p>The majority of the Group's market risk relates to non-traded market risk exposure from retail and commercial banking activities from assets and liabilities that are not classified as held for trading.</p> <p>Traded market risk exposure arises in ClB and Capital Resolution through transactions in financial instruments primarily in debt securities, securities financing and derivatives.</p>	<ul style="list-style-type: none"> The Group's average internal non-trading interest rate VaR, largely sterling related, was broadly unchanged at £96 million (2014 - £104 million), albeit period end VaR was slightly higher at £90 million (2014 - £87 million), reflecting increased exposure to medium-term interest rates. Market risk is higher than at RBS Group because some structural interest rate risk exposures are hedged at a consolidated level. NatWest's average and period end internal trading VaR was broadly unchanged in 2015 compared to 2014. RBSSI's average internal trading VaR decreased to £1.3 million (2014 - £7.4 million), primarily reflecting strategic exits including from US asset-backed products trading in the first half of 2015.

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Financial review Capital and risk management

Capital management*

Definition

Capital management lies at the core of the RBS Group's strength and sustainability goals. The Group defines capital as that part of the liability side of its balance sheet that has the capacity to absorb losses. The construction of capital starts with Common Equity Tier 1 (CET1) and other classes of capital such as Additional Tier 1 (AT1) and Tier 2. The Group will build up sufficient minimum requirements for eligible liabilities (MREL) over the coming years in line with regulatory requirements. Capital management involves the optimisation and efficient use of capital required by businesses, the outcomes of stress testing, the requirements of the market and the regulators and the supply of adequate forms of capital at acceptable prices.

The Prudential Regulatory Authority (PRA) monitors capital and leverage on a legal entity basis. Consequently, quantitative capital, leverage and RWA disclosures for significant legal entities within the Group, primarily NatWest and to a lesser extent Ulster Bank Ireland Limited (UBIL), are included in this section; capital is based on a CRR transitional basis and leverage on CRR Delegated Act.

Overview and key developments

- NatWest:
 - CET1 ratio decreased from 13.9% to 11.6%, reflecting the current year loss of £1.4 billion, including PPI provisions of £0.4 billion and the impairment of investments in US related subsidiaries of £1.6 billion following additional provisions relating to US RMBS litigation. The loss on remeasurement of the retirement benefit schemes resulted in a CET1 capital reduction of £1.4 billion, which was partially offset by a capital injection of £800 million from RBS plc.
 - Modelled credit risk RWAs decreased by £1.5 billion, primarily Retail as a result of risk parameter improvements in PBB.
 - Standardised RWAs decreased by £6 billion primarily reflecting a move from risk-weighting to capital deduction of significant investments in financial institutions, as part of phased in implementation of end-point CRR.
 - Leverage ratio was 4.7% at 31 December 2015.
- UBIL:
 - CET1 ratio improved from 17.3% to 29.6%. 2015 CET1 ratio benefited from the inclusion of £0.9 billion of 2014 profit.
 - RWAs were £5.0 billion lower with the contributors being the reduction in the tracker mortgage portfolio, lower Central Bank of Ireland add-on for corporate exposures and exchange rate measurements.
 - Leverage ratio was 24.0 % at 31 December 2015, reflecting the strong capital position.

Risk appetite and strategy

Risk appetite

The RBS Group's risk appetite framework establishes appetite targets on quantitative and qualitative measures which are set by the Board, aligned with its key strategic risk objectives. Capital risk appetite is set at the holding company level and cascaded to material subsidiaries to help inform capital targets alongside other quantitative measures such as Individual Capital Guidance set annually by the PRA.

The RBS Group has a capital management framework including policies and procedures that are designed to measure actual and projected capital performance against risk appetite, ensures that it continues to comply with regulatory requirements and is positioned to meet anticipated future changes to its capital requirements.

The RBS Group's capital risk appetite at the holding company level, which informs its capital targets at subsidiary levels, is reviewed and set annually by the Board. Capital risk appetite sets target ratios for CET1 and leverage under stress scenarios and reverse stress tests. These then inform capital targets. The RBS Group also looks at other factors that may impact capital targets such as double leverage, distributable reserves, capital headroom to Maximum Distributable Amount (MDA) and intra group limits and exposures. Risk appetites are also set at legal entity level and may encompass additional specific risk measures such as intra group exposures and limits and double leverage.

Strategy

The Group maintains a sufficient level of capital that allows it to operate over its strategic horizon with an agreed risk appetite in pursuit of its business strategy, taking into account regulatory requirements, support for customers and to provide confidence to stakeholders.

The RBS Group is able to accumulate additional capital through the reduction in RWAs (either through disposals or natural attrition) accumulation of profits over time, by raising new equity via, for example, a rights issue or debt exchange and by raising AT1 and Tier 2 capital by issuing subordinated liabilities at the holding company level and downstreaming to subsidiaries such as NatWest. The cost and availability of additional capital is dependent upon market conditions and perceptions at the time. The RBS Group is also able to manage the demand for capital through management actions including adjusting its lending strategy, risk hedging strategies and through business disposals.

The level of CET1 at the consolidated level and within specific legal entities is the cornerstone of capital strategy. Complementing CET1, the RBS Group issues externally and will allocate internally AT1 capital, Tier 2 capital and looking forward, MREL instruments in accordance with internal needs, regulatory requirements and strategic plans. The amount of additional capital is determined as part of the annual budgeting cycle, by market conditions and through ongoing dialogue with regulators. It is under constant review and evaluation to ensure that it provides efficient and optimally valued benefits at all times.

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Financial review Capital and risk management

The capital raising strategy is driven by two factors: the optimal blend to satisfy regulatory requirements, and the most cost effective means of financing. The RBS Group has a range of instruments available to it both internally and externally. It also has legacy capital instruments that may still have some transitional benefits under the changing regulatory framework. The RBS Group constantly looks at the value and efficiency provided by those instruments and will take such market related actions to the extent that circumstances and conditions merit such action. The RBS Group's policy is to manage its externally issued portfolio of debt securities at holding company and subsidiary level for value.

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Financial review Capital and risk management

Capital management* continued

Framework and governance

The framework for capital management within the RBS Group first looks at the sources and drivers of risk based capital requirements. Through the internal budget and planning cycle, and increasingly through stress testing, each franchise balances the blend of products that is offered to customers, having regard to the impact of each on capital and leverage against the backdrop of the overall business strategy. Capital and risk management, including capital planning (refer page 25), stress testing and ICAAP, are conducted on an overall basis within the RBS Group such that common frameworks and models apply across the RBS Group. Therefore, for the most part, discussions on these aspects reflect those in the RBS Group as relevant for the businesses and operations in the Group.

A number of tools and processes taken together contribute to an integrated view of capital management. The diagram below presents this view:

Governance

The RBS Group Board sets the strategic direction and ensures that the RBS Group manages risk effectively by approving and monitoring its strategic risk appetite, considering RBS Group-wide stress scenarios and agreed mitigants, as well as identifying longer-term strategic threats to the business operations. The Board also approves the ICAAP.

Capital planning

- The RBS Group uses the budgeting cycle to forecast future capital requirements at CET1, Tier 1, Tier 2 and total capital levels including MREL at both holding company level and major operating entity level. Forecasts are measured against minimum regulatory requirements and specific regulatory guidance such as the Individual Capital Guidance.
- Strategic considerations in the medium-term capital plan will be driven by key impacts such as a more restrictive approach to the capital base, higher capital ratio targets and enhanced risk coverage.

Stress testing (and use of)

- This is an integral part of capital planning. Stress testing results are produced through the same capital planning and stress testing models used for the budgeting and monthly review.
- In addition to informing the ICAAP, stress testing in the RBS Group is a key risk management tool used to support strategic financial planning, risk appetite, risk identification and risk mitigation.
- Stress testing results are presented to senior management (and BRC/Board) periodically, and used to assess capital impacts of business decisions.

Recovery and resolution planning

The RBS Group prepares an annual recovery plan, which include a framework of indicators identifying the points at which appropriate actions may be taken in the event of unexpected weaknesses in its capital or liquidity resulting from either idiosyncratic or systemic stress, as well as a menu of options for addressing such weaknesses. The RBS Group's 2015 Recovery Plan was prepared in line with the PRA's requirement that banks prepare, maintain and review recovery plans.



Internal Capital Adequacy Assessment Process (ICAAP)

The ICAAP assesses the RBS Group's material risks determining how much capital is required to cover these risks. The ICAAP consists of two types of internal capital assessment:

- a Point-in-time capital assessment as at the financial year end, and
- a Forward-looking stress capital assessment.

The final ICAAP is approved by the RBS Group Board prior to submission to the PRA.

Assessing, monitoring and maintaining adequate capital.

It is the RBS Group's policy to build and sustain a strong capital base and to use it efficiently throughout its activities to support strategic objectives and optimise shareholder returns while maintaining a prudent relationship between its capital base and the underlying risks of the business, including the risk of excessive leverage.

Board Risk Committee (BRC)

With sight of various risk types the RBS Group Board Risk Committee (BRC) is responsible for providing oversight and advice to the Board in relation to current and potential future risk exposures of the RBS Group and future risk strategy, including determination of risk appetite and tolerance.

Capital Risk Assessment (CRA)

CRAs are annual 'top down' processes to help identify, understand and assess material risks. Consideration is given to whether and how much capital should be set aside against each risk type forming a key input to the ICAAP. For effective risk management CRAs are marked against financial or non-financial thresholds.

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Financial review Capital and risk management

Capital planning

Capital and leverage is actively managed and regulatory ratios are a key factor in the RBS Group's planning processes and stress analyses. Capital planning is an activity undertaken within Treasury to determine the appropriate amount of capital needed over the budget horizon under both base and stress projections using both risk and leverage based assessment tools and given a specific risk appetite.

Capital plans are derived for the RBS Group overall and its major operating, regulated entities. Capital plans are prepared in compliance with specific regulatory rules (for example CRD IV) and in accordance with system wide and local, specific regulatory guidance. Capital plans for UK regulated entities are drawn up centrally whereas capital plans for non-UK regulated entities are drawn up locally and subject to central review and challenge to ensure consistency of approach and adherence to capital management policies. Capital plans take into account any funding arrangements between the holding company entity and operating entities. The RBS Group is transitioning to a single point of entry (SPE) structure under the Independent Commission on Banking's (ICB's) ringfencing requirements. This creates a need to actively manage any legacy securities issued externally by the operating entities and any internal funding arrangements between entities, particularly the holding company.

The starting point for any capital plan will be with the annual budget cycle which forecasts the Group's balance sheet trajectory over a 5 year forward looking horizon. The budget cycle will incorporate assumptions about the future shape and direction of the balance sheet of the RBS Group and its operating entities. It will include assumptions around the future path of RWAs, profitability and tax. Idiosyncratic factors such as conduct and litigation costs and disposals are also considered. Finally known or expected system or firm specific regulatory guidance (for example phasing in of CRD IV assumptions or leverage requirements) are also considered.

The capital plans are tested for capital adequacy and measured against the RBS Group's risk appetite framework using a range of stress scenarios covering adverse economic conditions as well as other adverse factors that could impact the bank. In addition the RBS Group maintains a recovery plan, including for designated significant legal entities within the Group, which sets out a range of potential mitigating actions that could be taken in response to an extreme stress. Known and expected assumptions around the future direction of regulation is also taken into account. Furthermore specific idiosyncratic risks such as conduct risk are factored into capital plans.

From these inputs a forecast will be derived on how much capital is required to support these assumptions using both risk and leverage based approaches. This will estimate the required amount of CET1 through to non-capital minimum requirement eligible liabilities (MREL) in each period over the forecast.

Once the capital plan is approved it is then subject to ongoing review and assessment to reflect changes to the underlying components such as forecasts or new regulatory guidance or assumptions. Shorter term forecasts are more frequently undertaken to understand and respond to variations of actual performance against the plan.

Capital policies and procedures are subject to independent oversight. Regular reporting of actual and projected capital and leverage ratios, including those in stressed scenarios, is undertaken, including submissions to the RBS Group's ALCo, ERF, EXCo, Board Risk Committee and the Board.

The regulatory framework within which the RBS Group operates continues to be developed at a global level through the FSB and Basel Committee, at a European level mainly through the issuance of CRD IV technical standards and guidelines and within the UK by the PRA and through directions from the FPC.

The RBS Group continues to monitor regulatory developments very closely, analysing the potential capital impacts to ensure it continues to maintain a strong capital position that exceeds the minimum regulatory requirements and risk appetite and is consistent with market expectations.

Capital requirements: Pillar 1 and 2

Capital demand is normally the aggregation of Pillar 1, Pillar 2A, the greater of the CRD IV or Pillar 2B buffers, and any management buffer (for example over and above MDA). Pillar 2 is becoming an increasingly important component of our capital requirements.

Pillar 2A is determined through the ICAAP process mentioned herein and reflects RBS Group specific risks. Factors driving Pillar 2 requirements include operational risk, interest rate risk in the banking book, credit concentration risk and pension risk amongst others.

The Pillar 2B requirement and recently introduced PRA buffer reflects the impact of stress through the analysis undertaken in annual ICAAP. The amount of stress capital may well also be informed by performance under the new regulatory stress testing process. The amount of stress based capital requirement is the higher of Pillar 2B or the CRD IV risk buffers plus any management buffer.

A management buffer may be overlaid on top of that to reflect additional risks that the RBS Group Board believe are prudent to cover (such as headroom over and above any MDA threshold).

Capital supply

Capital supply consists of the amount of CET1, AT1, Tier 2 and, going forward, non-capital MREL securities in existence at any one time.

*unaudited

Financial review Capital and risk management

Capital management* continued

Regulatory developments and the impact on RBS Group and its subsidiaries' current and future capital position

Regulatory proposals and rules issued or set by the following regulators are the most relevant for the RBS Group:

- Basel - recommendations for all major international institutions - usually through Basel Committee of Banking Supervision (BCBS);
- EU - issue consistent rules for all EU banks and investment firms, commonly through the European Banking Authority (EBA); and
- PRA - additional local rules for UK banks and investment firms.

Capital

Following the implementation of the Basel III proposals through the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), collectively known as CRR/CRD IV, which came into effect on 1 January 2014, the regulatory drive towards improved capital standards for banks continues and is centred on three broad themes:

- Robust definitions of capital for CET1 and leverage purposes that are not dependent on one or more economic cycles;
- Improved strength of banks, with strategic plans and business models capable of undergoing one or more significant stress events; and
- Valid and viable recovery plans in place for banks to return to normality after a period of stress or, easy application of the resolution frameworks.

Many of these aspects still require analysis and debate and therefore any implementation is likely to take many years.

CRR/CRD IV introduced the following minimum requirements to be met by 2019:

- Pillar 1 requirement of: CET1 of 4.5% of RWAs; Tier 1 of 6%; and total capital of 8%; and
- CRD IV Combined buffers: capital conservation buffer of 2.5% of RWAs; countercyclical capital buffer of up to 2.5%; GSIB surcharge of 1.0% for the RBS Group based on the most recent determination from the FSB.

The PRA policy statement PS7/13 outlined changes to the minimum level of CET1 capital for large UK banks as follows:

- The PRA required UK banks to meet the CRD IV end point Pillar 1 requirement from 1 January 2015;
- All Pillar 2A risks must be met with at least 56% CET1 capital. This matches the proportion of CET1 capital required for Pillar 1. The remaining (44%) allocation of Pillar 2A is restricted to 19% Tier 1 and 25% Tier 2; and
- All regulatory deductions from capital align CET1 with the end-point CRR definition, effectively making fully loaded Basel III the regulatory definition.

The PRA issued Policy Statement 17/15 in July 2015 setting out the Pillar 2 capital requirements for UK banks. The changes are intended to support a more risk sensitive and consistent approach to setting Pillar 2A (P2A) capital and to provide greater transparency of the PRA capital setting process by allowing firms to manage present and future regulatory capital demands. Implementation is from 1 January 2016 in line with the CRD IV capital conservation and systemic buffers and the European Banking Authority's Supervisory Review and Evaluation Process guidelines. The changes are as follows:

- The variable element of P2A is now expressed as a percentage of RWAs plus fixed add-ons instead of the current method where P2A is a formula comprising both a variable and a fixed element;
- The PRA buffer replaces the current Capital Planning Buffer (CPB). Use of the buffer will not be a breach in capital requirements and will not result in capital distribution restrictions however, failure to meet Pillar 2B (P2B) buffer may result in enhanced supervisory action;
- The P2B buffer, presently applicable only for RBS Group, is now calculated as a percentage of RWAs rather than absolute terms and is to be met with CET1;
- Firms already subject to a CPB are required to meet P2B with CET1 in full immediately;
- Where the PRA considers that firms have weak risk management or governance, PRA may require firms to hold additional PRA buffer on a scalar ranging from 10-40% of a firm's CET1 Pillar 1 plus P2A capital requirements; and
- Firms have the discretion to publicly disclose their aggregate P2A charge from 1 January 2016. Component parts of P2A and the PRA buffer remain confidential.

Leverage

The RBS Group's leverage ratio requirements are also subject to the following key aspects (consistent with proposals outlined in PS27/15 - 'Implementing a UK leverage ratio framework'):

- Minimum Tier 1 leverage ratio of 3%. To be met 75% by CET1 and a maximum 25% fully CRD IV compliant AT1;
- A supplementary leverage buffer applying to GSIBs equal to 35% of the corresponding risk-weighted systemic risk buffer rates to be met with CET1; and
- A countercyclical leverage ratio buffer equal to 35% of the risk-weighted countercyclical capital buffer rate to be met from CET1. The countercyclical buffer is currently set at 0%.

Stress testing

In October 2015, the BoE published its approach to stress testing of the UK banking system out to 2018. The publication outlines the following key features of the BoE approach:

- A cyclical scenario to assess the risks to the banking system based on the financial cycle.
- The severity of the scenario to be counter-cyclical in nature.

*unaudited

Financial review Capital and risk management

- Every second year, the BoE will complement the annual testing with an additional exploratory scenario to probe the resilience of the system to risks not easily linked to the financial cycle.
- The BoE intends to include an integrated framework for decision-making around the setting of capital buffers, as well as a clear and transparent process for determining whether banks need to strengthen their capital positions.
- A hurdle rate framework is to be enhanced, and will align to the overall capital framework. Within the hurdle rate, a bank will be expected to meet all of its minimum risk-based CET1 capital requirements (Pillar 1) in the scenario, as well as Pillar 2A CET1 requirements. Additionally, GSIB buffers will be included in the hurdle rate.

As a major UK bank, the RBS Group will be included in the annual cyclical scenarios and may also be required to participate in the biennial exploratory scenario stress tests to the extent that the risks being probed are relevant to it.

MREL and TLAC

The banking resolution and recovery directive introduces requirements for banks to maintain at all times a sufficient aggregate amount of own funds and eligible liabilities (that may be bailed in using the bail-in tool), known as the minimum requirements for eligible liabilities (MREL). The aim is that the minimum amount should be proportionate and adapted for each category of bank on the basis of their risk or the composition of their sources of funding.

The EBA noted that the technical standards would be compatible with the proposed term sheet published by the FSB on TLAC requirements for GSIBs, but there remains a degree of uncertainty as to the extent to which MREL and TLAC requirements may differ.

Following the FSB finalising its TLAC proposals in November 2015, the PRA published its proposed requirements for MREL which will be the way in which the UK implements the TLAC standard. MREL will apply to GSIBs from 2019 and to other relevant UK firms from 2020. The purpose of MREL is to ensure that, in the event of failure, a bank has sufficient loss-absorbing and recapitalisation capacity to allow for an orderly resolution that minimises any adverse impact on financial stability whilst preventing public funds being exposed to loss. The requirements will be firm-specific but the PRA's consultation paper proposes that MREL will be required:

- At a consolidated and individual bank level, including for the holding entity of a banking group.
- At an amount at least equal to two times the current minimum Pillar 1 and Pillar 2A capital requirements, or, if higher, any applicable leverage ratio requirement, or the minimum capital requirements under Basel plus any applicable CRD IV capital buffers: once for loss absorbency, once for recapitalisation

Regulatory proposals relating to Domestically Systemically Important Banks (DSIBs) and Other Systemically Important Institutions (OSII) continue to be progressed and could impact the level of CET1 that is required to be held by the RBS Group and specific legal entities including NatWest and the Royal Bank. The EBA published in December 2014 a quantitative methodology as to how European regulators could quantify which firms would qualify as DSIBs. The PRA published CP39/15 on this in October 2015, and published its list of the sixteen firms designated as OSII; the RBS Group is included within this list.

Systemic risk buffer (SRB)

In January 2015, HM Treasury issued an explanatory memorandum on the SRB for banks, building societies and investment firms. The regulation implements Articles 133 and 134 of Directive 2013/36/EU and addresses the outstanding capital buffer element of the ring-fencing policy recommended by the ICB and agreed by the UK Government.

The purpose of the SRB is to prevent and mitigate long term non-cyclical systemic or macro prudential risks not covered by existing regulation where there is potential for serious negative consequences for the financial system and real economy

The SRB will apply to large banks with core (ring fenced entity) deposits of more than £25 billion and large building societies with deposits of more than £25 billion. Implementation will occur from 1 January 2019 and capital buffers will range from 0-3% of a firm's RWAs.

On 29 January 2016, the FPC proposed that those banks and building societies with total assets above £175 billion will be set progressively higher SRB rates as total assets increase through defined buckets. HM Government required the FPC to produce a framework for the SRB at rates between 0% and 3% of RWAs. Under the FPC's proposals, ring-fenced bank sub-groups and large building societies in scope with total assets below £175 billion will be subject to a 0% SRB. Based on current information, under these proposals the FPC expects the largest ring-fenced bank in 2019 to have a 2.5% SRB. In line with the FPC's previous announcement on the leverage ratio framework, those institutions subject to the SRB will also be set a 3% minimum leverage ratio requirement, together with an additional leverage ratio buffer calculated at 35% of the applicable SRB rate. For example, an institution with an SRB rate of 1% would have an additional leverage ratio buffer of 0.35%. The proposed calibration is expected to add around an aggregate 0.5 percentage points of risk-weighted assets to equity requirements of the system in aggregate.

The PRA will be responsible for applying the framework and will have ultimate discretion over which firms must hold the buffer and its specific size. This framework will apply to NatWest given its size.

Financial review Capital and risk management

Capital management* continued

Ring-fencing

- The UK Financial Services (Banking Reform) Act passed into UK law in December 2013 implementing recommendations of the ICB. The PRA is in the process of finalising its rules with respect to ring-fencing.
- The PRA is consulting on the need for firms to hold capital resources equivalent to at least 25% of annual fixed overheads in respect of critical services to facilitate operational continuity in resolution.

*unaudited

Financial review Capital and risk management

Measurement

Capital, RWAs and leverage ratios

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

Capital (2)	2015		2014 (1)	
	NatWest £bn	UBIL £bn	NatWest £bn	UBIL £bn
CET1	7.2	5.7	9.5	4.2
Tier 1	7.2	5.7	9.6	4.2
Total	12.1	6.2	14.8	4.7

RWAs

Credit risk				
- non-counterparty	54.4	17.8	61.7	22.5
- counterparty	0.4	0.3	0.6	0.4
Market risk	0.6	—	0.5	—
Operational risk	6.4	1.1	5.5	1.3
	61.8	19.2	68.3	24.2

Risk asset ratios	%	%	%	%
CET1	11.6	29.6	13.9	17.3
Tier 1	11.6	29.6	14.0	17.3
Total	19.6	32.1	21.7	19.5

Leverage

Tier 1 capital (£bn)	7.2	5.7
Exposure (£bn)	153.1	23.7
Leverage ratio (%)	4.7	24.0

Notes:

- (1) Capital and leverage ratios have not been impacted by the pension accounting policy change.
- (2) Capital Requirements Regulation (CRR) as implemented by the Prudential Regulation Authority in the UK, with effect from 1 January 2014. All regulatory adjustments and deductions to CET1 have been applied in full for with the exception of unrealised gains on available-for-sale (AFS) securities which has been included from 2015 under the PRA transitional basis.
- (3) UBIL 2014 profit (unverified for regulatory reporting purposes in 2014) is excluded from 2014 but included in 2015.

General:

In accordance with the PRA's Policy Statement PS7/2013 issued in December 2013 on the implementation of CRD IV, all regulatory adjustments and deduction to CET1 have been applied in full (end-point CRR) with the exception of unrealised gains on AFS securities which will be included from 2015 (PRA transitional basis).

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

Measures in relation to end-point CRR basis, including RWAs, are based on the current interpretation, expectations, and understanding, of the CRR requirements, as well as further regulatory clarity and implementation guidance from the UK and EU authorities (end-point CRR basis). The actual end-point CRR impact may differ when the final technical standards are interpreted and adopted.

Capital base:

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

Risk-weighted assets (RWAs):

- (1) Current securitisation positions are shown as risk-weighted at 1,250%.
- (2) RWA uplifts include the impact of credit valuation adjustments and asset valuation correlation on banks and central counterparties.
- (3) RWAs reflect implementation of the full internal model method suite, and include methodology changes that took effect immediately on CRR implementation.
- (4) Non-financial counterparties and sovereigns that meet the eligibility criteria under CRR are exempt from the credit valuation adjustments volatility charges.
- (5) The CRR final text includes a reduction in the risk-weight relating to small and medium-sized enterprises.

*unaudited

Financial review Capital and risk management

Capital management* continued

Capital resources

	2015		2014	
	NatWest £m	UBIL £m	NatWest £m	UBIL £m
Shareholders' equity	11,282	5,753	13,312	5,081
Regulatory adjustments and deductions				
Defined benefit pension fund adjustment	—	142	—	320
Cash flow hedging reserve	1	—	3	—
Deferred tax assets	(622)	(210)	(742)	—
Prudential valuation adjustments	(1)	—	(1)	—
Goodwill and other intangible assets	(498)	—	(530)	—
Expected losses less impairments	(703)	(22)	(785)	(3)
Instruments of financial sector entities where the institution has a significant investment	(2,413)	—	(2,318)	—
Significant investments in excess of secondary capital	(424)	—	—	—
Other regulatory adjustments	532	27	529	(1,217)
	(4,128)	(63)	(3,844)	(900)
CET1 capital	7,154	5,690	9,468	4,181
Additional Tier 1 (AT1) capital				
Qualifying instruments and related share premium subject to phase out	204	—	234	—
Tier 1 deductions				
Instruments of financial sector entities where the institution has a significant investment	(187)	—	(140)	—
Tier 1 capital	7,171	5,690	9,562	4,181
Qualifying Tier 2 capital				
Qualifying instruments and related share premium	5,058	492	5,380	528
Tier 2 deductions				
Instruments of financial sector entities where the institution has a significant investment	(92)	—	(102)	—
Other regulatory adjustments	—	(7)	(8)	(5)
	(92)	(7)	(110)	(5)
Tier 2 capital	4,966	485	5,270	523
Total regulatory capital	12,137	6,175	14,832	4,704

Note:

(1) Regulatory capital for 2014 has not been impacted by the change in accounting policy for pensions.

Leverage exposure

The leverage exposure is based on the CRR delegated act.

	2015	
	NatWest £bn	UBIL £bn
Leverage		
Derivatives	2.1	0.7
Loans and advances	207.6	19.9
Other assets	10.7	2.2
Total assets	220.4	22.8
Derivatives		
- netting	(1.4)	(0.1)
- potential future exposures	0.2	0.2
Undrawn commitments	9.9	1.0
Regulatory deductions and other adjustments	(5.2)	(0.2)
Exclusion of intra-group exposures between Core UK group	(70.8)	—
Leverage exposure	153.1	23.7

*unaudited

Financial review Capital and risk management

Liquidity and funding risk

Definition

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.

All the quantitative disclosures in this section are audited.

Sources of funding and liquidity

The risk arises through the maturity transformation role that banks perform. It is dependent on Group specific factors such as maturity profile, composition of sources and uses of funding, the quality and size of the liquidity portfolio as well as broader market factors, such as wholesale market conditions alongside depositor and investor behaviour.

The Group's primary funding source is its customer deposit base, primarily built through its retail and commercial franchises in the UK and Ireland. These deposits form a stable base which fully funds the Group's customer lending activities. As one of the primary operating entities of the RBS Group, the Group's liquidity risk is monitored and managed centrally, on a fully integrated basis as part of the PRA regulated UK Domestic Liquidity Subgroup (UK DoLSUB).

Complementary to its deposit funding, the Group maintains access to various wholesale markets for funding, on both a public and private basis, across a range of currencies and maturities. The RBS Group has set policies for the prudent use of wholesale funding, as part of its wider liquidity policies.

The RBS Group accesses the wholesale funding markets directly or through its main operating subsidiaries via established funding programmes. The use of different entities to access the market from time to time allows the Group to further diversify its funding mix and in certain limited circumstances demonstrate to regulators that specific operating subsidiaries enjoy market access in their own right.

The Group may access various funding facilities offered by central banks from time to time. The use of such facilities can be both part of a wider strategic objective to support initiatives to help stimulate economic growth or as part of the broader liquidity management and funding strategy. Overall usage and repayment of available central bank facilities will fit within the overall liquidity risk appetite and concentration limits.

Overview and key developments

- The Group's liquidity portfolio at 31 December 2015 was £48.0 billion (carrying value - £74.5 billion), compared with £38.0 billion (carrying value - £62.1 billion) in 2014. The liquidity portfolio is largely secondary liquidity, being assets eligible for discounting at central banks. £64.0 billion by carrying value comprised UK mortgage lending, an increase from £51.9 billion at the end of 2014 reflecting the growth strategy in UK PBB.

- The Group includes three of the UK DoLSUB centrally managed liquidity portfolios, being National Westminster Bank Plc, Coutts and Co and Ulster Bank Limited. The UK DoLSUB component of the Group's liquidity portfolio represented £43.0 billion (2014 - £34.0 billion) with the remainder being Ulster Bank Ireland Limited.
- The customer loan:deposit ratio was broadly unchanged at 76% (2014 - 75%) as reduction in Capital Resolution was broadly offset by mortgage growth in UK PBB. Third party customer loans, increased by £5 billion to £167 billion reflecting UK PBB lending growth and third party customer deposits increased by £2 billion to £220 billion mainly within UK PBB and Commercial Banking.
- NatWest redeemed £387 million of Tier 2 subordinated debt during 2015.

Policy, framework and governance

Internal liquidity policies are designed to ensure that the Group:

- *Has a clearly stated liquidity risk tolerance:* appetite for liquidity risk is set by the RBS Group Board as a percentage of the Individual Liquidity Adequacy Assessment (ILAA) stressed outflows, and liquidity position is monitored against this risk tolerance on a daily basis. In setting risk limits the Board considers the nature of the RBS Group's activities, overall risk appetite, market best practice and regulatory compliance.
- *Has in place strategies, policies and practices to ensure that the RBS Group maintains sufficient liquidity:* the risk management framework determines the sources of liquidity risk and the steps that can be taken when these risks exceed certain actively monitored limits. These actions include when and how to use the liquid asset portfolio, and what other adjustments to the balance sheet should be undertaken to manage these risks within the RBS Group's risk appetite.
- *Incorporates liquidity costs, benefits and risks in product pricing and performance management:* The Group uses internal funds transfer pricing to ensure that these costs are reflected in the measurement of business performance, and to correctly incentivise businesses to source the most appropriate mix of funding.

The RBS Group Asset and Liability Management Committee (ALCo) sets and reviews the liquidity risk management framework and limits within the risk appetite set by the Board. ALCo, and by delegation the ALCo Technical Committee, oversees the implementation of liquidity management across the Group.

Regulatory oversight and liquidity framework*

The Group operates across multiple jurisdictions and is subject to a number of regulatory regimes.

*unaudited

Financial review Capital and risk management

Liquidity and funding risk continued

The principal regulator, the Prudential Regulation Authority (PRA), has a comprehensive set of liquidity regulations which were revised in 2015 to replace the existing BIPRU 12 regime with the CRD IV liquidity regime in the UK. To comply with the PRA regulatory framework, the RBS Group undertakes the following:

- An annual exercise to complete the Internal Liquidity Adequacy Assessment Process (ILAAP); and
- An annual Liquidity Supervisory Review and Evaluation Process (L-SREP) with the PRA, that involves a comprehensive review of the RBS ILAAP, liquidity policies and risk management framework. This results in the settings of the Individual Liquidity Guidance, which influences the size and overall composition of the liquidity portfolio.

On 1 October 2015 the LCR became the PRA's primary regulatory standard for liquidity, replacing the previous BIPRU 12 regime. LCR is being introduced on a phased basis and UK banks are initially required to maintain a minimum of 80% of LCR, rising to 100% by 1 January 2018.

The Basel Committee on Banking Supervision (BCBS) published its final recommendations for implementation of the NSFR in October 2014, proposing an implementation date of 1 January 2018, by which time banks are expected to meet an NSFR ratio of 100% from this point onwards. The EC has stated that it shall, if appropriate, submit a legislative proposal to the European Parliament by the end of 2016 for implementing the NSFR in the EU. In the meantime, RBS Group uses the definitions from the BCBS guidelines, and its own internal interpretations, to calculate the NSFR.

Measurement, monitoring and contingency planning

In implementing the liquidity risk management framework, a suite of tools are used to monitor, limit and stress test the risks within the balance sheet. The limits control the amount and composition of funding sources, asset and liability mismatches and funding concentrations, in addition to the level of liquidity risk.

Liquidity risks are reviewed at a significant legal entity level daily, and at a business level monthly, with performance reported to ALCos at least monthly. Any breach of internal metric limits will set in motion a series of actions and escalations that could lead to activation of the Contingency Funding Plan (CFP).

The RBS Group maintains a CFP, which forms the basis of analysis and management actions to be undertaken in a liquidity stress. The CFP is linked to stress test results and forms the foundation for liquidity risk limits. The CFP sets out the circumstances under which the plan would be invoked; this includes material worsening of liquidity condition indicators which are reported to senior management daily. It also prescribes a communications plan, roles and responsibilities, as well as potential management actions to take in response to various levels of liquidity stress. On invocation of the CFP, the Contingent Liquidity Team would be convened to identify the likely impact of the stress event and determine the appropriate management response.

*unaudited

Stress testing*

Under the liquidity risk management framework the RBS Group maintains the ILAA, a component of which is an assessment of net stressed liquidity outflows. These liquidity stress tests apply scenario-based behavioural and contractual assumptions to cash inflows and outflows under the worst of three severe stress scenarios, as prescribed by the PRA. These are a market-wide stress, an idiosyncratic stress and a combination of both.

A stress event can occur when either firm-specific or market-wide factors lead to depositors and investors withdrawing or not renewing funding on maturity. This could be caused by many factors including fears over the viability of the firm. Additionally, liquidity stress can be brought on by customers choosing to draw down on loan agreements and facilities.

Simulated liquidity stress testing is performed at least monthly for each business as well as the major operating subsidiaries in order to evaluate the strength of the RBS Group's liquidity position. The stressed outflows are measured over certain time periods which extend from two weeks to three months. The RBS Group is expected to be able to withstand stressed outflows through its own resources (primarily through the use of the liquidity portfolio) without having to resort to extraordinary central bank or governmental support.

Stress tests are designed to examine the impact of a variety of firm-specific and market-wide scenarios on the future adequacy of the liquidity reserves. Stress test scenarios are designed to take into account the RBS Group's experience during the financial crisis, recent market conditions and events. These scenarios can be run at any time in response to the emergence of firm-specific or market-wide risks that could have a material impact on the RBS Group's liquidity position. In the past these have included credit rating changes and political and economic conditions changing in particular countries.

The RBS Group's liquidity risk appetite is measured by reference to the liquidity portfolio as a percentage of net stressed ILAA outflows.

Liquidity risk

Liquidity portfolio

Liquidity risks are mitigated by a centrally managed liquidity portfolio. The size of the portfolio is determined under the liquidity risk management framework with reference to the RBS Group's liquidity risk appetite.

The majority of the portfolio is centrally managed by RBS Group Treasury, ring-fenced from the CIB trading book, and is the ultimate responsibility of the RBS Group Treasurer. This portfolio is held in the PRA regulated UK DoLSub comprising RBS Group's five licensed deposit taking UK banks: The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Co and Adam & Company.

Ulster Bank Ireland Limited, a significant operating subsidiary of the Group, holds locally managed portfolios that comply with local regulations that may differ from PRA rules. These portfolios are the responsibility of the local Treasurer who reports to the RBS Group Treasurer.

Financial review Capital and risk management

Funding risk

The composition of the Group's balance sheet is a function of the broad array of product offerings and diverse markets served by its core businesses. The structural composition of the balance sheet is augmented as needed through active management of both asset and liability portfolios. The objective of these activities is to optimise the liquidity profile, while ensuring adequate coverage of all cash requirements under extreme stress conditions.

Funding sources

The table below shows the Group's principal funding sources excluding repurchase agreements (repos).

	2015			2014		
	Third Party £m	Amounts due to holding company and fellow subsidiaries £m	Total £m	Third Party £m	Amounts due to holding company and fellow subsidiaries £m	Total £m
Deposits by banks						
derivative cash collateral	33	—	33	35	—	35
other deposits	3,473	17,609	21,082	3,333	20,128	23,461
	3,506	17,609	21,115	3,368	20,128	23,496
Debt securities in issue						
certificates of deposit (CDs)	1	—	1	10	—	10
securitisations	1,472	—	1,472	1,697	—	1,697
	1,473	—	1,473	1,707	—	1,707
Subordinated liabilities	1,395	5,621	7,016	1,780	5,656	7,436
Notes issued	2,868	5,621	8,489	3,487	5,656	9,143
Wholesale funding	6,374	23,230	29,604	6,855	25,784	32,639
Customer deposits						
cash collateral	19	—	19	12	—	12
other deposits	216,912	7,752	224,664	217,544	13,112	230,656
Total customer deposits	216,931	7,752	224,683	217,556	13,112	230,668
Total funding excluding disposal groups	223,305	30,982	254,287	224,411	38,896	263,307
Disposal group funding	2,623	—	2,623	—	—	—
Total funding	225,928	30,982	256,910	224,411	38,896	263,307

Notes issued

The table below shows the Group's debt securities in issue and subordinated liabilities by residual maturity.

	Subordinated liabilities				Total		
	Debt securities in issue £m	Third party £m	Amounts due to holding company £m	Total £m	Third party £m	Amounts due to holding company £m	Total £m
2015							
Less than 1 year	1	14	14	28	15	14	29
1-3 years	—	—	564	564	—	564	564
3-5 years	—	—	1,232	1,232	—	1,232	1,232
More than 5 years	1,472	1,381	3,811	5,192	2,853	3,811	6,664
	1,473	1,395	5,621	7,016	2,868	5,621	8,489
2014							
Less than 1 year	10	418	14	432	428	14	442
1-3 years	—	—	311	311	—	311	311
3-5 years	—	—	1,356	1,356	—	1,356	1,356
More than 5 years	1,697	1,362	3,975	5,337	3,059	3,975	7,034
	1,707	1,780	5,656	7,436	3,487	5,656	9,143

Financial review Capital and risk management

Liquidity and funding risk continued

Deposits and repos

The table below shows the composition of the Group's deposits and repos.

	Deposits			Deposits and repos			
	Third party £m	Amounts due to holding company and fellow subsidiaries £m	Total £m	Repos Third party £m	Third party £m	Amounts due to holding company and fellow subsidiaries £m	Total £m
2015							
Financial institutions							
- central and other banks	3,506	17,609	21,115	3,476	6,982	17,609	24,591
- other financial institutions	13,521	7,402	20,923	5,124	18,645	7,402	26,047
Personal and corporate deposits	203,410	350	203,760	1,854	205,264	350	205,614
Total excluding disposal groups	220,437	25,361	245,798	10,454	230,891	25,361	256,252
Disposal groups	2,623	—	2,623	—	2,623	—	2,623
	223,060	25,361	248,421	10,454	233,514	25,361	258,875
2014							
Financial institutions							
- central and other banks	3,368	20,128	23,496	2,736	6,104	20,128	26,232
- other financial institutions	13,566	13,112	26,678	3,659	17,225	13,112	30,337
Personal and corporate deposits	203,990	—	203,990	—	203,990	—	203,990
	220,924	33,240	254,164	6,395	227,319	33,240	260,559

Reverse repos at 31 December 2015 were £10.7 billion (2014 - £8.7 billion). Fair value of securities received as collateral for reverse repos was £10.6 billion (2014 - £8.6 billion), of which £10.6 billion (2014 - £7.0 billion) had been rehypothecated for the Group's own transactions, in line with normal market practice.

Loan:deposit ratios and funding surplus

The table below shows third party customer loans, deposits, loan:deposit ratios (LDR) and funding surplus, excluding intra RBS Group balances.

	Loans (1) £m	Deposits (2) £m	LDR %	Funding surplus £m
2015	167,376	219,522	76	52,146
2014	162,480	217,556	75	55,076

Notes:

(1) Excludes reverse repurchase agreements and stock borrowing and amounts due to holding company and fellow subsidiaries and includes disposal groups.

(2) Excludes repurchase agreements and stock lending and amounts due to holding company and fellow subsidiaries and includes disposal groups.

Encumbrance

The Group evaluates the extent to which assets can be financed in a secured form (encumbrance), but certain asset types lend themselves more readily to encumbrance. The typical characteristics that support encumbrance are an ability to pledge those assets to another counterparty or entity through operation of law without necessarily requiring prior notification, homogeneity, predictable and measurable cash flows, and a consistent and uniform underwriting and collection process. Retail assets including residential mortgages, credit card receivables and personal loans display many of these features.

The Group categorises its assets into three broad groups; assets that are:

- Already encumbered and used to support funding currently in place via own asset securitisations, covered bonds and securities repurchase agreements.
- Positioned with the central bank as part of the RBS Group's contingency funding.
- Not currently encumbered. In this category, the Group has in place an enablement programme which seeks to identify assets which are capable of being encumbered and to identify the actions to facilitate such encumbrance whilst not impacting customer relationships or servicing.

The Group's third party balance sheet encumbrance ratios are set out below.

Encumbrance ratios (third party)	2015 %	2014 %
Total	13	19
Excluding balances relating to derivative and securities financing transactions	11	16

Financial review Capital and risk management

Balance sheet encumbrance - third party

	Encumbered as a result of transactions with counterparties other than central banks			Assets encumbered at the central bank and unencumbered assets				Total unencumbered assets £bn	Total third party £bn	Balances with holding company and fellow subsidiaries £bn	
	Covered bonds and securitisations £bn	Repos and similar £bn	Total encumbered assets (1) £bn	Positioned at the central bank (2) £bn	Readily available for encumbrance (3) £bn	Capable of being encumbered (4) £bn	Cannot be encumbered (5) £bn			Total £bn	Total £bn
2015											
Cash and balances at central banks	—	0.5	0.5	—	1.2	—	—	1.2	1.7	—	1.7
Loans and advances											
- banks	0.8	0.4	1.2	1.4	0.8	0.4	—	2.6	3.8	99.4	103.2
- residential mortgages											
- UK	12.4	—	12.4	64.0	8.7	6.0	—	78.7	91.1	—	91.1
- Irish	7.4	—	7.4	1.2	4.0	—	0.1	5.3	12.7	—	12.7
- credit card	—	—	—	—	3.0	0.2	—	3.2	3.2	—	3.2
- personal loans	—	—	—	—	4.3	2.9	—	7.2	7.2	—	7.2
- other	—	—	—	4.9	3.9	33.1	9.6	51.5	51.5	0.6	52.1
Reverse repos	—	—	—	—	—	—	10.7	10.7	10.7	—	10.7
Debt securities	—	3.7	3.7	1.9	1.6	—	—	3.5	7.2	—	7.2
Equity shares	—	—	—	—	—	—	0.7	0.7	0.7	—	0.7
Settlement balances	—	—	—	—	—	—	1.4	1.4	1.4	0.7	2.1
Derivatives	—	—	—	—	—	—	0.9	0.9	0.9	1.7	2.6
Intangible assets	—	—	—	—	—	—	0.5	0.5	0.5	—	0.5
PPE	—	—	—	—	—	1.0	—	1.0	1.0	—	1.0
Deferred tax	—	—	—	—	—	—	1.8	1.8	1.8	—	1.8
Other assets	—	—	—	—	—	—	1.2	1.2	1.2	0.1	1.3
Total before disposal groups	20.6	4.6	25.2	73.4	27.5	43.6	26.9	171.4	196.6	102.5	299.1
Disposal groups	—	—	—	—	0.8	1.9	0.6	3.3	3.3	—	3.3
Total	20.6	4.6	25.2	73.4	28.3	45.5	27.5	174.7	199.9	102.5	302.4
Securities retained				1.1							
Total liquidity portfolio				74.5							
Liabilities secured											
Intra-Group - secondary liquidity	(2.0)	—	(2.0)								
Intra-Group - other	(4.8)	—	(4.8)								
Third-party ⁽⁶⁾	(1.5)	(11.2)	(12.7)								
	(8.3)	(11.2)	(19.5)								

For the notes to this table refer to the following page.

Financial review Capital and risk management

Liquidity and funding risk continued

Balance sheet encumbrance - third party

	Encumbered as a result of transactions with counterparties other than central banks			Assets encumbered at the central bank and unencumbered assets				Total unencumbered assets £bn	Total third party £bn	Balances with holding company and fellow subsidiaries £bn	Total £bn
	Covered bonds and securitisations £bn	Repos and similar £bn	Total encumbered assets (1) £bn	Positioned at the central bank (2) £bn	Readily available for encumbrance (3) £bn	Capable of being encumbered (4) £bn	Cannot be encumbered (5) £bn				
2014*											
Cash and balances at central banks	—	0.5	0.5	0.4	1.8	—	—	2.2	2.7	—	2.7
Loans and advances											
- banks	0.9	0.5	1.4	0.4	1.0	1.8	—	3.2	4.6	103.3	107.9
- residential mortgages											
- UK	16.4	—	16.4	51.9	5.0	5.8	0.1	62.8	79.2	—	79.2
- Irish	8.6	—	8.6	0.9	4.3	—	0.1	5.3	13.9	—	13.9
- US	—	—	—	—	—	0.3	—	0.3	0.3	—	0.3
- credit card	1.8	—	1.8	—	1.6	0.2	—	1.8	3.6	—	3.6
- personal loans	—	—	—	—	4.7	2.2	—	6.9	6.9	—	6.9
- other	1.8	—	1.8	5.4	3.4	34.9	13.1	56.8	58.6	1.0	59.6
Reverse repos	—	—	—	—	—	—	8.7	8.7	8.7	—	8.7
Debt securities	—	8.6	8.6	2.1	2.3	—	—	4.4	13.0	0.8	13.8
Equity shares	—	—	—	—	0.2	0.1	0.5	0.8	0.8	—	0.8
Settlement balances	—	—	—	—	—	—	1.7	1.7	1.7	0.3	2.0
Derivatives	—	—	—	—	—	—	1.2	1.2	1.2	2.7	3.9
Intangible assets	—	—	—	—	—	—	0.8	0.8	0.8	—	0.8
PPE	—	—	—	—	—	1.4	0.2	1.6	1.6	—	1.6
Deferred tax	—	—	—	—	—	—	1.7	1.7	1.7	—	1.7
Other assets	—	—	—	—	—	—	1.8	1.8	1.8	—	1.8
Total	29.5	9.6	39.1	61.1	24.3	46.7	29.9	162.0	201.1	108.1	309.2
Securities retained				1.0							
Total liquidity portfolio				62.1							
Liabilities secured											
Intra-Group - secondary liquidity	(2.4)	—	(2.4)								
Intra-Group - other	(5.4)	—	(5.4)								
Third-party (6)	(1.7)	(7.2)	(8.9)								
	(9.5)	(7.2)	(16.7)								

*Restated - refer to page 99 for further details.

Notes:

- (1) Total assets encumbered as a result of transactions with counterparties other than central banks are those on the balance sheet that have been pledged to provide security for the liability shown above and are therefore not available to secure funding or to meet other collateral needs.
- (2) Assets positioned at the central bank relates to the Group's liquidity portfolio and comprise: cash balances at central banks, high quality debt securities and loans that have been pre-positioned with central banks. In addition, the liquidity portfolio includes securitisations of own assets which has reduced over the years and has been replaced by loans.
- (3) Readily realisable for encumbrance: including assets that have been enabled for use with central banks but not positioned; and unencumbered debt securities.
- (4) Other realisable assets that are capable of being encumbered are those assets on the balance sheet that have no restrictions for funding and collateral purposes but are not readily realisable in their current form. These assets include loans that could be prepositioned with central banks but have not been subject to internal and external documentation review and diligence work.
- (5) Assets that cannot be encumbered comprise:
 - (a) reverse repurchase agreements and trading related settlement balances.
 - (b) non-financial assets such as intangibles, prepayments and deferred tax.
 - (c) loans that cannot be pre-positioned with central banks based on criteria set by the central banks, including date of origination and level of documentation.
- (6) In accordance with market practice the Group employs its own assets and securities received under reverse repo transactions as collateral for repos.

Financial review Capital and risk management

Business risk*

Definition

Business risk is the risk that the Group makes inappropriate business or strategic choices or that it is not able to execute its chosen strategy in line with its budget. The risk is that the Group does not deliver its budgeted performance which could lead to a deterioration in stakeholder trust and confidence or to a breach of regulatory thresholds.

The Group could make inappropriate business or strategic choices if it fails to adequately assess the current and prospective operating environment. It may not be able to execute its chosen strategy in line with its budget if there are material changes to its internal or external operating environment.

All the disclosures in this section are unaudited.

Sources of risk

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

Governance

The Board has ultimate responsibility for business risk and for approving strategic plans, initiatives and changes to strategic direction. Refer to the Risk governance section on page 12.

The RBS Group's strategic planning process is managed by Strategy and Corporate Development. The Risk and Finance functions are key contributors to strategic planning. As part of the process, each customer business develops a strategic plan within a framework set by the RBS Group's senior management. The strategic plans are consolidated at RBS Group-wide level, and reviewed and assessed against risk appetite by the RBS Group's Chief Executive, the Chief Financial Officer and the Director of Strategy and Corporate Finance before presentation to, and approval by, the Board.

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

Risk assessment, controls and assurance

Business risk is directly managed and controlled through the RBS Group's strategic planning, budgeting and new product development processes, in which the following elements are incorporated:

- Evaluation of the macroeconomic environment;
- Industry analysis;
- Competitor analysis, across geography, product, customer;
- Customer behaviour analysis (i.e. understanding customer segments, trends and behaviours);
- Understanding of technological developments;
- Assessment of regulatory developments and changes; and Evaluation of the political environment.

*unaudited

The following aspects of the strategic planning process also control business risk:

- The Top Risks process which aims to identify early, monitor closely and avoid or otherwise manage effectively strategic risks that have the highest likelihood of impacting strategic plans; and
- At the end of the strategic planning process sensitivity analysis is undertaken on the consolidated budget to assess the robustness of the plan and compliance with strategic risk objectives, including under a variety of stressed conditions

Furthermore, business risk is controlled as a result of having a requirement for the RBS Group and each business to incorporate the following elements when formulating strategic plans:

- Organisational capabilities;
- Organisational resources;
- Organisational commitment; and
- Stakeholder requirements, including customers, regulators, employees, and investors.

Business risk is also controlled via the monthly performance review processes which include financial reviews carried out by the Finance Function via the franchise Finance Directors and Financial Planning & Analysis. These reviews are carried out to understand emerging trends, issues and, where there are adverse variations from plans, enable management to take appropriate actions. A wide variety of financial, risk, customer and market metrics are monitored to assess business performance and hence the effectiveness of chosen strategies. Deviations from plan are analysed to determine drivers, which could be strategic, environmental or management-related. The monthly performance review process also includes the provision of monthly reports to the Executive Committees and the Board.

In addition, business performance reviews are carried out on a quarterly basis to discuss detailed business issues and agree action plans. These are led by franchise Chief Executive Officers and Finance Directors, with the RBS Group's Chief Executive, Chief Financial Officer, Chief Risk Officer and other stakeholders in attendance.

Finally, business risk is controlled through the adoption of policy standards that inform the approach to strategy development and business planning. Examples include the policy standards on Corporate Governance, Business Commitment Approval Process, Acquisitions & Disposals, Capital Management and Political Legislative & Regulatory Environment.

Risk appetite

Refer to the Risk appetite section on page 17.

Risk identification and monitoring

Business risk is identified and managed at the product and transaction level. Estimated revenue, costs and capital, including the potential range of outcomes, are key considerations in the design of any new product or investment decision. All policies that ultimately seek to manage and control financial impact at the product and transaction level are therefore relevant to business risk management, including policies on conduct, funding and investment spending.

Financial review Capital and risk management

Business risk* continued

Business risk is reported, assessed and challenged at every governance level within the organisation. Each franchise monitors its financial performance relative to plans and reports this on a regular basis to the Finance Directors of each franchise. The monthly and quarterly performance review processes described above, as well as the Top risks process are also all central to the identification and monitoring of business risk.

Business risk is reviewed and assessed through the planning cycles. Financial plans are developed on a bottom-up basis and refined under expected and potential scenarios reflecting expectations of the external environment and strategic priorities. These scenarios are tested against a range of sensitivities and stresses to identify the key risk drivers behind any potential volatility, together with management actions to address and manage them.

Risk mitigation

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

Key strategies are reviewed and approved by the Board. These reviews are intended to maximise the capture of market and customer insight while providing independent scrutiny and challenge. Strategic plans contain analysis of current and expected operating conditions, current and targeted competitive and market positioning, key strategic initiatives, financial and customer targets and milestones, and upside and downside risks.

A major part of the Top risks process is to ensure that all appropriate action is taken to mitigate the most material risks to strategic objectives.

A full sensitivity analysis of the consolidated strategic plan is undertaken, at the end of the strategic and financial planning process, to assess the robustness of the plan, and compliance with strategic risk objectives, under a variety of stressed conditions. In certain cases, following consideration of an opportunity, the RBS Group may decide not to pursue the opportunity as a result of a perceived strategic risk.

The RBS Group also undertakes strategic reviews to decide on how to react to specific developments.

Risk measurement

A wide variety of financial, risk, customer and market metrics are used to monitor business performance and thus, inter alia, the effectiveness of chosen strategies. Any deviations from the expected values are analysed to determine drivers which could be strategic, environmental or management. Example metrics include: customer attrition, deposit balances, revenues, impairments or loan losses, profitability and risk-weighted returns.

The stress test outcomes form a core part of the assessment of earnings and capital adequacy risk appetite and are approved by the Board. The measurement of change in profit and loss of the franchises under stress thereby acts as a measure of business risk. Franchises also conduct their own bottom-up stress testing exercises to assess the financial performance of their businesses under stress.

Reputational risk*

Definition

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

All the disclosures in this section are unaudited.

Sources of risk

Reputational risk can arise from the conduct of either the RBS Group as a whole or that of the individuals it employs; from the activities of customers and the countries in which they operate; from the products the RBS Group offers and the transactions it supports; and from its operations and infrastructure.

Governance

Reputational risk is of significant importance and is controlled by a governance framework, with Board-level oversight reinforced by a Reputational Risk Policy.

Reputational risk appetite is agreed at RBS Group-wide level by the Executive Risk Forum (ERF) and cascaded to business franchises and functions.

The Sustainable Banking Committee is responsible for overseeing how the RBS Group manages its reputation and delivers its commitments on trust, advocacy, and customer service.

The Board's oversight of reputational issues is supported by the senior RBS Group-wide Reputational Risk Forum (RRF), which opines on cases that represent a material reputational risk to the whole organisation. The RRF, which has delegated authority from the ERF, also acts as a central forum to approve sector or theme-specific reputational risk appetite positions (including Environmental, Social & Ethical risk positions) following review at business franchise risk committees.

*unaudited

Financial review Capital and risk management

Risk appetite

Refer to the Risk appetite section on page 17.

Risk monitoring and measurement

Emerging reputational issues are identified by business franchises and functions with the Sustainability Services and Enterprise Wide Risk teams focusing on new and emerging sustainability and strategic risks respectively. The Risk Management Monthly Report, provided to the Executive Risk Forum and the Board Risk Committee (BRC), may also discuss reputational risks facing the RBS Group, and the annual Sustainability Report covers progress on sustainability principles.

Management information on customers, transactions, products or issues that have been escalated to relevant reputational risk approving authorities and forums is captured by each business franchise with select cases being reviewed by senior risk committees within the businesses. A summary of material reputational risk issues discussed at the senior RBS Group-wide Reputational Risk Forum is also provided in the Risk Management Monthly Report.

ESE ratings of customers and transactions are captured and analysed centrally by the Reputational and ESE Risk Team and reported externally in the annual Sustainability Report.

Risk mitigation

Reputational risk is mitigated through governance frameworks and training of staff to ensure early identification, assessment and escalation of cases with potential reputational risk, if appropriate. This includes creating appropriate fora, for example reputational risk committees or individual reputational risk approvers.

Also important is the setting of clear reputational risk appetite criteria, ensuring higher risk cases are escalated for informed debate and senior-level approval. Effective communication channels and incident response planning also ensure that cases resulting in reputational impact are appropriately managed, for example by declining or exiting business or by ensuring incident management plans are implemented to manage the impact of negative media coverage.

Conduct and regulatory risk*

Definition

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

All the disclosures in this section are unaudited.

*unaudited

Sources of risk

Conduct and regulatory risk exists across all stages of the RBS Group's relationships with its customers, from the development of its business strategies, through governance arrangements, to post-sales processes. Activities through which conduct risk may arise are diverse and include product design, marketing and sales, complaint handling, staff training, and handling of confidential and non-public price sensitive information. Conduct risk also exists if the RBS Group does not take effective action to prevent fraud, bribery and money laundering. Regulatory risk arises from the regulatory, business or operating environment and from the RBS Group's response to it.

As set out in the Litigation, Investigations and Reviews section, the RBS Group and certain members of it are party to legal proceedings and are subject to investigation and other regulatory action in the UK, the US and other jurisdictions.

Governance

RBS Group Conduct & Regulatory Affairs (C&RA) is responsible for defining appropriate standards of conduct, and for driving adherence to them, for designing the framework for managing conduct and regulatory risk, and for overseeing remediation activity. It also provides appropriate controls, challenge and oversight to ensure good customer outcomes. In so doing, C&RA acts as a second line of defence control function.

Key elements of the governance structure are set out below:

- The C&RA Executive Committee considers emerging issues material to C&RA's strategy, and implements Board and Executive Committee risk management policy decisions;
- The Financial Crime Accountable Executive Committee (accountable to the Executive Risk Forum) ensures that the customer businesses and the Services function fulfil strategic objectives by identifying and managing their financial crime risks effectively; and
- The Mandatory Change Advisory Committee (MCAC), reports to the Bank-Wide Investment Committee, and comprises representatives of the customer businesses and functions. The MCAC acts as the 'reception committee' for reviewing externally mandated changes that may affect the RBS Group and recommending appropriate responses, including the timely mobilisation of change implementation activities. In doing so, it agrees business or function owners of individual risks; and commissions and reviews impact assessments from customer businesses and functions.

Controls and assurance

Under the RBS Group Policy Framework, C&RA owns 23 conduct risk policies. Each policy is designed to provide both high-level direction and RBS Group-wide requirements. The policies are designed to ensure the RBS Group meets its regulatory obligations, and to provide the necessary clarity for staff on their conduct obligations.

C&RA's Regulatory Affairs department separately oversees the regulatory changes, interactions with regulators and regulatory approvals for individuals.

Assurance and monitoring activities are essential to help measure the extent to which the RBS Group manages its delivery of specific customer outcomes.

Financial review Capital and risk management

Conduct and regulatory risk* continued

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

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

Risk appetite

Work to refine and embed the risk appetite framework and associated control processes continued in 2015. The risk appetite statements set the minimum standards which the RBS Group franchises augment with specific conduct risks inherent in their business model. The franchises undertake an annual self-assessment of the inherent and residual conduct risks against the risk appetite statements.

Risk monitoring and measurement

C&RA works closely with the customer-facing businesses to assess business models, strategy and products and influence better outcomes for customers.

The RBS Group's senior boards and committees receive updates on conduct risk exposures and action plans through monthly C&RA-initiated reporting. The reporting is intended to be focused, forward-looking and action-oriented.

C&RA provides appropriate reporting of all material regulatory reviews and other regulatory developments worldwide to the appropriate RBS-wide committees, including the Board, the Group Audit Committee and the BRC.

An annual Money Laundering Reporting Officer's Report is submitted to the Board and the FCA. Covering the operation and effectiveness of the systems and controls in place to comply with Anti-Money Laundering (AML) law and regulation, it also describes the RBS Group's AML framework. In addition, it covers the systems and controls in place to prevent the financing of terrorism and to ensure compliance with sanctions as well as embargoes and export controls imposed by the UN, governments and other supranational bodies.

The Group Audit Committee is provided with an annual Whistleblowing Update Report. It details cases by internal reporting categories based on the Public Interest Disclosure Act (1998); identifies underlying causal and subject trends; and highlights the outcome of investigations and actions taken.

C&RA is working with each business to enhance the management information linked to their risk appetite statements. This is required to ensure appropriate customer outcomes are delivered, and that the management information is compliant with the Basel Committee on Banking Supervision principles for effective risk data aggregation and risk reporting.

Risk mitigation

C&RA communicates information on regulatory developments, and follow-ups with regulators, to customer-facing businesses and functions, helping them identify and execute any required mitigating changes to strategy or business models.

Early identification and effective management of changes in legislation and regulation are critical to the successful mitigation of conduct and regulatory risk. All regulatory and compliance changes are managed to ensure timely compliance readiness. Those changes assessed as having a 'High' or 'Medium-High' impact are managed especially closely, with the aim of mitigating the impact through, for instance, changes to strategy or business activities, or external engagement.

Operational risk*

Definition

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

Operational risks may have a direct customer or reputational impact (for example, a major IT systems failure or fraudulent activity) or both. Operational risk failures may also have a link with conduct risk failures.

All the disclosures in this section are unaudited.

Sources of risk

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

Cyber risk

Cyber attacks are increasing in frequency and severity across the industry and their threat to the security of the RBS Group's information from continues to be closely monitored. During 2015, the RBS Group participated in industry-wide cyber attack simulations in order to help test and develop defence planning. To mitigate the risks, a large-scale programme to improve user access controls is in progress, along with a number of other actions, including a reduction in the number of external websites, enhancement of protection against malware, and the implementation of a staff education programme on information protection.

Risk governance

A strong operational risk management function is vital to support the RBS Group's ambitions. Better management of operational risk directly supports the strategic risk objective of improving stakeholder confidence and is vital for stability and reputational integrity.

The operational risk function, an independent second line of defence, plays a leadership role and seeks to achieve a robust operational risk management framework and culture across the RBS Group. The Global Head of Operational Risk reports to the Chief Risk Officer.

*unaudited

Financial review Capital and risk management

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

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

Controls and assurance

The Control Environment Certification (CEC) process is a half-yearly self-assessment of the adequacy and effectiveness of the RBS Group's internal control environment. This covers material risks and the key controls that underpin them, including financial, operational and compliance controls, as well as the supporting risk management frameworks.

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

The CEC helps to ensure compliance with the RBS Group Policy Framework, Sarbanes-Oxley 404 requirements concerning internal control over financial reporting (as referenced in the Compliance report section), and the requirements of the UK Corporate Governance Code.

Risk appetite

The operational risk appetite framework is place to manage the risk to an acceptable level in line with stated risk appetite. Risk appetite provides the RBS Group with a clear understanding of its acceptable levels of risk in relation to its strategic objectives and wider obligations.

This has led to the development of a number of risk appetite statements covering the RBS Group's most material operational risks. These risks were identified due to their significance and they are regularly reported to the OREC, the ERF and the BRC. Work has commenced to cascade these statements to each business. The statements are monitored and reported at business risk committees.

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

*unaudited

Risk identification and assessment

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

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

During 2015, an enhanced end-to-end risk assessment methodology was designed, which is now being implemented across the RBS Group. This approach enhances the understanding of the risk profile of the RBS Group's key products and services, and it will be used to identify and quantify the most material risks. Subject matter experts and key stakeholders are engaged from across the RBS Group to support management decision-making in line with the RBS Group's financial and non-financial appetite statement.

The New Product Risk Assessment process aims to ensure that the risks represented by new products (and material variations to existing products) are identified and assessed before launch. There is now a requirement to demonstrate that all products provide fair outcomes to customers. Ongoing enhancements to improve the risk rating of new and significant changes to products as well as increasing the focus on customers were introduced during 2015.

Risk mitigation

Risks are mitigated through the application of key preventative and detective controls as an integral step in risk assessment methodology, to enable a determination of the residual risk. Control owners are accountable for the design, execution, performance and maintenance of key controls.

These key controls are regularly assessed for adequacy and tested for effectiveness. The control testing results are monitored and, where a material change in performance is identified, it results in a re-evaluation of the associated risk. During 2015, work continued on enhancing management information reporting, driving consistency and more focused actions to mitigate risk.

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

Risk monitoring

Monitoring and reporting are part of the RBS Group's operational risk management processes, which aim to ensure that risks and issues are identified, considered by senior executives, and managed effectively.

The most material operational risks and their position relevant to risk appetite are regularly reviewed at the OREC, along with any emerging risks and the actions taken to mitigate them. These are also reported to the BRC and the ERF. Exposures specific to each business are communicated through monthly risk and control reports that are discussed at business risk committees.

Financial review Capital and risk management

Operational risk* continued

Risk measurement

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

As part of the wider Internal Capital Adequacy Assessment Process (ICAAP), an operational risk economic capital model is used as a key capital benchmark. The model utilises loss data and scenario analysis inputs from the operational risk framework to provide a risk-sensitive view of the Group's operational risk capital requirement.

Scenario analysis is used to assess the potential impact of extreme but plausible operational risks. It provides a forward-looking basis for evaluating and managing operational risk exposures.

Capital

Pillar 1 capital requirements for operational risk are set out in the Capital management section - Measurement - capital, RWAs and leverage.

Event and loss data management

The event and loss data management process ensures the capture and recording of operational risk loss events that meet defined criteria. The loss data is used for regulatory and industry reporting and is included in the capital modelling, for the calculation of the regulatory capital for operational risk.

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

All losses and recoveries associated with an operational risk event are reported against their financial accounting date. A single event can result in multiple losses (or recoveries) that may take time to crystallise. Losses and recoveries with a financial accounting date in 2015 may relate to events that occurred, or were identified in, prior years.

Pension risk*

Definition

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

All the disclosures in this section are unaudited.

Sources of risk

The Group has exposure to pension risk through its defined benefit schemes worldwide. The Main scheme is the principal source of pension risk, representing more than 90% of the Group's pension scheme liabilities.

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

Key developments in 2015

A payment of £650 million was made to the Main scheme in 2015 in line with the current Schedule of Contributions, in addition to the regular annual contribution of around £270 million for ongoing accrual of benefits and the expenses of running the scheme. Following developments in pension accounting and reporting during 2015 the Group revised its policy for determining whether or not it has an unconditional right to a refund of any surpluses in its employee pension funds and also revised prior periods (refer to page 101 - Accounting policies and page 115 Note 4, Pensions, for more details). The incremental impact of this, combined with the one-off accelerated payment of £4.2 billion made in 2016, is anticipated to improve the Group's risk profile, capital planning, and resilience through the period to 2019. Subject to PRA approval, the adverse core capital impact resulting from the accounting policy change and the accelerated payment is expected to be partially offset by a reduction in core capital requirements. Any such core capital offsets are likely to occur at the earliest from 1 January 2017, but they will depend on the PRA's assessment of CET1 capital position at that time.

Governance

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

*unaudited

Financial review Capital and risk management

The Pension Risk Committee (PRC) chaired by the RBS Group Treasurer, acts as a sub-committee of the RBS Asset and Liability Committee (ALCo) and formulates the RBS Group's view of pension risk. The PRC considers mechanisms that could potentially be used for managing risk within the pension schemes as well as financial strategy and employee welfare implications, and also reviews actuarial assumptions from a sponsor perspective as appropriate. The PRC is a key component of the RBS Group's approach to pension risk where risk management, asset strategy and financing issues are reviewed and monitored on behalf of the RBS Group. The PRC also serves as a formal link between the RBS Group, RIEL and the trustee.

For further information on Risk governance, refer to page 12.

Risk appetite

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

The RBS Group maintains an independent view of the risk inherent in pension funds, with an associated risk appetite, and has defined limits against which risk is measured. In addition to the scrutiny provided by the PRC, the RBS Group also achieves this through regular pension risk monitoring and reporting to the Board, the Executive Committee and the BRC on the material pension schemes that the RBS Group has an obligation to support.

Risk mitigation

The trustee has taken measures to mitigate inflation and interest rate risks both by investing in suitable financial assets and by entering into inflation and interest rate swaps. The Main scheme also uses derivatives to manage the allocation of the portfolio to different asset classes and to manage risk within asset classes. The assets of the Main scheme, which represented around 90% of the Group's pension plan assets at 31 December 2015, are invested in a diversified portfolio of quoted and private equity, government and corporate fixed interest and index-linked bonds, property and other alternative assets.

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

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

Risk monitoring and measurement

Pension risk reporting is submitted quarterly to the RBS Group Board in the RBS Group Risk Monthly Management Report. The report includes a measurement of the overall deficit or surplus position based on the latest data, estimated capital requirements and an assessment of the associated assets and liabilities.

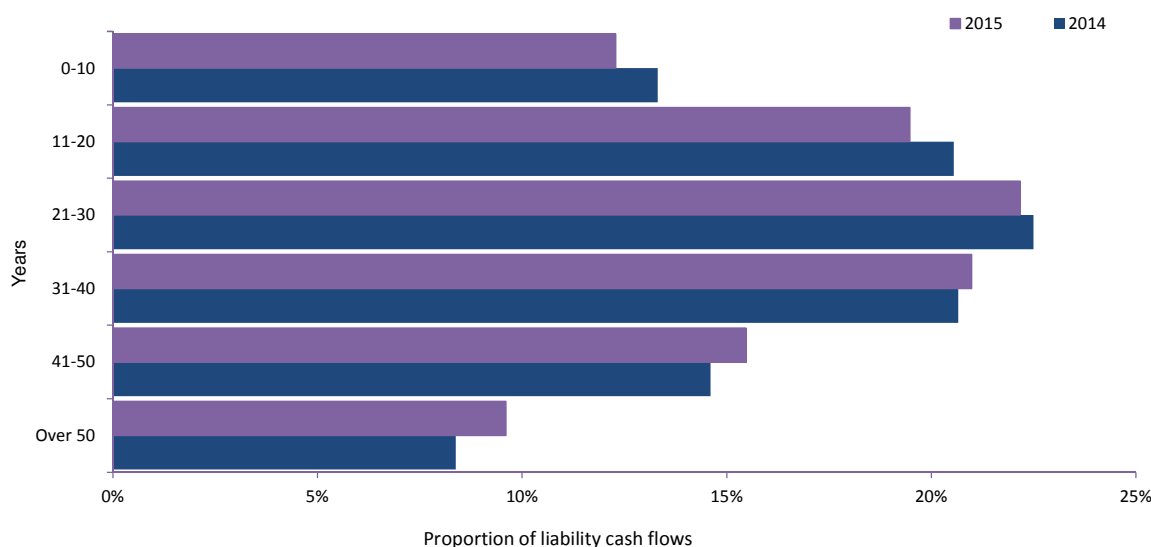
Financial review Capital and risk management

Pension risk* continued

The table below shows the sensitivity of the Main scheme's assets and liabilities (measured according to IAS 19 'Employee Benefits') to changes in interest rates and equity values at the year end, taking account of the current asset allocation and hedging arrangements. Asset sensitivity to changes in nominal yields increased over the year as swap yields fell at longer durations and the Main scheme increased its interest rate hedging ratio.

	Change in value of assets £m	Change in value of liabilities £m	Change in pension obligations £m
2015			
Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields	874	363	511
Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields	1,029	1,104	(75)
Fall in credit spreads of 0.25% at all durations with no change in nominal or real swap yields	70	1,526	(1,456)
Fall in equity values of 10%	(667)	—	(667)
2014			
Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields	447	413	34
Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields	932	1,159	(227)
Fall in credit spreads of 0.25% at all durations with no change in nominal or real swap yields	65	1,581	(1,516)
Fall in equity values of 10%	(771)	—	(771)

The chart below shows the pension liability cash flow profile, allowing for expected indexation of future payments. The majority of expected cash flows (77%) are anticipated within the next 40 years. The profile will vary depending on the assumptions made regarding inflation expectations and mortality.



*unaudited

Financial review Capital and risk management

Credit risk: management basis

Definition

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

The following disclosures in this section are audited:

- Risk assessment and monitoring
- Wholesale credit risk management
 - Risk mitigation
 - Problem debt management - Forbearance
- Personal credit risk management
 - Problem debt management - Forbearance
 - Overview of personal portfolios - Balances, forbearance and LTV distribution

Sources of credit risk*

The principal sources of credit risk for the Group are as follows:

Lending - The Group offers a number of lending products that involve an obligation to provide credit facilities to customers. To mitigate the risk of loss, security may be obtained in the form of physical collateral (such as commercial real estate assets and residential property) or financial collateral (such as cash and bonds). Exposures arising from leasing activities are also included.

Off-balance sheet products - The Group provides trade finance and guarantees for customers, as well as committed but undrawn lending facilities, and is exposed to credit risk as a result.

Derivatives and securities financing - The Group enters into derivatives contracts and securities financing transactions. These result in counterparty credit risk, which is the risk of financial loss arising from the failure of a counterparty to meet obligations that vary in value by reference to a market factor. To mitigate the risk of loss, collateral and netting are used along with the additional legal rights provided under the terms of over-the-counter contracts.

Debt securities - The Group holds some debt securities for liquidity management purposes and is exposed to credit risk as a result.

Other activities - The Group is exposed to settlement risk through its activities in foreign exchange, trade finance and payments.

Overview and key developments

Credit quality and impairment - The portfolio reduced due to the strategic disposal of Capital Resolution assets. Improvement in asset quality was evidenced by a reduction in the number of customers showing financial stress, the number of customers in default and a release of provisions. This was achieved against a backdrop of supportive economic conditions in the Group's key markets.

UK personal lending - The Group's mortgage lending grew while underwriting standards remained unchanged. This reflected improving economic conditions as well as the continued low interest rate environment.

Credit risk management function*

Governance

Credit risk management is conducted on an overall basis within the RBS Group such that common policies, procedures, frameworks and models apply across the RBS Group. Therefore, for the most part, discussions on these aspects reflect those in the RBS Group as relevant for the businesses and operations in the Group.

The activities of the RBS Group's credit risk management function, which is led by the RBS Group Chief Credit Officer (GCCO), include:

- approving credit for customers;
- ensuring that credit risk is within the risk appetite set by the Board;
- managing concentration risk and credit risk control frameworks;
- developing and ensuring compliance with credit risk policies; and
- conducting RBS Group-wide assessments of provision adequacy.

*unaudited

Financial review Capital and risk management

Credit risk: management basis continued

The key elements of the credit risk management function are set out below.

Leadership	GCCO	The GCCO has overall responsibility for the credit risk function. The GCCO chairs the Credit Risk Committee and, with the RBS Group CRO, co-chairs the RBS Group provisions committee.
Governance	Credit Risk committee Provisions Committee (1)	Authority over strategy, frameworks and policy as well as oversight of the Group credit profile. Approval of recommendations from business provisions committees in accordance with approval thresholds.
Risk appetite	Concentration frameworks <ul style="list-style-type: none"> - Wholesale <ul style="list-style-type: none"> ◦ Single name ◦ Sector ◦ Country ◦ Product and asset class - Personal credit appetite framework Reputational and environmental, social and ethical frameworks Credit policy	Frameworks are maintained at an RBS Group level to ensure that the risk of an outsized loss due to a concentration to a particular borrower, sector, product type or country remains within appetite. The credit frameworks are aligned to the RBS Group's risk appetite framework. The Group uses a product and asset class framework to control credit risk for its Personal businesses. The framework sets limits that measure and control the quality of both existing and new business for each relevant franchise or segment.
Controls and risk assurance	Control assurance Quality assurance Model risk management	Credit policy standards are in place for both Wholesale and Personal portfolios and are expressed as a set of mandatory controls. Assurance activities, as defined by credit policy, are undertaken by an independent assurance function.
Credit stewardship	Credit assessment standards Credit risk mitigation and collateral Credit documentation Regular portfolio/customer review Problem debt identification and management	Credit risk stewardship takes place throughout the customer lifecycle, from initial credit approval and on a continuous basis thereafter. The methodology applied for assessing and monitoring credit risk varies between customer types and segments.
Customers	Segmentation	Customers are managed differently, reflecting different customer types and risks. Wholesale customers are grouped by industry clusters and managed on an individual basis (includes Corporates, Banks and Financial Institutions). Personal customers are grouped into portfolios of similar risk and managed on a portfolio basis (2).

Notes:

(1) Authority is delegated by Executive Risk Forum.

(2) For further information on the Group's provisioning and impairment practices refer to page 70.

*unaudited

Financial review Capital and risk management

Risk appetite*

Risk appetite across all risk types is set by the RBS Group Board using specific quantitative targets under stress, including earnings volatility and capital adequacy. The credit risk frameworks take into account concentrations at Group-wide level and have been designed to reflect factors that influence the ability to meet those targets. Tools such as stress testing and economic capital are used to measure credit risk volatility and develop links between the credit risk appetite frameworks and risk appetite targets. The frameworks are supported by a suite of policies and transaction acceptance standards that set out the risk parameters within which franchises must operate. For further information on the specific frameworks for Wholesale and Personal refer to page 52 and 56 respectively.

Risk measurements and models*

Credit risk assets

A range of measures is used for credit risk exposures. The internal measure used, unless otherwise stated, is credit risk assets (CRA) consisting of:

- Lending exposure - measured using drawn balances (gross of impairments). Comprises cash balances at central banks as well as loans and advances to banks and customers.

- Counterparty exposures - measured using the mark-to-market value of derivatives after the effect of enforceable netting agreements and regulator-approved models but before the effect of collateral. Calculations are gross of credit value adjustments.
- Contingent obligations - measured using the value of the committed amount and including primarily letters of credit and guarantees.

CRA exclude issuer risk (primarily debt securities) and securities financing transactions. CRA take account of regulatory netting although, in practice, obligations are settled under legal netting arrangements that provide a right of legal set-off but do not meet the offset criteria under IFRS.

Risk models

The output of credit risk models is used in the credit approval process - as well as for ongoing credit risk assessment, monitoring and reporting - to inform credit risk appetite decisions. These models may be divided into different categories:

Model	Calculation method	Wholesale	Personal
PD model	Individual counterparty	Each customer is assigned a probability of default (PD) rating and corresponding grade. PD is calculated using a combination of quantitative inputs, such as recent financial performance, and qualitative inputs such as management performance and sector outlook.	Each customer account is scored and models are used to assign a PD rating. Inputs vary across portfolios and include both internal account and customer level data, as well as data from credit bureaus. This score is used to support automated credit decision-making through the use of a statistically-derived scorecard.
LGD model	Individual counterparty	Loss given default (LGD) models estimate the amount that cannot be recovered in the event of a customer default. When estimating LGD, the Group's models assess both borrower and facility characteristics, as well as any credit risk mitigants. The cost of collections and a time-discount factor for the delay in cash recovery are also incorporated.	
EAD model	Individual counterparty	Exposure at default (EAD) models provide estimates of credit facility utilisation at the time of a customer default, recognising that customers may make further drawings on unused credit facilities prior to default or that exposures may increase due to market movements. Regulatory requirements stipulate that EAD must always be equal to, or higher, than current utilisation, though exposures can be reduced by a legally enforceable netting agreement.	
EC model	Portfolio level	The credit economic capital model is a framework that allows for the calculation of portfolio credit loss distributions and associated metrics over a given risk horizon for a variety of business purposes. The model takes into account migration risk (the risk that credit assets will deteriorate in credit quality across multiple years), factor correlation (the assumption that groups of obligors share a common factor) and contagion risk (for example, the risk that the weakening of the sovereign's credit worthiness has a significant impact on the creditworthiness of a business operating in that country).	

*unaudited

Financial review Capital and risk management

Credit risk: management basis continued

Changes to credit models

Models are reviewed and updated on an ongoing basis in order to reflect the impact of more recent data, changes to products and portfolios, and new regulatory requirements. Extensive changes were made to Wholesale models between 2012 and 2014. To a lesser extent, the impact of these changes continued through 2015, resulting in some downwards rating migrations across internal asset quality bands.

Model changes affect year-on-year comparisons of risk measures in certain disclosures. Where meaningful, in commentary differentiations are made between instances where movements in risk measures reflect the impact of model changes and those where such movements reflect changes in the size of underlying credit portfolios or their credit quality.

For more information on model governance and review refer to the Model section on page 15.

Risk mitigation*

Risk mitigation techniques are used in the management of credit portfolios across the Group, typically to mitigate credit concentrations in relation to an individual customer, a borrower group or a collection of related borrowers. Where possible, customer credit balances are netted against obligations. Mitigation tools applied 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. When seeking to mitigate risk, at a minimum the Group considers the following:

- The suitability of the proposed risk mitigation, particularly if restrictions apply;
- The means by which legal certainty is to be established, including required documentation, supportive legal opinions and the steps needed to establish legal rights;
- The acceptability of the methodologies to be used for initial and subsequent valuation of collateral, the frequency of valuations and the advance rates given;
- The actions which can be taken if the value of collateral or other mitigants is less than needed;
- The risk that the value of mitigants and counterparty credit quality may deteriorate simultaneously;
- The need to manage concentration risks arising from collateral types; and
- The need to ensure that any risk mitigation remains legally effective and enforceable.

The business and credit teams are supported by specialist in-house documentation teams. The Group uses industry-standard loan and security documentation wherever possible. However, when non-standard documentation is used, external lawyers are employed to review it on a case-by-case basis. Mitigants (including any associated insurance) are monitored throughout the life of the transaction to ensure that they perform as anticipated. Similarly, documentation is also monitored to ensure it remains enforceable.

For further information refer to the sub-sections on Wholesale credit risk management and Personal credit risk management.

Counterparty credit risk

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

Amounts owed by the Group to a counterparty are netted against amounts the counterparty owes the Group, in accordance with relevant regulatory and internal policies. However, generally, this is only done if a netting and collateral agreement is in place as well as a legal opinion to the effect that the agreement is enforceable in the relevant jurisdictions.

Collateral may consist of either cash or securities. In the case of derivatives, collateral generally takes the form of cash. In the case of securities financing transactions, collateral usually takes the form of debt securities and, to a much lesser extent, equity securities at the outset. However, if the value of collateral falls relative to the obligation, the Group may require additional collateral in the form of cash (variation margin). The vast majority of agreements are subject to daily collateral calls with collateral valued using internal valuation methodologies.

Industry standard documentation - such as master repurchase agreements and credit support annexes accompanied by legal opinion - is used for financial collateral taken as part of trading activities.

The Group restricts counterparty credit exposures by setting limits that take into account the potential adverse movement of an exposure after adjusting for the impact of netting and collateral (where applicable).

Risk assessment and monitoring

Practices for credit stewardship - including credit assessment, approval and monitoring as well as the identification and management of problem debts - differ between the Wholesale and Personal portfolios. For further information refer to the relevant sub-sections on pages 53 and 56. A key aspect of credit risk stewardship is ensuring that, when signs of impairment are identified, appropriate impairment provisions are recognised.

*unaudited

Financial review Capital and risk management

Impairment, provisioning and write-offs

In the overall assessment of credit risk, impairment, provisioning and write-offs are used as key indicators of credit quality. The impairment, provisioning and write-off processes are described in more detail below.

Impairment

A financial asset is impaired if there is objective evidence that the amount, or timing, of future cash flows has been adversely affected since its initial recognition. Refer to accounting policies on page 105 for details regarding the quantification of impairment losses.

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

Provisioning

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

Provision method	Customer type	Quantification method	Key factors considered
Individual	Impaired, individually significant	Case-by-case assessment of future cashflows	<ul style="list-style-type: none"> Customer and guarantor performance. Future value of collateral. Future economic conditions based on factors available at the time.
Collective	Impaired but not individually significant, grouped into homogenous portfolios	Quantitative review of relevant portfolio	<ul style="list-style-type: none"> Level of arrears. Value of security. Historical and projected cash recovery trends. Current economic conditions. Operational processes. Latest cash collection profile.
Latent	Not impaired	$PD\% \times LGD\% \times EAD \times$ Emergence Period	<ul style="list-style-type: none"> For wholesale customers PD, LGD and EAD values are used. For personal, calculations are performed at portfolio level by product (e.g. mortgages, credit cards or unsecured loans). Portfolio-level emergence periods are based on products or businesses with similar homogenous characteristics. Emergence periods range from 120 to 274 days.

Refer to pages 70 to 74 for an analysis of impaired loans, related provisions and impairments. Refer to page 106 for details of accounting policies. For details on collateral, refer to the Counterparty credit risk section on page 48 as well as the Wholesale and Personal risk mitigation sections on pages 52 and 56.

The Restructuring credit team will ultimately recommend or approve any provision that may be required.

Sensitivity of impairments to assumptions

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

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

Financial review Capital and risk management

Credit risk: management basis *continued*

Available-for-sale portfolios

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

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

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

Write-offs

Impaired loans and receivables are written-off when there is no longer any realistic prospect of recovery of part, or the entire loan. For loans that are individually assessed for impairment, the timing of write-off is determined on a case-by-case basis. Such loans are reviewed regularly and write-offs may be prompted by bankruptcy, insolvency, forbearance and similar events. For details of the typical time frames, from initial impairment to write off, for collectively assessed portfolios refer to the accounting policies section on page 105.

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 review Capital and risk management

Portfolio overview*

The table below summarises the Group's credit risk exposures measured by CRA.

	Wholesale							Total £m
	Personal (1) £m	Property £m	Services £m	Retail & Leisure £m	Manufacturing £m	Banks & other FIs £m	Other £m	
2015								
UK	101,304	16,864	7,786	6,720	5,358	1,871	5,501	145,404
RoI (2)	14,319	1,740	731	1,020	1,034	167	2,288	21,299
Other Western Europe	375	62	30	125	150	630	598	1,970
North America	204	44	45	371	45	345	37	1,091
RoW (3)	2,229	223	163	11	30	502	49	3,207
Total	118,431	18,933	8,755	8,247	6,617	3,515	8,473	172,971
Watch Red	—	236	147	157	169	9	56	774
AQ10	5,015	2,761	493	613	248	87	247	9,464
2014								
UK	90,592	20,211	8,145	6,919	5,116	1,872	6,039	138,894
RoI (2)	16,021	7,529	1,144	1,725	1,257	393	1,536	29,605
Other Western Europe	546	55	108	120	98	881	1,177	2,985
North America	190	68	61	247	67	708	409	1,750
RoW (3)	1,760	205	1,468	58	21	1,251	183	4,946
Total	109,109	28,068	10,926	9,069	6,559	5,105	9,344	178,180
Watch Red	—	349	204	201	86	14	150	1,004
AQ10	6,335	11,331	1,023	1,537	454	213	443	21,336

Notes:

(1) Personal portfolio includes business customers within Business Banking.

(2) RoI: Republic of Ireland.

(3) Rest of World comprises Asia Pacific, Central and Eastern Europe, the Middle East, Central Asia and Africa, and supranationals such as the World Bank.

Key points

- The make up of the portfolio continued to evolve during the year as a result of the Group's focus on the UK personal sector and disposals of RCR assets.
- Exposure in Personal increased from £109.1 billion at 31 December 2014 to £118.4 billion at 31 December 2015 while Wholesale decreased from £69.1 billion at 31 December 2014 to £54.5 billion at 31 December 2015. Personal represents 68% of the overall portfolio (2014 - 61%), with significant focus on the UK market (86%). Refer to page 58 for further information on the key credit metrics of the Personal portfolio.
- Exposure to the Property sector significantly fell during 2015, driven by RCR disposals in the UK and RoI. The concentration of Property as a proportion of the Group portfolio has, as a result, reduced from 16% at December 2014 to 11% at December 2015. Exposure to this sector consists of 69% to commercial real estate (2014 - 77%), construction 8% (2014 - 6%), housing associations 19% (2014 - 14%) and building materials 4% (2014 - 3%). The commercial real estate portfolio mostly consisted of lending secured against UK investment property assets. Asset quality improved during 2015, with forbearance, Watchlist and defaulted customers all showing a significant decrease during the period. At 31 December 2015, exposure to customers in default represented 15% of total exposure to the sector, compared to 40% at 31 December 2014.
- Exposure to the Services and Retail & Leisure sectors in the UK and RoI were stable during the year. This reflected the importance of these sectors to the Group's strategy. Reductions observed in other geographic areas to those sectors were in line with the exit strategy. Asset quality improved as a result of supportive economic conditions.
- All other Wholesale sectors represent less than 5% of the total portfolio with no material concentration to a specific sector. The Group has no material exposure to the Oil & Gas, Mining & Metals or the transport sectors or to emerging market countries. Asset quality across all wholesale sectors improved during 2015, reflecting a supportive economic environment in the UK.

*unaudited

Financial review Capital and risk management

Credit risk: management basis *continued*

Wholesale credit risk management

This section sets out further detail on the Group's approach to credit risk management for its wholesale customers.

Risk assessment*

Before credit facilities are made available to customers a credit assessment is undertaken. The assessment process is the same for all customers. However, within the RBS Group, credit risk management is organised in terms of the complexity of the assessment rather than aligned to franchises. Capital Resolution is not managed separately but is shown in tables to aid understanding of the size of the exit portfolio. Credit is only granted to customers following joint approval by an approver from the business and the credit risk function.

These approvers act within a delegated approval authority under the wholesale Credit Authorities Framework (CAF) approved by the Executive Risk Forum.

The level of delegated authority held by approvers is dependent on their experience and expertise. Only a small number of senior executives hold the highest authority provided under the CAF. Both business and credit approvers are accountable for the quality of each decision taken but the credit risk approver holds ultimate sanctioning authority.

In 2015, new Transaction Acceptance Standards (TAS) were introduced to provide more detailed transactional lending and risk acceptance guidelines which are one of the tools to control risk appetite at the customer/transaction level. TAS are supplementary to Credit Policy.

When assessing credit risk the following must be considered at a minimum:

- The amount, terms, tenor, structure, conditions, purpose and appropriateness of all credit facilities;
- Compliance with relevant credit policies and transaction acceptance standards;
- The customer's ability to meet obligations, based on an analysis of financial information;
- A review of payment and covenant compliance history;
- The customer's risk profile, including sector, sensitivity to economic and market developments and management capability;
- Legal capacity of the customer to engage in the transaction;
- Credit risk mitigation including requirements for valuation and revaluation. The customer's credit grade and the loss given default estimate for the facilities;
- The requirement for the provision of financial information, covenants and/or monitoring formulae to monitor the customer's financial performance;
- 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 other risks such as environmental, social and ethical, regulatory and reputational risks; and
- The portfolio impact of the transaction, including the impact on any credit risk concentration limits or agreed business franchise risk appetite.

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

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; compliance with terms and conditions; and refinancing risk.

Risk mitigation

The Group mitigates credit risk through the use of netting, collateral and market standard documentation, depending on the nature of the counterparty and its assets. The most common types of mitigation are:

- Other physical assets - Including stock, plant, equipment, machinery, vehicles, ships and aircraft. Such assets are suitable collateral only if the Group can identify, locate, and segregate them from other assets on which it does not have a claim. The Group values physical assets in a variety of ways, depending on the type of asset and may rely on balance sheet valuations in certain cases.
- Receivables - These are amounts owed to the Group's counterparties by their own customers. The Group values them after taking into account the quality of its counterparty's receivable management processes and excluding any that are past due.

All collateral is assessed case by case to ensure that it will retain its value independently of the provider. The Group monitors the value of the collateral and, if there is a shortfall, will seek additional collateral.

Problem debt management

Early problem identification*

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

Watchlist*

For customers not managed in Capital Resolution, there are three Watch classifications - Amber, Red and Black - reflecting progressively deteriorating conditions.

Watch Amber customers are performing customers who show early signs of potential financial difficulty, or have other characteristics that warrant closer monitoring.

Watch Red customers are performing customers who show signs of declining creditworthiness and so require active management. When a customer is classified as Watch Red, the Restructuring team engaged to consider whether the relationship should be transferred to them. Watch Red customers who continue to be managed outside of restructuring tend to be those requiring specialist subject matter expertise that is only available outside of Restructuring.

*unaudited

Financial review Capital and risk management

The Watch Black portfolio includes AQ10 exposures.

Once on the Watchlist a number of mandatory actions are taken, including a review of the customer's credit grade and facility and security documentation. Depending on the severity of the financial difficulty and the size of the exposure, the customer relationship strategy is reassessed by credit officers, by specialist credit risk or relationship management units in the relevant business or by Restructuring.

In more material cases, a forum of experienced credit, portfolio management and remedial management specialists in either the relevant business or Restructuring may reassess the customer relationship strategy.

Appropriate corrective action is taken when circumstances emerge that may affect the customer's ability to service its debt. Such circumstances include deteriorating trading performance, imminent breach of covenant, challenging macroeconomic conditions, a late payment or the expectation of a missed payment.

Remediation strategies available in the business include granting a customer various types of concessions. Any decision to approve a concession will be a function of specific country and sector appetite, the credit quality of the customer, the market environment and the loan structure and security. For further information, refer to the Wholesale forbearance section below.

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

Customers managed in Capital Resolution are by their nature subject to heightened scrutiny and regular review against specific disposal plans. Capital Resolution customers are separately identified in the Group's internal Watchlist reporting, with their Watchlist classification based on asset quality.

The Watchlist process will be replaced by the Risk of Credit Loss framework in early 2016. This will ensure the problem debt portfolio is managed consistently and efficiently, with added focus on customers whose credit profiles have deteriorated outside original risk appetite.

Restructuring*

The Restructuring team manages customer relationships with the Group's Wholesale problem debt portfolio. The factor common to all customers with Restructuring involvement is that the Group's exposure is outside risk appetite. The primary function of Restructuring is to restore customers to an acceptable credit profile, minimise losses to the Group and protect the Group's capital.

Specialists in Restructuring work with customers experiencing financial difficulties, and showing signs of financial stress, with the aim of restoring their business to financial health whenever possible. The objective is to find a mutually acceptable solution, including restructuring of existing facilities, repayment or refinancing if that is the customer's preferred option.

Specialists within Restructuring conduct a detailed assessment of the viability of the business, as well as the ability of management to deal with the causes of financial difficulty, focusing on both financial and operational issues. Following the assessment, options - which may include forbearance or restructuring of facilities or both - are developed. Credit risk decisions, including reviewing and approving any operational and financial restructuring solutions in relation to these customers, are made by a dedicated Restructuring Credit team.

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

Forbearance

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

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

Types of Wholesale forbearance

The type of forbearance offered is tailored to the customer's individual circumstances. For wholesale customers forbearance may involve the following types of concessions:

- **Covenant waiver**
A recalibration of covenants or a covenant amendment may be used to cure a potential or actual covenant breach. In return for this relief, the Group would seek to obtain a return commensurate with the risk that it is required to take. The increased return for the increased risk can be structured flexibly to take into account the customer's circumstances. For example it may be structured as either increased margin on a cash or payment-in-kind basis, deferred-return instruments or both. While the Group considers these types of concessions qualitatively different from other forms of forbearance, they constitute a significant proportion of Wholesale forbore loans and are therefore included in these disclosures.
- **Amendment to margin**
Contractual margin may be amended to bolster the customer's day-to-day liquidity to help sustain its business as a going concern. This would normally be a short-term solution. The Group would seek a return commensurate to the risk that it is required to take.

*unaudited

Financial review Capital and risk management

Credit risk: management basis continued

- **Payment concessions and loan rescheduling (including extensions in contractual maturity)**
May be granted to improve the customer's liquidity or on the expectation that the customer's liquidity will recover when market conditions improve. In addition, they may be granted if the customer will benefit from access to alternative sources of liquidity, such as an issue of equity capital. These options have been used in CRE transactions, particularly during periods where a shortage of market liquidity has ruled out immediate refinancing and made short-term collateral sales unattractive.
- **Debt forgiveness/debt for equity swap**
May be granted where the customer's business condition or economic environment is such that it cannot meet obligations and where other forms of forbearance are unlikely to succeed. Debt forgiveness can be used for stressed corporate transactions and is typically structured on the basis of projected cash flows from operational activities, rather than underlying tangible asset values. Provided that the underlying business model, strategy and debt level are viable, maintaining the business as a going concern is the preferred option, rather than realising the value of the underlying assets.

Loans may be forbore more than once, generally where a temporary concession has been granted and circumstances warrant another temporary or permanent revision of the loan's terms. All customers are assigned a PD and related facilities an LGD. These are re-assessed prior to finalising any forbearance arrangement in light of the loan's amended terms and any revised grading is incorporated in the calculation of the impairment loss provisions for the Group's Wholesale exposures.

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

- **Enforcement of security or otherwise taking control of assets**
- Where the Group holds collateral or other security interest and is entitled to enforce its rights, it may enforce its security or otherwise take control of the assets. The preferred strategy is to consider other possible options prior to exercising these rights.
- **Insolvency** - Where there is no suitable forbearance option or the business is no longer sustainable, insolvency will be considered. Insolvency may be the only option that ensures that the assets of the business are properly and efficiently distributed to relevant creditors.

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

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

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

For performing loans, credit metrics are an integral part of the latent provision methodology and therefore the impact of covenant concessions will be reflected in the latent provision. For non-performing loans, covenant concessions will be considered in determining the overall provision for these loans.

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

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

Financial review Capital and risk management

Flow into forbearance

The table below shows the value of loans (excluding loans where the Group has initiated recovery procedures) where forbearance was completed during the year, by sector and types. This only includes the forborne facility exposure. No exit criteria are currently applied.

	2015				2014			
	Performing £m	Non- performing £m	Total £m	Provision coverage (1) %	Performing £m	Non- performing £m	Total £m	Provision coverage (1) %
<i>Wholesale forbearance during the year by sector</i>								
Property	197	639	836	58	488	3,731	4,219	71
Natural resources	30	2	32	33	54	2	56	89
Transport	10	13	23	42	25	34	59	61
Retail & Leisure	84	100	184	35	198	376	574	58
Services	162	116	278	46	192	275	467	56
Other	51	106	157	51	187	197	384	56
Total	534	976	1,510	53	1,144	4,615	5,759	68

Note:

(1) Provision coverage reflects impairment provision as a percentage of non-performing loans.

Forbearance arrangements

The table below shows the incidence of the main types of Wholesale renegotiations.

	2015 £m	2014 £m
<i>Wholesale renegotiations during the year by type (1,2)</i>		
Payment concessions	1,317	4,386
Non-payment concessions	193	1,373
Total	1,510	5,759

Notes:

(1) Forbearance arrangements in 2014 included £19 million of payment and £30 million of non-payment refinancing concessions respectively; refinancing forbearance arrangements in 2015 totalled nil.

(2) Previously reported forbearance types are classified as non-payment (covenant concessions, release of security) and payment (payment concessions and loan rescheduling, forgiveness of all or part of the outstanding debt, variation in margin, standstill agreements).

Key points

- At 31 December 2015 loans totalling £0.9 billion were granted credit approval for forbearance but had not yet reached legal completion. These loans are referred to as "In Process" and are not included in the tables above. 70% of these were non-performing loans, with an associated provision coverage of 31%; and 30% were performing loans. The principal types of arrangements offered were payment concessions.
- Loans forborne during 2014 and 2015 outstanding at 31 December 2015 were £2.3 billion, of which £0.8 billion related to arrangements completed during 2014.
- Additional provisions charged in 2015 relating to loans forborne during 2014 totalled £0.1 billion. Provision coverage of those loans at 31 December 2015 was 77%.
- Non-RCR forborne cases that were performing as at Q4 2014 and are still performing as at Q4 2015 totalled £0.7 billion. By value, 90% of the performing non-RCR loans granted forbearance in 2014 remained performing at 31 December 2015.

Financial review Capital and risk management

Credit risk: management basis *continued*

Personal credit risk management

This section sets out further detail on the Group's approach to credit risk management for its Personal customers.

Risk appetite*

The RBS Group uses a credit risk appetite framework to control credit risk for its personal businesses. The framework sets limits that measure and control, for each relevant franchise or reportable segment, the quality of both existing and new business. The actual performance of each portfolio is tracked relative to these limits and action taken where necessary. These limits apply to a range of credit risk-related measures including expected loss of the portfolio, the expected loss in a given stress scenario, projected credit default rates and the LTV of personal mortgage portfolios.

Personal credit risk assessment*

Personal lending entails making a large number of small-value loans. To ensure that these lending decisions are made consistently, credit information is analysed, including the historical debt servicing behaviour of customers with respect to both the Group and their other lenders. The Group then sets its lending rules accordingly, developing different rules for different products. The process is then largely automated, with customers receiving a credit score that reflects a comparison of their credit profile with the rule set. However, for relatively high-value, complex personal loans, including some residential mortgage lending, specialist credit managers make the final lending decisions.

Personal risk mitigation*

The Group takes collateral in the form of residential property to mitigate the credit risk arising from mortgages and home equity lending. The Group values residential property during the loan underwriting process by either appraising properties individually or valuing them collectively using statistically valid models. The Group updates residential property values quarterly using the relevant residential property index, namely:

Region	Index used
UK	Halifax quarterly regional house price index
Northern Ireland	Office for National Statistics house price index
Rol	Central Statistics Office residential property price index

Problem debt management*

Personal customers in financial difficulty are managed through either collections or recoveries functions. Further details of these are set out below:

Collections*

Collections functions in each of RBS's personal businesses provide support to customers who cannot meet their obligations to RBS. Such customers may miss a payment on their loan, borrow more than their agreed limit, or ask for help. Dedicated support teams are also in place to identify and help customers who have not yet missed a payment but may be facing financial difficulty. The collections function uses a range of tools to initiate contact with such customers, establish the cause of their financial difficulty and support them where possible.

In the process, they may consider granting the customer forbearance.

Additionally, in the UK and Ireland support is provided to customers with unsecured loans who establish a repayment plan with the Group through a debt advice agency or a self-help tool. Such "breathing space" suspends collections activity for a 30-day period to allow time for the repayment plan to be put in place. Arrears continue to accrue for customer loans granted breathing space.

If collections strategies are unsuccessful the relationship is transferred to the recoveries team.

Forbearance

Forbearance takes place when a concession is made on the contractual terms of a loan in response to a customer's financial difficulties.

Customers who contact the Group 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.

The type of forbearance granted will differ based upon an assessment of the customer's circumstances. Forbearance is granted principally to customers with mortgages and less frequently to customers with unsecured loans.

Forbearance options include, but are not limited to:

- **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. Ulster Bank Rol also offers payment concessions in the form of discounted interest rates that involve the forgiveness of some interest.
- **Capitalisation of arrears** - The customer repays the arrears over the remaining term of the mortgage and returns to an up-to-date position.
- **Term extensions** - The maturity date of the loan is extended.
- **Interest only conversions** - The loan converts from principal and interest repayment to interest only repayment on a permanent or, in Ulster Bank Rol only, temporary basis. UK Personal, interest only conversions have not been used to support customers in financial difficulty since 2009.

Types of forbearance offered in the unsecured portfolios vary by reportable segment.

Monitoring of forbearance - The granting of forbearance will only change the delinquency status of the loan in exceptional circumstances, which can include capitalisation of principal and interest in arrears, where the loan may be returned to the performing book if it remains up to date for the duration of the probation period and is deemed likely to continue to do so.

Additionally for some forbearance types a loan may be transferred to the performing book if a customer makes payments that reduce loan arrears below 90 days (Ulster Bank Rol, PBB collections function).

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Financial review Capital and risk management

Impairments for forbearance Methodology used for provisioning and impairments for forborne loans will differ depending on whether the loans are performing or non-performing and which business is managing them due to local market conditions. The type of provisioning methodology used and specific factors considered for forborne loans is summarised below:

	Performing forborne loans - Latent calculation ⁽¹⁾	Non-performing forborne loans	
	Difference in PD/LGD used for forborne population	Treatment	Difference in LGD used for forborne population
UK PBB (excl Northern Ireland)	<ul style="list-style-type: none"> Forborne loans form a separate risk pool for 24 months. Calculation uses the higher of the observed (forborne and total population) default rates, or PD. An extended emergence period is incorporated for forborne loans. 	Collective	<ul style="list-style-type: none"> No difference in treatment for non-forborne loans, LGD models unaffected by forbearance.
Northern Ireland	<ul style="list-style-type: none"> The PD model used in latent provision calculations is calibrated separately for forborne loans, using information on the historic performance of loans subject to similar arrangements. An extended emergence period is incorporated for forborne loans. 	Collective	<ul style="list-style-type: none"> No difference in treatment for non-forborne loans, LGD models unaffected by forbearance.
Ulster Bank RoI	<ul style="list-style-type: none"> Forborne loans and previous forborne loans form a separate risk pool taking into account the term of the forbearance treatment and applicable post-probationary periods. The PD model used in latent provision calculations is calibrated separately for forborne loans, using information on the historic performance of loans subject to similar arrangements. An extended emergence period is incorporated for forborne loans. 	Collective	<ul style="list-style-type: none"> Forborne (and previously forborne) loans form a separate risk pool where specific LGDs are allocated using observed performance of these loans.
Private Banking	<ul style="list-style-type: none"> An extended emergence period is incorporated for forborne loans. 	Individual	<ul style="list-style-type: none"> No difference in treatment for non-forborne loans, LGD models unaffected by forbearance.

Note:

(1) Once such loans are no longer separately identified, the use of account level PDs, refreshed monthly in the latent provision methodology, captures the underlying credit risk without a material time lag. There is no reassessment of the PD at the time forbearance is granted but the loan is subject to the latent provisioning described above.

Financial review Capital and risk management

Credit risk: management basis continued

Recoveries*

Once a loan has been identified as impaired it is managed by recoveries teams in the relevant businesses. The teams seek to minimise the Group's loss by maximising cash recovery while treating customers fairly.

Where an acceptable repayment arrangement cannot be agreed with the customer litigation may be considered. In the UK and Northern Ireland, no repossession procedures are initiated until at least six months following the emergence of arrears (in the Republic of Ireland, regulations prohibit taking legal action for an extended period). Additionally, certain forbearance options are made available to customers managed by the recoveries function.

Personal portfolio overview: Personal credit risk

	2015			
	UK PBB £m	Ulster Bank Rol £m	Private Banking £m	Total £m
Mortgages	85,257	13,770	6,187	105,214
Of which:				
Interest only variable rate*	9,073	622	3,224	12,919
Interest only fixed rate*	8,391	11	1,973	10,375
Mixed (capital and interest only)*	3,568	86	1	3,655
Buy-to-let*	12,790	2,005	451	15,246
Forbearance	2,418	3,515	63	5,996
Forbearance stock: arrears status				
Current	2,089	2,143	63	4,295
1-3 months in arrears	193	653	—	846
> 3 months in arrears	136	719	—	855
Provisions	120	1,062	3	1,185
REIL	520	2,550	19	3,089
Other lending	8,416	280	3,240	11,936
Total lending	93,673	14,050	9,427	117,150
Mortgage LTV ratios				
- Total portfolio	56%	83%	51%	60%
- New business	69%	77%	55%	68%
- Performing	56%	80%	51%	59%
- Non-performing	63%	106%	90%	89%

Note:

(1) Impairment provisions above include latent provisions.

Mortgage LTV distribution

LTV ratio value 2015	<=50% £m	50% <=70% £m	70% <=90% £m	90% <=100% £m	100% <=110% £m	110% <=130% £m	130% <=150% £m	>150% £m	Total with LTVs £m	Other £m	Total £m
UK PBB	31,435	31,992	19,130	2,168	181	183	100	24	85,213	44	85,257
Performing	31,110	31,533	18,841	2,115	159	167	88	18	84,031	43	84,074
Non-performing	325	459	289	53	22	16	12	6	1,182	1	1,183
Ulster Bank Rol	2,549	2,395	2,816	1,279	1,258	2,302	891	280	13,770	—	13,770
Performing	2,382	2,220	2,580	1,126	1,082	1,899	558	92	11,939	—	11,939
Non-performing	167	175	236	153	176	403	333	188	1,831	—	1,831
Private Banking	2,298	2,697	783	36	11	3	12	20	5,860	327	6,187
Performing	2,295	2,696	780	27	9	1	12	19	5,839	327	6,166
Non-performing	3	1	3	9	2	2	—	1	21	—	21

*unaudited

Financial review Capital and risk management

	2014			
	UK PBB £m	Ulster Bank Rol £m	Private Banking £m	Total £m
Mortgages	73,558	15,272	6,104	94,934
Of which:				
Interest only variable rate*	9,159	795	3,793	13,747
Interest only fixed rate*	7,374	8	1,472	8,854
Mixed (capital and interest only)*	3,899	120	—	4,019
Buy-to-let*	9,606	1,902	523	12,031
Forbearance	2,784	3,856	50	6,690
Forbearance stock: arrears status				
Current	2,407	2,214	50	4,671
1-3 months in arrears	211	686	—	897
> 3 months in arrears	166	956	—	1,122
Provisions	125	1,378	3	1,506
REIL	668	3,270	20	3,958
Other lending	9,037	329	4,876	14,242
Total lending	82,595	15,601	10,980	109,176
Mortgage LTV ratios				
- Total portfolio	58%	93%	51%	63%
- New business	71%	77%	47%	68%
- Performing	58%	89%	51%	62%
- Non-performing	69%	115%	78%	99%

Mortgage LTV distribution

LTV ratio value 2014	<=50% £m	50% <=70% £m	70% <=90% £m	90% <=100% £m	100% <=110% £m	110% <=130% £m	130% <=150% £m	>150% £m	Total with LTVs £m	Other £m	Total £m
UK PBB	25,304	27,565	17,545	2,010	540	288	151	106	73,509	49	73,558
<i>Performing</i>	25,052	27,120	17,156	1,917	496	254	140	88	72,223	47	72,270
<i>Non-performing</i>	252	445	389	93	44	34	11	18	1,286	2	1,288
Ulster Bank Rol	2,331	2,135	2,650	1,309	1,336	2,688	1,973	850	15,272	—	15,272
<i>Performing</i>	2,152	1,942	2,385	1,143	1,144	2,196	1,437	393	12,792	—	12,792
<i>Non-performing</i>	179	193	265	166	192	492	536	457	2,480	—	2,480
Private Banking	2,646	2,565	694	39	25	9	4	15	5,997	107	6,104
<i>Performing</i>	2,640	2,562	683	35	23	9	4	13	5,969	107	6,076
<i>Non-performing</i>	6	3	11	4	2	—	—	2	28	—	28

*unaudited

Financial review Capital and risk management

Credit risk: management basis continued

Key credit portfolios

UK PBB*

Overview

- The UK personal mortgage portfolio increased by 16% to £85.3 billion. £72.5 billion (2014 - £64.0 billion) was owner-occupied and £12.8 billion (2014 - £9.6 billion) was buy-to-let. Of the total portfolio approximately £23 billion related to properties in the south east of England, while £18 billion related to properties in Greater London.
- Gross new mortgage lending amounted to £21.7 billion in 2015. Lending to owner-occupiers during this period was £18.0 billion (2014 - £14.8 billion) and had an average LTV by weighted value of 71% (2014 - 72%). Buy-to-let lending was £3.7 billion (2014 - £2.8 billion) with an average LTV by weighted value of 64% (2014 - 64%).
- Based on the Halifax House Price Index at September 2015, the portfolio average indexed LTV by volume was 50% (2014 - 51%) and 55.7% by weighted value of debt outstanding (2014 - 56.8). This excludes £2 billion of mortgages granted by Ulster Bank Northern Ireland which are indexed against the house price index published by the Office of National Statistics.
- Of the total mortgage portfolio, approximately 74% (£63 billion) were fixed interest rate products of varying time durations with 2% (£2 billion) a combination of fixed and variable rates and the remainder variable rate. Approximately 12% (£9.0 billion) of owner-occupied mortgages were on interest-only terms with a bullet repayment and 5% (£3.3 billion) were on a combination of interest-only and capital and interest. The remainder were capital and interest. 66% (£8.5 billion) of the buy-to-let mortgages were on interest-only terms and 2% (£0.3 billion) on a combination of interest only and capital and interest.
- The arrears rate fell from 0.8% in December 2014 to 0.7% at the end of 2015. This reflected the growth in the mortgage portfolio, the stable UK economy and underlying asset quality.
- The flow of new forbearance was £183 million in the second half of 2015 compared with £191 million in the second half of 2014. The value of mortgages subject to forbearance has decreased by 13% since the previous year end to £2.4 billion (equivalent to 2.8% of the total mortgage book) as a result of improved market conditions and methodology changes.
- The majority (93%) of UK PBB forbearance is permanent in nature (term extensions, capitalisation of arrears, historic conversions to interest only). Temporary forbearance comprises payment concessions such as reduced or deferred payments with such arrangements typically agreed for a period of three to six months.
- The impairment charge for mortgage loans remained low at £7.0 million in 2015 reflecting continuing house price increases, albeit these were less significant than those experienced in 2014 which saw a net release of £6.9 million.
- A summary of the maturity profile for bullet principal repayment interest only mortgages (excluding mixed repayment mortgages) is set out below:*

The table below shows interest only mortgage portfolios (excluding mixed repayment mortgages) by type and by contractual year of maturity.

2015	2016 (1) £m	2017-18 £m	2019-23 £m	2024-28 £m	2029-33 £m	2034-43 £m	After 2043 £m	Total £m
Bullet principal repayment (2)	303	764	2,585	3,773	4,570	5,121	344	17,460
Conversion to amortising (2,3)	4	—	—	—	—	—	—	4
Total	307	764	2,585	3,773	4,570	5,121	344	17,464

2014	2015 (4) £m	2016-17 £m	2018-22 £m	2023-27 £m	2028-32 £m	2033-42 £m	After 2042 £m	Total £m
Bullet principal repayment (2)	278	714	2,598	3,528	4,518	4,630	252	16,518
Conversion to amortising (2,3)	14	1	—	—	—	—	—	15
Total	292	715	2,598	3,528	4,518	4,630	252	16,533

Notes:

(1) 2016 includes pre-2016 maturity exposure.

(2) Includes £1.0 billion (2014 - £1.1 billion) of repayment mortgages that have been granted interest only concessions (forbearance).

(3) Maturity date relates to the expiry of the interest only period.

(4) 2015 includes pre-2015 maturity exposure.

*unaudited

Financial review Capital and risk management

Ulster Bank Rol*

Overview

- Ulster Bank Rol's residential mortgage portfolio totalled £13.8 billion at 31 December 2015. Excluding the impact of exchange rate movements, the portfolio decreased by 4.4% from 31 December 2014 as a result of amortisation - a portion of which related to the variable rate mortgage portfolio and the sale of a £0.3 billion buy-to-let mortgage portfolio. The volume of new business has increased reflecting continuing market demand.
- Gross new mortgage lending amounted to £522 million in 2015. Lending to owner-occupiers during this period was £511 million (2014 - £392 million) and had an average LTV by weighted value of 77% (2014 - 76%). Buy-to-let lending was £10 million (2014 - £10 million) with an average LTV by weighted value of 66% (2014 - 73%).
- The interest-rate product mix was approximately 87% (£12.0 billion) of the mortgage portfolio on variable-rate products and 13% (£1.7 billion) on fixed rate.
- The portfolio average indexed LTV decreased from 93% at 31 December 2014 to 83% at 31 December 2015 as a result of improved market conditions and the sale of a buy-to-let mortgage portfolio.
- At 31 December 2015, 26% of total mortgage assets (£3.5 billion) were subject to a forbearance arrangement, a decrease of 9% (£0.3 billion) from 31 December 2014. Excluding the impact of exchange rate movements, the value of mortgage assets subject to a forbearance arrangement has decreased by £131 million (3.3%).
- The number of customers approaching Ulster Bank Rol for the first time in respect of forbearance assistance declined through 2015.
- A total of 59% (£2.1 billion) of forborne loans were subject to a long term arrangement (capitalisations, term extensions, economic concessions) at 31 December 2015 (2014 - 51%, £2.0 billion). Short term forbearance comprises payment concessions, amortising payments of outstanding balances, payment holidays and temporary interest only arrangements.
- The impairment release was driven by a decrease in defaulted assets leading to reduced loss expectations.
- Ulster Bank Rol stopped offering interest only loans as a standard mortgage offering for new lending in the Republic of Ireland in 2010. Interest only mortgages are now granted only to customers in need of forbearance. A summary of the maturity profile for bullet principal repayment interest only mortgages (excluding mixed repayment mortgages) is set out below:*

The table below shows interest only mortgage portfolios (excluding mixed repayment mortgages) by type and by contractual year of maturity.

	2016 (1)	2017-18	2019-23	2024-28	2029-33	2034-43	After 2043	Total
	£m	£m	£m	£m	£m	£m	£m	£m
2015								
Bullet principal repayment (2)	7	14	28	44	67	26	6	192
Conversion to amortising (2,3)	308	119	5	3	3	2	1	441
Total	315	133	33	47	70	28	7	633
2014								
Bullet principal repayment (2)	6	16	32	45	69	35	8	211
Conversion to amortising (2,3)	352	205	29	2	4	—	—	592
Total	358	221	61	47	73	35	8	803

Notes:

(1) 2016 includes pre-2016 maturity exposure.

(2) Includes £0.1 billion (2014 - £0.3 billion) of repayment mortgages that have been granted interest only concessions (forbearance).

(3) Maturity date relates to the expiry of the interest only period.

(4) 2015 includes pre-2015 maturity exposure.

*unaudited

Financial review Capital and risk management

Credit risk: management basis continued

Private Banking*

Overview

- The majority of the Private Banking personal lending portfolio relates to mortgage lending. The mortgage portfolio was broadly unchanged at £6.2 billion.
- Gross new mortgage lending amounted to £2.2 billion in 2015. Lending to owner-occupiers during this period was £2.0 billion (2014 - £2.1 billion) with an average LTV by weighted value of 54% (2014 - 51%). Buy-to-let lending was £0.2 billion (2014 - £0.2 billion) with an average LTV by weighted value of 65% (2014 - 59%).
- The number of customers with mortgages in forbearance at the end of 2015 increased from 42 to 58 compared to the end of 2014. In value terms, the exposure increased from £50 million to £63 million.
- A total of 85% (£53.6 million) of forbearance loans were subject to a long term arrangement (capitalisations, term extensions, economic concessions) at 31 December 2015 (2014 - 65% or £32.7 million). Short term forbearance comprises payment concessions, amortising payments of outstanding balances, payment holidays and temporary interest only arrangements.
- Private Banking offers interest-only mortgages to high net worth customers, with over a third of the book typically being refinanced/replaced per annum. A summary of the maturity profile for bullet principal repayment interest only mortgages (excluding mixed repayment mortgages) is set out below.

The table below shows interest only mortgage portfolios (excluding mixed repayment mortgages) by type and by contractual year of maturity.

	2016 (1) £m	2017-18 £m	2019-23 £m	2024-28 £m	2029-33 £m	2034-43 £m	After 2043 £m	Total £m
2015								
Bullet principal repayment	838	1,513	1,562	829	267	187	1	5,197
	2015 (2) £m	2016-17 £m	2018-22 £m	2023-27 £m	2028-32 £m	2033-42 £m	After 2042 £m	Total £m
2014								
Bullet principal repayment	1,202	1,404	1,965	425	162	106	1	5,265

Notes:

- (1) 2016 includes pre-2016 maturity exposure.
(2) 2015 includes pre-2015 maturity exposure.

*unaudited

Financial review Capital and risk management

Credit risk: balance sheet analysis

Credit risk assets analysed on pages 51 to 62 are reported internally to senior management. However they exclude certain exposures, primarily securities and reverse repurchase agreements and take account of legal netting agreements, that provide a right if legal set-off but do not meet the offset criteria in IFRS. The tables that follow are therefore provided to supplement disclosures of credit risk assets to reconcile to the balance sheet. All the disclosures in this section are audited.

Financial assets exposure summary

The table below analyses the Group's financial assets exposures, both gross and net of offset arrangements.

	Group				
	Gross exposure £m	IFRS offset (1) £m	Carrying value £m	Balance sheet offset (2) £m	Exposure post offset (3) £m
2015					
Cash and balances at central banks	1,690	—	1,690	—	1,690
Reverse repos	24,668	(13,987)	10,681	(449)	10,232
Lending	169,457	—	169,457	(6,865)	162,592
Debt securities	7,204	—	7,204	—	7,204
Equity shares	717	—	717	—	717
Derivatives	889	—	889	(171)	718
Settlement balances	2,506	(1,057)	1,449	(26)	1,423
Total third party excluding disposal groups	207,131	(15,044)	192,087	(7,511)	184,576
Disposal groups	3,219	—	3,219	—	3,219
Total third party including disposal groups	210,350	(15,044)	195,306	(7,511)	187,795
Amounts due from holding company and fellow subsidiaries	102,385	—	102,385	(1,334)	101,051
Total gross of short positions	312,735	(15,044)	297,691	(8,845)	288,846
Short positions	(3,577)	—	(3,577)	—	(3,577)
Net of short positions	309,158	(15,044)	294,114	(8,845)	285,269
2014					
Cash and balances at central banks	2,709	—	2,709	—	2,709
Reverse repos	24,547	(15,872)	8,675	(265)	8,410
Lending	167,103	—	167,103	(6,795)	160,308
Debt securities	13,047	—	13,047	—	13,047
Equity shares	779	—	779	—	779
Derivatives	1,231	(5)	1,226	(259)	967
Settlement balances	3,486	(1,776)	1,710	—	1,710
Total third party	212,902	(17,653)	195,249	(7,319)	187,930
Amounts due from holding company and fellow subsidiaries	108,094	—	108,094	(1,715)	106,379
Total gross of short positions	320,996	(17,653)	303,343	(9,034)	294,309
Short positions	(6,827)	—	(6,827)	—	(6,827)
Net of short positions	314,169	(17,653)	296,516	(9,034)	287,482

Notes:

- (1) Relates to offset arrangements that comply with IFRS criteria and transactions cleared through and novated to central clearing houses, primarily London Clearing House and US Government Securities Clearing Corporation.
- (2) This reflects the amounts by which the Group's credit risk is reduced through master netting and cash management pooling arrangements. Derivative master netting agreements include cash pledged with counterparties in respect of net derivative liability positions and are included in lending.
- (3) The Group holds collateral in respect of net exposures above. For 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 debtors; 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.

Key points

- Total third party exposure post offset was broadly unchanged at £188 billion as £12 billion growth in mortgage lending was offset by reduction in commercial real estate lending of £8 billion reflecting disposal strategy and £6 billion decrease in debt securities following exits from US asset-backed business in the first half of the year.
- The exposure included £118 billion (2014 - £116 billion) of lending secured by property, £105 billion (2014 - £95 billion) residential and £13 billion (2014 - £21 billion) commercial real estate.

Financial review Capital and risk management

Credit risk: balance sheet analysis *continued*

The table below analyses the Bank's financial assets exposures, both gross and net of offset arrangements.

	Bank		
	Carrying value £m	Balance sheet offset (1) £m	Exposure post offset (2) £m
2015			
Cash and balances at central banks	819	—	819
Lending	135,273	(6,658)	128,615
Equity shares	4	—	4
Derivatives	760	(171)	589
Settlement balances	47	—	47
Total third party	136,903	(6,829)	130,074
Amounts due from holding company and fellow subsidiaries	73,685	(1,191)	72,494
Total	210,588	(8,020)	202,568
2014			
Cash and balances at central banks	1,054	—	1,054
Lending	124,084	(6,569)	117,515
Equity shares	5	—	5
Derivatives	983	(258)	725
Settlement balances	42	—	42
Total third party	126,168	(6,827)	119,341
Amounts due from holding company and fellow subsidiaries	81,628	(1,466)	80,162
Total	207,796	(8,293)	199,503

Notes:

- (1) This reflects the amounts by which the Bank's credit risk is reduced through master netting and cash management pooling arrangements. Derivative master netting agreements include cash pledged with counterparties in respect of net derivative liability positions and are included in lending.
- (2) The Bank holds collateral in respect of net exposures above. For 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 debtors; 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.

Key point

- The growth in financial assets principally reflects mortgage growth in UK PBB, following concentrated investment in the mortgage business during 2015, including increasing mortgage advisors.

Financial review Capital and risk management

Sector concentration

The following tables analyse the Group's financial assets by industry sector.

2015	Group								
	Reverse repos £m	Lending £m	Securities		Derivatives £m	financial assets £m	Other £m	Balance sheet value £m	Exposure post offset £m
			Debt £m	Equity £m				Offset £m	
Central and local government	362	1,327	5,914	—	1	106	7,710	(1,135)	6,575
Financial institutions - banks	157	3,718	70	—	35	1,690	5,670	(1)	5,669
- other	10,137	2,875	1,188	723	216	1,297	16,436	(1,580)	14,856
Personal - mortgages	—	105,149	—	—	—	—	105,149	—	105,149
- unsecured	—	11,138	—	—	33	—	11,171	—	11,171
Property	—	15,868	—	2	258	—	16,128	(277)	15,851
Construction	—	2,491	—	—	2	—	2,493	(814)	1,679
Manufacturing	—	3,933	—	—	34	22	3,989	(397)	3,592
Finance leases and instalment credit	—	211	—	—	—	—	211	—	211
Retail, wholesale and repairs	—	6,443	—	—	20	4	6,467	(659)	5,808
Transport and storage	—	1,256	—	—	12	—	1,268	(238)	1,030
Health, education and leisure	—	6,074	—	—	170	—	6,244	(485)	5,759
Hotels and restaurants	—	2,971	—	—	17	—	2,988	(117)	2,871
Utilities	—	748	—	—	52	—	800	(246)	554
Other	25	10,590	32	2	39	20	10,708	(1,562)	9,146
Total third party	10,681	174,792	7,204	727	889	3,139	197,432	(7,511)	189,921
Amounts due from holding company and fellow subsidiaries	—	99,972	—	—	1,724	689	102,385	(1,334)	101,051
Total gross of provisions	10,681	274,764	7,204	727	2,613	3,828	299,817	(8,845)	290,972
Provisions	—	(5,335)	—	(10)	—	—	(5,345)	n/a	(5,345)
Total excluding disposal groups	10,681	269,429	7,204	717	2,613	3,828	294,472	(8,845)	285,627
Disposal groups	—	2,312	419	23	25	440	3,219	—	3,219
Total	10,681	271,741	7,623	740	2,638	4,268	297,691	(8,845)	288,846

2014

Central and local government	10	1,167	9,213	—	2	237	10,629	(970)	9,659
Financial institutions - banks	3,017	4,623	337	2	61	2,709	10,749	(2)	10,747
- other	5,648	3,055	3,081	762	282	1,434	14,262	(1,318)	12,944
Personal - mortgages	—	95,269	—	—	—	—	95,269	—	95,269
- unsecured	—	13,449	—	—	—	—	13,449	—	13,449
Property	—	24,285	1	2	374	5	24,667	(308)	24,359
Construction	—	2,614	2	—	4	—	2,620	(741)	1,879
Manufacturing	—	4,401	148	3	45	5	4,602	(498)	4,104
Finance leases and instalment credit	—	181	11	—	—	—	192	(1)	191
Retail, wholesale and repairs	—	7,439	35	—	44	3	7,521	(953)	6,568
Transport and storage	—	1,515	25	5	21	—	1,566	(214)	1,352
Health, education and leisure	—	6,785	14	—	188	—	6,987	(552)	6,435
Hotels and restaurants	—	3,372	—	20	45	—	3,437	(140)	3,297
Utilities	—	707	12	—	57	—	776	(198)	578
Other	—	12,149	168	—	103	26	12,446	(1,424)	11,022
Total third party	8,675	181,011	13,047	794	1,226	4,419	209,172	(7,319)	201,853
Amounts due from holding company and fellow subsidiaries	—	104,300	782	—	2,672	340	108,094	(1,715)	106,379
Total gross of provisions	8,675	285,311	13,829	794	3,898	4,759	317,266	(9,034)	308,232
Provisions	—	(13,908)	—	(15)	—	—	(13,923)	n/a	(13,923)
Total	8,675	271,403	13,829	779	3,898	4,759	303,343	(9,034)	294,309

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

The following tables analyse the Bank's financial assets by industry sector.

	Bank							Exposure post offset £m
	Lending £m	Securities Debt £m	Equity £m	Derivatives £m	Other financial assets £m	Balance sheet value £m	Offset £m	
2015								
Central and local government	1,281	—	—	1	—	1,282	(1,135)	147
Financial institutions - banks	1,022	—	—	2	819	1,843	(1)	1,842
- other	2,227	—	4	216	2	2,449	(1,105)	1,344
Personal - mortgages	83,092	—	—	—	—	83,092	—	83,092
- unsecured	7,993	—	—	—	—	7,993	—	7,993
Property	12,540	—	—	256	—	12,796	(257)	12,539
Construction	1,901	—	—	2	—	1,903	(784)	1,119
Manufacturing	3,073	—	—	31	22	3,126	(385)	2,741
Finance leases and instalment credit	5	—	—	—	—	5	—	5
Retail, wholesale and repairs	5,364	—	—	19	4	5,387	(627)	4,760
Transport and storage	1,121	—	—	8	—	1,129	(232)	897
Health, education and leisure	5,397	—	—	163	—	5,560	(478)	5,082
Hotels and restaurants	2,439	—	—	17	—	2,456	(111)	2,345
Utilities	499	—	—	16	—	515	(246)	269
Other	9,011	—	—	29	19	9,059	(1,468)	7,591
Total third party	136,965	—	4	760	866	138,595	(6,829)	131,766
Amounts due from holding company and fellow subsidiaries	72,359	—	—	1,326	—	73,685	(1,191)	72,494
Total gross of provisions	209,324	—	4	2,086	866	212,280	(8,020)	204,260
Provisions	(1,692)	—	—	—	—	(1,692)	n/a	(1,692)
Total	207,632	—	4	2,086	866	210,588	(8,020)	202,568
2014								
Central and local government	1,112	—	—	2	—	1,114	(970)	144
Financial institutions - banks	1,805	—	2	3	1,054	2,864	(2)	2,862
- other	2,030	—	3	229	2	2,264	(1,052)	1,212
Personal - mortgages	71,303	—	—	—	—	71,303	—	71,303
- unsecured	9,027	—	—	—	—	9,027	—	9,027
Property	13,242	—	—	370	5	13,617	(275)	13,342
Construction	1,836	—	—	4	—	1,840	(710)	1,130
Manufacturing	3,182	—	—	36	5	3,223	(486)	2,737
Finance leases and instalment credit	17	—	—	—	—	17	(1)	16
Retail, wholesale and repairs	5,858	—	—	40	3	5,901	(918)	4,983
Transport and storage	868	—	—	14	—	882	(208)	674
Health, education and leisure	5,770	—	—	182	—	5,952	(544)	5,408
Hotels and restaurants	2,460	—	—	45	—	2,505	(135)	2,370
Utilities	139	—	—	17	—	156	(147)	9
Other	7,965	—	—	41	27	8,033	(1,379)	6,654
Total third party	126,614	—	5	983	1,096	128,698	(6,827)	121,871
Amounts due from holding company and fellow subsidiaries	78,717	782	—	2,129	—	81,628	(1,466)	80,162
Total gross of provisions	205,331	782	5	3,112	1,096	210,326	(8,293)	202,033
Provisions	(2,530)	—	—	—	—	(2,530)	n/a	(2,530)
Total	202,801	782	5	3,112	1,096	207,796	(8,293)	199,503

For geographic concentrations refer to:

- Lending: Loans and related credit metrics; and
- Debt securities: IFRS measurement classification and issuer.

Financial review Capital and risk management

Asset quality

The asset quality analysis presented below is based on the Group's internal asset quality ratings which have ranges for the probability of default, as set out below. Customers are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades across the Group map to both an asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across portfolios. Debt securities are analysed by external ratings and are therefore excluded from the following tables and are set out on pages 74 and 75.

The table that follows details the relationship between the Group's master grading scale and AQ bands and external ratings published by Standard & Poor's (S&P), for illustrative purposes only. This relationship is established by observing S&P's default study statistics, notably the one year default rates for each S&P rating grade. A degree of judgement is required to relate the PD ranges associated with the master grading scale to these default rates given that, for example, the S&P published default rates do not increase uniformly by grade and the historical default rate is nil for the highest rating categories.

Internal asset quality band	Probability of default range	Indicative S&P rating
AQ1	0% - 0.034%	AAA to AA
AQ2	0.034% - 0.048%	AA-
AQ3	0.048% - 0.095%	A+ to A
AQ4	0.095% - 0.381%	BBB+ to BBB-
AQ5	0.381% - 1.076%	BB+ to BB
AQ6	1.076% - 2.153%	BB- to B+
AQ7	2.153% - 6.089%	B+ to B
AQ8	6.089% - 17.222%	B- to CCC+
AQ9	17.222% - 100%	CCC to C
AQ10	100%	D

The mapping to the S&P ratings is used by the Group as one of several benchmarks for its wholesale portfolios, depending on customer type and the purpose of the benchmark. The mapping is based on all issuer types rated by S&P. It should therefore be considered illustrative and does not, for instance, indicate that exposures reported against S&P ratings either have been or would be assigned those ratings if assessed by S&P. In addition, the relationship is not relevant for retail portfolios, smaller corporate exposures or specialist corporate segments given that S&P does not typically assign ratings to such entities.

	Group										Balances due from holding company and fellow subsidiaries £bn	Past due £bn	Impaired £bn	Impairment provision £bn	Total £bn
	AQ1 £bn	AQ2 £bn	AQ3 £bn	AQ4 £bn	AQ5 £bn	AQ6 £bn	AQ7 £bn	AQ8 £bn	AQ9 £bn	AQ10 £bn					
2015															
Cash and balances at central banks	1.7	—	—	—	—	—	—	—	—	—	—	—	—	—	1.7
Banks															
- Reverse repos	0.2	—	—	—	—	—	—	—	—	—	—	—	—	—	0.2
- Bank loans	1.4	0.3	1.7	0.1	0.1	0.1	—	—	—	—	99.4	—	—	—	103.1
- Total	1.6	0.3	1.7	0.1	0.1	0.1	—	—	—	—	99.4	—	—	—	103.3
Customers															
- Reverse repos	6.8	0.4	0.2	1.9	1.2	—	—	—	—	—	—	—	—	—	10.5
- Customer loans	10.4	5.2	17.5	66.3	28.2	16.4	10.2	2.5	2.2	0.7	0.6	3.9	7.6	(5.3)	166.4
- Total	17.2	5.6	17.7	68.2	29.4	16.4	10.2	2.5	2.2	0.7	0.6	3.9	7.6	(5.3)	176.9
Settlement balances and other financial assets	0.9	—	—	0.5	—	—	—	—	—	—	0.7	—	—	—	2.1
Derivatives	0.6	—	—	0.1	0.1	0.1	—	—	—	—	1.7	—	—	—	2.6
Undrawn commitments	8.9	1.3	1.9	14.6	13.4	5.2	3.7	0.3	—	0.3	—	—	—	—	49.6
Contingent liabilities	0.3	0.1	0.3	0.6	0.5	0.3	0.2	—	—	—	—	—	—	—	2.3
	31.2	7.3	21.6	84.1	43.5	22.1	14.1	2.8	2.2	1.0	102.4	3.9	7.6	(5.3)	338.5
Disposal groups															2.8
Total															341.3
Total %	9.2	2.2	6.4	24.8	12.9	6.5	4.2	0.8	0.6	0.3	30.3	1.2	2.2	(1.6)	100

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

	Group										Balances due from holding company and fellow subsidiaries £bn	Past due £bn	Impaired £bn	Impairment provision £bn	Total £bn
2014	AQ1 £bn	AQ2 £bn	AQ3 £bn	AQ4 £bn	AQ5 £bn	AQ6 £bn	AQ7 £bn	AQ8 £bn	AQ9 £bn	AQ10 £bn					
Cash and balances at central banks	2.7	—	—	—	—	—	—	—	—	—	—	—	—	—	2.7
Banks															
- Reverse repos	2.1	0.2	0.3	0.2	0.2	—	—	—	—	—	—	—	—	—	3.0
- Bank loans	2.3	0.2	0.8	0.9	0.2	0.1	0.1	—	—	—	103.3	—	—	—	107.9
- Total	4.4	0.4	1.1	1.1	0.4	0.1	0.1	—	—	—	103.3	—	—	—	110.9
Customers															
- Reverse repos	4.3	—	0.3	0.5	0.6	—	—	—	—	—	—	—	—	—	5.7
- Customer loans	13.3	6.7	11.0	60.4	28.6	16.7	10.0	3.1	3.1	0.6	1.0	4.0	18.9	(13.9)	163.5
- Total	17.6	6.7	11.3	60.9	29.2	16.7	10.0	3.1	3.1	0.6	1.0	4.0	18.9	(13.9)	169.2
Settlement balances and other financial assets	0.9	—	0.1	0.3	0.1	—	—	—	—	—	0.3	0.3	—	—	2.0
Derivatives	0.3	0.1	—	0.2	0.2	0.1	0.2	—	—	0.1	2.7	—	—	—	3.9
Undrawn commitments	9.2	2.0	2.3	13.3	13.4	5.6	2.8	0.4	0.1	0.7	—	—	—	—	49.8
Contingent liabilities	0.3	0.2	0.3	0.7	0.6	0.3	0.2	—	—	—	0.3	—	—	—	2.9
Total	35.4	9.4	15.1	76.5	43.9	22.8	13.3	3.5	3.2	1.4	107.6	4.3	18.9	(13.9)	341.4
Total %	10.4	2.8	4.4	22.4	12.9	6.7	3.9	1.0	0.9	0.4	31.5	1.3	5.5	(4.1)	100

Financial review Capital and risk management

	Bank										Balances due from holding company and fellow subsidiaries £bn	Past due £bn	Impaired £bn	Impairment provision £bn	Total £bn
	AQ1 £bn	AQ2 £bn	AQ3 £bn	AQ4 £bn	AQ5 £bn	AQ6 £bn	AQ7 £bn	AQ8 £bn	AQ9 £bn	AQ10 £bn					
2015															
Cash and balances at central banks	0.8	—	—	—	—	—	—	—	—	—	—	—	—	—	0.8
Banks															
- Bank loans	0.7	—	—	0.1	0.1	0.1	—	—	—	—	72.2	—	—	—	73.2
- Total	0.7	—	—	0.1	0.1	0.1	—	—	—	—	72.2	—	—	—	73.2
Customers															
- Customer loans	9.0	3.4	15.1	61.6	21.1	9.5	8.3	1.9	0.5	0.6	0.2	2.8	2.2	(1.7)	134.5
- Total	9.0	3.4	15.1	61.6	21.1	9.5	8.3	1.9	0.5	0.6	0.2	2.8	2.2	(1.7)	134.5
Derivatives	0.5	—	—	0.1	0.1	0.1	—	—	—	—	1.3	—	—	—	2.1
Undrawn commitments	8.8	0.5	1.0	13.0	12.1	4.5	3.3	0.2	—	0.2	—	—	—	—	43.6
Contingent liabilities	0.1	0.1	0.2	0.5	0.4	0.2	0.1	—	—	—	—	—	—	—	1.6
Total	19.9	4.0	16.3	75.3	33.8	14.4	11.7	2.1	0.5	0.8	73.7	2.8	2.2	(1.7)	255.8
Total %	7.8	1.6	6.4	29.4	13.2	5.6	4.6	0.8	0.2	0.3	28.8	1.1	0.9	(0.7)	100
2014															
Cash and balances at central banks	1.1	—	—	—	—	—	—	—	—	—	—	—	—	—	1.1
Banks															
- Bank loans	0.8	—	—	0.7	0.2	0.1	—	—	—	—	76.7	—	—	—	78.5
- Total	0.8	—	—	0.7	0.2	0.1	—	—	—	—	76.7	—	—	—	78.5
Customers															
- Customer loans	9.8	2.8	9.5	56.1	20.6	8.8	8.3	2.3	0.1	0.5	2.0	2.6	3.4	(2.5)	124.3
- Total	9.8	2.8	9.5	56.1	20.6	8.8	8.3	2.3	0.1	0.5	2.0	2.6	3.4	(2.5)	124.3
Derivatives	0.4	0.1	—	0.1	0.1	0.1	0.2	—	—	—	2.1	—	—	—	3.1
Undrawn commitments	8.8	0.5	1.1	11.9	12.2	4.9	2.0	0.2	0.1	0.3	0.1	—	—	—	42.1
Contingent liabilities	0.3	0.1	0.2	0.5	0.4	0.2	0.1	—	—	—	—	—	—	—	1.8
Total	21.2	3.5	10.8	69.3	33.5	14.1	10.6	2.5	0.2	0.8	80.9	2.6	3.4	(2.5)	250.9
Total %	8.5	1.4	4.3	27.6	13.4	5.6	4.2	1.0	0.1	0.3	32.2	1.0	1.4	(1.0)	100

Key points Group

- Capital Resolution's disposal strategy and other portfolio reduction strategies resulted in the non-investment grade (AQ5 and lower) portfolios decreasing by £2.4 billion (3%). Overall credit quality has remained broadly stable with about 42% (excluding cash and central bank balances) being investment grade or higher, supported by benign economic and credit conditions.
- Customer loans increased by £2.9 billion (2%) to £166.4 billion, with investment grade loans showing an increase from 56% of the total in 2014 to 60% in 2015. The increase of £12.4 billion in AQ3 and AQ4 reflected the improved asset quality in UK PBB's book along with growth in their mortgage business, partially offset by a decrease in impaired loans of £11.3 billion, primarily in Ulster.
- Bank loans decreased by £4.8 billion across most AQ bands. The increase in AQ3 reflects improvements in asset quality within Ulster Bank Rol.

Bank

- Customer loans increased by £10.2 billion (8%) to £134.5 billion, primarily in AQ3 and AQ4 reflected the improved asset quality in UK PBB's book along with growth in their mortgage business.

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

Loans, REIL and impairment provisions

Risk elements in lending (REIL) comprises impaired loans and accruing loans past due 90 days or more as to principal or interest. Impaired loans are all loans (including loans subjected to forbearance) for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans. Accruing loans past due 90 days or more comprise loans past due 90 days where no impairment loss is expected.

Loans and related credit metrics

Segmental analysis

The tables below analyse gross loans and advances (excluding reverse repos) and the related credit metrics by segment.

	Gross loans to		REIL £m	Provisions £m	Credit metrics			Impairment losses/ (releases) £m	Amounts written-off £m
	Banks £m	Customers £m			REIL as a % of gross loans to customers %	Provisions as a % of REIL %	Provisions as a % of gross loans to customers %		
2015									
UK PBB	770	99,359	2,076	1,555	2.1	75	1.6	20	587
Ulster Bank Rol	1,971	18,575	3,503	1,911	18.9	55	10.3	(142)	168
Commercial Banking	366	40,029	1,043	402	2.6	39	1.0	3	137
Private Banking	45	10,574	102	32	1.0	31	0.3	12	4
CIB	261	378	—	—	—	nm	—	(2)	—
Capital Resolution	54	2,088	1,640	1,435	78.5	88	68.7	(622)	6,380
Central items & other	251	71	—	—	—	—	—	—	—
Total third party	3,718	171,074	8,364	5,335	4.9	64	3.1	(731)	7,276
Amounts due from holding company and fellow subsidiaries	99,403	569	—	—	—	—	—	—	—
Disposal groups	674	1,658	20	20	1.2	100	1.2	—	—
Total	103,795	173,301	8,384	5,355	4.8	64	3.1	(731)	7,276

2014

UK PBB	748	88,840	2,778	2,130	3.1	77	2.4	165	546
Ulster Bank Rol	1,037	20,522	4,366	2,383	21.3	55	11.6	(306)	91
Commercial Banking	567	39,119	1,431	523	3.7	37	1.3	42	206
Private Banking	47	10,313	103	24	1.0	23	0.2	(5)	14
CIB	214	516	—	—	—	nm	—	—	—
Capital Resolution	1,100	13,997	11,135	8,827	79.6	79	63.1	(1,143)	1,213
Central items & other	910	3,081	21	21	0.7	100	0.7	—	1
Total third party	4,623	176,388	19,834	13,908	11.2	70	7.9	(1,247)	2,071
Amounts due from holding company and fellow subsidiaries	103,272	1,028	—	—	—	—	—	—	—
Total	107,895	177,416	19,834	13,908	11.2	70	7.8	(1,247)	2,071

Key points

- UK PBB: Gross mortgage lending increased by £11.7 billion, the strongest performance since 2009, reflecting strategy and investment. Unsecured balances continued to decline gradually.
- Ulster Bank Rol: Customer lending decreased by £1.9 billion. Strong new lending volumes were offset by high levels of customer repayments, the sale of a £0.3 billion buy-to-let mortgage portfolio and exchange rate movements. Tracker mortgages portfolio reduced by £1.4 billion from £10.6 billion in 2014 to £9.2 billion, making up two thirds of the mortgage book, and commercial real estate lending fell by £0.4 billion.
- Commercial Banking: Customer lending increased by £0.9 billion reflecting net new lending across key segments.
- Capital Resolution: Progress was made in de-risking the balance sheet as the Group continued the run-down or sale of certain businesses and higher risk or capital intensive assets. The run-down target of RCR was achieved a year ahead of schedule, contributing to overall Group commercial real estate gross lending decreasing from £21.0 billion in 2014 to £12.9 billion
- Credit quality remained stable, with risk elements in lending decreasing to £8.4 billion (4.8% of gross customer loans) at 31 December 2015, from £19.8 billion (11.2%) at 31 December 2014 and were covered by impairment provision by 64% or £5.4 billion (2014 - 70% or £13.9 billion). The decrease on REIL and impairment provision included write-offs of £7.3 billion, principally reflecting RCR Ireland's accelerated disposal strategy.

Financial review Capital and risk management

Sector and geographical concentration

The tables below analyse gross loans and advances to banks and customers (excluding reverse repos) and related credit metrics by sector and geography based on the location of lending office. Ulster Bank RoI contributes a significant proportion of the European loan exposure.

2015	Gross loans £m	REIL £m	Provisions £m	Credit metrics		Provisions as a % of gross loans %	Impairment losses/(releases) £m	Amounts written-off £m
				REIL as a % of gross loans %	Provisions as a % of REIL %			
Central and local government	1,327	1	1	0.1	100	0.1	—	—
Finance	2,875	34	21	1.2	62	0.7	2	38
Personal - mortgages (1)	105,149	3,089	931	2.9	30	0.9	(89)	152
- unsecured	11,138	970	838	8.7	86	7.5	108	387
Property	15,868	2,301	1,653	14.5	72	10.4	(386)	5,454
Construction	2,491	211	156	8.5	74	6.3	(39)	163
<i>of which: Commercial real estate</i>	<i>12,868</i>	<i>2,327</i>	<i>1,662</i>	<i>18.1</i>	<i>71</i>	<i>12.9</i>	<i>(424)</i>	<i>5,471</i>
Manufacturing	3,933	129	93	3.3	72	2.4	1	92
Finance leases and instalment credit	211	13	10	6.2	77	4.7	(1)	3
Retail, wholesale and repairs	6,443	328	236	5.1	72	3.7	1	287
Transport and storage	1,256	44	25	3.5	57	2.0	(3)	18
Health, education and leisure	6,074	248	128	4.1	52	2.1	10	125
Hotels and restaurants	2,971	241	164	8.1	68	5.5	(7)	244
Utilities	748	1	1	0.1	100	0.1	(1)	1
Other	10,590	754	645	7.1	86	6.1	(113)	312
Latent	—	—	433	—	—	—	(214)	—
Total third-party	171,074	8,364	5,335	4.9	64	3.1	(731)	7,276
Amounts due from fellow subsidiaries	569	—	—	—	—	—	—	—
Disposal groups	1,658	20	20	1.2	100	1.2	—	—
Total customers	173,301	8,384	5,355	4.8	64	3.1	(731)	7,276
Of which:								
UK								
Personal - mortgages	91,343	539	87	0.6	16	0.1	12	16
- unsecured	10,549	921	792	8.7	86	7.5	113	375
Property and construction	16,621	1,509	873	9.1	58	5.3	(46)	2,090
<i>of which: commercial real estate</i>	<i>11,321</i>	<i>1,369</i>	<i>769</i>	<i>12.1</i>	<i>56</i>	<i>6.8</i>	<i>(49)</i>	<i>2,013</i>
Other	32,427	916	562	2.8	61	1.7	(38)	308
Latent	—	—	183	—	—	—	(112)	—
	150,940	3,885	2,497	2.6	64	1.7	(71)	2,789
Europe								
Personal - mortgages	13,770	2,550	844	18.5	33	6.1	(101)	135
- unsecured	589	49	46	8.3	94	7.8	(5)	12
Property and construction	1,738	1,003	936	57.7	93	53.9	(379)	3,527
<i>of which: commercial real estate</i>	<i>1,547</i>	<i>958</i>	<i>893</i>	<i>61.9</i>	<i>93</i>	<i>57.7</i>	<i>(375)</i>	<i>3,458</i>
Other	3,785	877	762	23.2	87	20.1	(73)	812
Latent	—	—	250	—	—	—	(102)	—
	19,882	4,479	2,838	22.5	63	14.3	(660)	4,486
Banks	3,718	—	—	—	—	—	—	—
Amounts due from holding company and fellow subsidiaries	99,403	—	—	—	—	—	—	—
Disposal groups	674	—	—	—	—	—	—	—
Total banks	103,795	—	—	—	—	—	—	—

Note:

(1) Mortgages are reported in sectors other than personal mortgages by certain businesses based on the nature of the relationship with the customer.

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

2014	Gross loans £m	REIL £m	Provisions £m	Credit metrics			Impairment losses/(releases) £m	Amounts written-off £m
				REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %		
Central and local government	1,167	1	1	0.1	100	0.1	—	—
Finance	3,055	84	57	2.7	68	1.9	(1)	17
Personal - mortgages (1)	95,269	3,959	1,278	4.2	32	1.3	3	34
- unsecured	13,449	1,316	1,137	9.8	86	8.5	239	463
Property	24,285	10,255	7,845	42.2	76	32.3	(985)	1,028
Construction	2,614	577	365	22.1	63	14.0	3	94
<i>of which: commercial real estate</i>	<i>21,020</i>	<i>10,415</i>	<i>7,899</i>	<i>49.5</i>	<i>76</i>	<i>37.6</i>	<i>(993)</i>	<i>1,059</i>
Manufacturing	4,401	278	196	6.3	71	4.5	(18)	35
Finance leases and instalment credit	181	3	2	1.7	67	1.1	2	3
Retail, wholesale and repairs	7,439	783	548	10.5	70	7.4	90	111
Transport and storage	1,515	76	47	5.0	62	3.1	(3)	5
Health, education and leisure	6,785	482	250	7.1	52	3.7	(28)	107
Hotels and restaurants	3,372	732	435	21.7	59	12.9	(49)	92
Utilities	707	8	3	1.1	38	0.4	3	2
Other	12,149	1,280	1,076	10.5	84	8.9	(2)	80
Latent	—	—	668	—	—	—	(501)	—
Total third-party	176,388	19,834	13,908	11.2	70	7.9	(1,247)	2,071
Amounts due from fellow subsidiaries	1,028	—	—	—	—	—	—	—
	177,416	19,834	13,908	11.2	70	7.8	(1,247)	2,071
Of which:								
UK								
Personal - mortgages	79,348	686	101	0.9	15	0.1	(4)	25
- unsecured	11,576	1,222	1,054	10.6	86	9.1	231	397
Property and construction	19,480	4,376	3,023	22.5	69	15.5	(54)	542
<i>of which: commercial real estate</i>	<i>13,980</i>	<i>4,114</i>	<i>2,834</i>	<i>29.4</i>	<i>69</i>	<i>20.3</i>	<i>(32)</i>	<i>501</i>
Other	31,747	1,400	890	4.4	64	2.8	(17)	225
Latent	—	—	295	—	—	—	(47)	—
	142,151	7,684	5,363	5.4	70	3.8	109	1,189
Europe								
Personal - mortgages	15,618	3,268	1,176	20.9	36	7.5	7	9
- unsecured	863	76	66	8.8	87	7.6	8	66
Property and construction	7,384	6,456	5,187	87.4	80	70.2	(928)	580
<i>of which: commercial real estate</i>	<i>7,006</i>	<i>6,303</i>	<i>5,065</i>	<i>90.0</i>	<i>80</i>	<i>72.3</i>	<i>(961)</i>	<i>558</i>
Other	7,601	2,326	1,724	30.6	74	22.7	13	227
Latent	—	—	373	—	—	—	(454)	—
	31,466	12,126	8,526	38.5	70	27.1	(1,354)	882
Banks	4,623	—	—	—	—	—	—	—
Amounts due from holding company and fellow subsidiaries	103,272	—	—	—	—	—	—	—
Total banks	107,895	—	—	—	—	—	—	—

Note:

(1) Mortgages are reported in sectors other than personal mortgages by certain businesses based on the nature of the relationship with the customer.

Financial review Capital and risk management

REIL and impairment flow statements

	REIL £m	Impairment provision £m
2015		
At beginning of year	19,834	13,908
Currency translation and other adjustments	(798)	(532)
Additions	1,892	—
Transfers between REIL and potential problem loans	(146)	—
Transfers to performing book	(889)	—
Repayments and disposals	(4,233)	—
Amounts written-off	(7,276)	(7,276)
Recoveries of amounts previously written-off	—	82
Release to the income statement	—	(731)
Unwind of discount	—	(96)
At end of year	8,384	5,355
2014		
At beginning of year	25,064	17,972
Currency translation and other adjustments	(960)	(641)
Additions	2,975	—
Transfers between REIL and potential problem loans	(200)	—
Transfers to performing book	(932)	—
Repayments and disposals	(4,042)	—
Amounts written-off	(2,071)	(2,071)
Recoveries of amounts previously written-off	—	52
Release to the income statement	—	(1,247)
Unwind of discount	—	(157)
At end of year	19,834	13,908

Risk elements in lending

The table below analyses REIL between UK and overseas, based on the location of the lending office.

	2015 £m	2014 £m
Impaired loans		
- UK	3,171	6,822
- overseas	4,479	12,058
Total REIL	7,650	18,880
Accruing loans which are contractually overdue 90 days or more as to principal or interest		
UK	714	862
Overseas	20	92
Total	734	954
Total risk elements in lending	8,384	19,834

Note:

(1) For details on impairment methodology refer to Credit risk on page 49 and Accounting policy 15 Impairment of financial assets on page 105.

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

Past due analysis

The table below shows loans and advances to customers that were past due at the balance sheet date but are not considered impaired.

	2015 £m	2014 £m
Past due 1-29 days	2,202	2,056
Past due 30-59 days	523	582
Past due 60-89 days	431	459
Past due 90 days or more	734	954
	3,890	4,051

Past due analysis by sector

Personal	2,382	2,529
Property construction	397	489
Financial institution	25	13
Other corporate	1,086	1,020
	3,890	4,051

Securities and AFS reserves

Debt securities

The table below analyses debt securities by issuer and IFRS measurement classifications. US central and local government includes US federal agencies. The other financial institutions category includes US government sponsored agencies and securitisation entities, the latter principally relating to asset-backed securities (ABS). Ratings are based on the lowest of Standard & Poor's, Moody's and Fitch.

	Central and local government			Other financial institutions		Corporate	Total	Of which ABS
	UK £m	US £m	Other £m	Banks £m	institutions £m	£m	£m	£m
2015								
Held-for-trading (HFT)	—	4,391	—	65	822	32	5,310	1
Available-for-sale	—	—	1,523	5	366	—	1,894	—
Long positions excluding disposal groups	—	4,391	1,523	70	1,188	32	7,204	1
Disposal groups	14	94	122	162	21	6	419	139
Total	14	4,485	1,645	232	1,209	38	7,623	140
Of which US agencies	—	—	—	—	806	—	806	—
Short positions (HFT)	—	(3,432)	—	(17)	(84)	(44)	(3,577)	—
2014								
Held-for-trading	—	6,880	—	75	2,938	406	10,299	2,168
Available-for-sale	119	—	2,214	262	143	10	2,748	140
Long positions excluding intercompany balances	119	6,880	2,214	337	3,081	416	13,047	2,308
Intercompany	—	—	—	—	782	—	782	782
Total	119	6,880	2,214	337	3,863	416	13,829	3,090
Of which US agencies	—	181	—	—	2,726	—	2,907	2,039
Short positions (HFT)	—	(6,052)	—	(46)	(345)	(384)	(6,827)	—

Financial review Capital and risk management

Ratings

The table below analyses debt securities by issuer and external ratings. Ratings are based on the lowest of Standard and Poor's, Moody's and Fitch.

	Central and local government			Other financial institutions		Corporate	Total	Of which ABS
	UK £m	US £m	Other £m	Banks £m	£m			
2015								
AAA	—	—	640	11	366	—	1,017	—
AA to AA+	—	4,391	883	52	804	5	6,135	—
A to AA-	—	—	—	1	—	11	12	—
BBB- to A-	—	—	—	6	15	16	37	—
Non-investment grade	—	—	—	—	2	—	2	—
Unrated	—	—	—	—	1	—	1	1
Total excluding disposal groups	—	4,391	1,523	70	1,188	32	7,204	1
Disposal groups	14	94	122	162	21	6	419	139
Total	14	4,485	1,645	232	1,209	38	7,623	140
2014								
AAA	—	—	1,828	244	153	—	2,225	161
AA to AA+	119	6,880	351	38	2,773	11	10,172	2,075
A to AA-	—	—	35	26	38	32	131	22
BBB- to A-	—	—	—	21	50	361	432	7
Non-investment grade	—	—	—	8	29	11	48	6
Unrated	—	—	—	—	38	1	39	37
Total excluding intercompany	119	6,880	2,214	337	3,081	416	13,047	2,308
Issued by Group companies	—	—	—	—	782	—	782	782
Total	119	6,880	2,214	337	3,863	416	13,829	3,090

Derivatives

Summary

The table below analyses derivatives by type of contract. The master netting arrangements and collateral shown below do not result in a net presentation on the Group's balance sheet under IFRS.

Contract type	2015			2014		
	Notional £bn	Assets £m	Liabilities £m	Notional £bn	Assets £m	Liabilities £m
Interest rate	16	770	190	69	1,021	271
Exchange rate	6	105	189	9	175	204
Other	—	14	—	1	30	12
		889	379		1,226	487
Counterparty mark-to-market netting		(152)	(152)		(245)	(245)
Cash collateral		(19)	—		(14)	—
Securities collateral		(71)	(2)		(27)	—
Total excluding disposal groups		647	225		940	242
Disposal groups		25	27		—	—
Total		672	252		940	242
Balances due from holding company and fellow subsidiaries	90	1,724	2,291	110	2,672	3,971

Financial review Capital and risk management

Market risk

Definition

Market risk is the risk of losses arising from fluctuations in interest rates, credit spreads, foreign currency rates, equity prices, commodity prices and other factors, such as market-implied volatilities, that may lead to a reduction in earnings, economic value or both.

The Group is exposed to traded market risk through its trading activities and to non-traded market risk as a result of its banking activities. In many respects, it manages its traded and non-traded market risk exposures separately, largely in line with the regulatory definitions of the trading and non-trading books.

The following disclosures in this section are audited:

- Traded market risk - Internal VaR
- Non-traded market risk:
 - Interest rate risk VaR
 - Foreign exchange risk

Disclosures in this section relate either to the Group as a whole or to individual legal entities on a solo basis within the Group. The choice reflects either the way the Group manages the risk or the basis on which it reports the risk measure to the regulator.

The following disclosures are presented on an individual legal entity basis:

- Traded market risk:
 - Internal VaR
 - Regulatory VaR back-testing
 - Minimum capital requirements

The legal entities have been selected based on their materiality for the risk measure in question.

All other disclosures are on an overall Group basis.

The introductory sentence to each table or graph indicates the basis of presentation of the disclosure.

Sources of risk*

Traded market risk

The majority of traded market risk exposure arises in CIB and Capital Resolution.

The Group is principally engaged in the purchase, sale and financing of US Treasury, US Agency and corporate debt and the execution clearance of exchange traded futures and options on futures contracts. The Group transacts primarily with institutional counterparties and US government sponsored entities through its US trading subsidiary, RBS Securities Inc (RBSSI).

Some of these transactions involve trading or clearing financial instruments on an exchange, including interest rate swaps, futures and options. Holders of these instruments provide margin on a daily basis with cash or other security at the exchange.

Other products are not transacted on an exchange. Of these over-the-counter transactions, those with standard terms may be cleared through central counterparties, while those that are more complex are settled directly with the counterparty and may give rise to counterparty credit risk. For more information on the management of counterparty credit risk, refer to the Credit risk section on page 48.

Non-traded market risk

The majority of non-traded market risk exposure arises from retail and commercial banking activities in all franchises from assets and liabilities that are not classified as held for trading.

Non-traded market risk largely comprises interest rate risk and foreign exchange risk.

Interest rate risk

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

NTIRR comprises four primary risk factors: repricing risk, yield curve risk, basis risk and optionality risk. For more information, refer to page 84.

Foreign exchange risk

Non-traded foreign exchange risk exposures arise from two main sources:

- *Structural foreign exchange risk* - arising from the capital deployed in foreign subsidiaries, branches and joint arrangements and related currency funding where it differs from sterling; and
- *Transactional foreign exchange risk* - arising from customer transactions and profits and losses that are in a currency other than the functional currency of the transacting operation.

Equity risk

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

Pension risk

Pension-related activities also give rise to market risk. Refer to pages 42 to 44 for more information on risk related to pensions.

*unaudited

Financial review Capital and risk management

Risk governance*

The RBS Group's Market Risk function is responsible for identifying, measuring, monitoring and controlling the market risk arising from both trading and non-trading activities.

For general information on risk governance, refer to the Risk governance section on page 12.

More specific information on the governance, management and measurement of traded and non-traded market risk is provided in each of the dedicated sections below.

Risk appetite*

The RBS Group's qualitative market risk appetite is set out in policy statements.

Its quantitative market risk appetite is expressed in terms of limits for the trading and non-trading activities that are consistent with business plans.

The Director of Market Risk cascades the limits further down the organisation as required. For each trading business, a document known as a dealing authority compiles details of all applicable limits and trading restrictions.

The limit framework at RBS Group level comprises VaR, stressed value-at-risk (SVaR) and sensitivity and stress limits (for more details on VaR and SVaR, refer to pages 78 to 82). The limit framework at trading unit level also comprises additional metrics that are specific to the market risk exposures within its scope. These additional metrics aim to control various risk dimensions such as product type, exposure size, aged inventory, currency and tenor.

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

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

For further information on risk appetite, refer to page 17.

Risk controls and assurance

For information on risk controls and assurance, refer to page 15.

Traded market risk

Risk assessment

Identification and assessment of traded market risk is achieved through gathering, analysing, monitoring and reporting market risk information by business line or at a consolidated level. Industry expertise, continued system developments and techniques such as stress testing are also used to enhance the effectiveness of the identification and assessment of all material market risks.

This is complemented by the New Product Risk Assessment process, which requires market risk teams to assess and quantify the market risk associated with all proposed new products.

Risk monitoring*

Traded market risk exposures are monitored against limits and analysed daily by market risk reporting and control functions. A daily report that summarises market risk exposures against the limits set by the Executive Risk Forum is sent to the RBS Group Chief Risk Officer and market risk managers across the function.

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

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

A market risk update is also included in the RBS Group Risk Management Monthly Report provided to the Executive Committee, the Board Risk Committee and the RBS Group Board. The update focuses on risk profiles relative to risk appetite; it also covers the key risks and trends, together with a discussion of relevant issues and market topics.

The reporting and updates facilitate frequent reviews and discussions of traded market risk exposures and related issues between the market risk function, senior management and the front office.

Risk measurement

The RBS Group uses a comprehensive set of methodologies and techniques to measure traded market risk.

*unaudited

Financial review Capital and risk management

Market risk continued

The main measurement methods are VaR and SVaR. Risks that are not adequately captured by these model methodologies are captured by the risks not in VaR (RNIV) framework to ensure that the RBS Group is adequately capitalised for market risk. In addition, stress testing is used to identify any vulnerabilities and potential losses in excess of VaR and SVaR.

The key inputs into these measurement methods are market data and sensitivities. Sensitivities refer to the changes in deal or portfolio value that result from small changes in market parameters that are subject to the market risk limit framework. These methods have been designed to capture correlation effects and allow the RBS Group to form an aggregated view of its traded market risk across risk types, markets and business lines while also taking into account the characteristics of each risk type.

Value-at-risk*

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

For internal risk management purposes, VaR assumes a time horizon of one trading day and a confidence level of 99%. The VaR model is based on a historical simulation, utilising market data from the previous 500 days on an equally weighted basis.

The Group's internal traded VaR model captures all trading book positions including those products approved by the regulator. For an explanation of the distinction between internal VaR and regulatory VaR, refer to page 82.

The internal VaR model captures the potential impact on the income statement of the following risk factors:

- Interest rate risk - which arises from the impact of changes in interest rates and volatilities on cash instruments and derivatives. This includes interest rate tenor basis risk and cross-currency basis risk.
- Credit spread risk - which arises from the impact of changes in the credit spreads of sovereign bonds, corporate bonds, securitised products and credit derivatives.
- Currency risk - which arises from the impact of changes in currency rates and volatilities.
- Equity risk - which arises from the impact of changes in equity prices, volatilities and dividend yields.
- Commodity risk - which arises from the impact of changes in commodity prices and volatilities.

The following types of risk - which are components of the above-mentioned factors - are also considered:

- Basis risk - which is the risk that imperfect correlation between two instruments in a hedging strategy creates the potential for excess gains or losses, thus adding risk to the position;
- Prepayment risk - which is the risk associated with early unscheduled return of principal on a fixed rate security; and
- Inflation risk - which is the risk of a decrease in the value of instruments as a result of changes in inflation rates and associated volatilities.

VaR limitations*

Historical VaR and the Group's implementation of this risk measurement methodology have a number of known limitations, as summarised below, and VaR should be interpreted in light of these. The approach taken is to supplement VaR with other risk metrics that address these limitations to ensure appropriate coverage of all material market risks.

Historical simulation VaR may not provide the best estimate of future market movements. It can only provide a forecast of portfolio losses based on events that occurred in the past. The Group model uses the previous 500 days of data; this period represents a balance between model responsiveness to recent shocks and risk factor data coverage.

The use of a 99% confidence level VaR statistic does not provide information about losses beyond this level, usually referred to as 'tail' risks. These risks are more appropriately assessed using measures such as SVaR and stress testing.

The use of a one-day time horizon does not fully capture the profit and loss implications of positions that cannot be liquidated or hedged within one day. This may not fully reflect market risk at times of severe illiquidity in the market when a one-day period may be insufficient to liquidate or hedge positions fully. Thus, the regulatory VaR that is used for modelled market risk capital uses a ten-day time horizon.

Finally, volatile market conditions, such as those experienced in 2015, can lead to new risk factors emerging. This issue is addressed by using a combination of proxy risk factors and the RNIV framework to supplement the VaR model.

*unaudited

Financial review Capital and risk management

1-day 99% traded internal VaR*

The table below analyses internal VaR for the trading portfolios of NatWest and RBSSI, segregated by type of market risk exposure.

	2015				2014			
	Average £m	Period end £m	Maximum £m	Minimum £m	Average £m	Period end £m	Maximum £m	Minimum £m
NatWest								
Interest rate	0.6	0.7	5.4	0.3	0.7	0.5	3.0	0.4
Credit spread	0.7	1.0	1.4	—	0.2	0.2	0.4	0.1
Currency	0.1	0.2	1.0	—	0.1	0.1	0.1	—
Diversification (2)		(1.4)				(0.3)		
Total	0.6	0.5	2.6	0.4	0.7	0.5	3.0	0.4

	2015				2014			
	Average (1) £m	Period end £m	Maximum (1) £m	Minimum £m	Average £m	Period end £m	Maximum £m	Minimum £m
RBSSI								
Interest rate	2.3	2.3	6.0	0.9	6.4	3.0	14.5	1.6
Credit spread	1.3	0.8	2.8	0.8	10.2	2.7	17.6	2.7
Currency	—	—	—	—	0.1	—	0.2	—
Equity	0.2	—	0.4	—	0.3	0.3	0.8	0.2
Commodity	0.3	—	0.5	0.1	0.1	—	0.5	—
Diversification (2)		(1.9)				(4.1)		
Total	1.3	1.2	3.2	0.6	7.4	1.9	18.1	1.4

Notes:

(1) The average and maximum currency and total VaR for 2015 have been adjusted to reflect genuine maximum exposures.

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

Key points

NatWest

- Total traded VaR was broadly unchanged in 2015 compared with 2014, on both a period-end and average basis.

RBSSI

- Total traded VaR declined in 2015 compared with 2014, on both a period-end and average basis. The decline was primarily driven by the decrease in credit spread VaR reflecting the exit from a significant part of US asset-backed product (ABP) trading in the first half of 2015.

VaR validation*

Quantitative analysis is used to:

- Perform internal back-testing to complement the regulatory back-testing; and
- Identify risks not adequately captured in VaR, and ensure that such risks are addressed via the RNIV framework (refer to page 81).

In addition, as part of ongoing risk management, any market or portfolio weaknesses that could become significant are identified.

The VaR model is also subject to independent reviews carried out by Model Risk Management (refer to page 15).

As well as being an important market risk measurement and control tool, the VaR model is also used to determine a significant component of the market risk capital requirement (refer to page 82 for more information on calculation of capital requirements). Therefore, it is subject to not only ongoing internal review and validation but also regulator-prescribed back-testing.

VaR back-testing*

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

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

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

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

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

Back-testing at the legal entity level is performed and reported on 1-day 99% regulatory VaR. Back-testing at the franchise level and lower-level portfolios is performed on 1-day 99% internal VaR.

*unaudited

Financial review Capital and risk management

Market risk continued

The table below shows regulatory back-testing exceptions for a period of 250 business days for 1-day 99% traded regulatory VaR vs. Actual and Hypo P&L for the legal entities approved by the PRA.

Description	Back-testing exceptions		Model status
	Actual	Hypo	
National Westminster Bank Plc	9	7	Amber
RBS Securities Inc (RBSSI)	4	3	Green
RBS Financial Products Inc	—	—	Green

Key points

- Statistically the Group would expect to see back-testing exceptions 1% of the time over a period of 250 business days. From a capital requirement perspective, the PRA categorises a firm's VaR model as green, amber or red. A green model status is consistent with a satisfactory VaR model and is achieved for models that have four or fewer exceptions in a continuous 250-day period. An amber model status suggests potential issues regarding the quality or accuracy of the model in question but no definitive conclusions.
- Most of the back-testing exceptions experienced in the period were driven by the higher market volatility and reduced liquidity.
- NatWest experienced nine exceptions during the period. There is normally a back-to-back arrangement with RBS plc. However, on the dates when the exceptions occurred, the residual risk at end of the day resulted in the exceptions due to the business being adversely positioned to market moves.
- The exceptions in RBSSI resulted from losses in the US Rates business due to adverse rate movements, losses on the sale of positions and residual equity positions as part of disposal strategy.

Financial review Capital and risk management

*Stressed VaR (SVaR)**

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

The risk system simulates 99% VaR on the current portfolio for each 250-day period from 1 January 2005 to the current VaR date, moving forward one day at a time. The SVaR is the worst VaR outcome of the simulated results.

This is in contrast with VaR, which is based on a rolling 500-day historical data set. For the purposes of both internal risk management and regulatory SVaR calculation, a time horizon of ten trading days is assumed with a confidence level of 99%.

The internal traded SVaR model captures all trading book positions, including not only those products, locations and legal entities approved by the regulator.

*Risks not in VaR (RNIVs)**

The RNIV approach is used for market risks that are insufficiently captured by the VaR and SVaR model methodologies, for example due to a lack of suitable historical data. The RNIV framework has been developed to quantify these market risks and to ensure that the RBS Group holds adequate capital.

The need for an RNIV calculation is typically identified in one of the following two circumstances: (i) as part of the New Product Risk Assessment process, when a risk manager assesses that the associated risk is not adequately captured by the VaR model; or (ii) as a result of a recommendation made by Model Risk Management or the model validation team when reviewing the VaR model.

The RNIV calculations provide a capital estimate of risks not captured in the VaR model and are regularly reported and discussed with senior management and the regulator. The methodology used in the material RNIV calculations is internally reviewed by Model Risk. Where appropriate, risk managers set sensitivity limits to control specific risk factors giving rise to the RNIV. RNIV calculations form an integral part of the RBS Group's ongoing model and data improvement efforts to capture all market risks in scope for model approval in VaR and SVaR.

The Group adopts two approaches for the quantification of RNIVs:

- A VaR/SVaR approach. Under this approach, two values are calculated: (i) the VaR RNIV; and (ii) the SVaR RNIV.
- A stress-scenario approach. Under this approach, an assessment of ten-day extreme, but plausible, market moves is used in combination with position sensitivities to give a stress-type loss number - the stress-based RNIV value.

For each legal entity covered by the PRA VaR approval (refer to Regulatory VaR), RNIV amounts are aggregated to obtain the following three measures: (i) Total VaR RNIV; (ii) Total SVaR RNIV; and (iii) Total stress-based RNIV. In each of these categories, potential diversification benefits between RNIVs are ignored.

*Stress testing**

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

The RBS Group conducts historical, macroeconomic and vulnerability-based stress testing.

Scenario-based sensitivity analysis measures the sensitivity of the current portfolio to defined movements in market risk factors. These risk factor movements and the resulting valuation changes are typically smaller than those considered in other stress tests.

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

Historical stress tests form part of the market risk limit framework and their results are reported daily to senior management

Macroeconomic stress tests are carried out periodically as part of the firm-wide, cross-risk capital planning process. The scenario narratives are translated into risk factor shocks using historical events and insights by economists, risk managers and the front office. Market risk stress results are combined with those for other risks into the capital plan that is presented to the Board. The cross-risk capital planning process is conducted twice a year, in April/May and October/November, with a planning horizon of five years. The scenario narratives cover both regulatory scenarios and macroeconomic scenarios identified by the firm.

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

*Economic capital**

The market risk economic capital framework uses models to calculate the market and default risk in the trading book which are aligned with other models that are used for limit setting and market risk management. The results are annualised to be consistent with the other economic capital models to permit consolidation of all risk types as part of the RBS Group-wide economic capital programme.

*unaudited

Financial review Capital and risk management

Market risk continued

Market risk regulatory capital*

Regulatory treatment

The market risks subject to capital requirements under Pillar 1 are primarily interest rate, credit spread and equity risks in the trading book and foreign exchange and commodity risks in both the trading and non-trading books. Interest rate and equity risks are split between general and specific risks. General risks represent market risks due to a move in a market as a whole, such as a main index or yield curve, while specific risks represent market risks arising from events particular to an underlying issuer.

The Group uses two broad methodologies to calculate its market risk capital charge: (i) the non-modelled approach, whereby regulator-prescribed rules are applied, and (ii) the internal model approach, where, subject to regulatory approval, a model such as VaR is used to calculate the capital charge.

VaR and SVaR capture general and specific risks but not risks arising from the impact of defaults and rating changes associated with traded credit products and their derivatives. For these risks, two product-dependent approaches are used:

- The incremental risk charge (IRC) model captures risks arising from rating migration and default events for the more liquid traded credit instruments and their derivatives.
- Securitisation and re-securitisation risks in the trading book are treated with the non-trading book non-modelled capitalisation approach.

Regulatory VaR

The Group's VaR model has been approved by the PRA to calculate its regulatory market risk capital requirement for the trading book for those legal entities under its jurisdiction. These legal entities are NatWest Plc, RBS Securities Inc and RBS Financial Products Inc.

While internal VaR provides a measure of the economic risk, regulatory VaR is one of the measures of regulatory capital requirements by legal entity.

The calculation of regulatory VaR differs from that of the internal VaR as it takes into account only regulator-approved products, locations and legal entities and it is based on a ten-day, rather than a one-day, holding period for market risk capital calculations.

The PRA approval covers general market risk in interest rate, foreign exchange, equity and commodity products and specific market risk in interest rate and equity products.

Regulatory SVaR*

The Group's SVaR model has also been approved by the PRA for use in the capital requirement calculation. The distinction between regulatory SVaR and internal SVaR is the same as that between regulatory VaR and internal VaR.

Risks not in VaR

As discussed earlier, the RNIV framework ensures that the risks not captured in VaR are adequately covered by capital.

Incremental risk charge (IRC)*

The IRC model quantifies the impact of rating migration and default events on the market value of instruments with embedded credit risk (in particular, bonds and credit default swaps) that are held in the trading book. It further captures basis risk between different instruments, maturities and reference entities. Following the internal ratings-based approach for credit risk, the IRC is calculated over a one-year capital horizon with a 99.9% confidence level. The dependency of positions is modelled using a single-factor Gaussian copula.

The IRC is mainly driven by three-month credit rating transition, default and correlation parameters. The portfolio impact of correlated defaults and rating changes is assessed by observing changes in the market value of positions using stressed recovery rates and modelled credit spread changes. Revaluation matrices are used to capture any non-linear behaviour.

*unaudited

Financial review Capital and risk management

Minimum capital requirements

The following table analyses total market risk minimum capital requirements for NatWest and RBSSI at 31 December 2015, calculated in accordance with the Capital Requirements Regulation (CRR). The minimum capital requirements represent 8% of the corresponding RWA amounts.

	2015		2014	
	NatWest £m	RBSSI £m	NatWest £m	RBSSI £m
Interest rate position risk requirement	12	9	10	16
Equity position risk requirement	—	1	—	1
Foreign currency position risk requirement	20	—	2	—
Specific interest rate risk of securitisation positions	—	1	—	27
Total (standard method)	32	11	12	44
Pillar 1 model based position risk requirement	14	62	24	213
Total market risk minimum capital requirement	46	73	36	257

The following table analyses the principal contributors to the Pillar 1 model based position risk requirements (PRRs) presented in the previous table.

NatWest	2015				2014
	Average £m	Maximum £m	Minimum £m	Period end £m	Period end £m
Value-at-risk (VaR)	5	7	3	3	9
Stressed VaR (SVaR)	15	21	10	11	15
				14	24

RBSSI	2015				2014
	Average £m	Maximum £m	Minimum £m	Period end £m	Period end £m
Value-at-risk (VaR)	13	25	10	10	35
Stressed VaR (SVaR)	59	70	33	33	108
Incremental risk charge (IRC)	18	40	11	15	54
RNIV	10	18	4	4	16
				62	213

Key points

NatWest

- The total market risk minimum capital requirement rose during 2015, with an increase in the non-modelled component and a smaller decrease in the Pillar 1 model-based component.
- The increase in the non-modelled component was chiefly driven by a higher PRR reflecting allocation of the US dollar position in RBS Group from the sale of Citizens.
- The decrease in the Pillar 1 model-based component was driven by lower VaR and SVaR charges reflecting significant risk reduction, mainly in the rates business.

RBSSI

- The total market risk minimum capital requirement fell significantly during 2015, chiefly reflecting de-risking strategy.
- The decline in the non-modelled component primarily reflected reductions in trading book securitisation positions.
- The decline in all Pillar 1 model-based charges was principally driven by the wind-down and exit from the US mortgage business, which is now largely complete, a large reduction in the flow credit trading business and a general risk reduction in the US rates business.

*unaudited

Financial review Capital and risk management

Market risk continued

Valuation and independent price verification

Traders are responsible for marking-to-market their trading book positions daily, ensuring that assets and liabilities in the trading book are measured at their fair value. Any profits or losses on the revaluation of positions are recognised daily.

Product controllers are responsible for ensuring that independent price verification processes are in place covering all trading book positions held by their business. Independent price verification and trader supervision are the key controls over front office marking of positions.

Model validation*

The Group uses a variety of models to manage and measure market risk. These include pricing models (used for valuation of positions) and risk models (for risk measurement and capital calculation purposes). They are developed in both RBS Group-level and lower-level functions and are subject to independent review and sign-off.

For general information on the independent model validation carried out by Model Risk Management (MRM), which applies also to market risk models (including VaR), refer to page 15. Additional details relating to pricing and market risk models are presented below.

Pricing models

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

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

These committees comprise representatives of the major stakeholders in the valuation process - trading, finance, market risk, model development and model review functions.

The review process comprises the following steps:

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

Risk models

All model changes are approved through model governance committees at franchise level. Changes to existing models that have an impact on VaR exceeding 5% at legal entity level or 15% at a major business level are also subject to MRM review and sign-off as are all model changes that require regulator approval before implementation.

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

In addition to MRM's independent oversight, the model testing team monitors the model performance for market risk through back-testing, which is discussed in more detail on page 79, and other processes.

Non-traded market risk

Risk governance

The RBS Group manages non-traded interest rate risk and non-traded foreign exchange risk separately.

The Chief Risk Officer delegates responsibility for day-to-day control of non-traded market risk to the Director of Market Risk.

Non-traded market risk positions are reported to the ALCo and the Board, monthly in the case of interest rate risk and quarterly in the case of foreign exchange risk.

The Executive Risk Forum (ERF) approves the non-traded market risk framework. The non-traded market risk policy statement sets out the governance and risk management framework through effective identification, measurement, reporting, mitigation, monitoring and control.

The key models used for managing non-traded market risk benefit from the validation process described on this page.

Risk assessment, monitoring and mitigation

Interest rate risk*

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

- Repricing risk - which arises when asset and liability positions either mature (in the case of fixed-rate positions) or their interest rates reset (in the case of floating-rate positions) at different dates. These mismatches may give rise to net interest income and economic value volatility as interest rates vary.
- Yield curve risk - which arises from unanticipated changes in the shape of the yield curve, such that rates at different maturity points may move differently. Such movements may give rise to interest income and economic value volatility.
- The two risk factors above incorporate the duration risk arising from the reinvestment of maturing swaps hedging net free reserves (or net exposure to equity and other low fixed-rate or non-interest-bearing liability balances including, but not limited to, current accounts).

*unaudited

Financial review Capital and risk management

- Basis risk - which arises when related instruments with the same tenor are valued using different reference yield curves. Changes in the spread between the different reference curves can result in unexpected changes in the valuation of or income difference between assets, liabilities or derivative instruments. This occurs, for example, in the retail and commercial portfolios, when products valued on the basis of the Bank of England base rate are funded with LIBOR-linked instruments.
- Optionality risk - which arises when customers have the right to terminate, prepay or otherwise alter a transaction without penalty, resulting in a change in the timing or magnitude of the cash flows of an asset, liability or off-balance sheet instrument.

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

The RBS Group's policy is to manage the interest rate sensitivity within risk limits that are approved by the ERF and endorsed by the ALCo before being cascaded to lower levels. These include, in particular, interest rate sensitivity and VaR limits.

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

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

Foreign exchange risk

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

Foreign exchange exposures arising from customer transactions are sold down by businesses on a regular basis in line with RBS Group policy.

Risk measurement

Interest rate risk*

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

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

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

NII sensitivity is calculated and monitored at RBS Group level.

Value-at-risk*

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

*unaudited

Financial review Capital and risk management

Market risk continued

The table below shows the NTIRR VaR for the Group's retail and commercial banking activities at a 99% confidence level together with a currency analysis of period end VaR. It captures the risk resulting from mismatches in the repricing dates of assets and liabilities. This includes any mismatch between structural hedges and stable non and low interest bearing liabilities such as equity and money transmission accounts as regards their interest rate repricing behavioural profile.

	Average £m	Period end £m	Maximum £m	Minimum £m
2015	96	90	112	84
2014	104	87	118	87

Key points

- The average VaR for the Group at £96 million was higher than that for the RBS Group. This is because the RBS Group hedges some structural interest rate risk exposures at a consolidated level.
- The period end VaR was slightly higher in 2015 compared to 2014, reflecting increased exposure to medium-term interest rates.
- The exposure is largely to sterling interest rates.

Foreign exchange risk

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

	Net investments in foreign operations £m	Net investment hedges £m	Structural foreign currency exposures £m
2015			
US dollar	434	—	434
Euro	5,627	(385)	5,242
Swiss franc	790	—	790
Other non-sterling	58	—	58
	6,909	(385)	6,524
2014			
US dollar	2,511	(680)	1,831
Euro	4,834	(39)	4,795
Swiss franc	913	—	913
Other non-sterling	44	—	44
	8,302	(719)	7,583

Key points

- The £1.1 billion decrease in the Group's structural foreign currency exposure to £6.5 billion at 31 December 2015 was primarily a result of conduct provisions in US subsidiaries, partly offset by a reduction in Ulster Bank Rol loan impairment provisions.
- Changes in foreign currency exchange rates will affect equity in proportion to structural foreign currency exposure. A 5% strengthening in foreign currencies against sterling would result in a gain or loss of £0.3 billion in equity respectively (2014 - £0.4 billion).

Calculation of regulatory capital*

The RBS Group holds capital for two types of non-traded market risk exposures: NTIRR and non-trading book foreign exchange.

Capital for NTIRR is captured under the Pillar 2A process. This is calculated by considering the potential impact on the RBS Group's economic value over a one year horizon. The four main sources of NTIRR - repricing, yield curve, basis and optionality risks - are captured in the calculation.

Pillar 1 capital must be held for non-trading book foreign exchange exposures, as outlined under CRR Articles 455 and 92(3)c. Structural foreign exchange exposures are excluded from the calculations as outlined under CRR Article 352(2); such exposures are considered under Pillar 2A.

The capital calculations under ICAAP are also used for economic capital purposes.

*unaudited

Report of the directors

The directors present their report together with the audited accounts for the year ended 31 December 2015.

Group structure

National Westminster Bank Plc (the 'company') is a wholly-owned subsidiary of The Royal Bank of Scotland plc (the 'holding company' or 'the Royal Bank'), which is incorporated in Great Britain and has its registered office at 36 St Andrew Square, Edinburgh EH2 2YB. The 'Group' or 'NatWest Group' comprises the company and its subsidiary and associated undertakings. Details of the principal subsidiary undertakings and their activities are shown in Note 15 on the accounts. A full list of related undertakings of the company is shown in Note 41 on the accounts on pages 178 to 181. 'RBS Group' comprises The Royal Bank of Scotland Group plc (the 'ultimate holding company') and its subsidiary and associated undertakings.

The financial statements of The Royal Bank of Scotland Group plc can be obtained from RBS Secretariat, RBS Gogarburn, Edinburgh, EH12 1HQ, the Registrar of Companies or at www.rbs.com

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

At 31 December 2015, HMT's holding in the ultimate holding company's ordinary shares was 72.6%.

Results and dividends

The loss attributable to the ordinary shareholders of the company for the year ended 31 December 2015 amounted to £1,205 million compared with a profit of £1,733 million for the year ended 31 December 2014, as set out in the consolidated income statement on page 95.

In 2015, the company did not pay an ordinary dividend to the holding company (2014 - £175 million).

Strategic report

Activities

The Group is engaged principally in providing a wide range of banking and other financial services. Further details of the organisational structure and business overview of the Group, including the products and services provided by each of its operating segments and the competitive markets in which they operate, are contained in the Financial review on page 3.

Risk factors

The Group's future performance and results could be materially different from expected results depending on the outcome of certain potential risks and uncertainties. Full details of these and other risk factors are set out on pages 193 to 218.

The reported results of the Group are also sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of the Group's critical accounting policies and key sources of accounting judgments are included in Accounting policies on pages 108 to 111.

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

Financial performance

A review of the Group's performance during the year ended 31 December 2015 and the Group's financial position as at that date is contained in the Financial review on pages 6 to 10.

Employees

Policies and practices in respect of employee issues are managed on a consistent basis across the RBS Group, and the following sections reflect this approach.

As at 31 December 2015, the Group employed 29,200 employees (full-time equivalent basis). Details of employee related costs are included in Note 3 on the accounts.

Living our values

Our values, introduced in 2012, guide our actions every day, in every part of our business. They are at the heart of the way we work. They are embedded within our behavioural frameworks - this means the way we recruit, promote, reward and manage our people are all aligned.

Building a healthy culture and risk culture that lives up to our values is one of our core priorities. We have governance to monitor and guide and track progress on our cultural goals. We gather qualitative and quantitative feedback to assess our progress and respond accordingly. We do this in tandem with feedback from regulators and industry bodies.

Report of the directors

Engaging our people

We recognise that building an engaged, healthy and inclusive workforce is crucial if we are to achieve our ambition. We continue to ask people across the Bank to share their thoughts on what it's like to work at the RBS Group via our annual employee survey (OurView). The results enable our people leaders to monitor levels of engagement and work with their teams to make improvements. It also enables us to monitor employee perception and the progress we are making versus our goals. Our most recent survey at RBS Group, in which more than 62,000 colleagues took part, showed significant improvement in employee engagement and leadership.

In 2015 we launched *determined to make a difference*, an internal campaign that provides a rallying call for our employees. It was drawn from our extensive research with staff and is based on their reflections about the difference we make for our customers, colleagues, communities and shareholders.

Rewarding our people

Our approach to performance management allows us to provide clarity for our people about how their individual contribution links to our ambition. It recognises behaviour that supports our values and holds individuals to account for behaviour and performance that does not.

In the UK we are a living wage employer meaning that we adhere to Living Wage Benchmarks (both national and London) for all employees. All third party contractors who regularly work in our buildings will also be in scope by 2017 at the latest.

In 2015, we announced the removal of incentive schemes for our customer facing employees in Personal & Business Banking. Instead, we gave every eligible employee an increase to their guaranteed pay. This change ensures that our people are paid clearly, fairly and simply for the job they do for our customers every day. It also ensures our customers can be certain that if they take a product from us, it has no financial impact on what our people are paid.

Developing our people

Developing great leaders with the capability to deliver our ambition is a key priority. In 2015, we launched *'Determined to lead'*, a programme that focuses on great people management, a consistent tone from leaders throughout the Group and the tools to engage our people. In 2015 we trained over 13,000 leaders within RBS Group.

We are committed to professionalising all our people. We offer a wide range of learning which can be mandatory, role specific or related to personal development.

We have mandatory learning that has to be completed by everyone and is focused on keeping our people, our customers and the Bank safe. Elements of our learning have been aligned to the Chartered Banker: Professional Standards Board foundation standards. We committed that our people in the UK (excluding Ulster Bank) would complete this learning in 2015.

Youth employment

RBS Group has hired over 250 graduates and over 300 Apprentices in 2015. We have been accredited by "Investors in Young People" for how we attract, recruit and develop our talent.

Health and wellbeing of our people

We offer a wide range of health benefits and services to help maintain physical and mental health, and support our people if they become unwell.

In 2015, our wellbeing programme focused on three main areas; Mental Health, Physical Health and Resilience. Activities include the continued promotion of Lifematters (RBS Group's Employee Assistance Programme), participation in the Global Corporate Challenge, the launch of Resilience programmes and continued support for Time to Change, the UK's biggest programme to challenge mental health stigma.

Employee consultation

We recognise employee representatives such as trade unions and work councils in a number of businesses and countries. There has been ongoing engagement and discussion with those bodies given the changes the bank announced in February 2015. Management have continued to meet regularly with our European Employee Council to discuss developments and update on the progress of our strategic plans.

Inclusion

Building a more inclusive bank is essential for our customers and colleagues. Our inclusion policy standard applies to all our people globally; and our strategy for diversity and inclusion is owned by the RBS Board and Executive Committee.

During 2015 we continued our roll out of unconscious bias learning for all employees. We've introduced a gender goal to have at least 30% of women in the RBS Group's top three leadership levels by 2020. Further, we aim to have 50/50 balance at all levels by 2030. This is supported by the launch of a female development proposition. An increased focus on disability has led to the development of a comprehensive plan to support our colleagues and customers with additional needs and will help RBS group achieve its ambition of becoming a 'disability smart' organisation. From an LGBT perspective, we continue to deliver improvements to our people policies and customer operating procedures, including the introduction of guidance to support employees going through gender transition, introducing the 'Mx' honorific, and improving our customer gender change process.

Report of the directors

We are finalising plans to improve our ethnic representation within senior roles and are continuing to support our 15,000 strong employee-led networks.

RBS Group has been recognised for its work on Equality, Diversity and Inclusion by our Platinum ranking from Opportunity Now (gender) - our Gold ranking for Race for Opportunity (race); retaining a position in the Times Top 50 Employers for Women; and improving upon our ranking in the Stonewall Workplace Equality Index (LGBT).

Sustainability

Our purpose is to serve customers well. Sustainable banking means serving today's customers in a way that also helps future generations. We will rebuild our reputation and earn our customers' trust by putting customers first, making RBS Group a great place to work, supporting our communities and being mindful of environmental impacts with the Sustainable Banking Committee's role to oversee how the bank will reach its ambition to be number 1 for customer service, trust and advocacy by 2020.

For more information on our approach and progress read the RBS Sustainability Report, available on rbs.com/sustainable.

Going concern

The directors, having considered the Group's business activities and financial position discussed in the Financial review including the Group's regulatory capital resources (pages 22 to 30) and its liquidity and funding profile (pages 31 to 36) and the risk factors set out on pages 193 to 218 and having made such enquiries as they considered appropriate, have prepared the financial statements on a going concern basis. They considered the financial statements of The Royal Bank of Scotland Group plc for the year ended 31 December 2015, approved on 25 February 2016, which were prepared on a going concern basis.

Corporate governance

Internal control over financial reporting

The internal controls over financial reporting for the Group are consistent with those at the RBS Group level. The RBS Group is required to comply with Section 404 of the US Sarbanes-Oxley Act of 2002 and assess the effectiveness of internal control over financial reporting as of 31 December 2015.

The RBS Group assessed the effectiveness of its internal control over financial reporting as of 31 December 2015 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in the 2013 publication of 'Internal Control - Integrated Framework'.

Based on its assessment, management has concluded that, as of 31 December 2015, the RBS Group's internal control over financial reporting is effective.

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

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

In addition to the requirements for RBS Group, the NatWest Group is required to comply with Section 404(a) of the US Sarbanes-Oxley Act of 2002 and assess the effectiveness of internal control over financial reporting as of 31 December 2015.

Based on the criteria discussed above, the NatWest Group concluded the internal control over financial reporting is effective and the report will be included in the NatWest Group's Annual Report on Form 20-F. The NatWest Group's auditors are not required to report on the NatWest Group's internal control over financial reporting.

Board of directors

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

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

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

The roles of Chairman and Chief Executive are distinct and separate, with a clear division of responsibilities. The Chairman leads the Board and ensures the effective engagement and contribution of all executive and non-executive directors. The Chief Executive has responsibility for all Group businesses and acts in accordance with authority delegated by the Board. The non-executive directors combine broad business and commercial experience with independent and objective judgement and they provide independent challenge to the executive directors and the leadership team.

Report of the directors

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

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

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

The Group Nominations and Governance Committee comprises all of the non-executive directors, and is chaired by the Chairman of the Group. It assists the Board in the selection and appointment of directors. It reviews the structure, size and composition of the Board, and membership and chairmanship of Board committees.

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

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

Share capital

Details of the ordinary and preference share capital at 31 December 2015 are shown in Note 24 on the accounts.

Annual report on Form 20-F

An annual report on Form 20-F will be filed with the Securities and Exchange Commission in the US and copies will be available on request from the Secretary. Much of the detailed financial information therein is shown in these accounts.

Directors

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

Sandy Crombie, Alison Davis, Morten Friis, Robert Gillespie, Penny Hughes, Ross McEwan, Brendan Nelson, Baroness Noakes and Ewen Stevenson all served throughout the year and to the date of signing of the financial statements.

Howard Davies was appointed to the Board on 14 July 2015 and assumed the role of Chairman on 1 September 2015. Mike Rogers was appointed to the Board on 26 January 2016.

Philip Hampton stepped down from the Board on 31 August 2015.

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

Directors' interests

The interests of the directors in the shares of the ultimate holding company at 31 December 2015 are disclosed in the Report and Accounts of that company. None of the directors held an interest in the loan capital of the ultimate holding company or in the shares or loan capital of the company or any of its subsidiaries, during the period from 1 January 2015 to 30 March 2016.

Directors' indemnities

In terms of section 236 of the Companies Act 2006 (the "Companies Act"), Qualifying Third Party Indemnity Provisions have been issued by the ultimate holding company to directors, members of the Group's Executive and Management Committees, PRA/FCA Approved Persons and certain directors and/or officers of the Group's subsidiaries.

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

Post balance sheet events

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

Report of the directors

Political donations

During 2015, no political donations were made in the UK or EU, nor any political expenditure in the UK or EU.

Directors' disclosure to auditors

Each of the directors at the date of approval of this report confirms that:

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

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

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

Auditors

Deloitte LLP are currently the auditors. On 3 November 2014, RBS Group announced its intention to appoint Ernst & Young LLP (EY) as auditor of the Company for the year ending 31 December 2016. It is expected that EY will be appointed to fill the casual vacancy arising from Deloitte LLP's resignation following the signing of the 2015 accounts and the Group's Form 20-F. A resolution to appoint EY as the company's auditors will be proposed at the forthcoming Annual General Meeting.

By order of the Board

Aileen Taylor
Company Secretary
30 March 2016

National Westminster Bank Plc
is registered in England No. 929027

Statement of directors' responsibilities

This statement should be read in conjunction with the responsibilities of the auditor set out in their report on page 94.

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

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

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

The directors confirm that to the best of their knowledge:

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

By order of the Board

Howard Davies
Chairman

Ross McEwan
Chief Executive

Ewen Stevenson
Chief Financial Officer

30 March 2016

Board of directors

Chairman

Howard Davies

Executive directors

Ross McEwan

Ewen Stevenson

Non-executive directors

Sandy Crombie

Alison Davis

Morten Friis

Robert Gillespie

Penny Hughes

Brendan Nelson

Baroness Noakes

Mike Rogers

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Independent auditor's report to the members of National Westminster Bank Plc

We have audited the financial statements of National Westminster Bank Plc (the "Bank") and its subsidiaries (together the "Group") for the year ended 31 December 2015 which comprise the accounting policies, the balance sheets as at 31 December 2015, the consolidated income statement, the consolidated statement of comprehensive income, the statements of changes in equity and the cash flow statements for the year ended 31 December 2015, the related Notes 1 to 41 and the information identified as 'audited', in the Capital and risk management section of the Financial review. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union and, as regards the Bank financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Bank'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 Bank'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 Bank and the Bank's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

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 2015 and of the Group's loss for the year then ended;
- the Group's financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation; and
- 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.

Separate opinion in relation to IFRSs as issued by the IASB

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

In our opinion the Group financial statements comply with IFRSs as issued by the IASB.

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 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.

Michael Lloyd (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
30 March 2016

Consolidated income statement for the year ended 31 December 2015

	Note	2015 £m	2014 £m	2013 £m
Interest receivable		6,280	6,499	7,483
Interest payable		(1,384)	(1,922)	(3,462)
Net interest income	1	4,896	4,577	4,021
Fees and commissions receivable		2,133	2,439	2,600
Fees and commissions payable		(517)	(498)	(490)
Income from trading activities		14	77	726
Gain on redemption of own debt		—	—	239
Other operating income		10	682	268
Non-interest income	2	1,640	2,700	3,343
Total income		6,536	7,277	7,364
Staff costs		(1,450)	(1,668)	(1,683)
Premises and equipment		(544)	(280)	(375)
Other administrative expenses		(5,624)	(3,775)	(6,488)
Depreciation and amortisation		(453)	(226)	(214)
Write down of goodwill and other intangible assets		(107)	—	(2)
Operating expenses	3	(8,178)	(5,949)	(8,762)
(Loss)/profit before impairment releases/(losses)		(1,642)	1,328	(1,398)
Impairment releases/(losses)	11	728	1,249	(5,407)
Operating (loss)/profit before tax		(914)	2,577	(6,805)
Tax (charge)/credit	6	(292)	(844)	842
(Loss)/profit for the year		(1,206)	1,733	(5,963)
Attributable to:				
Non-controlling interests		(1)	—	—
Ordinary shareholders		(1,205)	1,733	(5,963)
		(1,206)	1,733	(5,963)

Consolidated statement of comprehensive income

	2015 £m	2014* £m	2013* £m
(Loss)/profit for the year	(1,206)	1,733	(5,963)
Items that do not qualify for reclassification			
(Loss)/gain on remeasurement of retirement benefit schemes	(167)	(1,567)	260
Tax	328	247	(195)
	161	(1,320)	65
Items that do qualify for reclassification			
Available-for-sale financial assets	(11)	(38)	42
Cash flow hedges	2	3	5
Currency translation	(326)	160	106
Tax	3	12	(9)
	(332)	137	144
Other comprehensive (loss)/income after tax	(171)	(1,183)	209
Total comprehensive (loss)/income for the year	(1,377)	550	(5,754)
Attributable to:			
Non-controlling interests	(24)	(34)	21
Ordinary shareholders	(1,353)	584	(5,775)
	(1,377)	550	(5,754)

*Restated - refer to page 99 for further details

The accompanying notes on pages 113 to 181, the accounting policies on pages 99 to 112 and the audited sections of the Financial review: Capital and risk management on pages 11 to 86 form an integral part of these financial statements.

Balance sheet as at 31 December 2015

	Note	Group		Bank	
		2015	2014*	2015	2014*
		£m	£m	£m	£m
Assets					
Cash and balances at central banks	8	1,690	2,709	819	1,054
Amounts due from holding company and subsidiaries	8	99,403	103,272	72,227	76,699
Other loans and advances to banks	8	3,875	7,640	1,022	1,805
Loans and advances to banks	8	103,278	110,912	73,249	78,504
Amounts due from subsidiaries	8	569	1,028	132	2,018
Other loans and advances to customers	8	176,263	168,138	134,251	122,279
Loans and advances to customers	8	176,832	169,166	134,383	124,297
Debt securities subject to repurchase agreements	27	3,740	8,583	—	—
Other debt securities		3,464	5,246	—	782
Debt securities	13	7,204	13,829	—	782
Equity shares	14	717	779	4	5
Investments in Group undertakings	15	—	—	6,554	7,866
Settlement balances		2,138	2,050	47	42
Amounts due from holding company and subsidiaries	12	1,724	2,672	1,326	2,129
Other derivatives	12	889	1,226	760	983
Derivatives	12	2,613	3,898	2,086	3,112
Intangible assets	16	517	848	498	530
Property, plant and equipment	17	1,031	1,591	811	735
Deferred tax	22	1,802	1,732	1,546	1,505
Prepayments, accrued income and other assets	18	1,297	1,686	395	220
Assets of disposal groups	19	3,311	—	—	—
Total assets		302,430	309,200	220,392	218,652
Liabilities					
Amounts due to holding company and subsidiaries	8	17,609	20,128	8,210	7,425
Other deposits by banks	8	6,982	6,104	2,726	2,123
Deposits by banks	8	24,591	26,232	10,936	9,548
Amounts due to subsidiaries	8	7,752	13,112	8,718	13,207
Other customer accounts	8	223,909	221,215	176,421	169,003
Customer accounts	8	231,661	234,327	185,139	182,210
Debt securities in issue	8	1,473	1,707	—	—
Settlement balances	8	2,461	2,143	53	67
Short positions	20	3,577	6,827	—	—
Amounts due to holding company and subsidiaries	12	2,291	3,971	1,993	3,397
Other derivatives	12	379	487	302	359
Derivatives	12	2,670	4,458	2,295	3,756
Provisions, accruals and other liabilities	21	7,543	6,315	1,704	1,590
Retirement benefit liabilities	4	3,547	3,987	3,242	3,438
Amounts due to holding company	8	5,621	5,656	4,413	4,413
Other subordinated liabilities	8	1,395	1,780	1,328	1,709
Subordinated liabilities	23	7,016	7,436	5,741	6,122
Liabilities of disposal groups	19	2,724	—	—	—
Total liabilities		287,263	293,432	209,110	206,731
Non-controlling interests		346	394	—	—
Owners' equity	24	14,821	15,374	11,282	11,921
Total equity		15,167	15,768	11,282	11,921
Total liabilities and equity		302,430	309,200	220,392	218,652

*Restated - refer to page 99 for further details

The accompanying notes on pages 113 to 181, the accounting policies on pages 99 to 112 and the audited sections of the Financial review: Capital and risk management on pages 11 to 86 form an integral part of these financial statements.

The accounts were approved by the Board of directors on 30 March 2016 and signed on its behalf by:

Howard Davies
Chairman

Ross McEwan
Chief Executive

Ewen Stevenson
Chief Financial Officer

National Westminster Bank Plc
Registration No. 929027

Statement of changes in equity for the year ended 31 December 2015

	Group			Bank		
	2015 £m	2014* £m	2013* £m	2015 £m	2014* £m	2013 £m
Called-up share capital						
At 1 January and 31 December	1,678	1,678	1,678	1,678	1,678	1,678
Share premium						
At 1 January and 31 December	2,225	2,225	2,225	2,225	2,225	2,225
Available-for-sale reserve						
At 1 January	29	55	21	—	6	3
Unrealised (losses)/gains	(5)	(29)	40	—	—	5
Realised (gains)/losses	(6)	(9)	2	—	(7)	(1)
Tax	—	12	(8)	—	1	(1)
At 31 December	18	29	55	—	—	6
Cash flow hedging reserve						
At 1 January	(3)	(6)	(10)	(3)	(6)	(10)
Amount recognised in equity	—	—	(1)	—	—	(1)
Amount transferred from equity to earnings	2	3	6	2	3	6
Tax	—	—	(1)	—	—	(1)
At 31 December	(1)	(3)	(6)	(1)	(3)	(6)
Foreign exchange reserve						
At 1 January	1,121	927	842	(10)	(10)	(9)
Retranslation of net assets	(283)	231	83	—	—	(1)
Foreign currency (losses)/gains on hedges of net assets	(20)	(37)	2	—	—	—
Tax	3	—	—	—	—	—
At 31 December	821	1,121	927	(10)	(10)	(10)
Capital redemption reserve						
At 1 January and 31 December	647	647	647	647	647	647
Retained earnings						
At 1 January	9,677	7,262	11,089	7,384	3,990	3,226
(Loss)/profit attributable to ordinary shareholders	(1,205)	1,733	(5,963)	(1,422)	2,416	(1,412)
Ordinary dividends paid	—	(175)	—	—	(175)	—
Capital contribution	800	2,177	2,070	800	2,177	2,070
(Loss)/gain on remeasurement of retirement benefit schemes						
- gross	(167)	(1,567)	260	(348)	(1,265)	302
- tax	328	247	(195)	329	241	(196)
Share-based payments - tax	—	—	1	—	—	—
At 31 December	9,433	9,677	7,262	6,743	7,384	3,990
Owners' equity at 31 December	14,821	15,374	12,788	11,282	11,921	8,530
Non-controlling interests						
At 1 January	394	1,278	1,257	—	—	—
Currency translation adjustments and other movements	(23)	(34)	21	—	—	—
Loss attributable to non-controlling interests	(1)	—	—	—	—	—
Equity withdrawn and disposals	(24)	(850)	—	—	—	—
At 31 December	346	394	1,278	—	—	—
Total equity at 31 December	15,167	15,768	14,066	11,282	11,921	8,530
Total equity is attributable to:						
Non-controlling interests	346	394	1,278	—	—	—
Ordinary shareholders	14,821	15,374	12,788	11,282	11,921	8,530
	15,167	15,768	14,066	11,282	11,921	8,530

*Restated - refer to page 99 for further details

The accompanying notes on pages 113 to 181, the accounting policies on pages 99 to 112 and the audited sections of the Financial review: Capital and risk management on pages 11 to 86 form an integral part of these financial statements.

Cash flow statement for the year ended 31 December 2015

		Group			Bank		
	Note	2015 £m	2014* £m	2013* £m	2015 £m	2014* £m	2013 £m
Operating activities							
Operating (loss)/profit before tax		(914)	2,577	(6,805)	(1,105)	2,541	(1,538)
Adjustments for non-cash items and other adjustments included within income statement		(4,993)	(4,163)	6,593	2,304	(1,800)	1,285
Cash contribution to defined benefit pension schemes		(807)	(804)	(504)	(724)	(712)	(411)
Changes in operating assets and liabilities		8,772	(13,713)	(2,941)	(548)	(5,737)	6,833
Income taxes received/(paid)		169	25	(153)	62	(128)	91
Net cash flows from operating activities	30	2,227	(16,078)	(3,810)	(11)	(5,836)	6,260
Cash flows from investing activities							
Sale and maturity of securities		2,226	709	187	782	471	14
Purchase of securities		(1,417)	(2,070)	(149)	—	—	—
Sale of property, plant and equipment		413	287	209	15	49	15
Purchase of property, plant and equipment		(207)	(187)	(109)	(165)	(66)	(57)
Net investment in business interests and intangible assets	31	(2,716)	(8)	162	(715)	17	(1,262)
Net cash flows from investing activities		(1,701)	(1,269)	300	(83)	471	(1,290)
Cash flows from financing activities							
Capital contribution		800	1,500	2,070	800	1,500	2,070
Repayment of subordinated liabilities		(387)	(60)	(93)	(387)	—	—
Dividends paid		—	(175)	—	—	(175)	—
Interest on subordinated liabilities		(262)	(270)	(269)	(255)	(250)	(258)
Net cash flows from financing activities		151	995	1,708	158	1,075	1,812
Effects of exchange rate changes on cash and cash equivalents		115	221	(198)	(55)	(108)	(6)
Net increase/(decrease) in cash and cash equivalents		792	(16,131)	(2,000)	9	(4,398)	6,776
Cash and cash equivalents at 1 January		85,751	101,882	103,882	66,178	70,576	63,800
Cash and cash equivalents at 31 December	34	86,543	85,751	101,882	66,187	66,178	70,576

The accompanying notes on pages 113 to 181, the accounting policies on pages 99 to 112 and the audited sections of the Financial review: Capital and risk management on pages 11 to 86 form an integral part of these financial statements.

Accounting policies

1. Presentation of accounts

The accounts are prepared on a going concern basis (see the Report of the directors, page 89) and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the IFRS Interpretations Committee of the IASB as adopted by the European Union (EU) (together IFRS). The EU has not adopted the complete text of IAS 39 'Financial Instruments: Recognition and Measurement'; it has relaxed some of the standard's hedging requirements. The Group has not taken advantage of this relaxation: its financial statements are prepared in accordance with IFRS as issued by the IASB.

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

International Private Banking

The International Private Banking business was reclassified to disposal groups on 31 March 2015. It is measured at fair value less costs to sell which reflects the agreed sale to Union Bancaire Privee (fair value hierarchy level 3).

Change of accounting policy

The Group changed its accounting policy for the recognition of surpluses in its defined benefit pension schemes: in particular, the policy for determining whether or not it has an unconditional right to a refund of surpluses in its employee pension funds. Where the Group has a right to a refund, this is not deemed unconditional if pension fund trustees are able unilaterally to enhance benefits for plan members. As a result of this change, a minimum funding requirement to cover an existing shortfall in a scheme may give rise to an additional liability and surpluses may not be recognised in full. The revised accounting policy, by taking account of the powers of pension trustees in assessing the economic benefit available as a refund, provides more relevant information about the effect on the Group's financial position of its defined benefit pension schemes.

In accordance with IFRS, the amended policy has been applied retrospectively and prior periods restated. The impact of the change in policy is set out below.

Consolidated income statement

	2015		
	Under previous policy £m	Adjustment £m	As published £m
Staff costs	(1,386)	(64)	(1,450)
Operating expenses	(8,114)	(64)	(8,178)
Loss before impairment losses	(1,578)	(64)	(1,642)
Operating loss before tax	(850)	(64)	(914)
Tax charge	(304)	12	(292)
Loss for the year	(1,154)	(52)	(1,206)
Loss attributable to ordinary shareholders	(1,153)	(52)	(1,205)

There are no adjustments to the income statement in 2014 and 2013.

Consolidated statement of comprehensive income

	2015			2014			2013		
	Under previous policy £m	Adjustment £m	As published £m	As previously reported £m	Adjustment £m	Restated £m	As previously reported £m	Adjustment £m	Restated £m
(Loss)/profit for the year	(1,154)	(52)	(1,206)	1,733	—	1,733	(5,963)	—	(5,963)
Gain/(loss) on remeasurement of retirement benefit schemes	1,035	(1,202)	(167)	182	(1,749)	(1,567)	314	(54)	260
Tax	(123)	451	328	(103)	350	247	(204)	9	(195)
Total comprehensive (loss)/income after tax	(574)	(803)	(1,377)	1,949	(1,399)	550	(5,709)	(45)	(5,754)

Accounting policies

Balance sheet

	2015			Group 2014			2013		
	Under previous policy £m	Adjustment £m	As published £m	As previously reported £m	Adjustment £m	Restated £m	As previously reported £m	Adjustment £m	Restated £m
Deferred tax assets	968	834	1,802	1,361	371	1,732	2,253	21	2,274
Prepayments, accrued income and other assets	1,436	(139)	1,297	1,801	(115)	1,686	1,415	(77)	1,338
Retirement benefit liabilities	566	2,981	3,547	2,248	1,739	3,987	2,976	28	3,004
Owners' equity	17,107	(2,286)	14,821	16,857	(1,483)	15,374	12,872	(84)	12,788

	2015			Bank 2014			2014		
	Under previous policy £m	Adjustment £m	As published £m	As previously reported £m	Adjustment £m	Restated £m	As previously reported £m	Adjustment £m	Restated £m
Deferred tax assets				749	797	1,546	1,157	348	1,505
Retirement benefit liabilities				261	2,981	3,242	1,699	1,739	3,438
Owners' equity				13,466	(2,184)	11,282	13,312	(1,391)	11,921

Statement of changes in equity

	2015			Group 2014			2013		
	Under previous policy £m	Adjustment £m	As published £m	As previously reported £m	Adjustment £m	Restated £m	As previously reported £m	Adjustment £m	Restated £m
Retained earnings									
At 1 January	11,160	(1,483)	9,677	7,346	(84)	7,262	11,128	(39)	11,089
(Loss)/profit attributable to ordinary shareholders	(1,153)	(52)	(1,205)	1,733	—	1,733	(5,963)	—	(5,963)
Gain/(loss) on remeasurement of retirement benefit schemes									
- gross	1,035	(1,202)	(167)	182	(1,749)	(1,567)	314	(54)	260
- tax	(123)	451	328	(103)	350	247	(204)	9	(195)
At 31 December	11,719	(2,286)	9,433	11,160	(1,483)	9,677	7,346	(84)	7,262

	2015			Bank 2014			2014		
	Under previous policy £m	Adjustment £m	As published £m	As previously reported £m	Adjustment £m	Restated £m	As previously reported £m	Adjustment £m	Restated £m
Retained earnings									
At 1 January				8,775	(1,391)	7,384	3,990	—	3,990
(Loss)/profit attributable to ordinary shareholders				(1,370)	(52)	(1,422)	2,416	—	2,416
Gain/(loss) on remeasurement of retirement benefit schemes									
- gross				830	(1,178)	(348)	474	(1,739)	(1,265)
- tax				(108)	437	329	(107)	348	241
At 31 December				8,927	(2,184)	6,743	8,775	(1,391)	7,384

Accounting policies

The Group adopted a number of new and revised IFRSs effective 1 January 2015.

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 that for those that are independent of service.

Annual Improvements to IFRS 2010 - 2012 and 2011 - 2013 cycles were issued in December 2013 making a number of minor amendments to IFRS.

The implementation of these requirements has not had a material effect on the Group's accounts.

2. Basis of consolidation

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

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

3. Revenue recognition

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

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

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

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

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

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

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

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

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

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

Accounting policies

4. Assets held for sale and discontinued operations

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

5. Employee benefits

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

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

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

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

The charge to profit or loss for pension costs (recorded in operating expenses) comprises:

- the current service cost
- interest, computed at the rate used to discount scheme liabilities, on the net defined benefit liability or asset
- past service cost resulting from a scheme amendment or curtailment
- gains or losses on settlement.

A curtailment occurs when the Group significantly reduces the number of employees covered by a plan. A plan amendment occurs when the Group introduces, or withdraws, a defined benefit plan or changes the benefits payable under an existing defined benefit plan. Past service cost may be either positive (when benefits are introduced or changed so that the present value of the defined benefit obligation increases) or negative (when benefits are withdrawn or changed so that the present value of the defined benefit obligation decreases). A settlement is a transaction that eliminates all further obligation for part or all of the benefits.

Actuarial gains and losses (i.e. gains or and losses on re-measuring the net defined benefit asset or liability) are recognised in other comprehensive income in full in the period in which they arise.

6. Intangible assets and goodwill

Intangible assets acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to profit or loss over the assets' estimated economic lives using methods that best reflect the pattern of economic benefits and is included in Depreciation and amortisation. These estimated useful economic lives are:

Computer software	3 to 12 years
Other acquired intangibles	5 to 10 years

Expenditure on internally generated goodwill and brands is written-off as incurred. Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have been established. These costs include payroll, the costs of materials and services, and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred as are all training costs and general overheads. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

Intangible assets include goodwill arising on the acquisition of subsidiaries and joint ventures. Goodwill on the acquisition of a subsidiary is the excess of the fair value of the consideration transferred, the fair value of any existing interest in the subsidiary and the amount of any non-controlling interest measured either at fair value or at its share of the subsidiary's net assets over the Group's interest in the net fair value of the subsidiary's identifiable assets, liabilities and contingent liabilities. Goodwill arises on the acquisition of a joint venture when the cost of investment exceeds the Group's share of the net fair value of the joint venture's identifiable assets and liabilities. Goodwill is measured at initial cost less any subsequent impairment losses. Goodwill arising on the acquisition of associates is included within their carrying amounts. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

Accounting policies

7. Property, plant and equipment

Items of property, plant and equipment (except investment property - see Accounting policy 9) are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, these are accounted for separately.

Depreciation is charged to profit or loss on a straight-line basis so as to write-off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases) over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Freehold land is not depreciated.

The estimated useful lives of the Group's property, plant and equipment are:

Freehold buildings	50 years
Long leasehold property (leases with more than 50 years to run)	50 years
Short leaseholds	unexpired period of the lease
Property adaptation costs	10 to 15 years
Computer equipment	up to 5 years
Other equipment	4 to 15 years

The residual value and useful life of property, plant and equipment are reviewed at each balance sheet date and updated for any changes to previous estimates.

8. Impairment of intangible assets and property, plant and equipment

At each reporting date, the Group assesses whether there is any indication that its intangible assets, or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss if any. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

If an asset does not generate cash flows that are independent from those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. For the purposes of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units or groups of cash-generating units expected to benefit from the combination. The recoverable amount of an asset or cash-generating unit is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash-generating unit that have not been taken into account in estimating future cash flows. If the recoverable amount of an intangible or tangible asset is less than its carrying value, an impairment loss is recognised immediately in profit or loss and the carrying value of the asset reduced by the amount of the loss.

A reversal of an impairment loss on intangible assets (excluding goodwill) or property, plant and equipment is recognised as it arises provided the increased carrying value is not greater than it would have been had no impairment loss been recognised. Impairment losses on goodwill are not reversed.

9. Investment property

Investment property comprises freehold and leasehold properties that are held to earn rentals or for capital appreciation or both. Investment property is not depreciated but is stated at fair value. Fair value is based on current prices for similar properties in the same location and condition. Any gain or loss arising from a change in fair value is recognised in profit or loss. Rental income from investment property is recognised on a straight-line basis over the term of the lease in Other operating income. Lease incentives granted are recognised as an integral part of the total rental income.

10. Foreign currencies

The Group's consolidated financial statements are presented in sterling which is the functional currency of the company.

Group entities record transactions in foreign currencies in their functional currency - the currency of the primary economic environment in which they operate - at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the foreign exchange rates ruling at the balance sheet date. Foreign exchange differences arising on the settlement of foreign currency transactions and from the translation of monetary assets and liabilities are reported in income from trading activities except for differences arising on cash flow hedges and hedges of net investments in foreign operations (see Accounting policy 23).

Non-monetary items denominated in foreign currencies that are stated at fair value are translated into the relevant functional currency at the foreign exchange rates ruling at the dates the values are determined. Translation differences arising on non-monetary items measured at fair value are recognised in profit or loss except for differences arising on available-for-sale non-monetary financial assets, for example equity shares, which are recognised in other comprehensive income unless the asset is the hedged item in a fair value hedge.

Assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into sterling at foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of a foreign operation are recognised in other comprehensive income. The amount accumulated in equity is reclassified from equity to profit or loss on disposal of a foreign operation.

Accounting policies

11. Leases

As lessor

Contracts with customers to lease assets are classified as finance leases if they transfer substantially all the risks and rewards of ownership of the asset to the customer; all other contracts with customers to lease assets are classified as operating leases.

Finance lease receivables are included in the balance sheet, within Loans and advances to customers, at the amount of the net investment in the lease being the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Finance lease income is allocated to accounting periods so as to give a constant periodic rate of return before tax on the net investment and included in Interest receivable. Unguaranteed residual values are subject to regular review; if there is a reduction in their value, income allocation is revised and any reduction in respect of amounts accrued is recognised immediately.

Rental income from operating leases is recognised in income on a straight-line basis over the lease term unless another systematic basis better represents the time pattern of the asset's use. Operating lease assets are included within Property, plant and equipment and depreciated over their useful lives (see Accounting policy 7). Operating lease rentals receivable are included in Other operating income.

As lessee

The Group's contracts to lease assets are principally operating leases. Operating lease rental expense is included in Premises and equipment costs and recognised as an expense on a straight-line basis over the lease term unless another systematic basis better represents the benefit to the Group.

12. Provisions

The Group recognises a provision for a present obligation resulting from a past event when it is more likely than not that it will be required to transfer economic benefits to settle the obligation and the amount of the obligation can be estimated reliably.

Provision is made for restructuring costs, including the costs of redundancy, when the Group has a constructive obligation to restructure. An obligation exists when the Group has a detailed formal plan for the restructuring and has raised a valid expectation in those affected by starting to implement the plan or by announcing its main features.

If the Group has a contract that is onerous, it recognises the present obligation under the contract as a provision. An onerous contract is one where the unavoidable costs of meeting the Group's contractual obligations exceed the expected economic benefits. When the Group vacates a leasehold property, a provision is recognised for the costs under the lease less any expected economic benefits (such as rental income).

Contingent liabilities are possible obligations arising from past events, whose existence will be confirmed only by uncertain future events, or present obligations arising from past events that are not recognised because either an outflow of economic benefits is not probable or the amount of the obligation cannot be reliably measured. Contingent liabilities are not recognised but information about them is disclosed unless the possibility of any outflow of economic benefits in settlement is remote.

13. Tax

Income tax expense or income, comprising current tax and deferred tax, is recorded in the income statement except income tax on items recognised outside profit or loss which is credited or charged to other comprehensive income or to equity as appropriate.

Current tax is income tax payable or recoverable in respect of the taxable profit or loss for the year arising in profit or loss, other comprehensive income or equity. Provision is made for current tax at rates enacted or substantively enacted at the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that they will be recovered. Deferred tax is not recognised on temporary differences that arise from initial recognition of an asset or a liability in a transaction (other than a business combination) that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is calculated using tax rates expected to apply in the periods when the assets will be realised or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, at the balance sheet date.

Deferred tax assets and liabilities are offset where the Group has a legally enforceable right to offset and where they relate to income taxes levied by the same taxation authority either on an individual Group company or on Group companies in the same tax group that intend, in future periods, to settle current tax liabilities and assets on a net basis or on a gross basis simultaneously.

14. Financial assets

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

Accounting policies

Held-to-maturity investments - a financial asset may be classified as a held-to-maturity investment only if it has fixed or determinable payments, a fixed maturity and the Group has the positive intention and ability to hold to maturity. Held-to-maturity investments are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see Accounting policy 3) less any impairment losses.

Held-for-trading - a financial asset is classified as held-for-trading if it is acquired principally for sale in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial assets are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. 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 are recognised in profit or loss as they arise.

Loans and receivables - non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables, except those that are classified as available-for-sale or as held-for-trading, or designated as at fair value through profit or loss. Loans and receivables are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see Accounting policy 3) less any impairment losses.

Available-for-sale financial assets - financial assets that are not classified as held-to-maturity; held-for-trading; designated as at fair value through profit or loss; or loans and receivables are classified as available-for-sale. Financial assets can be designated as available-for-sale on initial recognition. Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Unquoted equity investments whose fair value cannot be measured reliably are carried at cost and classified as available-for-sale financial assets.

Impairment losses and exchange differences resulting from retranslating the amortised cost of foreign currency monetary available-for-sale financial assets are recognised in profit or loss together with interest calculated using the effective interest method (see Accounting policy 3) as are gains and losses attributable to the hedged risk on available-for-sale financial assets that are hedged items in fair value hedges (see Accounting policy 23). Other changes in the fair value of available-for-sale financial assets and any related tax are reported in other comprehensive income until disposal, when the cumulative gain or loss is reclassified from equity to profit or loss.

Reclassifications - held-for-trading and available-for-sale financial assets that meet the definition of loans and receivables (non-derivative financial assets with fixed or determinable payments that are not quoted in an active market) may be reclassified to loans and receivables if the Group has the intention and ability to hold the financial asset for the foreseeable future or until maturity. The Group typically regards the foreseeable future for this purpose as twelve months from the date of reclassification. Additionally, held-for-trading financial assets that do not meet the definition of loans and receivables may, in rare circumstances, be transferred to available-for-sale financial assets or to held-to-maturity investments. Reclassifications are made at fair value. This fair value becomes the asset's new cost or amortised cost as appropriate. Gains and losses recognised up to the date of reclassification are not reversed.

Fair value - the Group's approach to determining the fair value of financial instruments measured at fair value is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 9.

15. Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as held-to-maturity, as available-for-sale or as loans and receivables is impaired. A financial asset or group of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

Financial assets carried at amortised cost - if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables or as held-to-maturity investments has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition. For collateralised loans and receivables, estimated future cash flows include cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

Accounting policies

Where, in the course of the orderly realisation of a loan, it is exchanged for equity shares or property, the exchange is accounted for as the sale of the loan and the acquisition of equity securities or investment property. Where the Group's interest in equity shares following the exchange is such that the Group controls an entity, that entity is consolidated.

Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant. In making collective impairment assessments, financial assets are grouped into portfolios on the basis of similar risk characteristics. Future cash flows from these portfolios are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics.

Historical loss experience is adjusted, on the basis of observable data, to reflect current conditions not affecting the period of historical experience. Impairment losses are recognised in profit or loss and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses. If, in a subsequent period, the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

Impaired loans and receivables are written off, i.e. the impairment provision is applied in writing down the loan's carrying value partially or in full, when the Group concludes that there is no longer any realistic prospect of recovery of part or all of the loan. For loans that are individually assessed for impairment, the timing of write off is determined on a case-by-case basis. Such loans are reviewed regularly and write off will be prompted by bankruptcy, insolvency, renegotiation and similar events.

The typical time frames from initial impairment to write off for the Group's collectively-assessed portfolios are:

- Retail mortgages: write off usually occurs within five years, or when an account is closed if earlier.
- Credit cards: the irrecoverable amount is written off after 12 months; three years later any remaining amounts outstanding are written off.
- Overdrafts and other unsecured loans: write off occurs within six years.
- Business and commercial loans: write offs of commercial loans are determined in the light of individual circumstances; the period does not exceed five years. Business loans are generally written off within five years.

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

Financial assets carried at fair value - when a decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in other comprehensive income and there is objective evidence that it is impaired, the cumulative loss is reclassified from equity to profit or loss. The loss is measured as the difference between the amortised cost (including any hedge accounting adjustments) of the financial asset and its current fair value. Impairment losses on available-for-sale equity instruments are not reversed through profit or loss, but those on available-for-sale debt instruments are reversed, if there is an increase in fair value that is objectively related to a subsequent event.

16. Financial liabilities

Financial liabilities are recognised initially at fair value and classified into held-for-trading; designated as at fair value through profit or loss; or amortised cost. Issues of financial liabilities measured at amortised cost are recognised on settlement date; all other regular way transactions in financial liabilities are recognised on trade date.

Held-for-trading - a financial liability is classified as held-for-trading if it is incurred principally for repurchase in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial liabilities are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Gains and losses are recognised in profit or loss as they arise.

Designated as at fair value through profit or loss - financial liabilities may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

Financial liabilities that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Gains and losses are recognised in profit or loss as they arise.

Financial liabilities designated as at fair value through profit or loss principally comprise structured liabilities issued by the Group: designation significantly reduces the measurement inconsistency between these liabilities and the related derivatives carried at fair value.

Amortised cost - all other financial liabilities are measured at amortised cost using the effective interest method (see Accounting policy 3).

Accounting policies

Fair value - the Group's approach to determining the fair value of financial instruments measured at fair value is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 9.

17. Financial guarantee contracts

Under a financial guarantee contract, the Group, in return for a fee, undertakes to meet a customer's obligations under the terms of a debt instrument if the customer fails to do so. A financial guarantee is recognised as a liability; initially at fair value and, if not designated as at fair value through profit or loss, subsequently at the higher of its initial value less cumulative amortisation and any provision under the contract measured in accordance with Accounting policy 12. Amortisation is calculated so as to recognise fees receivable in profit or loss over the period of the guarantee.

18. Loan commitments

Provision is made for loan commitments, other than those classified as held-for-trading, if it is probable that the facility will be drawn and the resulting loan will be recognised at an amount less than the cash advanced. Syndicated loan commitments in excess of the level of lending under the commitment approved for retention by the Group are classified as held-for-trading and measured at fair value.

19. Derecognition

A financial asset is derecognised when the contractual right to receive cash flows from the asset has expired or when it has been transferred and the transfer qualifies for derecognition. A transfer requires that the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Group assesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. The asset remains on the balance sheet if substantially all the risks and rewards have been retained. It is derecognised if substantially all the risks and rewards have been transferred. If substantially all the risks and rewards have been neither retained nor transferred, the Group assesses whether or not it has retained control of the asset. If the Group has retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement; if the Group has not retained control of the asset, it is derecognised.

A financial liability is removed from the balance sheet when the obligation is discharged, or is cancelled, or expires. On the redemption or settlement of debt securities (including subordinated liabilities) issued by the Group, the Group derecognises the debt instrument and records a gain or loss being the difference between the debt's carrying amount and the cost of redemption or settlement. The same treatment applies where the debt is exchanged for a new debt issue that has terms substantially different from those of the existing debt.

The assessment of whether the terms of the new debt instrument are substantially different takes into account qualitative and quantitative characteristics including a comparison of the present value of the cash flows under the new terms with the present value of the remaining cash flows of the original debt issue discounted at the effective interest rate of the original debt issue.

20. Sale and repurchase transactions

Securities subject to a sale and repurchase agreement under which substantially all the risks and rewards of ownership are retained by the Group continue to be shown on the balance sheet and the sale proceeds recorded as a financial liability. Securities acquired in a reverse sale and repurchase transaction under which the Group is not exposed to substantially all the risks and rewards of ownership are not recognised on the balance sheet and the consideration paid is recorded as a financial asset.

Securities borrowing and lending transactions are usually secured by cash or securities advanced by the borrower. Borrowed securities are not recognised on the balance sheet or lent securities derecognised. Cash collateral given or received is treated as a loan or deposit; collateral in the form of securities is not recognised. However, where securities borrowed are transferred to third parties, a liability for the obligation to return the securities to the stock lending counterparty is recorded.

21. Netting

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when, and only when, the Group currently has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. The Group is party to a number of arrangements, including master netting agreements, that give it the right to offset financial assets and financial liabilities but where it does not intend to settle the amounts net or simultaneously and therefore the assets and liabilities concerned are presented gross.

22. Capital instruments

The Group classifies a financial instrument that it issues as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms and as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities. The components of a compound financial instrument issued by the Group are classified and accounted for separately as financial assets, financial liabilities or equity as appropriate.

Incremental costs and related tax that are directly attributable to an equity transaction are deducted from equity.

The consideration for any ordinary shares of the company purchased by the Group (treasury shares) is deducted from equity. On the cancellation of treasury shares their nominal value is removed from equity and any excess of consideration over nominal value is treated in accordance with the capital maintenance provisions of the Companies Act.

Accounting policies

On the sale or reissue of treasury shares the consideration received and related tax are credited to equity, net of any directly attributable incremental costs.

23. Derivatives and hedging

Derivative financial instruments are initially recognised, and subsequently measured, at fair value. The Group's approach to determining the fair value of financial instruments is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 9.

A derivative embedded in a contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract; unless the entire contract is measured at fair value with changes in fair value recognised in profit or loss.

Gains and losses arising from changes in the fair value of derivatives that are not the hedging instrument in a qualifying hedge are recognised as they arise in profit or loss. Gains and losses are recorded in Income from trading activities except for gains and losses on those derivatives that are managed together with financial instruments designated at fair value; these gains and losses are included in Other operating income.

The Group enters into three types of hedge relationship: hedges of changes in the fair value of a recognised asset or liability or unrecognised firm commitment (fair value hedges); hedges of the variability in cash flows from a recognised asset or liability or a highly probable forecast transaction (cash flow hedges); and hedges of the net investment in a foreign operation.

Hedge relationships are formally designated and documented at inception. The documentation identifies the hedged item and the hedging instrument and details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in fair values or cash flows attributable to the hedged risk, consistent with the documented risk management strategy, hedge accounting is discontinued. Hedge accounting is also discontinued if the Group revokes the designation of a hedge relationship.

Fair value hedge - in a fair value hedge, the gain or loss on the hedging instrument is recognised in profit or loss. The gain or loss on the hedged item attributable to the hedged risk is recognised in profit or loss and, where the hedged item is measured at amortised cost, adjusts the carrying amount of the hedged item. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; or if the hedging instrument expires or is sold, terminated or exercised; or if hedge designation is revoked. If the hedged item is one for which the effective interest rate method is used, any cumulative adjustment is amortised to profit or loss over the life of the hedged item using a recalculated effective interest rate.

Cash flow hedge - in a cash flow hedge, the effective portion of the gain or loss on the hedging instrument is recognised in other comprehensive income and the ineffective portion in profit or loss.

When the forecast transaction results in the recognition of a financial asset or financial liability, the cumulative gain or loss is reclassified from equity to profit or loss in the same periods in which the hedged forecast cash flows affect profit or loss. Otherwise the cumulative gain or loss is removed from equity and recognised in profit or loss at the same time as the hedged transaction. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; if the hedging instrument expires or is sold, terminated or exercised; if the forecast transaction is no longer expected to occur; or if hedge designation is revoked. On the discontinuance of hedge accounting (except where a forecast transaction is no longer expected to occur), the cumulative unrealised gain or loss is reclassified from equity to profit or loss when the hedged cash flows occur or, if the forecast transaction results in the recognition of a financial asset or financial liability, when the hedged forecast cash flows affect profit or loss. Where a forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss is reclassified from equity to profit or loss immediately.

Hedge of net investment in a foreign operation - in the hedge of a net investment in a foreign operation, the portion of foreign exchange differences arising on the hedging instrument determined to be an effective hedge is recognised in other comprehensive income. Any ineffective portion is recognised in profit or loss. Non-derivative financial liabilities as well as derivatives may be the hedging instrument in a net investment hedge. On disposal or partial disposal of a foreign operation, the amount accumulated in equity is reclassified from equity to profit or loss.

24. Cash and cash equivalents

In the cash flow statement, cash and cash equivalents comprises cash and deposits with banks with an original maturity of less than three months together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

25. Shares in Group entities

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

Critical accounting policies and key sources of estimation uncertainty

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law and IFRS require the directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's 'Conceptual Framework for Financial Reporting'.

Accounting policies

The judgements and assumptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results.

(i) Pensions

The Group operates a number of defined benefit pension schemes as described in Note 4 on the accounts. As described in Accounting policy 5, the assets of the schemes are measured at their fair value at the balance sheet date. Scheme liabilities are measured using the projected unit credit 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 the interest rate applicable to high-quality corporate bonds of the same currency and term as the liabilities. Any recognisable surplus or deficit of scheme assets over liabilities is recorded in the balance sheet as an asset (surplus) or liability (deficit).

In determining the value of scheme liabilities, financial and demographic assumptions are made including price inflation, pension increases, earnings growth and the longevity of scheme members. 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 on the accounts, together with sensitivities of the balance sheet and income statement to changes in those assumptions.

A pension asset of £16 million and a liability of £3,547 million were recognised on the balance sheet at 31 December 2015 (2014 - asset £4 million, liability £3,987 million).

(ii) Provisions for liabilities

As set out in Note 21, at 31 December 2015 the Group recognised provisions for liabilities in respect of Payment Protection Insurance, £599 million (2014 - £487 million), other customer redress, £479 million (2014 - £464 million) and other regulatory proceedings and litigation, £3,827 million (2014 - £1,811 million). Provisions are liabilities of uncertain timing or amount, and are recognised when there is a present obligation as a result of a past event, the outflow of economic benefit is probable and the outflow can be estimated reliably. Judgement is involved in determining whether an obligation exists, and in estimating the probability, timing and amount of any outflows. Where the Group can look to another party such as an insurer to pay some or all of the expenditure required to settle a provision, any reimbursement is recognised when, and only when, it is virtually certain that it will be received.

Payment Protection Insurance - the Group has established a provision for redress payable in respect of the mis-selling of Payment Protection Insurance policies. The provision is management's best estimate of the anticipated costs of redress and related administration expenses. The determination of appropriate assumptions to underpin the provision requires significant judgement by management. The principal assumptions underlying the provision together with sensitivities to changes in those assumptions are given in Note 21.

Provisions for litigation - the Group and members of the Group are party to legal proceedings in the United Kingdom, the United States and other jurisdictions, arising out of their normal business operations. The measurement and recognition of liabilities in respect of litigation involves a high degree of management judgement. Before the existence of a present obligation as the result of a past event can be confirmed, numerous facts may need to be established, involving extensive and time-consuming discovery, and novel or unsettled legal questions addressed. Once it is determined there is an obligation, assessing the probability of economic outflows and estimating the amount of any liability can be very difficult. In many proceedings, it is not possible to determine whether any loss is probable or to estimate the amount of any loss. Furthermore, for an individual matter, there can be a wide range of possible outcomes and often it is not practicable to quantify a range of such outcomes. The Group's outstanding litigation is periodically assessed in consultation with external professional advisers, where appropriate, to determine the likelihood of the Group incurring a liability. A detailed description of the Group's material legal proceedings and a discussion of the nature of the associated uncertainties are given in Note 29.

Tax contingencies - determining the Group's income tax charge and its provisions for income taxes necessarily involves a significant degree of estimation and judgement. The tax treatment of some transactions is uncertain and tax computations are yet to be agreed with the tax authorities in a number of jurisdictions. The Group recognises anticipated tax liabilities based on all available evidence and, where appropriate, in the light of external advice. Any difference between the final outcome and the amounts provided will affect current and deferred income tax assets and liabilities in the period when the matter is resolved.

(iii) Deferred tax

The Group makes provision for deferred tax on temporary differences where tax recognition occurs at a different time from accounting recognition. Deferred tax assets of £1,802 million were recognised as at 31 December 2015 (2014 - £1,732 million).

The Group has recognised deferred tax assets in respect of losses, principally in the UK, and temporary differences. Deferred tax assets are recognised in respect of unused tax losses and other temporary differences to the extent that it is probable that there will be future UK taxable profits against which the losses and other temporary differences can be utilised. The Group has considered the carrying value of the deferred tax asset as at 31 December 2015 and concluded that it is recoverable based on future projections.

Accounting policies

Deferred tax assets of £2,388 million (2014 - £1,763 million) have not been recognised in respect of tax losses and other temporary differences where the availability of future taxable profits is uncertain. Further details about the Group's deferred tax assets are given in Note 22.

(iv) Loan impairment provisions

The Group's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans classified as loans and receivables and carried at amortised cost in accordance with Accounting policy 15.

A loan is impaired when there is objective evidence that events since the loan was granted have affected expected cash flows from the loan. Such objective evidence, indicative that a borrower's financial condition has deteriorated, can include for loans that are individually assessed: the non-payment of interest or principal; debt renegotiation; probable bankruptcy or liquidation; significant reduction in the value of any security; breach of limits or covenants; and deteriorating trading performance and, for collectively assessed portfolios: the borrowers' payment status and observable data about relevant macroeconomic measures.

The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate.

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

Individual component - all impaired loans that exceed specific thresholds are individually assessed for impairment. Individually assessed loans principally comprise the Group's portfolio of commercial loans to medium and large businesses. Impairment losses are recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held. These estimates take into account the customer's debt capacity and financial flexibility; the level and quality of its earnings; the amount and sources of cash flows; the industry in which the counterparty operates; and the realisable value of any security held. Estimating the quantum and timing of future recoveries involves significant judgement. The size of receipts will depend on the future performance of the borrower and the value of security, both of which will be affected by future economic conditions; additionally, collateral may not be readily marketable. The actual amount of future cash flows and the date they are received may differ from these estimates and consequently actual losses incurred may differ from those recognised in these financial statements.

Collective component - this is made up of two elements: loan impairment provisions for impaired loans that are below individual assessment thresholds (collectively assessed provisions) and for loan losses that have been incurred but have not been separately identified at the balance sheet date (latent loss provisions).

Collectively assessed provisions are established on a portfolio basis using a present value methodology taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates and the related average life. These portfolios include mortgages, credit card receivables and other personal lending. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends. Latent loss provisions are held against estimated impairment losses in the performing portfolio that have yet to be identified as at the balance sheet date. To assess the latent loss within its portfolios, the Group has developed methodologies to estimate the time that an asset can remain impaired within a performing portfolio before it is identified and reported as such.

(v) Fair value - financial instruments

In accordance with Accounting policies 14, 16 and 23, financial instruments classified as held-for-trading or designated as at fair value through profit or loss and financial assets classified as available-for-sale are recognised in the financial statements at fair value. All derivatives are measured at fair value.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. It also uses the assumptions that market participants would use when pricing the asset or liability. In determining fair value the Group maximises the use of relevant observable inputs and minimises the use of unobservable inputs.

Where the Group manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, it measures the fair value of a group of financial assets and financial liabilities on the basis of the price that it would receive to sell a net long position (i.e. an asset) for a particular risk exposure or to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction at the measurement date under current market conditions.

Credit valuation adjustments are made when valuing derivative financial assets to incorporate counterparty credit risk.

Adjustments are also made when valuing financial liabilities measured at fair value to reflect the Group's own credit standing.

Accounting policies

Where the market for a financial instrument is not active, fair value is established using a valuation technique. These valuation techniques involve a degree of estimation, the extent of which depends on the instrument's complexity and the availability of market-based data. Further details about the Group's valuation methodologies and the sensitivity to reasonably possible alternative assumptions of the fair value of financial instruments valued using techniques where at least one significant input is unobservable are given in Note 9.

Accounting developments

International Financial Reporting Standards

A number of IFRSs and amendments to IFRS were in issue at 31 December 2015 that would affect the Group from 1 January 2016 or later.

Effective for 2016

'Accounting for Acquisitions of Interests in Joint Operations' issued in May 2014 amends IFRS 11 'Joint Arrangements'. An acquirer of an interest in a joint operation that is a business applies the relevant principles for business combinations in IFRS 3 and other standards and makes the relevant disclosures accordingly. The effective date is 1 January 2016.

'Clarification of Acceptable Methods of Depreciation and Amortisation' issued in May 2014 amends IAS 16 'Property, Plant and Equipment' and IAS 38 'Intangible Assets' requiring amortisation to be based on the consumption of an asset, introducing a rebuttable presumption that this is not achieved by an amortisation profile aligned to revenue. The effective date is 1 January 2016.

Annual Improvements to IFRS 2012 - 2014 cycle was issued in September 2014 making a number of minor amendments to IFRS. Its effective date is 1 January 2016.

Amendments to IFRS 10 'Consolidated Financial Statements', IFRS 12 'Disclosure of Interests in Other Entities' and IAS 28 'Investments in Associates and Joint Ventures' were issued in September 2014 to clarify the accounting for sales between an investor, its associate or joint ventures, and in December 2014 to clarify the application of the investment entity consolidation exception. The September 2014 amendments will be effective from a date to be determined by the IASB and the December 2014 amendments from 1 January 2016.

An amendment to IAS 1 'Presentation of Financial Statements' was issued in December 2014 to clarify the application of materiality to financial statements. Its effective date is 1 January 2016.

None of these amendments is expected to have a material effect on the Group's financial statements.

Effective after 2016 - IFRS 9

In July 2014, the IASB published IFRS 9 'Financial Instruments' with an effective date of 1 January 2018. IFRS 9 replaces the current financial instruments standard IAS 39, setting out new accounting requirements in a number of areas. The Group is continuing its assessment of the standard's effect on its financial statements.

The principle features of IFRS 9 are as follows:

Recognition and derecognition

The material in IAS 39 setting out the criteria for the recognition and derecognition of financial instruments has been included unamended in IFRS 9.

Classification and measurement

Financial assets - There are three classifications for financial assets in IFRS 9: fair value through profit or loss; fair value through other comprehensive income; and amortised cost.

- Financial assets with terms that give rise to interest and principal cash flows only and which are held in a business model whose objective is to hold financial assets to collect their cash flow are measured at amortised cost.
- Financial assets with terms that give rise to interest and principal cash flows only and which are held in a business model whose objective is achieved by holding financial assets to collect their cash flow and selling them are measured at fair value through other comprehensive income.
- Other financial assets are measured at fair value through profit and loss.

However, at initial recognition, any financial asset may be irrevocably designated as measured at fair value through profit or loss if such designation eliminates a measurement or recognition inconsistency.

The Group continues to evaluate the overall effect, but expects that the measurement basis of the majority of the Group's financial assets will be unchanged on application of IFRS 9.

Financial liabilities - IFRS 9's requirements on the classification and measurement of financial liabilities are largely unchanged from those in IAS 39. However, there is a change to the treatment of changes in the fair value attributable to own credit risk of financial liabilities designated as at fair value through profit or loss which are recognised in other comprehensive income and not in profit or loss as required by IAS 39.

Hedge accounting

Hedge accounting requirements are designed to align accounting more closely to the risk management framework; permit a greater variety of hedging instruments; and remove or simplify some of the rule-based requirements in IAS 39. The basic mechanics of hedge accounting: fair value, cash flow and net investment hedges are retained. There is an option in IFRS 9 for an accounting policy choice to continue with the IAS 39 hedge accounting framework. The Group is actively considering its implementation approach.

Accounting policies

Credit impairment

IFRS 9's credit impairment requirements apply to financial assets measured at amortised cost, to those measured at fair value through other comprehensive income, to lease receivables and to certain loan commitments and financial guarantee contracts. On initial recognition a loss allowance is established at an amount equal to 12-month expected credit losses ('ECL') that is the portion of life-time expected losses resulting from default events that are possible within the next 12 months.

Where a significant increase in credit risk since initial recognition is identified, the loss allowance increases so as to recognise all expected default events over the expected life of the asset. The Group expects that financial assets where there is objective evidence of impairment under IAS39 will be credit impaired under IFRS 9, and carry loss allowances based on all expected default events.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted: determined by evaluating at the reporting date for each customer or loan portfolio a range of possible outcomes using reasonable and supportable information about past events, current conditions and forecasts of future events and economic conditions. The estimation of ECL also takes into account the time value of money. Recognition and measurement of credit impairments under IFRS 9 are more forward-looking than under IAS 39.

A single bank-wide programme has been established to implement the necessary changes in the modelling of credit loss parameters, and the underlying credit management and financial processes; this programme is led jointly by Risk and Finance. The inclusion of loss allowances on all financial assets will tend to result in an increase in overall impairment balances when compared with the existing basis of measurement under IAS 39.

Transition

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. Hedge accounting is generally applied prospectively from that date.

Effective after 2016 – other standards

In January 2016, the IASB amended IAS 7 'Cash Flow Statements' to require disclosure of the movements in financing liabilities. The amendment is effective from 1 January 2017.

In January 2016, the IASB amended IAS12 'Income taxes' to clarify the recognition of deferred tax assets in respect of unrealised losses. The amendment is effective from 1 January 2017.

IFRS 15 'Revenue from Contracts with Customers' was issued in May 2014. It will replace IAS 11 'Construction Contracts', IAS 18 'Revenue' and several Interpretations. Contracts are bundled or unbundled into distinct performance obligations with revenue recognised as the obligations are met. It is effective from 1 January 2018.

IFRS 16 'Leases' was issued in January 2016 to replace IAS 17 'Leases'. Accounting for finance leases will remain substantially the same. Operating leases will be brought on balance sheet through the recognition of assets representing the contractual rights of use and liabilities will be recognised for the contractual payments. The effective date is 1 January 2019.

The Group is assessing the effect of adopting these standards on its financial statements.

Notes on accounts

1 Net interest income

	Group		
	2015 £m	2014 £m	2013 £m
Loans and advances to customers	5,610	5,746	6,570
Loans and advances to banks	661	734	823
Debt securities	9	19	90
Interest receivable	6,280	6,499	7,483
Customer accounts: demand deposits	427	342	360
Customer accounts: savings deposits	276	573	1,058
Customer accounts: other time deposits	307	589	1,519
Deposits by banks	117	139	234
Debt securities in issue	5	9	18
Subordinated liabilities	250	269	267
Internal funding of trading businesses	2	1	6
Interest payable	1,384	1,922	3,462
Net interest income	4,896	4,577	4,021

2 Non-interest income

	Group		
	2015 £m	2014 £m	2013 £m
Fees and commissions receivable			
Payment services	668	701	757
Credit and debit card fees	455	551	606
Lending (credit facilities)	469	480	394
Brokerage	176	269	323
Investment management	231	308	353
Trade finance	24	12	17
Other	110	118	150
	2,133	2,439	2,600
Fees and commissions payable	(517)	(498)	(490)
Income from trading activities			
Foreign exchange	132	509	508
Interest rate	(92)	(405)	181
Credit	(25)	(31)	33
Equities and other	(1)	4	4
	14	77	726
Gain on redemption of own debt	—	—	239
Other operating income			
Operating lease and other rental income	10	13	22
Changes in the fair value of financial assets and liabilities designated as at fair value through profit or loss and related derivatives	77	21	1
Changes in the fair value of investment properties	60	4	(93)
Profit/(loss) on sale of securities	9	9	(1)
Profit on sale of property, plant and equipment	3	60	12
(Loss)/profit on sale of subsidiaries and associates	(84)	9	3
(Loss)/profit on disposal or settlement of loans and receivables	(159)	(85)	1
Dividend income	49	234	18
Share of profits of associated entities	—	9	9
Other income ⁽¹⁾	45	408	296
	10	682	268

Note:

(1) Includes income from activities other than banking.

Notes on accounts

3 Operating expenses

	Group		
	2015 £m	2014 £m	2013 £m
Wages, salaries and other staff costs	1,116	1,299	1,316
Social security costs	76	93	79
Pension costs			
- defined benefit schemes (see Note 4)	288	242	261
- curtailment and settlement gains (see Note 4)	(57)	—	—
- defined contribution schemes	27	34	27
Staff costs	1,450	1,668	1,683
Premises and equipment	544	280	375
Other administrative expenses (1)	5,624	3,775	6,488
Property, plant and equipment, depreciation and write down (see Note 17)	386	113	138
Intangible assets amortisation (see Note 16)	67	113	76
Depreciation and amortisation	453	226	214
Write down of intangible assets (see Note 16)	107	—	2
	8,178	5,949	8,762

Restructuring costs included in operating expenses comprise:

	2015 £m	2014 £m	2013 £m
Staff costs	93	17	36
Premises and depreciation	523	5	4
Other (2)	112	4	3
	728	26	43

Notes:

(1) Includes Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs, and other litigation and conduct costs. Further details are provided in Note 21.

(2) Includes other administration expenses, write down of goodwill and other intangible assets.

The average number of persons employed, rounded to the nearest hundred, in the Group during the year, excluding temporary staff, was 29,800 (2014 - 31,200; 2013 - 28,800). The number of persons employed by the Group at 31 December, excluding temporary staff, was as follows:

	2015	2014*	2013*
UK Personal & Business Banking	13,300	13,900	15,200
Ulster Bank Rol	2,500	2,500	2,600
Personal & Business Banking	15,800	16,400	17,800
Commercial Banking	100	100	100
Private Banking	1,700	1,800	1,800
Commercial & Private Banking	1,800	1,900	1,900
Corporate & Institutional Banking	200	300	400
Capital Resolution	100	500	400
Central & Other	11,300	11,300	11,100
Non-Core	n/a	n/a	300
Total	29,200	30,400	31,900
UK	16,300	17,300	19,100
USA	1,000	1,500	2,000
Europe	3,300	3,900	4,200
Rest of the World	8,600	7,700	6,600
Total	29,200	30,400	31,900

*Re-presented to reflect the segmental reorganisation

Notes on accounts

4 Pensions

The Group sponsors a number of pension schemes in the UK and overseas whose assets are independent of the Group's finances.

The Royal Bank of Scotland Group Pension Fund (the "Main 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 Main scheme corporate trustee is RBS Pension Trustee Limited (RBSPT) a wholly owned subsidiary of National Westminster Bank Plc. RBSPT is the legal owner of the Main scheme assets which are held separately from the assets of the Group. The Board of RBSPT comprises four trustee directors nominated by members selected from eligible active staff and pensioner members who apply and six 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 apply to the Group's other pension schemes, although different legislative frameworks apply to the Group's overseas schemes.

The Main scheme, accounting for 94% (2014 - 93%) of the Group's retirement benefit obligations, was closed to new entrants in 2006. Since 2009, pensionable salary increases in the Main scheme and certain other UK and Irish schemes have been limited to 2% per annum or CPI inflation if lower. Also with effect from 1 October 2012, the normal pension age for future benefits was increased to 65 unless members elected to contribute to maintain a normal pension age of 60.

The Group's defined benefit schemes generally provide a pension of one-sixtieth of final pensionable salary for each year of service prior to retirement up to a maximum of 40 years. Employees making additional contributions can secure additional benefits.

Since October 2006, new UK entrants may join The Royal Bank of Scotland Retirement Savings Plan, a defined contribution pension scheme.

The Group also provides post-retirement benefits other than pensions, principally through subscriptions to private healthcare schemes in the UK and unfunded post-retirement benefit plans. Provision for the costs of these benefits is charged to the income statement over the average remaining future service lives of eligible employees. The amounts are not material.

Interim valuations of the Group's schemes under IAS 19 'Employee Benefits' were prepared at 31 December with the support of independent actuaries, using the following assumptions:

	Main scheme	
	2015	2014
	%	%
Principal IAS 19 actuarial assumptions		
Discount rate	3.9	3.7
Expected return on plan assets	3.9	3.7
Rate of increase in salaries	1.8	1.8
Rate of increase in pensions in payment	2.8	2.8
Inflation assumption (RPI)	3.0	3.0

Notes on accounts

4 Pensions continued

Discount rate

The Group discounts its defined benefit pension obligations at discount rates determined by reference to the yield on 'high quality' corporate bonds.

The sterling yield curve (applied to 93% of the Group's defined benefit obligations) is constructed by reference to yields on 'AA' corporate bonds from which a single discount rate is derived based on a cash flow profile similar in structure and duration to the pension obligations. Significant judgement is required when setting the criteria for bonds to be included in the population from which the yield curve is derived.

The criteria include issue size, quality of pricing and the exclusion of outliers. Judgement is also required in determining the shape of the yield curve at long durations: a constant credit spread relative to gilts is assumed.

	Main scheme	
	2015	2014
Major classes of plan assets as a percentage of total plan assets	%	%
Quoted assets		
Quoted equities		
- Consumer industry	5.3	4.3
- Manufacturing industry	3.2	3.2
- Energy and utilities	2.6	2.9
- Financial institutions	5.4	3.9
- Technology and telecommunications	3.4	4.2
- Other	0.9	2.8
Private equity	3.4	4.3
Index-linked bonds	28.2	28.1
Government fixed interest bonds	9.0	3.6
Corporate fixed interest bonds	18.0	15.3
Unquoted assets		
Corporate and other bonds	3.3	2.3
Hedge funds	0.2	1.6
Real estate	6.4	5.8
Derivatives	6.4	10.6
Cash and other assets	4.1	7.1
Equity exposure of equity futures	(1.4)	1.3
Cash exposure of equity futures	1.6	(1.3)
	100.0	100.0

Notes on accounts

4 Pensions continued

The assets of the Main scheme, which represent 95% of plan assets at 31 December 2015 (2014 - 94%), are invested in a diversified portfolio of quoted and private equity, government and corporate fixed-interest and index-linked bonds, and other assets including property and hedge funds.

The Main scheme employs derivative instruments to achieve a desired asset class exposure or to match assets more closely to liabilities. The value of assets shown reflects the assets owned by the scheme, with any derivative holdings valued on a mark-to-market basis.

The Main scheme's holdings of derivative instruments are summarised in the table below:

	2015			2014		
	Notional amounts £m	Fair value Assets £m	Liabilities £m	Notional amounts £m	Fair value Assets £m	Liabilities £m
Inflation rate swaps	9,018	76	647	8,467	73	415
Interest rate swaps	15,739	5,722	3,710	23,858	6,055	3,305
Currency forwards	10,247	—	222	8,562	2	—
Equity and bond call options	6,277	744	1	7,382	846	48
Equity and bond put options	6,109	2	12	7,409	1	61
Other	2,236	1,506	1,479	2,437	665	628

The investment strategy of other schemes is similar to that of the Main scheme, adjusted to take account of the nature of liabilities, risk appetite of the trustees, size of the scheme and any local regulatory constraints. The use of derivative instruments outside the Main scheme is not material.

Swaps are part of the management of the inflation and interest rate sensitivity of the Main scheme liabilities. They have been executed at prevailing market rates and within standard market bid/offer spreads with a number of banks, including The Royal Bank of Scotland plc and National Westminster Bank Plc (the "banks"). At 31 December 2015, the gross notional value of the swaps was £26,871 million (2014 - £34,163 million) and had a net positive fair value of £1,444 million (2014 - £2,433 million).

Collateral is required on all swap transactions. The banks had delivered £1,267 million of collateral at 31 December 2015 (2014 - £2,908 million).

Ordinary shares of the holding company with a fair value of £2 million (2014 - £2 million) and other financial instruments issued by the Group with a value of £1,144 million (2014 - £2,172 million) are held by the Main scheme.

IAS 19 post-retirement mortality assumptions (Main scheme)

	2015	2014
Longevity at age 60 for current pensioners (years)		
Males	27.8	28.0
Females	29.8	30.0
Longevity at age 60 for future pensioners currently aged 40 (years)		
Males	29.1	29.3
Females	31.4	31.6

Notes on accounts

4 Pensions continued

	Group*				Bank*			
	Fair value of plan assets £m	Present value of defined benefit obligations £m	Asset ceiling/minimum funding (1) £m	Net pension liability £m	Fair value of plan assets £m	Present value of defined benefit obligations £m	Asset ceiling/minimum funding (1) £m	Net pension liability £m
Changes in value of net pension deficit								
At 1 January 2014	26,065	28,964	—	2,899	24,272	26,955	—	2,683
Change of accounting policy			105	105				
Currency translation and other adjustments	(69)	(95)		(26)				
Income statement								
Net interest expense	1,207	1,309		102	1,137	1,234		97
Current service cost		319		319		278		278
Less direct contributions from other scheme members		(189)		(189)		(191)		(191)
Past service cost		10		10		18		18
	1,207	1,449		242	1,137	1,339		202
Statement of comprehensive income								
Return on plan assets above recognised interest income	4,848			(4,848)	4,629			(4,629)
Experience gains and losses		(25)		(25)		(3)		(3)
Effect of changes in actuarial financial assumptions		4,282		4,282		3,757		3,757
Effect of changes in actuarial demographic assumptions		409		409		401		401
Asset ceiling/minimum funding adjustments		—	1,749	1,749		—	1,739	1,739
	4,848	4,666	1,749	1,567	4,629	4,155	1,739	1,265
Contributions by employer	804	—		(804)	712	—		(712)
Contributions by plan participants and other scheme members	200	200		—	194	194		—
Benefits paid	(923)	(923)		—	(867)	(867)		—
At 1 January 2015	32,132	34,261	1,854	3,983	30,077	31,776	1,739	3,438
Currency translation and other adjustments	(13)	(58)		(45)				
Income statement								
Net interest expense	1,134	1,220	64	150	1,118	1,157	64	103
Current service cost		297		297		244		244
Less direct contributions from other scheme members		(199)		(199)		(195)		(195)
Past service costs		40		40		28		28
Gains on curtailments or settlement		(57)		(57)		—		—
	1,134	1,301	64	231	1,118	1,234	64	180
Statement of comprehensive income								
Return on plan assets above recognised interest income	(427)	—		427	(415)			415
Experience gains and losses		(276)		(276)		(233)		(233)
Effect of changes in actuarial financial assumptions		(1,246)		(1,246)		(1,124)		(1,124)
Effect of changes in actuarial demographic assumptions		60		60		112		112
Asset ceiling/minimum funding adjustments			1,202	1,202		—	1,178	1,178
	(427)	(1,462)	1,202	167	(415)	(1,245)	1,178	348
Contributions by employer	807	—		(807)	724	—		(724)
Contributions by plan participants and other scheme members	201	201		—	195	195		—
Benefits paid	(1,050)	(1,050)		—	(996)	(996)		—
Transfer to disposal groups	(299)	(297)		2	—	—		—
At 31 December 2015	32,485	32,896	3,120	3,531	30,703	30,964	2,981	3,242

*Restated - refer to page 99 for further details

Note:

(1) In recognising the net surplus or deficit of a pension scheme, the funded status of each scheme is adjusted to reflect any minimum funding requirement imposed on the sponsor and any ceiling on the amount that the sponsor has a right to recover from a scheme.

Notes on accounts

Analysis of net pension deficit

	Main scheme	
	2015 £m	2014 £m
Fund assets at fair value	30,703	30,077
Present value of fund liabilities	30,966	31,776
Funded status	263	1,699
Asset ceiling/minimum funding	2,981	1,739
Retirement benefit liability	3,244	3,438
Minimum funding requirement	3,657	4,190
Asset ceiling	(413)	(752)
	3,244	3,438

Net pension deficit comprises

	Group		Bank	
	2015 £m	2014* £m	2015 £m	2014* £m
Net assets of schemes in surplus (included in Prepayments, accrued income and other assets, Note 18)	(16)	(4)	—	—
Net liabilities of schemes in deficit	3,547	3,987	3,242	3,438
	3,531	3,983	3,242	3,438

*Restated - refer to page 99 for further details

The weighted average duration of the Main scheme's defined benefit obligation at 31 December 2015 is 19.1 years (2014 – 20 years).

The defined benefit obligation is attributable to the different classes of scheme members in the following proportions (Main scheme).

	2015 %	2014 %
Active	17.5	18.8
Deferred	41.9	41.0
Pensioner	40.6	40.2
	100.0	100.0

The table below sets out the sensitivities of the present value of defined benefit obligations at 31 December to a change in the principal actuarial assumptions:

	Main scheme (decrease)/increase in obligation at 31 December	
	2015 £m	2014 £m
0.25% increase in the discount rate	(1,392)	(1,466)
0.25% increase in inflation	1,106	1,159
0.25% additional rate of increase in pensions in payment	945	982
Longevity increase of one year	853	988

Pension liabilities are calculated on the central assumptions and under the relevant sensitivity scenarios. The sensitivity to pension liabilities is the difference between these calculations.

The sensitivity analysis presented above may not be representative of the actual change in the defined benefit obligation as it is unlikely that the changes in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

Notes on accounts

History of defined benefit schemes	Group					Bank				
	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m
Fair value of plan assets	32,485	32,132	26,065	24,078	22,564	30,703	30,077	24,272	22,441	21,111
Present value of defined benefit obligations	32,896	34,261	28,964	29,238	26,236	30,964	31,776	26,955	27,336	24,659
Net deficit	411	2,129	2,899	5,160	3,672	261	1,699	2,683	4,895	3,548
Experience gains/(losses) on plan liabilities	276	25	154	(228)	(213)	233	3	102	(233)	(208)
Experience gains on plan assets	(427)	4,848	1,022	374	855	(415)	4,629	986	301	935
Actual return on pension schemes assets	707	6,055	2,098	1,467	1,957	703	5,766	1,997	1,329	1,966
Actual return on pension schemes assets	2.2%	23.2%	8.7%	6.5%	9.5%	2.3%	23.8%	8.9%	6.3%	10.3%

Triennial funding valuation

In May 2014, the triennial funding valuation of the Main scheme was agreed which showed that the value of the liabilities exceeded the value of assets by £5.6 billion at 31 March 2013, a ratio of 82%. To eliminate this deficit, RBS Group agreed to pay annual additional contributions of £650 million from 2014 to 2016 and £450 million (indexed in line with inflation) from 2017 to 2023. These contributions are in addition to regular annual contributions of approximately £270 million in respect of the ongoing accrual of benefits as well as contributions to meet the expenses of running the scheme.

In January 2016, RBS Group sought regulatory approval to accelerate the settlement of the outstanding additional contributions of £4.2 billion and it entered into a Memorandum of Understanding with the trustee of the Main scheme which, among other things, will bring forward the date of the next triennial funding valuation to no later than 31 December 2015.

The trustee of the Main scheme is responsible for setting the actuarial assumptions used in the triennial funding valuation having taken advice from the Scheme Actuary. These represent the trustee's prudent estimate of the future experience of the Main scheme taking into account the covenant provided by RBS Group and investment strategy of the scheme. They are agreed with RBS Group and documented in the Statement of Funding Principles.

The key assumption methodology used at the 31 March 2013 valuation is set out below:

Principal actuarial assumptions

Discount rate	Fixed interest swap yield curve plus 1.5% per annum at all durations	
Inflation assumption	Retail price index (RPI) swap yield curve	
Rate of increase in pensions in payment	(RPI floor 0%, cap 5%): Limited price indexation (LPI) (0,5) swap yield curve	
Post retirement mortality assumptions:		
Longevity at age 60 for current pensioners (years)	Male	28.8
	Female	30.8
Longevity at age 60 for future pensioners currently aged 40 (years)	Male	30.7
	Female	32.9

Notes on accounts

5 Auditor's remuneration

Amounts paid to the Group's auditor for statutory audit and other services are set out below.

	Group	
	2015 £m	2014 £m
Fees payable for the audit of the Group's annual accounts	1.2	1.2
Fees payable to the auditor and its associates for other services to the Group		
- the audit of the Bank's subsidiaries pursuant to legislation	1.4	1.4
Total audit and audit-related assurance services fees	2.6	2.6

Fees payable to the auditor for non-audit services are disclosed in the consolidated financial statements of The Royal Bank of Scotland Group plc.

6 Tax

	Group		
	2015 £m	2014 £m	2013 £m
Current tax			
(Charge)/credit for the year	(51)	32	28
Over/(under) provision in respect of prior years	21	(62)	(345)
	(30)	(30)	(317)
Deferred tax			
Charge for the year arising from UK tax rate changes	(51)	—	(49)
Other (charges)/credits for the year	(237)	(278)	803
Reduction in the carrying value of deferred tax assets	—	(622)	—
Over provision in respect of prior years	26	86	405
Tax (charge)/credit for the year	(292)	(844)	842

The actual tax (charge)/credit differs from the expected tax credit/(charge) computed by applying the standard rate of UK corporation tax of 20.25% (2014 - 21.50%; 2013 - 23.25%) as follows:

	2015 £m	2014 £m	2013 £m
Expected tax credit/(charge)	185	(554)	1,582
Losses and temporary differences in year where no deferred tax asset recognised	(933)	(4)	(496)
Foreign profits taxed at other rates	493	119	(133)
UK tax rate change impact ⁽¹⁾	(51)	—	(49)
Non-deductible goodwill impairment	(25)	—	—
Items not allowed for tax			
- losses on disposal and write-downs	(1)	(4)	—
- bank levy	(3)	—	—
- regulatory and legal actions	(106)	(4)	(53)
- other disallowable items	(39)	(70)	(76)
Non-taxable items	39	65	9
Taxable foreign exchange movements	4	2	(2)
Losses brought forward and utilised	98	204	—
(Reduction)/increase in carrying value of deferred tax asset in respect of:			
- US losses and temporary differences	—	(775)	—
- Ireland losses	—	153	—
Adjustments in respect of prior years	47	24	60
Actual tax (charge)/credit	(292)	(844)	842

Note:

(1) In recent years, the UK government has steadily reduced the rate of UK corporation tax, with the latest enacted rates standing at 20% with effect from 1 April 2015, 19% from 1 April 2017 and 18% from 1 April 2020. The Finance (No 2) Act 2015 restricts the rate at which tax losses are given credit in future periods to the main rate of UK corporation tax, excluding the Banking Surcharge 8% rate introduced by this Act. Deferred tax assets and liabilities at 31 December 2015 take into account the reduced rates in respect of tax losses and non-banking temporary differences and where appropriate, the banking surcharge inclusive rate in respect of other banking temporary differences.

7 (Loss)/profit dealt with in the accounts of the Bank

As permitted by section 408(3) of the Companies Act 2006, no income statement for the Bank has been presented as a primary financial statement. Of the loss attributable to ordinary shareholders, £1,422 million loss (2014 - £2,416 million profit; 2013 - £1,412 million loss) has been dealt with in the accounts of the Bank.

Notes on accounts

8 Financial instruments - classification

The following tables analyse the Group's financial assets and liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown within other assets and other liabilities.

	Group					Total £m
	Held-for- trading £m	Designated as at fair value through profit or loss £m	Available- for-sale £m	Loans and receivables £m	Other assets £m	
Assets						
Cash and balances at central banks	—	—	—	1,690		1,690
Loans and advances to banks						
- amounts due from holding company and fellow subsidiaries	4,659	1,150	—	93,594		99,403
- reverse repos	157	—	—	—		157
- other ⁽¹⁾	—	—	—	3,718		3,718
Loans and advances to customers						
- amounts due from fellow subsidiaries	402	—	—	167		569
- reverse repos	10,524	—	—	—		10,524
- other	174	—	—	165,565		165,739
Debt securities ⁽²⁾	5,310	—	1,894	—		7,204
Equity shares	2	33	682	—		717
Settlement balances	—	—	—	2,138		2,138
Derivatives						
- amounts due from holding company and fellow subsidiaries	1,724					1,724
- other	889					889
Assets of disposal groups					3,311	3,311
Other assets	—	—	—	—	4,647	4,647
31 December 2015	23,841	1,183	2,576	266,872	7,958	302,430
Cash and balances at central banks	—	—	—	2,709		2,709
Loans and advances to banks						
- amounts due from holding company and fellow subsidiaries	3,092	1,898	—	98,282		103,272
- reverse repos	2,469	—	—	548		3,017
- other ⁽¹⁾	5	—	—	4,618		4,623
Loans and advances to customers						
- amounts due from fellow subsidiaries	55	—	—	973		1,028
- reverse repos	5,658	—	—	—		5,658
- other	184	—	—	162,296		162,480
Debt securities ⁽²⁾	10,299	—	2,748	782		13,829
Equity shares	10	46	723	—		779
Settlement balances	—	—	—	2,050		2,050
Derivatives						
- amounts due from holding company and fellow subsidiaries	2,672					2,672
- other	1,226					1,226
Other assets*	—	—	—	—	5,857	5,857
31 December 2014	25,670	1,944	3,471	272,258	5,857	309,200

*Restated - refer to page 99 for further details

For the notes to this table refer to page 124.

Notes on accounts

8 Financial instruments - classification

	Group				
	Held-for-trading £m	Designated as at fair value through profit or loss £m	Amortised cost £m	Other liabilities £m	Total £m
Liabilities					
Deposits by banks					
- amounts due to holding company and fellow subsidiaries	3,508	—	14,101		17,609
- repos	3,476	—	—		3,476
- other (3)	33	—	3,473		3,506
Customer accounts					
- amounts due to fellow subsidiaries	—	—	7,752		7,752
- repos	6,978	—	—		6,978
- other (4)	20	2,231	214,680		216,931
Debt securities in issue (5)	—	—	1,473		1,473
Settlement balances	—	—	2,461		2,461
Short positions	3,577	—	—		3,577
Derivatives					
- amounts due to holding company	2,291				2,291
- other	379				379
Subordinated liabilities					
- amounts due to holding company	—	—	5,621		5,621
- other	—	—	1,395		1,395
Liabilities of disposal groups				2,724	2,724
Other liabilities			690	10,400	11,090
31 December 2015	20,262	2,231	251,646	13,124	287,263
Deposits by banks					
- amounts due to holding company and fellow subsidiaries	4,620	—	15,508		20,128
- repos	2,736	—	—		2,736
- other (3)	35	—	3,333		3,368
Customer accounts					
- amounts due to fellow subsidiaries	6	—	13,106		13,112
- repos	3,659	—	—		3,659
- other (4)	13	3,681	213,862		217,556
Debt securities in issue (5)	—	—	1,707		1,707
Settlement balances	—	—	2,143		2,143
Short positions	6,827	—	—		6,827
Derivatives					
- amounts due to holding company	3,971				3,971
- other	487				487
Subordinated liabilities					
- amounts due to holding company	—	—	5,656		5,656
- other	—	—	1,780		1,780
Other liabilities*			677	9,625	10,302
31 December 2014	22,354	3,681	257,772	9,625	293,432

*Restated - refer page 99 for further details

For the notes to this table refer to page 124.

Notes on accounts

8 Financial instruments - classification

The above includes amounts due from/to:

	Group			
	2015		2014	
	Holding company £m	Fellow subsidiaries £m	Holding company £m	Fellow subsidiaries £m
Assets				
Loans and advances to banks	92,367	7,036	99,452	3,820
Derivatives	1,712	12	2,659	13
Liabilities				
Deposits by banks	13,701	3,908	17,169	2,959

Notes:

- (1) Includes items in the course of collection from other banks of £705 million (2014 - £865 million).
- (2) Debt securities balances with Group companies are shown on pages 74 and 75.
- (3) Includes items in the course of transmission to other banks of £237 million (2014 - £263 million).
- (4) The carrying amount of other customer accounts designated as at fair value through profit or loss is £268 million (2014 - £379 million) higher than the principal amount. No amounts have been recognised in the profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial both during the period and cumulatively. Measured as the change in fair value from movements in the period in the credit risk premium payable.
- (5) Comprises bonds and medium term notes of £1,472 million (2014 - £1,697 million) and certificates of deposit and other commercial paper of £1 million (2014 - £10 million).

Amounts included in operating (loss)/profit before tax:

	Group		
	2015 £m	2014 £m	2013 £m
Gains on financial assets/liabilities designated as at fair value through profit or loss	77	20	1
(Losses)/gains on disposal or settlement of loans and receivables	(159)	(85)	1

Notes on accounts

8 Financial instruments - classification

	Bank					Total £m
	Held-for- trading £m	Designated as at fair value through profit or loss £m	Available- for-sale £m	Loans and receivables £m	Other assets £m	
Assets						
Cash and balances at central banks	—	—	—	819		819
Loans and advances to banks						
- amounts due from holding company and subsidiaries	24	1,075	—	71,128		72,227
- other (1)	—	—	—	1,022		1,022
Loans and advances to customers						
- amounts due from subsidiaries	—	—	—	132		132
- other	139	—	—	134,112		134,251
Equity shares	—	—	4	—		4
Investment in group undertakings	—	—	—	—	6,554	6,554
Settlement balances	—	—	—	47		47
Derivatives						
- amounts due from holding company and fellow subsidiaries	1,326					1,326
- other	760					760
Other assets	—	—	—	—	3,250	3,250
31 December 2015	2,249	1,075	4	207,260	9,804	220,392
Cash and balances at central banks	—	—	—	1,054		1,054
Loans and advances to banks						
- amounts due from holding company and subsidiaries	377	1,844	—	74,478		76,699
- other (1)	—	—	—	1,805		1,805
Loans and advances to customers						
- amounts due from subsidiaries	—	—	—	2,018		2,018
- other	61	—	—	122,218		122,279
Debt securities (2)	—	—	—	782		782
Equity shares	1	—	4	—		5
Investment in group undertakings	—	—	—	—	7,866	7,866
Settlement balances	—	—	—	42		42
Derivatives						
- amounts due from holding company and fellow subsidiaries	2,129					2,129
- other	983					983
Other assets*	—	—	—	—	2,990	2,990
31 December 2014	3,551	1,844	4	202,397	10,856	218,652

*Restated - refer to page 99 for further details

For the notes to this table refer to page 126.

Notes on accounts

8 Financial instruments - classification

	Bank				
	Held-for-trading £m	Designated as at fair value through profit or loss £m	Amortised cost £m	Other liabilities £m	Total £m
Liabilities					
Deposits by banks					
- amounts due to holding company and subsidiaries	1,117	—	7,093		8,210
- other (3)	2	—	2,724		2,726
Customer accounts					
- amounts due to fellow subsidiaries	—	—	8,718		8,718
- other (4)	20	1,075	175,326		176,421
Settlement balances	—	—	53		53
Derivatives					
- amounts due to holding company and subsidiaries	1,993				1,993
- other	302				302
Subordinated liabilities					
- amounts due to holding company	—	—	4,413		4,413
- other	—	—	1,328		1,328
Other liabilities	—	—	—	4,946	4,946
31 December 2015	3,434	1,075	199,655	4,946	209,110

Deposits by banks					
- amounts due to holding company and subsidiaries	1,347	—	6,078		7,425
- other (3)	2	—	2,121		2,123
Customer accounts					
- amounts due to fellow subsidiaries	—	—	13,207		13,207
- other (4)	13	1,844	167,146		169,003
Settlement balances	—	—	67		67
Derivatives					
- amounts due to holding company	3,397				3,397
- other	359				359
Subordinated liabilities					
- amounts due to holding company	—	—	4,413		4,413
- other	—	—	1,709		1,709
Other liabilities*	—	—	—	5,028	5,028
31 December 2014	5,118	1,844	194,741	5,028	206,731

*Restated - refer to page 99 for further details

The above includes amounts due from/to:

	Bank					
	2015			2014		
	Holding company £m	Fellow subsidiaries £m	Subsidiaries £m	Holding company £m	Fellow subsidiaries £m	Subsidiaries £m
Assets						
Loans and advances to banks	70,568	1,606	53	74,919	841	939
Loans and advances to customers	—	99	33	—	1,937	81
Derivatives	1,314	12	—	2,119	10	—
Liabilities						
Deposits by banks	5,833	1,258	1,119	5,504	1,616	305
Derivatives	1,993	—	—	3,394	—	3

Notes:

(1) Includes items in the course of collection from other banks of £643 million (2014 - £785 million).

(2) Debt securities balances with Group companies are shown on pages 74 and 75.

(3) Includes items in the course of transmission to other banks of £228 million (2014 - £251 million).

(4) The carrying amount of other customer accounts designated as at fair value through the profit or loss is £217 million (2014 - £330 million) higher than the principal amount. No amounts have been recognised in the profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial both during the period and cumulatively. Measured as the change in fair value from movements in the period in the credit risk premium payable.

The tables below present information on financial assets and liabilities that are offset on the balance sheet under IFRS or subject to enforceable master netting agreements, together with financial collateral received or given.

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	Offsetable instruments			Offsetable potential not recognised by IFRS			
	Gross £m	IFRS offset £m	Balance sheet £m	Effect of master netting agreement and similar agreements £m	Cash collateral £m	Other financial collateral £m	Net amount after the effect of netting arrangements and related collateral £m
2015							
Assets							
Derivatives	2,362	—	2,362	(1,486)	(19)	(71)	786
Reverse repurchase agreements	24,668	(13,987)	10,681	(449)	—	(10,107)	125
Settlement balances	1,083	(1,057)	26	(26)	—	—	—
	28,113	(15,044)	13,069	(1,961)	(19)	(10,178)	911
Liabilities							
Derivatives	2,799	—	2,799	(1,486)	—	(2)	1,311
Repurchase agreements	24,442	(13,987)	10,455	(449)	—	(10,006)	—
Settlement balances	1,679	(1,057)	622	(26)	—	—	596
	28,920	(15,044)	13,876	(1,961)	—	(10,008)	1,907
2014							
Assets							
Derivatives	2,820	(5)	2,815	(1,960)	(14)	(27)	814
Reverse repurchase agreements	24,487	(15,872)	8,615	(265)	—	(8,301)	49
Settlement balances	1,801	(1,776)	25	—	—	—	25
	29,108	(17,653)	11,455	(2,225)	(14)	(8,328)	888
Liabilities							
Derivatives	3,703	(5)	3,698	(1,960)	—	—	1,738
Repurchase agreements	22,267	(15,872)	6,395	(265)	—	(6,130)	—
Settlement balances	1,776	(1,776)	—	—	—	—	—
	27,746	(17,653)	10,093	(2,225)	—	(6,130)	1,738

Note:

(1) The effect of master netting agreements on derivatives within the Bank was £1,343 million (2014 - £1,710 million).

Reclassification of financial instruments

In 2008 and 2009, the Group reclassified financial assets from the held-for-trading (HFT) category into the loans and receivables (LAR) category.

The tables below show the carrying value, fair value and the effect on profit or loss of these reclassifications undertaken by the Group. There have been no further reclassifications.

	Group			
	Carrying value £m	Fair value £m	Amounts recognised in income statement Income £m	Amount that would have been recognised had reclassification not occurred £m
Loans reclassified from HFT to LAR				
2015	—	—	(10)	(7)
2014	169	166	7	7

9 Financial instruments - valuation

Valuation of financial instruments carried at fair value

Control environment

Common valuation policies, procedures, frameworks and models apply across the RBS Group. Therefore, for the most part, discussions on these aspects below reflect those in the RBS Group as relevant for businesses in the Group.

The Group's control environment for the determination of the fair value of financial instruments includes formalised protocols for the review and validation of fair values independent of the businesses entering into the transactions. There are specific controls to ensure consistent pricing policies and procedures, incorporating disciplined price verification. The Group ensures that appropriate attention is given to bespoke transactions, structured products, illiquid products and other instruments which are difficult to price.

Independent price verification (IPV)

IPV is a key element of the control environment. Valuations are first performed by the business which entered into the transaction. Such valuations may be directly from available prices, or may be derived using a model and variable model inputs. These valuations are reviewed, and if necessary amended, by a team independent of those trading the financial instruments, in the light of available pricing evidence.

IPV differences are classified according to the quality of independent market observables into IPV quality bands linked to the fair value hierarchy principles, as laid out in IFRS 13 'Fair Value Measurement'. These differences are classified into fair value levels 1, 2 and 3 (with the valuation uncertainty risk increasing as the levels rise from 1 to 3) and then further classified into high, medium, low and indicative depending on the quality of the independent data available to validate the prices. Valuations are revised if they are outside agreed thresholds.

Governance framework

IPV takes place at least each month end date, for exposures in the regulatory trading book and at least quarterly for exposures in the regulatory banking book. The IPV control includes formalised reporting and escalation of any valuation differences in breach of established thresholds. The Pricing Unit determines IPV policy, monitors adherence to that policy and performs additional independent reviews of highly subjective valuation issues.

The Modelled Product Review Committee sets the policy for model documentation, testing and review, and prioritises models with significant exposure for review by the RBS Group Pricing Model Risk team. Valuation Committees are made up of valuation specialists and senior business representatives from various functions and oversee pricing, reserving and valuations issues as relevant to businesses within the RBS Group. These committees meet monthly to review and ratify any methodology changes. The Executive Valuation Committee meets quarterly to address key material and subjective valuation issues, to review items escalated by the Valuation Committees and to discuss other relevant matters including prudential valuation.

Valuation hierarchy

Initial classification of a financial instrument is carried out by the Product Control team following the principles in IFRS 13. They base their judgment on information gathered during the IPV process for instruments which include the sourcing of independent prices and model inputs. The quality and completeness of the information gathered in the IPV process gives an indication as to the liquidity and valuation uncertainty of an instrument.

These initial classifications are reviewed and challenged by the Pricing Unit and are also subject to senior management review. Particular attention is paid to instruments crossing from one level to another, new instrument classes or products, instruments that are generating significant profit and loss and instruments where valuation uncertainty is high.

Valuation techniques

The Group derives fair value of its instruments differently depending on whether the instrument is a non-modelled or a modelled product.

Non-modelled products

Non-modelled products are valued directly from a price input typically on a position by position basis and include cash, equities and most debt securities.

Modelled products

Modelled products valued using a pricing model range in complexity from comparatively vanilla products such as interest rate swaps and options (e.g. interest rate caps and floors) through to more complex derivatives. The valuation of modelled products requires an appropriate model and inputs into this model. Sometimes models are also used to derive inputs (e.g. to construct volatility surfaces). The Group uses a number of modelling methodologies.

Inputs to valuation models

Values between and beyond available data points are obtained by interpolation and extrapolation. When utilising valuation techniques, the fair value can be significantly affected by the choice of valuation model and by underlying assumptions concerning factors such as the amounts and timing of cash flows, discount rates and credit risk. The principal inputs to these valuation techniques are as follows:

- Bond prices - quoted prices are generally available for government bonds, certain corporate securities and some mortgage-related products.
- Credit spreads - where available, these are derived from prices of credit default swaps or other credit based instruments, such as debt securities. For others, credit spreads are obtained from pricing services.
- Interest rates - these are principally benchmark interest rates such as the London Interbank Offered Rate (LIBOR), Overnight Index Swaps (OIS) rate and other quoted interest rates in the swap, bond and futures markets.

Notes on accounts

- Foreign currency exchange rates - there are observable prices both for spot and forward contracts and futures in the world's major currencies.
- Equity and equity index prices - quoted prices are generally readily available for equity shares listed on the world's major stock exchanges and for major indices on such shares.
- Commodity prices - many commodities are actively traded in spot and forward contracts and futures on exchanges in London, New York and other commercial centers.
- Price volatilities and correlations - volatility is a measure of the tendency of a price to change with time. Correlation measures the degree which two or more prices or other variables are observed to move together.
- Prepayment rates - the fair value of a financial instrument that can be prepaid by the issuer or borrower differs from that of an instrument that cannot be prepaid. In valuing prepayable instruments that are not quoted in active markets, the Group considers the value of the prepayment option.
- Counterparty credit spreads - adjustments are made to market prices (or parameters) when the creditworthiness of the counterparty differs from that of the assumed counterparty in the market price (or parameters).
- Recovery rates/loss given default - these are used as an input to valuation models and reserves for asset-backed securities and other credit products as an indicator of severity of losses on default. Recovery rates are primarily sourced from market data providers or inferred from observable credit spreads.

Consensus pricing

The Group uses consensus prices for the IPV of some instruments. The consensus service encompasses the equity, interest rate, currency, commodity, credit, property, fund and bond markets, providing comprehensive matrices of vanilla prices and a wide selection of exotic products. CIB contribute to consensus pricing services where there is a significant interest either from a positional point of view or to test models for future business use. Data sourced from consensus pricing services are used for a combination of control processes including direct price testing, evidence of observability and model testing. In practice this means that the Group submits prices for all material positions for which a service is available. Data from consensus services are subject to the same level of quality review as other inputs used for IPV process.

In order to determine a reliable fair value, where appropriate, management applies valuation adjustments to the pricing information gathered from the above sources. The sources of independent data are reviewed for quality and are applied in the IPV processes using a formalised input quality hierarchy. These adjustments reflect the Group's assessment of factors that market participants would consider in setting a price.

Furthermore, on an ongoing basis, the Group assesses the appropriateness of any model used. To the extent that the price determined by internal models does not represent the fair value of the instrument, for instance in highly stressed market conditions, the Group makes adjustments to the model valuation to calibrate to other available pricing sources.

Where unobservable inputs are used, the Group may determine a range of possible valuations derived from differing stress scenarios to determine the sensitivity associated with the valuation. When establishing the fair value of a financial instrument using a valuation technique, the Group considers adjustments to the modelled price which market participants would make when pricing that instrument. Such adjustments include the credit quality of the counterparty and adjustments to compensate for model limitations.

Valuation reserves

When valuing financial instruments in the trading book, adjustments are made to mid-market valuations to cover bid-offer spread, liquidity and credit risk.

Credit valuation adjustments (CVA)

CVA represents an estimate of the adjustment to fair value that a market participant would make to incorporate the counterparty credit risk inherent in derivative exposures. CVA is actively managed by a credit and market risk hedging process, and therefore movements in CVA are partially offset by trading revenue on the hedges. CVA reserve at 31 December 2015 was £49 million (2014 - £155 million).

The CVA is calculated on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the credit risk.

Where a positive exposure exists to a counterparty that is considered to be close to default, the CVA is calculated by applying expected losses to the current level of exposure. Otherwise, expected losses are applied to estimated potential future positive exposures which are modelled to reflect the volatility of the market factors which drive the exposures and the correlation between those factors.

Expected losses are determined from market implied probabilities of default and internally assessed recovery levels. The probability of default is calculated with reference to observable credit spreads and observable recovery levels. For counterparties where observable data do not exist, the probability of default is determined from the credit spreads and recovery levels of similarly rated entities.

Collateral held under a credit support agreement is factored into the CVA calculation. In such cases where the Group holds collateral against counterparty exposures, CVA is held to the extent that residual risk remains.

Notes on accounts

9 Financial instruments – valuation

Valuation hierarchy

The following tables show financial instruments carried at fair value on the balance sheet by valuation hierarchy - level 1, level 2 and level 3.

	2015				2014			
	Level 1 £bn	Level 2 £bn	Level 3 £bn	Total £bn	Level 1 £bn	Level 2 £bn	Level 3 £bn	Total £bn
Assets								
Loans and advances	—	16.8	0.3	17.1	—	13.4	—	13.4
Debt securities	6.7	0.5	—	7.2	9.9	3.1	—	13.0
- of which AFS	1.9	—	—	1.9	2.4	0.3	—	2.7
Equity shares	—	—	0.7	0.7	—	0.1	0.7	0.8
- of which AFS	—	—	0.7	0.7	—	—	0.7	0.7
Derivatives	—	2.6	—	2.6	—	3.9	—	3.9
	6.7	19.9	1.0	27.6	9.9	20.5	0.7	31.1
Proportion	24.3%	72.1%	3.6%	100.0%	31.8%	65.9%	2.3%	100.0%
Liabilities								
Deposits	—	16.0	0.2	16.2	—	14.8	—	14.8
Short positions	3.5	0.1	—	3.6	6.3	0.5	—	6.8
Derivatives	—	2.6	0.1	2.7	—	4.4	—	4.4
	3.5	18.7	0.3	22.5	6.3	19.7	—	26.0
Proportion	15.6%	83.1%	1.3%	100.0%	24.2%	75.8%	—	100.0%

Notes:

- (1) Level 1: valued using unadjusted quoted prices in active markets, for identical financial instruments. Examples include G10 government securities, listed equity shares, certain exchange-traded derivatives and certain US agency securities.
Level 2: valued using techniques based significantly on observable market data. Instruments in this category are valued using:
(a) quoted prices for similar instruments or identical instruments in markets which are not considered to be active; or
(b) valuation techniques where all the inputs that have a significant effect on the valuations are directly or indirectly based on observable market data.
Level 2 instruments included non-G10 government securities, most government agency securities, investment-grade corporate bonds, certain mortgage products, including CLOs, most bank loans, repos and reverse repos, less liquid listed equities, state and municipal obligations, most notes issued, and certain money market securities and loan commitments and most OTC derivatives.
Level 3: instruments in this category have been valued using a valuation technique where at least one input which could have a significant effect on the instrument's valuation, is not based on observable market data. Level 3 instruments primarily include cash instruments which trade infrequently, certain syndicated and commercial mortgage loans, certain emerging markets instruments, unlisted equity shares, certain residual interests in securitisations, CDOs, other mortgage-backed products and less liquid debt securities, certain structured debt securities in issue, and OTC derivatives where valuation depends upon unobservable inputs such as certain credit and exotic derivatives. No gain or loss is recognised on the initial recognition of a financial instrument valued using a technique incorporating significant unobservable data.
- (2) Transfers between levels are deemed to have occurred at the beginning of the quarter in which the instruments were transferred. There were no significant transfers between level 1 and level 2.
- (3) For an analysis of derivatives by type of contract refer to Capital and risk management - Balance sheet analysis - derivatives.
- (4) The determination of an instrument's level cannot be made at a global product level as a single product type can be in more than one level. For example, a single name corporate credit default swap could be in Level 2 or Level 3 depending on whether the reference counterparty's obligations are liquid or illiquid.

Level 3 balances at 31 December 2015 comprised loans and advances of £0.3 billion, equity shares of £0.7 billion, deposits of £0.2 billion and derivative liabilities of £0.1 billion. The deposits are structured retail deposits with corresponding loans to the parent company and had a valuation sensitivity of +£4 million / - £8 million. In addition there were loans of £0.1 billion with sensitivity of +£17 million / - £13 million. Equity shares of £0.7 billion (2014 - £0.7 billion) principally comprised £0.6 billion investment in a fellow subsidiary which has not changed in the two years presented. Sensitivity due to reasonably possible changes to valuations is not applicable to this investment given the valuation approach.

Notes on accounts

9 Financial instruments – valuation continued

Fair value of financial instruments not carried at fair value

The following table shows the carrying value and fair value of financial instruments carried at amortised cost on the balance sheet.

	Group					Bank				
	Items where fair value approximates carrying value £bn	Carrying value £bn	Fair value £bn	Fair value hierarchy level Level 2 £bn	Fair value hierarchy level Level 3 £bn	Items where fair value approximates carrying value £bn	Carrying value £bn	Fair value £bn	Fair value hierarchy level Level 2 £bn	Fair value hierarchy level Level 3 £bn
2015										
Financial assets										
Cash and balances at central banks	1.7					0.8				
Loans and advances to banks	1.5	95.9	96.1	7.9	88.2	0.8	71.5	71.7	5.8	65.9
Loans and advances to customers		165.7	163.3	0.2	163.1		134.2	133.6	—	133.6
Settlement balances	2.1					—				
Financial liabilities										
Deposits by banks	5.8	11.7	11.8	0.4	11.4	5.9	3.9	4.2	0.1	4.1
Customer accounts	168.8	53.6	53.7	18.5	35.2	146.6	37.5	37.5	18.5	19.0
Debt securities in issue		1.5	1.2	—	1.2		—	—	—	—
Settlement balances	2.5					0.1				
Notes in circulation (1)	0.7					—				
Subordinated liabilities		7.0	6.9	1.3	5.6		5.7	5.7	1.3	4.4
2014										
Financial assets										
Cash and balances at central banks	2.7					1.1				
Loans and advances to banks	0.9	102.5	102.7	15.4	87.3	0.8	75.5	75.6	11.2	64.4
Loans and advances to customers		163.3	158.7	0.7	158.0		124.2	122.2	0.1	122.1
Debt securities		0.8	0.7	—	0.7		0.8	0.7	—	0.7
Settlement balances	2.0					—				
Financial liabilities										
Deposits by banks	2.8	16.0	16.2	2.9	13.3	2.4	5.8	5.9	0.9	5.0
Customer accounts	148.0	79.0	78.9	37.1	41.8	119.6	60.8	60.6	36.0	24.6
Debt securities in issue		1.7	1.6	—	1.6		—	—	—	—
Settlement balances	2.1					0.1				
Notes in circulation (1)	0.7					—				
Subordinated liabilities		7.4	7.5	1.6	5.9		6.1	6.4	1.6	4.8

Note:

(1) Included in Provisions, accruals and other liabilities.

Notes on accounts

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Quoted market values are used where available; otherwise, fair values have been estimated based on discounted expected future cash flows and other valuation techniques. These techniques involve uncertainties and require assumptions and judgments covering prepayments, credit risk and discount rates. Furthermore there is a wide range of potential valuation techniques. Changes in these assumptions would significantly affect estimated fair values. The fair values reported would not necessarily be realised in an immediate sale or settlement.

The assumptions and methodologies underlying the calculation of fair values of financial instruments at the balance sheet date are as follows:

Short-term financial instruments

For certain short-term financial instruments: cash and balances at central banks, items in the course of collection from other banks, settlement balances, items in the course of transmission to other banks, customer demand deposits and notes in circulation, carrying value is a reasonable approximation of fair value.

Loans and advances to banks and customers

In estimating the fair value of loans and advances to banks and customers measured at amortised cost, RBS's loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans. Two principal methods are used to estimate fair value:

- (a) Contractual cash flows are discounted using a market discount rate that incorporates the current spread for the borrower or where this is not observable, the spread for borrowers of a similar credit standing. This method is used for portfolios where counterparties have external ratings: institutional and corporate lending in CIB.
- (b) Expected cash flows (unadjusted for credit losses) are discounted at the current offer rate for the same or similar products. This approach is adopted for lending portfolios in UK PBB, Ulster Bank Rol Commercial Banking (SME loans) and Private Banking in order to reflect the homogeneous nature of these portfolios.

For certain portfolios where there are very few or no recent transactions, such as Ulster Bank Rol's portfolio of lifetime tracker mortgages, a bespoke approach is used based on available market data.

Debt securities

The majority of debt securities are valued using quoted prices in active markets, or using quoted prices for similar assets in active markets. Fair values of the rest are determined using discounted cash flow valuation techniques.

Deposits by banks and customer accounts

Fair values of deposits are estimated using discounted cash flow valuation techniques.

Debt securities in issue and subordinated liabilities

Fair values are determined using quoted prices for similar liabilities where available or by reference to valuation techniques, adjusting for own credit spreads where appropriate.

Notes on accounts

10 Financial instruments - maturity analysis

Remaining maturity

The following table shows the residual maturity of financial instruments, based on contractual date of maturity.

	Group					
	2015			2014		
	Less than 12 months £m	More than 12 months £m	Total £m	Less than 12 months £m	More than 12 months £m	Total £m
Assets						
Cash and balances at central banks	1,690	—	1,690	2,709	—	2,709
Loans and advances to banks	89,095	14,183	103,278	93,380	17,532	110,912
Loans and advances to customers	44,353	132,479	176,832	45,108	124,058	169,166
Debt securities	2,233	4,971	7,204	3,882	9,947	13,829
Equity shares	—	717	717	—	779	779
Settlement balances	2,138	—	2,138	2,050	—	2,050
Derivatives	293	2,320	2,613	509	3,389	3,898
Liabilities						
Deposits by banks	20,843	3,748	24,591	20,691	5,541	26,232
Customer accounts	220,674	10,987	231,661	219,527	14,800	234,327
Debt securities in issue	1	1,472	1,473	10	1,697	1,707
Settlement balances and short positions	2,928	3,110	6,038	2,723	6,247	8,970
Derivatives	270	2,400	2,670	476	3,982	4,458
Subordinated liabilities	28	6,988	7,016	432	7,004	7,436

	Bank					
	2015			2014		
	Less than 12 months £m	More than 12 months £m	Total £m	Less than 12 months £m	More than 12 months £m	Total £m
Assets						
Cash and balances at central banks	819	—	819	1,054	—	1,054
Loans and advances to banks	65,848	7,401	73,249	67,935	10,569	78,504
Loans and advances to customers	26,827	107,556	134,383	29,257	95,040	124,297
Debt securities	—	—	—	782	—	782
Equity shares	—	4	4	—	5	5
Settlement balances	47	—	47	42	—	42
Derivatives	175	1,911	2,086	250	2,862	3,112
Liabilities						
Deposits by banks	9,287	1,649	10,936	7,378	2,170	9,548
Customer accounts	175,282	9,857	185,139	169,288	12,922	182,210
Settlement balances and short positions	53	—	53	67	—	67
Derivatives	194	2,101	2,295	321	3,435	3,756
Subordinated liabilities	28	5,713	5,741	429	5,693	6,122

Notes on accounts

10 Financial instruments - maturity analysis continued

On balance sheet liabilities

The following table shows, by contractual maturity, the undiscounted cash flows payable up to a period of 20 years from the balance sheet date, including future payments of interest.

	Group					
	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
2015						
Deposits by banks	12,041	1,706	1,387	1,498	909	—
Customer accounts	212,740	3,937	2,375	1,269	2,437	3,286
Debt securities in issue	30	84	198	167	315	357
Subordinated liabilities	52	192	2,750	1,859	1,310	1,357
Settlement balances and other liabilities	3,151	—	—	—	—	—
	228,014	5,919	6,710	4,793	4,972	5,001
Guarantees and commitments notional amount						
Guarantees (1)	1,050	—	—	—	—	—
Commitments (2)	49,325	—	—	—	—	—
	50,375	—	—	—	—	—
2014						
Deposits by banks	8,956	4,888	2,639	1,223	1,214	—
Customer accounts	210,531	7,091	4,937	2,493	3,671	4,609
Debt securities in issue	49	103	254	216	409	457
Subordinated liabilities	188	511	790	3,767	1,525	1,302
Settlement balances and other liabilities	2,820	—	—	—	—	—
	222,544	12,593	8,620	7,699	6,819	6,368
Guarantees and commitments notional amount						
Guarantees (1)	1,677	—	—	—	—	—
Commitments (2)	49,631	—	—	—	—	—
	51,308	—	—	—	—	—

Notes:

- (1) The Group is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Group expects most guarantees it provides to expire unused.
- (2) The Group has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Group does not expect all facilities to be drawn, and some may lapse before drawdown.

Notes on accounts

	Bank					
	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
2015						
Deposits by banks	8,089	76	94	726	837	—
Customer accounts	176,417	1,757	1,469	1,115	2,437	3,286
Subordinated liabilities	49	185	2,439	1,345	961	1,283
Settlement balances	53	—	—	—	—	—
	184,608	2,018	4,002	3,186	4,235	4,569
Guarantees and commitments notional amount						
Guarantees	594	—	—	—	—	—
Commitments	43,411	—	—	—	—	—
	44,005	—	—	—	—	—
2014						
Deposits by banks	3,641	2,993	201	694	672	—
Customer accounts	167,001	3,966	3,822	1,759	3,663	4,609
Subordinated liabilities	141	507	462	3,399	967	1,267
Settlement balances	67	—	—	—	—	—
	170,850	7,466	4,485	5,852	5,302	5,876
Guarantees and commitments notional amount						
Guarantees	783	—	—	—	—	—
Commitments	41,954	—	—	—	—	—
	42,737	—	—	—	—	—

The tables above show the timing of cash outflows to settle financial liabilities, prepared on the following basis:

Financial liabilities are included at the earliest date on which the counterparty can require repayment regardless of whether or not such early repayment results in a penalty. If repayment is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the liability is included at the earliest possible date that the conditions could be fulfilled without considering the probability of the conditions being met. For example, if a structured note automatically prepays when an equity index exceeds a certain level, the cash outflow will be included in the less than three months period whatever the level of the index at the year end.

The settlement date of debt securities issued by certain securitisation vehicles consolidated by the Group depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date.

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

Held-for-trading liabilities amounting to £20.3 billion (2014 - £22.4 billion) for the Group and £3.4 billion (2014 - £5.1 billion) for the Bank have been excluded from the tables.

Notes on accounts

11 Financial assets - impairments

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

	Group				
	Individually assessed £m	Collectively assessed £m	Latent £m	2015 £m	2014 £m
At 1 January	8,963	4,277	668	13,908	17,972
Transfers to disposal groups	(20)	—	—	(20)	—
Currency translation and other adjustments	(409)	(112)	(21)	(542)	(641)
Transfers from fellow subsidiaries	(2)	12	—	10	—
Amounts written-off	(6,403)	(873)	—	(7,276)	(2,071)
Recoveries of amounts previously written-off	30	52	—	82	52
Release to income statement	(468)	(49)	(214)	(731)	(1,247)
Unwind of discount (recognised in interest income)	(24)	(72)	—	(96)	(157)
At 31 December	1,667	3,235	433	5,335	13,908

	Bank				
	Individually assessed £m	Collectively assessed £m	Latent £m	2015 £m	2014 £m
At 1 January	424	1,853	253	2,530	3,133
Currency translation and other adjustments	(18)	18	—	—	(2)
Amounts written-off	(176)	(637)	—	(813)	(801)
Recoveries of amounts previously written-off	5	29	—	34	26
Charge/(release) to income statement	3	82	(97)	(12)	230
Unwind of discount (recognised in interest income)	(9)	(38)	—	(47)	(56)
At 31 December	229	1,307	156	1,692	2,530

	Group		
	2015 £m	2014 £m	2013 £m
Impairment (releases)/losses charged to the income statement			
Loans and advances to customers	(731)	(1,247)	5,411
Loans and advances to banks	—	—	(6)
	(731)	(1,247)	5,405
Debt securities	3	(2)	2
Release to the income statement for continuing operations	(728)	(1,249)	5,407

	Group		
	2015 £m	2014 £m	2013 £m
Gross income not recognised but which would have been recognised under the original terms of impaired loans			
UK	202	237	332
Overseas	60	78	323
	262	315	655

Notes on accounts

	Group		
	2015 £m	2014 £m	2013 £m
Interest on impaired loans included in net interest income			
UK	53	74	101
Overseas	44	83	175
	97	157	276

The following tables analyse impaired financial assets.

	Group					
	2015			2014		
	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m
Loans and receivables						
Loans and advances to customers (1)	7,630	4,903	2,727	18,880	13,240	5,640

	Group	
	Carrying value 2015 £m	Carrying value 2014 £m
Available-for-sale securities		
Equity shares	5	8

	Bank					
	2015			2014		
	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m
Loans and receivables						
Loans and advances to customers (2)	2,168	1,536	632	3,399	2,277	1,122

Notes:

(1) Impairment provisions individually assessed on balances of £2,203 million (2014 - £11,764 million).

(2) Impairment provisions individually assessed on balances of £540 million (2014 - £1,056 million).

Financial and non-financial assets recognised on the balance sheet, obtained during the year by taking possession of collateral or calling on other credit enhancements, were £23 million (2014 - £29 million) for the Group and £23 million (2014 - £26 million) for the Bank.

In general, the Group seeks to dispose of property and other assets not readily convertible into cash, obtained by taking possession of collateral, as rapidly as the market for the individual asset permits.

Notes on accounts

12 Derivatives

Companies in the Group transact derivatives as principal either as a trading activity or to manage balance sheet foreign exchange, interest rate and credit risk.

The following table shows the notional amount and fair value of the Group's derivatives.

	Group					
	2015			2014		
	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m
Exchange rate contracts						
Spot, forwards and futures	14	193	205	14	280	270
Currency swaps	3	96	179	7	123	216
Options purchased	1	31	—	2	72	—
Options written	1	—	30	2	—	72
Interest rate contracts						
Interest rate swaps	79	2,088	2,190	106	3,092	3,713
Options purchased	4	100	—	20	171	—
Options written	4	—	66	28	—	175
Futures and forwards	5	—	—	8	—	—
Equity and commodity contracts	1	105	—	2	160	12
		2,613	2,670		3,898	4,458
Amounts above include:						
Due from/to holding company		1,712	2,291		2,659	3,971
Due from/to fellow subsidiaries		12	—		13	—

	Bank					
	2015			2014		
	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m
Exchange rate contracts						
Spot, forwards and futures	11	155	169	10	206	204
Currency swaps	1	36	70	3	49	74
Options purchased	1	31	—	2	68	—
Options written	1	—	30	2	—	68
Interest rate contracts						
Interest rate swaps	44	1,756	1,965	53	2,608	3,237
Options purchased	4	96	—	4	169	—
Options written	4	—	61	4	—	173
Futures and forwards	1	—	—	—	—	—
Equity and commodity contracts	—	12	—	—	12	—
		2,086	2,295		3,112	3,756
Amounts above include:						
Due from/to holding company		1,314	1,993		2,119	3,394
Due from/to fellow subsidiaries		12	—		10	—
Due from/to subsidiaries		—	—		—	3

Notes on accounts

13 Debt securities

	Group							
	Central and local government			Banks £m	Other financial institutions £m	Corporate £m	Total £m	Of which ABS (1) £m
	UK £m	US £m	Other £m					
2015								
Held-for-trading	—	4,391	—	65	822	32	5,310	1
Available-for-sale	—	—	1,523	5	366	—	1,894	—
	—	4,391	1,523	70	1,188	32	7,204	1
Available-for-sale								
Gross unrealised gains	—	—	1	—	4	—	5	—
2014								
Held-for-trading	—	6,880	—	75	2,938	406	10,299	2,168
Available-for-sale	119	—	2,214	262	143	10	2,748	140
Loans and receivables	—	—	—	—	782	—	782	782
	119	6,880	2,214	337	3,863	416	13,829	3,090
Available-for-sale								
Gross unrealised gains	1	—	3	3	1	—	8	1

Note:

(1) Includes asset-backed securities issued by US federal agencies and government sponsored entities, and covered bonds.

The following table analyses the Group's available-for-sale debt securities and the related yield (based on weighted averages) by remaining maturity and issuer.

	Within 1 year		After 1 but within 5 years		After 10 years		Total	
	Amount £m	Yield %	Amount £m	Yield %	Amount £m	Yield %	Amount £m	Yield %
2015								
Central and local governments								
- Other	1,087	1.2	436	2.4	—	—	1,523	1.6
Banks	5	0.7	—	—	—	—	5	0.7
Other financial institutions	244	3.1	122	2.3	—	—	366	2.9
	1,336	1.6	558	2.3	—	—	1,894	1.8
2014								
Central and local governments								
- UK	99	—	20	1.0	—	—	119	0.2
- Other	1,995	1.3	219	0.9	—	—	2,214	1.3
Banks	—	—	262	1.0	—	—	262	1.0
Other financial institutions	3	1.0	134	1.0	6	0.9	143	1.0
Corporate	—	—	10	1.0	—	—	10	1.0
	2,097	1.3	645	1.0	6	0.9	2,748	1.2
Of which ABS	—	—	134	0.9	6	0.9	140	0.9

Note:

(1) There are no balances with a maturity of after 5 but within 10 years.

Notes on accounts

14 Equity shares

	Group					
	2015			2014		
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Held-for-trading	1	1	2	1	9	10
Designated as at fair value through profit or loss	—	33	33	—	46	46
Available-for-sale	3	679	682	9	714	723
	4	713	717	10	769	779
Available-for-sale						
Gross unrealised gains	1	7	8	4	34	38
Gross unrealised losses	—	(3)	(3)	—	(3)	(3)

	Bank					
	2015			2014		
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Held-for-trading	—	—	—	—	1	1
Available-for-sale	—	4	4	—	4	4
	—	4	4	—	5	5

Gross gains of £9 million (2014 - £65 million) and gross losses of nil (2014 - £56 million) were realised on the sale of available-for-sale equity shares.

Dividend income from available-for-sale equity shares was £49 million (2014 - £234 million).

Unquoted equity investments whose fair value cannot be reliably measured are carried at cost and classified as available-for-sale financial assets. They include investments in fellow subsidiaries of £634 million (2014 - £634 million). Disposals generated no gains or losses in 2015 or 2014.

15 Investments in Group undertakings

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

	Bank	
	2015 £m	2014 £m
At 1 January	7,866	5,412
Currency translation and other adjustments	5	37
Additional investments in Group undertakings	700	675
Disposals	(16)	—
(Impairment)/write-back of investments	(2,001)	1,742
At 31 December	6,554	7,866

The impairment charge in 2015 principally relates to the Bank's investment in NatWest Group Holdings Corp., the indirect parent of RBS Securities Inc. The 2014 write back principally relates to the Bank's investment in Ulster Bank Limited.

The principal subsidiary undertakings of the Bank are shown below. Their capital consists of ordinary and preference shares which are unlisted.

All of the subsidiary undertakings are owned by the Bank, or directly or indirectly through intermediate holding companies. All of these subsidiaries are included in the Group's consolidated financial statements and have an accounting reference date of 31 December.

	Nature of business	Country of incorporation and principal area of operations
Coutts & Company ⁽¹⁾	Private banking	Great Britain
RBS Securities Inc. ⁽²⁾	Broker dealer	US
Ulster Bank Limited ⁽³⁾	Banking	Northern Ireland

Notes:

(1) Coutts & Company is incorporated with unlimited liability. Its registered office is 440 Strand, London WC2R 0QS.

(2) Shares are not directly held by the Bank.

(3) Ulster Bank Limited and its subsidiary undertakings also operate in the Republic of Ireland.

Full information on all related undertakings is included in Note 41.

Notes on accounts

16 Intangible assets

	Group					
	2015			2014		
	Goodwill £m	Other (1) £m	Total £m	Goodwill £m	Other(1) £m	Total £m
Cost						
At 1 January	647	1,658	2,305	688	2,841	3,529
Transfers to disposal groups	(186)	(154)	(340)	—	—	—
Transfers (to)/from holding company and fellow subsidiaries	—	(24)	(24)	—	127	127
Currency translation and other adjustments	(15)	(5)	(20)	(41)	(13)	(54)
Additions	—	—	—	—	59	59
Disposals and write-off of fully amortised assets	—	(19)	(19)	—	(1,356)	(1,356)
At 31 December	446	1,456	1,902	647	1,658	2,305
Accumulated amortisation and impairment						
At 1 January	473	984	1,457	506	2,226	2,732
Transfer to disposal groups	—	(153)	(153)	—	—	—
Transfers to fellow subsidiaries	—	(41)	(41)	—	—	—
Currency translation and other adjustments	(27)	(9)	(36)	(33)	1	(32)
Disposals and write-off of fully amortised assets	—	(16)	(16)	—	(1,356)	(1,356)
Charge for the year	—	67	67	—	113	113
Write down of other intangible assets	—	107	107	—	—	—
At 31 December	446	939	1,385	473	984	1,457
Net book value at 31 December	—	517	517	174	674	848

Note:

(1) Principally internally generated software.

Internally generated software	Bank	
	2015 £m	2014 £m
Cost		
At 1 January	1,262	2,491
Transfers (to)/from holding company	(25)	127
Disposals and write-off of fully amortised assets	—	(1,356)
At 31 December	1,237	1,262
Accumulated amortisation		
At 1 January	732	2,002
Transfers to holding company and fellow subsidiaries	(42)	—
Disposals and write-off of fully amortised assets	—	(1,356)
Charge for the year	49	86
At 31 December	739	732
Net book value at 31 December	498	530

The carrying value of the Group's goodwill of £174 million as at 1 January 2015 related to the investment by Private Banking in Bank Von Ernst. This business was transferred to disposal groups in March 2015.

The analysis of goodwill by operating segment is shown in Note 35.

Acquisition of Bank Von Ernst by Private Banking	Goodwill	Assumptions		Recoverable amount exceeded carrying value	Consequential impact of 1% adverse movement in		Consequential impact of 5% adverse movement in forecast pre-tax earnings
		Terminal growth rate	Pre-tax discount rate		Discount rate	Terminal growth rate	
		£m	%		%	£m	
30 September 2014	173	4.5	11.4	1,772	(490)	(319)	(189)

Notes on accounts

17 Property, plant and equipment

	Group					
	Investment properties £m	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Total £m
2015						
<i>Cost or valuation</i>						
At 1 January	334	1,470	133	664	312	2,913
Transfers from fellow subsidiaries	—	—	—	5	7	12
Transfers to disposal groups	—	—	—	(40)	(20)	(60)
Currency translation and other adjustments	(21)	14	(1)	(3)	6	(5)
Additions	3	89	7	57	143	300
Change in fair value of investment properties	60	—	—	—	—	60
Disposals and write-off of fully depreciated assets	(349)	(239)	(41)	(96)	(44)	(769)
At 31 December	27	1,334	98	587	405	2,451
<i>Accumulated impairment, depreciation and amortisation</i>						
At 1 January	—	562	76	433	251	1,322
Transfers from fellow subsidiaries	—	—	—	3	4	7
Transfers to disposal groups	—	—	—	(24)	(16)	(40)
Currency translation and other adjustments	—	7	(1)	(1)	—	5
Disposals and write-off of fully depreciated assets	—	(142)	(38)	(63)	(17)	(260)
Charge for the year	—	10	3	44	35	92
Write down of property, plant and equipment	—	279	—	—	15	294
At 31 December	—	716	40	392	272	1,420
Net book value at 31 December	27	618	58	195	133	1,031
2014						
<i>Cost or valuation</i>						
At 1 January	397	1,443	138	698	408	3,084
Currency translation and other adjustments	(22)	15	(1)	(6)	1	(13)
Additions	103	33	2	15	27	180
Change in fair value of investment properties	7	—	—	—	—	7
Disposals and write-off of fully depreciated assets	(151)	(21)	(6)	(43)	(124)	(345)
At 31 December	334	1,470	133	664	312	2,913
<i>Accumulated impairment, depreciation and amortisation</i>						
At 1 January	—	525	75	424	306	1,330
Currency translation and other adjustments	—	—	(1)	(3)	2	(2)
Disposals and write-off of fully depreciated assets	—	(7)	(2)	(34)	(76)	(119)
Charge for the year	—	44	4	46	19	113
At 31 December	—	562	76	433	251	1,322
Net book value at 31 December	334	908	57	231	61	1,591

Investment property valuations principally employ present value techniques that discount expected cash flows. Expected cash flows reflect rental income, occupancy and residual market values; valuations are sensitive to changes in these factors. The fair value measurement of non-specialised properties in locations where the market for such properties is active and transparent are categorised as level 2 - 54% (2014 - 72%), otherwise investment property fair value measurements are categorised as level 3 - 46% (2014 - 28%).

Valuations were carried out by qualified surveyors who are members of the Royal Institution of Chartered Surveyors, or an equivalent overseas body; property with a fair value of nil (2014 - £25 million) was valued by independent valuers.

Rental income from investment properties was £9 million (2014 - £24 million). Direct operating expenses of investment properties were £6 million (2014 - £21 million).

Notes on accounts

17 Property, plant and equipment

	Bank				
	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Total £m
2015					
<i>Cost or valuation</i>					
At 1 January	912	90	508	16	1,526
Additions	84	5	56	51	196
Disposals and write-off of fully depreciated assets	(118)	(30)	(68)	—	(216)
At 31 December	878	65	496	67	1,506
<i>Accumulated impairment, depreciation and amortisation</i>					
At 1 January	397	51	343	—	791
Disposals and write-off of fully depreciated assets	(86)	(28)	(44)	—	(158)
Charge for the year	26	3	32	1	62
At 31 December	337	26	331	1	695
Net book value at 31 December	541	39	165	66	811
2014					
<i>Cost or valuation</i>					
At 1 January	903	91	533	7	1,534
Currency translation and other adjustments	(3)	—	—	—	(3)
Additions	31	1	12	16	60
Disposals and write-off of fully depreciated assets	(19)	(2)	(37)	(7)	(65)
At 31 December	912	90	508	16	1,526
<i>Accumulated impairment, depreciation and amortisation</i>					
At 1 January	376	50	340	7	773
Disposals and write-off of fully depreciated assets	(7)	(1)	(32)	(7)	(47)
Charge for the year	28	2	35	—	65
At 31 December	397	51	343	—	791
Net book value at 31 December	515	39	165	16	735

Notes on accounts

18 Prepayments, accrued income and other assets

	Group		Bank	
	2015 £m	2014* £m	2015 £m	2014 £m
Prepayments	33	24	20	—
Accrued income	140	227	100	124
Tax recoverable	110	243	—	22
Pension schemes in net surplus (see Note 4)	16	4	—	—
Interests in associates	11	29	7	7
Other assets	987	1,159	268	67
	1,297	1,686	395	220

*Restated - refer to page 99 for further details

19 Assets and liabilities of disposal groups

	2015 £m
Assets of disposal groups	
Cash and balances at central banks	440
Loans and advances to banks	674
Loans and advances to customers	1,638
Debt securities and equity shares	442
Derivatives	25
Property, plant and equipment	15
Other assets	77
	3,311
Liabilities of disposal groups	
Deposits by banks	32
Customer accounts	2,591
Derivatives	27
Other liabilities	74
	2,724

Disposal groups at 31 December 2015 is International Private Banking (fair value less costs to sell reflects the agreed sale to Union Bancaire Privée fair value hierarchy level 3).

20 Short positions

	Group	
	2015 £m	2014 £m
Debt securities		
- Government	3,432	6,052
- other issuers	145	775
	3,577	6,827

Note:

(1) All short positions are classified as held-for-trading.

Notes on accounts

21 Provisions, accruals and other liabilities

	Group		Bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Notes in circulation	687	674	—	—
Current tax	103	44	69	—
Accruals	520	788	180	304
Deferred income	100	124	81	93
Deferred tax (see Note 22)	14	2	—	—
Provisions for liabilities and charges (see table below)	5,329	3,156	1,325	1,044
Other liabilities	790	1,527	49	149
	7,543	6,315	1,704	1,590

	Group						Total £m
	Payment Protection Insurance (1) £m	Interest Rate Hedging Products (2) £m	Regulatory and legal actions			Property and other (6) £m	
			Other customer redress (3) £m	Other regulatory provisions (4) £m	Litigation (5) £m		
Provisions for liabilities and charges							
At 1 January 2015	487	266	464	86	1,725	128	3,156
Transfer	—	—	—	(21)	21	—	—
Currency translation and other movements	—	—	—	2	105	10	117
Charge to income statement	359	85	276	27	2,117	294	3,158
Releases to income statement	(1)	(13)	(23)	(7)	(8)	(7)	(59)
Provisions utilised	(246)	(233)	(238)	(82)	(138)	(106)	(1,043)
At 31 December 2015	599	105	479	5	3,822	319	5,329

	Bank						Total £m
	Payment Protection Insurance (1) £m	Interest Rate Hedging Products (2) £m	Regulatory and legal actions			Property and other (6) £m	
			Other customer redress (3) £m	Litigation (5) £m			
Provisions for liabilities and charges							
At 1 January 2015	—	468	231	287	—	58	1,044
Currency translation and other movements	—	—	—	—	—	5	5
Charge to income statement	—	359	81	260	6	234	940
Releases to income statement	—	—	—	(21)	—	(5)	(26)
Provisions utilised	—	(240)	(223)	(126)	—	(49)	(638)
At 31 December 2015	—	587	89	400	6	243	1,325

For the notes to these tables refer to the following page.

Notes on accounts

21 Provisions, accruals and other liabilities continued

Notes:

- (1) To reflect the developments detailed in Note 29, the Group increased its provision for PPI by £359 million in 2015 (2014 - £440 million), bringing the cumulative charge to £2.6 billion, of which £2.0 billion (77%) in redress had been paid by 31 December 2015. Of the £2.6 billion cumulative charge, £2.4 billion relates to redress and £0.2 billion to administrative expenses.

The principal assumptions underlying the Group's provision in respect of PPI sales are: assessment of the total number of complaints that the Group will receive; the proportion of these that will result in redress; and the average cost of such redress. The number of complaints has been estimated from an analysis of the Group's portfolio of PPI policies sold by vintage and by product. Estimates of the percentage of policyholders that will lodge complaints (the take up rate) and of the number of these that will be upheld (the uphold rate) have been established based on recent experience, guidance in FSA policy statements and the expected rate of responses from proactive customer contact. The average redress assumption is based on recent experience and FSA calculation rules. The table below shows the sensitivity of the provision to changes in the principal assumptions (all other assumptions remaining the same).

Assumption	Actual to date	Current assumptions	Sensitivity	
			Change in assumption %	Consequential change in provision £m
Single premium book past business review take up rate	55%	56%	+/-5	+/-33
Uphold rate ⁽¹⁾	91%	89%	+/-5	+/-21
Average redress	£1,677	£1,638	+/-5	+/-22

Note:

(1) Uphold rates exclude claims where no PPI policy was held.

Interest that will be payable on successful complaints has been included in the provision as has the estimated cost to the Group of administering the redress process. There are uncertainties as to the eventual cost of redress which will depend on actual complaint volumes, take up and uphold rates and average redress costs. Assumptions related to these are inherently uncertain and the ultimate financial impact may be different from the amount provided. We continue to monitor the position closely and refresh the underlying assumptions.

Background information in relation to PPI claims is given in Note 29.

- (2) The Group has a provision of £105 million for its liability in respect of the sale of Interest Rate hedging Products (IRHP), having an incurred cost of £1.0 billion. The provision includes redress that will be paid to customers, consequential loss (including interest) on customer redress, the cost to the Group of exiting the hedging positions and the cost of undertaking the review.

In 2015, the Group increased its provision by £72 million (2014 - £166 million), principally reflecting a marginal increase in redress experience compared to expectations and the cost of a small number of consequential loss claims over and above interest offered as part of basic redress payments. The outcomes of all cases have now been agreed with the independent skilled person appointed to review all decisions.

The cumulative charge for IRHP is £1.0 billion, of which £0.8 billion relates to redress and £0.2 billion to administrative expenses.

The principal assumptions underlying the Group's provision are:

- the proportion of relevant customers with interest rate caps that will ask to be included in the review;
- the type of consequential loss claims that will be received;
- movements in market rates that will impact the cost of closing out legacy hedging positions; and
- the cost of the review.

Uncertainties remain over the number of transactions that will qualify for redress and the nature and cost of that redress, including the cost of consequential loss claims.

Background information in relation to Interest Rate Hedging Products claims is given in Note 29.

- (3) The Group has provided for other customer redress, primarily in relation to investment advice in retail and private banking, £45 million (2014 - £156 million) and packaged accounts, £113 million (2014 - £112 million).
- (4) The Group is subject to a number of investigations by regulatory and other authorities. Details of these investigations and a discussion of the nature of the associated uncertainties are given in Note 29.
- (5) Arising out of its normal business operations, the Group is party to legal proceedings in the United Kingdom, the United States and other jurisdictions. An additional charge of £2.1 billion was booked in 2015; as a result of greater levels of certainty on expected outcomes, primarily in respect of mortgage-backed securities and securities-related litigation following third party settlements and regulatory decisions. Detailed descriptions of the Group's legal proceedings and discussion of the associated uncertainties are given in Note 29.
- (6) The majority of property provisions relate to vacant leasehold property and comprise the present value of the shortfall between rentals payable and rentals receivable from sub-letting. Other provisions include restructuring provisions of £72 million principally termination benefits.

Notes on accounts

22 Deferred tax

	Group		Bank	
	2015 £m	2014* £m	2015 £m	2014* £m
Deferred tax liability	14	2	—	—
Deferred tax asset	(1,802)	(1,732)	(1,546)	(1,505)
Net deferred tax asset	(1,788)	(1,730)	(1,546)	(1,505)

*Restated - refer to page 99 for further details

Net deferred tax asset comprised:

	Group									
	Pension £m	Accelerated capital allowances £m	Provisions £m	Deferred gains £m	Available- for-sale financial assets £m	Cash flow hedging £m	Share schemes £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2014	(519)	21	(962)	18	23	8	12	(792)	(60)	(2,251)
Charge/(credit) to income statement	82	(27)	951	(5)	4	(3)	(12)	(209)	33	814
(Credit)/charge to other comprehensive income	(268)	—	—	—	(12)	1	—	—	—	(279)
Currency translation and other adjustments	1	—	(24)	—	—	—	—	11	(2)	(14)
At 1 January 2015	(704)	(6)	(35)	13	15	6	—	(990)	(29)	(1,730)
Acquisitions/(disposals) of subsidiaries	7	—	—	(3)	(4)	—	—	—	(1)	(1)
Charge/(credit) to income statement	160	—	(26)	8	(4)	(2)	—	108	18	262
Credit to other comprehensive income	(336)	—	—	—	—	—	—	—	—	(336)
Currency translation and other adjustments	—	—	—	—	—	—	—	13	4	17
At 31 December 2015	(873)	(6)	(61)	18	7	4	—	(869)	(8)	(1,788)

	Bank								
	Pension £m	Accelerated capital allowances £m	Provisions £m	Deferred gains £m	Available for sale securities £m	Cash flow hedging £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2014	(537)	1	(11)	10	1	4	(718)	(35)	(1,285)
Charge/(credit) to income statement	85	(16)	(13)	—	—	(3)	(50)	17	20
(Credit)/charge to other comprehensive income	(241)	—	—	—	—	1	—	—	(240)
At 1 January 2015	(693)	(15)	(24)	10	1	2	(768)	(18)	(1,505)
Charge/(credit) to income statement	146	6	(23)	4	—	(2)	140	18	289
Credit to other comprehensive income	(330)	—	—	—	—	—	—	—	(330)
At 31 December 2015	(877)	(9)	(47)	14	1	—	(628)	—	(1,546)

Notes on accounts

22 Deferred tax continued

Deferred tax assets in respect of unused tax losses are recognised if the losses can be used to offset probable future taxable profits after taking into account the expected reversal of other temporary differences. Recognised deferred tax assets in respect of tax losses are analysed further below.

	2015 £m	2014 £m
UK tax losses carried forward		
- National Westminster Bank Plc	628	768
- Ulster Bank Limited	31	—
	659	768
Overseas tax losses carried forward		
- Ulster Bank Ireland Limited	210	222
	869	990

UK tax losses

Under UK tax rules, tax losses can be carried forward indefinitely. In periods from April 2015, the Finance Act 2015 limits the offset of losses carried forward by UK banks to 50% of profits. The main rate of UK Corporation Tax will reduce from 20% to 19% from 1 April 2017 and to 18% from 1 April 2020. Under the Finance (No 2) Act 2015, tax losses carried forward at 31 December 2015 are given credit in future periods at the main rate of UK corporation tax, excluding the Banking Surcharge rate (8%) introduced by the Act. Deferred tax assets and liabilities at 31 December 2015 take into account the reduced rates in respect of tax losses and non-banking temporary differences and where appropriate, the banking surcharge inclusive rate in respect of other banking temporary differences.

National Westminster Bank Plc – the deferred tax asset in respect of tax losses at 31 December 2015 relates to residual unrelieved trading losses that arose between 2009 and 2014. 59% of the losses that arose were relieved against taxable profits arising in other UK Group companies. Based on the strategic plan, the Group expects that the recognised deferred tax asset of £628 million in respect of tax losses amounting to £3,307 million will be recovered by the end of 2020.

Overseas tax losses

Ulster Bank Ireland Limited – a deferred tax asset of £210 million has been recognised in respect of losses of £1,678 million (2014 - £1,776 million; 2013 - £592 million) of total tax losses of £7,083 million (2014 - £8,599 million; 2013 - £11,575 million) carried forward at 31 December 2015. These losses arose principally as a result of significant impairment charges between 2008 and 2013 reflecting challenging economic conditions in the Republic of Ireland. Impairment charges have reduced and Ulster Bank Ireland Limited returned to profitability during 2014 and 2015. Based on RBS Group's strategic plan, the losses on which a deferred tax asset has been recognised will be utilised against future taxable profits by the end of 2022.

Unrecognised deferred tax

Deferred tax assets of £2,388 million (2014 - £1,763 million; 2013 - £1,517 million) have not been recognised in respect of tax losses and other temporary differences carried forward of £10,580 million (2014 - £9,875 million; 2013 - £11,849 million) in jurisdictions where doubt exists over the availability of future taxable profits. Of these losses and other temporary differences, £4,830 million will expire after 5 years. The balance of tax losses and other temporary differences carried forward has no expiry date.

Deferred tax liabilities of £244 million (2014 - £175 million; 2013 - £175 million) have not been recognised in respect of retained earnings of overseas subsidiaries and held-over gains on the incorporation of overseas branches. Retained earnings of overseas subsidiaries are expected to be reinvested indefinitely or remitted to the UK free from further taxation. No taxation is expected to arise in the foreseeable future in respect of held-over gains. Changes to UK tax legislation largely exempts from UK tax, overseas dividends received on or after 1 July 2009.

Notes on accounts

23 Subordinated liabilities

	Group		Bank	
	2015 £m	2014 £m	2015 £m	2014 £m
Dated loan capital	4,446	4,790	3,326	3,640
Undated loan capital	2,265	2,350	2,110	2,186
Preference shares	305	296	305	296
	7,016	7,436	5,741	6,122

The following tables analyse the remaining contractual maturity of subordinated liabilities by the final redemption date and by the next call date.

2015 - final redemption	Group						Total £m
	2016 £m	2017 £m	2018-2020 £m	2021-2025 £m	Thereafter £m	Perpetual £m	
Sterling	23	—	1,100	2,341	—	1,649	5,113
US dollar	4	—	270	—	—	636	910
Euro	1	294	132	294	—	272	993
	28	294	1,502	2,635	—	2,557	7,016

2015 - call date	Group							Total £m
	Currently £m	2016 £m	2017 £m	2018-2020 £m	2021-2025 £m	Thereafter £m	Perpetual £m	
Sterling	—	1,753	—	2,800	399	—	161	5,113
US dollar	432	478	—	—	—	—	—	910
Euro	—	154	294	132	279	—	134	993
	432	2,385	294	2,932	678	—	295	7,016

2014 - final redemption	Group						Total £m
	2015 £m	2016 £m	2017-2019 £m	2020-2024 £m	Thereafter £m	Perpetual £m	
Sterling	428	—	1,100	2,343	—	1,649	5,520
US dollar	3	—	256	—	—	605	864
Euro	1	—	311	452	—	288	1,052
	432	—	1,667	2,795	—	2,542	7,436

2014 - call date	Group							Total £m
	Currently £m	2015 £m	2016 £m	2017-2019 £m	2020-2024 £m	Thereafter £m	Perpetual £m	
Sterling	—	1,428	700	2,800	431	—	161	5,520
US dollar	—	608	—	256	—	—	—	864
Euro	—	147	—	311	452	—	142	1,052
	—	2,183	700	3,367	883	—	303	7,436

Notes on accounts

23 Subordinated liabilities

	Bank						Total £m
	2016 £m	2017 £m	2018-2020 £m	2021-2025 £m	Thereafter £m	Perpetual £m	
2015 - final redemption							
Sterling	23	—	1,000	2,311	—	1,628	4,962
US dollar	4	—	—	—	—	636	640
Euro	1	—	—	—	—	138	139
	28	—	1,000	2,311	—	2,402	5,741

	Bank						Total £m
	Currently £m	2016 £m	2017 £m	2018-2020 £m	2021-2025 £m	Thereafter £m	
2015 - call date							
Sterling	—	1,723	—	2,700	399	140	4,962
US dollar	162	478	—	—	—	—	640
Euro	—	139	—	—	—	—	139
	162	2,340	—	2,700	399	140	5,741

	Bank						Total £m
	2015 £m	2016 £m	2017-2019 £m	2020-2024 £m	Thereafter £m	Perpetual £m	
2014 - final redemption							
Sterling	425	—	1,000	2,313	—	1,629	5,367
US dollar	3	—	—	—	—	605	608
Euro	1	—	—	—	—	146	147
	429	—	1,000	2,313	—	2,380	6,122

	Bank						Total £m
	Currently £m	2015 £m	2016 £m	2017-2019 £m	2020-2024 £m	Thereafter £m	
2014 - call date							
Sterling	—	1,426	700	2,700	401	140	5,367
US dollar	—	608	—	—	—	—	608
Euro	—	147	—	—	—	—	147
	—	2,181	700	2,700	401	140	6,122

Redemptions

National Westminster Bank Plc

£87 million 5.95% undated notes

£300 million 7.88% notes 2015

Ulster Bank Ireland Ltd

£60 million floating rate notes 2018

Capital treatment	2015 £m	2014 £m
Tier 2	87	—
Tier 2	300	—
Tier 2	—	60
	387	60

There were no issuances in 2015 or 2014.

Notes on accounts

23 Subordinated liabilities continued

Dated loan capital	Capital treatment	2015 £m	2014 £m
<i>National Westminster Bank Plc</i>			
£300 million 7.88% notes 2015 (redeemed September 2015)	Tier 2	—	312
£300 million 6.50% notes 2021 (not callable)	Tier 2	317	319
£2,000 million floating rate notes 2023 (callable January 2018) ⁽¹⁾	Tier 2	2,009	2,009
£1,000 million floating rate notes 2019 (callable quarterly) ⁽¹⁾	Tier 2	1,000	1,000
		3,326	3,640

Notes:

(1) On-lent from The Royal Bank of Scotland Group plc on a subordinated basis.

(2) In the event of certain changes in tax laws, dated loan capital issues may be redeemed in whole, but not in part, at the option of the issuer, at the principal amount thereof plus accrued interest, subject to prior regulatory approval.

(3) Except as stated above, claims in respect of the Group's dated loan capital are subordinated to the claims of other creditors. None of the Group's dated loan capital is secured.

(4) Interest on all floating rate subordinated notes is calculated by reference to market rates.

Undated loan capital	Capital treatment	2015 £m	2014 £m
<i>National Westminster Bank Plc</i>			
US\$193 million floating rate notes (callable semi-annually)	Tier 2	130	124
US\$229 million floating rate notes (callable semi-annually)	Tier 2	155	147
US\$285 million floating rate notes (callable semi-annually)	Tier 2	193	183
€178 million 6.63% notes (callable quarterly)	Tier 2	131	139
€10 million floating rate notes (callable quarterly)	Tier 2	8	8
£87 million 5.95% notes (redeemed January 2015)	Tier 2	—	92
£53 million 7.13% notes (callable every five years from October 2022)	Tier 2	54	54
£35 million 11.50% notes (callable December 2022) ⁽²⁾	Tier 2	35	35
£700 million floating rate notes (callable every five years from January 2018) ⁽¹⁾	Tier 2	700	700
£700 million floating rate notes (callable quarterly from September 2016) ⁽¹⁾	Tier 2	704	704
		2,110	2,186

Notes:

(1) On-lent from The Royal Bank of Scotland plc on a subordinated basis.

(2) Exchangeable at the option of the issuer into 8.392% (gross) non-cumulative preference shares of £1 each of National Westminster Bank Plc at any time.

(3) The company can satisfy interest payment obligations by issuing sufficient ordinary shares to appointed Trustees to enable them, on selling these shares, to settle the interest payment.

(4) Except as stated above, claims in respect of the Group's undated loan capital are subordinated to the claims of other creditors. None of the Group's undated loan capital is secured.

(5) In the event of certain changes in tax laws, undated loan capital issues may be redeemed in whole, but not in part, at the option of the Group, at the principal amount thereof plus accrued interest, subject to prior regulatory approval.

(6) Interest on all floating rate subordinated notes is calculated by reference to market rates.

Preference shares ⁽¹⁾	Capital treatment	2015 £m	2014 £m
<i>National Westminster Bank Plc</i>			
£140 million 9.00% Series A non-cumulative preference shares of £1 (not callable)	Tier 1	143	143
US\$246 million 7.76% Series C non-cumulative preference shares of US\$25 (callable quarterly)	Tier 1	162	154
		305	296

Note:

(1) Further details of the contractual terms of the preference shares are given in Note 24.

The Group has now resumed payments on all discretionary non-equity capital instruments following the end of the European Commission ban in 2012. Future coupons and dividends on hybrid capital instruments will only be paid subject to, and in accordance with, the terms of the relevant instruments.

The preference shares issued by the company are classified as liabilities; these securities remain subject to the capital maintenance rules of the Companies Act 2006.

Notes on accounts

24 Share capital and reserves

Allotted, called up and fully paid	2015	2014	Number of shares - millions	
	£m	£m	2015	2014
Ordinary shares of £1	1,678	1,678	1,678	1,678
Non-cumulative preference shares of £1	140	140	140	140
Non-cumulative preference shares of US\$25	123	123	10	10

Ordinary shares

The bank did not pay an ordinary dividend in 2015 (2014 - £175 million; 2013 - nil)

Preference shares

The 9% non-cumulative preference shares Series A of £1 each are non-redeemable.

The non-cumulative preference shares Series C of US\$25 each carry the right to a gross dividend of 8.625% inclusive of associated tax credit. They are redeemable at the option of the Bank at US\$25 per share.

The holders of sterling and dollar preference shares are entitled, on the winding-up of the Bank, to priority over the ordinary shareholders as regards payment of capital. Otherwise the holders of preference shares are not entitled to any further participation in the profits or assets of the Bank and accordingly these shares are classified as non-equity shares.

The holders of sterling and dollar preference shares are not entitled to receive notice of, attend, or vote at any general meeting unless the business of the meeting includes the consideration of a resolution for the winding-up of the Bank or the sale of the whole of the business of the Bank or any resolution directly affecting any of the special rights or privileges attached to any of the classes of preference shares.

Under IFRS, the Group's preference shares are classified as debt and are included in subordinated liabilities on the balance sheet (see Note 23).

Reserves

Under UK companies legislation, when shares are redeemed or purchased wholly or partly out of the company's profits, the amount by which the company's issued share capital is diminished must be transferred to the capital redemption reserve. The capital maintenance provisions of UK companies legislation apply to the capital redemption reserve as if it were part of the company's paid up share capital.

UK law prescribes that only reserves of the Bank are taken into account for the purpose of making distributions and the permissible applications of the share premium account and capital redemption reserve of £459 million (2014 and 2013 - £459 million) included within other reserves.

The Group received capital contributions of £800 million (2014 - £2,177 million; 2013 - £2,070 million) from the holding company for which no additional share capital was issued. As such, these were recorded as capital contributions in retained earnings.

The Group optimises capital efficiency by maintaining reserves in subsidiaries, including regulated entities. Certain preference shares and subordinated debt are also included within regulatory capital. The remittance of reserves to the parent or the redemption of shares or subordinated capital by regulated entities may be subject to maintaining the capital resources required by the relevant regulator.

Notes on accounts

25 Leases

Minimum amounts receivable under non-cancellable leases:

Year in which receipt will occur	Group		
	Finance lease contracts		
	Gross amounts £m	Present value adjustments £m	Present value £m
2015			
Receivable:			
Within 1 year	86	(5)	81
After 1 year but within 5 years	106	(9)	97
After 5 years	57	(29)	28
Total	249	(43)	206

2014

Receivable:			
Within 1 year	58	(5)	53
After 1 year but within 5 years	90	(9)	81
After 5 years	62	(33)	29
Total	210	(47)	163

	Group		
	2015 £m	2014 £m	2013 £m
Amounts recognised as income and expense			
Finance leases - contingent rental income	(3)	(3)	(3)
Operating leases - minimum rentals payable	89	95	101

Acting as a lessor the Group provides asset finance to its customers. It purchases plant, equipment and intellectual property; renting them to customers under lease arrangements that, depending on their terms, qualify as either operating or finance leases.

Notes on accounts

26 Structured entities

A structured entity (SE) is an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose, they do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions. As well as being a key element of securitisations, SEs are also used in fund management activities to segregate custodial duties from the fund management advice.

Consolidated structured entities

Securitisations

In a securitisation, assets, or interests in a pool of assets, are transferred generally to a SE which then issues liabilities to third party investors. The majority of securitisations are supported through liquidity facilities or other credit enhancements. The Group arranges securitisations to facilitate client transactions and undertakes own asset securitisations to sell or to fund portfolios of financial assets.

The Group also acts as an underwriter and depositor in securitisation transactions in both client and proprietary transactions.

The Group's involvement in client securitisations takes a number of forms. It may: sponsor or administer a securitisation programme; provide liquidity facilities or programme-wide credit enhancement; and purchase securities issued by the vehicle.

Own asset securitisations

In own-asset securitisations, the pool of assets held by the SE is either originated by the RBS Group, or (in the case of whole loan programmes) purchased from third parties.

The table below analyses the asset categories for those own-asset securitisations where the transferred assets continue to be recorded on the Group's balance sheet.

Asset type	Group							
	2015				2014			
	Debt securities in issue				Debt securities in issue			
	Assets £m	Held by third parties £m	Held by the Group (1) £m	Total £m	Assets £m	Held by third parties £m	Held by the Group (1) £m	Total £m
Mortgages								
- UK (2)	3,253	—	—	—	5,453	—	—	—
- Irish	7,395	1,472	6,836	8,308	8,593	1,697	7,846	9,543
UK credit cards (2)	—	—	—	—	1,778	—	—	—
Other loans (2,3)	—	—	—	—	1,830	—	—	—
	10,648	1,472	6,836	8,308	17,654	1,697	7,846	9,543

Notes:

(1) Debt securities retained by the Group may be pledged with central banks.

(2) These assets have been transferred to SEs that are consolidated by RBS plc.

(3) Corporate, social housing and student loans.

Covered bond programme

Certain loans and advances to customers have been assigned to bankruptcy remote limited liability partnerships to provide security for issues of debt securities by the RBS Group. The Group retains all of the risks and rewards of these loans, the partnerships are consolidated by the RBS Group, the loans retained on the RBS Group's balance sheet and the related covered bonds included within debt securities in issue of the RBS Group. At 31 December 2015, £9,187 million of mortgages have been assigned to bankruptcy remote limited liability partnerships to provide security for issues of debt securities by the RBS Group (2014 - £10,943 million).

Notes on accounts

26 Structured entities continued

Unconsolidated structured entities

The Group's interests in unconsolidated structured entities are analysed below.

	Asset backed securitisation vehicles		Total £m
	Sponsored £m	Not sponsored £m	
2015			
Held-for-trading			
Debt securities	—	1	1
2014			
Held-for-trading			
Debt securities	34	1,953	1,987
Other than held-for-trading			
Debt securities	—	6	6
Total exposure	34	1,959	1,993

Notes:

- (1) Income from interests in unconsolidated structured entities includes interest receivable, changes in fair value and other income less impairments.
- (2) A sponsored entity is a structured entity established by the Group where the Group provides liquidity and/or credit enhancements or provides ongoing services to the entity. The Group can act as sponsor for its own or for customers' transactions.
- (3) In 2015 no assets were transferred into sponsored structured entities (2014 - £325 million) which are not consolidated by the Group and for which the Group held no interest at 31 December 2015. The income arising from sponsored entities where the Group holds no interest at year end was losses of £5 million (2014 - gains of £50 million).

27 Asset transfers

Under IAS 39 a financial asset is transferred if the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. Following a transfer the financial asset will be derecognised; not derecognised and retained in full on the Group's balance sheet; or continue to be recognised on the balance sheet to the extent of the Group's continuing involvement.

Transfers that do not qualify for derecognition

Securities repurchase agreements and lending transactions

The Group enters into securities repurchase agreements and securities lending transactions under which it transfers securities in accordance with normal market practice.

Generally, the agreements require additional collateral to be provided if the value of the securities falls below a predetermined level. Under standard terms for repurchase transactions in the UK and US markets, the recipient of collateral has an unrestricted right to sell or repledge it, subject to returning equivalent securities on settlement of the transaction.

Securities sold under repurchase transactions are not derecognised if the Group retains substantially all the risks and rewards of ownership. The fair value (and carrying value) of securities transferred under such repurchase transactions included on the balance sheet, are set out below. All of these securities could be sold or repledged by the holder.

	Group	
	2015 £m	2014 £m
Assets subject to securities repurchase agreements or security lending transactions		
Debt securities	3,740	8,583
Equity shares	8	—

The following table analyses assets that have been transferred but have failed the derecognition rules under IAS 39 and therefore continue to be recognised on the Bank's balance sheet.

Asset type	2015 £m	2014 £m
UK mortgages	12,440	16,396
UK credit cards	—	1,778
Other loans (2)	—	1,830
	12,440	20,004

Notes:

- (1) The fair value of the transferred assets for the Group and Bank is £12,449 million (2014 - £19,727 million) where recourse is to these assets only.
- (2) Comprises corporate, social housing and student loans.

Notes on accounts

28 Capital resources

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

	2015		2014	
	NatWest £m	UBIL £m	NatWest £m	UBIL £m
Shareholders' equity	11,282	5,753	13,312	5,081
Regulatory adjustments and deductions				
Defined benefit pension fund adjustment	—	142	—	320
Cash flow hedging reserve	1	—	3	—
Deferred tax assets	(622)	(210)	(742)	—
Prudential valuation adjustments	(1)	—	(1)	—
Goodwill and other intangible assets	(498)	—	(530)	—
Expected losses less impairments	(703)	(22)	(785)	(3)
Instruments of financial sector entities where the institution has a significant investment	(2,413)	—	(2,318)	—
Significant investments in excess of secondary capital	(424)	—	—	—
Other regulatory adjustments	532	27	529	(1,217)
	(4,128)	(63)	(3,844)	(900)
CET1 capital	7,154	5,690	9,468	4,181
Additional Tier 1 capital				
Qualifying instruments and related share premium subject to phase out	204	—	234	—
Tier 1 deductions				
Instruments of financial sector entities where the institution has a significant investment	(187)	—	(140)	—
Tier 1 capital	7,171	5,690	9,562	4,181
Qualifying Tier 2 capital				
Qualifying items and related share premium	5,058	492	5,380	528
Tier 2 deductions				
Instruments of financial sector entities where the institution has a significant investment	(92)	—	(102)	—
Other regulatory adjustments	—	(7)	(8)	(5)
	(92)	(7)	(110)	(5)
Tier 2 capital	4,966	485	5,270	523
Total regulatory capital	12,137	6,175	14,832	4,704

Note:

(1) Regulatory capital for 2014 has not been impacted by the change in accounting policy for pensions.

In the management of capital resources, the Group is governed by the RBS Group's policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the RBS Group has regard to the supervisory requirements of the PRA. The PRA uses risk asset ratio (RAR) as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks); by international agreement, the RAR should be not less than 8% with a Tier 1 component of not less than 4%. The Group has complied with the PRA's capital requirements throughout the year.

A number of subsidiaries and sub-groups within the Group, principally banking entities, are subject to various individual regulatory capital requirements in the UK and overseas. Furthermore, the payment of dividends by subsidiaries and the ability of members of the RBS Group to lend money to other members of the RBS Group may be subject to restrictions such as local regulatory or legal requirements, the availability of reserves and financial and operating performance.

Notes on accounts

29 Memorandum items

Contingent liabilities and commitments

The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December 2015. 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	
	2015 £m	2014 £m	2015 £m	2014 £m
Contingent liabilities and commitments				
Guarantees and assets pledged as collateral security	1,050	1,677	594	783
Other contingent liabilities	1,230	1,237	1,008	974
Standby facilities, credit lines and other commitments	49,608	49,790	43,616	42,108
	51,888	52,704	45,218	43,865

Note:

(1) In the normal course of business, the Bank guarantees specified third party liabilities of certain subsidiaries; it also gives undertakings that individual subsidiaries will fulfil their obligations to third parties under contractual or other arrangements.

Banking commitments and contingent obligations, which have been entered into on behalf of customers and for which there are corresponding obligations from customers, are not included in assets and liabilities. The Group's maximum exposure to credit loss, in the event of its obligation crystallising and all counterclaims, collateral or security proving valueless, is represented by the contractual nominal amount of these instruments included in the table above. These commitments and contingent obligations are subject to the Group's normal credit approval processes.

Guarantees - the Group gives guarantees on behalf of customers. A financial guarantee represents an irrevocable undertaking that the Group will meet a customer's specified obligations to a third party if the customer fails to do so. The maximum amount that the Group could be required to pay under a guarantee is its principal amount as 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.

Standby facilities and credit lines - under a loan commitment the Group agrees to make funds available to a customer in the future. Loan commitments, which are usually for a specified term, may be unconditionally cancellable or may persist, provided all conditions in the loan facility are satisfied or waived. Commitments to lend include commercial standby facilities and credit lines, liquidity facilities to commercial paper conduits and unutilised overdraft facilities.

Other commitments - these include documentary credits, which are commercial letters of credit providing for payment by the Group to a named beneficiary against presentation of specified documents, forward asset purchases, forward deposits placed and undrawn note issuance and revolving underwriting facilities, and other short-term trade related transactions.

Capital Support Deed

The Bank, together with other members of the RBS Group, is party to a Capital Support Deed (CSD). Under the terms of the CSD, the Bank may be required, if compatible with its legal obligations, to make distributions on, or repurchase or redeem, its ordinary shares. The amount of this obligation is limited to the Bank's capital resources in excess of the capital and financial resources needed to meet its regulatory requirements. The Bank may also be obliged to make onward distribution to its ordinary shareholders of dividends or other capital distributions received from subsidiaries that are party to the CSD. The CSD also provides that, in certain circumstances, funding received by the Bank from other parties to the CSD becomes immediately repayable, such repayment being limited to the Bank's available resources.

Notes on accounts

29 Memorandum items continued

Contractual obligations for future expenditure not provided for in the accounts

The following table shows contractual obligations for future expenditure not provided for in the accounts at the year end.

	Group		Bank	
	2015	2014	2015	2014
	£m	£m	£m	£m
Operating leases				
Minimum rentals payable under non-cancellable leases ⁽¹⁾				
- within 1 year	85	86	68	68
- after 1 year but within 5 years	239	263	196	208
- after 5 years	571	593	460	470
	895	942	724	746
Contracts to purchase goods or services ⁽²⁾	28	39	—	—
	923	981	724	746

Notes:

(1) Predominantly property leases.

(2) Of which due within 1 year: £19 million (2014 - £24 million).

Trustee and other fiduciary activities

In its capacity as trustee or other fiduciary role, the Group may hold or place assets on behalf of individuals, trusts, companies, pension schemes and others. The assets and their income are not included in the Group's financial statements. The Group earned fee income of £230 million (2014 - £309 million; 2013 - £341 million) from these activities.

The Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS), the UK's statutory fund of last resort for customers of authorised financial services firms, pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the industry. In relation to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year (which runs from 1 April to 31 March), subject to annual maxima set by the Prudential Regulation Authority. In addition, the FSCS has the power to raise levies on a firm that has ceased to participate in the scheme and is in the process of ceasing to be authorised for the costs that it would have been liable to pay had the FSCS made a levy in the financial year it ceased to be a participant in the scheme.

The FSCS has borrowed from HM Treasury to fund compensation costs associated with the failure of Bradford & Bingley, Heritable Bank, Kaupthing Singer & Friedlander, Landsbanki 'Icesave' and London Scottish Bank plc. The industry repaid the remaining balance on the non-Bradford and Bingley loans during the period. The Bradford and Bingley loan is interest bearing with the reference rate being the higher of 12 month LIBOR plus 111 basis points or the relevant gilt rate for the equivalent cost of borrowing from HMT. The FSCS and HM Treasury have agreed that the period of these loans will reflect the expected timetable for recoveries from the estate of Bradford & Bingley. In addition, the FSCS levied an interim payment relating to resolution costs for Dunfermline Building Society of £325 million. The total capital element levied on the industry in the 2015/16 scheme year was £353 million (£399 million in the 2014/15 scheme year).

The Group has accrued £32 million for its share of estimated FSCS levies.

Notes on accounts

Litigation, investigations and reviews

NatWest Group and other members of the RBS Group are party to legal proceedings and the subject of investigation and other regulatory and governmental action ("Matters") in the United Kingdom (UK), the United States (US), the European Union (EU) and other jurisdictions.

The RBS Group recognises a provision for a liability in relation to these Matters when it is probable that an outflow of economic benefits will be required to settle an obligation resulting from past events, and a reliable estimate can be made of the amount of the obligation. While the outcome of these Matters is inherently uncertain, the directors believe that, based on the information available to them, appropriate provisions have been made in respect of the Matters as at 31 December 2015 (see Note 21). The aggregate provisions in the Group for regulatory and legal actions of £2.4 billion recognised during 2015 mainly included provisions in respect of mortgage backed securities litigation (£2.1 billion).

In many proceedings and investigations, it is not possible to determine whether any loss is probable or to estimate reliably the amount of any loss, either as a direct consequence of the relevant proceedings and investigations or as a result of adverse impacts or restrictions on the RBS Group's reputation, businesses and operations. Numerous legal and factual issues may need to be resolved, including through potentially lengthy discovery and document production exercises and determination of important factual matters, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a liability can reasonably be estimated for any claim. The RBS Group cannot predict if, how, or when such claims will be resolved or what the eventual settlement, damages, fine, penalty or other relief, if any, may be, particularly for claims that are at an early stage in their development or where claimants seek substantial or indeterminate damages.

In respect of certain matters described below, we have established a provision and in certain of those matters, we have indicated that we have established a provision.

There are situations where the RBS Group may pursue an approach that in some instances leads to a settlement agreement. This may occur in order to avoid the expense, management distraction or reputational implications of continuing to contest liability, or in order to take account of the risks inherent in defending claims or investigations even for those matters for which the RBS Group believes it has credible defences and should prevail on the merits. The uncertainties inherent in all such matters affect the amount and timing of any potential outflows for both matters with respect to which provisions have been established and other contingent liabilities. The Group may not be directly involved in all of the following litigation, investigations and reviews but due to the potential implications to the RBS Group of such litigation, investigations and reviews, if a final outcome is adverse to the RBS Group it may also have an adverse effect on the Group.

The future outflow of resources in respect of any matter may ultimately prove to be substantially greater than or less than the aggregate provision that the RBS Group has recognised. Where (and as far as) liability cannot be reasonably estimated, no provision has been recognised.

Other than those discussed below, no member of the Group is or has been involved in governmental, legal or regulatory proceedings (including those which are pending or threatened) that are expected to be material, individually or in aggregate. The RBS Group expects that in future periods additional provisions, settlement amounts, and customer redress payments will be necessary, in amounts that are expected to be substantial in some instances.

Litigation

Shareholder litigation (UK)

Between March and July 2013, claims were issued in the High Court of Justice of England and Wales by sets of current and former shareholders, against the RBS Group (and in one of those claims, also against certain former individual officers and directors) alleging that untrue and misleading statements and/or improper omissions, in breach of the Financial Services and Markets Act 2000, were made in connection with the rights issue announced by the RBS Group on 22 April 2008. In July 2013 these and other similar threatened claims were consolidated by the Court via a Group Litigation Order. The RBS Group's defence to the claims was filed on 13 December 2013. Since then, further High Court claims have been issued against the RBS Group under the Group Litigation Order which is now closed to further claimants. The aggregate value of the shares subscribed for at 200 pence per share by the claimant shareholders is approximately £4 billion although their damages claims are not yet quantified.

The court timetable provides that a trial of the preliminary issue of whether the rights issue prospectus contained untrue and misleading statements and/or improper omissions will commence in March 2017. In the event that the court makes such a finding, further trial(s) will be required to consider whether any such statements and/or omissions caused loss and, if so, the quantum of that loss.

Other securitisation and securities related litigation in the US

RBS Group companies have been named as defendants in their various roles as issuer, depositor and/or underwriter in a number of claims in the US that relate to the securitisation and securities underwriting businesses. These cases include actions by individual purchasers of securities and a purported class action suit. Together, the pending individual and class action cases (including those claims specifically described in this note) involve the issuance of approximately US\$42 billion of mortgage-backed securities (MBS) issued primarily from 2005 to 2007.

In general, plaintiffs in these actions claim that certain disclosures made in connection with the relevant offerings contained materially false or misleading statements and/or omissions regarding the underwriting standards pursuant to which the mortgage loans underlying the securities were issued.

Notes on accounts

RBS Group companies remain as defendants in more than 20 lawsuits brought by or on behalf of purchasers of MBS, including the purported class action identified below.

In the event of an adverse judgment in any of these cases, the amount of the RBS Group's liability will depend on numerous factors that are relevant to the calculation of damages, which may include the recognised loss of principal value in the securities at the time of judgment (write-downs); the value of the remaining unpaid principal balance of the securities at the time the case began, at the time of judgment (if the plaintiff still owns the securities at the time of judgment), or at the time when the plaintiff disposed of the securities (if plaintiff sold the securities); and a calculation of pre and post judgment interest that the plaintiff could be awarded, which could be a material amount.

In September 2011, the US Federal Housing Finance Agency (FHFA) as conservator for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) filed MBS-related lawsuits against the RBS Group and a number of other financial institutions, all of which, except for the two cases described below, have since settled for amounts that were publicly disclosed.

The primary FHFA lawsuit against the RBS Group remains pending in the United States District Court for the District of Connecticut, and it relates to approximately US\$32 billion of MBS for which RBS Group entities acted as sponsor/depositor and/or lead underwriter or co-lead underwriter. Of these US\$32 billion, approximately US\$8.6 billion were outstanding at 31 December 2015 with cumulative write downs to date on the securities of approximately US\$1.1 billion (being the recognised loss of principal value suffered by security holders). In September 2013, the Court denied the defendants' motion to dismiss FHFA's amended complaint in this case. This matter continues in the discovery phase.

The other remaining FHFA lawsuit that involves the RBS Group relates to MBS issued by Nomura Holding America Inc. (Nomura) and subsidiaries and is now the subject of an appeal. On 11 May 2015, following a trial, the United States District Court for the Southern District of New York issued a written decision in favour of FHFA on its claims against Nomura and RBS Securities Inc., a member of the Group, finding, as relevant to the Group, that the offering documents for four Nomura-issued MBS for which RBS Securities Inc. served as an underwriter, relating to US\$1.4 billion in original principal balance, contained materially misleading statements about the mortgage loans that backed the securitisations, in violation of the Securities Act and Virginia securities law.

RBS Securities Inc. estimates that its net exposure under the Court's judgment is approximately US\$383 million, which consists of the difference between the amount of the judgment against RBS Securities Inc. (US\$636 million) and the current estimated market value of the four MBS that FHFA would return to RBS Securities Inc. pursuant to the judgment, plus the costs and attorney's fees that will be due to FHFA if the judgment is upheld.

The Court has stayed the judgment pending the result of the appeal that the defendants are taking to the United States Court of Appeals for the Second Circuit, though post-judgment interest on the judgment amount will accrue while the appeal is pending. RBS Securities Inc. intends to pursue a contractual claim for indemnification against Nomura with respect to any losses it suffers as a result of this matter.

The National Credit Union Administration Board (NCUA) is litigating two MBS cases against RBS Group companies (on behalf of US Central Federal Credit Union and Western Corporate Federal Credit Union). The original principal balance of the MBS at issue in these two NCUA cases is US\$3.25 billion. In September 2015, in a third case brought by NCUA (on behalf of Southwest Corporate Federal Credit Union and Members United Corporate Federal Credit Union), the NCUA accepted RBS's offer of judgment for US\$129.6 million, plus attorney's fees, to resolve the matter, which concerned US\$312 million in MBS. RBS has paid to the plaintiff the agreed US\$129.6 million plus attorney's fees.

Other remaining MBS lawsuits against RBS Group companies include, among others, cases filed by the Federal Home Loan Banks of Boston and Seattle. RBS has settled the MBS lawsuits filed by the Federal Home Loan Bank of San Francisco and the Commonwealth of Virginia on behalf of the Virginia Retirement System for amounts that have now been provided for or paid to the plaintiffs.

RBS Group companies are also defendants in a purported MBS class action entitled *New Jersey Carpenters Health Fund v. Novastar Mortgage Inc. et al.*, which remains pending in the United States District Court for the Southern District of New York. Another MBS class action (*Luther v. Countrywide Financial Corp. et al.* and related class action cases) was settled in 2013 without any contribution from the RBS Group, but several members of the settlement class are appealing the court-approved settlement to the United States Court of Appeals for the Ninth Circuit.

Certain other claims on behalf of public and private institutional investors have been threatened against the RBS Group in connection with various mortgage-related offerings. The RBS Group cannot predict whether any of these threatened claims will be pursued, but expects that several may.

The RBS Group has £3.8 billion in cumulative provisions relating to the MBS litigation described in this note, including £2.1 billion added in 2015. Additional settlement costs or provisions related to the MBS litigation, as well as the investigations into MBS-related conduct involving the RBS Group set out under 'Investigations and reviews' on page 162 (for which no provisions have been made), may be necessary in future periods for amounts that could be substantial in some instances and in aggregate could be substantially in excess of the £3.8 billion in existing provisions.

In many of the securitisation and securities related cases in the US, the RBS Group has or will have contractual claims to indemnification from the issuers of the securities (where an RBS Group company is underwriter) and/or the underlying mortgage originator (where an RBS Group company is issuer). The amount and extent of any recovery on an indemnification claim, however, is uncertain and subject to a number of factors, including the ongoing creditworthiness of the indemnifying party a number of whom are or may be insolvent.

London Interbank Offered Rate (LIBOR)

Certain members of the RBS Group have been named as defendants in a number of class actions and individual claims filed in the US with respect to the setting of LIBOR and certain other benchmark interest rates. The complaints are substantially similar and allege that certain members of the RBS Group and other panel banks individually and collectively violated various federal laws, including the US commodities and antitrust laws, and state statutory and common law, as well as contracts, by manipulating LIBOR and prices of LIBOR-based derivatives in various markets through various means.

Most of the USD LIBOR-related actions in which RBS Group companies are defendants, including all purported class actions relating to USD LIBOR, were transferred to a coordinated proceeding in the United States District Court for the Southern District of New York.

In the coordinated proceeding, consolidated class action complaints were filed on behalf of (1) exchange-based purchaser plaintiffs, (2) over-the-counter purchaser plaintiffs, and (3) corporate debt purchaser plaintiffs. Over 35 other USD LIBOR-related actions naming RBS Group companies as defendants, including purported class actions on behalf of lenders and mortgage borrowers, were also made part of the coordinated proceeding.

In a series of orders issued in 2013 and 2014, the Court overseeing the coordinated USD proceeding dismissed class plaintiffs' antitrust claims and claims under RICO (Racketeer Influenced and Corrupt Organizations Act), but declined to dismiss (a) certain Commodity Exchange Act claims on behalf of persons who transacted in Eurodollar futures contracts and options on futures contracts on the Chicago Mercantile Exchange (on the theory that defendants' alleged persistent suppression of USD LIBOR caused loss to plaintiffs), and (b) certain contract and unjust enrichment claims on behalf of over-the-counter purchaser plaintiffs who transacted directly with a defendant. Since then, the Court has issued additional orders broadly addressing other potential grounds for dismissal of various of plaintiffs' claims, including dismissal for lack of personal jurisdiction, and the Court is now in the process of applying these rulings across the cases in the coordinated proceeding. The Court's dismissal of plaintiffs' antitrust claims is currently on appeal to the United States Court of Appeals for the Second Circuit.

Certain members of the RBS Group have also been named as defendants in class actions relating to (i) JPY LIBOR and Euroyen TIBOR, (ii) Euribor, (iii) Swiss Franc LIBOR, and (iv) Pound sterling LIBOR, all of which are pending before other judges in the United States District Court for the Southern District of New York. On 28 March 2014, the Court in the action relating to Euroyen TIBOR futures contracts dismissed the plaintiffs' antitrust claims, but declined to dismiss their claims under the Commodity Exchange Act for price manipulation.

Details of LIBOR investigations involving the RBS Group are set out under 'Investigations and reviews' on page 162.

ISDAFIX antitrust litigation

Beginning in September 2014, RBS plc and a number of other financial institutions were named as defendants in several purported class action complaints (now consolidated into one complaint) pending in the United States District Court for the Southern District of New York) alleging manipulation of USD ISDAFIX rates. RBS plc has reached an agreement to settle this matter, subject to final settlement documentation and court approval. The settlement amount is covered by an existing provision.

FX antitrust litigation

RBS Group companies have settled all claims that are or could be asserted on behalf of the classes in a consolidated action alleging an antitrust conspiracy in relation to foreign exchange transactions, which is pending in the United States District Court for the Southern District of New York. Following the Court's preliminary approval of the settlement on 15 December 2015, the RBS Group paid the total settlement amount (US\$255 million) into escrow pending final court approval of the settlement. Other class action complaints, including a complaint asserting Employee Retirement Income Security Act claims on behalf of employee benefit plans that engaged in FX transactions, are pending in the same court and name certain members of the RBS Group as defendants.

In September 2015, certain members of the RBS Group, as well as a number of other financial institutions, were named as defendants in two purported class actions filed in Ontario and Quebec on behalf of persons in Canada who entered into foreign exchange transactions or who invested in funds that entered into foreign exchange transactions. The plaintiffs allege that the defendants violated the Canadian Competition Act by conspiring to manipulate the prices of currency trades.

Certain other foreign exchange transaction related claims have been or may be threatened against the RBS Group in other jurisdictions. The RBS Group cannot predict whether any of these claims will be pursued, but expects that several may.

US Treasury securities antitrust litigation

Beginning in July 2015, numerous class action antitrust complaints were filed in US federal courts against a number of primary dealers of US Treasury securities, including RBS Securities Inc. The complaints allege that the defendants rigged the US Treasury securities auction bidding process to deflate prices at which they bought such securities and colluded to increase the prices at which they sold such securities to plaintiffs. The complaints assert claims under the US antitrust laws and the Commodity Exchange Act on behalf of persons who transacted in US Treasury securities or derivatives based on such instruments, including futures and options. On 8 December 2015, all pending matters were transferred to the United States District Court for the Southern District of New York for coordinated or consolidated pretrial proceedings.

Interest rate swaps antitrust litigation

On 25 November 2015, RBS plc and other members of the RBS Group, as well as a number of other interest rate swap dealers, were named as defendants in a class action antitrust complaint filed in the United States District Court for the Southern District of New York. A similar complaint was filed in the United States District Court for the Northern District of Illinois on 18 February 2016. The complaints allege that the defendants violated the US antitrust laws by restraining competition in the market for interest rate swaps through various means and thereby caused inflated bid-ask spreads for interest rate swaps, to the alleged detriment of the plaintiff class. The RBS Group companies named as defendants anticipate moving to dismiss the claims asserted in these matters.

Thornburg adversary proceeding

RBS Securities Inc. and certain other RBS Group companies, as well as several other financial institutions, are defendants in an adversary proceeding filed in the US bankruptcy court in Maryland by the trustee for TMST, Inc. (formerly known as Thornburg Mortgage, Inc.). The trustee seeks recovery of transfers made under certain restructuring agreements as, among other things, avoidable fraudulent and preferential conveyances and transfers. On 25 September 2014, the Court largely denied the defendants' motion to dismiss this matter and, as a result, discovery is ongoing.

Interest rate hedging products litigation

The RBS Group is dealing with a large number of active litigation claims in relation to the sale of interest rate hedging products (IRHPs). In general claimants allege that the relevant interest rate hedging products were mis-sold to them, with some also alleging the RBS Group made misrepresentations in relation to LIBOR. Claims have been brought by customers who were considered under the UK Financial Conduct Authority (FCA) redress programme, as well as customers who were outside of the scope of that programme, which was closed to new entrants on 31 March 2015. The RBS Group encouraged those customers that were eligible to seek redress under the FCA redress programme to participate in that programme. The RBS Group remains exposed to potential claims from customers who were either ineligible to be considered for redress or who are dissatisfied with their redress offers.

In addition to claims alleging that IRHPs were mis-sold, the RBS Group has received a number of claims involving allegations that it breached a legal duty of care in its conduct of the FCA redress programme. These claims have been brought by customers who are dissatisfied with redress offers made to them through the FCA redress programme. The claims followed a preliminary decision against another UK bank. RBS has since been successful in opposing an application by a customer to amend its pleadings to include similar claims against RBS, on the basis that the bank does not owe a legal duty of care to customers in carrying out the FCA review. The customer was declined permission to appeal by the Mercantile Court and has formally applied to the Court of Appeal for leave to appeal.

Weiss v. National Westminster Bank Plc

NatWest is defending a lawsuit filed by a number of US nationals (or their estates, survivors, or heirs) who were victims of terrorist attacks in Israel. The plaintiffs allege that NatWest is liable for damages arising from those attacks pursuant to the US Anti-terrorism Act because NatWest previously maintained bank accounts and transferred funds for the Palestine Relief & Development Fund, an organisation which plaintiffs allege solicited funds for Hamas, the alleged perpetrator of the attacks. On 28 March 2013, the trial court (the United States District Court for the Eastern District of New York) granted summary judgment in favour of NatWest on the issue of scienter, but on 22 September 2014, that summary judgment ruling was vacated by the United States Court of Appeals for the Second Circuit. The appeals court returned the case to the trial court for consideration of NatWest's other asserted grounds for summary judgment and, if necessary, for trial.

Investigations and reviews

The Group's businesses and financial condition can be affected by the actions of various governmental and regulatory authorities in the UK, the EU, the US and elsewhere. The RBS Group has engaged, and will continue to engage, in discussions with relevant governmental and regulatory authorities, including in the UK, the US, the EU and elsewhere, on an ongoing and regular basis, and in response to informal and formal inquiries or investigations, regarding operational, systems and control evaluations and issues including those related to compliance with applicable laws and regulations, including consumer protection, business conduct, competition, anti-trust, anti-bribery, anti-money laundering and sanctions regimes. The Corporate & Institutional Banking (CIB) segment in particular has been providing information regarding a variety of matters, including, for example, the setting of benchmark rates and related derivatives trading, conduct in the foreign exchange market, and various issues relating to the issuance, underwriting, and sales and trading of fixed-income securities, including structured products and government securities. Any matters discussed or identified during such discussions and inquiries may result in, among other things, further inquiry or investigation, other action being taken by governmental and regulatory authorities, increased costs being incurred by the RBS Group, remediation of systems and controls, public or private censure, restriction of the RBS Group's business activities and/or fines.

Notes on accounts

Any of the events or circumstances mentioned in this paragraph or below could have a material adverse effect on the RBS Group, its business, authorisations and licences, reputation, results of operations or the price of securities issued by it.

The RBS Group is co-operating fully with the investigations and reviews described below.

Loan securitisation business investigations

In the US, the RBS Group is involved in reviews, investigations and proceedings (both formal and informal) by federal and state governmental law enforcement and other agencies and self-regulatory organisations, including the DOJ and various other members of the RMBS Working Group of the Financial Fraud Enforcement Task Force (including several state attorneys general), relating to, among other things, issuance, underwriting and trading in mortgage-backed securities, collateralised debt obligations (CDOs), collateralised loan obligations (CLOs) and synthetic products.

In connection with these inquiries, RBS Group companies have received requests for information and subpoenas seeking information about, among other things, the structuring of CDOs, financing to loan originators, purchase of whole loans, sponsorship and underwriting of securitisations, due diligence, representations and warranties, communications with ratings agencies, disclosure to investors, document deficiencies, trading activities and practices and repurchase requests.

These ongoing matters include, among others, active investigations by the civil and criminal divisions of the DOJ and the office of the attorney general of Connecticut, on behalf of the Connecticut Department of Banking, relating primarily to due diligence on and disclosure related to loans purchased for, or otherwise included in, securitisations and related disclosures. On 31 August 2015, the Connecticut Department of Banking issued two letters to RBS Securities Inc., indicating that it has concluded that RBS Securities Inc. may have violated the Connecticut Uniform Securities Act when underwriting MBS, noting RBS plc's May 2015 FX-related guilty plea, and offering an opportunity for RBS Securities Inc. to demonstrate its compliance with the law and why administrative proceedings seeking fines and other remedies should not be commenced. RBS Securities Inc. submitted responses to these letters in October 2015, and related discussions are ongoing.

The investigations also include civil and criminal investigations relating to alleged misrepresentations in the trading of various forms of asset-backed securities, including residential mortgage-backed securities, commercial mortgage-backed securities, CDOs, and CLOs. In March and December 2015, two former RBS Securities Inc. traders entered guilty pleas in the United States District Court for the District of Connecticut, each to one count of conspiracy to commit securities fraud while employed at RBS Securities Inc.

In 2007, the New York State Attorney General issued subpoenas to a wide array of participants in the securitisation and securities industry, focusing on the information underwriters obtained from the independent firms hired to perform due diligence on mortgages. The RBS Group completed its production of documents requested by the New York State Attorney General in 2008, principally producing documents related to loans that were pooled into one securitisation transaction.

In May 2011, the New York State Attorney General requested additional information about the RBS Group's mortgage securitisation business and, following the formation of the RMBS Working Group, has focused on the same or similar issues as the other state and federal RMBS Working Group investigations described above. The investigation is ongoing and the RBS Group continues to respond to requests for information.

At this stage, as there remains considerable uncertainty around the outcome of MBS-related regulatory and governmental investigations it is not practicable reliably to estimate the aggregate potential impact on the RBS Group which is expected to be material.

US mortgages - loan repurchase matters

The RBS Group's CIB business in North America has been a purchaser of non-agency US residential mortgages in the secondary market, and an issuer and underwriter of non-agency residential mortgage-backed securities (MBS). CIB did not originate or service any US residential mortgages and it was not a significant seller of mortgage loans to government sponsored enterprises (GSEs) (e.g. the Federal National Mortgage Association and the Federal Home Loan Mortgage Association).

In issuing MBS, CIB generally assigned certain representations and warranties regarding the characteristics of the underlying loans made by the originator of the residential mortgages; however, in some circumstances, CIB made such representations and warranties itself. Where CIB has given those or other representations and warranties (whether relating to underlying loans or otherwise), CIB may be contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of such representations and warranties.

In certain instances where it is required to repurchase loans or related securities, CIB may be able to assert claims against third parties who provided representations or warranties to CIB when selling loans to it, although the ability to recover against such parties is uncertain. Between the start of 2009 and 31 December 2015, CIB received approximately US\$753 million in repurchase demands in respect of loans made primarily from 2005 to 2008 and related securities sold where obligations in respect of contractual representations or warranties were undertaken by CIB. However, repurchase demands presented to CIB are subject to challenge and rebuttal by CIB.

At this stage, as there remains considerable uncertainty around the outcome of loan repurchase related claims it is not practicable reliably to estimate the aggregate potential impact, if any, on the RBS Group which may be material.

Notes on accounts

LIBOR and other trading rates

In February 2013, the RBS Group announced settlements with the Financial Services Authority (FSA) in the UK, the United States Commodity Futures Trading Commission (CFTC) and the United States Department of Justice (DOJ) in relation to investigations into submissions, communications and procedures around the setting of LIBOR. The RBS Group agreed to pay penalties of £87.5 million, US\$325 million and US\$150 million to these authorities respectively to resolve the investigations and also agreed to certain undertakings in its settlement with the CFTC. As part of the agreement with the DOJ, RBS plc entered into a Deferred Prosecution Agreement (DPA) in relation to one count of wire fraud relating to Swiss Franc LIBOR and one count for an antitrust violation relating to Yen LIBOR. The DPA expired in April 2015 and is of no further effect.

In April 2013, RBS Securities Japan Limited entered a plea of guilty to one count of wire fraud relating to Yen LIBOR and in January 2014, the US District Court for the District of Connecticut entered a final judgment in relation to the conviction of RBS Securities Japan Limited pursuant to the plea agreement.

In February 2014, the RBS Group paid settlement penalties of approximately €260 million and €131 million to resolve investigations by the European Commission (EC) into Yen LIBOR competition infringements and EURIBOR competition infringements respectively. This matter is now concluded.

In July 2014, RBS plc and RBS N.V. entered into an Enforceable Undertaking with the Australian Securities and Investments Commission (ASIC) in relation to potential misconduct involving the Australian Bank Bill Swap Rate. RBS plc and RBS N.V. made various undertakings and agreed to make a voluntary contribution of A\$1.6 million to fund independent financial literacy projects in Australia.

In October 2014, the EC announced its findings that (1) the RBS Group and one other financial institution had participated in a bilateral cartel aimed at influencing the Swiss Franc LIBOR benchmark interest rate between March 2008 and July 2009; and (2) the RBS Group and three other financial institutions had participated in a related cartel on bid-ask spreads of Swiss Franc interest rate derivatives in the European Economic Area (EEA). The RBS Group received full immunity from fines.

The RBS Group is co-operating with investigations and new and ongoing requests for information by various other governmental and regulatory authorities, including in the UK, US and Asia, into its submissions, communications and procedures relating to a number of trading rates, including LIBOR and other interest rate settings, and non-deliverable forwards.

The RBS Group is providing information and documents to the CFTC as part of its investigation into the setting of USD, EUR and GBP ISDAFIX and related trading activities. The RBS Group understands that the CFTC investigation is at an advanced stage. The RBS Group is also under investigation by competition authorities in a number of jurisdictions stemming from the actions of certain individuals in the setting of LIBOR and other trading rates, as well as interest rate-related trading.

At this stage, as there remains considerable uncertainty around the outcome of these investigations, it is not practicable to estimate the aggregate impact reliably, if any, on the RBS Group which may be material.

Foreign exchange related investigations

In November 2014, RBS plc reached a settlement with the FCA and the CFTC in relation to investigations into failings in RBSG's FX businesses within its Corporate & Institutional Banking (CIB) segment. RBS plc agreed to pay penalties of £217 million to the FCA and US\$290 million to the CFTC to resolve the investigations. The fines were paid on 19 November 2014.

On 20 May 2015, RBS plc announced that it had reached settlements with the DOJ and the Board of Governors of the Federal Reserve System (Federal Reserve) in relation to investigations into its FX business within its CIB segment. RBS plc paid a penalty of US\$274 million to the Federal Reserve and has agreed to pay a penalty of US\$395 million to the DOJ to resolve the investigations. The DOJ fine is fully covered by existing provisions.

As part of its plea agreement with the DOJ, RBS plc pled guilty in the United States District Court for the District of Connecticut to a one-count information charging an antitrust conspiracy. RBS plc admitted that it knowingly, through one of its euro/US dollar currency traders, joined and participated in a conspiracy to eliminate competition in the purchase and sale of the euro/US dollar currency pair exchanged in the FX spot market.

The charged conspiracy occurred between as early as December 2007 to at least April 2010. Pursuant to the plea agreement (which is publicly available), the DOJ and RBS plc have agreed jointly to recommend to the Court that it impose a sentence consisting of a US\$395 million criminal fine and a term of probation, which among other things, would prohibit RBS plc from committing another crime in violation of US law or engaging in the FX trading practices that form the basis for the charged crime and require RBS plc to implement a compliance program designed to prevent and detect the unlawful conduct at issue and to strengthen its compliance and internal controls as required by other regulators (including the FCA and the CFTC). If RBS plc is sentenced to a term of probation, a violation of the terms of probation could lead to the imposition of additional penalties.

RBS plc and RBS Securities Inc. have also entered into a cease and desist order with the Federal Reserve relating to FX and other designated market activities (the FX Order). In the FX Order, which is publicly available and will remain in effect until terminated by the Federal Reserve, RBS plc and RBS Securities Inc. agreed to take certain remedial actions with respect to FX activities and certain other designated market activities, including the creation of an enhanced written internal controls and compliance program, an improved compliance risk management program, and an enhanced internal audit program. RBS plc and RBS Securities Inc. are obligated to implement and comply with these programs after they are approved by the Federal Reserve, and are also required to conduct, on an annual basis, a review of applicable compliance policies and procedures and a risk-focused sampling of key controls.

The RBS Group is responding to investigations and inquiries from other governmental and regulatory (including competition) authorities on similar issues relating to failings in its FX business within its CIB segment, including with respect to potential collateral consequences of the RBS plc guilty plea described above. The timing and amount of financial penalties with respect to any further settlements and related litigation risks and collateral consequences remain uncertain and could be material.

On 21 July 2014, the Serious Fraud Office in the UK (SFO) announced that it was launching a criminal investigation into allegations of fraudulent conduct in the foreign exchange market, apparently involving multiple financial institutions. On 15 March 2016, the SFO announced that it was closing its investigation, having concluded that, based on the information and material obtained, there was insufficient evidence for a realistic prospect of conviction.

Interest rate hedging products (IRHP) redress programme

In June 2012, following an industry wide review, the FSA announced that the RBS Group 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 classified as retail clients or private customers under FSA rules.

In January 2013, the FSA issued a report outlining the principles to which it wished the RBS Group and other UK banks to adhere in conducting the review and redress exercise. This exercise is being scrutinised by an independent reviewer, KPMG (appointed as a Skilled Person under section 166 of the Financial Services and Markets Act), who is reviewing and approving all outcomes, and the FCA is overseeing this. The RBS Group has reached agreement with KPMG in relation to redress determinations for all in scope customers. The review and redress exercise was closed to new entrants on 31 March 2015. RBS and KPMG are now focussing on securing the few remaining acceptances of redress offers and assessing consequential loss claims. In October 2015, RBS agreed with the FCA that its review was nearing completion, and on 31 October 2015 all customers who had received final redress offers but had not yet responded were informed that the final date for acceptance of those offers was 31 January 2016.

Customers who have not yet received a final redress determination will be given three months to accept any redress offer before that offer lapses. As at the end of February 2016, 95% of all review files had been closed.

The Central Bank of Ireland also requested Ulster Bank Ireland Limited (UBIL), along with a number of Irish banks, to undertake a similar exercise and past business review in relation to the sale of IRHP to retail designated small and medium sized businesses in the Republic of Ireland. The RBS Group also agreed to undertake a similar exercise and past business review in respect of relevant customers of RBS International. The reviews undertaken in respect of both RBS International customers and UBIL customers are complete.

The Group provisions in relation to the above redress exercises total £1.0 billion to date for these matters, of which £0.9 billion had been utilised at 31 December 2015.

Judicial Review of Skilled Person's role in IRHP review

RBS plc and NatWest have been named as interested parties in a number of claims for judicial review of KPMG's decisions as Skilled Person in the RBS Group's previously disclosed IRHP redress programme. This follows a similar claim from a customer of another UK bank, also against KPMG.

All of these claims were stayed pending the outcome of the other bank's case. The trial in that case was heard on 25 January 2016. The court decided in favour of KPMG, finding that (1) KPMG is not a body amenable to judicial review in respect of its role as Skilled Person in this matter; and (2) that there was no unfairness by the other bank in the procedure adopted. The claimant has sought permission to appeal the decision.

If permission to appeal is granted and the appeal court finds that a section 166-appointed Skilled Person is susceptible to judicial review, the claims against RBS plc and NatWest may then proceed to full hearing to assess the fairness of KPMG's role in the redress programme in those particular cases. If deemed unfair, this could have a consequential impact on the reasonableness of the methodology applied to reviewed and settled IRHP files generally.

As there remains some uncertainty, it is not practicable reliably to estimate the impact of this matter, if any, on the Group which may be material.

FSA mystery shopping review

In February 2013, the FSA announced the results of a mystery shopping review it undertook into the investment advice offered by banks and building societies to retail clients. As a result of that review the FSA announced that firms involved were cooperative and agreed to take immediate action. The RBS Group was one of the firms involved.

The action required included a review of the training provided to advisers, considering whether changes are necessary to advice processes and controls for new business, and undertaking a past business review to identify any historic poor advice (and where breaches of regulatory requirements are identified, to put this right for customers).

Subsequent to the FSA announcing the results of its mystery shopping review, the FCA has required the RBS Group to carry out a past business review and customer contact exercise on a sample of historic customers that received investment advice on certain lump sum products through the UK Financial Planning channel of the Personal & Business Banking (PBB) segment of the RBS Group, which includes RBS plc and NatWest, during the period from March 2012 until December 2012.

This review was conducted under section 166 of the Financial Services and Markets Act, under which a Skilled Person was appointed to carry out the exercise. Redress has been paid/offered to certain customers in this sample group. Following discussions with the FCA after issue of the draft section 166 report, the RBS Group agreed with the FCA that it would carry out a wider review/remediation exercise relating to certain investment, insurance and pension sales from 1 January 2011 to present.

The RBS Group will be writing to the relevant customers during 2016. In addition, the RBS Group agreed with the FCA that it would carry out a remediation exercise for a specific customer segment who were sold a particular structured product, in response to concerns raised by the FCA with regard to (a) the target market for the product and (b) how the product may have been described to customers by certain advisers. Redress has been paid / offered to certain customers who took out the structured product.

The Group provisions in relation to investment advice total £140 million to date for these matters, of which £56 million had been utilised at 31 December 2015.

Card Protection Plan Limited

In August 2013, the FCA announced that Card Protection Plan Limited and 13 banks and credit card issuers, including the RBS Group, had agreed to a compensation scheme in relation to the sale of card and/or identity protection insurance to certain retail customers. The closing date before which any claims under the compensation scheme must have been submitted has now passed. All compensation payments have now been made and all claims, whether through the courts or the Financial Ombudsman Service, are now barred. The compensation payments were covered by existing provisions.

Packaged accounts

As a result of an uplift in packaged current account complaints, the RBS Group proactively put in place dedicated resources in 2013 to investigate and resolve complaints on an individual basis. The Group has made provisions totalling £230 million to date for this matter.

FCA review of the RBS Group's treatment of SMEs

In November 2013, a report by Lawrence Tomlinson, entrepreneur in residence at the UK Government's Department for Business Innovation and Skills, was published ("Tomlinson Report"). The Tomlinson Report was critical of the RBS Group's treatment of SMEs.

The Tomlinson Report was passed to the PRA and FCA. Shortly thereafter, the FCA announced that an independent Skilled Person would be appointed under section 166 of the Financial Services and Markets Act to review the allegations in the Tomlinson Report. On 17 January 2014, a Skilled Person was appointed. The Skilled Person's review is focused on the RBS Group's UK small and medium sized business customers with credit exposures of up to £20 million whose relationship was managed within the RBS Group's Global Restructuring Group or within similar units within the RBS Group's Corporate Banking Division that were focused on customers in financial difficulties. In the period 2008 to 2013 the RBS Group was one of the leading providers of credit to the UK SME sector.

Separately, in November 2013 the RBS Group instructed the law firm Clifford Chance to conduct an independent review of the principal allegation made in the Tomlinson Report: the RBS Group was alleged to be culpable of systematic and institutional behaviour in artificially distressing otherwise viable businesses and through that putting businesses into insolvency. Clifford Chance published its report on 17 April 2014 and, while they made certain recommendations to enhance customer experience and transparency of pricing, they concluded that there was no evidence to support the principal allegation.

A separate independent review of the principal allegation, led by Mason Hayes & Curran, Solicitors, was conducted in the Republic of Ireland. The report was published in December 2014 and found no evidence to support the principal allegation.

RBS is co-operating fully with the FCA in its review.

The Skilled Person review focuses on the allegations made in the Tomlinson Report and certain observations made by Sir Andrew Large in his 2013 Independent Lending Review, and is broader in scope than the reviews undertaken by Clifford Chance and Mason, Hayes & Curran which are referred to above. The Skilled Person is expected to deliver the initial findings from its review to the RBS Group and the FCA during the first half of 2016 but no final timescale has been determined.

The RBS Group will have an opportunity to respond to any such review findings before the Skilled Person delivers its final report. In the event that the Skilled Person's review concludes that there were material failings in the RBS Group's treatment of SME customers those conclusions could, depending on their nature, scale and type, result in the commencement of regulatory enforcement action by the FCA, the imposition of redress requirements and the commencement of litigation claims against the RBS Group, as well as potentially wider investigations and litigation related to the RBS Group's treatment of customers in financial difficulty. At this stage, as there remains considerable uncertainty around the final conclusions of the Skilled Person's review and any collateral consequences thereof, it is not practicable reliably to estimate the potential impact on the RBS Group.

Multilateral interchange fees

On 11 September 2014, the Court of Justice upheld earlier decisions by the EU Commission and the General Court that MasterCard's multilateral interchange fee (MIF) arrangements for cross border payment card transactions with MasterCard and Maestro branded consumer credit and debit cards in the EEA are in breach of competition law.

In April 2013, the EC announced it was opening a new investigation into interchange fees payable in respect of payments made in the EEA by MasterCard cardholders from non-EEA countries.

In May 2013, the EC announced it had reached an agreement with Visa regarding immediate cross border credit card MIF rates. This agreement has now been market tested and was made legally binding on 26 February 2014. The agreement is to last for four years.

In addition, on 8 June 2015, a regulation on interchange fees for card payments entered into force. The regulation requires the capping of both cross-border and domestic MIF rates for debit and credit consumer cards. The regulation also sets out other reforms including to the Honour All Cards Rule which require merchants to accept all cards with the same level of MIF but not cards with different MIF levels.

In the UK, the Office of Fair Trading (OFT) had previously opened investigations into domestic interchange fees applicable in respect of Visa and MasterCard consumer and commercial credit and debit card transactions. On 6 May 2015, the successor body to the OFT, the Competition & Markets Authority (CMA), announced that it had closed these investigations on the grounds of administrative priorities.

There remains uncertainty around the outcomes of the ongoing EC investigation, and regulation, but they may have a material adverse effect on the structure and operation of four party card payment schemes in general and, therefore, on the RBS Group's business in this sector.

Payment Protection Insurance(PPI)

Since 2011, the RBS Group has been implementing a policy statement agreed with the FCA for the handling of complaints about the mis-selling of PPI. The RBS Group is also monitoring developments following the UK Supreme Court's decision in the case of *Plevin v Paragon Personal Finance Ltd* in November 2014. That decision was that the sale of a single premium PPI policy could create an 'unfair relationship' under s.140A of the Consumer Credit Act 1974 (the 'Consumer Credit Act') because the premium contained a particularly high level of undisclosed commission.

The Financial Ombudsman Service (FOS) has confirmed on its website that unfair relationship provisions in the Consumer Credit Act and the *Plevin* judgment are 'potentially relevant considerations' in some of the PPI complaints referred to FOS. On 27 May 2015, the FCA announced that it was considering whether additional rules and/or guidance are required to deal with the impact of the *Plevin* decision on complaints about PPI generally.

On 26 November 2015, the FCA issued Consultation Paper 15/39, in which it set out proposed rules and guidance for how firms should handle PPI complaints fairly in light of the *Plevin* decision and how the FOS should consider relevant PPI complaints. The Consultation Paper also contains proposals for the introduction in 2018 on a date to be confirmed of a deadline for submission of PPI complaints. The RBS Group submitted its response to the Consultation Paper on 26 February 2016.

The proposals in the Consultation Paper include an FCA-led communications campaign to raise awareness of the deadline and to prompt those who intend to complain to act ahead of the deadline. If the proposals are agreed and implemented, the RBS Group expects higher claims volumes, persisting longer than previously modelled, and additional compensation payments in relation to PPI claims made as a result of the *Plevin* judgment.

Complaints made after the proposed 2018 deadline would lose the right to be assessed by firms or by the Financial Ombudsman Service, bringing an end to new PPI cases in 2018.

PPI complaint volumes during Q4 2015 were in line with previous trends. Actual payments made to settle PPI claims during Q4 covered the four month period from 1 September until 31 December 2015. This is in contrast to payments made during Q3, which covered the period from 1 June until 31 August 2015. This change was due to enhanced operating processes introduced in Q4 2015.

The Group has made provisions totalling £2.6 billion to date for PPI claims, including £0.4 billion for 2015, of which £2.0 billion had been utilised by 31 December.

UK retail banking

In March 2014, the CMA announced that it would be undertaking an update of the OFT's 2013 personal current account (PCA) market study, in parallel with its market study into small and medium-sized enterprise (SME) banking which was announced in June 2013. In July 2014 the CMA published its preliminary findings in respect of both the PCA and SME market studies. The CMA provisionally decided to make a market investigation reference (MIR) into retail banking which would cover PCA and SME banking. On 6 November 2014, the CMA made its final decision to proceed with a MIR. On 22 October 2015 the CMA published a summary of its provisional findings and notice of possible remedies.

The CMA has provisionally concluded there are a number of competition concerns in the provision of PCAs, business current accounts and SME lending, particularly around low levels of customers searching and switching, resulting in banks not being put under enough competitive pressure, and new products and new banks not attracting customers quickly enough.

The notice of possible remedies sets out measures to address these concerns, including measures to make it easier for customers to compare products, and requiring banks to help raise public awareness of, and confidence in, switching bank accounts. On 7 March 2016, the CMA announced that it is extending the MIR by 3 months with a revised statutory deadline of 12 August 2016. The CMA also published a supplemental notice of possible remedies which sets out four additional remedies focussed on PCA overdrafts, in addition to the remedies set out in the October 2015 notice of possible remedies. The provisional decision on remedies will now be published in May 2016.

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Alongside the MIR, the CMA is also reviewing the undertakings given by certain banks following the Competition Commission's 2002 investigation into SME banking as well as the 2008 Northern Ireland PCA Banking Market Investigation Order 2008.

At this stage as there remains uncertainty around the final outcome of these reviews it is not practicable reliably to estimate the potential impact on RBS, which may be material.

FCA Wholesale Sector Competition Review

On 9 July 2014, the FCA launched a review of competition in the wholesale sector to identify any areas which may merit further investigation through an in-depth market study.

The initial review was an exploratory exercise and focused primarily on competition in wholesale securities and investment markets, and related activities such as corporate banking. It commenced with a three month consultation exercise, including a call for inputs from stakeholders. Following this consultation period, the FCA published its feedback statement on 19 February 2015 which announced that the FCA is to undertake a market study into investment and corporate banking and potentially into asset management. The terms of reference for the investment and corporate banking market study were published on 22 May 2015. The FCA is intending to publish an interim report in April 2016.

On 18 November 2015, the FCA also announced that a market study would be undertaken into asset management. The FCA intends to publish an interim report in Summer 2016 with the final report expected in early 2017.

At this stage, as there remains considerable uncertainty around the outcome of these reviews it is not practicable reliably to estimate the aggregate impact, if any, on the RBS Group which may be material.

Credit default swaps (CDS) investigation

In April 2011 the EC opened an antitrust investigation into the CDS information market to which the RBS Group was a party. In general terms, the EC raised concerns that a number of banks, Markit and ISDA may have jointly prevented exchanges from entering the CDS market. On 4 December 2015 the EC decided to close the case against the RBS Group and the other bank parties to the investigation. Markit and ISDA remain party to the investigation.

Governance and risk management consent order

In July 2011, the RBS Group agreed with the Board of Governors of the Federal Reserve System, the New York State Banking Department, the Connecticut Department of Banking, and the Illinois Department of Financial and Professional Regulation to enter into a consent Cease and Desist Order (Governance Order) (which is publicly available) to address deficiencies related to governance, risk management and compliance systems and controls in the US branches of RBS plc and RBS N.V. branches (the US Branches).

In the Governance Order, the RBS Group agreed to create the following written plans or programmes.

- a plan to strengthen board and senior management oversight of the corporate governance, management, risk management, and operations of the RBS Group's US operations on an enterprise-wide and business line basis;
- an enterprise-wide risk management programme for the RBS Group's US operations;
- a plan to oversee compliance by the RBS Group's US operations with all applicable US laws, rules, regulations, and supervisory guidance;
- a Bank Secrecy Act/anti-money laundering compliance programme for the US Branches on a consolidated basis;
- a plan to improve the US Branches' compliance with all applicable provisions of the Bank Secrecy Act and its rules and regulations as well as the requirements of Regulation K of the Federal Reserve;
- a customer due diligence programme designed to ensure reasonably the identification and timely, accurate, and complete reporting by the US Branches of all known or suspected violations of law or suspicious transactions to law enforcement and supervisory authorities, as required by applicable suspicious activity reporting laws and regulations; and
- a plan designed to enhance the US Branches' compliance with Office of Foreign Assets Control (OFAC) requirements.

The Governance Order identified specific items to be addressed, considered, and included in each proposed plan or programme. The RBS Group also agreed in the Governance Order to adopt and implement the plans and programmes after approval by the regulators, to comply fully with the plans and programmes thereafter, and to submit to the regulators periodic written progress reports regarding compliance with the Governance Order. The RBS Group has created, submitted, and adopted plans and/or programmes to address each of the areas identified above. In connection with the RBS Group's efforts to implement these plans and programmes, it has, among other things, made investments in technology, hired and trained additional personnel, and revised compliance, risk management, and other policies and procedures for the RBS Group's US operations. The RBS Group continues to test the effectiveness of the remediation efforts it has undertaken to ensure they are sustainable and meet regulators' expectations. Furthermore, the RBS Group continues to work closely with the regulators in its efforts to fulfil its obligations under the Governance Order, which will remain in effect until terminated by the regulators.

The RBS Group may be subject to formal and informal supervisory actions and may be required by its US banking supervisors to take further actions and implement additional remedial measures with respect to these and additional matters. The RBS Group's activities in the US may be subject to significant limitations and/or conditions.

US dollar processing consent order

In December 2013 RBSG and RBS plc agreed a settlement with the Federal Reserve, the New York State Department of Financial Services (DFS), and the Office of Foreign Assets Control (OFAC) with respect to RBS plc's historical compliance with US economic sanction regulations outside the US. As part of the settlement, RBSG and RBS plc entered into a consent Cease and Desist Order with the Federal Reserve (US Dollar Processing Order), which remains in effect until terminated by the Federal Reserve. The US Dollar Processing Order (which is publicly available) indicated, among other things, that RBSG and RBS plc lacked adequate risk management and legal review policies and procedures to ensure that activities conducted outside the US comply with applicable OFAC regulations.

The RBS Group agreed to create an OFAC compliance programme to ensure compliance with OFAC regulations by the RBS Group's global business lines outside the US, and to adopt, implement, and comply with the programme. Prior to and in connection with the US Dollar Processing Order, the RBS Group has made investments in technology, hired and trained personnel, and revised compliance, risk management, and other policies and procedures.

Under the US Dollar Processing Order (as part of the OFAC compliance programme) the RBS Group was required to appoint an independent consultant to conduct an annual OFAC compliance review of compliance policies and their implementation and an appropriate risk-focused sampling of US dollar payments. The RBS Group appointed the independent consultant and their report was submitted to the authorities on 14 June 2015. The independent consultant review examined a significant number of sanctions alerts and no reportable issues were identified.

Pursuant to the US Dollar Processing Order, the authorities have requested a second annual review to be conducted by an independent consultant during the course of 2016 and the RBS Group is currently in discussions to agree the scope and timing of such review. In addition, pursuant to requirements of the US Dollar Processing Order, the RBS Group has provided the required written submissions, including quarterly updates, in a timely manner, and RBS continues to participate in a constructive dialogue with the authorities.

US/Swiss tax programme

In August 2013, the DOJ announced a programme for Swiss banks (the Programme) which provides Swiss banks with an opportunity to obtain resolution, through non-prosecution agreements or non-target letters, of the DOJ's investigations of the role that Swiss banks played in concealing the assets of US tax payers in offshore accounts (US related accounts). In December 2013, Coutts & Co Ltd., a member of the RBS Group incorporated in Switzerland, notified the DOJ that it intended to participate in the Programme.

As required by the Programme, Coutts & Co Ltd. subsequently conducted a review of its US related accounts and presented the results of the review to the DOJ. On 23 December 2015, Coutts & Co Ltd. entered into a non-prosecution agreement (the NPA) in which Coutts & Co Ltd. paid a US\$78.5 million penalty and acknowledged responsibility for certain conduct set forth in a statement of facts accompanying the agreement. Under the NPA, which has a term of four years, Coutts & Co Ltd. is required, among other things, to provide certain information, cooperate with DOJ's investigations, and commit no U.S. federal offenses. If Coutts & Co Ltd. abides by the NPA, the DOJ will not prosecute it for certain tax-related and monetary transaction offenses in connection with US related accounts.

German prosecutor investigation into Coutts & Co Ltd

A prosecuting authority in Germany undertook an investigation into Coutts & Co Ltd in Switzerland, and current and former employees, for alleged aiding and abetting of tax evasion by certain Coutts & Co Ltd clients. Coutts & Co Ltd cooperated with the relevant authorities and on 4 December 2015 paid EUR 23.8 million to settle the investigation against it. The settlement amount was covered by an existing provision.

Review of suitability of advice provided by Coutts & Co

In 2013 the FCA conducted a thematic review of the advice processes across the UK wealth management industry. As a result of this review, Coutts & Co undertook a past business review into the suitability of investment advice provided to its clients. This review is well advanced, with the focus on Coutts & Co contacting remaining clients and offering redress in appropriate cases. The RBS Group has made appropriate provision based on its estimate of exposure arising from this review.

Enterprise Finance Guarantee Scheme

The Enterprise Finance Guarantee (EFG) scheme is a government lending initiative for small businesses with viable business proposals that lack security for conventional lending. From 2009 until the end of 2015, the RBS Group provided over £980 million of lending under the EFG scheme. The RBS Group has identified a number of instances where it has not properly explained to customers how borrower and guarantor liabilities work under the EFG scheme. There are also concerns around the eligibility of some customers to participate in the EFG scheme and around potential over or under-payment of quarterly premiums paid by customers. In January 2015, the RBS Group announced a review of all EFG loans where there is a possibility that the customer may have been disadvantaged. The review has been completed and the RBS Group is in the final stages of advising customers of their review outcome, which in some cases involves payment of redress. The RBS Group has made appropriate provision based on its estimate of exposure arising from this review.

Notes on accounts

30 Net cash flow from operating activities

	Group			Bank		
	2015 £m	2014* £m	2013* £m	2015 £m	2014 £m	2013 £m
Operating (loss)/profit before tax	(914)	2,577	(6,805)	(1,105)	2,541	(1,538)
Decrease/(increase) in prepayments and accrued income	123	(253)	(22)	17	(24)	(19)
Interest on subordinated liabilities	250	269	267	243	251	250
(Decrease)/increase in accruals and deferred income	(294)	(36)	(182)	(139)	37	(76)
(Recoveries)/impairment losses	(728)	(1,249)	5,407	(12)	228	586
Loans and advances written-off net of recoveries	(7,194)	(2,019)	(1,652)	(779)	(775)	(937)
Unwind of discount on impairment losses	(96)	(157)	(276)	(47)	(56)	(70)
(Profit)/loss on sale of property, plant and equipment	(3)	(60)	(12)	8	(28)	(4)
Loss/(profit) on sale of subsidiaries and associates	84	(9)	(3)	15	(11)	1
(Profit)/loss on sale of securities	(9)	(9)	1	—	(6)	(1)
Charge for defined benefit pension schemes	288	242	261	181	200	211
Pension scheme curtailment and settlement gains	(57)	—	—	—	—	—
Cash contribution to defined benefit pension schemes	(807)	(804)	(504)	(724)	(712)	(411)
Other provisions charged net of releases	3,099	1,012	3,448	914	857	1,092
Other provisions utilised	(1,043)	(1,595)	(935)	(638)	(1,192)	(685)
Depreciation and amortisation	453	226	214	111	151	128
Write down of goodwill and other intangible assets	107	—	2	—	—	—
Gain on redemption of own debt	—	—	(239)	—	—	—
Write down of investment in subsidiaries	—	—	—	2,001	(1,742)	931
Elimination of foreign exchange differences	(404)	(499)	262	77	90	2
Other non-cash items	431	(26)	52	352	220	(124)
Net cash (outflow)/inflow from trading activities	(6,714)	(2,390)	(716)	475	29	(664)
Decrease/(increase) in loans and advances to banks and customers	10,879	21,253	9,612	(3,749)	2,170	(615)
Decrease in securities	4,488	10,978	11,961	1	1,252	14
(Increase)/decrease in other assets	(134)	(108)	(11)	(214)	(2)	79
Decrease/(increase) in derivative assets	1,260	(381)	1,269	1,026	(470)	1,270
Changes in operating assets	16,493	31,742	22,831	(2,936)	2,950	748
(Decrease)/increase in deposits by banks and customers	(4,307)	(43,227)	(18,385)	4,317	(8,489)	8,556
Decrease in debt securities in issue	(234)	(404)	(1,616)	—	—	—
Increase/(decrease) in other liabilities	1,628	(84)	(1,101)	(449)	(1,003)	(1,083)
(Decrease)/increase in derivative liabilities	(1,788)	380	(1,477)	(1,461)	772	(1,425)
(Decrease)/increase in settlement balances and short positions	(3,020)	(2,120)	(3,193)	(19)	33	37
Changes in operating liabilities	(7,721)	(45,455)	(25,772)	2,388	(8,687)	6,085
Income taxes received/(paid)	169	25	(153)	62	(128)	91
Net cash inflow/(outflow) from operating activities	2,227	(16,078)	(3,810)	(11)	(5,836)	6,260

*Restated - refer to page 99 for further details

Notes on accounts

31 Analysis of the net investment in business interests and intangible assets

	Group			Bank		
	2015 £m	2014 £m	2013 £m	2015 £m	2014 £m	2013 £m
Acquisitions and disposals						
Additional investments in Group undertakings	—	—	—	(700)	—	(1,280)
Other assets sold	(2,632)	8	163	—	—	—
Repayments of investments	—	—	—	—	6	19
Non-cash consideration	—	—	3	—	—	—
(Loss)/profit on disposal	(84)	9	3	(15)	11	(1)
Net (outflow)/inflow of cash in respect of disposals	(2,716)	17	169	(15)	17	18
Dividends received from associates	—	5	12	—	—	—
Net cash expenditure on intangible assets	—	(30)	(19)	—	—	—
Net (outflow)/inflow	(2,716)	(8)	162	(715)	17	(1,262)

32 Interest received and paid

	Group			Bank		
	2015 £m	2014 £m	2013 £m	2015 £m	2014 £m	2013 £m
Interest received	6,313	6,526	7,584	5,084	5,093	5,764
Interest paid	(1,520)	(2,114)	(3,670)	(1,225)	(1,715)	(2,974)
	4,793	4,412	3,914	3,859	3,378	2,790

33 Analysis of changes in financing during the year

	Group						Bank					
	Share capital and share premium			Subordinated liabilities			Share capital and share premium			Subordinated liabilities		
	2015 £m	2014 £m	2013 £m	2015 £m	2014 £m	2013 £m	2015 £m	2014 £m	2013 £m	2015 £m	2014 £m	2013 £m
At 1 January	3,903	3,903	3,903	7,436	7,528	7,627	3,903	3,903	3,903	6,122	6,106	6,123
Repayment of subordinated liabilities				(387)	(60)	(93)				(387)	—	—
Net cash outflow from financing	—	—	—	(387)	(60)	(93)	—	—	—	(387)	—	—
Currency translation and other adjustments	—	—	—	(33)	(32)	(6)	—	—	—	6	16	(17)
At 31 December	3,903	3,903	3,903	7,016	7,436	7,528	3,903	3,903	3,903	5,741	6,122	6,106

34 Analysis of cash and cash equivalents

	Group			Bank		
	2015 £m	2014 £m	2013 £m	2015 £m	2014 £m	2013 £m
At 1 January						
- cash	10,937	20,276	18,234	3,857	4,653	2,959
- cash equivalents	74,814	81,606	85,648	62,321	65,923	60,841
	85,751	101,882	103,882	66,178	70,576	63,800
Net cash inflow/(outflow)	792	(16,131)	(2,000)	9	(4,398)	6,776
At 31 December	86,543	85,751	101,882	66,187	66,178	70,576
Comprising:						
Cash and balances at central banks	1,690	2,709	2,493	819	1,054	734
Treasury bills and debt securities	—	527	—	—	—	—
Loans and advances to banks	84,853	82,515	99,389	65,368	65,124	69,842
Cash and cash equivalents	86,543	85,751	101,882	66,187	66,178	70,576

Note:

(1) Includes cash collateral posted with bank counterparties in respect of derivative liabilities of nil (2014 - £5 million; 2013 - nil)

The Bank and certain subsidiary undertakings are required to maintain balances with Central banks which, at 31 December 2015, amounted to £203 million (2014 - £198 million; 2013 - £198 million).

35 Segmental analysis

(a) Reportable segments

The directors manage the Group primarily by class of business and present the segmental analysis on that basis. This includes the review of net interest income for each class of business - interest receivable and payable for all reportable segments is therefore presented net. Segments charge market prices for services rendered between each other; funding charges between segments are determined by RBS Treasury, having regard to commercial demands. The segment performance measure is operating profit/(loss).

Organisational structure

The Group continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. To support this and reflect the progress made on the initiatives above the previously reported operating segments have been realigned as follows:

Personal & Business Banking (PBB) comprises two reportable segments, UK Personal & Business Banking (UK PBB) and Ulster Bank RoI. UK PBB serves individuals and mass affluent customers in the UK together with small businesses (generally up to £2 million turnover). UK PBB includes Ulster Bank customers in Northern Ireland. Ulster Bank RoI serves individuals and businesses in the Republic of Ireland (RoI).

Commercial & Private Banking (CPB) comprises two reportable segments, Commercial Banking and Private Banking. Commercial Banking serves commercial and mid-corporate customers in the UK. Private Banking serves high net worth individuals in the UK.

Corporate & Institutional Banking (CIB) serves UK and Western European corporate customers, and global financial institutions, supported by trading and distribution platforms in the UK, US and Singapore.

Capital Resolution consists of established businesses: CIB Capital Resolution and RBS Capital Resolution (RCR).

CIB Capital Resolution was created from non-strategic portfolios from CIB, to enable the build of a strong go-forward CIB business, consisting of three regional businesses (Americas, EMEA and APAC), Shipping, Markets assets, Other legacy assets including Global Transaction Services. There is a three stage process in place to guide the business down; starting with taking capital out, then running down the cost base and finally managing tail risk in the longer-term.

RCR was created on 1 January 2014 to de-risk the balance sheet. The original RBS Group perimeter was £47 billion of funded assets consisting of four asset groups: Ulster Bank (Ulster RCR), Real Estate Finance (ex. Ireland), Corporate and Markets. The remaining RBS Group funded assets of £4.6 billion are included in Capital Resolution.

Central items & other comprises corporate functions, such as Treasury, Finance, Risk Management, Compliance, Legal, Communications and Human Resources. Central functions manages the Group capital resources and Group-wide regulatory projects and provides services to the reportable segments. Balances relating to the international private banking business are also included.

Non-Core Division, established in 2009 as a principal vehicle for risk reduction, was dissolved on 31 December 2013.

Reporting changes

In line with the Group's strategy to be a simpler bank, the following reporting changes have been implemented in relation to the presentation of the Group results:

The following items previously reported separately after operating profit are now being reported within operating profit.

- Gain/(loss) on redemption of own debt;
- Write-down of goodwill;

Comparatives have been restated accordingly for the changes outlined above.

Notes on accounts

35 Segmental analysis

	Group						
	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses £m	Depreciation and amortisation £m	Impairment (losses)/releases £m	Operating profit/(loss) £m
2015							
UK Personal & Business Banking	3,366	733	4,099	(2,900)	—	(20)	1,179
Ulster Bank Rol	365	182	547	(381)	—	141	307
Personal & Business Banking	3,731	915	4,646	(3,281)	—	121	1,486
Commercial Banking	1,125	402	1,527	(692)	—	(3)	832
Private Banking	385	192	577	(506)	—	(12)	59
Commercial & Private Banking	1,510	594	2,104	(1,198)	—	(15)	891
Corporate & Institutional Banking	(25)	33	8	(168)	—	—	(160)
Capital Resolution	6	(223)	(217)	(2,393)	—	622	(1,988)
Central items & other	(326)	321	(5)	(685)	(453)	—	(1,143)
Total	4,896	1,640	6,536	(7,725)	(453)	728	(914)
2014*							
UK Personal & Business Banking	3,254	908	4,162	(3,070)	—	(164)	928
Ulster Bank Rol	467	127	594	(366)	—	306	534
Personal & Business Banking	3,721	1,035	4,756	(3,436)	—	142	1,462
Commercial Banking	1,073	454	1,527	(560)	—	(43)	924
Private Banking	423	221	644	(412)	—	5	237
Commercial & Private Banking	1,496	675	2,171	(972)	—	(38)	1,161
Corporate & Institutional Banking	3	53	56	(266)	—	—	(210)
Capital Resolution	(19)	547	528	(435)	(3)	1,145	1,235
Central items & other	(624)	390	(234)	(614)	(223)	—	(1,071)
Total	4,577	2,700	7,277	(5,723)	(226)	1,249	2,577

*Re-presented to reflect the segmental reorganisation.

	Group						
	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses £m	Depreciation and amortisation £m	Impairment (losses)/releases £m	Operating profit/(loss) £m
2013*							
UK Personal & Business Banking	2,993	888	3,881	(3,074)	—	(587)	220
Ulster Bank Rol	478	428	906	(374)	—	(1,525)	(993)
Personal & Business Banking	3,471	1,316	4,787	(3,448)	—	(2,112)	(773)
Commercial Banking	984	518	1,502	(1,080)	—	(143)	279
Private Banking	389	226	615	(589)	—	(6)	20
Commercial & Private Banking	1,373	744	2,117	(1,669)	—	(149)	299
Corporate & Institutional Banking	1	200	201	(147)	—	—	54
Capital Resolution	22	398	420	(2,400)	(2)	8	(1,974)
Central items & other	(951)	724	(227)	(809)	(212)	(19)	(1,267)
Non-Core	105	(39)	66	(75)	—	(3,135)	(3,144)
Total	4,021	3,343	7,364	(8,548)	(214)	(5,407)	(6,805)

	2015			2014			2013		
	External £m	Inter segment £m	Total £m	External £m	Inter segment £m	Total £m	External £m	Inter segment £m	Total £m
Total revenue									
UK Personal & Business Banking	4,949	(15)	4,934	4,947	(26)	4,921	4,867	(46)	4,821
Ulster Bank Rol	636	15	651	680	33	713	1,149	(34)	1,115
Personal & Business Banking	5,585	—	5,585	5,627	7	5,634	6,016	(80)	5,936
Commercial Banking	1,393	12	1,405	1,467	13	1,480	1,534	2	1,536
Private Banking	676	42	718	768	48	816	846	50	896
Commercial & Private Banking	2,069	54	2,123	2,235	61	2,296	2,380	52	2,432
Corporate & Institutional Banking	61	—	61	54	2	56	200	—	200
Capital Resolution	19	72	91	1,081	129	1,210	809	217	1,026
Central items & other	703	(126)	577	700	(199)	501	1,624	(189)	1,435
Non-Core	n/a	n/a	n/a	n/a	n/a	n/a	287	—	287
Total	8,437	—	8,437	9,697	—	9,697	11,316	—	11,316

*Re-presented to reflect the segmental reorganisation.

Notes on accounts

35 Segmental analysis

	2015			2014*			2013*		
	External £m	Inter segment £m	Total £m	External £m	Inter segment £m	Total £m	External £m	Inter segment £m	Total £m
Total income									
UK Personal & Business Banking	4,063	36	4,099	4,086	76	4,162	3,769	112	3,881
Ulster Bank Rol	547	—	547	559	35	594	928	(22)	906
Personal & Business Banking	4,610	36	4,646	4,645	111	4,756	4,697	90	4,787
Commercial Banking	1,613	(86)	1,527	1,611	(84)	1,527	1,590	(88)	1,502
Private Banking	582	(5)	577	656	(12)	644	623	(8)	615
Commercial & Private Banking	2,195	(91)	2,104	2,267	(96)	2,171	2,213	(96)	2,117
Corporate & Institutional Banking	8	—	8	54	2	56	200	1	201
Capital Resolution	(155)	(62)	(217)	656	(128)	528	425	(5)	420
Central items & other	(122)	117	(5)	(345)	111	(234)	(324)	97	(227)
Non-Core	n/a	n/a	n/a	n/a	n/a	n/a	153	(87)	66
Total	6,536	—	6,536	7,277	—	7,277	7,364	—	7,364

	2015			2014*			2013*		
	Assets £m	Liabilities £m	Cost to acquire fixed assets and intangible assets £m	Assets £m	Liabilities £m	Cost to acquire fixed assets and intangible assets £m	Assets £m	Liabilities £m	Cost to acquire fixed assets and intangible assets £m
UK Personal & Business Banking	108,008	126,362	—	97,925	123,357	—	91,480	119,063	6
Ulster Bank	22,359	16,227	—	23,959	19,840	—	27,192	22,640	5
Personal & Business Banking	130,367	142,589	—	121,884	143,197	—	118,672	141,703	11
Commercial Banking	40,472	65,075	—	39,557	61,745	—	39,624	63,764	—
Private Banking	25,304	24,309	—	26,903	22,913	5	27,655	23,681	18
Commercial & Private Banking	65,776	89,384	—	66,460	84,658	5	67,279	87,445	18
Corporate & Institutional Banking	26,238	22,862	10	20,048	14,822	2	30,066	32,997	—
Capital Resolution	4,012	7,545	—	80,405	19,805	107	101,454	31,676	20
Central items & other	76,037	24,883	262	20,403	30,950	128	30,169	43,034	78
Non-Core	n/a	n/a	n/a	n/a	n/a	n/a	5,764	2,483	9
Total	302,430	287,263	272	309,200	293,432	242	353,404	339,338	136

Segmental analysis of goodwill is as follows:

	Private Banking £m
At 1 January 2014	182
Currency translation and other adjustments	(8)
At 1 January 2015	174
Currency translation and other adjustments	12
Transfer to disposal groups	(186)
At 31 December 2015	—

*Restated - refer to page 99 for further details. Re-presented to reflect the segmental reorganisation.

Notes on accounts

35 Segmental analysis

(b) Geographical segments

The geographical analysis in the tables below has been compiled on the basis of location of office where the transactions are recorded.

	Group				
	UK £m	USA £m	Europe £m	RoW £m	Total £m
2015					
Total revenue	7,654	241	473	69	8,437
Net interest income	4,443	(7)	438	22	4,896
Net fees and commissions	1,343	104	141	28	1,616
Income from trading activities	(58)	22	46	4	14
Other operating income	218	78	(284)	(2)	10
Total income	5,946	197	341	52	6,536
Operating profit/(loss) before tax	1,097	(2,422)	429	(18)	(914)
Total assets	252,036	25,319	22,702	2,373	302,430
Total liabilities	243,638	23,922	17,359	2,344	287,263
Net assets attributable to equity shareholders and non-controlling interests	8,398	1,397	5,343	29	15,167
Contingent liabilities and commitments	49,258	1	2,610	19	51,888
Cost to acquire property, plant and equipment and intangible assets	173	69	7	23	272
2014*					
Total revenue	7,935	632	1,052	78	9,697
Net interest income	4,099	(7)	463	22	4,577
Net fees and commissions	1,538	196	172	35	1,941
Income from trading activities	(428)	320	179	6	77
Other operating income	549	60	73	—	682
Total income	5,758	569	887	63	7,277
Operating profit before tax	850	98	1,620	9	2,577
Total assets	248,805	27,033	30,645	2,717	309,200
Total liabilities	241,881	23,522	25,353	2,676	293,432
Net assets attributable to equity owners and non-controlling interests	6,924	3,511	5,292	41	15,768
Contingent liabilities and commitments	47,622	493	4,558	31	52,704
Cost to acquire property, plant and equipment and intangible assets	66	55	119	2	242
2013*					
Total revenue	8,297	902	2,024	93	11,316
Net interest income	3,430	(10)	577	24	4,021
Net fees and commissions	1,628	266	177	39	2,110
Income from trading activities	183	438	98	7	726
Other operating income	(305)	116	696	—	507
Total income	4,936	810	1,548	70	7,364
Operating (loss)/profit before tax	(1,695)	(1,710)	(3,394)	(6)	(6,805)
Total assets	256,099	59,263	35,158	2,884	353,404
Total liabilities	252,160	55,262	29,044	2,872	339,338
Net assets attributable to equity owners and non-controlling interests	3,939	4,001	6,114	12	14,066
Contingent liabilities and commitments	50,062	57	3,280	45	53,444
Cost to acquire property, plant and equipment and intangible assets	74	20	38	4	136

*Restated - refer to page 99 for further details.

Notes on accounts

36 Directors' and key management remuneration

The directors of the Bank are also directors of the ultimate holding company and are remunerated for their services to the RBS Group as a whole. The remuneration of the directors is disclosed in the Report and Accounts of the RBS Group.

Compensation of key management

The aggregate remuneration of directors and other members of key management during the year, borne by the RBS Group, was as follows:

	2015 £000	2014 £000
Short-term benefits	19,395	20,917
Post-employment benefits	435	1,964
Termination benefits	—	3,481
Share-based payments	3,472	4,889
	<u>23,302</u>	<u>31,251</u>

Key management comprises members of the RBS Group Executive Committee.

37 Transactions with directors and key management

(a) At 31 December 2015, the amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions in the Group, as defined in UK legislation, were £8,947 in respect of loans to four persons who were directors of the Bank at any time during the financial period.

(b) For the purposes of IAS 24 'Related Party Disclosures', key management comprise directors of the Bank and members of the RBS Group Executive Committee. The captions in the primary financial statements include the following amounts attributable, in aggregate, to key management:

	2015 £000	2014 £000
Loans and advances to customers	2,618	3,095
Customer accounts	11,049	17,924

Key management have banking relationships with Group entities which are entered into in the normal course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with other persons of a similar standing or, where applicable, with other employees. These transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Key management had no reportable transactions or balances with the ultimate holding company.

Notes on accounts

38 Related parties

UK Government

On 1 December 2008, the UK Government through HM Treasury became the ultimate controlling party of The Royal Bank of Scotland Group plc. The UK Government's shareholding is managed by UK Financial Investments Limited, a company wholly owned by the UK Government. As a result, the UK Government and UK Government controlled bodies became related parties of the Group. During 2015, all of the B shares held by the UK Government were converted into ordinary shares of £1 each and the Dividend Access Share Retirement Agreement was agreed between RBS and HM Treasury.

The Group enters into transactions with many of these bodies on an arm's length basis. Transactions include the payment of: taxes principally UK corporation tax (page 121) and value added tax; national insurance contributions; local authority rates; and regulatory fees and levies; together with banking transactions such as loans and deposits undertaken in the normal course of banker-customer relationships.

Bank of England facilities

The Group may participate in a number of schemes operated by the Bank of England in the normal course of business.

Members of the Group that are UK authorised institutions are required to maintain non-interest bearing (cash ratio) deposits with the Bank of England amounting to 0.18% of their average eligible liabilities in excess of £600 million. They also have Bank of England reserve accounts: sterling current accounts that earn interest at the Bank of England Rate.

Other related parties

- (a) In their roles as providers of finance, Group companies provide development and other types of capital support to businesses. These investments are made in the normal course of business and on arm's length terms. In some instances, the investment may extend to ownership or control over 20% or more of the voting rights of the investee company. However, these investments are not considered to give rise to transactions of a materiality requiring disclosure under IAS 24.
- (b) The Group recharges The Royal Bank of Scotland Group Pension Fund with the cost of administration services incurred by it. The amounts involved are not material to the Group.
- (c) In accordance with IAS 24, transactions or balances between Group entities that have been eliminated on consolidation are not reported.
- (d) The captions in the primary financial statements of the parent company include amounts attributable to subsidiaries. These amounts have been disclosed in aggregate in the relevant notes to the financial statements.

The table below discloses items included in income and operating expenses on transactions between the Group and fellow subsidiaries of the RBS Group.

	2015 £m	2014 £m	2013 £m
Income			
Interest receivable	646	742	1,470
Interest payable	549	734	1,588
Fees and commissions receivable	76	80	143
Fees and commissions payable	63	58	74
Expenses			
Other administrative expenses	2,249	2,122	2,327

39 Ultimate holding company

The Group's ultimate holding company is The Royal Bank of Scotland Group plc and its immediate parent company is The Royal Bank of Scotland plc. Both companies are incorporated in Great Britain and registered in Scotland. As at 31 December 2015, The Royal Bank of Scotland Group plc heads the largest group in which the Group is consolidated and The Royal Bank of Scotland plc heads the smallest group in which the Group is consolidated. Copies of the consolidated accounts of both companies may be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, PO Box 1000, Edinburgh EH12 1HQ.

Following placing and open offers by The Royal Bank of Scotland Group plc in December 2008 and April 2009, the UK Government, through HM Treasury, currently holds 72.6% of the issued ordinary share capital of the ultimate holding company and is therefore the Group's ultimate controlling party.

40 Post balance sheet events

Pension fund

Subsequently and pursuant to the Memorandum of Understanding RBS Group agreed with the Trustee a Statement of Funding Principles in relation to an actuarial valuation as at 31 December 2015. The RBS Group and Trustee also updated the existing Schedule of Contributions and Recovery Plan to reflect the £4.2 billion contribution, which was paid during March 2016.

Notes on accounts

41 Related undertakings

Legal entities and activities at 31 December 2015

In accordance with the Companies Act 2006, Natwest's related undertakings and the accounting treatment for each are listed below. All undertakings are wholly-owned by the company or subsidiaries of the company and are consolidated by reason of contractual control (Section 1162(2) CA 2006), unless otherwise indicated. Group interest refers to ordinary shares of equal values and voting rights unless further analysis is provided in the footnotes. Activities are classified in accordance with Annex I to the Capital Requirements Directive ("CRD IV") and the definitions in Article 4 of the Capital Requirements Regulation.

The following table details active related undertakings incorporated in the United Kingdom which are 100% owned by the Group and fully consolidated for accounting purposes.

Entity name	Activity(1)	Entity name	Activity(1)
Coutts Finance Company	BF	UB SIG (NI) Ltd	BF
Latam Directors Ltd	BF	Ulster Bank Commercial Services (NI) Ltd	BF
RB Investments 3 Ltd	OTH	Ulster Bank Pension Trustees Ltd	OTH
RBS Asset Management (ACD) Ltd	BF	West Register (Northern Ireland) Property Ltd	BF
RBS Residential Venture No.1 Ltd	OTH	WR (NI) Property Investments Ltd	BF
RBS Special Opportunities General Partner (England) Ltd	BF	WR (NI) Property Realisations Ltd	OTH
RBS Special Opportunities General Partner (Scotland) II Ltd	BF		
RBS Special Opportunities General Partner (Scotland) Ltd	OTH		

For notes to this table refer to page 181.

Notes on accounts

The following table details active related undertakings incorporated outside the United Kingdom which are 100% owned by the Group and fully consolidated for accounting purposes.

Country	Entity name	Activity(1)	Country	Entity name	Activity(1)
Cayman Islands	Coutts General Partner (Cayman) V Ltd	OTH	Republic of Ireland	Walter Property Ltd	BF
Cayman Islands	Equator Investments (Cayman) Ltd	BF	Republic of Ireland	West Register (Republic of Ireland) Property Ltd	BF
Cayman Islands	RBS Special Opportunities General Partner (Cayman) Ltd	OTH	Jersey	Pitstop Ltd	OTH
France	RDS Metropolis SAS	BF	Isle Of Man	Coutts & Co (Manx) Ltd	BF
Germany	patus 455. GmbH	BF	Netherlands	NatWest Securities B.V.	BF
Germany	RBS Deutschland Holdings GmbH	BF	Netherlands	RBS Investments Netherlands B.V.	BF
Germany	RBS Real Estate Holdings Germany GmbH	SC	Netherlands	RBS Netherlands B.V.	BF
Germany	RBS Structured Financial Services GmbH	BF	Netherlands	RBS Netherlands Holdings B.V.	BF
Germany	West Register PRIME Düsseldorf 2 GmbH	BF	Netherlands	RBS-CBFM Netherlands B.V.	BF
Germany	West Register PRIME Holding GmbH	OTH	Switzerland	Coutts & Co Ltd	CI
India	RBS Business Services Private Ltd	OTH	Switzerland	Coutts & Co Trustees (Suisse) S.A.	OTH
Republic of Ireland	Easycash (Ireland) Ltd	BF	Switzerland	RBS Services (Switzerland) Ltd	OTH
Republic of Ireland	First Active Holdings Ltd	BF	United States	Candlelight Acquisition LLC	OTH
Republic of Ireland	First Active Insurances Services Ltd	BF	United States	Communications Capital Group I, LLC	BF
Republic of Ireland	First Active Investments No. 4 Ltd	BF	United States	Communications Capital Group II, LLC	BF
Republic of Ireland	First Active Treasury plc	BF	United States	Financial Asset Securities Corp.	BF
Republic of Ireland	Hume Street Nominees Ltd	OTH	United States	Governor Acquisition Company, LLC	OTH
Republic of Ireland	National Westminster Services (Ireland) Ltd	SC	United States	Greenwich Capital Derivatives, Inc.	BF
Republic of Ireland	Norgay Property Ltd	BF	United States	Harborview Commercial Holdings I, LLC	BF
Republic of Ireland	RBS Asset Management (Dublin) Ltd	BF	United States	Lease Plan North America LLC	BF
Republic of Ireland	The RBS Group Ireland Retirement Savings Trustee Ltd	OTH	United States	NatWest Group Holdings Corp	BF
Republic of Ireland	UB SIG (ROI) Ltd	BF	United States	Random Properties Acquisition Corp. I	OTH
Republic of Ireland	Ulster Bank (Ireland) Holdings	BF	United States	Random Properties Acquisition Corp. II	OTH
Republic of Ireland	Ulster Bank Commercial Services Ltd	BF	United States	Random Properties Acquisition Corp. III	OTH
Republic of Ireland	Ulster Bank Dublin Trust Company	BF	United States	Random Properties Acquisition Corp. IV	OTH
Republic of Ireland	Ulster Bank Holdings (ROI) Ltd	BF	United States	RBS Acceptance Inc.	CI
Republic of Ireland	Ulster Bank Ireland Ltd	CI	United States	RBS Americas Property Corp.	SC
Republic of Ireland	Ulster Bank Pension Trustees (RI) Ltd	OTH	United States	RBS Commercial Funding Inc.	BF
Republic of Ireland	Ulster Bank Wealth	BF	United States	RBS Equity Corp	BF
			United States	RBS Financial Products Inc.	BF
			United States	RBS Holdings USA Inc.	BF
			United States	RBS Investments USA Corp.	BF
			United States	RBS Securities Inc.	BF
			United States	RBS Smart Products Inc	BF
			United States	Surprise Acquisition Company, LLC	OTH

The following table details active related undertakings incorporated in the United Kingdom where the Group ownership is less than 100%.

Entity name	Activity(1)	Accounting treatment(2)	Group interest %
GWNW City Developments Ltd	OTH	EAJV	50

For notes to this table refer to page 181

Notes on accounts

The following table details active related undertakings incorporated outside the United Kingdom where the Group ownership is less than 100%.

Country	Entity name	Activity (1)	Accounting treatment (2)	Group interest%
Cayman Islands	Coutts & Co (Cayman) Ltd	CI	IA	44
Cayman Islands	Redlion Investments Ltd	OTH	IA	44
Cayman Islands	Royhaven Secretaries Ltd	BF	IA	44
Germany	Argos Vermögensverwaltung GmbH	OTH	IA	40
Germany	BLIXA Elfte Vermögensverwaltung GmbH	OTH	IA	40
Germany	NASIL GmbH & Co. KG	BF	FC	94
Germany	TN Eagle 2 GmbH	BF	FC	99
Germany	TN Jet Stream 2 GmbH	BF	FC	99
Germany	TN Jet Stream GmbH	BF	FC	99
Gibraltar	Gosport	OTH	IA	44
Gibraltar	RBS (Gibraltar) Ltd	OTH	IA	44
Gibraltar	Sotomar Ltd	BF	IA	44
Guernsey	Drummonds Insurance PCC Ltd	BF	IA	44
Jersey	C.J Fiduciaries Ltd	BF	IA	44
Jersey	Citron 2004 Ltd	BF	IA	44
Jersey	Coutts & Co Trustees (Jersey) Ltd	BF	IA	44
Jersey	Fidelis Nominees Ltd	BF	IA	44

Country	Entity name	Activity (1)	Accounting treatment (2)	Group interest%
Jersey	Magnus Nominees Ltd	BF	IA	44
Jersey	RBS International Employees' Pension Trustees Ltd	BF	IA	44
Jersey	Rostand Nominees Ltd	BF	IA	44
Jersey	Rouge 2004 Ltd	BF	IA	44
Jersey	The Royal Bank of Scotland International (Holdings) Ltd	BF	IA	44
Jersey	The Royal Bank of Scotland International Ltd	BF	IA	44
Jersey	Vert 2004 Ltd	OTH	IA	44
Republic of Ireland	Qulpic Ltd	BF	FC	67
Republic of Ireland	The Drive4Growth Company Ltd	OTH	IA	20
Republic of Ireland	Zrko Ltd	BF	FC	67
Isle Of Man	Isle of Man Bank Ltd	CI	IA	44
United States	Amtrust Acquisition LLC	BF	IA	24
Virgin Islands, British	Action Corporate Services Ltd	BF	IA	44

The following table details active related undertakings which are 100% owned by the Group but are not consolidated for accounting purposes(3).

Country	Entity Name	Activity (1)	Accounting treatment (2)	Notes
United States	West Granite Homes Inc.	OTH	NC	(4)

For notes to this table refer to page 181.

Notes on accounts

The following tables detail related undertakings that are not active.

Actively being dissolved

Country	Entity name	Activity (1)	Accounting treatment (2)	Group interest %
Cayman Islands	Redshield Holdings Ltd	BF	IA	44
Germany	Greta Film Investition GmbH & Co. KG	BF	IA	25
Republic of Ireland	Danroc Ltd	OTH	FC	100
Republic of Ireland	First Active Investments No. 3 Ltd	BF	FC	100
Republic of Ireland	First Active Nominees Ltd	OTH	FC	100
Republic of Ireland	First Active Property Investments Ltd	OTH	FC	100
Republic of Ireland	GRG Real Estate Asset Management (Republic of Ireland) Ltd	BF	FC	100
Republic of Ireland	Meritvale Ltd	OTH	FC	100
Republic of Ireland	NatWest Holdings (Ireland)	BF	FC	100
Republic of Ireland	The Royal Bank of Scotland Finance (Ireland)	BF	FC	100
Republic of Ireland	UIF Finance Company	BF	FC	100

Country	Entity name	Activity (1)	Accounting treatment (2)	Group interest %
Republic of Ireland	Ulster Bank Group Treasury Ltd	OTH	FC	100
Republic of Ireland	Ulster Bank Investment Funds Ltd	OTH	FC	100
Republic of Ireland	Ulster International Finance	BF	FC	100
United Kingdom	GRG Real Estate Asset Management (Northern Ireland) Ltd	BF	FC	100
United Kingdom	NatWest Corporate Services (Ireland)	BF	FC	100
Virgin Islands, British	Minister Corporate Services Ltd	BF	IA	44

Dormant

Country	Entity name	Activity (1)	Accounting treatment (2)	Group interest %
Bahamas	CTB Ltd	BF	IA	44
Republic of Ireland	First Active plc	BF	FC	100
Jersey	Coutts (CI)	BF	IA	44
United Kingdom	Acre 146 Ltd	BF	FC	100
United Kingdom	RBS Investment Executive Ltd	OTH	NC	100
United Kingdom	Strand Nominees Ltd	BF	FC	100

Notes:

- (1) Activity:
Banking and Financial institution - BF
Credit institution - CI
Service company - SC
Other/non-financial - OTH
- (2) Accounting treatment:
Equity accounting - Associate - EAA
Equity accounting - Joint Venture - EAJV
Fully consolidated - FC
Investment Accounting - IA
Not consolidated - NC
- (3) Related undertaking not consolidated as it is not controlled by the Group.
- (4) Related undertaking owned for the benefit of Group pension schemes.

Additional information

Financial summary

The Group's financial statements are prepared in accordance with IFRS. Selected data under IFRS for each of the last five years are presented below.

Summary consolidated income statement	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m
Net interest income	4,896	4,577	4,021	2,873	3,007
Non-interest income (1,2)	1,640	2,700	3,343	3,553	3,084
Total income	6,536	7,277	7,364	6,426	6,091
Operating expenses (3)	(8,178)	(5,949)	(8,762)	(6,542)	(5,793)
(Loss)/profit before impairment losses	(1,642)	1,328	(1,398)	(116)	298
Impairment releases/(losses)	728	1,249	(5,407)	(3,183)	(4,792)
Operating (loss)/profit before tax	(914)	2,577	(6,805)	(3,299)	(4,494)
Tax (charge)/credit	(292)	(844)	842	47	600
(Loss)/profit for the year	(1,206)	1,733	(5,963)	(3,252)	(3,894)

Attributable to:

Non-controlling interests	(1)	—	—	—	8
Ordinary shareholders	(1,205)	1,733	(5,963)	(3,252)	(3,902)

Notes:

- (1) Includes loss on strategic disposals of £122 million (2014, 2013 and 2012 - nil; 2011 - £45 million).
(2) Includes gain on redemption of own debt of nil (2014 - nil; 2013 - £239 million; 2012 - nil; 2011 - £25 million).
(3) Includes write-down of goodwill and other intangible assets of nil (2014 - nil; 2013 - £2 million; 2012 - £117 million; 2011 - nil).

Summary consolidated balance sheet	2015 £m	2014* £m	2013* £m	2012* £m	2011* £m
Loans and advances	280,110	280,078	314,139	329,532	309,090
Debt securities and equity shares	7,921	14,608	23,851	35,813	41,933
Derivatives and settlement balances	4,751	5,948	6,758	7,148	7,665
Other assets	9,648	8,566	8,656	8,222	9,446
Total assets	302,430	309,200	353,404	380,715	368,134
Owners' equity	14,821	15,374	12,788	16,492	13,469
Non-controlling interests	346	394	1,278	1,257	1,272
Subordinated liabilities	7,016	7,436	7,528	7,627	8,002
Deposits	256,252	260,559	303,786	322,171	309,439
Derivatives, settlement balances and short positions	8,708	13,428	16,359	20,150	22,485
Other liabilities	15,287	12,009	11,665	13,018	13,467
Total liabilities and equity	302,430	309,200	353,404	380,715	368,134

*Restated - refer to page 99 for further details

Other financial data	2015	2014*	2013*	2012*	2011*
Dividend payout ratio (1)	—	10.1%	—	—	—
Return on average total assets (2)	(0.39%)	0.50%	(1.54%)	(0.84%)	(0.99%)
Return on average ordinary shareholders' equity (3)	(7.7%)	11.7%	(34.4%)	(22.3%)	(29.8%)
Average owners' equity as a percentage of average total assets	5.0%	4.3%	4.5%	3.8%	3.3%
Ratio of earnings to combined fixed charges and preference share dividends (4)					
- including interest on deposits	0.35	2.32	(0.95)	0.05	(0.40)
- excluding interest on deposits	(2.26)	9.56	(21.61)	(9.02)	(15.64)
Ratio of earnings to fixed charges only (4)					
- including interest on deposits	0.35	2.32	(0.95)	0.05	(0.40)
- excluding interest on deposits	(2.26)	9.56	(21.61)	(9.02)	(15.64)

*Restated refer to page 99 for further details

Notes:

- (1) Dividend payout ratio represents dividends paid and current year final dividends proposed as a percentage of net profit attributable to ordinary shareholders.
(2) Return on average total assets represents profit attributable to ordinary shareholders as a percentage of average total assets.
(3) Return on average ordinary shareholders' equity represents (loss)/profit attributable to ordinary shareholders expressed as a percentage of average ordinary shareholders' equity.
(4) For this purpose, earnings consist of income before tax and non-controlling interests, plus fixed charges less the unremitted income of associated undertakings (share of profits less dividends received). Fixed charges consist of total interest expense, including or excluding interest on deposits and debt securities in issue, as appropriate, and the proportion of rental expense deemed representative of the interest factor (one third of total rental expenses).

Additional information

Financial summary continued

The geographic analysis, including the average balance sheet and interest rates, changes in net interest income and average interest rates, yields, spreads and margins have been compiled on the basis of location of office - UK and overseas - unless indicated otherwise. 'UK' in this context includes transactions conducted through the offices in the UK which service international banking transactions.

Analysis of loans to customers by geographical area and type of customer

The following table analyses loans and advances to customers before provisions by remaining maturity, geographical area and type of customer.

	Within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	2015 Total £m	2014 £m	2013 £m	2012 £m	2011 £m
UK								
Central and local government	1,292	—	3	1,295	1,128	1,360	1,211	1,889
Finance	1,811	688	200	2,699	3,225	3,869	4,636	7,706
Residential mortgages	7,981	19,616	63,746	91,343	79,348	73,143	68,856	7,292
Personal lending	4,862	3,255	2,432	10,549	11,576	12,061	13,630	14,545
Property	4,404	5,596	4,480	14,480	17,261	18,688	21,060	24,677
Construction	1,354	644	143	2,141	2,219	2,596	3,021	3,859
Manufacturing	1,872	1,170	371	3,413	3,600	3,066	4,115	3,954
Services industries and business activities	10,279	7,589	4,417	22,285	22,059	21,526	21,651	22,961
Agriculture, forestry and fishing	866	868	878	2,612	2,397	2,191	2,063	2,112
Finance leases and instalment credit	38	46	39	123	138	127	123	80
Accrued interest	166	—	—	166	176	361	222	207
Total UK	34,925	39,472	76,709	151,106	143,127	138,988	140,588	89,282
Overseas								
US	216	—	36	252	769	1,104	3,098	3,457
Rest of the World	4,023	5,348	10,914	20,285	33,520	40,969	42,396	45,115
Total Overseas	4,239	5,348	10,950	20,537	34,289	42,073	45,494	48,572
Reverse repos								
US	10,524	—	—	10,524	5,658	14,199	22,811	17,373
Loans and advances to customers - gross	49,688	44,820	87,659	182,167	183,074	195,260	208,893	155,227
Loan impairment provisions				(5,335)	(13,908)	(17,972)	(14,385)	(12,338)
Loans and advances to customers - net				176,832	169,166	177,288	194,508	142,889
Fixed rate	8,235	15,838	52,066	76,139	67,824	54,677	57,794	21,583
Variable rate	30,929	28,982	35,593	95,504	109,592	126,384	128,288	116,271
Reverse repos	10,524	—	—	10,524	5,658	14,199	22,811	17,373
Loans and advances to customers - gross	49,688	44,820	87,659	182,167	183,074	195,260	208,893	155,227

The Group provides credit facilities at variable rates to its corporate and retail customers. Variable rate credit extended to the Group's corporate and commercial customers includes bullet and instalment loans, finance lease agreements and overdrafts; interest is generally charged at a margin over a bench mark rate such as LIBOR or base rate. Interest on variable rate retail loans may also be based on LIBOR or base rate; other variable rate retail lending is charged at variable interest rates set by the Group such as its mortgage standard variable rate in the UK.

Additional information

Average balance sheet and related interest

		2015			2014*		
		Average balance £m	Interest £m	Rate %	Average balance £m	Interest £m	Rate %
Assets							
Loans and advances to banks	- UK	92,118	630	0.68	96,318	699	0.73
	- Overseas	9,406	31	0.33	10,061	35	0.35
Loans and advances to customers	- UK	133,096	5,080	3.82	128,376	5,131	4.00
	- Overseas	27,156	530	1.95	37,964	615	1.62
Debt securities	- UK	111	2	1.80	691	13	1.88
	- Overseas	2,722	7	0.26	1,180	6	0.51
Interest-earning assets	- UK	225,325	5,712	2.54	225,385	5,843	2.59
	- Overseas	39,284	568	1.45	49,205	656	1.33
Total interest-earning assets	- banking business (1,5)	264,609	6,280	2.37	274,590	6,499	2.37
	- trading business (4)	28,545			59,115		
Interest-earning assets		293,154			333,705		
Non-interest-earning assets		15,667			12,495		
Total assets		308,821			346,200		
Percentage of assets applicable to overseas operations		21.5%			29.4%		
Liabilities							
Deposits by banks	- UK	11,204	82	0.73	9,397	103	1.10
	- Overseas	4,615	35	0.76	6,705	36	0.54
Customer accounts: demand deposits	- UK	78,353	402	0.51	63,813	300	0.47
	- Overseas	4,100	25	0.61	4,937	42	0.85
Customer accounts: savings deposits	- UK	48,282	272	0.56	65,956	564	0.86
	- Overseas	1,241	4	0.32	1,370	9	0.66
Customer accounts: other time deposits	- UK	15,998	268	1.68	18,698	517	2.77
	- Overseas	4,640	39	0.84	6,327	72	1.14
Debt securities in issue	- Overseas	1,534	5	0.33	1,806	9	0.50
Subordinated liabilities	- UK	6,752	243	3.60	6,977	259	3.71
	- Overseas	403	7	1.74	399	10	2.51
Internal funding of trading business	- UK	(284)	2	(0.70)	(4,749)	1	(0.02)
Interest-bearing liabilities	- UK	160,305	1,269	0.79	160,092	1,744	1.09
	- Overseas	16,533	115	0.70	21,544	178	0.83
Total interest-bearing liabilities	- banking business	176,838	1,384	0.78	181,636	1,922	1.06
	- trading business (4)	24,913			61,466		
Interest-bearing liabilities		201,751			243,102		
Non-interest-bearing liabilities:							
Demand deposits	- UK	57,743			45,865		
	- Overseas	9,254			9,138		
Other liabilities		24,499			33,276		
Total equity		15,574			14,819		
Total liabilities and equity		308,821			346,200		
Percentage of liabilities applicable to overseas operations		18.1%			27.6%		

*Restated - refer to page 99 for further details

For the notes to this table refer to the following page.

Additional information

Average balance sheet and related interest continued

		2013*		
		Average balance £m	Interest £m	Rate %
Assets				
Loans and advances to banks	- UK	101,665	764	0.75
	- Overseas	8,281	59	0.71
Loans and advances to customers	- UK	119,904	5,635	4.70
	- Overseas	42,545	935	2.20
Debt securities	- UK	2,598	88	3.39
	- Overseas	341	2	0.59
Interest-earning assets	- UK	224,167	6,487	2.89
	- Overseas	51,167	996	1.95
Total interest-earning assets	- banking business (1,5)	275,334	7,483	2.72
	- trading business (4)	94,194		
Interest-earning assets		369,528		
Non-interest-earning assets		17,915		
Total assets		387,443		
Percentage of assets applicable to overseas operations		37.0%		
Liabilities				
Deposits by banks	- UK	6,004	68	1.13
	- Overseas	11,446	166	1.45
Customer accounts: demand deposits	- UK	57,873	307	0.53
	- Overseas	4,454	53	1.19
Customer accounts: savings deposits	- UK	73,296	1,042	1.42
	- Overseas	1,520	16	1.05
Customer accounts: other time deposits	- UK	27,948	1,376	4.92
	- Overseas	7,611	143	1.88
Debt securities in issue	- Overseas	2,597	18	0.69
Subordinated liabilities	- UK	7,056	258	3.66
	- Overseas	564	9	1.60
Internal funding of trading business	- UK	(2,109)	6	(0.28)
Interest-bearing liabilities	- UK	170,068	3,057	1.80
	- Overseas	28,192	405	1.44
Total interest-bearing liabilities	- banking business	198,260	3,462	1.75
	- trading business (4)	92,550		
Interest-bearing liabilities		290,810		
Non-interest-bearing liabilities:				
Demand deposits	- UK	40,161		
	- Overseas	9,893		
Other liabilities		29,222		
Total equity		17,357		
Total liabilities and equity		387,443		
Percentage of liabilities applicable to overseas operations		38.0%		

*Restated - refer to page 99 for further details.

Notes:

- (1) Interest income includes £196 million (2014 - £149 million; 2013 - £210 million) in respect of loan fees forming part of the effective interest rate of loans and receivables.
- (2) Net interest margin is net interest income of the banking business as a percentage of average interest-earning assets of the banking business.
- (3) The analysis into UK and Overseas has been compiled on the basis of location of office.
- (4) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.
- (5) Interest income includes amounts (unwind of discount) recognised on impaired loans and receivables. The average balances of such loans are included in average loans and advances to banks and loans and advances to customers.

Additional information

Analysis of change in net interest income - volume and rate analysis

Volume and rate variances have been calculated based on movements in average balances over the period and changes in interest rates on average interest-earning assets and average interest-bearing liabilities. Changes due to a combination of volume and rate are allocated pro rata to volume and rate movements.

	2015 over 2014			2014 over 2013		
	Increase/(decrease) due to changes in:		Net change	Increase/(decrease) due to changes in:		Net change
	Average volume £m	Average rate £m	£m	Average volume £m	Average rate £m	£m
Interest-earning assets						
Loans and advances to banks						
UK	(27)	(42)	(69)	(36)	(29)	(65)
Overseas	(2)	(2)	(4)	11	(35)	(24)
Loans and advances to customers						
UK	185	(236)	(51)	378	(882)	(504)
Overseas	(196)	111	(85)	(93)	(227)	(320)
Debt securities						
UK	(10)	(1)	(11)	(49)	(26)	(75)
Overseas	5	(4)	1	4	—	4
Total interest receivable of the banking business						
UK	148	(279)	(131)	293	(937)	(644)
Overseas	(193)	105	(88)	(78)	(262)	(340)
	(45)	(174)	(219)	215	(1,199)	(984)
Interest-bearing liabilities						
Deposits by banks						
UK	(18)	39	21	(37)	2	(35)
Overseas	13	(12)	1	52	78	130
Customer accounts: demand deposits						
UK	(74)	(28)	(102)	(29)	36	7
Overseas	6	11	17	(5)	16	11
Customer accounts: savings deposits						
UK	127	165	292	97	381	478
Overseas	1	4	5	1	6	7
Customer accounts: other time deposits						
UK	67	182	249	370	489	859
Overseas	17	16	33	21	50	71
Debt securities in issue						
Overseas	1	3	4	5	4	9
Subordinated liabilities						
UK	8	8	16	3	(4)	(1)
Overseas	—	3	3	3	(4)	(1)
Internal funding of trading business						
UK	2	(3)	(1)	(3)	8	5
Total interest payable of the banking business						
UK	112	363	475	401	912	1,313
Overseas	38	25	63	77	150	227
	150	388	538	478	1,062	1,540
Movement in net interest income						
UK	260	84	344	694	(25)	669
Overseas	(155)	130	(25)	(1)	(112)	(113)
	105	214	319	693	(137)	556

Additional information

Financial summary continued

Loan impairment provisions

The following table shows the movements in loan impairment provisions.

	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m
Provisions at the beginning of the year					
UK	5,363	5,760	5,643	5,101	4,488
Overseas	8,545	12,212	8,748	7,246	4,921
	13,908	17,972	14,391	12,347	9,409
Transfer to disposal groups					
Overseas	(20)	—	—	—	—
Currency translation and other adjustments					
UK	(12)	708	(11)	29	(18)
Overseas	(520)	(1,349)	115	(164)	(216)
	(532)	(641)	104	(135)	(234)
Transfer from fellow subsidiaries					
UK	—	—	—	251	—
Amounts written-off					
UK	(2,789)	(1,189)	(1,160)	(884)	(1,113)
Overseas	(4,487)	(882)	(530)	(106)	(215)
	(7,276)	(2,071)	(1,690)	(990)	(1,328)
Recoveries of amounts previously written-off					
UK	59	49	33	59	37
Overseas	23	3	5	10	6
	82	52	38	69	43
(Released)/charged to income statement					
UK	(71)	109	1,356	1,213	1,825
Overseas	(660)	(1,356)	4,049	1,964	2,952
	(731)	(1,247)	5,405	3,177	4,777
Unwind of discount (recognised in interest income)					
UK	(53)	(74)	(101)	(126)	(118)
Overseas	(43)	(83)	(175)	(202)	(202)
	(96)	(157)	(276)	(328)	(320)
Provisions at the end of the year					
UK	2,497	5,363	5,760	5,643	5,101
Overseas	2,838	8,545	12,212	8,748	7,246
	5,335	13,908	17,972	14,391	12,347
Provisions at the end of the year comprise					
Customers	5,335	13,908	17,972	14,385	12,338
Banks	—	—	—	6	9
	5,335	13,908	17,972	14,391	12,347
Gross loans and advances to customers					
Customers	151,106	143,127	138,988	140,588	89,282
Banks	20,532	34,289	42,073	45,494	48,572
	171,638	177,416	181,061	186,082	137,854

For the notes to this table refer to the following page.

Additional information

Financial summary continued

	2015	2014	2013	2012	2011
Closing customer provisions as a % of gross loans and advances to customers (1)					
UK	1.7%	3.7%	4.1%	4.0%	5.7%
Overseas	13.8%	24.9%	29.0%	19.2%	14.9%
Total	3.1%	7.8%	9.9%	7.7%	9.0%
Customer charge to income statement as a % of gross loans and advances to customers (1)					
UK	—	0.1%	1.0%	0.9%	2.0%
Overseas	(3.2%)	(4.0%)	9.6%	4.3%	6.1%
Total	(0.4%)	(0.7%)	3.0%	1.7%	3.5%
Average loans and advances to customers (gross)	186,900	192,004	207,315	157,898	163,860
As a % of average loans and advances to customers during the year					
Total customer provisions charged to income statement	(0.4%)	(0.6%)	2.6%	2.0%	2.9%
Amounts written-off (net of recoveries) - customers	3.8%	1.1%	0.8%	0.6%	0.8%

Notes:

(1) For the purposes of these ratios closing provisions and customer charge relating to loans and advances to banks are excluded.

Analysis of closing customer loan impairment provisions

The following table analyses customer loan impairment provisions by geographical area and type of UK customer.

	2015		2014		2013		2012		2011	
	Closing provision £m	% of loans to total loans %	Closing provision £m	% of loans to total loans %	Closing provision £m	% of loans to total loans %	Closing provision £m	% of loans to total loans %	Closing provision £m	% of loans to total loans %
UK										
Central and local government	—	0.8	1	0.6	1	0.8	—	0.7	—	1.4
Manufacturing	48	2.0	77	2.0	95	1.7	92	2.2	86	2.9
Construction	131	1.2	239	1.3	307	1.4	296	1.6	307	2.8
Finance	11	1.6	24	1.8	34	2.1	27	2.5	23	5.6
Service industries and business activities	483	13.0	761	12.4	878	11.9	826	11.6	723	16.7
Agriculture, forestry and fishing	19	1.5	26	1.4	36	1.2	25	1.1	28	1.5
Property	742	8.4	2,784	9.7	2,686	10.3	2,182	11.3	1,940	17.9
Residential mortgages	87	53.2	101	44.7	142	40.4	242	37.0	17	5.3
Personal lending	793	6.1	1,054	6.5	1,232	6.7	1,540	7.3	1,575	10.6
Finance leases and instalment credit	—	0.1	2	0.1	4	0.1	15	0.1	12	0.1
Accrued interest	—	0.1	—	0.1	—	0.2	—	0.1	—	0.2
Total UK	2,314	88.0	5,069	80.6	5,415	76.8	5,245	75.5	4,711	65.0
Overseas	2,588	12.0	8,171	19.4	11,356	23.2	8,011	24.5	6,726	35.0
Impaired book provisions	4,902	100.0	13,240	100.0	16,771	100.0	13,256	100.0	11,437	100.0
Latent book provisions	433		668		1,201		1,129		901	
Total provisions	5,335		13,908		17,972		14,385		12,338	

Additional information

Financial summary continued

Analysis of write-offs

The following table analyses amounts written-off by geographical area and type of domestic customer.

	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m
UK					
Manufacturing	25	16	20	15	105
Construction	111	71	86	62	166
Finance	18	16	3	12	22
Service industries and business activities	257	185	193	186	189
Agriculture, forestry and fishing	8	2	3	10	3
Property	1,979	474	255	188	116
Residential mortgages	16	25	93	5	2
Personal lending	375	397	502	404	510
Finance leases and instalment credit	—	3	5	2	—
Total UK	2,789	1,189	1,160	884	1,113
Overseas	4,487	882	530	106	215
Total write-offs	7,276	2,071	1,690	990	1,328

Analysis of recoveries

The following table analyses recoveries of amounts written-off by geographical area and type of domestic customer.

	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m
UK					
Manufacturing	—	—	1	—	1
Construction	1	8	—	1	1
Finance	1	—	—	—	—
Service industries and business activities	27	7	7	6	5
Property	5	22	—	5	2
Personal lending	25	12	25	47	28
Total UK	59	49	33	59	37
Overseas	23	3	5	10	6
Total recoveries	82	52	38	69	43

Forbearance

The table below shows loans granted forbearance during the year. These loans are unimpaired: either the loan was performing before and after the granting of forbearance or the loan was non-performing before but subsequently transferred to the performing book. Loans with impairment provisions subject to forbearance continue to be reported as impaired loans.

	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m
Forbearance loans (1,2)	1,874	3,764	4,552	4,278	3,903

Notes:

(1) Wholesale loans subject to forbearance include only those arrangements above thresholds set individually by the segments, ranging from nil to £3 million.

(2) For 2015, wholesale loans subject to forbearance were £535 million (2014 - £1,144 million) and secured retail loans subject to forbearance were £1,339 million (2014 - £2,620 million). Unsecured retail loans subject to forbearance amount to £61 million (2014 - £76 million).

Additional information

Financial summary continued

Cross border exposures

Cross border exposures are loans and advances including finance leases and instalment credit receivables and other monetary assets, such as debt securities and net derivatives, including non-local currency claims of overseas offices on local residents.

The Group monitors the geographical breakdown of these exposures based on the country of domicile of the borrower or guarantor of ultimate risk. Cross border exposures exclude exposures to local residents in local currencies.

The table below sets out the most significant cross border exposures. Germany has not experienced repayment difficulties that have required restructuring of outstanding debt.

	Government £m	Banks £m	Other £m	Total £m
2015				
Germany	426	666	165	1,257
2014				
Germany	1,864	715	242	2,821
2013				
Germany	7	473	554	1,034

Risk elements in lending

Risk elements in lending (REIL) comprises impaired loans and accruing loans past due 90 days or more as to principal or interest.

Impaired loans are all loans for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans.

Accruing loans past due 90 days or more comprise loans past due 90 days where no impairment loss is expected.

	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m
Impaired loans (2)					
UK	3,171	6,822	7,731	8,644	7,902
Overseas	4,459	12,058	16,056	15,123	13,643
Total	7,630	18,880	23,787	23,767	21,545
Accruing loans which are contractually overdue 90 days or more as to principal or interest					
UK	714	862	1,113	1,086	1,039
Overseas	21	92	164	582	258
Total	735	954	1,277	1,668	1,297
Total REIL	8,365	19,834	25,064	25,435	22,842
Closing provisions for impairment as a % of total REIL	64%	70%	72%	57%	54%
REIL as a % of gross lending to customers excluding reverse repos	4.9%	11.2%	13.8%	13.7%	16.6%

Notes:

- (1) The write-off of impaired loans affects the closing provisions for impairment as a % of total risk elements in lending (the coverage ratio). The coverage ratio reduces if the loan written off carries a higher than average provision and increases if the loan written off carries a lower than average provision.
- (2) Impaired loans at 31 December 2015 include £1,635 million (2014 - £5,743 million; 2013 - £5,643 million) of loans subject to forbearance granted during the year.

	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m
Gross income not recognised but which would have been recognised under the original terms of impaired loans					
UK	202	237	322	405	322
Overseas	60	78	323	435	403
	262	315	645	840	725
Interest on impaired loans included in net interest income					
UK	53	74	101	126	118
Overseas	44	83	175	202	202
	97	157	276	328	320

Additional information

Potential problem loans

Potential problem loans (PPL) are loans for which an impairment event has taken place but no impairment loss is expected. This category is used for advances which are not past due 90 days or revolving credit facilities where identification as 90 days overdue is not feasible.

	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m
Potential problem loans	805	736	513	342	139

Both REIL and PPL are reported gross and take no account of the value of any security held which could reduce the eventual loss should it occur, nor of any provision marked. Therefore impaired assets which are highly collateralised, such as mortgages, will have a low coverage ratio of provisions held against the reported impaired balance.

Analysis of deposits - product analysis

The following table analyses deposits by type and geographical area.

	2015 £m	2014 £m	2013 £m
UK			
Deposits			
- interest-free	76,902	67,552	66,183
- interest-bearing	151,375	157,275	168,505
Total UK	228,277	224,827	234,688
Overseas			
Deposits			
- interest-free	5,238	10,359	10,599
- interest-bearing	12,283	18,978	23,240
Total Overseas	17,521	29,337	33,839
Total deposits	245,798	254,164	268,527
Overseas			
US	2,712	4,816	7,478
Rest of the World	14,809	24,521	26,361
Total overseas offices	17,521	29,337	33,839
Repos			
US	10,454	6,395	33,370
Rest of world	—	—	1,889
Total Repos	10,454	6,395	35,259

Certificates of deposit and other time deposits

The following table shows certificates of deposit and other time deposits over \$100,000 or equivalent by remaining maturity.

	Within 3 months £m	Over 3 months but within 6 months £m	Over 6 months but within 12 months £m	Over 12 months £m	Total £m
UK based companies and branches					
Certificates of deposit	—	—	—	1	1
Other time deposits	11,780	658	1,140	7,944	21,522
Overseas based companies and branches					
Other time deposits	813	676	1,081	117	2,687
	12,593	1,334	2,221	8,062	24,210

Additional information

Financial summary continued

Short-term borrowings

Short-term borrowings comprise repurchase agreements, borrowings from financial institutions and other short-term borrowings, primarily commercial paper. Borrowings from the holding company and fellow subsidiaries are excluded.

The table below shows details of short-term borrowings.

	Repurchase agreements	Other short-term borrowings	2015 Total	Repurchase agreements	Other short-term borrowings	2014 Total	2013 Total
At year end							
- balance (£bn)	10.5	15.6	26.1	6.4	15.4	21.8	50.1
- weighted average interest rate	1.0%	0.2%	0.5%	0.6%	0.2%	0.3%	0.4%
During the year							
- maximum balance (£bn)	23.2	19.4	42.6	48.4	20.6	69.0	97.4
- average balance (£bn)	12.9	15.9	28.8	29.7	15.3	45.0	72.0
- weighted average interest rate	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%	0.4%

Balances are generally based on monthly data. Average interest rates during the year are computed by dividing total interest expense by the average amount borrowed. Average interest rates at year end are average rates for a single day and as such may reflect one-day market distortions, which may not be indicative of generally prevailing rates. Original maturities of commercial paper are not in excess of one year. Other short-term borrowings consist principally of borrowings in the money markets included within deposits by banks and customer accounts in the financial statements and generally have original maturities of one year or less.

Other contractual cash obligations

The table below summarises other contractual cash obligations by payment date.

	Group					
	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
2015						
Operating leases	22	63	147	92	161	410
Contractual obligations to purchase goods or services	9	9	5	5	—	—
	31	72	152	97	161	410
2014						
Operating leases	23	63	150	113	163	430
Contractual obligations to purchase goods or services	13	12	7	6	1	—
	36	75	157	119	164	430
2013						
Operating leases	23	67	160	133	175	425
Contractual obligations to purchase goods or services	3	14	4	6	—	—
	26	81	164	139	175	425
	Bank					
	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
2015						
Operating leases	17	51	119	77	146	314
2014						
Operating leases	18	50	118	90	140	330
2013						
Operating leases	18	52	123	104	144	321

Additional information

Risk factors

Set out below are certain risk factors that could adversely affect the Group's future results, its financial condition and prospects and cause them to be materially different from what is expected. The Group is a principal subsidiary of RBSG and, accordingly, risk factors which relate to RBSG and the RBS Group will also directly or indirectly impact the Group's financial position, results of operations, reputation or prospects. The factors discussed below and elsewhere in this report should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties facing the Group.

The Group is reliant on the RBS Group

The Group is part of the RBS Group and receives capital, liquidity and funding support from the RBS Group. The Group also receives certain services from the RBS Group and has access to the infrastructure of the RBS Group which the Group requires in order to operate its business. The reduction or cessation of the ability of the RBS Group to provide intra-group funding, capital injections, liquidity or other support directly or indirectly to the Group or to receive such liquidity or funding support from the Group, may result in funding or capital pressures and liquidity stress for the Group. In particular, as described further below, the RBS Group is required to implement the UK ring-fencing regime by 1 January 2019, and it is expected that the majority of the Group's operations will be transferred to the ring-fenced bank subgroup ("RFB"). This will result in significant changes to the funding and other financial support received and provided by the Group and lead to the restructuring of the arrangements in place between the Group and RBS Group entities both within and outside the RFB, which may have a material adverse effect on the operations, financial condition and results of operations of the Group.

The Group is subject to political risks

The European Union Referendum Act 2015 requires the UK government to hold a referendum on the UK's membership of the European Union the date of which has been scheduled for 23 June 2016. The outcome of the EU referendum and consequences for the UK could significantly impact the environment in which the Group and the RBS Group and their customers and investors operate, introducing significant new uncertainties in financial markets, as well as the legal and regulatory requirements and environment to which the Group and the RBS Group, and their customers and investors are subject. Uncertainty as to the outcome of the referendum will therefore lead to additional market volatility and is likely to adversely impact customer and investor confidence prior to the vote.

In the event of a result supporting the UK's exit from the European Union, the lack of precedent means that it is unclear how the UK's access to the EU Single Market and the wider trading, legal and regulatory environment would be impacted and hence how this would affect the Group or the RBS Group or their customers and investors. During a transitional period, when the terms of the exit would be negotiated, or beyond, the related uncertainty could have a material adverse effect on any of the Group's business, financial condition, credit ratings and results of operations. A vote supporting the UK's exit from the European Union may also give rise to further political uncertainty regarding Scottish independence.

Implementation of the ring-fencing regime in the UK which began in 2015 and must be completed by 1 January 2019 will result in material structural changes to the RBS Group's business. These changes could have a material adverse effect on the Group.

The UK Government's White Paper on Banking Reform, published in September 2012, outlined material structural reforms for the UK banking industry. The implementation of the "ring-fencing" of retail banking operations was introduced under the UK Financial Services (Banking Reform) Act 2013 (the "Banking Reform Act 2013") and adopted through secondary legislation (the "UK ring-fencing regime"). These reforms form part of a broader range of structural reforms of the banking industry seeking to improve the resilience and resolvability of banks and which range from structural reforms (including ring-fencing) to the implementation of a new recovery and resolution framework (which in the UK will incorporate elements of the ring-fencing regime). See "*The RBS Group and its subsidiaries, including the Group, are subject to a new and evolving framework on recovery and resolution, the impact of which remains uncertain and which may result in additional compliance challenges and costs.*"

The Prudential Regulation Authority ("PRA") is carrying out consultations with the RBS Group and other affected UK banks and is expected to publish the majority of its final rules and supervisory statements during the first half of 2016. The PRA has indicated that the implementation of the UK ring-fencing regime may be further amended in light of any finalised EU proposals for the mandatory separation of proprietary trading and related trading activities which are currently being considered by the European Parliament and the European Council. A preliminary plan outlining the RBS Group's anticipated legal and operating structure under the new regime was submitted to the PRA and the Financial Conduct Authority ("FCA") by the deadline set by the regulators of 6 January 2015. On 29 January 2016, the RBS Group submitted an update to its draft ring-fencing plans to the regulators.

The Group has identified a number of material operational, execution and legal risks associated with the implementation of the UK ring-fencing regime. These are in addition to the uncertainty associated with starting to plan and prepare for implementation before final rules and guidance are in place or before the RBS Group applies for or obtains certain waivers or modifications (as envisaged under the rules), which it expects to require.

Additional information

These risks may be exacerbated by the RBS Group's other ongoing restructuring efforts, including, in particular, the separation of the Williams & Glyn business, and new and developing legal requirements relating to the regulatory framework for banking resolution.

- The RBS Group intends to establish a ring-fenced bank ("RFB") subgroup organised under an intermediate holding company for its UK-focussed banking services, which is expected to include the majority of the operations of the Group, while the non-ring-fenced group entities ("NRFBs") will hold the RBS Group's remaining trading activities, the operations of RBS International and certain non-EEA branches and subsidiaries and some banking activities that are not permitted activities for the RFB. The establishment of the RFB and the NRFBs will require a significant legal and organisational restructuring of the RBS Group and Group and the transfer of large numbers of assets, liabilities and customers between legal entities (including the Group and its subsidiaries) and the realignment of employees, (which may be subject to consultation with employee representatives) and will be contingent upon court, regulatory or board approvals. The Group is unable to predict how some customers may react to the required changes, including for some customers a requirement to deal with both the RFB and NRFBs to obtain the full range of products and services. The migration of some customers is also dependent on the completion of the technical separation of Williams & Glyn from the RBS Group.
- As part of the establishment of the RFB, the RFB, including Group entities, will need to operate independently from the NRFBs and as a result, amendments may need to be made to the Group's existing corporate governance structure to ensure its independence from NRFBs and the Group cannot predict the extent of the associated increase in overhead and compliance costs. In addition, the senior manager regime (as described further below) will extend to the RFB and remuneration policies will be required to be designed at Group level.
- As a result of the ring-fence, subject to certain exceptions, the Group will no longer be able to undertake certain activities, including investment and wholesale banking and activities such as dealing in investments and dealing in commodities will be prohibited. In addition, the Group will no longer be allowed to have exposure to certain financial institutions or to operate branches or subsidiaries outside the EEA to the extent such branches or subsidiaries perform activities which would be regulated if located in the UK. Such changes will limit the scope of the Group's activities and may have a material adverse effect on the Group's business, financial condition and results of operations.
- In order to comply with the requirements of the UK ring-fencing regime, the RBS Group will need to revise its operations infrastructure so as to comply with the shared services, independence and resolvability requirements set out in the UK ring-fencing rules, including in areas such as information technology ("IT") infrastructure, human resources and critical service providers. Arrangements currently in place between RFB, including Group entities, and NRFBs entities will need to be reviewed in light of these requirements and the requirement that all such transactions take place on an arm's-length basis, which may result in increased operational costs for the Group if it has to rely on third party providers for the provision of such services.
- The implementation of the UK ring-fencing regime will significantly impact the management of the RBS Group's treasury operations, including internal and external funding arrangements and may impact the credit ratings of some of the RFB or NRFBs entities, including the credit ratings of the Group. Reliance on intragroup exemptions in relation to the calculation of risk-weighted assets and large exposures may not be possible between the RFB and NRFB entities. Intragroup distributions (including payments of dividends) between RFB and NRFB entities will also be subject to certain limitations. The RFB subgroup will have to meet prudential requirements, including Pillar 2A requirements and the UK's Systemic Risk Buffer, at RFB subgroup level, in addition to meeting existing requirements applied on an individual entity basis (where applicable). To the extent Group entities are no longer able to rely on intra-group financing and liquidity arrangements or exemptions or are subject to standalone prudential requirements, including capital or leverage requirements, on a subconsolidated or entity basis, this could result in increased capital requirements and funding costs and related compliance costs.
- In order to comply with the UK ring-fencing regime, from 2026 it will not be possible for the RFB and the NRFBs to participate in the same defined benefit pension plan. As a result, it will be necessary for either the RFB or NRFBs to leave the current pension plan which is likely to trigger certain legal and regulatory obligations and the costs of separation may be material. Such separation may also result in additional or increased annual cash contributions in the event the pension trustees determine that the employer covenant has been weakened as a result of such separation.
- The Group will also need to evaluate, among other things, any accounting consequences resulting from the restructuring as well as any tax costs, the tax attributes of each of the RFB and NRFBs and the ability to transfer tax losses between RFB and NRFB entities. Transfers of assets that have related hedging arrangements may result in adverse operational, financial or accounting consequences if the transfer is not consistent with the unaffected continuation of such hedging arrangements.

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The steps required to implement the UK ring-fencing regime within the RBS Group to comply with the new rules and regulations are extraordinarily complex and will take an extended period of time to plan, execute and implement and entail significant costs and operational risks. Although final implementation is not required until 1 January 2019, there is no certainty that the RBS Group will be able to complete the legal restructuring and migration of customers on time or in accordance with future rules and the consequences of non-compliance are currently uncertain. The Group will be directly affected by the restructuring required to implement the UK ring-fencing regime and conducting the Group's operations in accordance with the new rules may result in additional costs (transitional and recurring) following implementation and impact the Group's profitability. As a result, the implementation of the UK ring-fencing regime could have a material adverse effect on the Group's reputation, results of operations, financial condition and prospects.

Operational risks are inherent in the Group's businesses and these risks could increase as a result of other key strategic and regulatory initiatives being implemented by the RBS Group.

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events, including legal risk. The Group has complex and diverse operations and operational risk and losses can result from IT failures, internal and external fraud, errors by employees or third parties, failure to document transactions properly or to obtain proper authorisations, failure to comply with applicable regulatory requirements and conduct of business rules (including those arising out of anti-bribery, anti-money laundering and antiterrorism legislation, as well as the provisions of applicable sanctions programmes), equipment failures, financial reporting errors or deficiencies, business continuity and data security system failures, information security threats or deficiencies, including cyber risk, natural disasters or the inadequacy or failure of systems and controls, including those of the Group's suppliers or counterparties. Although the Group has implemented risk controls and loss mitigation actions and significant resources and planning have been devoted to plans to mitigate operational risk associated with the Group's activities, it is not possible to be certain that such actions have been or will be effective in controlling each of the operational risks faced by the Group. Operational risks for the Group may be heightened as a result of the restructuring of the RBS Group relating to the implementation of its strategic programme, the implementation of the UK ring-fencing regime, the divestment of Williams & Glyn and the restructuring of the CIB business. Such initiatives are being delivered against the backdrop of ongoing cost challenges and put significant pressure on the RBS Group's ability to maintain effective internal controls, which could, in turn, increase operational risks for the Group. Ineffective management of operational risks could have a material adverse effect on the Group's business, financial condition and results of operations.

The Group's businesses and performance can be negatively affected by the performance of the UK economy as well as actual or perceived global economic and financial market conditions and other global risks and the Group will be increasingly impacted by developments in the UK as its operations become increasingly concentrated in the UK.

On completion of the restructuring of the RBS Group relating to the implementation of its strategic programme and the UK ring-fencing regime, the RBS Group's and the Group's business focus will be primarily in the UK and Western Europe. Although the prospects for the UK and the United States remain the strongest among the G7 in 2016, and Ireland's economy continues to improve, actual or perceived difficult global economic conditions, failure to meet economic growth projections, regulators' concerns relating to the UK buy-to-let market and possible restrictions on mortgage lending as well as increased competition, particularly in the UK, would create challenging economic and market conditions and a difficult operating environment for the Group's businesses.

In addition, the Group's businesses and many of its customers are, and will continue to be, affected by global economic conditions, perceptions of those conditions and future economic prospects, in particular insofar as they impact the UK economy. In Europe, a number of European economies have not yet recovered from the effects of the financial crisis and consensus forecasts of growth in 2016 and 2017 for some of the largest European economies such as France and Italy remain weak and the economic recovery of Greece and other European economies remains uncertain. As a result, concerns relating to sovereign default, exit or breakup of the eurozone, and the direct and indirect impact of such events on the UK and other European economies, remain acute.

The outlook for the global economy over the near to medium-term remains uncertain due to a number of factors including: major geopolitical instability, historically depressed oil and commodity prices, concerns around global growth and liquidity, uncertainty relating to the scope and timing of interest rate rises against a backdrop of historically high sovereign and household borrowing levels and stagnant inflation or deflation. In particular, slowing growth and high debt levels in emerging market economies to which the Group is exposed (including those economies to which the Group remains exposed pending the exit of certain of its business and which include China, India, Saudi Arabia and Russia) remains an area of concern and a further slowing of emerging country economic growth or recession, appreciation of the US dollar, new or extended economic sanctions or increased financing needs as existing debt matures, could impact the Group directly by resulting in credit losses and indirectly by further impacting global economic growth and financial markets.

Additional information

The UK economy and Group's businesses and performance are also affected by financial market conditions. Financial markets, in particular equity and commodity markets, experienced considerable volatility in late 2014 and in 2015 which has continued into 2016 and has translated in a downward trend in financial markets which has in turn resulted in significant value destruction.

These trends are attributable to many of the factors noted above as well as significant downward movements in world markets, especially China, and revised projections for Chinese and emerging market economic growth during the second half of 2015 and the beginning of 2016. Financial markets also were and will likely continue to be impacted by the uncertainty as to how economies and counterparties will be affected, directly or indirectly, by the impact and timing of monetary policy measures adopted by the Bank of England, the European Central Bank ("ECB"), the US Federal Reserve and other central banks, including the Bank of Japan. While the ECB has been implementing a quantitative easing programme since January 2015 designed to improve confidence in the eurozone and encourage more private bank lending, there remains considerable uncertainty as to whether such measures have been or will be sufficient or successful.

The challenging operating environment for the Group's businesses, created by uncertain economic and market conditions, is characterised by:

- prolonged periods of low interest rates resulting from ongoing central bank measures to foster economic growth which constrain, through margin compression and low returns on assets, the interest income earned by the Group;
- budgetary concerns affecting sovereign credit ratings and impacting consumer confidence and spending and business confidence;
- reduced activity levels, additional write-downs and impairment charges and lower profitability, which either alone or in combination with regulatory changes or the activities of other market participants may restrict the ability of the Group to access capital, funding and liquidity; and
- the risk of increased volatility in yields and asset valuations as central banks accelerate looser monetary policies (such as in Japan or Europe) or tighten or unwind historically unprecedented loose monetary policy or extraordinary measures (such as in the US).

Developments relating to current economic conditions in the UK and elsewhere and instability in financial markets, including those discussed above, could have a material adverse effect on the Group's business, financial condition, results of operations and prospects.

In addition, the Group is exposed to risks arising out of geopolitical events, such as trade barriers, exchange controls and other measures taken by sovereign governments that can hinder economic or financial activity levels. Furthermore, unfavourable political, military or diplomatic events, armed conflict, pandemics and terrorist acts and threats, and the responses to them by governments, could also adversely affect economic activity and have an adverse effect upon the Group's business, financial condition and results of operations.

Changes in interest rates, foreign exchange rates, credit spreads, bond, equity and commodity prices, basis, volatility and correlation risks and other market factors have significantly affected and will continue to affect the Group's business and results of operations.

Some of the most significant market risks that the Group faces are interest rate, foreign exchange, credit spread, bond, equity and commodity prices and basis, volatility and correlation risks. Monetary policy has been highly accommodative in recent years, including as a result of certain policies implemented by the Bank of England and HM Treasury such as the 'Funding for Lending' scheme, which have helped to support demand at a time of very pronounced fiscal tightening and balance sheet repair. There remains considerable uncertainty as to whether or when the Bank of England and other central banks will increase interest rates, following the US Federal Reserve's decision in December 2015 to raise US interest rates for the first time since 2006. A continued period of low interest rates and yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs, the effect of which may be heightened during periods of liquidity stress and adversely affect the Group's results of operations and profitability. Conversely, sudden rises in interest rates could lead to generally weaker than expected growth, or even contracting GDP, reduced business confidence, higher levels of unemployment or underemployment, adverse changes to levels of inflation, falling property prices in the UK housing market and elsewhere, and consequently to an increase in delinquency rates and default rates among customers. Similar risks result from the exceptionally low level of inflation in developed economies, which in Europe particularly could deteriorate into sustained deflation if policy measures prove ineffective. Reduced monetary stimulus and the actions and commercial soundness of other financial institutions have the potential to impact market liquidity. Any adverse impact on the credit quality of the Group's customers and other counterparties, coupled with a decline in collateral values, could lead to a reduction in recoverability and value of the Group's assets and higher levels of impairment allowances, which could have an adverse effect on the Group's operations, financial position or prospects.

Changes in currency rates, particularly in the sterling-euro exchange rates and sterling-US dollar exchange rates, affect the value of assets, liabilities, income and expenses denominated in foreign currencies and the reported earnings of the Group's non-UK subsidiaries and may affect the Group's reported consolidated financial condition. Such changes may result from the decisions of the ECB and of the US Federal Reserve and lead to sharp and sudden variations in foreign exchange rates, such as those seen in the GBP/USD exchange rates in 2015 and early 2016. For accounting purposes, the Group carries some of its issued debt, such as debt securities, at the current market price on its balance sheet. Factors affecting the current market price for such debt, such as the credit spreads of the Group, may result in a change to the fair value of such debt, which is recognised in the income statement as a profit or loss.

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The performance and volatility of financial markets affect bond and equity prices and have caused, and may in the future cause, changes in the value of the Group's investment and trading portfolios. Financial markets experienced significant volatility during 2015 and early 2016, following concerns about the political and economic recovery in Greece, volatility and instability in the Chinese and global stock markets and weakening fundamentals of the Chinese economy, resulting in further short-term changes in the valuation of certain of the Group's assets. In addition, oil prices continued to fall significantly against their historical levels during 2015 and early 2016 and remained at such low levels, and other commodity prices also decreased.

Any of the adverse developments noted above may also adversely impact the value of the Group's pension fund which may result in the Group being required to make additional contributions. See *"The RBS Group and the Group are subject to pension risks and may be required to make additional contributions to cover pension funding deficits and to restructure its pension schemes as a result of the implementation of the UK ring-fencing regime."*

The Group is subject to a number of legal, regulatory and governmental actions and investigations. Unfavourable outcomes in such actions and investigations could have a material adverse effect on the Group's operations, operating results, reputation, financial position and future prospects.

The operations of the Group and RBS Group are diverse and complex, and the Group and RBS Group operate in legal and regulatory environments that expose them to potentially significant litigation, civil and criminal regulatory and governmental investigations and other regulatory risk. The RBS Group and the Group have settled a number of legal and regulatory investigations over the past several years but continues to be, and may in the future be, involved in a number of legal and regulatory proceedings and investigations in the UK, the US, Europe and other jurisdictions.

The RBS Group, and with respect to certain matters, the Group or subsidiaries of the Group, are involved in ongoing reviews, investigations and proceedings (both formal and informal) by governmental law enforcement and other agencies and litigation (including class action litigation), relating to, among other matters, the offering of securities, conduct in the foreign exchange market, the setting of benchmark rates such as LIBOR and related derivatives trading, the issuance, underwriting, and sales and trading of fixed-income securities (including structured products and government securities), product mis-selling, customer mistreatment (including alleged mistreatment of small and medium enterprises by RBS's Global Restructuring Group, as alleged in the November 2013 report by Lawrence Tomlinson), anti-money laundering, sanctions, and various other compliance issues. In the US, ongoing matters include various civil and criminal federal and state investigations relating to the securitisation of mortgages, as well as the trading of various forms of asset-backed securities.

The RBS Group and the Group, where applicable, continue to cooperate with governmental and regulatory authorities in these and other investigations and reviews. For more detail on certain of the RBS Group's and the Group's ongoing legal, governmental and regulatory proceedings, see pages 159 to 169. Legal, governmental and regulatory proceedings and investigations are subject to many uncertainties, and their outcomes, including the timing and amount of fines or settlements, which may be material, are often difficult to predict, particularly in the early stages of a case or investigation.

Settlements, resolutions and outcomes in relation to ongoing investigations involving the RBS Group or the Group may result in material financial fines or penalties, non-monetary penalties, ongoing commitments, restrictions upon or revocation of regulatory permissions and licences and other collateral consequences and may prejudice both contractual and legal rights otherwise available to the Group and the outcome of on-going claims against the Group may give rise to additional legal claims being asserted against the Group, any of which outcomes could materially adversely impact the Group's capital position and prospects. Monetary penalties and other outcomes could be materially in excess of provisions, if any, made by the Group. The adverse resolution of proceedings against the RBS Group, including the imposition of large monetary penalties or fines, may adversely affect the Bank or its subsidiaries by impacting investor and counterparty confidence in the Group by association with RBS Group and impact the Group's ability to fund itself including due to reduced deposits and the RBS Group may no longer be able to extend intra-group funding to the Group. It is expected that the RBS Group and the Group will continue to have a material exposure to litigation and governmental and regulatory proceedings and investigations relating to legacy issues in the medium term. Adverse outcomes or resolution of current or future regulatory, governmental or law enforcement proceedings or adverse judgements in litigation against the RBS Group or the Group could result in restrictions or limitations on the Group's operations or have a material adverse effect on the Group's reputation, results of operations, capital position and prospects.

The RBS Group or the Group may be required to make new or increase existing provisions in relation to existing or future legal proceedings, investigations and governmental and regulatory matters which may be substantial, including with respect to current matters in relation to which the RBS Group and/or the Group have not yet recognised legal provisions. In 2015, the RBS Group booked a provision of £334 million in respect of foreign exchange trading-related investigations. In 2015 the RBS Group booked an additional £2.1 billion related principally to mortgage-backed securities ("MBS") litigation in the US (resulting in total provisions made for this matter of £3.8 billion, of which £0.1 billion had been utilised at 31 December 2015). No provisions have been made in relation to resolving the ongoing US Department of Justice and various US State Attorneys General investigations into MBS-related conduct matters.

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The costs of resolving these investigations and the costs (beyond existing provisions) of resolving MBS litigation in the US could individually or in aggregate prove to be substantial. The RBS Group also booked in 2015 additional provisions of £600 million for Payment Protection Insurance, resulting in total provisions made for this matter of £4.3 billion, of which £3.3 billion had been utilised by 31 December 2015 and there remains a risk of future provisions and costs. The provision for interest rate hedging products redress and administration costs was also increased by £68 million (net of releases) in 2015, with total provisions relating to this matter totalling £1.5 billion, of which £1.35 billion had been utilised at 31 December 2015. The costs of resolving these or other investigations and legal proceedings (beyond existing provisions, if any) could individually or in aggregate prove to be substantial. Significant new provisions or increases in existing provisions relating to legal proceedings, investigations and governmental and regulatory matters may have a material adverse effect on the Group's financial condition and results of operations as well as its reputation.

Pursuant to the State Aid Commitment Deed and its strategic programme, the RBS Group is in the process of separating Williams & Glyn with a view to fully divesting the business by the end of 2017. The scale and complexity of this process and the diversion of RBS Group or Group resources required to support it, or delays in meeting the divestment deadline, could have a material adverse effect on the Group's operations, operating results, financial position and reputation.

The RBS Group has met all of the divestment commitments contained within the set of conditions upon which state aid approval was received from the European Commission for the financial assistance provided to the Group by the UK Government in December 2008, save for the divestment of the RBS Group's RBS branches in England and Wales, the Group's NatWest branches in Scotland, Direct SME banking and certain mid-corporate customers as a separate business under the Williams & Glyn brand ("Williams & Glyn"). In connection with the receipt of such aid, the RBS Group entered into a state aid commitment deed with HM Treasury (as amended from time to time, the "State Aid Commitment Deed"). In light of its obligations under the State Aid Commitment Deed to fully divest Williams & Glyn by the end of 2017, the RBS Group has been actively seeking to fully divest Williams & Glyn in accordance with this timetable. Due to significant execution challenges, the separation of the Williams & Glyn business from the RBS Group will now not be until after Q1 2017, as previously announced.

The RBS Group remains committed to full divestment by the end of 2017, although it continues to face significant challenges and risks in separating the Williams & Glyn business, some of which may only emerge as various separation process phases are progressed.

The complexities or delays in separation may impact the RBS Group's ability to meet the divestment deadline and could result in the Group adopting an alternative divestment structure to either of the current plans for divestment.

There is potential for non-compliance if the RBS Group fails to meet this deadline, which might result in the RBS Group breaching the terms of the State Aid Commitment Deed and might constitute a misuse of state aid. In such circumstances, a divestiture trustee may be appointed, with the mandate to complete the disposal at no minimum price. This may adversely affect the attractiveness of, and result in additional execution risks in respect of the sale of, Williams & Glyn.

Furthermore, a failure to comply with the terms of the State Aid Commitment Deed could result in the imposition of additional remedies or limitations on the RBS Group's operations, additional supervision by the RBS Group's regulators, and loss of investor confidence, any of which could have a material adverse impact on the RBS Group, and as a result, could adversely affect the Group. Delays in execution may also impact the RBS Group's ability to carry out its strategic programme and implement mandatory regulatory requirements, including the UK ring fencing regime, with which the Group is also required to comply. Such risks will increase in line with any additional delays.

The availability and interest of buyers or investors for Williams & Glyn or the ability of the RBS Group to divest the business on commercially attractive terms is not certain. In particular, Williams & Glyn is a complex business and unforeseen difficulties in integrating the business with that of any buyer could deter potential buyers from bidding for the business or completing the sale. In addition, the number of potential bidders with synergy potential or strategic interests may be limited and such investors may value the business below what the RBS Group considers to be the fair value of the Williams & Glyn business.

The divestment of the Williams & Glyn business from the RBS Group, including the separation of some of the Group's operations, requires significant structural, governance and IT changes, which are complex to implement and will impact the RBS Group's and Group's customers, operations and controls. In particular, a key component of the current separation plan is the successful migration of the Williams & Glyn business to a stand-alone and operational technology platform. Given the current interconnectedness of the Williams & Glyn business and other parts of the RBS Group and the Group and in order to seek to meet the deadlines for divestment, this process will necessarily divert management and personnel resources from the effective conduct of the RBS Group's and the Group's operations and jeopardise the delivery and implementation of a number of other significant change projects resulting from mandatory regulatory developments or as part of its strategic programme. In addition, the execution of the separation and divestment will result in significant costs. There are currently approximately 6,000 employees (FTE) engaged on the project and total costs incurred to 31 December 2015 relating to the separation and divestment of Williams & Glyn were £1.2 billion and are expected to increase through to completion. Although the RBS Group is committed to achieving the separation and divestment in the most cost-efficient manner, due to unforeseen complexities and factors outside of the RBS Group's control, costs could be materially higher than currently contemplated.

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Furthermore, an essential precondition for a trade sale or IPO of Williams & Glyn will be the granting of a banking licence by the PRA, an application for which was submitted in September 2015, which in turn will depend, among other things, on demonstrating progress on the separation. Delays in obtaining the licence may impact the sale process and buyer confidence or the RBS Group's ability to meet the prescribed deadlines for divestment. As a direct consequence of the divestment of Williams & Glyn, the RBS Group and the Group will lose existing customers, deposits and other assets. They may also lose the potential for realising additional associated revenues and margins, or cost savings that they otherwise might have achieved. The RBS Group will also be unable to fully reduce its shared central costs in proportion to the scale of reduction in income resulting from the divestment of Williams & Glyn. The RBS Group's financial condition may also be exposed to risk with respect to the control, management and results of operations of Williams & Glyn during a transitional period. The divestment may also have a negative impact on the RBS Group's or the Group's competitive position, including through the emergence of a new competitor. Depending on the form in which Williams & Glyn is divested, the RBS Group or the Group may agree or be required to provide services for, or other forms of support (financial or otherwise) to, Williams & Glyn, which may result in reputational and financial exposure for the RBS Group or the Group and may require significant attention from the RBS Groups or the Group's senior management, in particular in respect of managing conflicts of interests and confidentiality of data.

The Group's businesses are subject to substantial regulation and oversight. Significant regulatory developments and increased scrutiny by the Group's key regulators has had and is likely to continue to increase compliance and conduct risks and could have a material adverse effect on how the Group conducts its business and on its results of operations and financial condition.

The Group is subject to extensive financial services laws, regulations, corporate governance requirements, administrative actions and policies in each jurisdiction in which it operates. Many of these have been introduced or amended recently and are subject to further material changes. Among others, the adoption of rules relating to the UK ring-fencing regime, prohibitions on proprietary trading, the entry into force of CRD IV and the BRRD and certain other measures in the UK and the EU are considerably affecting the regulatory landscape in which the Group operates and will operate in the future. Increased regulatory focus in certain areas, including conduct, consumer protection regimes, anti-money laundering and antiterrorism laws and regulations, as well as the provisions of applicable sanctions programmes and ongoing and possible future changes in the financial services regulatory landscape (including requirements imposed by virtue of the Group's participation in government or regulator-led initiatives), have resulted in the Group facing greater regulation and scrutiny in the UK and other countries in which it operates.

Although it is difficult to predict with certainty the effect that the recent regulatory changes, developments and heightened levels of public and regulatory scrutiny will have on the Group, the enactment and implementation of legislation and regulations in the UK, the US and the other jurisdictions in which the Group operates has resulted in increased capital, funding and liquidity requirements, changes in the competitive landscape, changes in other regulatory requirements and increased operating costs, and has impacted, and will continue to impact, product offerings and business models.

Such changes may also result in an increased number of regulatory investigations and proceedings and have increased the risks relating to the Group's ability to comply with the applicable body of rules and regulations in the manner and within the time frames required. Changes in accounting standards or guidance by internal accounting bodies or in the timing of their implementation, whether mandatory or as a result of recommended disclosure relating to the future implementation of such standards could also result in the Group having to recognise additional liabilities on its balance sheet, or in further write-downs or impairments. Any of these developments (including failures to comply with new rules and regulations) could have an impact on how the Group conducts its business, its authorisations and licences, the products and services it offers, its reputation and the value of its assets, and could have a material adverse effect on its business, funding costs and results of operations and financial condition.

Areas in which, and examples of where, governmental policies, regulatory and accounting changes and increased public and regulatory scrutiny could have an adverse impact (some of which could be material) on the Group include those set out above as well as the following:

- amendments to the framework or requirements relating to the quality and quantity of regulatory capital to be held by the RBS Group or the Group, either on a solo, consolidated or subgroup level, including amendments to the rules relating to the calculation of risk-weighted assets and reliance on credit ratings as well as tax rules affecting the eligibility of deferred tax assets;
- new or amended regulations or taxes that reduce profits attributable to shareholders which may diminish, or restrict, the accumulation of the distributable profits or distributable items necessary to make distributions or coupon payments;
- the design and implementation of national or supranational mandated recovery, resolution or insolvency regimes or the implementation of additional or conflicting loss-absorption requirements, including those mandated under MREL or by the Financial Stability Board's recommendations on TLAC;
- the monetary, fiscal, interest rate and other policies of central banks and other governmental or regulatory bodies;
- further investigations, proceedings or fines either against the Group in isolation or together with other large financial institutions with respect to market conduct wrongdoing;

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- the imposition of government-imposed requirements and/or related fines and sanctions with respect to lending to the UK SME market and larger commercial and corporate entities and residential mortgage lending; additional rules and regulatory initiatives and review relating to customer protection, including the FCA's Treating Customers Fairly regime and increased focus by regulators on how institutions conduct business, particularly with regard to the delivery of fair outcomes for customers and orderly/transparent markets;
- the imposition of additional restrictions on the Group's ability to compensate its senior management and other employees and increased responsibility and liability rules applicable to senior and key employees;
- regulations relating to, and enforcement of, anti-bribery, anti-money laundering, anti-terrorism or other similar sanctions regimes;
- rules relating to foreign ownership, expropriation, nationalisation and confiscation of assets;
- changes to financial reporting standards (including accounting standards) and guidance or the timing of their implementation;
- changes to risk aggregation and reporting standards;
- changes to corporate governance requirements, corporate structures and conduct of business rules;
- competition reviews and investigations relating to the retail banking sector in the UK, including with respect to SME banking and PCAs;
- financial market infrastructure reforms in the EU establishing new rules applying to investment services, short selling, market abuse and investment funds;
- increased attention to competition and innovation in UK payment systems following the establishment of the new Payments Systems Regulator and developments relating to current European proposals for a directive on payment services;
- restrictions on proprietary trading and similar activities within a commercial bank and/or a group;
- the introduction of, and changes to, taxes, levies or fees applicable to the Group's operations, such as the imposition of a financial transaction tax, changes in tax rates, the introduction of the bank corporation surcharge of 8% which came into effect on 1 January 2016 or changes to the treatment of carry-forward tax losses that reduce the value of deferred tax assets and require increased payments of tax;
- investigations into facilitation of tax evasion or the creation of new civil or criminal offences relating thereto;
- the regulation or endorsement of credit ratings used in the EU (whether issued by agencies in EU member states or in other countries, such as the US); and
- other requirements or policies affecting the Group's profitability, such as the imposition of onerous compliance obligations, further restrictions on business growth, product offering, or pricing.

Changes in laws, rules or regulations, or in their interpretation or enforcement, or the implementation of new laws, rules or regulations, including contradictory laws, rules or regulations by key regulators in different jurisdictions, or failure by the Group to comply with such laws, rules and regulations, may have a material adverse effect on the Group's business, financial condition and results of operations.

In addition, uncertainty and lack of international regulatory coordination as enhanced supervisory standards are developed and implemented may adversely affect the Group's ability to engage in effective business, capital and risk management planning.

The RBS Group is currently implementing a number of significant investment and rationalisation initiatives as part of the RBS Group's IT investment programme. Should such investment and rationalisation initiatives fail to achieve the expected results, it could have a material adverse impact on the Group's operations and its ability to retain or grow its customer business and could require the Group to recognise impairment charges.

The RBS Group's strategic programme to simplify and downsize the RBS Group with an increased focus on service to its customers involves significant investments in technology and more efficient support functions intended to contribute to delivering significant improvements in the RBS Group's Return on Equity and cost-to-income ratio in the longer term as well as improve the resilience, control environment, accessibility and product offering of the RBS Group, including the Group. The RBS Group has an IT transformational budget of around £4 billion (which excludes IT expenditure and costs relating to the implementation of the UK ring-fencing regime and the Williams & Glyn separation) to be spent from 2015 to 2017. At 31 December 2015, £1.2 billion of this budget had already been spent, and the budget for 2016 and 2017 is now higher than previously estimated as business plans have developed.

This investment in the RBS Group's IT capability will be used to further simplify and upgrade its (including the Group's) IT systems and capabilities to make them more cost-effective and improve controls and procedures, enhance the digital services provided to its bank customers and address system failures which adversely affect its relationship with its customers and reputation and may lead to regulatory investigations and redress.

As with any project of comparable size and complexity, there can be no assurance that the RBS Group will be able to implement all of the initiatives forming part of its IT investment programme, on time or at all, and it may experience unexpected cost increases and delays. This is especially true in light of the separation of the Williams & Glyn business which requires the delivery of a stand-alone IT platform for the separated business, and the focus on meeting this requirement may limit the RBS Group's capacity and resources to implement the planned changes to the Group IT infrastructure while the separation work is ongoing. Any failure by the RBS Group to implement or realise the benefits of its IT investment programme, whether on time or at all, could have a material adverse effect on the Group's business, results of operations and its ability to retain or grow its customer business.

Additional information

The Group's operations are highly dependent on its and the RBS Group's IT systems. A failure of the RBS Group's or the Group's IT systems could adversely affect its operations and investor and customer confidence and expose the Group to regulatory sanctions.

The Group's operations are dependent on the ability to process a very large number of transactions efficiently and accurately while complying with applicable laws and regulations where it does business. The proper functioning of the Group's payment systems, financial and sanctions controls, risk management, credit analysis and reporting, accounting, customer service and other IT systems, as well as the communication networks between its branches and main data processing centers, are critical to the Group's operations.

The vulnerabilities of the Group's IT systems are due to their complexity, attributable in part to overlapping multiple legacy systems resulting from the RBS Group's historical acquisitions and insufficient investment prior to 2013, creating challenges in recovering from system breakdowns. IT failures adversely affect the Group's relationship with its customers and reputation and have led, and may in the future, lead to regulatory investigations and redress. The Group experienced system failures in 2012, as a result of which the Group was required to set aside a provision for compensation to customers who suffered losses as a result of the system failure and that resulted in the Group reaching a settlement with the FCA, the PRA and the Central Bank of Ireland and paying related fines. The Group experienced a limited number of IT failures in 2015 affecting customers, although improvements introduced since 2012 allowed the Group to contain the impact of such failures. The Group's regulators in the UK are actively surveying progress made by banks in the UK to modernise, manage and secure their IT infrastructures, in order to prevent future failures affecting customers. Any critical system failure, any prolonged loss of service availability or any material breach of data security could cause serious damage to the Group's ability to service its customers, could result in significant compensation costs or fines resulting from regulatory investigations and could breach regulations under which the Group operates. In particular, failures or breaches resulting in the loss or publication of confidential customer data could cause long-term damage to the Group's reputation, business and brands, which could undermine its ability to attract and keep customers.

The RBS Group is currently implementing a significant IT investment programme. A failure to safely and timely implement one or several of these initiatives could lead to disruptions of the Group's IT infrastructure and in turn cause long-term damage to the Group's reputation, brands, results of operations and financial position. See *"The RBS Group is currently implementing a number of significant investment and rationalisation initiatives as part of the RBS Group's IT investment programme. Should such investment and rationalisation initiatives fail to achieve the expected results, it could have a material adverse impact on the Group's operations and its ability to retain or grow its customer business and could require the Group to recognise impairment charges."*

The Group is exposed to cyberattacks and a failure to prevent or defend against such attacks could have a material adverse effect on the Group's operations, results of operations or reputation.

The RBS Group and the Group are subject to cybersecurity threats which have regularly targeted financial institutions as well as governments and other institutions and have increased in frequency and severity in recent years. The Group relies on the effectiveness of its internal policies and associated procedures, infrastructure and capabilities to protect the confidentiality, integrity and availability of information held on its computer systems, networks and mobile devices, and on the computer systems, networks and mobile devices of third parties on whom the Group relies.

The Group also takes measures to protect itself from attacks designed to prevent the delivery of critical business processes to its customers. Despite these preventative measures, the RBS Group's and the Group's computer systems, software, networks and mobile devices, and those of third parties on whom the Group relies, are vulnerable to cyberattacks, sabotage, unauthorised access, computer viruses, worms or other malicious code, and other events that have a security impact.

Failure to protect the Group's operations from cyberattacks or to continuously review and update current processes in response to new threats could result in the loss of customer data or other sensitive information as well as instances of denial of service for the Group's customers. During 2015, the Group experienced a number of distributed denial of service ("DDoS") attacks, one of which had a temporary impact on some of its web services, as well as a smaller number of malware attacks. The Bank of England, the FCA and HM Treasury in the UK and regulators, in the US and in Europe have identified cybersecurity as a systemic risk to the financial sector and highlighted the need for financial institutions to improve resilience to cyberattacks and the Group expects greater regulatory engagement, supervision and enforcement on cybersecurity in the future. The Group participated in the Bank of England's industry-wide exercise in 2015 to test how a major firm responds to significant cyberattacks against its critical economic functions.

The outputs of this exercise and other regulatory and industry-led initiatives are being incorporated into the Group's on-going IT priorities and improvement measures. The Group expects that it and the RBS Group will be the target of continued attacks in the future and there can be no assurance that the Group will be able to prevent all threats. Any failure in the Group's cybersecurity policies, procedures or capabilities, or cyber-related crime, could lead to the Group suffering reputational damage and a loss of customers, regulatory investigations or sanctions being imposed and could have a material adverse effect on the Group's results of operations, financial condition or prospects.

Additional information

The Group's operations entail inherent reputational risk.

Reputational risk, meaning the risk of brand damage and/or financial loss due to a failure to meet stakeholders' expectations of the Group's conduct, performance and business profile, is inherent in the Group's business. Stakeholders include customers, investors, rating agencies, employees, suppliers, governments, politicians, regulators, special interest groups, consumer groups, media and the general public.

Brand damage can be detrimental to the business of the Group in a number of ways, including its ability to build or sustain business relationships with customers, low staff morale, regulatory censure or reduced access to, or an increase in the cost of, funding. In particular, negative public opinion resulting from the actual or perceived manner in which the Group or any member of the RBS Group conducts its business activities and operations, financial performance, ongoing investigations and proceedings and the settlement of any such investigations and proceedings, IT failures or cyber-attacks resulting in the loss or publication of confidential customer data or other sensitive information, the level of direct and indirect government support, or actual or perceived practices in the banking and financial industry may adversely affect the Group's ability to keep and attract customers and, in particular, corporate and retail depositors. Modern technologies, in particular online social networks and other broadcast tools which facilitate communication with large audiences in short time frames and with minimal costs, may also significantly enhance and accelerate the impact of damaging information and allegations.

Reputational risks may also be increased as a result of the restructuring of the RBS Group to implement its strategic programme and the UK ring-fencing regime, which could, in turn, have an adverse effect on the Group. Although the RBS Group has implemented a Reputational Risk Policy across customer-facing businesses (including those of the Group) to improve the identification, assessment and management of customers, transactions, products and issues which represent a reputational risk, the Group cannot ensure that it will be successful in avoiding damage to its business from reputational risk, which could result in a material adverse effect on the Group's business, financial condition, results of operations and prospects.

The Group's business performance and financial position could be adversely affected if its or the RBS Group's capital is not managed effectively or if it or the RBS Group is unable to meet its capital targets.

Effective management of the RBS Group's and the Group's capital is critical to their ability to operate their businesses, comply with regulatory obligations and pursue the RBS Group's strategy of returning to standalone strength, resume dividend payments on its ordinary shares and maintain discretionary payments.

The RBS Group and the Group (on a standalone basis) are required by regulators in the UK, the EU and other jurisdictions in which they undertake regulated activities to maintain adequate capital resources. Adequate capital also gives the RBS Group and the Group financial flexibility in the face of continuing turbulence and uncertainty in the global economy and specifically in its core UK and European markets. On a fully loaded basis, the RBS Group's and the Bank's CET1 ratio was 15.5% and 11.6%, respectively, at 31 December 2015.

During the restructuring period and until the implementation of the UK ring-fencing regime in 2019, the RBS Group has lifted its capital targets and currently aims to have a CET1 ratio at or over 13%. The RBS Group plans capital levels for RBS Group and RBS Group entities, including the Group and the Bank based on regulatory requirements and additional internal modelling and stress scenarios.

However, the RBS Group's or the Group's ability to achieve such targets depends on a number of factors, including the implementation of the RBS Group's strategic programme and any of the factors described below. A shortage of capital could arise from:

- a depletion of the RBS Group's or the Group's capital resources through increased costs or liabilities (including pension, conduct, litigation and legacy costs), reduced profits or losses (and therefore retained earnings) or reduced asset values resulting in write-downs or impairments;
- an increase in the amount of capital that is needed to be held, including as a result of changes to the actual level of risk faced by the RBS Group or the Group, changes in the minimum levels of capital or liquidity required by legislation or by the regulatory authorities or the calibration of capital or leverage buffers applicable to the RBS Group or the Group, including countercyclical buffers, increases in risk-weighted assets or in the risk weighting of existing asset classes or an increase in the RBS Group's view of the management buffer it should hold taking account of, for example, the capital levels or capital targets of the RBS Group's peer banks or through the changing views of rating agencies.

In addition, the RBS Group's capital requirements, determined either as a result of regulatory requirements or management targets, may impact the level of capital required to be held by the Group and as part of its capital management strategy, the RBS Group may decide to impose higher capital levels to be held by the Bank or the Group.

The RBS Group's and the Group's current capital strategy is based on the expected accumulation of additional capital through the accrual of profits over time and/or through the planned reduction of its risk-weighted assets through disposals or natural attrition, the execution of which is subject to operational and market risks. Further losses or a failure by the Group to meet profitability targets or reduce risk-weighted assets in accordance with or within the timeline contemplated by the RBS Group's capital plan, combined with a depletion of its capital resources or an increase in the amount of capital it needs to hold (including as a result of the reasons described above), would adversely impact the Group's ability to meet its capital targets or requirements and achieve its capital strategy.

Additional information

If circumstances were to result in the RBS Group or the Group having or being perceived to have a shortage of capital as a result of any of the circumstances described above, then the RBS Group may be subject to regulatory interventions and sanctions and may suffer a loss of confidence in the market with the result that access to liquidity and funding may become constrained or more expensive. This may also trigger the implementation of its capital recovery plans.

This, in turn, may affect the RBS Group's or the Group's capacity to continue its business operations or pursue strategic opportunities, impacting future growth potential, or impede the RBS Group's ability to pay future dividends and make other distributions (including coupons on capital instruments). If, in response to such shortage, the RBS Group is required to convert certain regulatory capital instruments into equity or raises additional capital through the issuance of share capital or regulatory capital instruments, existing RBSG shareholders may experience a dilution of their holdings. Separately, the RBS Group may address a shortage of capital by taking action to reduce leverage and/or risk-weighted assets, by modifying the RBS Group's legal entity structure or by asset or business disposals. Such actions may adversely affect the Group results of operations, financial position or prospects.

Failure by the RBS Group or the Group to comply with regulatory capital and leverage requirements may result in intervention by their regulators and loss of investor confidence, and may have a material adverse effect on the Group's results of operations, financial condition and reputation.

The RBS Group and, where applicable RBS Group entities, including the Group, are subject to extensive regulatory supervision in relation to the levels and quality of capital they must hold, including as a result of the transposition of the Basel Committee on Banking Supervision's regulatory capital framework ("Basel III") in Europe by a Directive and Regulation (collectively known as "CRD IV"). In addition, the RBS Group has been identified as a global systemically important bank ("GSIB") by the Financial Stability Board ("FSB") and is therefore subject to more intensive oversight and supervision by its regulators as well as additional capital requirements, although in the FSB's most recent annual list of GSIBs published in November 2015, the RBS Group was moved down to the last bucket, meaning that it will be subject to the lowest level of additional loss-absorbing capital requirements. Each business within the RBS Group, including the Group, is subject to performance metrics respecting regulatory capital requirements to ensure that relevant Individual Capital Guidance or minimum CET1 levels are met.

Under CRD IV, the RBS Group is required, on a consolidated basis, to hold at all times a minimum amount of regulatory capital calculated as a percentage of risk-weighted assets ("Pillar 1 requirement"). CRD IV also introduced six new capital buffers that are in addition to the Pillar 1 and Pillar 2A requirements (as described below) and are required to be met with CET1 capital. In December 2015, the Bank of England published a report on the framework of capital requirements for UK banks, which outlines the expectation that capital buffers be used actively by the regulator to serve a macro-prudential purpose.

The combination of the capital conservation buffer (which, subject to transitional provisions, will be set at 2.5% from 2019), the countercyclical capital buffer (of up to 2.5%) and the higher of (depending on the institution) the systemic risk buffer, the global systemically important institutions buffer ("GSIB Buffer") and the other systemically important institutions buffer, is referred to as the "combined buffer requirement".

These rules entered into force on 1 May 2014 for the countercyclical capital buffer and on 1 January 2016 for the capital conservation buffer and the GSIB buffer. The GSIB buffer is currently set at 1.5% for the RBS Group, but will reduce to 1.0% on 1 January 2017, and is being phased in over the period from 1 January 2017 to 1 January 2019. The systemic risk buffer will be applicable from 1 January 2019. The Bank of England's Financial Policy Committee (the "FPC") is responsible for determining which institutions should hold the systemic risk buffer, and if so, how large the buffer should be up to a maximum of 3% of a firm's risk-weighted assets. The FPC is currently consulting on the proposed framework for the systemic risk buffer, with final rules to be finalised by 31 May 2016. The systemic risk buffer is part of the UK framework for identifying and setting higher capital buffers for domestic systemically important banks ("D-SIBs"), which are groups that, upon distress or failure, could have an important impact on their domestic financial systems. The Group expects that it may be designated as a D-SIB. This follows on 2012 framework recommendations by the FSB that national authorities should identify D-SIBs and take measures to reduce the probability and impact of the distress or failure of D-SIBs. In addition, national supervisory authorities may add extra capital requirements (the "Pillar 2A requirements") to cover risks that they believe are not covered or insufficiently covered by Pillar 1 requirements.

The RBS Group's current Pillar 2A requirement set by the PRA is set at an equivalent of 5.0% of risk-weighted assets. The PRA has also introduced a firm specific Pillar 2B buffer ("PRA buffer") which is a forward-looking requirement set annually and based on various factors including firm-specific stress test results and credible recovery and resolution planning and is to be met with CET1 capital (in addition to any capital used to meet any Pillar 1 or Pillar 2A requirements). Where appropriate, the PRA may require an increase in an institution's PRA Buffer to reflect additional capital required to be held to mitigate the risk of additional losses that could be incurred as a result of weak risk management and governance, including with respect to the effectiveness of the internal stress testing framework and control environment. UK banks are required to meet the higher of the combined buffer requirement or PRA buffer requirement. The Pillar 2A requirements and the PRA buffer will result in the setting of a fixed amount of CET1 capital which must be held by the RBS Group and may change during the period of restructuring of the RBS Group, while risk-weighted assets are expected to continue to reduce during the same period, which will in turn put pressure on the RBS Group's ability to maintain its capital ratio targets and implement its distribution strategy.

Additional information

In addition to capital requirements and buffers, the new regulatory framework adopted under CRD IV, as transposed in the UK, sets out minimum leverage ratio requirements for financial institutions. The FPC has directed the PRA to implement: (i) a minimum leverage requirement of 3% which applies to major UK banks, (ii) an additional leverage ratio to be met by GSIBs and ring-fenced institutions to be calibrated at 35% of the relevant firm's systemic risk capital buffer and which is being phased in from 2016 and (iii) a countercyclical leverage ratio buffer for all firms subject to the minimum leverage ratio requirements which is calibrated at 35% of a firm's countercyclical capital buffer.

Most of the capital requirements which apply or will apply to the RBS Group or to the Group (directly or indirectly as a result of RBS Group internal capital management) will need to be met in whole or in part with CET1 capital. CET1 capital broadly comprises retained earnings and equity instruments, including ordinary shares. As a result, the RBS Group may be required to issue additional ordinary shares in order to maintain or increase its CET1 capital if its retained earnings from the profits of its operations are insufficient, which could result in the dilution of RBS Group existing shareholders.

Further, under the provisions of CRD IV Regulation, deferred tax assets that rely on future profitability (for example, deferred tax assets related to trade losses) and do not arise from temporary differences, must be deducted in full from CET1 capital. Other deferred tax assets which rely on future profitability and arise from temporary differences are subject to a threshold test and only the amount in excess of the threshold is deducted from CET1 capital. The regulatory treatment of such deferred tax assets may change and adversely impact the RBS Group's or the Group's CET1 capital and related ratios.

The Basel Committee and other agencies remain focussed on changes that will increase, or recalibrate, measures of risk-weighted assets as the key measure of the different categories of risk in the denominator of the risk-based capital ratio. While they are at different stages of maturity, a number of initiatives across risk types and business lines are in progress that are expected to impact the calculation of risk-weighted assets. The Basel Committee is currently consulting on new rules relating to the risk weighting of real estate exposures and other changes to risk-weighting calculations. These rules are expected to be finalised later in 2016 and come into force by 2019. In the UK, the PRA is also considering ways of reducing the sensitivity of UK mortgage risk weights to economic conditions. The 2014 UK stress test demonstrated that the risk weights on some banks' residential mortgage portfolios can increase significantly in stressed conditions.

The Basel Committee also recently published for consultation a revised standardised measurement approach for operational risk. The new approach would replace the three existing standardised approaches for calculating operational risk, as well as the internal model-based approach. The proposed new methodology combines a financial statement-based measure of operational risk, with an individual firm's past operational losses.

While the quantum of impact of these reforms remains uncertain owing to lack of clarity of the proposed changes and the timing of their introduction, the implementation of such initiatives could result in higher levels of risk-weighted assets and therefore higher levels of capital, and in particular CET1 capital, required to be held by the RBS Group or the Group under Pillar 1 requirements. Such requirements would be separate from any further capital overlays required to be held as part of the PRA's determination of the RBS Group's Pillar 2A or PRA Buffer requirements with respect to such exposures.

If the RBS Group is unable to raise the requisite amount of regulatory capital, or if the RBS Group or the Group otherwise fail to meet regulatory capital and leverage requirements, they may be exposed to increased regulatory supervision or sanctions, loss of investor or customer confidence, restrictions on distributions or may be required to reduce further the amount of their risk-weighted assets or total assets and engage in the disposal of core and other non-core businesses, which may not occur on a timely basis or achieve prices which would otherwise be attractive to the RBS Group or the Group. A breach of the RBS Group's applicable capital or leverage requirements may also trigger the application of the RBS Group's recovery plan to remediate a deficient capital position. Any of these developments, including the failure by the RBS Group to meet its regulatory capital and leverage requirements, may have a material adverse impact on the Group's capital position, operations, reputation or prospects.

The RBS Group is subject to stress tests mandated by its regulators in the UK and in Europe which may result in additional capital requirements which, in turn, may impact the RBS Group's and the Group's financial condition, results of operations and investor confidence or result in restrictions on distributions.

The RBS Group is subject to stress tests by its regulator in the UK and by the European regulators with respect to RBS NV and Ulster Bank. The results of the 2015 Bank of England stress tests showed that RBS Group's capital position remained above the Pillar 1 minimum capital requirements of 4.5% and met the leverage ratio of 3.0% in the hypothetical stress scenario. Although the PRA judged that the RBS Group did not meet its CET1 individual capital guidance after management actions in this scenario, in light of past and future plans to improve its capital position, the PRA did not require the RBS Group to submit a revised capital plan. In October 2015, the Bank of England published its approach to stress testing for the UK banking system applicable until 2018. The results of these tests will be used by the FPC and the PRA, alongside other inputs, to set the level of a financial institution's capital buffers, in particular the capital conservation buffer, countercyclical buffer and the PRA buffer.

The PRA will also use the stress test results to inform its determination of whether banks' current capital positions are adequate or need strengthening. For some banks, their individual stress-test results might imply that the capital conservation buffer and countercyclical rates set for all banks is not consistent with the impact of the stress on them. In that case, the PRA can increase regulatory capital buffers for individual banks by adjusting their PRA buffers.

Additional information

In addition, if the stress tests reveal that a bank's existing regulatory capital buffers are not sufficient to absorb the impact of the stress, it is possible that it will need to take action to strengthen its capital position. There is a strong presumption that the PRA would require a bank to take action if, at any point during the stress, a bank were projected to breach any of its minimum CET1 capital or leverage ratio requirements. However, if a bank is projected to fail to meet its systemic buffers, it will still be expected to strengthen its capital position over time but the supervisory response is expected to be less intensive than if it were projected to breach its minimum capital requirements.

Failure by the RBS Group to meet the thresholds set as part of the stress tests carried out by its regulators in the UK and elsewhere may result in the RBS Group's regulators requiring the RBS Group to hold additional capital (which may, in turn, result the Group being required to hold additional capital), increased supervision and/or regulatory sanctions, restrictions on capital distributions and loss of investor confidence, which may impact the RBS Group's or the Group's financial condition, results of operations and prospects.

As a result of extensive reforms being implemented within the EU and the UK relating to the resolution of financial institutions, additional requirements will arise to ensure that financial institutions maintain sufficient loss-absorbing capacity. Such changes to the funding and regulatory capital framework may require the RBS Group to meet higher funding levels than anticipated within the RBS Group's strategic plans and affect the RBS Group's and the Group's funding costs.

In addition to the capital and leverage requirements under CRD IV, the EU Bank Recovery and Resolution Directive ("BRRD") introduces, among other things, a requirement for banks to maintain at all times a sufficient aggregate amount of own funds and "eligible liabilities" (that is, liabilities that can absorb loss and assist in recapitalising a firm in accordance with a predetermined resolution strategy), known as the minimum requirements for eligible liabilities ("MREL"), designed to ensure that the resolution of a financial institution may be carried out, without public funds being exposed to the risk of loss and in a way which ensures the continuity of critical economic functions, maintains financial stability and protects depositors. MREL is being implemented as part of the resolution planning process and not as a separate or additional capital requirement under Basel III. Indeed, if a bank's resolution plans are not deemed sufficient, the regulator can require it to carry higher MREL over and above regulatory minima and potentially higher than its peers. Certain capital resources required under CRD IV and associated institution-specific capital requirements set by the PRA or FCA may count toward meeting MREL, but the PRA has indicated its intention to prohibit certain double-counting of existing capital resources. In particular, CET1 capital used to meeting a financial institution's risk-weighted or leverage buffer requirements may not count towards meeting MREL requirements. As a result, the RBS Group may be required to issue additional instruments in the form of CET1 capital or subordinated or senior unsecured debt instruments and may result in an increased risk of a breach of the RBS Group's combined buffer requirement, triggering the restrictions relating to the MDA described above.

In addition to the requirements described above, the FSB published in November 2015 a final term sheet setting out its total loss-absorbing capacity ("TLAC") standards for global systemically important banks ("G-SIBs"). Although the Bank of England has indicated that it would use its powers to set MRELS for G-SIBs to implement the FSB's TLAC standards, the TLAC and MREL requirements differ in a number of ways. The EBA is mandated to assess the implementation of MREL in the European Union and the consistency of MREL with the final TLAC standards in a report required by October 2016.

This may result in the European Commission making amendments to the European regime on loss-absorbing requirements, which may in turn impact the UK authorities' implementation of the MREL requirements under the BRRD, and therefore may impact the quality or quantity of the capital required to be held by the RBS Group.

The UK government is required to transpose the BRRD's provisions relating to MREL into law through further secondary legislation with a requirement that the Bank of England take into account the final draft regulatory technical standards published by the EBA in July 2015. The Bank of England is responsible for setting the MREL requirements for each UK bank, building society and certain investment firms in consultation with the PRA and the FCA, and such requirement will be set depending on the resolution strategy of the financial institution.

The Bank of England is currently consulting on the approach to be adopted in setting MREL, including, with respect to GSIBs, in line with the FSB's TLAC standards. GSIBs will be expected to meet their MREL requirements from 1 January 2019 and other financial institutions by 1 January 2020, subject to transitional arrangements. Until that time, MREL will be set equal to applicable minimum capital requirements, unless the Bank of England has particular concerns about a firm's resolvability. MREL requirements are expected to be set on a consolidated and individual basis, on a case by case basis.

For the holding entity of the banking group, the Bank of England has proposed to set MREL at a level equivalent to two times the current minimum Pillar 1 and Pillar 2A capital requirements for that financial institution or, if higher, any applicable leverage ratio requirement, or the minimum capital requirements under Basel III plus, if applicable, capital buffer requirements: one for loss absorbency and one for recapitalisation. In terms of applying MREL requirements to individual banking group entities (such as the Bank), the Bank of England has indicated that it expects to align the scope of MREL with the scope of capital requirements, unless there are compelling reasons to deviate from this and that it will, on an entity-by-entity basis, consider whether individual entities within a group could feasibly enter insolvency upon the resolution of the group as a whole. Where this is the case those entities may be set an individual MREL equal to their regulatory minimum capital requirements. As a result, the Bank, on a solo basis, or the Group, on a sub-consolidated basis, may be required to meet specific MREL requirements set by the regulator.

Additional information

For institutions, including the RBS Group, for which bail-in is the required resolution strategy and which are structured to permit single point of entry resolution due to their size and systemic importance, the Bank of England has indicated that in order to qualify as MREL, eligible liabilities (i.e. total loss-absorbing liabilities) will be expected to be issued from the resolution entity (i.e. the holding company for the Group) and be structurally subordinated to operating and excluded liabilities (which include insured deposits, short-term debt, derivatives, structured notes and tax liabilities).

The capital raised through such issuances would then be transferred downstream to material operating subsidiaries in the form of capital or another form of subordinated claim. In this way, MREL resources will be structurally subordinated to senior liabilities of operating companies, allowing losses from operating companies to be transferred to the holding company and, if necessary, for resolution to occur at the holding company level, without placing the operating companies into a resolution process. In addition, the instruments which may qualify towards MREL will be determined in the PRA's final rules.

In order to achieve structural subordination for MREL purposes, senior unsecured issuances by RBSG will therefore need to be subordinated to the excluded liabilities described above. The TLAC standard includes an exemption from this requirement if the total amount of excluded liabilities on RBSG's balance sheet does not exceed 5% of its external TLAC (i.e. the eligible liabilities RBSG has issued to investors which meet the TLAC requirements) and the Bank of England has indicated in its consultation on MREL that it intends to adopt a similar approach.

Compliance with these and other future changes to capital adequacy and loss-absorbency requirements in the EU and the UK by the relevant deadline will require the RBS Group to restructure its balance sheet and issue additional capital compliant with the rules. In particular, these changes will require the RBS Group to issue Tier 1 capital (potentially including ordinary shares and additional Tier 1 instruments), Tier 2 capital and certain loss-absorbing debt securities, including senior securities, which may be costly and will result in certain existing Tier 1 and Tier 2 securities and other senior instruments issued by the RBS Group ceasing to count towards the RBS Group's loss-absorbing capital for the purposes of meeting MREL/TLAC requirements.

There remains considerable uncertainty as to how these rules will be implemented and the final requirements to which the RBS Group will be subject, and the RBS Group may therefore need to revise its capital plan accordingly. The requirement to increase the RBS Group's, and, if applicable, the Group's, levels of CET1 and Tier 2 capital, or other debt securities which qualify for meeting MREL, could have a number of negative consequences for the RBS Group or the Group, including with respect to the RBS Group, including impairing the RBS Group's potential future ability to pay dividends on, or make other distributions in respect of, ordinary shares and diluting the ownership of existing shareholders of the RBS Group.

The Group's borrowing costs and its sources of liquidity depend significantly on its and the RBS Group's credit ratings and, to a lesser extent, on the rating of the UK Government.

The credit ratings of the Bank, its principal subsidiaries, as well as those of RBSG, The Royal Bank of Scotland plc ("RBS plc") and other RBS Group companies directly affect the cost of, access to and sources of their financing and liquidity. A number of UK and other European financial institutions, including RBSG, RBS plc and other RBS Group companies, have been downgraded multiple times in recent years in connection with rating methodology changes and credit rating agencies' revised outlook relating to regulatory developments, macroeconomic trends and a financial institution's capital position and financial prospects.

During 2015, credit rating agencies completed their reviews and revisions of their ratings of banks by country to address the agencies' perception of the impact of ongoing regulatory changes designed to improve the resolvability of banks in a manner that minimises systemic risk, such that the likelihood of extraordinary support for failing banks is less predictable, as well as to address the finalisation of revised capital and leverage rules under CRD IV and firm-specific requirements.

As a result, RBSG's and other RBS Group entities, including the Bank's, and Ulster Bank Ireland Ltd.'s ("UBIL") long-term (and for some RBSG entities short term) credit ratings were downgraded by S&P and Fitch. S&P further downgraded the long-term credit rating of RBSG and other RBS Group entities, including the Bank, as a result of a number of factors, including S&P's assessment of the RBS Group's financial flexibility to absorb losses while a going concern, and the RBS Group's underperformance relative to similar peers in terms of profitability. Moody's also finalised its review of RBS and downgraded RBSG's long-term senior unsecured and issuer credit ratings by two notches. The long-term deposit and senior unsecured ratings for RBS plc and certain other subsidiaries of RBSG, including the Bank, however, were upgraded by one notch to take into account the protection offered to senior unsecured creditors by loss-absorbing capital. The credit ratings of RBSG and UBIL are rated below investment grade by that credit agency. The outlook for RBSG and the Bank by Moody's and S&P is currently positive and is stable for Fitch.

Rating agencies regularly review the RBSG and Group entity credit ratings, including those of the Bank and UBIL, and their ratings of long-term debt are based on a number of factors, including the RBS Group's financial strength as well as factors not entirely within the RBS Group's control, including conditions affecting the financial services industry generally.

In particular, the rating agencies may further review the RBSG and Group entity ratings, including those of the Bank or UBIL, as a result of the implementation of the UK ring-fencing regime, pension and litigation/regulatory investigation risk and other macroeconomic and political developments, including as a result of an outcome in favour of an exit from the European Union.

Additional information

Any further reductions in the long-term or short-term credit ratings of the Bank, UBIL or RBSG or of certain of RBSG's subsidiaries, including further downgrades below investment grade, could increase the Group's funding and borrowing costs, require the Group to replace funding lost due to the downgrade, which may include the loss of customer deposits and may limit the Group's access to capital and money markets and trigger additional collateral or other requirements in derivatives contracts and other secured funding arrangements or the need to amend such arrangements, limit the range of counterparties willing to enter into transactions with the Group and its subsidiaries and adversely affect its competitive position, all of which could have a material adverse impact on the Group's earnings, cash flow and financial condition.

Any downgrade in the UK Government's credit ratings could also adversely affect the credit ratings of the Bank, UBIL, RBSG and RBS Group companies and may result in the effects noted above. In particular, political developments, including any exit, or uncertainty relating to a potential exit, of the UK from the European Union or the outcome of any further Scottish referendum could during a transitional period negatively impact the credit ratings of the UK Government and result in a downgrade of the credit ratings of the Bank, RBSG and RBS Group entities.

The Group's ability to meet its obligations including its funding commitments depends on the Group's ability to access sources of liquidity and funding.

Liquidity risk is the risk that a bank will be unable to meet its obligations, including funding commitments, as they fall due. This risk is inherent in banking operations and can be heightened by a number of factors, including an over-reliance on a particular source of wholesale funding (including, for example, short-term and overnight funding), changes in credit ratings or market-wide phenomena such as market dislocation and major disasters.

Credit markets worldwide, including interbank markets, have experienced severe reductions in liquidity and term funding during prolonged periods in recent years. In 2015, although the RBS Group's and the Group's overall liquidity position remained strong, credit markets experienced increased volatility and certain European banks, in particular in the peripheral countries of Spain, Portugal, Greece and Italy, remained reliant on the ECB as one of their principal sources of liquidity.

The Group relies on retail and wholesale deposits to meet a considerable portion of its funding. The level of deposits may fluctuate due to factors outside the Group's control, such as a loss of confidence (including in other RBS Group entities), increasing competitive pressures for retail customer deposits or the repatriation of deposits by foreign wholesale depositors, which could result in a significant outflow of deposits within a short period of time.

An inability to grow, or any material decrease in, the Group's deposits could, particularly if accompanied by one of the other factors described above, have a material adverse impact on the Group's ability to satisfy its liquidity needs. Increases in the cost of retail deposit funding may impact the Group's margins and profitability.

The market view of bank credit risk has changed radically as a result of the financial crisis and banks perceived by the market to be riskier have had to issue debt at significantly higher costs. Although conditions have improved, there have been recent periods where corporate and financial institution counterparties have reduced their credit exposures to banks and other financial institutions, limiting the availability of these sources of funding. The perceived ability of the Bank of England to resolve the RBS Group in an orderly manner may also increase investors' perception of risk and hence affect the availability and cost of funding for the RBS Group.

Any uncertainty relating to the credit risk of financial institutions may lead to reductions in levels of interbank lending or may restrict the Group's access to traditional sources of funding or increase the costs or collateral requirements for accessing such funding.

The RBS Group and the Group have, at times, been required to rely on shorter-term and overnight funding with a consequent reduction in overall liquidity, and to increase recourse to liquidity schemes provided by central banks. Such schemes require assets to be pledged as collateral. Changes in asset values or eligibility criteria can reduce available assets and consequently available liquidity, particularly during periods of stress when access to the schemes may be needed most. The implementation of the UK ring-fencing regime may also impact the RBS Group's funding strategy which is managed centrally and applies to the Group, and the cost of funding may increase for certain Group entities, including the Group, which will be required to manage their own funding and liquidity strategy.

If the Group is unable to raise funds through deposits or in the capital markets, its liquidity position could be adversely affected and it might be unable to meet deposit withdrawals on demand or at their contractual maturity, to repay borrowings as they mature, to meet its obligations under committed financing facilities, to comply with regulatory funding requirements or to fund new loans, investments and businesses. The Group may need to liquidate unencumbered assets to meet its liabilities, including disposals of assets not previously identified for disposal to reduce its funding commitments. In a time of reduced liquidity, the Group may be unable to sell some of its assets, or may need to sell assets at depressed prices, which in either case could have a material adverse effect on the Group's financial condition and results of operations.

The Group's business and results of operations may be adversely affected by increasing competitive pressures and technology disruption in the markets in which it operates.

The markets for UK financial services, and the other markets within which the Group operates, are very competitive, and management expects such competition to continue or intensify in response to customer behaviour, technological changes (including the growth of digital banking), competitor behaviour, new entrants to the market (including non-traditional financial services providers such as large retail or technology conglomerates), new lending models (such as peer-to-peer lending) and the impact of regulatory actions and other factors.

Additional information

In particular, the emergence of disintermediation in the financial sector resulting from new banking, lending and payment solutions offered by rapidly evolving incumbents, challengers and new entrants, in particular with respect to payment services and products, and the introduction of disruptive technology may impede the Group's ability to grow or retain its market share and impact its revenues and profitability, particularly in its key UK retail banking segment. Increasingly many of the products and services offered by the Group are, and will become, technology intensive and the Group's ability to develop such services has become increasingly important to retaining and growing the Group's customer business in the UK.

There can be no certainty that the Group's investment in its IT capability intended to address the material increase in customer use of online and mobile technology for banking will be successful or that it will allow the Group to continue to grow such services in the future. Certain of the Group's current or future competitors may have more efficient operations, including better IT systems allowing them to implement innovative technologies for delivering services to their customers. Furthermore, the Group's competitors may be better able to attract and retain customers and key employees and may have access to lower cost funding and/or be able to attract deposits on more favourable terms than the Group. If the Group is unable to offer competitive, attractive and innovative products that are also profitable, it could lose market share, incur losses on some or all of its activities and lose opportunities for growth.

In addition, constraints imposed on the Group's ability to compensate its employees at the same level as its competitors, may also have an impact on its ability to compete effectively. Intensified competition from incumbents, challengers and new entrants in the Group's core markets could lead to greater pressure on the Group to maintain returns and may lead to unsustainable growth decisions. These and other changes in the Group's competitive environment could have a material adverse effect on the Group's business, margins, profitability, financial condition and prospects.

The Group operates in markets that are subject to intense scrutiny by the competition authorities and its business and results of operations could be materially affected by competition rulings and other government measures.

The competitive landscape for banks and other financial institutions in the UK and the rest of Europe is changing rapidly. Recent regulatory and legal changes have and may continue to result in new market participants and changed competitive dynamics in certain key areas, such as in retail banking in the UK where the introduction of new entrants is being actively encouraged by the UK Government. The competitive landscape in the UK is also likely to be affected by the UK Government's implementation of the UK ring-fencing regime and other customer protection measures introduced by the Banking Reform Act 2013.

The implementation of these reforms may result in the consolidation of newly separated businesses or assets of certain financial institutions with those of other parties to realise new synergies or protect their competitive position and is likely to increase competitive pressures on the Group.

The UK retail banking sector has been subjected to intense scrutiny by the UK competition authorities and by other bodies in recent years, including market reviews conducted by the Competition & Markets Authority ("CMA") and its predecessor the Office of Fair Trading regarding SME banking and Personal Current Accounts ("PCAs"), the Independent Commission on Banking and the Parliamentary Commission on Banking Standards. These reviews raised significant concerns about the effectiveness of competition in the banking sector. Although these reviews are ongoing, preliminary findings in the CMA's Retail Banking Market Investigation contemplated proposing measures primarily intended to make it easier for consumers and businesses to compare bank products, increase the transparency of price comparison between banks and amend overdraft charging, which would, if implemented, impose additional compliance requirements on the Group and could, in aggregate, adversely impact the Group's competitive position, product offering and revenues. The wholesale banking sector has also been the subject of recent scrutiny.

Adverse findings resulting from current or future competition investigations may result in the imposition of reforms or remedies which may impact the competitive landscape in which the Group operates or result in restrictions on mergers and consolidations within the UK financial sector. The impact of any such developments in the UK will become more significant as the Group's business becomes increasingly concentrated in the UK retail sector. These and other changes to the competitive framework in which the Group operates could have a material adverse effect on the Group's business, margins, profitability, financial condition and prospects.

The Group is exposed to conduct risk which may adversely impact the Group or its employees and may result in conduct having a detrimental impact on the Group's customers or counterparties.

In recent years, the Group has sought to refocus its culture on serving the needs of its customers and continues to redesign many of its systems and processes to promote this focus and strategy. However, the Group is exposed to various forms of conduct risk in its operations. These include business and strategic planning that does not consider customers' needs, ineffective management and monitoring of products and their distribution, a culture that is not customer-centric, outsourcing of customer service and product delivery via third parties that do not have appropriate levels of control, oversight and culture, the possibility of alleged mis-selling of financial products or the mishandling of complaints related to the sale of such products, or poor governance of incentives and rewards. Some of these risks have materialised in the past and ineffective management and oversight of conduct issues may result in customers being poorly or unfairly treated and may in the future lead to further remediation and regulatory intervention/enforcement.

Additional information

The Group's businesses are also exposed to risks from employee misconduct including non-compliance with policies and regulatory rules, negligence or fraud, any of which could result in regulatory sanctions and serious reputational or financial harm to the RBS Group and the Group. In recent years, a number of multinational financial institutions, including entities within the RBS Group, have suffered material losses due to the actions of employees. It is not always possible to deter employee misconduct and the precautions the Group takes to prevent and detect this activity may not always be effective.

The Group has implemented a number of policies and allocated new resources in order to help mitigate against these risks. The Group has also prioritised initiatives to reinforce good conduct in its engagement with the markets in which it operates, together with the development of preventative and detective controls in order to positively influence behaviour. The Group's strategic programme is also intended to improve the Group's control environment. Nonetheless, no assurance can be given that the Group's strategy and control framework will be effective and that conduct issues will not have an adverse effect on the Group's results of operations, financial condition or prospects.

The Group may be adversely impacted if its risk management is not effective.

The management of risk is an integral part of all of the Group's activities. Risk management comprises the definition and monitoring of the Group's risk appetite and reporting of the Group's exposure to uncertainty and the consequent adverse effect on profitability or financial condition arising from different sources of uncertainty and risks as described throughout these risk factors. Ineffective risk management may arise from a wide variety of events and behaviours, including lack of transparency or incomplete risk reporting, unidentified conflicts or misaligned incentives, lack of accountability control and governance, lack of consistency in risk monitoring and management or insufficient challenges or assurance processes.

Failure to manage risks effectively could adversely impact the Group's reputation or its relationship with its customers, shareholders or other stakeholders, which in turn could have a significant effect on the Group's business prospects, financial condition and/or results of operations.

Risk management is also strongly related to the use and effectiveness of internal stress tests and models. See *"The Group relies on valuation, capital and stress test models to conduct its business, assess its risk exposure and anticipate capital and funding requirements. Failure of these models to provide accurate results or accurately reflect changes in the micro and macroeconomic environment in which the Group operates could have a material adverse effect on the Group's business, capital and results."*

A failure by the Group to embed a strong risk culture across the organisation could adversely affect the Group's ability to achieve its strategic objectives.

In response to weaknesses identified in previous years, the RBS Group is currently seeking to embed a strong risk culture within the RBS Group (including the Group) based on a robust risk appetite and governance framework. A key component of this approach is the three lines of defence model designed to identify, manage and mitigate risk across all levels of the organisation. This framework is still in the process of being implemented and improvements continue and will continue to be made to clarify and improve the three lines of defence and internal risk responsibilities and resources, including in response to feedback from regulators. A failure by any of these three lines to carry out their responsibilities or to effectively embed this culture could have a material adverse effect on the Group through an inability to achieve its strategic objectives for its customers, employees and wider stakeholders.

The RBS Group and the Group are subject to pension risks and may be required to make additional contributions to cover pension funding deficits and to restructure its pension schemes as a result of the implementation of the UK ring-fencing regime.

The RBS Group and the Group maintain a number of defined benefit pension schemes for certain former and current employees. Pension risk is the risk that the assets of the RBS Group's various defined benefit pension schemes, including those in which the Group participates, do not fully match the timing and amount of the schemes' liabilities, as a result of which the RBS Group and/or the Group are required or chooses to make additional contributions to address deficits that may emerge. Risk arises from the schemes because the value of the asset portfolios may be less than expected and because there may be greater than expected increases in the estimated value of the schemes' liabilities and additional future contributions to the schemes may be required.

The value of pension scheme liabilities varies with changes to long-term interest rates (including prolonged periods of low interest rates as is currently the case), inflation, monetary policy, pensionable salaries and the longevity of scheme members, as well as changes in applicable legislation. In particular, as life expectancies increase, so too will the pension scheme liabilities; as the impact on the pension scheme liabilities due to a one year increase in longevity is expected to be £853 million.

Given recent economic and financial market difficulties and volatility, the low interest rate environment and the risk that such conditions may occur again over the near and medium term, the RBS Group has experienced increasing pension deficits and was required to make further contributions following the last triennial valuation of The Royal Bank of Scotland Group Pension Fund, which is the Group's main defined benefit pension scheme (the "Main Scheme"), which showed that the value of liabilities exceeded the value of assets by £5.6 billion at 31 March 2013, a ratio of 82%.

Additional information

Following the publication of the IASB's exposure draft of amendments to IFRIC 14, the RBS Group and the Group have revised their pension accounting policy for determining whether or not they have an unconditional right to a refund of any surpluses in their employee pension funds. This change has resulted in the accelerated recognition of a £4.2 billion liability corresponding to the nominal value of all committed contributions in respect of past service pursuant to the May 2014 triennial valuation agreement with the Main Scheme pension trustee.

The RBS Group has agreed in principle with the Main Scheme pension trustee to make an accelerated cash payment of the outstanding committed future contributions (£4.2 billion) to the Main Scheme (the majority of which payment has been provided for as a result of the accounting policy change described above) and to bring forward the next triennial valuation to be as of a date between 31 October 2015 and 31 December 2015. The contribution of £4.2 billion was paid by the Group in March 2016. The 2015 triennial valuation is expected to result in a significant increase in the regular annual contributions in respect of the ongoing accrual of benefits. This will have the effect of significantly decreasing the amount of any pension surplus that the RBS Group and the Group can recognise as a balance sheet asset.

The next triennial period valuation will therefore take place in Q4 2018 and the Main Scheme pension trustee has agreed that it would not seek a new valuation prior to that date, except where a material change arises. Notwithstanding this accelerated payment and any additional contributions which may be required beforehand as a result of a material change, the RBS Group expects to have to agree to additional contributions to which the Group will contribute, over and above the existing committed past service contributions, from Q1 2020 as a result of the next triennial valuation. The underlying assumptions used to calculate the triennial valuation deficit as at 31 March 2013 are set out further in note 4 Pensions on page 115.

The cost of such additional contributions could be material and any additional contributions that are committed to the Main Scheme following new actuarial valuations would in turn, under RBS Group's and the Group's revised accounting policy, trigger the recognition of a significant additional liability in the RBS Group's and the Group's accounts, which in turn could have a material adverse effect on the Group's results of operations, financial position and prospects.

In addition, the UK ring-fencing regime will require significant changes to the structure of the RBS Group's existing defined benefit pension schemes as RFB entities may not be liable for debts to pension schemes that might arise as a result of the failure of a NRFB entity after 1 January 2026. The restructuring of the RBS Group's defined benefit pension plans to implement the UK ring-fencing regime could affect assessments of the RBS Group's schemes deficits, or result in the pension scheme trustees making a determination that the employer covenant has been weakened, and result in additional contributions being required.

The RBS Group is developing a strategy to meet these requirements, which has been discussed with the PRA and will require the agreement of the pension scheme trustee. Discussions with the pension scheme trustee will be influenced by the RBS Group's overall ring-fence strategy and its pension funding and investment strategies.

If agreement is not reached with the pension trustee, alternative options less favourable to the RBS Group will need to be developed to meet the requirements of the pension regulations. The costs associated with the restructuring of the RBS Group's existing defined benefit pension schemes could be material and could result in higher levels of additional contributions than those described above and currently agreed with the pension trustee which could have a material adverse effect on the Group's results of operations, financial position and prospects.

Pension risk and changes to the RBS Group's funding of its pension schemes may have a significant impact on the RBS Group's and/or the Group's capital position.

The RBS Group's capital position is influenced by pension risk in several respects: Pillar 1 capital is impacted by the requirement that net asset pension balances are to be deducted from capital and that actuarial gains/losses impact reserves and, by extension, CET1 capital; Pillar 2A requirements result in the RBS Group being required to carry a capital add-on to mitigate stress on the pension fund and finally the RBS Group's target CET1 ratio incorporates a management buffer over the combined buffer requirement which assumes, amongst other risks, a buffer to mitigate a deterioration in the RBS Group's pension fund position. Changes to the RBS Group's capital position or capital requirements relating to pension risks, are then reflected in the capital which the Group is required to hold, in line with the RBS Group's capital strategy which requires Group entities, including the Group, to maintain adequate capital at all times. In addition, an increase in the pension risk to which the Group is exposed (as a result of its participation in the Main Scheme) may result in increased regulatory capital requirements applicable to the Group on an individual basis.

The Group believes that the accelerated payment to the Group's Main Scheme pension fund will improve the RBS Group's capital planning and resilience through the period to 2019 and provide the Main Scheme pension trustee with more flexibility over its investment strategy. The RBS Group estimates that the accelerated payment will adversely impact the RBS Group's CET1 capital in 2016 by 30 to 40 basis points and reduce the Group's MDA level of CET1 capital or management buffer capital required for pension risk which may trigger MDA requirements and result in mandatory restrictions on discretionary distributions.

Additional information

The RBS Group's expectations as to the impact on its and the Group's capital position of this payment in the near and medium term and of the accounting impact under its revised accounting policy are based on a number of assumptions and estimates, including with respect to the beneficial impact on its Pillar 2A requirements and confirmation of such impact by the PRA and the timing thereof, any of which may prove to be inaccurate (including with respect to the calculation of the CET1 ratio impact on future periods), including as a result of factors outside of the RBS Group's control (which include the PRA's approval). As a result, if any of these assumptions proves inaccurate, the RBS Group's capital position may significantly deteriorate and fall below the RBS Group's or the Group's minimum capital requirements and in turn result in increased regulatory supervision or sanctions, restrictions on discretionary distributions or loss of investor confidence, which could individually or in aggregate have a material adverse effect on the RBS Group's and the Group's results of operations, financial prospects or reputation.

The impact of the Group's pension obligations on its results and operations are also dependent on the regulatory environment in which it operates.

There is a risk that changes in prudential regulation, pension regulation and accounting standards, or a lack of coordination between such sets of rules, may make it more challenging for the Group to manage its pension obligations resulting in an adverse impact on the Group's CET1 capital.

The RBS Group has been, and will remain, in a period of major restructuring through to 2019, which carries significant execution and operational risks, and there can be no assurance that the final results will be successful and that the RBS Group will be a viable, competitive, customer-focussed and profitable bank.

In the first quarter of 2015, the RBS Group articulated a new strategy focussed on the growth of its strategic operations in UK Personal & Business Banking and Commercial & Private Banking and the further restructuring of its Corporate and Institutional Banking ("CIB") business to focus mainly on UK and Western European corporate and financial institutions. It also announced the acceleration of the run-down of certain of its operations, businesses and portfolios in order to reduce risk-weighted assets as well as the scope and complexity of its activities.

In 2015, the RBS Group also continued the run-down of the higher risk and capital intensive assets in RBS Capital Resolution ("RCR"), which has now been merged into Capital Resolution, and strengthened the RBS Group's capital position, including through the full divestment of the RBS Group's interest in Citizens Financial Group ("CFG"), which were key goals of its previous strategic plan.

This strategy is intended to leave the RBS Group better positioned for the implementation of the UK ring-fencing regime. The RBS Group also remains focussed on meeting its returns and efficiency targets (including cost reductions) as well as improving customer experience and employee engagement.

The RBS Group's strategy is also focussed on strengthening its overall capital position. During the restructuring period and until the implementation of the UK ring-fencing regime in 2019, the RBS Group has lifted its capital targets and currently aims for a CET1 ratio at or over 13%.

Implementing the RBS Group's current strategic programme, including the restructuring of its CIB business, will require further material changes to be implemented within the RBS Group over the medium term at the same time that it will also be implementing structural changes to comply with the UK ring-fencing regime and divesting Williams & Glyn. The RBS Group expects this restructuring period to be disruptive and likely to increase operational and people risks for the RBS Group and may divert management resources from the conduct of the RBS Group's operations and development of its business, any of which, could adversely affect the Group.

The RBS Group may not be able to successfully implement any part of its strategic programme in the time frames contemplated or at all, and, as a result, the RBS Group may not be able to achieve its stated capital targets or its strategic objectives. The RBS Group's strategic programme comprises a number of different actions and initiatives, any of which could fail to be implemented due to operational or execution issues. Implementation of the RBS Group's strategic programme is expected to result in significant costs, which could be materially higher than currently contemplated, including due to material uncertainties and factors outside of the Group's control. Although one of the objectives of the RBS Group's strategic programme is to achieve a medium-term reduction in annual underlying costs (excluding restructuring and conduct-related charges), this level of cost saving (for RBS Group or for the Group) may not be achieved within the planned timescale or at any time. Such risks are linked to and additional to the risks relating to the implementation of the UK ring-fencing regime and the divestment of Williams & Glyn, and will be increased by issues or delays in their implementation, in particular delays in the separation and divestment of Williams & Glyn.

On completion of the implementation of its strategic programme and the UK ring-fencing regime in 2019, the RBS Group's businesses will be primarily concentrated in the UK and Western Europe, and therefore its potential for profitability and growth will be largely dependent on its success with its retail and SME customers in the UK, which, in large part, are within the Group's operations. Due to the changed nature of the RBS Group's business model, future levels of revenue may not be achieved in the timescale envisaged or at any time. As a result, in addition to the execution risks associated with the implementation of its strategic programme and of the UK ring-fencing regime, the RBS Group may not be able to execute its strategic programme, or the restructured RBS Group, on completion of these restructuring measures, may not be a viable, competitive, customer-focussed and profitable bank, which, in turn, could adversely affect the Group.

Additional information

As a result of the commercial and regulatory environment in which it operates, the Group may be unable to attract or retain senior management (including members of the board) and other skilled personnel of the appropriate qualification and competence. The Group may also suffer if it does not maintain good employee relations.

The Group's future success depends on its ability to attract, retain and remunerate highly skilled and qualified personnel, including senior management (which includes directors and other key employees), in a highly competitive labour market. This cannot be guaranteed, particularly in light of heightened regulatory oversight of banks and the increasing scrutiny of, and (in some cases) restrictions placed upon, employee compensation arrangements, in particular those of banks in receipt of Government support (such as the RBS Group), which may place the Group at a competitive disadvantage. In addition, the market for skilled personnel is increasingly competitive, thereby raising the cost of hiring, training and retaining skilled personnel.

Certain of the Group's directors as well as members of its executive committee and certain other senior managers and employees will also be subject to the new responsibility regime introduced under the Banking Reform Act 2013 which introduces clearer accountability rules for those within the new regime. The senior managers' regime and certification regime take effect on 7 March 2016, whilst the conduct rules will apply to the wider employee population from 7 March 2017 onwards, with the exception of some transitional provisions. The new regulatory regime may contribute to reduce the pool of candidates for key management and non-executive roles, including non-executive directors with the right skills, knowledge and experience, or increase the number of departures of existing employees, given concerns over the allocation of responsibilities introduced by the new rules.

The RBS Group's evolving strategy has led to the departure of a large number of experienced and capable employees, including Group employees. The restructuring relating to the ongoing implementation of the RBS's Group's strategic programme may cause experienced staff members to leave and prospective staff members not to join the RBS Group. The lack of continuity of senior management and the loss of important personnel could have an adverse impact on the Group's business and future success.

The failure to attract or retain a sufficient number of appropriately skilled personnel to manage the complex restructuring required to implement the UK ring-fencing regime and the Group's strategy could prevent the Group from successfully implementing its strategy and meeting regulatory commitments. This could have a material adverse effect on the Group's business, financial condition and results of operations.

In addition, many of the Group's employees in the UK and other jurisdictions in which the Group operates are represented by employee representative bodies, including trade unions. Engagement with its employees and such bodies is important to the Group and a breakdown of these relationships could adversely affect the Group's business, reputation and results.

HM Treasury (or UKFI on its behalf) may be able to exercise a significant degree of influence over the RBS Group, including the Group, and any further offer or sale of its interests may affect the price of its securities.

On 6 August 2015, the UK Government made its first sale of RBSG ordinary shares since its original investment in 2009 and sold approximately 5.4% of its stake in RBSG. Following this initial sale, the UK Government exercised its conversion rights under the B Shares on 14 October 2015 which resulted in HM Treasury holding 72.88% of the ordinary share capital of RBSG, and indirectly of the Bank's share capital. The UK Government, through HM Treasury, currently holds 72.6% of the issued ordinary share capital of the RBS Group. The UK Government has indicated its intention to continue to sell down its shareholding in the RBS Group over the next five years.

In addition, UKFI manages HM Treasury's shareholder relationship with the RBS Group and, although HM Treasury has indicated that it intends to respect the commercial decisions of the RBS Group and that the RBS Group companies (including the Bank) will continue to have their own independent board of directors and management team determining their own strategy, should HM Treasury's intentions change, its position as a majority shareholder (and UKFI's position as manager of this shareholding) means that HM Treasury or UKFI might be able to exercise a significant degree of influence over, among other things, the election of directors and appointment of senior management, remuneration policy or the conduct of any RBS Group company, including the Bank.

The manner in which HM Treasury or UKFI exercises HM Treasury's rights as majority shareholder could give rise to conflicts between the interests of HM Treasury and the interests of other shareholders. The Board has a duty to promote the success of the RBS Group, including the Group, for the benefit of its members as a whole.

Additional information

The financial performance of the Group has been, and may continue to be, materially affected by customer and counterparty credit quality and deterioration in credit quality could arise due to prevailing economic and market conditions and legal and regulatory developments.

The Group has exposure to many different industries, customers and counterparties, and risks arising from actual or perceived changes in credit quality and the recoverability of monies due from borrowers and other counterparties are inherent in a wide range of the Group's businesses.

In particular, the Group has significant exposure, directly and through its subsidiaries, to certain individual customers and other counterparties in weaker business sectors and geographic markets and also has concentrated country exposure in the UK, Ireland, other Western European countries and the rest of the world. At 31 December 2015, credit risk assets in the UK were £145 billion, in Ireland were £21 billion and in the rest of the world were £6 billion; and within certain business sectors, namely personal finance and real estate (at 31 December 2015, personal finance lending amounted to £118 billion and lending exposure to real estate was £19 billion).

Provisions for default on loans have decreased in recent years in line with the perceived reduction in risks relating to these customers, counterparties or asset classes. If the risk profile of these loans were to increase, including as a result of a degradation of economic or market conditions, this could result in an increase in the cost of risk and the Group may be required to make additional provisions, which in turn would reduce earnings and impact the Group's profitability. The Group's lending strategy or processes may also fail to identify or anticipate weaknesses or risks in a particular sector, market or borrower category, which may result in an increase in default rates, which may, in turn, impact the Group's profitability.

The credit quality of the Group's borrowers and its other counterparties is impacted by prevailing economic and market conditions and by the legal and regulatory landscape in their respective markets. Credit quality has improved in certain of the Group's core markets, in particular the UK and Ireland, as these economies have improved. Notwithstanding the above, asset quality remains weak across certain portfolios and the Group or its subsidiaries may inaccurately assess the levels of provisions required to mitigate such risks.

However, a further deterioration in economic and market conditions or changes to legal or regulatory landscapes could worsen borrower and counterparty credit quality and also impact the Group's ability to enforce contractual security rights.

In addition, the Group's credit risk is exacerbated when the collateral it holds cannot be realised as a result of market conditions or regulatory intervention or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due to the Group, which is most likely to occur during periods of illiquidity and depressed asset valuations, such as those experienced in recent years. This has particularly been the case with respect to large parts of the Group's commercial real estate portfolio. Any such deterioration in the Group's recoveries on defaulting loans could have an adverse effect on the Group's results of operations and financial condition.

In addition, as the RBS Group implements its strategy and withdraws from many geographic markets and continues to materially scale down its international activities, the Group's relative exposure to the UK and to certain sectors and asset classes in the UK will increase as its business becomes more concentrated in the UK. In particular, in the UK, the Group is at risk from downturns in the UK economy and volatility in property prices in both the residential and commercial sectors. With UK home loans representing the most significant portion of the Group's total loans and advances to the retail sector, the Group has a large exposure to adverse developments in the UK retail property sector. As a result, a fall in house prices, particularly in London and the South East of the UK, would be likely to lead to higher impairment and negative capital impact as loss given default rate increases. In addition, reduced affordability of residential and commercial property in the UK, for example, as a result of higher interest rates or increased unemployment, could also lead to higher impairment.

Concerns about, or a default by, one financial institution could lead to significant liquidity problems and losses or defaults by other financial institutions, as the commercial and financial soundness of many financial institutions may be closely related as a result of credit, trading, clearing and other relationships. Even the perceived lack of creditworthiness of, or questions about, a counterparty may lead to market-wide liquidity problems and losses for, or defaults by, the Group. This systemic risk may also adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with which the Group interacts on a daily basis. The effectiveness of recent prudential reforms designed to contain systemic risk in the EU and the UK is yet to be tested. Counterparty risk within the financial system or failures of the Group's financial counterparties could have a material adverse effect on the Group's access to liquidity or could result in losses which could have a material adverse effect on the Group's financial condition, results of operations and prospects.

The trends and risks affecting borrower and counterparty credit quality have caused, and in the future may cause, the Group to experience further and accelerated impairment charges, increased repurchase demands, higher costs, additional write-downs and losses for the Group and an inability to engage in routine funding transactions.

Additional information

The Group's earnings and financial condition have been, and its future earnings and financial condition may continue to be, materially affected by depressed asset valuations resulting from poor market conditions.

The Group's businesses are inherently subject to risks in financial markets and in the wider economy, including changes in, and increased volatility of, interest rates, inflation rates, credit spreads, foreign exchange rates and commodity, equity, bond and property prices. In previous years, severe market events resulted in the Group recording large write-downs on its credit market exposures.

Any further deterioration in economic and financial market conditions or weak economic growth could lead to additional impairment charges and write-downs. Moreover, market volatility and illiquidity (and the assumptions, judgements and estimates in relation to such matters that may change over time and may ultimately not turn out to be accurate) make it difficult to value certain of the Group's exposures.

Valuations in future periods reflecting, among other things, the then-prevailing market conditions and changes in the credit ratings of certain of the Group's assets may result in significant changes in the fair values of the Group's exposures, such as credit market exposures, and the value ultimately realised by the Group may be materially different from the current or estimated fair value.

The disposal of Williams & Glyn could lead the Group to recognise further write-downs in the event that the sale proceeds are less than the carrying value of Williams & Glyn in the Group's accounts.

Any of the factors above could require the Group to recognise further significant write-downs and realise increased impairment charges, all of which may have a material adverse effect on its financial condition, results of operations and capital ratios.

The Group is committed to executing the run-down and sale of certain businesses, portfolios and assets forming part of the businesses and activities being exited by the Group. Failure by the Group to do so on commercially favourable terms could have a material adverse effect on the Group's operations, operating results, financial position and reputation.

The Group's ability to dispose of the remaining businesses, portfolios and assets forming part of the businesses and activities being exited by the Group and the price achieved for such disposals will be dependent on prevailing economic and market conditions, which remain volatile. As a result, there is no assurance that the Group will be able to sell, exit or run down these businesses, portfolios or assets either on favourable economic terms to the Group or at all or that it may do so within the intended timetable.

Material tax or other contingent liabilities could arise on the disposal or run-down of assets or businesses and there is no assurance that any conditions precedent agreed will be satisfied, or consents and approvals required will be obtained in a timely manner or at all. The Group may be exposed to deteriorations in the businesses, portfolios or assets being sold between the announcement of the disposal and its completion, which period may span many months.

In addition, the Group may be exposed to certain risks, including risks arising out of ongoing liabilities and obligations, breaches of covenants, representations and warranties, indemnity claims, transitional services arrangements and redundancy or other transaction-related costs, and counterparty risk in respect of buyers of assets being sold.

The occurrence of any of the risks described above could have a material adverse effect on the Group's business, results of operations, financial condition and capital position and consequently may have the potential to impact the competitive position of part or all of the Group's business.

The Group relies on valuation, capital and stress test models to conduct its business, assess its risk exposure and anticipate capital and funding requirements. Failure of these models to provide accurate results or accurately reflect changes in the micro and macroeconomic environment in which the Group operates could have a material adverse effect on the Group's business, capital and results.

Given the complexity of the Group's business, strategy and capital requirements, the Group relies on analytical models to manage its business, assess the value of its assets and its risk exposure and anticipate capital and funding requirements, including with stress testing. Valuation, capital and stress test models and the parameters and assumptions on which they are based, need to be constantly updated to ensure their accuracy.

Failure of these models to accurately reflect changes in the environment in which the Group operates, or to be updated in line with changes in the RBS Group's or the Group's business mode or operations, or the failure to properly input any such changes could have an adverse impact on the modelled results or could fail to accurately capture the Group's risk exposure, the risk profile of the Group's financial instruments or result in the Group being required to hold additional capital as a function of the PRA Buffer. Some of the analytical models used by the Group are predictive in nature. In addition, a number of the internal models used by the Group are designed, managed and analysed by the RBS Group and may inappropriately capture the risks and exposures relating to the Group's portfolios. The Group's internal models are subject to periodic review by its regulators and, if found deficient, the Group may be required to make changes to such models or may be precluded from using any such models, which would result in an additional capital requirement that could have a material impact on the Group's capital position. The use of predictive models has inherent risks and may incorrectly forecast future behaviour, leading to flawed decision making and potential losses.

Additional information

The Group also uses valuation models that rely on market data inputs. If incorrect market data is input into a valuation model, it may result in incorrect valuations or valuations different to those which were predicted and used by the Group in its forecasts or decision making. Internal stress test models may also rely on different, less severe, assumptions or take into account different data points than those defined by the Group's regulators.

The Group could face adverse consequences as a result of decisions which may lead to actions by management based on models that are poorly developed, implemented or used, or as a result of the modelled outcome being misunderstood or such information being used for purposes for which it was not designed. Risks arising from the use of models could have a material adverse effect on the Group's business, financial condition and/or results of operations, minimum capital requirements and reputation.

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Its results in future periods may be affected by changes to applicable accounting rules and standards.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, results reported in future periods may reflect amounts which differ from those estimates. Estimates, judgements and assumptions take into account historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The accounting policies deemed critical to the Group's results and financial position, based upon materiality and significant judgements and estimates, include pensions, provisions for liabilities, deferred tax, loan impairment provisions, fair value of financial instruments, which are discussed in detail in "Critical accounting policies and key sources of estimation uncertainty" on page 108. In addition, further development of standards and interpretations under IFRS could also significantly impact the financial results, condition and prospects of the Group. IFRS and Interpretations that have been issued by the International Accounting Standards Board ("the IASB") but which have not yet been adopted by the Group are discussed in "Accounting developments" on page 111.

In July 2014, the IASB published a new accounting standard for financial instruments (IFRS 9) effective for annual periods beginning on or after 1 January 2018. It introduces a new framework for the recognition and measurement of credit impairment based on expected credit losses, rather than the incurred loss model currently applied under IAS 39. The inclusion of loss allowances with respect to all financial assets will tend to result in an increase in overall impairment balances when compared with the existing basis of measurement under IAS 39.

The valuation of financial instruments, including derivatives, measured at fair value can be subjective, in particular where models are used which include unobservable inputs. Generally, to establish the fair value of these instruments, the Group relies on quoted market prices or, where the market for a financial instrument is not sufficiently active, internal valuation models that utilise observable market data. In certain circumstances, the data for individual financial instruments or classes of financial instruments utilised by such valuation models may not be available or may become unavailable due to prevailing market conditions.

In such circumstances, the Group's internal valuation models require the Group to make assumptions, judgements and estimates to establish fair value, which are complex and often relate to matters that are inherently uncertain. Resulting changes in the fair values of the financial instruments has had and could continue to have a material adverse effect on the Group's earnings, financial condition and capital position.

The RBS Group and its subsidiaries, including the Group, are subject to a new and evolving framework on recovery and resolution, the impact of which remains uncertain, and which may result in additional compliance challenges and costs.

In the UK and EU regulators have implemented or are in the process of implementing recovery and resolution regimes designed to prevent the failure of financial institutions and resolution tools to ensure the timely and orderly resolution of financial institutions. These initiatives are coupled with a broader set of initiatives to improve the resilience of financial institutions and reduce systemic risk, including the UK ring-fencing regime, the introduction of certain requirements and powers under CRD IV, including the rules relating to MDA, and certain of the measures introduced under the BRRD which came into force on 1 January 2015, including the requirements relating to MREL. The tools and powers introduced under the BRRD include preparatory and preventive measures, early supervisory intervention powers and resolution tools. In addition, banks headquartered in countries which are members of the eurozone are now subject to the European banking union framework. As a result of the above, there remains uncertainty as to how the relevant resolution regimes in force in the UK, the eurozone and other jurisdictions, would interact in the event of a resolution of the RBS Group.

In the UK, the BRRD came into effect in January 2015, subject to certain secondary rules being finalised by the European authorities, and therefore the requirements to which the RBS Group is subject may continue to evolve to ensure compliance with these rules or following the publication of review reports produced by the European Parliament and the Council of the EU relating to certain topics set out by the BRRD. Such further amendments to the BRRD or the implementing rules in the EU may also be necessary to ensure continued consistency with the FSB recommendations on resolution regimes and resolution planning for GSIBs, in particular with respect to TLAC requirements.

Additional information

In addition, the PRA is currently consulting on a new framework requiring financial institutions to ensure the continuity of critical shared services (provided by entities within the group or external providers) to facilitate recovery action, orderly resolution and post-resolution restructuring, which will apply from 1 January 2019 which may require the RBS Group and the Group to revise intragroup arrangements or arrangements with third parties.

The application of such rules to the RBS Group and the Group may require the restructuring of certain of their activities or reorganisation of the legal structure of their operations, and may limit the Group's ability to outsource certain functions and/or may result in increased costs resulting from the requirement to ensure the financial and operational resilience and independent governance of such critical services. Such rules will need to be implemented consistently with the UK ring-fencing regime.

Based on the RBS Group's current recovery and resolution plans, as submitted to the regulator, the RBS Group will have a "single point of entry" resolution and RBSG would be the resolution entity for the RBS Group. As a result, if any RBS Group entity suffers material losses or its capital position is otherwise adversely affected, and the conditions for resolution are met, a sole resolution process will be initiated by the RBS Group's resolution authority in the UK. Although the implementation of the resolution tools will occur at the RBS Group parent level, the resulting measures taken as a result of the implementation of the RBS Group's resolution plan or taken by the RBS Group's regulator may adversely impact the Group.

The BRRD requires national resolution funds to raise "ex ante" contributions on banks and investment firms in proportion to their liabilities and risk profiles and allow them to raise additional "ex post" funding contributions in the event the ex ante contributions do not cover the losses, costs or other expenses incurred by use of the resolution fund. Although the UK government indicated that it would consider using receipts from the UK bank levy to meet the ex ante and ex post funding requirements, the RBS Group may be required to make additional contributions in the future.

The new recovery and resolution regime implementing the BRRD in the UK replaces the previous regime and has imposed and is expected to impose in the near-to medium-term future, additional compliance and reporting obligations on the RBS Group, including the Group, which may result in increased costs, including as a result of mandatory participation in resolution funds, and heightened compliance risks and the RBS Group may not be in a position to comply with all such requirements within the prescribed deadlines or at all. The implementation of this new regime has required and will continue to require the Group to work with its regulators towards putting in place adequate resolution plans, the outcome of which may impact the Group's operations or structure.

The RBS Group may become subject to the application of stabilisation or resolution powers in certain significant stress situations, which may result in various actions being taken in relation to the RBS Group and any securities of the RBS Group, including the Group, including the write-off, write-down or conversion of securities issued by the RBS Group or the Group.

In the context of the recovery and resolution framework set out above, as the parent company of a UK bank, RBSG and other RBS Group entities, including the Bank, are subject to the "Special Resolution Regime" under the Banking Act 2009, that gives wide powers to HM Treasury, the Bank of England, the PRA and the FCA in circumstances where a UK bank has encountered or is likely to encounter financial difficulties, such that it is assessed as failing or likely to fail.

The Special Resolution Regime under the Banking Act 2009, as amended to implement the relevant provisions of the BRRD in the UK from 1 January 2015, includes powers to (a) transfer all or some of the securities issued by a UK bank or its parent, or all or some of the property, rights and liabilities of a UK bank or its parent, to a commercial purchaser or, transfer of the bank into temporary public ownership, or, in the case of property, rights or liabilities, to a bridge bank (an entity owned by the Bank of England); (b) together with another resolution tool only, transfer impaired or problem assets to one or more publicly owned asset management vehicles; (c) override any default provisions, contracts or other agreements, including provisions that would otherwise allow a party to terminate a contract or accelerate the payment of an obligation; (d) commence certain insolvency procedures in relation to a UK bank; and (e) override, vary or impose contractual obligations, for reasonable consideration, between a UK bank or its parent and its group undertakings (including undertakings which have ceased to be members of the group), in order to enable any transferee or successor bank of the UK bank to operate effectively. Where stabilisation options are used under (a) or (b) above which rely on the use of public funds, the option can only be used once there has been a contribution to loss absorption and recapitalisation of at least 8% of the total liabilities of the institution under resolution.

In addition, among the changes introduced by the Banking Reform Act 2013 and amendments made subsequently to implement the relevant provisions of the BRRD, the Banking Act 2009 was amended to insert a bail-in power as part of the powers available to the UK resolution authority. The bail-in power includes both a capital instruments write-down and conversion power applicable to Tier 1 and Tier 2 instruments and triggered at the point of non-viability of a financial institution and a bail-in tool applicable to eligible liabilities (including the senior unsecured debt securities issued by the RBS Group) and available in resolution.

Additional information

The capital instruments write-down and conversion power may be exercised independently of, or in combination with, the exercise of a resolution tool (other than the bail-in tool, which would be used instead of the capital instruments write-down and conversion power), and it allows resolution authorities to cancel all or a portion of the principal amount of capital instruments and/or convert such capital instruments into common equity Tier 1 instruments when an institution is no longer viable. The point of non-viability for such purposes is the point at which the Bank of England or the PRA determines that the institution meets the conditions for entry into the Special Resolution Regime as defined under the Banking Act 2009 or will no longer be viable unless the relevant capital instruments are written down or extraordinary public support is provided, and without such support the appropriate authority determines that the institution would no longer be viable.

Where the conditions for resolution exist and it is determined that a stabilisation power may be exercised, the Bank of England may use the bail-in tool (in combination with other resolution tools under the Banking Act 2009) to, among other things, cancel or reduce all or a portion of the principal amount of, or interest on, certain unsecured liabilities of a failing financial institution and/or convert certain debt claims into another security, including ordinary shares of the surviving entity. In addition, the Bank of England may use the bail-in tool to, among other things, replace or substitute the issuer as obligor in respect of debt instruments, modify the terms of debt instruments (including altering the maturity (if any) and/or the amount of interest payable and/or imposing a temporary suspension on payments) and discontinue the listing and admission to trading of financial instruments. The exercise of the bail-in tool will be determined by the Bank of England which will have discretion to determine whether the institution has reached a point of non-viability or whether the conditions for resolution are met, by application of the relevant provisions of the Banking Act 2009, and involves decisions being taken by the PRA and the Bank of England, in consultation with the FCA and HM Treasury. As a result, it will be difficult to predict when, if at all, the exercise of the bail-in power may occur.

The potential impact of these powers and their prospective use may include increased volatility in the market price of shares and other securities issued by the RBS Group and the Group (including its American depositary shares), as well as increased difficulties for RBS Group in issuing securities in the capital markets and increased costs of raising such funds.

If these powers were to be exercised (or there is an increased risk of exercise could result in a material adverse effect on the rights or interests of RBSG shareholders which would likely be extinguished or very heavily diluted.) in respect of RBSG or any entity within the RBS Group such exercise

Holders of debt securities (which may include holders of senior unsecured debt), would see the conversion of part (or all) of their claims into equity or written down in part or written off entirely. In accordance with the rules of the Special Resolution Regime, the losses imposed on holders of equity and debt instruments through the exercise of bail-in powers would be subject to the “no creditor worse off” safeguard, which requires losses not to exceed those which would be realised in insolvency.

In the UK and in other jurisdictions, the RBS Group and the Group are responsible for contributing to compensation schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers.

In the UK, the Financial Services Compensation Scheme (FSCS) was established under the FSMA and is the UK’s statutory fund of last resort for customers of authorised financial services firms. The FSCS can pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it. The FSCS is funded by levies on firms authorised by the FCA, including the RBS Group and the Group. In the event that the FSCS raises funds from the authorised firms, raises those funds more frequently or significantly increases the levies to be paid by such firms, the associated costs to the Group may have an adverse impact on its results of operations and financial condition.

To the extent that other jurisdictions where the Group operates have introduced or plan to introduce similar compensation, contributory or reimbursement schemes, the Group may make further provisions and may incur additional costs and liabilities, which may have an adverse impact on its financial condition and results of operations.

Recent changes in the tax legislation in the UK are likely to result in increased tax payments by the Group and may impact the recoverability of certain deferred tax assets recognised by the Group.

In accordance with IFRS, the Group has recognised deferred tax assets on losses available to relieve future profits from tax only to the extent it is probable that they will be recovered. The deferred tax assets are quantified on the basis of current tax legislation and accounting standards and are subject to change in respect of the future rates of tax or the rules for computing taxable profits and offsetting allowable losses.

The Finance Act 2015 included new restrictions on the use of certain brought forward tax losses of banking companies to 50% of relevant profits from 1 April 2015, which has impacted the extent to which the Group is able to recognise deferred tax assets and has been reflected in its year-end accounts. At 31 December 2015, the Group recognised a net deferred tax asset (taking account of the Finance Act 2015 changes) of £1.8 billion.

Additional information

On 16 March 2016, the UK Government announced their intention to further restrict the use of tax losses carried forward by UK banks. If these measures are enacted by the UK Parliament during the course of 2016, a longer recovery period of the deferred tax assets associated with UK tax losses will therefore arise. Failure to generate sufficient future taxable profits or further changes in tax legislation (including rates of tax) or accounting standards may reduce the recoverable amount of the recognised deferred tax assets. Further changes to the treatment of deferred tax assets may impact the Group's capital, for example by reducing further the Group's ability to recognise deferred tax assets. Further, the new 8% tax surcharge which applies to banking companies from 1 January 2016 cannot be offset by brought forward tax losses arising before this time, or by any tax losses arising in non-banking companies within the Group. In addition, the implementation of the rules relating to the UK ring-fencing regime and the resulting restructuring of the Group may further restrict the Group's ability to recognise tax deferred tax assets in respect of brought forward losses.

Forward-looking statements

Certain sections in this document contain 'forward-looking statements' as that term is defined in the United States Private Securities Litigation Reform Act of 1995, such as statements that include the words 'expect', 'estimate', 'project', 'anticipate', 'believe', 'should', 'intend', 'plan', 'could', 'probability', 'risk', 'Value-at-Risk (VaR)', 'target', 'goal', 'objective', 'may', 'endeavour', 'outlook', 'optimistic', 'prospects' and similar expressions or variations on these expressions.

In particular, this document includes forward-looking statements relating, but not limited to: RBSG and the Group's restructuring, which includes the separation and divestment of Williams & Glyn, the proposed restructuring of RBSG's CIB business, the implementation of the UK ring-fencing regime, the implementation of a major development program to update RBSG and the Group's IT infrastructure and the continuation of its balance sheet reduction programme, as well as capital and strategic plans, divestments, capitalisation, portfolios, net interest margin, capital and leverage ratios and requirements liquidity, risk-weighted assets (RWAs), RWA equivalents (RWAe), Pillar 2A, return on equity (ROE), profitability, cost:income ratios, loan:deposit ratios, AT1 and other funding plans, funding and credit risk profile; litigation, government and regulatory investigations; RBSG and the Group's future financial performance; the level and extent of future impairments and write-downs; including with respect to Goodwill; future pension contributions and RBSG and the Group's exposure to political risks, operational risk, conduct risk and credit rating risk and to various types of market risks, such as interest rate risk, foreign exchange rate risk and commodity and equity price risk. These statements are based on current plans, estimates, targets and projections, and are subject to inherent risks, uncertainties and other factors which could cause actual results to differ materially from the future results expressed or implied by such forward-looking statements. For example, certain market risk disclosures are dependent on choices relying on key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market risk disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated.

Other factors that could adversely affect our results and the accuracy of forward-looking statements in this document include the risk factors and other uncertainties discussed in this document. These include the significant risks for RBSG and the Group presented by the uncertainty relating to the referendum on the UK's membership of the European Union and the consequences of it; the separation and divestment of Williams & Glyn; RBSG and the Group's ability to successfully implement the various initiatives that are comprised in its restructuring plan, particularly the proposed restructuring of its CIB business and the balance sheet reduction programme as well as the significant restructuring required to be undertaken by RBSG and the Group in order to implement the UK ring fencing regime; the significant changes, complexity and costs relating to the implementation of its restructuring, the separation and divestment of Williams & Glyn and the UK ring-fencing regime; whether the Group will emerge from its restructuring and the UK ring-fencing regime as a viable, competitive, customer focused and profitable bank; the outcomes of the legal, regulatory and governmental actions and investigations that RBSG is subject to (including active civil and criminal investigations) and any resulting material adverse effect on RBSG of unfavourable outcomes (including where resolved by settlement); RBSG's ability to achieve its capital and leverage requirements or targets which will depend on RBSG and the Group's success in reducing the size of its business and future profitability; ineffective management of capital or changes to regulatory requirements relating to capital adequacy and liquidity or failure to pass mandatory stress tests; the ability to access sufficient sources of capital, liquidity and funding when required; changes in the credit ratings of RBSG, the Bank or the UK government; declining revenues resulting from lower customer retention and revenue generation in light of RBSG and the Group's strategic refocus on the UK the impact of global economic and financial market conditions (including low or negative interest rates) as well as increasing competition.

In addition, there are other risks and uncertainties. These include operational risks that are inherent to the Group's business and will increase as a result of the Group's significant restructuring; the potential negative impact on the Group's business of actual or perceived global economic and financial market conditions and other global risks; the impact of unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices; basis, volatility and correlation risks; heightened regulatory and governmental scrutiny and the increasingly regulated environment in which RBSG and The Group operate; the risk of failure to realise the benefit of the Group's substantial investments in its information technology and systems, the risk of failing to prevent a failure of RBSG or the Group's IT systems or to protect itself and its customers against cyber threats, reputational risks; risks relating to the failure to embed and maintain a robust conduct and risk culture across the organisation or if its risk management framework is ineffective; risks relating to increased pension liabilities and the impact of pension risk on RBSG and the Group's capital position; increased competitive pressures resulting from new incumbents and disruptive technologies; the Group's ability to attract and retain qualified personnel; HM Treasury exercising influence over the operations of RBSG; limitations on, or additional requirements imposed on, the Group's activities as a result of HM Treasury's investment in RBSG; the extent of future write-downs and impairment charges caused by depressed asset valuations; deteriorations in borrower and counterparty credit quality; the value and effectiveness of any credit protection purchased by the Group; risks relating to the reliance on valuation, capital and stress test models and any inaccuracies resulting therefrom or failure to accurately reflect changes in the micro and macroeconomic environment in which the Group operates, risks relating to changes in applicable accounting policies or rules which may impact the preparation of the Group's financial statements; the impact of the recovery and resolution framework and other prudential rules to which the Group is subject, the recoverability of deferred tax assets by the Group; and the success of RBSG and the Group in managing the risks involved in the foregoing.

The forward-looking statements contained in this document speak only as at the date hereof, and the Group does not assume or undertake any obligation or responsibility to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The information, statements and opinions contained in this document do not constitute a public offer under any applicable legislation or an offer to sell or solicit of any offer to buy any securities or financial instruments or any advice or recommendation with respect to such securities or other financial instruments.

Abbreviations and acronyms

ABS	Asset-backed securities	IASB	International Accounting Standards Board
AFS	Available-for-sale	ICAAP	Internal Capital Adequacy Assessment Process
AQ	Asset quality		
AT1	Additional Tier 1	IFRS	International Financial Reporting Standards
BCBS	Basel Committee on Banking Supervision	IPV	Independent price verification
C&RA	Conduct & Regulatory Affairs	IRC	Incremental risk charge
CDO	Collateralised debt obligation	LAR	Loans and receivables
CDS	Credit default swap	LCR	Liquidity coverage ratio
CET1	Common equity tier 1	LIBOR	London Interbank Offered Rate
CIB	Corporate & Institutional Banking	LGD	Loss given default
CLO	Collateralised loan obligation	LTV	Loan-to-value
CMBS	Commercial mortgage-backed securities	MDA	Maximum distributable amount
CPB	Commercial & Private Banking	NI	Northern Ireland
CRD	Capital Requirements Directive	NSFR	Net stable funding ratio
CRE	Commercial real estate	PBB	Personal & Business Banking
CVA	Credit valuation adjustment	PD	Probability of default
DFV	Designated as at fair value through profit or loss	PPI	Payment Protection Insurance
		PRA	Prudential Regulation Authority
EAD	Exposure at default	RBSG	The Royal Bank of Scotland Group plc
EBA	European Banking Authority	RCR	RBS Capital Resolution
EC	European Commission	REIL	Risk elements in lending
EMEA	Europe, the Middle East and Africa	RMBS	Residential mortgage-backed securities
ERF	Executive Risk Forum	RNIV	Risks not In VaR
EU	European Union	ROI	Republic of Ireland
FCA	Financial Conduct Authority	RoW	Rest of the World
FI	Financial institution	RWA	Risk-weighted asset
FSA	Financial Services Authority	SE	Structured entity
FSB	Financial Stability Board	SME	Small and medium-sized enterprise
FSCS	Financial Services Compensation Scheme	SVaR	Stressed value-at-risk
FVTPL	Fair value through profit or loss	TLAC	Total loss absorbing capacity
GDP	Gross domestic product	TSR	Total Shareholder Return
GSIB	Global systemically important bank	UK	United Kingdom
HFT	Held-for-trading	UKFI	UK Financial Investments Limited
HMT	HM Treasury	US/USA	United States of America
HTM	Held-to-maturity	VaR	Value-at-risk
IAS	International Accounting Standards		

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

The bank publishes its financial statements in pounds sterling ('£' or 'sterling'). The abbreviations '£m' and '£bn' represent millions and thousands of millions of pounds sterling, respectively, and references to 'pence' represent pence in the United Kingdom ('UK'). Reference to 'dollars' or '\$' are to United States of America ('US') dollars. The abbreviations '\$m' and '\$bn' represent millions and thousands of millions of dollars, respectively, and references to 'cents' represent cents in the US. The abbreviation '€' represents the 'euro', and the abbreviations '€m' and '€bn' represent millions and thousands of millions of euros, respectively.

Glossary of terms

Arrears - the aggregate of contractual payments due on a debt that have not been met by the borrower. A loan or other financial asset is said to be 'in arrears' when payments have not been made.

Asset-backed commercial paper (ABCP) - a form of asset-backed security generally issued by a commercial paper conduit.

Asset-backed securities (ABS) - securities that represent interests in specific portfolios of assets. They are issued by a structured entity following a securitisation. The underlying portfolios commonly comprise residential or commercial mortgages but can include any class of asset that yields predictable cash flows. Payments on the securities depend primarily on the cash flows generated by the assets in the underlying pool and other rights designed to assure timely payment, such as guarantees or other credit enhancements. Collateralised debt obligations, collateralised loan obligations, commercial mortgage backed securities and residential mortgage backed securities are all types of ABS.

Asset quality (AQ) band - probability of default banding for all counterparties on a scale of 1 to 10.

Assets under management - assets managed by the Group on behalf of clients.

Back-testing - statistical techniques that assess the performance of a model, and how that model would have performed had it been applied in the past.

Basel II - the capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the 'International Convergence of Capital Measurement and Capital Standards'.

Basel III - in December 2010, the Basel Committee on Banking Supervision issued final rules: 'Basel III: A global regulatory framework for more resilient banks and banking systems' and 'Basel III: International framework for liquidity risk measurement, standards and monitoring'.

Basis point - one hundredth of a per cent i.e. 0.01 per cent. 100 basis points is 1 per cent. Used when quoting movements in interest rates or yields on securities.

Buy-to-let mortgages - mortgages to customers for the purchase of residential property as a rental investment.

Capital requirements regulation (CRR) - refer to CRD IV.

Central counterparty (CCP) - an intermediary between a buyer and a seller (generally a clearing house).

Certificates of deposit (CDs) - bearer negotiable instruments acknowledging the receipt of a fixed term deposit at a specified interest rate.

Collateralised debt obligations (CDOs) - asset-backed securities for which the underlying asset portfolios are debt obligations: either bonds (collateralised bond obligations) or loans (collateralised loan obligations) or both. The credit exposure underlying synthetic CDOs derives from credit default swaps. The CDOs issued by an individual vehicle are usually divided in different tranches: senior tranches (rated AAA), mezzanine tranches (AA to BB), and equity tranches (unrated). Losses are borne first by the equity securities, next by the junior securities, and finally by the senior securities; junior tranches offer higher coupons (interest payments) to compensate for their increased risk.

Collateralised loan obligations (CLOs) - asset-backed securities for which the underlying asset portfolios are loans, often leveraged loans.

Collectively assessed loan impairment provisions - impairment loss provisions in respect of impaired loans, such as credit cards or personal loans, that are below individual assessment thresholds. Such provisions are established on a portfolio basis, taking account of the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends.

Commercial mortgage backed securities (CMBS) - asset-backed securities for which the underlying asset portfolios are loans secured on commercial real estate.

Commercial paper (CP) - unsecured obligations issued by a corporate or a bank directly or secured obligations (asset-backed CP), often issued through a commercial paper conduit, to fund working capital. Maturities typically range from two to 270 days. However, the depth and reliability of some CP markets means that issuers can repeatedly roll over CP issuance and effectively achieve longer term funding. CP is issued in a wide range of denominations and can be either discounted or interest-bearing.

Commercial paper conduit - a structured entity that issues commercial paper and uses the proceeds to purchase or fund a pool of assets. The commercial paper is secured on the assets and is redeemed either by further commercial paper issuance, repayment of assets or liquidity drawings.

Commercial real estate - freehold and leasehold properties used for business activities. Commercial real estate includes office buildings, industrial property, medical centres, hotels, retail stores, shopping centres, agricultural land and buildings, warehouses, garages etc.

Common Equity Tier 1 capital - the highest quality form of regulatory capital under Basel III comprising common shares issued and related share premium, retained earnings and other reserves excluding reserves which are restricted or not immediately available, less specified regulatory adjustments.

Contractual maturity - the date in the terms of a financial instrument on which the last payment or receipt under the contract is due for settlement.

Glossary of terms

Cost:income ratio - operating expenses as a percentage of total income.

Counterparty credit risk - the risk that a counterparty defaults before the maturity of a derivative or sale and repurchase contract. In contrast to non-counterparty credit risk, the exposure to counterparty credit risk varies by reference to a market factor (e.g. interest rate, exchange rate, asset price).

Coverage ratio - impairment provisions as a percentage of impaired loans.

Covered bonds - debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds.

CRD IV - the European Union has implemented the Basel III capital proposals through the CRR and the CRD, collectively known as CRD IV. CRD IV was implemented on 1 January 2014. The EBA's technical standards are still to be finalised through adoption by the European Commission and implemented within the UK.

Credit default swap (CDS) - a contract where the protection seller receives premium or interest-related payments in return for contracting to make payments to the protection buyer upon a defined credit event in relation to a reference financial asset or portfolio of financial assets. Credit events usually include bankruptcy, payment default and rating downgrades.

Credit derivative product company (CDPC) - a structured entity that sells credit protection under credit default swaps or certain approved forms of insurance policies. CDPCs are similar to monoline insurers. However, unlike monoline insurers, they are not regulated as insurers.

Credit derivatives - contractual agreements that provide protection against a credit event on one or more reference entities or financial assets. The nature of a credit event is established by the protection buyer and protection seller at the inception of a transaction, and such events include bankruptcy, insolvency or failure to meet payment obligations when due. The buyer of the credit derivative pays a periodic fee in return for a payment by the protection seller upon the occurrence of a credit event. Credit derivatives include credit default swaps, total return swaps and credit swap options.

Credit enhancements - techniques that improve the credit standing of financial obligations; generally those issued by a structured entity in a securitisation. External credit enhancements include financial guarantees and letters of credit from third party providers. Internal enhancements include excess spread - the difference between the interest rate received on the underlying portfolio and the coupon on the issued securities; and over-collateralisation – at inception, the value of the underlying portfolio is greater than the securities issued.

Credit grade - a rating that represents an assessment of the creditworthiness of a customer. It is a point on a scale representing the probability of default of a customer.

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

Credit risk mitigation - reducing the credit risk of an exposure by application of techniques such as netting, collateral, guarantees and credit derivatives.

Credit valuation adjustment (CVA) - the CVA is the difference between the risk-free value of a portfolio of trades and its market value, taking into account the counterparty's risk of default. It represents the market value of counterparty credit risk, or an estimate of the adjustment to fair value that a market participant would make to reflect the creditworthiness of its counterparty.

Currency swap - an arrangement in which two parties exchange specific principal amounts of different currencies at inception and subsequently interest payments on the principal amounts. Often, one party will pay a fixed rate of interest, while the other will pay a floating rate (though there are also fixed-fixed and floating-floating currency swaps). At the maturity of the swap, the principal amounts are usually re-exchanged.

Customer accounts - money deposited with the Group by counterparties other than banks and classified as liabilities. They include demand, savings and time deposits; securities sold under repurchase agreements; and other short term deposits. Deposits received from banks are classified as deposits by banks.

Debit valuation adjustment (DVA) - an adjustment made in valuing OTC derivative liabilities to reflect the entity's own credit risk.

Debt securities - transferable instruments creating or acknowledging indebtedness. They include debentures, bonds, certificates of deposit, notes and commercial paper. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue, such as the right to receive certain information. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured or unsecured.

Debt securities in issue - unsubordinated debt securities issued by the Group. They include commercial paper, certificates of deposit, bonds and medium-term notes.

Deferred tax asset - income taxes recoverable in future periods as a result of deductible temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in tax deductible amounts in future periods) and the carry-forward of tax losses and unused tax credits.

Glossary of terms

Deferred tax liability - income taxes payable in future periods as a result of taxable temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in taxable amounts in future periods).

Defined benefit obligation - the present value of expected future payments required to settle the obligations of a defined benefit plan resulting from employee service.

Defined benefit plan/scheme - pension or other post-retirement benefit plan other than a defined contribution plan.

Defined contribution plan/scheme - pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.

Deposits by banks - money deposited with the Group by banks and recorded as liabilities. They include money-market deposits, securities sold under repurchase agreements, federal funds purchased and other short term deposits. Deposits received from customers are recorded as customer accounts.

Derivative - a contract or agreement whose value changes with changes in an underlying variable such as interest rates, foreign exchange rates, share prices or indices and which requires no initial investment or an initial investment that is smaller than would be required for other types of contracts with a similar response to market factors. The principal types of derivatives are: swaps, forwards, futures and options.

Discontinued operation - a component of the Group that either has been disposed of or is classified as held for sale. A discontinued operation is either: a separate major line of business or geographical area of operations or part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or a subsidiary acquired exclusively with a view to resale.

Economic capital - an internal measure of the capital required by the Group to support the risks to which it is exposed.

Economic profit - the difference between the return on shareholders funds and the cost of that capital. Economic profit is usually expressed as a percentage.

Effective interest rate method - the effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees payable or receivable that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows.

Encumbrance - an interest in an asset held by another party. Encumbrance usually restricts the asset's transferability until the encumbrance is removed.

Equity risk - the risk of changes in the market price of the equities or equity instruments arising from positions, either long or short, in equities or equity-based financial instruments.

Eurozone - the 19 European Union countries that have adopted the euro: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

Expected loss (EL) - expected loss represents the anticipated loss on an exposure over one year. It is determined by multiplying probability of default, loss given default and exposure at default and can be calculated at individual, credit facility, customer or portfolio level.

Exposure - a claim, contingent claim or position which carries a risk of financial loss.

Exposure at default (EAD) - an estimate of the extent to which the bank will be exposed under a specific facility, in the event of the default of a counterparty.

FICO score - a credit score calculated using proprietary software developed by the Fair Isaac Corporation in the US from a consumer's credit profile. The scores range between 300 and 850 and are used in credit decisions made by banks and other providers of credit.

Financial Conduct Authority (FCA) - the statutory body responsible for conduct of business regulation and supervision of UK authorised firms from 1 April 2013. The FCA also has responsibility for the prudential regulation of firms that do not fall within the PRA's scope.

Financial Services Compensation Scheme (FSCS) - the UK's statutory fund of last resort for customers of authorised financial services firms. It pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the financial services industry.

First/second lien - a lien is a charge such as a mortgage held by one party, over property owned by a second party, as security for payment of some debt, obligation, or duty owed by that second party. The holder of a first lien takes precedence over all other encumbrances on that property i.e. second and subsequent liens.

Forbearance - forbearance takes place when a concession is made on the contractual terms of a loan in response to a customer's financial difficulties.

Forward contract - a contract to buy (or sell) a specified amount of a physical or financial commodity, at an agreed price, at an agreed future date.

Glossary of terms

Futures contract - a contract which provides for the future delivery (or acceptance of delivery) of some type of financial instrument or commodity under terms established at the outset. Futures differ from forward contracts in that they are standardised and traded on recognised exchanges and rarely result in actual delivery; most contracts are closed out prior to maturity by acquisition of an offsetting position.

G10 - the Group of Ten comprises the eleven industrial countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States) that have agreed to participate in the International Monetary Fund's (IMF's) General Arrangements to Borrow.

Government Sponsored Enterprises (GSEs) - a group of financial services corporations created by the US Congress. Their function is to improve the efficiency of capital markets and to overcome statutory and other market imperfections which otherwise prevent funds from moving easily from suppliers of funds to areas of high loan demand. They include the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association.

Gross yield - the interest rate earned on average interest-earning assets i.e. interest income divided by average interest-earning assets.

Haircut - a downward adjustment to collateral value to reflect its nature and any currency or maturity mismatches between the collateral and the exposure it secures.

Hedge funds - pooled investment vehicles that are not widely available to the public; their assets are managed by professional asset managers who participate in the performance of the fund.

Impaired loans - all loans for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans.

Impairment allowance - refer to Loan impairment provisions.

Impairment losses - (a) for impaired financial assets measured at amortised cost, impairment losses - the difference between carrying value and the present value of estimated future cash flows discounted at the asset's original effective interest rate - are recognised in profit or loss and the carrying amount of the financial asset reduced by establishing a provision (allowance) (b) for impaired available-for-sale financial assets, the cumulative loss that had been recognised directly in equity is removed from equity and recognised in profit or loss as an impairment loss.

Individual liquidity guidance (ILG) - guidance from the PRA on a firm's required quantity of liquidity resources and funding profile.

Individually assessed loan impairment provisions - impairment loss provisions for individually significant impaired loans assessed on a case-by-case basis, taking into account the financial condition of the counterparty and any guarantor and the realisable value of any collateral held.

Interest rate swap - a contract under which two counterparties agree to exchange periodic interest payments on a predetermined monetary principal, the notional amount.

Interest spread - the difference between the gross yield and the interest rate paid on average interest-bearing liabilities.

Internal Capital Adequacy Assessment Process (ICAAP) - the Group's own assessment, as part of Basel III requirements, of its risks, how it intends to mitigate those risks and how much current and future capital is necessary having considered other mitigating factors.

Internal funding of trading business - the internal funding of the trading book comprises net banking book financial liabilities that fund financial assets in the Group's trading portfolios. Interest payable on these financial liabilities is charged to the trading book.

International Accounting Standards Board (IASB) - the independent standard-setting body of the IFRS Foundation. Its members are responsible for the development and publication of International Financial Reporting Standards (IFRSs) and for approving Interpretations of IFRS as developed by the IFRS Interpretations Committee.

International Swaps and Derivatives Association (ISDA) master agreement - a standardised contract developed by ISDA for bilateral derivatives transactions. The contract grants legal rights of set-off for derivative transactions with the same counterparty.

Investment grade - generally represents a risk profile similar to a rating of BBB-/Baa3 or better, as defined by independent rating agencies.

Key management - members of the RBS Group Executive Committee.

Latent loss provisions - loan impairment provisions held against impairments in the performing loan portfolio that have been incurred as a result of events occurring before the balance sheet date but which have not been identified at the balance sheet date.

Level 1 - level 1 fair value measurements are derived from quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

Level 2 - level 2 fair value measurements use inputs, other than quoted prices included within level 1, that are observable for the asset or liability, either directly or indirectly.

Level 3 - level 3 fair value measurements use one or more unobservable inputs for the asset or liability.

Leverage ratio - a measure prescribed under Basel III. It is the ratio of Tier 1 capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives, and generally follow the accounting measure of exposure.

Liquidity and funding risk - the risk that the Group is unable to meet its financial liabilities when they fall due.

Glossary of terms

Liquidity coverage ratio (LCR) - the ratio of the stock of high quality liquid assets to expected net cash outflows over the following 30 days. High quality liquid assets should be unencumbered, liquid in markets during a time of stress and, ideally, central bank eligible.

Loan:deposit ratio - the ratio of loans and advances to customers net of provision for impairment losses and excluding reverse repurchase agreements to customer deposits excluding repurchase agreements.

Loan impairment provisions - loan impairment provisions are established to recognise incurred impairment losses on a portfolio of loans classified as loans and receivables and carried at amortised cost. It has three components: individually assessed loan impairment provisions, collectively assessed loan impairment provisions and latent loss provisions.

Loan-to-value ratio - the amount of a secured loan as a percentage of the appraised value of the security e.g. the outstanding amount of a mortgage loan as a percentage of the property's value.

London Interbank Offered Rate (LIBOR) - the benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.

Loss given default (LGD) - an estimate of the amount that will not be recovered by the Group in the event of default, plus the cost of debt collection activities and the delay in cash recovery.

Market risk - the risk of loss arising from fluctuations in interest rates, credit spreads, foreign currency rates, equity prices, commodity prices and other risk-related factors such as market volatilities that may lead to a reduction in earnings, economic value or both.

Master netting agreement - an agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.

Maximum distributable amount (MDA) - a restriction on distributions which may be made by a bank which does not meet the combined buffer requirements as set out in the PRA Supervisory Statement SS6/14 'Implementing CRD IV: capital buffers'.

Medium term notes (MTNs) - debt securities usually with a maturity of five to ten years, but the term may be less than one year or as long as 50 years. They can be issued on a fixed or floating coupon basis or with an exotic coupon; with a fixed maturity date (non-callable) or with embedded call or put options or early repayment triggers. MTNs are generally issued as senior unsecured debt.

Monoline insurers (monolines) - entities that specialise in providing credit protection against the notional and interest cash flows due to the holders of debt instruments in the event of default. This protection is typically in the form of derivatives such as credit default swaps.

Mortgage-backed securities - asset-backed securities for which the underlying asset portfolios are loans secured on property. See Residential mortgage backed securities and Commercial mortgage backed securities.

Mortgage servicing rights - the rights of a mortgage servicer to collect mortgage payments and forward them, after deducting a fee, to the mortgage lender.

Negative equity mortgages - mortgages where the value of the property mortgaged is less than the outstanding balance on the loan.

Net interest income - the difference between interest receivable on financial assets classified as loans and receivables or available-for-sale and interest payable on financial liabilities carried at amortised cost.

Net interest margin - net interest income as a percentage of average interest-earning assets.

Net stable funding ratio (NSFR) - the ratio of available stable funding to required stable funding over a one year time horizon, assuming a stressed scenario. Available stable funding includes items such as equity capital, preferred stock with a maturity of over one year and liabilities with an assessed maturity of over one year.

Non-performing loans - loans classified as Risk elements in lending and potential problem loans. They have a 100% probability of default and have been assigned an AQ10 internal credit grade.

Operational risk - the risk of loss resulting from inadequate or failed processes, people, systems or from external events.

Option - an option is a contract that gives the holder the right but not the obligation to buy (or sell) a specified amount of an underlying physical or financial commodity, at a specific price, at an agreed date or over an agreed period. Options can be exchange-traded or traded over-the-counter.

Over-the-counter (OTC) derivatives - derivatives with tailored terms and conditions negotiated bilaterally, in contrast to exchange traded derivatives that have standardised terms and conditions.

Own credit adjustment (OCA) - the effect of the Group's own credit standing on the fair value of financial liabilities.

Past due - a financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.

Glossary of terms

Pillar 1 - the part of CRD IV that sets out the process by which regulatory capital requirements should be calculated for credit, market and operational risk.

Pillar 2 - Pillar 2 is intended to ensure that firms have adequate capital to support all the relevant risks in their business and is divided into capital held against risks not captured or not fully captured by the Pillar 1 regulations (Pillar 2A) and risks to which a firm may become exposed over a forward-looking planning horizon (Pillar 2B). Capital held under Pillar 2A, in addition to the Pillar 1 requirements, is the minimum level of regulatory capital a bank should maintain at all times to cover adequately the risks to which it is or might be exposed, and to comply with the overall financial adequacy rules. Pillar 2B is a capital buffer which helps to ensure that a bank can continue to meet minimum requirements during a stressed period, and is determined by the PRA evaluating the risks to which the firm may become exposed (e.g. due to changes to the economic environment) during the supervisory review and evaluation process. All firms will be subject to a PRA buffer assessment and the PRA will set a PRA buffer only if it judges that the CRD IV buffers are inadequate for a particular firm given its vulnerability in a stress scenario, or where the PRA has identified risk management and governance failings, which the CRD IV buffers are not intended to address.

Pillar 3 - the part of CRD IV that sets out the information banks must disclose about their risks, the amount of capital required to absorb them, and their approach to risk management. The aim is to strengthen market discipline.

Position risk requirement - a capital requirement applied to a position treated under the Market Risk Rules as part of the calculation of the market risk capital requirement.

Potential future exposure - is a measure of counterparty risk/credit risk. It is calculated by evaluating existing trades done against the possible market prices in future during the lifetime of the transactions.

Potential problem loans (PPL) - loans for which an impairment event has taken place but no impairment loss is expected. This category is used for advances which are not past due 90 days or revolving credit facilities where identification as 90 days overdue is not feasible.

PRA Rule Book - contains provisions made by the PRA that apply to PRA authorised firms. Within 'Banking and Investment Rules', the Capital Requirements firms' section applies to the Group.

Private equity - equity investments in operating companies not quoted on a public exchange. Capital for private equity investment is raised from retail or institutional investors and used to fund investment strategies such as leveraged buyouts, venture capital, growth capital, distressed investments and mezzanine capital.

Probability of default (PD) - the likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon.

Prudential Regulation Authority (PRA) - the statutory body responsible for the prudential supervision of banks, building societies, insurers and a small number of significant investment firms in the UK. The PRA is a subsidiary of the Bank of England.

Regular way purchase or sale - a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.

Regulatory capital - the amount of capital that the Group holds, determined in accordance with rules established by the PRA for the consolidated Group and by local regulators for individual Group companies.

Repurchase agreement (Repo) - refer to Sale and repurchase agreements.

Residential mortgage - a loan to purchase a residential property where the property forms collateral for the loan. The borrower gives the lender a lien against the property and the lender can foreclose on the property if the borrower does not repay the loan per the agreed terms. Also known as a home loan.

Residential mortgage backed securities (RMBS) - asset-backed securities for which the underlying asset portfolios are residential mortgages. RBS Group RMBS classifications, including prime, non-conforming and sub-prime, reflect the characteristics of the underlying mortgage portfolios. RMBS are classified as prime RMBS where the loans have low default risk and are made to borrowers with good credit records and reliable payment histories and there is full documentation. Non-conforming RMBS include US Alt-A RMBS, together with RMBS in jurisdictions other than the US where the underlying mortgages are not classified as either prime or sub-prime. Classification of RMBS as subprime or Alt-A is based on Fair Isaac Corporation scores (FICO), level of documentation and loan-to-value ratios of the underlying mortgage loans. US RMBS are classified as sub-prime if the mortgage portfolio comprises loans with FICO scores between 500 and 650 with full or limited documentation. Mortgages in Alt-A RMBS portfolios have FICO scores of 640 to 720, limited documentation and an original LTV of 70% to 100%. In other jurisdictions, RMBS are classified as sub-prime if the mortgage portfolio comprises loans with one or more high risk characteristics such as: unreliable or poor payment histories; high loan-to-value ratios; high debt-to-income ratio; the loan is not secured on the borrower's primary residence; or a history of delinquencies or late payments on the loan.

Retail loans - loans made to individuals rather than institutions. The loans may be for car purchases, home purchases, medical care, home repair, holidays and other consumer uses.

Return on equity - profit attributable to ordinary shareholders divided by average shareholders' equity as a percentage.

Reverse repurchase agreement (Reverse repo) - refer to Sale and repurchase agreements.

Risk appetite - an expression of the maximum level of risk that the Group is prepared to accept to deliver its business objectives.

Glossary of terms

Risk asset ratio (RAR) - total regulatory capital as a percentage of risk-weighted assets.

Risk elements in lending (REIL) - impaired loans and accruing loans which are contractually overdue 90 days or more as to principal or interest.

Risk-weighted assets (RWAs) - assets adjusted for their associated risks using weightings established in accordance with the CRD IV as implemented by the PRA. Certain assets are not weighted but deducted from capital.

Sale and repurchase agreements - in a sale and repurchase agreement one party, the seller, sells a financial asset to another party, the buyer, at the same time the seller agrees to reacquire and the buyer to resell the asset at a later date. From the seller's perspective such agreements are repurchase agreements (repos) and from the buyer's reverse repurchase agreements (reverse repos).

Securitisation - a process by which assets or cash flows are transformed into transferable securities. The underlying assets or cash flows are transferred by the originator or an intermediary, typically an investment bank, to a structured entity which issues securities to investors. Asset securitisations involve issuing debt securities (asset-backed securities) that are backed by the cash flows of income-generating assets (ranging from credit card receivables to residential mortgage loans).

Settlement balances - payables and receivables that result from purchases and sales of financial instruments recognised on trade date. Asset settlement balances are amounts owed to the Group in respect of sales and liability settlement balances are amounts owed by the Group in respect of purchases.

Sovereign exposures - exposures to governments, ministries, departments of governments and central banks.

Standardised approach - a method used to calculate credit risk capital requirements under Pillar 1. In this approach the risk weights used in the capital calculation are determined by regulators. For operational risk, capital requirements are determined by multiplying three years' historical gross income by a percentage determined by the regulator. The percentage ranges from 12 to 18%, depending on the type of underlying business being considered.

Standstill - is an agreement, usually for a specified period of time, not to enforce the lender's rights as a result of a customer breaching the terms and conditions of their facilities. This is a concession to the customer. A standstill is most commonly used in a complex restructuring of a company's debts, where a group of creditors agree to delay enforcement action to give the company time to gather information and formulate a strategy with a view to establishing a formal restructuring.

Stress testing - a technique used to evaluate the potential effects on an institution's financial condition of an exceptional but plausible event and/or movement in a set of financial variables.

Stressed value-at-risk (SVaR) - a VaR measure using historical data from a one year period of stressed market conditions. For the purposes of calculating regulatory SVaR, a time horizon of ten trading days is assumed at a confidence level of 99%. Refer also to Value-at-risk below.

Structured credit portfolio (SCP) - a portfolio of certain illiquid assets - principally CDO super senior positions, negative basis trades and monoline exposures.

Structured entity (SE) - an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose, they do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions.

Structured notes - securities that pay a return linked to the value or level of a specified asset or index. Structured notes can be linked to equities, interest rates, funds, commodities and foreign currency.

Subordinated liabilities - liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.

Super senior CDO - the most senior class of instrument issued by a CDO vehicle. They benefit from the subordination of all other instruments, including AAA rated securities, issued by the CDO vehicle.

Supervisory slotting approach - a method of calculating regulatory capital, specifically for lending exposures in project finance and income producing real estate, where the PD estimates do not meet the minimum internal ratings based standards. Under this approach, the bank classifies exposures from 1 to 5, where 1 is strong and 5 is default. Specific risk-weights are assigned to each classification.

Tier 1 capital - a component of regulatory capital, comprising Common Equity Tier 1 and Additional Tier 1. Additional Tier 1 capital includes eligible non-common equity capital securities and any related share premium. Under Basel II, Tier 1 capital comprises Core Tier 1 capital plus other Tier 1 securities in issue, less certain regulatory deductions.

Tier 2 capital - qualifying subordinated debt and other Tier 2 securities in issue, eligible collective impairment allowances less certain regulatory deductions.

Total loss absorbing capacity (TLAC) - a Financial Stability Board requirement for global systemically important banks to have a sufficient amount of specific types of liabilities which can be used to absorb losses and recapitalise a bank in resolution. The implementation of the TLAC requirements is being discussed within local regulators.

Glossary of terms

Unaudited - financial information that has not been subjected to the audit procedures undertaken by the Group's auditors to enable them to express an opinion on the Group's financial statements.

US Federal Agencies - are independent bodies established by the US Government for specific purposes such as the management of natural resources, financial oversight or national security. A number of agencies, including, the Government National Mortgage Association, issue or guarantee publicly traded debt securities.

Value-at-risk (VaR) - a technique that produces estimates of the potential loss in the market value of a portfolio over a specified time period at a given confidence level.

Wholesale funding - wholesale funding comprises Deposits by banks, Debt securities in issue and Subordinated liabilities.

Write-down - a reduction in the carrying value of an asset to record a decline in its fair value or value in use.

Wrong-way risk - the risk of loss when the risk factors driving the exposure to a counterparty or customer are positively correlated with the creditworthiness of that counterparty i.e. the size of the exposure increases at the same time as the risk of the counterparty or customer being unable to meet that obligation, increases.

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