

Annual Report and Accounts

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Board of directors and secretary

Chairman

Philip Hampton
Nominations (Chair), RCR

Executive directors

Ross McEwan
Ewen Stevenson

Independent non-executive directors

Sandy Crombie
Senior Independent Director
Remuneration (Chair), Audit, Nominations, RCR

Alison Davis
Nominations, Remuneration, Sustainability

Morten Friis
Audit, Nominations, Risk

Robert Gillespie
Nominations, Remuneration, Risk, Sustainability

Penny Hughes
Sustainability (Chair), Nominations, Risk

Brendan Nelson
Audit (Chair), Nominations, RCR, Risk

Baroness Noakes
RCR (Chair), Risk (Chair), Audit, Nominations

Chief Governance Officer and Board Counsel

Aileen Taylor

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The Royal Bank of Scotland plc

Registered in Scotland No. SC90312

Audit	member of the Group Audit Committee
Nominations	member of the Group Nominations Committee
RCR	member of the RCR Board Oversight 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 terms 'the Royal Bank', 'RBS plc' or 'the Bank' mean The Royal Bank of Scotland plc, the 'Group' means the Bank and its subsidiaries, 'RBSG' or the 'holding company' mean The Royal Bank of Scotland Group plc and 'RBS Group' means the holding company and its subsidiaries, and 'NatWest' means National Westminster Bank Plc.

The Bank publishes its financial statements in pounds sterling ('£' or 'sterling'). The abbreviations '£m' and '£bn' represent millions and thousands of millions of pounds sterling, respectively, and references to 'pence' represent pence in the United Kingdom ('UK'). Reference to 'dollars' or '\$' are to United States of America ('US') dollars. The abbreviations '\$m' and '\$bn' represent millions and thousands of millions of dollars, respectively, and references to 'cents' represent cents in the US. The abbreviation '€' represents the 'euro', the European single currency, and the abbreviations '€m' and '€bn' represent millions and thousands of millions of euros, respectively.

International Financial Reporting Standards

As required by the Companies Act 2006 and Article 4 of the European Union IAS Regulation, the consolidated financial statements of the Group are prepared 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 (together 'IFRS'). They also comply with IFRS as issued by the IASB.

Revised organisational structure

During 2014, the RBS Group announced a new organisational structure based on three franchises:

- Personal & Business Banking, comprising two reportable segments, UK Personal & Business Banking, including Williams & Glyn, and Ulster Bank.
- Commercial & Private Banking, comprising two reportable segments, Commercial Banking and Private Banking.
- Corporate & Institutional Banking, a single reportable segment.

In addition, the RBS Group will continue to manage and report Citizens Financial Group and RBS Capital Resolution (RCR) separately until disposal or wind-down. No business lines were moved to RCR so comparative data has not been restated. Non-Core was dissolved on 31 December 2013.

Reporting changes

A number of previously reported reconciling items (Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs, regulatory and legal actions, restructuring costs, amortisation of purchased intangible assets, write down of other intangible assets and bank levy) have now been allocated to the reportable segments. Consistent with the manner in which the Group is managed, operating profit on a non-statutory basis excludes:

- Own credit adjustments;
- Gain on redemption of own debt;
- Write down of goodwill; and
- Strategic disposals.

and includes the results of Citizens that are included in discontinued operations in the statutory results.

In addition, during 2014 the Group also made changes to the method of allocating costs relating to Services and Functions and the calculation of segment return on equity.

Comparatives have been restated accordingly for the changes outlined above.

For further information on these changes, see page 12

Discontinued operations

The RBS Group disposed of 29.5% of its interest in Citizens in 2014. In accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', Citizens has been recognised as a discontinued operation with consequent changes to the presentation of comparative financial information. The assets and liabilities relating to Citizens are included in disposal groups at 31 December 2014.

Glossary

A glossary of terms is provided on pages 308 to 314.

Financial review

Description of business

Introduction

The Royal Bank of Scotland plc is a wholly-owned subsidiary of The Royal Bank of Scotland Group plc, a large banking and financial services group. The Group has a large and diversified customer base and provides a wide range of products and services to personal, commercial and large corporate and institutional customers.

Following the placing and open offers in December 2008 and in April 2009, HM Treasury owned approximately 70.3% of the enlarged ordinary share capital of the holding company. In December 2009, the holding company issued a further £25.5 billion of new capital to HM Treasury. This new capital took the form of B shares, which do not generally carry voting rights at general meetings of ordinary shareholders but are convertible into ordinary shares and qualify as Core Tier 1 capital. Following the issuance of the B shares, HM Treasury's holding of ordinary shares of the holding company remained at 70.3% although its economic interest rose to 84.4%.

At 31 December 2014, HM Treasury's holding of ordinary shares in the holding company was 62.3% and its economic interest was 79.1%.

Organisational structure

On 27 February 2014, the RBS Group announced a refreshed strategic direction with the ambition of building a bank which earns its customers' trust by serving them better than any other bank.

The RBS Group is now structured to deliver this ambition by organising itself around the needs of its customers, so as to combine customer groups with similar needs into franchises able to deliver co-ordinated services.

The reorganised bank will be a UK-focused retail and corporate bank with an international footprint to drive its corporate business. The previously reported operating divisions are now realigned into three franchises:

Personal & Business Banking (PBB) comprises two reportable segments, UK Personal & Business Banking, including Williams & Glyn, (UK PBB) and Ulster Bank.

- *UK Personal & Business Banking (UK PBB)* offers a comprehensive range of banking products and related financial services to the UK personal and small business market. It serves customers through a number of channels including: the RBS and NatWest network of branches and ATMs in the UK, telephony, online and mobile. UK PBB is committed to serving customers well, making banking easier and convenient whilst ensuring that we do business in an open, honest and sustainable manner.
- *Ulster Bank* is a retail and commercial bank in Northern Ireland and the Republic of Ireland. It provides a comprehensive range of financial services through both its Retail Banking division, which provides loan and deposit products through a network of branches and direct channels, and its Corporate Banking division, which provides services to businesses and corporate customers.

Commercial & Private Banking (CPB) comprises two reportable segments, Commercial Banking and Private Banking.

- *Commercial Banking* provides banking, finance and risk management services to the commercial, mid-corporate and corporate sector in the UK. It offers a full range of banking products and related financial services through a nationwide network of relationship managers, telephone and internet channels. The product range includes invoice finance through the RBSIF brand and asset finance through the Lombard brand.
- *Private Banking* provides banking and wealth management services in the UK through Coutts & Co and Adam & Company, offshore through RBS International, and Isle of Man Bank and internationally through Coutts & Co Ltd.

Corporate & Institutional Banking (CIB) serves our corporate and institutional clients primarily in the UK and Western Europe, as well as those US and Asian multinationals with substantial trade and investment links in the region, with debt financing, risk management and trade services, focusing on core product capabilities that are of most relevance to our clients. CIB is a single reportable segment.

In February 2015, the RBS Group announced plans to rationalise the CIB business (see page 5 for details).

In addition to the segments noted above, the RBS Group will continue to manage and report Citizens Financial Group (CFG) and RBS Capital Resolution (RCR) separately until disposal or wind-down.

Citizens Financial Group (CFG) provides financial services primarily through the Citizens and Charter One brands. CFG is engaged in retail and corporate banking activities through its branch network in 11 states in the United States and through non-branch offices in other states. The RBS Group disposed of 29.5% of its interest in CFG in 2014 and it is intended that RBS Group will complete the disposal of CFG by 2016. CFG has been reclassified as a discontinued operation, it continues to be presented as a reportable segment.

RBS Capital Resolution (RCR) became fully operational on 1 January 2014 with a pool of c.£29 billion of assets with particularly high long-term capital intensity, credit risk and/or potentially volatile outcomes in stressed environments. RCR brings assets under common management and increases focus on managing these assets so as to release capital.

Services supports the customer-facing businesses and provides operational technology, customer support in telephony, account management, lending and money transmission, global purchasing, property and other services. Services drives efficiencies and supports income growth across multiple brands and channels by using a single, scalable platform and common processes wherever possible. It also leverages RBS Group's purchasing power and is the centre of excellence for managing large-scale and complex change. For reporting purposes, Services costs are allocated to the operating segments above. It is not deemed a reportable segment.

Central Functions comprises corporate functions, such as treasury, finance, risk management, compliance, legal, communications and human resources. Central functions manages RBS capital resources and RBS Group-wide regulatory projects and provides services to the operating segments.

Financial review

Business divestments

To comply with the European Commission State Aid requirements the RBS Group agreed a series of restructuring measures. These included the sale of 80.01% of the Group's Global Merchant Services business (completed in 2010).

In October 2012, Santander UK plc withdrew from its agreed purchase of the UK branch-based businesses. In September 2013, the RBS Group reached an agreement with an investor consortium led by Corsair Capital and Centerbridge Partners for an investment in these businesses ahead of a stock market flotation. This includes 308 RBS branches in England and Wales along with the related direct SME customers across the UK ("UK branch-based businesses"). The new bank will be called Williams & Glyn, the brand RBS used for its branches in England and Wales before 1985. It is intended that Williams & Glyn will be launched by the end of 2016.

Citizens Financial Group (CFG)

Following a commitment given to the European Commission to dispose of CFG, in September 2014, the RBS Group completed an initial public offering of 28.75% of CFG common stock and currently has an interest of 70.5%. It is intended that the RBS Group will cede control of CFG by the end of 2015, with full disposal completed by the end of 2016.

Strategic review of CIB

On the 26 February 2015 RBS Group announced that it is making further changes to improve its medium-term returns, building a stronger, safer and more sustainable business, focused mainly on UK and Western European customers, both corporates and financial institutions, supported by trading and distribution platforms in the UK, US and Singapore. These changes will create a more focused corporate and institutional bank built on existing product and service strengths. RBS Group will have a strong, client-focused product offering in sterling, US dollar and euro, including:

- Debt financing, with debt capital markets, structured finance and loans.
- Risk management in currency, rates and inflation.
- Transaction services, with UK-focused cash, payments and trade.

CIB will reduce its geographical footprint to approximately 13 countries, compared with 38 at the end of 2014, though RBS Group will also retain its back office operations in Poland and India. In addition to its main distribution and trading hubs in the UK, US and Singapore, RBS Group will remain present in a number of Western European countries with coverage teams. A small sales team will be retained in Japan. US operations will shrink, while retaining the presence required to support the US dollar needs of RBS Group's UK and Western European customers. Priority client sectors will be targeted in infrastructure, transportation, financial institutions, energy and resources.

CIB will continue to reduce its balance sheet and risk profile. RWAs will be reduced by 60% by 2019, with a reduction of more than £25 billion targeted in 2015. Third party assets will be reduced by more than 60% by 2019.

This CIB strategy leaves RBS Group well-placed to meet the ring-fencing requirements of the Banking Reform Act 2013. As previously indicated, RBS Group intends to place most banking services inside the ring fence. CIB's remaining "Markets" activities, the operations of RBS International and some corporate banking activity are expected to remain outside the ring-fenced bank in separate legal entities.

Recent developments

Sale of North American loan portfolio to Mizuho

On 26 February 2015, RBS Group announced that it has entered into a definitive agreement with Mizuho Bank, Ltd. ("Mizuho"), a wholly-owned subsidiary of the Mizuho Financial Group, for the sale of a portfolio of US and Canadian loan commitments. As part of the transaction, the parties also continue to explore the transfer of certain associated derivatives, and the transition from RBS Group to Mizuho of certain coverage banking, debt capital markets, syndicate, and associated capabilities related to these commitments.

The transaction is aligned with the strategic direction RBS Group has announced for its Corporate & Institutional Banking business, which will focus mainly on UK and Western European customers, built on existing product and service strengths. RBS Group will remain engaged in the US, serving a select group of North American clients with strong links into the UK.

The portfolio sold to Mizuho comprises \$36.5 billion of loan commitments, including \$3.2 billion of drawn assets, as of 31 December 2014. The risk-weighted assets associated with the portfolio business were approximately \$8 billion as of 31 December 2014, and it generated profit after tax of \$0.1 billion in the year ended on that date. The cash consideration on that basis would be approximately \$3.0 billion, generating a loss on disposal of \$0.2 billion. Actual cash consideration and loss will depend upon settlement date portfolio balances. Sale proceeds will be used for general corporate purposes.

The transaction is expected to complete before the end of Q2 2015. RBS Group will work closely with Mizuho and our existing clients associated with these loan commitments to ensure an orderly and seamless transition at completion.

Moody's

On 17 March 2015, Moody's announced multiple rating reviews following the publication of its new bank rating methodology on 16 March 2015. The new methodology affects banking entities globally and reflects, among other things, Moody's lowered expectations about the likelihood of government support for European banks in light of the introduction of the BRRD. Moody's provided a preliminary indication of the outcome of its review which is to be completed later in 2015. Moody's preliminary indication contemplates that RBSG plc's long-term senior unsecured and issuer credit ratings would be downgraded by two notches to Ba1 and that the credit ratings of certain of the RBS Group subsidiaries may also be downgraded. If these downgrades occur, the credit ratings of RBSG plc and of certain of its subsidiaries would, therefore, be considered to be below-investment grade by that credit agency.

Financial review

Description of business *continued*

Intention to sell part of Citizens Financial Group Inc. stake

On 23 March 2015, RBS Group announced that it intends to sell part of its shareholding in Citizens Financial Group Inc. (CFG) in an underwritten public follow-on offering.

The offering is expected to comprise 115 million shares of CFG common stock, equivalent to 21% of CFG's common stock excluding an over-allotment option. A further 17.25 million shares will be made available by RBS Group under a 30 day over-allotment option.

If all the CFG shares made available in the offering are sold, assuming no exercise of the over-allotment option, RBS Group's remaining stake would comprise 269.7 million shares, equivalent to 49.3% of CFG's issued common stock. If the over-allotment option is exercised in full, RBS Group's remaining stake would be 252.5 million shares or 46.1% of CFG's common stock.

Competition

Personal & Business Banking

In the personal and small business banking business, the bank competes with a range of providers including UK banks and building societies, major retailers and life assurance companies. In the mortgage market, the bank competes with UK banks and building societies and specialist lenders. Increasingly, the ambitions of non-traditional players in the UK market are gaining credibility, with new entrants active and seeking to build their platforms either through organic growth or in some cases by acquiring businesses made available through restructuring of incumbents. Entrants with new business models such as peer-to-peer lending platforms, while currently small, have shown rapid growth and could emerge as significant competitors. Such competitors often target specific elements of the value chain or customer segments. RBS distributes life assurance products to banking customers in competition with independent advisors and life assurance companies.

In Ireland, Ulster Bank competes in retail and commercial banking with the major Irish banks and building societies, and with other UK and international banks and building societies active in the market.

In the UK credit card market large retailers and specialist card issuers are active in addition to the UK banks. In addition to physical distribution channels, providers compete through direct marketing activity and the internet.

Key competitive factors in this segment include cost management, digital sales focus, branch network re-shaping, and product simplification. Cost management remains a key focus in the market, as banks seek to simplify their organisational and IT architectures while at the same time investing to ensure that they can meet customers' evolving channel preferences. Customers have increasingly focused on use of internet and mobile as sales and service channels for certain types of products. Therefore, competitive position and performance in the sector increasingly depends on the possession of user-friendly and efficient online solutions. Although conveniently located branches are still important, RBS Group faces competitive pressure to adjust its branch formats to meet changing customer expectations and to manage its branch footprint as over-the-counter transaction volumes decline. In terms of product offering, the industry trend is to limit the number of

products and present the product structure and costs in a clear and transparent manner.

Commercial & Private Banking

Competition for corporate and institutional customers in the UK is from UK banks and from large foreign universal banks that offer combined investment and commercial banking capabilities as well as with new entrants and non-bank challengers. In asset finance and invoice finance, the bank competes with banks and specialist finance providers, both captive and non-captive. In the small business banking market, the bank competes with other UK banks, specialist finance providers and building societies. In Private Banking, The Royal Bank of Scotland International competes with other UK and international banks to offer offshore banking services. Coutts and Adam & Company compete as private banks with UK clearing and private banks, and with international private banks. Competition in wealth management remains strong as banks maintain their focus on competing for affluent and high net worth customers.

Corporate & Institutional Banking

In UK, European, Asian and the US corporate and institutional banking markets the bank competes with the large domestic banks active in these markets, the major international banks and a number of investment banks. Future competition in these markets, especially in Asia and the US, will be impacted by the implementation of the refined CIB strategy announced in this document. With continued pressure on margins and fees, market participants stay focused on optimising core businesses, principally through reallocation of resources to areas generating economic returns where client opportunities are bigger. In some cases this means closing part of overseas operations and focusing on home countries, while in others, notably among Japanese banks, competitors are searching for growth opportunities beyond home markets.

Citizens Financial Group (CFG)

In the United States, following a successful initial public offering, RBS Group retains a controlling interest in Citizens Financial Group (CFG). CFG competes in the New England, Mid-Atlantic and Mid-West retail and mid-corporate banking markets with local and regional banks and other financial institutions. CFG's mortgage lending, auto lending, student lending and commercial banking businesses operate in select additional markets. CFG Commercial Banking offers its corporate, not-for-profit and institutional clients a broad range of wholesale banking products and services including treasury services, specialty finance, foreign exchange, capital markets and debt syndication.

Risk factors

Set out below is a summary of certain risks which could adversely affect the Group; it should be read in conjunction with the Capital and risk management section on pages 33 to 163. The Group is the principal operating subsidiary of The Royal Bank of Scotland Group ("RBSG", together with its subsidiaries, the "RBS Group"). Accordingly, risk factors below which relate to RBSG and the RBS Group will also be applicable to the Bank and the Group. This summary should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. A fuller description of these and other risk factors is included on pages 288 to 307.

- The RBS Group is implementing a large number of existing and new programmes and initiatives intended to improve the RBS Group's capital position, meet legal and regulatory requirements and result in the RBS Group becoming a safer and more competitive, customer focused and profitable bank. These initiatives include, among other things, the execution of the RBS Group's strategic plan announced in 2013 and 2014 and which includes the implementation of its new divisional and functional structure (the "2013/2014 Strategic Plan") as well as a major investment programme to upgrade and rationalise the RBS Group's information technology ("IT") and operational infrastructure (the "IT and Operational Investment Plan"), further initiatives designed to reduce the size of the RBS Group's balance sheet and de-risk its business, in particular through the divestments of the RBS Group's interest in Williams & Glyn, its remaining stake in Citizens Financial Group, Inc ("CFG") and the "higher risk and capital intensive assets" in RCR as well as a significant restructuring of the RBS Group's Corporate and Institutional Banking ("CIB") division and of the RBS Group's business as a result of the implementation of the regulatory ring-fencing of retail banking operations (the "ring-fence"). Together, these initiatives are referred to as the "Transformation Plan" and present significant risks for the RBS Group and/or the Group, including the following:
 - The Transformation Plan, and in particular the restructuring of the RBS Group's CIB business and the divestment of certain of the RBS Group's portfolios and businesses, including its remaining stake in CFG, are designed to allow the RBS Group to achieve its capital targets. There is no assurance that the RBS Group will be able to successfully implement these initiatives on which its capital plan depends or that it will achieve its goals within the time frames contemplated.
 - The implementation of the ring-fence will likely result in considerable operational and legal difficulties as it will require a significant restructuring of the RBS Group and its businesses with the possible transfer of a large number of customers between new or existing legal entities. This implementation exercise will be complex, costly, will result in significant changes for the RBS Group's customers and there is no certainty that the RBS Group will be able to implement the ring-fence successfully or in time to meet the regulatory deadline of 2019.
 - The changes to the RBS Group resulting from the implementation of the Transformation Plan will result in major changes to the RBS Group's corporate structure, the delivery of its business activities in the UK and other jurisdictions as well as the RBS Group's business model. Although the goals of the Transformation Plan are for the RBS Group to emerge as a less complex and safer bank, there can be no assurance that the final results will be successful and that the RBS Group and/or the Group will be viable, competitive, customer focused and profitable banks at the end of this long period of restructuring.
 - The level of structural change required to implement the RBS Group's Transformation Plan is likely to be disruptive and increase operational and people risks for the RBS Group and/or the Group. In addition, the RBS Group will incur significant costs in implementing the Transformation Plan and its and the Group's revenues may also be impacted by lower levels of customer retention and revenue generation following the restructuring of its business and activities. Further, the competitive landscape in which the RBS Group and the Group operate is constantly evolving and recent regulatory and legal changes, including ring-fencing, are likely to result in new market participants. These changes, combined with the changes to the RBS Group's structure and business as a result of the implementation of the Transformation Plan, may result in increased competitive pressures on the RBS Group and/or the Group.
 - Substantial investments are being made in the RBS Group's IT and operational structure through targeted investment and rationalisation programmes as part of the IT and Operational Investment Plan. Any failure by the RBS Group to realise the benefits of this IT and Operational Investment Plan, whether on time or at all, could have a material adverse effect on the RBS Group's and/or the Group's businesses and their ability to retain or grow their customer business and remain competitive.
- The RBS Group's ability to implement its Transformation Plan and its and the Group's future success depends on their ability to attract and retain qualified personnel. The RBS Group could fail to attract or retain senior management, which may include members of the RBS Group Board, or other key employees. The RBS Group's changing strategy has led to the departure of many talented staff. Implementation of the RBS Group's Transformation Plan, and in particular of the ring-fence and restructuring of the RBS Group's CIB business, as well as increased legal and regulatory supervision, including the implementation of the new responsibility regime introduced under the Financial Services (Banking Reform) Act 2013 in the UK, (the "Banking Reform Act 2013") including the new Senior Persons Regime, may further hinder the Group's ability to attract or retain senior management and other skilled personnel. Following the implementation of CRD IV and the Government's views on variable compensation, there is now a restriction on the Group's ability to pay individual bonuses greater than fixed remuneration, which may put the Group at a competitive disadvantage. An inability to attract and retain qualified personnel could have an adverse impact on the implementation of the RBS Group's and the Group's strategy and regulatory commitments.

Risk factors continued

- The RBS Group has been, and continues to be, subject to litigation and regulatory and governmental investigations that may impact its business, reputation, results of operations and financial condition. Although the RBS Group settled a number of legal proceedings and regulatory investigations during 2014, the RBS Group is expected to continue to have material exposure to litigation and regulatory proceedings in the medium term. The RBS Group also expects greater regulatory and governmental scrutiny for the foreseeable future particularly as it relates to compliance with historical, existing and new laws and regulations.
- Ahead of the upcoming election in May 2015 in the UK, there is uncertainty around how the policies of the newly elected government may impact the RBS Group, including a possible referendum on the UK's membership of the EU. The implementation of these policies, including the outcome of the EU referendum, could significantly impact the environment in which the RBS Group and/or the Group operate and the fiscal, monetary, legal and regulatory requirements to which they are subject.
- Operational and reputational risks are inherent in the Group's businesses, but are heightened as a result of the implementation of the RBS Group's Transformation Plan. Employee misconduct may also result in regulatory sanctions and serious reputational or financial harm to the Group.
- Despite the improved outlook for the global and UK economy over the near to medium-term, actual or perceived difficult global economic conditions, potential volatility in the UK housing market as well as increased competition, particularly in the UK, may create challenging economic and market conditions and a difficult operating environment for the RBS Group's businesses, as it continues to refocus its operations on the UK. These factors, together with continuing uncertainty relating to the recovery of the Eurozone economy and volatile financial markets, in part due to the monetary and fiscal policies and measures carried out by central banks, have adversely affected and may continue to adversely affect the RBS Group's and/or the Group's businesses, earnings, financial condition and prospects.
- The RBS Group's business performance, financial condition and capital and liquidity ratios could be adversely affected if its capital is not managed effectively or as a result of increasingly stringent regulatory requirements relating to capital adequacy, including those arising out of the implementation of Basel III or future proposals and the uncertainty arising from the consistent implementation of such rules in the various jurisdictions in which the RBS Group operates. Maintaining adequate capital resources and meeting the requisite capital adequacy requirements may prove increasingly difficult and costly and will depend on the RBS Group's continued access to funding sources, including following the implementation of the ring-fence, as well as the effective management of its balance sheet and capital resources.
- 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. The inability to access liquidity and funding due to market conditions or otherwise or to do so at a reasonable cost, could adversely affect the Group's financial condition and results of operations. Furthermore, the Group's borrowing costs and its access to the debt capital markets and other sources of liquidity depend significantly on the credit ratings of RBSG, the Bank and other RBS Group companies and, to a lesser extent the UK Government's credit ratings.
- The RBS Group including the Bank and its subsidiaries, are subject to substantial regulation and oversight and 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 RBS Group and/or the Group, the enactment of legislation and regulations in the UK, the EU and the US 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, products offerings and business models as well as the risks that the RBS Group and/or the Group may be unable to comply with such requirements in the manner or within the timeframes required. A number of reviews and investigations are currently ongoing in the UK and other jurisdictions in which the Group operates which may result in further legislative changes.
- The RBS Group or any of its UK bank subsidiaries may face the risk of full nationalisation or other resolution procedures, including recapitalisation of the RBS Group or any of its UK bank subsidiaries, through the exercise of the bail-in tool which was introduced in the UK by the Banking Reform Act 2013 and implemented in line with the provisions of the Bank Recovery and Resolution Directive. In the event of the failure of the RBS Group, various actions could be taken by or on behalf of the UK Government, including actions in relation to any securities issued, new or existing contractual arrangements and transfers of part or all of the RBS Group's businesses.
- The Group is highly dependent on its IT systems, which are currently subject to a significant investment and rationalisation programme. The Group has been and expects to continue to be subject to cyber-attacks which expose the Group to loss of customer data or other sensitive information and which, combined with other failures of the Group's information technology systems, may hinder its ability to service its customers which could result in long-term damage to the Group's reputation, businesses and brands.

Financial review

- As a result of the UK Government's majority shareholding in the RBS Group it is able to exercise a significant degree of influence over the RBS Group including on dividend policy, the election of directors or appointment of senior management, remuneration policy and/or limiting the RBS Group's operations. The offer or sale by the UK Government of all or a portion of its shareholding in RBSG could affect the market price of the equity shares and other securities and acquisitions of ordinary shares by the UK Government (including through conversions of other securities or further purchases of shares) may result in the delisting of RBSG from the Official List.
- The RBS Group is required to make planned contributions to its pension schemes and to compensation schemes in respect of certain financial institutions (such as the UK Financial Services Compensation Scheme). Pension contributions may be increased to meet pension deficits or to address additional funding requirements, including those which may arise in connection with the restructuring of the RBS Group's pension plan as a result of the implementation of the ring-fence. The RBS Group may also be required to make further contributions under resolution financing arrangements applicable to banks and investment firms. Additional or increased contributions may have an adverse impact on the RBS Group's results of operations, cash flow and financial condition.
- The deterioration of the prevailing economic and market conditions and the actual or perceived failure or worsening credit of the Group's counterparties or borrowers and depressed asset valuations resulting from poor market conditions, have adversely affected the Group and could continue to adversely affect the Group if, due to a deterioration in economic and financial market conditions or continuing weak economic growth, it were to recognise or realise further write-downs or impairment charges. Changes in interest rates, foreign exchange rates, oil and other commodity prices also impact the value of the Group's investment and trading portfolios and may have a material adverse effect on the Group's financial performance and business operations.
- The value of certain financial instruments recorded at fair value is determined using financial models incorporating assumptions, judgements and estimates that may change over time or may ultimately not turn out to be accurate. The Group's valuation, capital and stress test models and the parameters and assumptions on which they are based rely on market data inputs and 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 the failure to properly input any such changes could have an adverse impact on the modeled results.
- Developments in regulatory or tax legislation could have an effect on how the Group conducts its business and on its results of operations and financial condition, and the recoverability of certain deferred tax assets recognised by the Group is subject to uncertainty.

Financial review

Financial summary

Summary consolidated income statement for the year ended 31 December 2014

	2014 £m	2013 £m
Net interest income	8,866	8,630
Fees and commissions receivable	4,320	4,598
Fees and commissions payable	(842)	(892)
Income from trading activities	1,190	2,860
Gain on redemption of own debt	6	162
Other operating income	1,078	1,397
Non-interest income	5,752	8,125
Total income	14,618	16,755
Operating expenses	(13,552)	(15,985)
Profit before impairment losses	1,066	770
Impairment releases/(losses)	1,337	(8,137)
Operating profit/(loss) before tax	2,403	(7,367)
Tax charge	(2,033)	(307)
Profit/(loss) from continuing operations	370	(7,674)
(Loss)/profit from discontinued operations, net of tax	(3,486)	410
Loss for the year	(3,116)	(7,264)
Non-controlling interests	(57)	13
Preference dividends	(61)	(58)
Loss attributable to ordinary shareholders	(3,234)	(7,309)

2014 compared with 2013

The Group reports an attributable loss of £3,234 million compared with a loss of £7,309 million in 2013. The result included a loss from discontinued operations of £3,486 million, which reflected an accounting write down of £3,994 million in relation to Citizens which has been written down to fair value less costs to sell as a consequence of it being reclassified as held-for-sale, and a tax charge of £2.0 billion, which included a £1.5 billion write-off of deferred tax assets.

Operating profit/(loss) before tax

Operating profit before tax was £2,403 million compared with a loss of £7,367 million in 2013. The significant improvement reflects net impairment releases of £1,337 million, compared with impairment losses of £8,137 million in 2013 and lower charges for litigation, conduct and redress costs of £2,202 million (2013 - £4,465 million). This was partially offset by a decline in income from trading activities, down £1,670 million to £1,190 million.

Net interest income

Net interest income increased by £236 million, or 3%, to £8,866 million largely reflecting improvements in deposit margins in Personal & Business Banking (PBB) and Commercial & Private Banking (CPB).

Non-interest income

Non-interest income decreased by £2,373 million, 29% to £5,752 million compared with £8,125 million in 2013, primarily due to lower income from trading activities, down £1,670 million to £1,190 million in line with Corporate & Institutional Banking's (CIB) smaller balance sheet and reduced risk profile, lower net fees and commissions, down £228 million, or 6%, mainly in CIB and Commercial Banking, and reduced AFS gains in Treasury of £517 million to £244 million from £761 million in 2013.

Financial review

Operating expenses

Operating expenses decreased by £2,433 million, or 15%, to £13,552 million from £15,985 million in 2013. Operating expenses, excluding restructuring costs and litigation, conduct and redress costs, declined £752 million, or 7%, to £10,196 million (2013 - £10,948 million) mainly reflecting the benefits of cost savings initiatives.

Litigation, conduct and redress costs were £2,202 million compared with £4,465 million, which in 2013 included a charge relating to regulatory and legal actions of £3,015 million, primarily relating to mortgage-backed securities and securities related litigation. Charges in 2014 include: investigations into the foreign exchange market (£720 million), investment advice in retail and private banking (£190 million), the fine relating to the 2012 IT incident (£59 million), PPI costs (£650 million), Interest Rate Hedging Products redress costs (£185 million) and other costs of £398 million including provisions relating to packaged accounts and investment products.

Restructuring costs increased £582 million to £1,154 million (2013 - £572 million), including £378 million in relation to Williams and Glyn.

Impairment releases/(losses)

Net impairment releases were £1,337 million in 2014 compared with a net impairment charge of £8,137 million in the prior year, which included £4,821 million relating to the creation of RCR. Releases were recorded principally in RCR (£1,298 million) and in Ulster Bank (£365 million) and reflected improving Irish economic and property market conditions and proactive debt management.

Discontinued operations

During the second half of 2014 the RBS Group disposed of 29.5% of its interest in Citizens primarily through an initial public offering. The RBS Group plans to cede control, by the end of 2015 and therefore Citizens is classified as a disposal group at 31 December 2014 and its results presented as a discontinued operation with comparatives re-presented. The results of Citizens in discontinued operations include a £3,994 million fair value write-down in relation to its reclassification to disposal groups.

Capital ratios

Capital ratios at 31 December 2014 were 10.0% (Common Equity Tier 1), 10.0% (Tier 1) and 15.5% (Total).

Financial review

Segment performance

In order to present a more complete picture of funding operational and business costs of the franchises and operating segments and to improve the transparency of the operating performance of segments, the following reporting changes have been implemented:

A number of previously reported central items (PPI costs, Interest Rate Hedging Products redress and related costs, regulatory and legal actions, restructuring costs, amortisation of purchased intangible assets, write - down of other intangible assets and bank levy) have now been allocated to the reportable segments. Only the following will now be reported as reconciling items:

- Own credit adjustments;
- Gain on redemption of own debt;
- Write-down of goodwill; and
- Strategic disposals.

Allocation of costs

As part of its internal reorganisation, RBS Group has centralised all services and functions. The costs relating to Services and Functions previously reported as direct expenses in the divisions are now reallocated to businesses using appropriate drivers and reported as indirect expenses in the segmental income statements.

Comparatives have been restated accordingly.

	2014 £m	2013 £m
Operating profit/(loss) by segment		
UK Personal & Business Banking	2,045	1,352
Ulster Bank	677	(1,552)
Personal & Business Banking	2,722	(200)
Commercial Banking	1,782	942
Private Banking	320	101
Commercial & Private Banking	2,102	1,043
Corporate & Institutional Banking	117	(1,851)
Central items	(3,719)	(2,102)
Citizens Financial Group	761	659
RCR	1,442	n/a
Non-Core	n/a	(4,400)
Operating profit/(loss) (1)	3,425	(6,851)
Own credit adjustments	(128)	(25)
Gain on redemption of own debt	6	162
Write down of goodwill	(130)	(208)
Strategic disposals	1	161
Citizens discontinued operations	(771)	(606)
Operating profit/(loss) before tax	2,403	(7,367)

Note:

(1) Operating profit/ (loss) includes the results of Citizens which are included in discontinued operations in the statutory results.

The performance of each segment is reviewed on pages 13 to 29.

Financial review

Personal & Business Banking

	2014 £m	2013 £m
Income statement		
Net interest income	5,409	5,231
Net fees and commissions	1,374	1,394
Other non-interest income	123	108
Non-interest income	1,497	1,502
Total income	6,906	6,733
Direct expenses		
- staff costs	(1,140)	(1,167)
- other costs	(439)	(567)
Indirect expenses	(1,713)	(1,730)
Restructuring costs		
- direct	(2)	(145)
- indirect	(100)	(99)
Litigation and conduct costs	(887)	(950)
Operating expenses	(4,281)	(4,658)
Profit before impairment losses	2,625	2,075
Impairment releases/(losses)	97	(2,275)
Operating profit	2,722	(200)
Operating expenses - adjusted ⁽¹⁾	(3,292)	(3,464)
Operating profit - adjusted ⁽¹⁾	3,711	994
	£bn	£bn
Balance sheet		
Loans and advances to customers (gross)	154.5	159.2
Loan impairment provisions	(5.3)	(8.4)
Net loans and advances to customers	149.2	150.8
Funded assets	161.8	160.0
Total assets	161.9	160.2
Customer deposits	169.3	166.6
Assets under management (excluding deposits)	4.9	5.8

Note:

(1) Excluding restructuring costs and litigation and conduct costs.

Key points

Personal & Business Banking (PBB) comprises the former UK Retail and business banking elements of former UK Corporate (UK Personal & Business Banking - UK PBB) and Ulster Bank reportable segments. PBB supports individuals in managing their personal and business banking, with a full range of financial services and advice. Through the RBS, NatWest, and Ulster Bank brands, PBB serves over 18 million personal and business customers in the UK and Ireland. Customers can choose how they manage their finances through access to our branches, online banking, fixed and mobile technology and one of the largest ATM networks in the UK and Ireland.

Financial review

UK Personal & Business Banking

	2014 £m	2013 £m
Income statement		
Net interest income	4,773	4,612
Net fees and commissions	1,235	1,253
Other non-interest income	68	9
Non-interest income	1,303	1,262
Total income	6,076	5,874
Direct expenses		
- staff costs	(893)	(928)
- other costs	(365)	(504)
Indirect expenses	(1,514)	(1,519)
Restructuring costs		
- direct	(10)	(118)
- indirect	(75)	(92)
Litigation and conduct costs	(906)	(860)
Operating expenses	(3,763)	(4,021)
Profit before impairment losses	2,313	1,853
Impairment losses (1)	(268)	(501)
Operating profit	2,045	1,352
Operating expenses - adjusted (2)	(2,772)	(2,951)
Operating profit - adjusted (2)	3,036	2,422
Balance sheet		
Loans and advances to customers (gross)		
- personal advances	7.4	8.1
- mortgages	103.2	99.3
- business	14.3	14.6
- cards	4.9	5.8
	129.8	127.8
Loan impairment provisions	(2.6)	(3.0)
Net loans and advances to customers	127.2	124.8
Funded assets	134.3	132.0
Total assets	134.3	132.0
Total customer deposits	148.7	144.9
Assets under management (excluding deposits)	4.9	5.8

Notes:

(1) Includes £2 million in 2013 pertaining to the creation of RCR and related strategy.

(2) Excluding restructuring costs and litigation and conduct costs.

Key points

The strategic goal of UK PBB is to become the number one personal and business bank for customer service, trust and advocacy in the UK. Throughout 2014, the business has made steady progress in making banking fairer and simpler for its customers through a number of fair banking initiatives and technology investments. Progress made in 2014 by UK PBB included:

Helping customers with their needs:

- As the UK's biggest lender for SMEs, UK PBB continued to offer support to small business customers. Following storms and floods in February 2014, the business introduced a £250 million interest free loan fund for small business to help them get themselves back on their feet. An additional £1 billion Small Business Fund was launched to support small businesses with fee free, fixed rate loans.
- UK PBB has been able to help more customers in 2014. With additional mortgage advisors recruited (up 18% from 630 to 744), gross mortgage lending increased by 37% year on year. The business's commitment to helping its customers get on and move up the property ladder has been a success and it has now helped almost 15,000 customers buy their first or next home with the government-backed Help to Buy schemes since their launch in May 2013.
- There are now more ways to bank with UK PBB than ever. With services being extended to the Post Office network, customers now have over 13,000 branches and post offices across the UK where they can carry out their every day banking.

Simpler and fairer products supported by the launch of the 'Goodbye-Hello' campaign:

- The business committed to responsible and fair lending by removing 0% teaser deals from its offering and introducing the new Clear Rate and cash-back credit cards in 2014.
- Business banking arrangement fees and surprise overdraft fees have been replaced with fixed rates on new business loans and text alerts when customers are overdrawn to keep them on track.
- Service charges have been reviewed and made simpler and fairer for customers. The business re-introduced access to the LINK ATM network for all basic account customers, reduced its daily overdraft fees for all customers, placed a 60 day cap on overdraft charges and improved credit card late fee terms.
- RBS plc and NatWest became the first of the main high street banks to ensure all of its savers get the same or better deals as new customers. Those deals are available regardless of how customers choose to bank (e.g. branch, telephony or digital). With just five personal savings products now on sale the range is the simplest on the high street both for customers and for front line staff. Teaser savings rates have been removed and the business is committed to helping customers save for the long term rather than luring them in for the short term.

Investments in Technology

- UK PBB continued with its commitment to invest in technology to make things better for the customer. As its award winning mobile banking application celebrated 5 years, the business received another gold award for the "Pay your Contacts" service, which was named "Best new service of the year" in July at the 'Best in Biz' International awards. UK PBB now has over 6.9 million online and mobile banking users, with the mobile app being used more than 23 million times every week.
- Further improvements have been made to the mobile banking application and personal customers are now able to use the new industry-wide Pay-m application that allows customers to receive payments from customers of other participating banks just by providing their mobile number. Customers will no longer have to divulge their sort code and account number to receive payment. Pay-m has already enrolled over 1.8 million customers in the service since its launch at the end of April 2014. WiFi in branches has also been a great success with customers already using the free service over 1 million times since it started in May.

2014 compared with 2013

UK PBB recorded an operating profit of £2,045 million, up £693 million, while adjusted operating profit totalled £3,036 million compared with £2,422 million in the prior year. This reflected higher income, up 3% to £6,076 million and lower adjusted expenses, down 6% to £2,772 million, together with substantially lower impairments, down £233 million to £268 million.

Net interest income increased by £161 million or 3% with strong improvements in deposit margins and volume growth. This was partly offset by lower asset margins linked to the continued change in the mix of the loan book towards secured lending and lower mortgage margins.

Non-interest income increased by £41 million or 3%, largely reflecting the transfer of the commercial cards business to UK PBB from CPB in August 2014.

Operating expenses decreased by £258 million or 6%, reflecting lower restructuring and litigation and conduct costs. Excluding these items, expenses declined by £179 million or 6% supported by a 7% reduction in headcount and lower Financial Services Compensation Scheme (FSCS) accruals. Litigation and conduct costs included additional provisions for Payment Protection Insurance redress (£650 million) and other conduct provisions in respect of legacy investment products and packaged account sales.

The net impairment charge was down by 47% to £268 million driven by a further decrease in new default charges together with releases of provisions and recoveries on previously written off debt.

Mortgage balances increased by £3.9 billion or 4%, to £103.2 billion driven by strong performance as advisor capacity increased. Gross new mortgage business increased by 37% to £19.7 billion, representing a market share of 10% with our stock share of 8% continuing to grow.

Financial review

Ulster Bank

	2014 £m	2013 £m
Net interest income	636	619
Net fees and commissions	139	141
Other non-interest income	55	99
Non-interest income	194	240
Total income	830	859
Direct expenses		
- staff costs	(247)	(239)
- other costs	(74)	(63)
Indirect expenses	(199)	(211)
Restructuring costs		
- direct	8	(27)
- indirect	(25)	(7)
Litigation and conduct costs	19	(90)
Operating expenses	(518)	(637)
Profit before impairment losses	312	222
Impairment releases/(losses) (1)	365	(1,774)
Operating profit	677	(1,552)
Operating expenses - adjusted (2)	(520)	(513)
Operating profit - adjusted (2)	675	(1,428)
	£bn	£bn
Balance sheet		
Loans and advances to customers (gross)		
Mortgages	17.5	19.0
Commercial real estate		
- investment	1.0	3.4
- development	0.3	0.7
Other corporate	4.9	7.1
Other lending	1.0	1.2
	24.7	31.4
Loan impairment provisions	(2.7)	(5.4)
Net loans and advances to customers	22.0	26.0
Funded assets	27.5	28.0
Total assets	27.6	28.2
Customer deposits	20.6	21.7

Notes:

(1) Includes £892 million in 2013 pertaining to the creation of RCR and related strategy.

(2) Excluding restructuring costs and litigation and conduct costs.

Key points

Following completion of a strategic review, Ulster Bank was confirmed as a core part of RBS Group reflecting its fit with RBS Group's retail and commercial strategy; 2014 saw a return to profitability with significant progress made addressing legacy issues and the strengthening of its core business for the future.

The transfer of £4.4 billion of gross assets to RCR on 1 January 2014 and subsequent deleveraging has enabled Ulster Bank to focus on the development of its core business. This has had a material impact on the comparison of 2014 financial performance with 2013.

Ulster Bank recorded an operating profit of £677 million in 2014, the first annual profit since 2008. This represented a major turnaround from 2013 largely due to impairment releases supported by enhanced collections performance and an improvement in key macroeconomic indicators. Net interest margin also improved and operating expenses were reduced.

Considerable progress was made to improve Ulster Bank's service offering and to enhance the customer experience. The bank continued to re-shape its distribution network during 2014 while online and mobile banking services were further developed to support the upward trend in digital transactions, which now represent 57% of total transaction volumes. The bank's 'Web Chat' initiative, launched in 2012, is now handling over 15,000 customer enquiries each month. Ulster Bank in Northern Ireland recently launched its 'Bank on Wheels' service and extended its partnership with the Post Office which provides customers with 484 new points of presence.

Financial review

There has been a significant increase in new lending activity during 2014 following the launch of the 'Big Yes' mortgage and 'Ahead for Business' campaigns. New mortgage lending increased by over 40% in 2014 while over £1 billion of new lending was made available to business customers, despite a challenging business environment.

The investment made to support customers in financial difficulty has resulted in a sustained reduction since Q1 2013 in the number of mortgage customers in arrears of 90 days or more and an increase in the number of business customers returning to mainstream management.

2014 compared with 2013

Ulster Bank recorded an operating profit of £677 million in 2014 compared with a loss of £1,552 million in 2013. The turnaround was driven by £365 million net impairment releases compared with impairment losses of £1,774 million in 2013. Adjusted operating profit was £675 million compared with a loss of £1,428 million.

Profit before impairment losses was £312 million, £90 million higher than in 2013.

Total income decreased by £29 million to £830 million largely as a result of the non-recurrence of significant hedging gains on the mortgage portfolio in 2013. Net interest income increased by £17 million to £636 million, primarily driven by a significant reduction in the cost of deposits and a benefit from the recognition of income on certain previously non-performing assets, partly offset by the adverse impact on the tracker mortgage book of lower European Central Bank refinancing interest rates. Net interest margin increased 39 basis points to 2.27%.

The continued focus on costs resulted in a reduction in staff numbers and the bank's property footprint. Litigation and conduct costs decreased by £109 million reflecting the outcome of reviews relating to provisions on PPI and Interest Rate Hedging Products. These benefits were partly offset by higher regulatory charges and levies including a new bank levy introduced in the Republic of Ireland, of £15 million, and the impact of a realignment of costs following the creation of RCR, £44 million.

Financial review

Commercial & Private Banking

	2014 £m	2013 £m
Income statement		
Net interest income	2,915	2,766
Net fees and commissions	1,216	1,297
Other non-interest income	342	318
Non-interest income	1,558	1,615
Total income	4,473	4,381
Direct expenses		
- staff costs	(821)	(827)
- other costs	(321)	(353)
Indirect expenses	(855)	(955)
Restructuring costs		
- direct	(48)	(36)
- indirect	(52)	(33)
Litigation and conduct costs	(202)	(453)
Operating expenses	(2,299)	(2,657)
Profit before impairment losses	2,174	1,724
Impairment losses	(72)	(681)
Operating profit	2,102	1,043
Operating expenses - adjusted ⁽¹⁾	(1,997)	(2,135)
Operating profit - adjusted ⁽¹⁾	2,404	1,565
	£bn	£bn
Balance sheet		
Loans and advances to customers (gross)	102.7	101.8
Loan impairment provisions	(1.1)	(1.6)
Net loans and advances to customers	101.6	100.2
Funded assets	110.1	109.4
Total assets	110.2	109.4
Assets under management (Private Banking)	28.3	29.7
Customer deposits	122.8	127.9

Note:

(1) Excluding restructuring costs and litigation and conduct costs.

Key points

Commercial & Private Banking comprises parts of the former UK Corporate, Wealth and International Banking divisions. It is committed to supporting the bank's ambition to be the number one bank for customer service, trust and advocacy in its chosen markets by 2020. Commercial Banking's customers range from UK businesses with an annual turnover of £2 million up to large UK corporations, including real estate and institutional customers. Aligning the Private Banking business with Commercial Banking will enable the bank to better serve and connect those who own and run businesses.

With a set of strong brands including RBS, NatWest, Lombard, Coutts and Adam & Company, the Commercial & Private Banking business provides its customers with dedicated relationship management and access to sophisticated products and services including lending, speciality finance, transaction banking, risk management and wealth management.

Financial review

Commercial Banking

	2014 £m	2013 £m
Income statement		
Net interest income	2,212	2,083
Net fees and commissions	885	944
Other non-interest income	283	253
Non-interest income	1,168	1,197
Total income	3,380	3,280
Direct expenses		
- staff costs	(508)	(513)
- other costs	(249)	(270)
Indirect expenses	(567)	(610)
Restructuring costs		
- direct	(40)	(18)
- indirect	(46)	(28)
Litigation and conduct costs	(112)	(247)
Operating expenses	(1,522)	(1,686)
Profit before impairment losses	1,858	1,594
Impairment losses (1)	(76)	(652)
Operating profit	1,782	942
Operating expenses - adjusted (2)	(1,324)	(1,393)
Operating profit - adjusted (2)	1,980	1,235

	£bn	£bn
Balance sheet		
Loans and advances to customers (gross)		
- Commercial real estate	18.3	20.2
- Asset and invoice finance	14.2	11.7
- Private sector education, health, social work, recreational and community services	6.9	7.9
- Banks & financial institutions	7.0	6.9
- Wholesale and retail trade repairs	6.0	5.8
- Hotels and restaurants	3.4	3.6
- Manufacturing	3.7	3.7
- Construction	1.9	2.1
- Other	24.7	23.1
Total loans and advances (gross)	86.1	85.0
Loan impairment provisions	(1.0)	(1.5)
Net loans and advances to customers	85.1	83.5
Funded assets	89.4	87.9
Total assets	89.4	87.9
Customer deposits	86.8	90.9

Notes:

(1) Includes £123 million in 2013 pertaining to the creation of RCR and related strategy.

(2) Excluding restructuring costs and litigation and conduct costs.

Key points

Commercial Banking implemented a simplified and delayed management structure in 2014. With over 120 products removed from sale and over 400 process improvements implemented, the segment is becoming easier to do business with.

Tangible progress is being made via a bank-wide strategic lending programme which will transform the end-to-end customer lending experience, ensuring faster decisions and a smoother application process. Over the year there has been an improvement in the Net Promoter Score and rating of overall service quality across the business, together with a continuing fall in complaints.

Commercial Banking continues to back UK businesses and communities, with over 8,400 Statement of Appetite letters issued in 2014 at a total value of £4.7 billion. As part of our plan to support entrepreneurs across the UK, the first of eight accelerator hubs opened in February 2015, offering free space, support and advice to high growth business owners. A series of customer campaigns were launched, proactively engaging customers on their international and asset finance needs.

Financial review

Commercial Banking *continued*

Significant progress has been made to drive connectivity across the bank, with a focus on providing employees with the skills and tools they need to serve customers better. This has included investment in professional qualifications as well as the development of a suite of banking tools to be rolled out in 2015. The alignment of Commercial & Private Banking continues to yield benefits, with a pilot resulting in over 140 referrals between the businesses.

2014 compared with 2013

Commercial Banking recorded an operating profit of £1,782 million compared with £942 million in the prior year. This was driven by lower net impairment losses, down £576 million, lower operating expenses, down £164 million and higher income, up £100 million. Adjusted operating profit increased by £745 million to £1,980 million.

Net interest income increased by £129 million or 6%, largely reflecting re-pricing activity on deposits partly offset by the impact of reduced asset margins, a result of the net transfer in of lower margin legacy loans (after the cessation of Non-Core).

Non-interest income was down £29 million or 2% as lower Corporate & Institutional Banking revenue share income, restructuring fees and the transfer out of commercial cards income to UK Personal & Business Banking in August 2014 were only partially offset by higher fair value gains and operating lease income, along with lower close out costs of interest rate products associated with impaired loans.

Operating expenses were down £164 million or 10%, as a result of lower litigation and conduct costs, primarily relating to interest rate swap redress, and lower underlying direct costs reflecting the continued focus on cost saving. These reductions were partially offset by higher restructuring costs, as the business aligns itself to better support customers, and growth in operating lease depreciation. Operating expenses excluding restructuring costs and litigation and conduct costs declined by £69 million.

Net impairment losses declined £576 million to £76 million, as 2013 included the impact of the creation of RCR. Excluding the RCR charges, underlying impairments declined by £453 million with fewer individual cases across the portfolio, reduced collectively assessed provisions and higher latent provision releases, reflecting improved credit conditions.

Financial review

Private Banking

	2014 £m	2013 £m
Income statement		
Net interest income	703	683
Net fees and commissions	331	353
Other non-interest income	59	65
Non-interest income	390	418
Total income	1,093	1,101
Direct expenses		
- staff costs	(313)	(314)
- other costs	(72)	(83)
Indirect expenses	(288)	(345)
Restructuring costs		
- direct	(8)	(18)
- indirect	(6)	(5)
Litigation and conduct costs	(90)	(206)
Operating expenses	(777)	(971)
Profit before impairment losses	316	130
Impairment releases/(losses)	4	(29)
Operating profit	320	101
Operating expenses - adjusted ⁽¹⁾	(673)	(742)
Operating profit - adjusted ⁽¹⁾	424	330
Of which: international private banking activities ⁽²⁾		
Total income	230	267
Operating expenses	(257)	(357)
Impairment losses	—	(20)
Operating loss	(27)	(110)
	£bn	£bn
Balance sheet		
Loans and advances to customers (gross)		
- Personal	5.4	5.5
- Mortgages	8.9	8.7
- Other	2.3	2.6
Total loans and advances to customers (gross)	16.6	16.8
Loan impairment provisions	(0.1)	(0.1)
Net loans and advances to customers	16.5	16.7
Funded assets	20.7	21.5
Total assets	20.8	21.5
Assets under management	28.3	29.7
Customer deposits	36.0	37.0
Of which: international private banking activities ⁽²⁾		
Net loans and advances to customers	3.0	3.1
Assets under management	14.5	15.0
Customer deposits (excluding repos)	7.3	7.8

Notes:

(1) Excluding restructuring costs and litigation and conduct costs.

(2) Private banking and wealth management activities outside of the British Isles, broadly indicative of the businesses being exited.

Financial review

Private Banking continued

Key points

During 2014, Private Banking has continued to provide excellent service to clients against the background of a major business review and significant organisational change.

Following the announcement of RBS Group's new strategy in February 2014, Private Banking set out a new vision and strategic direction in August. Coutts and Adam & Company will focus on growing the UK based high net worth client franchise. All private banking and wealth management activities where the primary relationship management is conducted outside the British Isles will be exited to align better with RBS Group's stated UK focus.

The ambition of the business is to be the leading UK based private bank and wealth manager for wealthy individuals seeking exceptional private banking and wealth management. Private Banking has gathered significant momentum behind its ambition, supported by a straightforward plan centred around five key priorities: an improved banking proposition; a refocused advice and wealth management model; an enhanced proposition for international clients managed from the UK; an integrated client approach across RBS Group; and increased client engagement.

Since September, good progress has been made towards the sale of the business outside the British Isles. A primary focus of the transaction is to execute the deal with minimal disruption for clients and staff.

Private Banking has made tangible steps towards working more closely with Commercial Banking, which includes an energetic approach to client cross referrals as well as functional synergies.

The business has progressed well against key priorities in 2014. Improvements are evidenced by several industry awards including: 'Best private bank in the UK' (PWM/The Banker) and 'Most innovative digital offering' (Private Banker International). Coutts continues to be recognised as a leader in philanthropy, with its '£1 million donors' report receiving significant media coverage, and its expertise as an adviser for family businesses and entrepreneurs remains a strong point of differentiation.

2014 compared with 2013

Private Banking recorded an operating profit of £320 million compared with a profit of £101 million in the prior year. This was driven by reduced operating expenses, down £194 million and net impairment releases of £4 million compared with a net £29 million loss in 2013. Adjusted operating profit increased by £94 million to £424 million.

Net interest income increased by £20 million or 3% as improved deposit margin reflected the full year impact of the 2013 deposit re-pricing initiative.

Non-interest income was down £28 million or 7%, with lower transactional and investment activity due to subdued market volatility across the international business.

Operating expenses declined by £194 million or 20% primarily driven by lower restructuring and litigation and conduct costs. Adjusted operating expenses declined by £69 million or 9% to £673 million, reflecting lower technology costs and one-off benefits from the exit of a number of London properties.

Net impairment releases of £4 million, compared with a net impairment loss of £29 million in the prior year reflected the non-repeat of a single £20 million provision, coupled with improved economic conditions and higher UK property prices.

Client deposits decreased by £1.0 billion or 3% reflecting the rebalancing of the bank's liquidity position.

Assets under management decreased by £1.4 billion or 5% to £28.3 billion, driven by low margin custody outflows.

Financial review

Corporate & Institutional Banking

	2014 £m	2013 £m
Net interest income	905	824
Net fees and commissions	828	896
Income from trading activities	2,055	3,121
Other non-interest income	125	133
Non-interest income	3,008	4,150
Total income	3,913	4,974
Direct expenses		
- staff costs	(692)	(943)
- other costs	(388)	(655)
Indirect expenses	(1,572)	(1,845)
Restructuring costs		
- direct	(91)	(67)
- indirect	(170)	(255)
Litigation and conduct costs	(885)	(2,441)
Operating expenses	(3,798)	(6,206)
Profit before impairment losses	115	(1,232)
Impairment releases/(losses) (1)	2	(619)
Operating profit	117	(1,851)
Operating expenses - adjusted (2)	(2,652)	(3,443)
Operating profit - adjusted (2)	1,263	912
	£bn	£bn
Balance sheet		
Loans and advances to customers (gross, excluding reverse repos)	70.5	66.8
Loan impairment provisions	—	(0.2)
Total net loans and advances to customers (excluding reverse repos)	70.5	66.6
Net loans and advances to banks (excluding reverse repos)(3)	17.8	31.9
Reverse repos	61.6	76.1
Securities	56.1	69.5
Cash and eligible bills	22.7	19.3
Other	8.9	9.9
Funded assets	237.6	273.3
Total assets	574.8	556.9
Customer deposits (excluding repos)	63.0	67.1

Notes:

(1) Includes £355 million in 2013 pertaining to the creation of RCR and related strategy.

(2) Excluding restructuring costs and litigation and conduct costs.

(3) Excludes disposal groups.

Key points

Corporate & Institutional Banking (CIB) focused on its strengths in core product areas during 2014, reducing the scale of the business and simplifying the operating model. This allowed CIB to better serve customers while deploying fewer resources. The commitment to customers was demonstrated by the award of The Banker's Most Innovative Bank in Risk Management in Q3 2014 and by winning IFR magazine's Sterling Bond House of the year award in Q4 2014. The drive to concentrate on core products is evidenced by the 23% year on year fall in adjusted expenses (excluding litigation and conduct costs and restructuring costs).

2014 compared with 2013

CIB recorded an operating profit of £117 million compared with a loss of £1,851 million in 2013. This included litigation and conduct costs of £885 million compared with £2,441 million a year before. The adjusted operating result improved from £912 million in 2013 to £1,263 million in 2014. This movement was primarily driven by substantial reductions in expenses, partially offset by lower income. Net impairment releases totalled £2 million compared with a net impairment charge of £619 million in 2013.

Financial review

Corporate & Institutional Banking *continued*

Total income declined by 21%, reflecting reduced deployment of resources and difficult trading conditions, characterised by subdued levels of client activity and limited market volatility.

Operating expenses fell by £2,408 million driven primarily by lower litigation and conduct costs. Adjusted expenses decreased by £791million, or 23% reflecting the continued focus on cost savings across both business and support areas.

Net impairment releases totalled £2 million compared with a net impairment charge of £619 million in 2013, reflecting a reduction in latent loss provisions and a low level of new impairments. This contrasted with 2013 which included substantial impairments related to the establishment of RCR.

Funded assets fell by 13% reflecting the focus on core product areas including the wind-down of Credit Trading and the US ABP businesses.

Financial review

Central items

	2014 £m	2013 £m
Central items not allocated	(3,719)	(2,102)

Funding and operating costs have been allocated to operating segments based on direct service usage, the requirement for market funding and other appropriate drivers where services span more than one segment.

Residual unallocated items relate to volatile corporate items that do not naturally reside within a segment.

2014 compared with 2013

Central items not allocated represented a charge of £3,719 million compared with a charge of £2,102 million in 2013 reflecting a reduction in gains on AFS asset sales and increased volatile items under IFRS.

Financial review

Citizens Financial Group

	2014 US\$m	2013 US\$m	2014 £m	2013 £m
Net interest income	3,317	2,960	2,013	1,892
Net fees and commissions	1,168	1,190	709	761
Other non-interest income	589	489	359	312
Non-interest income	1,757	1,679	1,068	1,073
Total income	5,074	4,639	3,081	2,965
Direct expenses				
- staff costs	(1,697)	(1,707)	(1,030)	(1,091)
- other costs	(1,631)	(1,544)	(990)	(986)
Indirect expenses	—	(89)	—	(57)
Restructuring costs				
- direct	(169)	(24)	(103)	(16)
Operating expenses	(3,497)	(3,364)	(2,123)	(2,150)
Profit before impairment losses	1,577	1,275	958	815
Impairment losses	(324)	(244)	(197)	(156)
Operating profit	1,253	1,031	761	659
Operating expenses - adjusted ⁽¹⁾	(3,328)	(3,340)	(2,020)	(2,134)
Operating profit - adjusted ⁽¹⁾	1,422	1,055	864	675
Average exchange rate - US\$/£			1.647	1.565
	US\$bn	US\$bn	£bn	£bn
Balance sheet				
Loans and advances to customers (gross)				
- residential mortgages	12.1	9.6	7.7	5.8
- home equity	18.8	20.1	12.0	12.1
- SBO home equity	1.8	—	1.2	—
- corporate and commercial	43.6	39.8	27.9	24.1
- other consumer	17.6	14.1	11.3	8.6
Total loans and advances to customers (gross)	93.9	83.6	60.1	50.6
Loan impairment provisions	(0.8)	(0.4)	(0.5)	(0.3)
Net loans and advances to customer	93.1	83.2	59.6	50.3
Customer deposits (excluding repos)	94.6	91.1	60.6	55.1
Spot exchange rate - US\$/£			1.562	1.654

Note:

(1) Excluding restructuring costs.

Financial review

Key points

In accordance with a commitment to the EC to sell Citizens by 31 December 2016, the RBS Group disposed of 29.5% of its interest in Citizens Financial Group, Inc. during the second half of 2014 primarily through an initial public offering in the USA. In accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', Citizens is presented with effect from 31 December 2014 as a discontinued operation, with comparatives restated, and as a disposal group.

Although Citizens has been reclassified as a discontinued operation it continues to be a reportable operating segment.

The results for 2014 are not directly comparable to prior periods; prior year results exclude Non-Core operations and include indirect expenses. In the context of the planned disposal of CFG, indirect expenses are no longer allocated to the segment.

2014 compared with 2013

Operating profit increased by \$222 million, or 22%, to \$1,253 million, reflecting the Q2 2014 gain on the sale of the Illinois franchise. The former Non-Core portfolio is now included and indirect expenses are no longer allocated on a prospective basis from 1 January 2014. On a comparable basis, operating profit excluding the impact of the Illinois sale, \$283 million net gain, and restructuring costs, \$169 million (2013 - \$24 million), was up 16% driven by an increase in net interest income and a decrease in impairment losses partially offset by lower non-interest income.

Net interest income was up \$357 million, or 12%, to \$3,317 million driven by a larger investment portfolio, loan growth including the transfer of assets from Non-Core, the benefit of interest rate swaps and deposit pricing discipline. This was partially offset by a reduction in loan spreads, reflecting the impact of the relatively persistent low-rate environment on loan yields, higher borrowing costs related to subordinated debt issuances and the impact of lost revenue from the Illinois franchise sale.

Higher rates led to investment security purchases resulting in average portfolio growth of \$5.4 billion over the year.

Average loans and advances were up 10% driven by the \$3.4 billion transfer of assets from Non-Core, commercial loan growth, auto loan organic growth and purchases of residential mortgages and auto loans, which were partially offset by a reduction in home equity loans.

Average customer deposits were down 2% with planned run-off of high priced deposits.

Excluding the gain on the sale of the Illinois franchise of \$283 million, non-interest income was down \$205 million, or 12%, to \$1,474 million reflecting lower securities gains of \$116 million, lower mortgage banking fees of \$52 million, as refinancing volumes have slowed, lower deposit fees of \$52 million due to a change in the posting order of transactions and the impact of lost revenue from the Illinois franchise sale. This was partially offset by underlying strength in commercial banking fee income. Mortgage origination activity has slowed as market rates have risen, leading to lower applications combined with lower levels of gains on sales of mortgages.

Excluding restructuring costs of \$169 million (2013 - \$24 million), total expenses were flat driven by the removal of indirect costs in 2014 and the impact of the Illinois franchise sale partially offset by lower mortgage servicing rights impairment release and higher consumer regulatory compliance costs.

Restructuring costs include costs related to the sale of the Illinois franchise, separation from the RBS Group, as well as efforts to improve processes and enhance efficiency.

Impairment losses increased by \$80 million to \$324 million due to charge-offs related to assets transferred from Non-Core.

Financial review

RBS Capital Resolution (RCR)

	2014 £m
Income statement	
Net interest income	187
Net fees and commissions	62
Income from trading activities (1)	(157)
Other non-interest income (1)	330
Non-interest income	235
Total income	422
Direct expenses	
- staff costs	(161)
- other costs	(75)
Indirect expenses	(41)
Restructuring costs	
- indirect	(1)
Operating expenses	(278)
Profit before impairment losses	144
Impairment releases (1)	1,298
Operating profit	1,442
Operating expenses - adjusted (2)	(277)
Operating profit - adjusted (2)	1,443
	£bn
Balance sheet	
Loans and advances to customers (gross) (3)	21.3
Funded assets	13.6
Total assets	27.6

Notes:

- (1) Asset disposals contributed £902 million to RCR's operating profit: impairment provision releases of £874 million; £81 million gain in income from trading activities and £53 million loss in other operating income.
 (2) Excluding restructuring costs.
 (3) Includes disposal groups.

RCR was created with effect from 1 January 2014.

2014

The original target was for RCR to reduce funded assets by between 55% to 70% by the end of 2015 and by 85% over three years from 1 January 2014. Based on the strong performance in 2014, RCR is now expected to reduce funded assets by 85% by the end of 2015, a year earlier than planned.

Operating profit of £1,442 million reflects impairment provision releases and higher than anticipated sale prices for assets driven by a combination of strong execution and favourable market conditions particularly in Ireland.

Funding employed

RCR continues to be funded primarily by RBS Treasury and has no material third party deposits.

The funding is based on the original target of reducing third party assets by 85% over three years from the creation of RCR on 1 January 2014.

Financial review

Non-Core

	2013 £m
Net interest income	501
Net fees and commissions	66
Loss from trading activities	(20)
Other operating income	162
Non-interest income	208
Total income	709
Direct expenses	
- staff	(175)
- other	(173)
Indirect expenses	(96)
Restructuring costs	
- direct	(6)
- indirect	(5)
Operating expenses	(455)
Operating profit before impairment losses	254
Impairment losses (1)	(4,654)
Operating loss	(4,400)

	£bn
Balance sheet	
Total assets (excluding derivatives)	26.1
Total assets (including derivatives)	29.1
Loans and advances to customers (gross)	34.7
Loan impairment provisions	(13.7)
Net loans and advances to customers	21.0
Customer deposits	1.4

Note:

(1) Includes £3,116 million pertaining to the creation of RCR and related strategy.

Non-Core was dissolved on 31 December 2013. Comparatives have not been restated.

Financial review

Consolidated balance sheet at 31 December 2014

	2014 £m	2013 £m
Assets		
Cash and balances at central banks	73,983	79,993
Net loans and advances to banks	23,884	40,044
Reverse repurchase agreements and stock borrowing	20,708	26,439
Loans and advances to banks	44,592	66,483
Net loans and advances to customers	332,951	389,203
Reverse repurchase agreements and stock borrowing	43,987	49,897
Loans and advances to customers	376,938	439,100
Debt securities subject to repurchase agreements	22,923	51,970
Other debt securities	61,351	48,726
Debt securities	84,274	100,696
Equity shares	5,203	8,278
Settlement balances	4,710	5,634
Derivatives	354,582	289,403
Intangible assets	7,765	12,352
Property, plant and equipment	6,123	7,866
Deferred tax	1,510	3,435
Prepayments, accrued income and other assets	4,413	5,904
Assets of disposal groups	81,033	790
Total assets	1,045,126	1,019,934
Liabilities		
Bank deposits	39,066	36,551
Repurchase agreements and stock lending	24,784	28,612
Deposits by banks	63,850	65,163
Customer deposits	357,649	415,847
Repurchase agreements and stock lending	37,350	56,457
Customer accounts	394,999	472,304
Debt securities in issue	41,996	59,746
Settlement balances	4,498	5,245
Short positions	23,028	28,004
Derivatives	350,783	286,133
Accruals, deferred income and other liabilities	12,262	14,753
Retirement benefit liabilities	2,550	3,188
Deferred tax	236	189
Subordinated liabilities	30,469	33,134
Liabilities of disposal groups	71,284	3,210
Total liabilities	995,955	971,069
Non-controlling interests	2,385	79
Owners' equity	46,786	48,786
Total equity	49,171	48,865
Total liabilities and equity	1,045,126	1,019,934

Financial review

Commentary on consolidated balance sheet

2014 compared with 2013

Total assets of £1,045.1 billion at 31 December 2014 were up £25.2 billion, 2%, compared with 31 December 2013. This was driven by mark-to-market increases in derivative assets, partly offset by a reduction in funded assets, primarily in CIB and RCR.

Loans and advances to banks decreased by £21.9 billion, 33%, to £44.6 billion. Excluding reverse repurchase agreements and stock borrowing ('reverse repos'), down £5.7 billion, 22%, to £20.7 billion, bank placings declined £16.2 billion, 40%, to £23.9 billion.

Loans and advances to customers declined £62.2 billion, 14%, to £376.9 billion. Within this, reverse repos were down £5.9 billion, 12%, to £44.0 billion. Customer lending decreased by £56.3 billion, 14%, to £333.0 billion, or £63.9 billion to £350.3 billion before impairments. This reflected the transfer to disposal groups at 31 December 2014 of £60.1 billion (equivalent 2013 - £50.6 billion) of customer balances relating to Citizens together with run-down and disposals in RCR.

Debt securities were down £16.4 billion, 16%, to £84.3 billion, driven mainly by the transfer of £15.3 billion of Citizens' debt securities to assets of disposal groups.

Equity shares decreased by £3.1 billion, 37%, to £5.2 billion primarily due to the ongoing run-down of the CIB equities business.

Movements in the value of derivative assets, up £65.2 billion, 23%, to £354.6 billion, and liabilities, up £64.7 billion, 23% to £350.8 billion, primarily reflects significant mark-to-market increases on interest rate contracts driven by significant downward shifts in major yield curves.

Property, plant and equipment decreased by £1.7 billion, 22%, to £6.1 billion driven largely by disposals of investment properties and the transfer of Citizens to assets of disposal groups.

Intangible assets decreased by £4.6 billion, 37%, to £7.8 billion primarily as a result of the transfer to disposal groups of £4.5 billion of intangible assets relating to Citizens.

The increase in assets and liabilities of disposal groups, up £80.2 billion to £81.0 billion, and £68.1 billion to £71.3 billion respectively, primarily reflects the transfer to disposal groups of Citizens at 31 December 2014. This was partly offset by a decrease resulting from the disposal of the Chicago area retail branches, small business operations and select middle market relationships in the Chicago area, which formed part of Citizens.

Deposits by banks decreased £1.3 billion, 2%, to £63.9 billion, with decreases in repos, down £3.8 billion, 13%, to £24.8 billion and increases in bank deposits, up £2.5 billion, 7%, to £39.1 billion, as a result of higher derivative cash collateral partly offset by the transfer of £6.8 billion of Citizens' bank deposits to liabilities of disposal groups.

Customer accounts decreased £77.3 billion, 16%, to £395.0 billion. Within this, repos decreased £19.1 billion, 34%, to £37.4 billion. Customer deposits were down £58.2 billion, 14%, at £357.6 billion, primarily reflecting the transfer to disposal groups of £60.6 billion (equivalent 2013 - £55.1 billion) of customer accounts relating to Citizens and the reduction of corporate deposits in both Commercial Banking and CIB.

Debt securities in issue decreased £17.8 billion, 30%, to £42.0 billion due to the buy-back and maturity of medium term notes in issue given the lower funding requirements of a reduced balance sheet.

Retirement benefit liabilities decreased by £0.6 billion, 20%, to £2.6 billion primarily driven by additional employer contributions of £0.7 billion to the Group's Main scheme as part of the schedule of additional contributions to eliminate the deficit in the scheme which were agreed following completion of the triennial valuation of the Main scheme.

Subordinated liabilities decreased by £2.7 billion, 8% to £30.5 billion, primarily as a result of redemptions of £2.3 billion of dated loan capital, £0.3 billion of undated loan capital and £1.5 billion of preference shares classified as debt. These decreases were partially offset by dated loan capital issuances of £1.4 billion.

Non-controlling interests increased by £2.3 billion to £2.4 billion, due to the disposal of a 29.5% interest in Citizens during the second half of 2014, primarily through an initial public offering in the USA.

Owner's equity decreased by £2.0 billion, 4%, to £46.8 billion, driven by the £3.2 billion attributable loss for the year. Partially offsetting this reduction were movements in cash flow hedging reserves, £1.1 billion and other reserve movements, £0.1 billion.

Financial review

Cash flow

	2014 £m	2013 £m
Net cash flows from operating activities	(14,420)	(20,965)
Net cash flows from investing activities	(4,910)	16,502
Net cash flows from financing activities	(2,000)	(1,084)
Effects of exchange rate changes on cash and cash equivalents	682	402
Net decrease in cash and cash equivalents	(20,648)	(5,145)

2014

The major factors contributing to the net cash outflow from operating activities of £14,420 million were the decrease of £11,605 million in operating assets and liabilities, the net loss before tax from continuing and discontinued operations of £855 million, loans and advances written-off net of recoveries of £5,052 million and other provisions utilised of £3,254 million. These were partially offset by the loss on reclassification to disposal groups of £3,994 million and other provisions charged net of releases of £2,478 million.

Net cash outflows from investing activities of £4,910 million related to net investment in business interests and intangible assets of £2,947 million, the net outflows from purchases of securities of £2,314 million, the purchase of property, plant and equipment of £810 million offset by net cash inflows from the sale of property, plant and equipment of £1,161 million.

Net cash outflows from financing activities of £2,000 million relate primarily to the repayment of subordinated liabilities of £4,181 million and interest paid on subordinated liabilities of £1,308 million partly offset by the proceeds of non-controlling interests issued of £2,117 million and the issue of subordinated liabilities of £1,438 million.

2013

The major factors contributing to the net cash outflow from operating activities of £20,965 million were the decrease of £18,983 million in operating assets and liabilities, the net loss before tax from continuing and discontinued operations of £6,761 million, loans and advances written-off net of recoveries of £3,975 million and other provisions utilised of £2,046 million. These were partially offset by provisions for impairment losses of £8,449 million and other provisions charged net of releases of £4,407 million.

Net cash inflows from investing activities of £16,502 million related to the net inflows from sales of securities of £12,074 million, the sale of property, plant and equipment of £888 million and net divestment of business interests and intangible assets of £4,237 million offset by net cash outflows from the purchase of property, plant and equipment of £697 million.

Net cash outflows from financing activities of £1,084 million relate primarily to the repayment of subordinated liabilities of £1,868 million and interest paid on subordinated liabilities of £1,395 million partly offset by the issue of subordinated liabilities of £2,285 million.

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Overview*

Presentation of information

Except as otherwise indicated by an asterisk (*), information in the Capital and risk management section (pages 33 to 163) is within the scope of the Independent auditor's report. Disclosures in this section include disposal groups in relevant exposures unless otherwise indicated.

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

Business model and associated risks

The Group aims to become a bank that its customers and all other stakeholders can depend on. It intends to do so by focusing on Personal & Business Banking (PBB), Commercial & Private Banking (CPB) and Corporate & Institutional Banking (CIB) customers, in its main market of the UK. By delivering only services that meet their needs, it aims to achieve an appropriate return. Accordingly, the Group plans to simplify its services as well as the processes it uses to deliver them, enabling the Group to provide customers with better value services. It aims to become the number one bank in the UK for customer service, trust and advocacy by 2020.

At present the RBS Group serves approximately 24 million customers worldwide. UK PBB offers individuals and small businesses a variety of traditional retail banking products, including current and savings accounts, residential mortgages and credit cards, while CPB provides both businesses and high-net-worth individuals with loan products and investment services. Both are focused on the UK. CIB offers wholesale banking services, including debt financing and fixed income trading, to corporations and financial institutions across a wide range of countries. Ulster Bank, part of PBB, offers loan and investment products, as well as transactional services, to individuals and businesses in Ireland.

The products are delivered through a diverse array of channels, including extensive branch networks, in-store branches and call centres, in addition to online and mobile channels.

The main sources of earnings are interest income from lending and fee income from transactional and other services. Given the low interest rate environment in both the UK and the US, its net interest margin, that is, the difference between the interest it earns from lending and the interest it pays on deposits, has been under pressure. In order to offset this pressure, work is underway to reduce costs and increase non-interest income.

The Group is reducing costs through rationalisation, integration and simplification. For example, PBB is rationalising its service delivery channels and simplifying the operations that support them. The other franchises are taking similar steps.

The Group also owns a number of businesses which it is divesting as it seeks to refocus on its UK customers and reduce its risk profile as well as to comply with regulatory requirements. It is in the process of selling its stake in Citizens Financial Group Inc (CFG Inc), a subsidiary offering loan and investment products, together with transactional services, to customers in the US. Similarly, it is committed to selling Williams & Glyn, which provides retail and commercial banking services in the UK, in the next few years. Other businesses identified for divestment and wind-down include the international private banking activities of CPB and RBS Securities Inc respectively. Finally, RBS Group continues to reduce the assets held in RCR (refer to page 28 for further details). These divestment and rationalisation projects expose it to execution and strategic risk.

Finally, the Group is also exposed to a range of other risks through its customer businesses including pension, business, regulatory, reputational and strategic risk. This is set out in the Risk coverage section.

*unaudited

Financial review Capital and risk management

Overview* continued

Risk coverage

The main risk types faced by RBS plc are presented below. For further information, refer to pages 49 to 163.

Risk type	How the risk arises	2014 overview
Conduct and legal risk	Conduct risk can result in fines and reputational damage if customers are not treated in line with their and other stakeholders' expectations. Conduct risk exists across all stages of the Group's relationships with its customers, from sales through service delivery to post-sales processes. It also exists in the activities the Group undertakes to manage its business, from the development of business strategies, through governance and human resource management. Conduct risk also exists if the Group does not take effective action to prevent fraud, bribery and money laundering.	The Group continued to remediate historical conduct issues, while also restructuring its customer-facing businesses and support functions around the needs of its customers. Actions taken to address underlying control deficiencies included strengthening significantly the systems and controls governing the Group's LIBOR submissions, and simplifying the retail product offering and sales processes. The conduct risk framework was also further developed, with the embedding of a new Conduct and Regulatory Affairs (C&RA) operating model, and the orientation of C&RA's assurance coverage and testing towards customer outcomes. The impact of conduct issues resulted in litigation and conduct costs to the Group remaining high at £2.2 billion in 2014, albeit lower than the £4.5 billion recorded in 2013.
Regulatory risk	Regulatory risk arises from the Group's regulatory, business or operating environments and from how it responds to them.	The level of regulatory risk remained high as policymakers and regulators continue to strengthen regulations and supervision in response to the events of 2007 and 2008. The Group will in future focus CIB's business model on its leading positions in UK rates, debt capital markets and foreign exchange; this will leave it well-placed to implement the ring-fencing requirements, in 2019.
Operational risk	Operational risk may arise 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.	The Group's transformation plan is material and complex affecting all business areas and functions simultaneously and so has the potential to increase operational risk profile at least in the short term. Significant investments were made to improve technology resilience for core banking services, operating practices and risk management across the three lines of defence. In particular, enhancements were made to cyber security programmes, mitigating a number of vulnerabilities.
Capital adequacy risk	Capital adequacy risk arises from inefficient management of capital resources.	CET1 was 10.0% on the end-point CRR basis despite absorbing the impact of Capital Requirements Regulation (CRR) implementation with effect from 1 January 2014. Key milestones achieved in 2014 included the sell down of the first tranche of CFG, and run down of RCR and CIB assets.
Liquidity and funding risk	Liquidity and funding risk arise through the maturity transformation role that the Group performs. It is exposed to capital adequacy risk if it manages its capital resources inefficiently. Liquidity and funding risk arises from the Group's day-to-day operations.	Liquidity metrics remained strong reflecting balance sheet and risk reduction as well as growth in UK PBB deposits. The liquidity portfolio of £149 billion covered external wholesale funding of £94 billion by more than 1.5 times.
Reputational risk	Reputational risk can arise from the conduct of either the 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 Group offers and the transactions it supports; and from its operations and infrastructure.	The most material threat to the Group's reputation continued to originate from historical and more recent conduct deficiencies. The Group has been the subject of investigations and review by a number of regulators, some of which have resulted in fines and public censure.

*unaudited

Financial review Capital and risk management

Risk type	How the risk arises	2014 overview
Credit risk	The most significant source of credit risk is lending. The Group offers a number of lending products where it has an obligation to provide credit facilities to a customer. A further significant source of credit risk arises from activities in the derivatives and securities financing transaction markets, which result in counterparty credit risk (the risk of financial loss arising from the failure of a customer to meet obligations that vary in value by reference to a market factor). The Group holds some debt securities generally for liquidity management purposes, and is exposed to credit risk as a result. It is also exposed to credit risk from off-balance sheet products such as trade finance activities and guarantees.	The Group's credit risk portfolio continued to improve with an overall reduction in exposure, an improvement in credit quality and a material provision release in 2014. These improvements were driven by supportive economic and market conditions in the UK and Ireland, better liquidity and increased collateral values, and also reflected improvements in credit risk measurement. Credit RWAs fell by £17.7 billion to £282.5 billion primarily as the implementation of CRR was more than offset by the effect of risk reduction and RCR disposal strategy. The wind-down of CIB's US asset-backed products business contributed to a £13 billion decrease in asset-backed securities, now at £25 billion. Impairment provisions of £17.9 billion, down £7.1 billion, covered risk elements in lending of £28.1 billion, down £11.1 billion, by 64%. Commercial real estate lending fell by £9.3 billion to £43.3 billion, of which £13.3 billion was in risk elements in lending with a provision coverage of 68%. Favourable market conditions, particularly in Ireland, resulted in impairment releases more than offsetting new impairment charges. This led to a net release of £1.1 billion, of which £1.3 billion was in RCR and £0.4 billion in Ulster Bank, partly offset by net impairment charges of £0.3 billion in UK PBB and £0.2 billion in CFG.
Market risk	The majority of the Group's traded market risk exposure arises in CIB and RCR through transactions in financial instruments including debt securities, loans, deposits and equities, as well as securities financing and derivatives. The majority of its 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.	The Group's traded market risk profile decreased significantly, with market risk limits being reduced across all businesses, in some instances by 50-60%. Average trading value-at-risk (VaR) decreased significantly during the year to £26.5 million, 33% of the 2013 average, reflecting risk reductions in CIB and RCR, as well as the effect of a more comprehensive economic view of risk from the incorporation of credit and funding valuation adjustments in the VaR calculation. Market risk RWAs also decreased by £6.0 billion to £22.8 billion.
Pension risk	The Group is exposed to pension risk through its defined benefit schemes worldwide and the variations in their value. The five largest schemes represent around 96% of pension liabilities. The largest is the Royal Bank of Scotland Group Pension Fund ('Main scheme') and this is the principal source of pension risk.	The triennial actuarial funding valuation of the Main scheme was agreed in May 2014 and showed an excess in the value of liabilities over the value of assets of £5.6 billion at 31 March 2013; a ratio of 82%. In 2014, various pension stress-testing initiatives were undertaken, both on internally defined scenarios and those to meet integrated Prudential Regulation Authority and European Banking Authority stress testing requirements.

*unaudited

Financial review Capital and risk management

Overview* continued

Risk type	How the risk arises	2014 overview
Country risk	Country risk arises from possible economic or political events in each country to which the Group has exposure, and from unfavourable conditions affecting daily operations in a country. It has the potential to affect all parts of the Group's portfolio across wholesale and retail activities that are directly or indirectly linked to the country in question. The activities of several customer businesses, particularly CIB but also Ulster Bank and CFG, expose the Group to country risk.	The Group maintained a cautious stance as many clients continued to reduce debt levels. Eurozone periphery net balance sheet exposures decreased by £5.7 billion, or 16%, to £30.5 billion, primarily in Ireland, Spain and Italy. Total exposure to Greece was £0.4 billion but only £0.1 billion after the effect of collateral and guarantees. Limits for Russia and Ukraine were adjusted, additional credit restrictions were placed on new business and exposures were reviewed against international sanctions
Business risk	Business risk exists at all levels of the organisation and is generated at the transaction level. It is affected by other risks the Group faces, which could contribute to any adverse changes in the bank's revenues or costs.	The Group reduced its business risk profile as it curtailed riskier activities in CIB, made disposals through RCR, and announced an intensified cost management programme.
Strategic risk	Strategic risk arises from strategic decisions that fail to reflect the operating environment, or which do not take adequate account of execution challenges. These include decisions related to the Group products and services which have implications for profitability, risk, the customer base, and for business growth.	In early 2014, RBS Group announced the results of a strategic review with a defined plan to shift the business mix towards the UK and the retail and commercial banking segments, with the aim of a lower risk profile. The year saw good progress, with results in general exceeding targets and run-down or sell-off of non-core assets ahead of schedule. Capital ratios increased considerably, a significant step towards targeted levels of financial strength which, when attained, will provide the Group with more strategic options. However, the Group continued to work through the impact of tougher regulatory regime on banks.

*unaudited

Top and emerging risk scenarios

As part of the risk management process, top and emerging risk scenarios are identified and monitored. These are events that, should they materialise, would lead to a significant unexpected negative outcome, thereby causing the Group as a whole, or a particular business, to fail to meet one or more strategic objectives. In assessing the potential impact of risk materialisation, both financial and reputational considerations are taken into account.

Management is concerned with a range of risk scenarios, but some have attracted particular attention from senior management during the past year. These were grouped into three broad categories:

- Macro-economic risks and other external risks;
- Regulatory and legal risks; and
- Risks related to operations.

Further information on these and other risks facing the Group is detailed in Risk factors on page 288 to 307.

The top and emerging risks were as follows:

Macro-economic and other external risks

(i) Risks related to the macro-economy

The Group remains vulnerable to changes in the external economic environment. Among other scenarios, the following could have a material negative impact: a recession in the UK in any of our other major markets; a resumption of the eurozone crisis (including a worsening of the situation in Greece); global deflation; large house price falls in the UK; and major geopolitical instability.

Impact

The ability to hit strategic targets could be reduced owing to multiple effects, including lower-than-expected revenues, increases in impairments and a material deterioration in key prudential metrics. Exiting non-strategic businesses or portfolios could be disrupted by market volatility.

Mitigants

The Group has improved its capital and liquidity ratios. A number of higher risk portfolios have been exited or reduced. Stress testing is used to inform strategic planning.

(ii) The effect of the run-up to, and the result of, the UK general election on performance and strategy

Political party statements suggest that the election outcome will affect matters that are material to the Group's strategy, including banking levy rates, banking sector competition and remuneration, the approach to sale of the public stake, and the UK's position in the EU. Of note is the potential for a referendum on the UK's membership of the EU during the next parliament, which would increase macro-economic and operational uncertainty.

Impact

Achievement of strategic objectives in general, more specifically its ability to generate income and retain high quality personnel, and its strategy, structure and attractiveness to investors, may all be affected to varying degrees in a range of election-related scenarios.

Mitigants

RBS Group actively monitors, and considers responses to, varying UK election outcomes to ensure that it is well prepared for all eventualities.

Regulatory and legal risks

(i) Risks to income, costs and business models arising from existing and future regulatory requirements or decisions

The Group faces potentially sustained increases in regulatory capital needs, but also risks related to regulatory intervention that affect its business models. These include: the results of a review of the personal current account and small business banking markets; Independent Commission on Banking ring fencing proposals and US Intermediate Holding Company requirements; and Risk Data Aggregation and Reporting.

Impact

RBS Group risks increased capital requirements, reduced income or raised costs due to business model changes and fines, remediation costs or legal action if it fails to comply with regulatory requirements. Its reputation may also suffer.

Mitigants

RBS Group considers proposed or potential regulatory requirements in strategic and financial planning rounds and plans accordingly.

(ii) Risks to income, costs and business models arising from existing and future regulatory requirements specifically related to conduct

RBS Group continues to manage issues related to its past business conduct. Remediation costs for some of these could remain high, while the impact of outcomes of other reviews remains uncertain. Moreover, it faces ongoing scrutiny of its business conduct, particularly towards retail customers, and of its ability to embed a strong appreciation of risk and good conduct across the bank.

Impact

The Group risks fines, remediation costs, legal action and reputational damage, but also lower income or higher expenses due to business model changes.

Mitigants

The Group continues to work to deal with past conduct breaches. Major programmes are in place to ensure that future conduct meets the expectations of external stakeholders and to ensure that a strong and pervasive risk culture is embedded throughout the Group.

Overview* continued

Risk related to operations

(i) Increased losses arising from a failure to execute successfully major projects

RBS Group has a number of transformational, execution and IT development projects under way, the successful conclusion of which are essential to meet new regulatory and strategic requirements. These new requirements affect its organisational structure, its business strategies, its information technology systems, its operational processes and its product offerings. Given the number, scale and complexity of these projects, there is a risk that it will not complete them successfully.

Impact

Failure to complete these projects successfully would affect the Group's ability to achieve its strategic objectives. It may also incur regulatory fines, lose market share and suffer damage to its reputation.

Mitigants

The 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.

(ii) An increase in RBS Group's obligations to support pension schemes

The Group has established various pension schemes for its employees as a result of which it has incurred certain obligations as sponsor of these schemes. If economic growth stagnates and interest rates remain low as a result, the value of pension scheme assets may not be adequate to fund the pension scheme's liabilities. All of the businesses are exposed to this risk.

Impact

The Group's pension schemes' combined deficit had risen by £2.1 billion at the most recent valuation, requiring it to set aside additional capital in support. Additional capital required if the deficit widened further would depend on the size of the deficit, the efficacy of management actions undertaken to address it, and the regulatory view of those actions. The Group increased its cash contributions to the schemes to address the increased deficit. Similarly, additional contributions required if the deficit widened further would depend on the size of the deficit. The Group 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.

Mitigants

The trustee is responsible for the investment of the Main scheme's assets, which are held separately from the Group's own assets. To restrict liability increases, defined benefit pension schemes are closed to new members and terms for existing members have been altered. Deficit-closing payments are spread over ten years to reduce the strain on income.

(iii) Impaired performance due to an inability to recruit or retain suitable staff

The 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 members to leave and prospective staff members not to join. Although these risks concern all customer businesses, they particularly affect CIB and CFG.

Impact

If it cannot retain or attract the necessary staff members, the Group may be unable to implement its business strategies or meet regulatory requirements on time, or at all. It may also experience control failures. Its reputation may suffer as a result.

Mitigants

The 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 develop and implement an enhanced recruitment strategy.

(iv) Increased losses arising from cyber attacks

The Group has experienced cyber attacks, which are increasing in frequency and severity across the industry. This risk affects all customer businesses.

Impact

A successful cyber attack could lead to fraudulent activity or the loss of customer data. RBS Group could experience significant losses as a result of the need to reimburse customers, pay fines or both. Further, a successful cyber attack could cause significant damage to its reputation.

Mitigants

The Group has participated in an industry-wide cyber attack simulation. It has also initiated a large-scale programme to improve controls over user access. It has reviewed its websites and taken steps to rationalise them, put additional anti-virus protections in place and taken steps to educate staff on information protection.

(v) Increased losses arising from the failure of information technology systems

The information technology systems are complex and at risk of disruption. Recovering from failure can be challenging.

Impact

A failure of information technology systems could lead to an inability to process transactions or provide services to its customers. Should a failure not be rectified promptly, it might lose funding, be subject to fines, incur remediation costs or face legal action. Its reputation might also suffer.

Mitigants

A major investment programme has significantly improved the resilience of the systems and more benefits are expected. It has improved back-up system sustainability and created a 'shadow bank' able to provide basic services if needed. It is also improving the documentation of critical business functions.

*unaudited

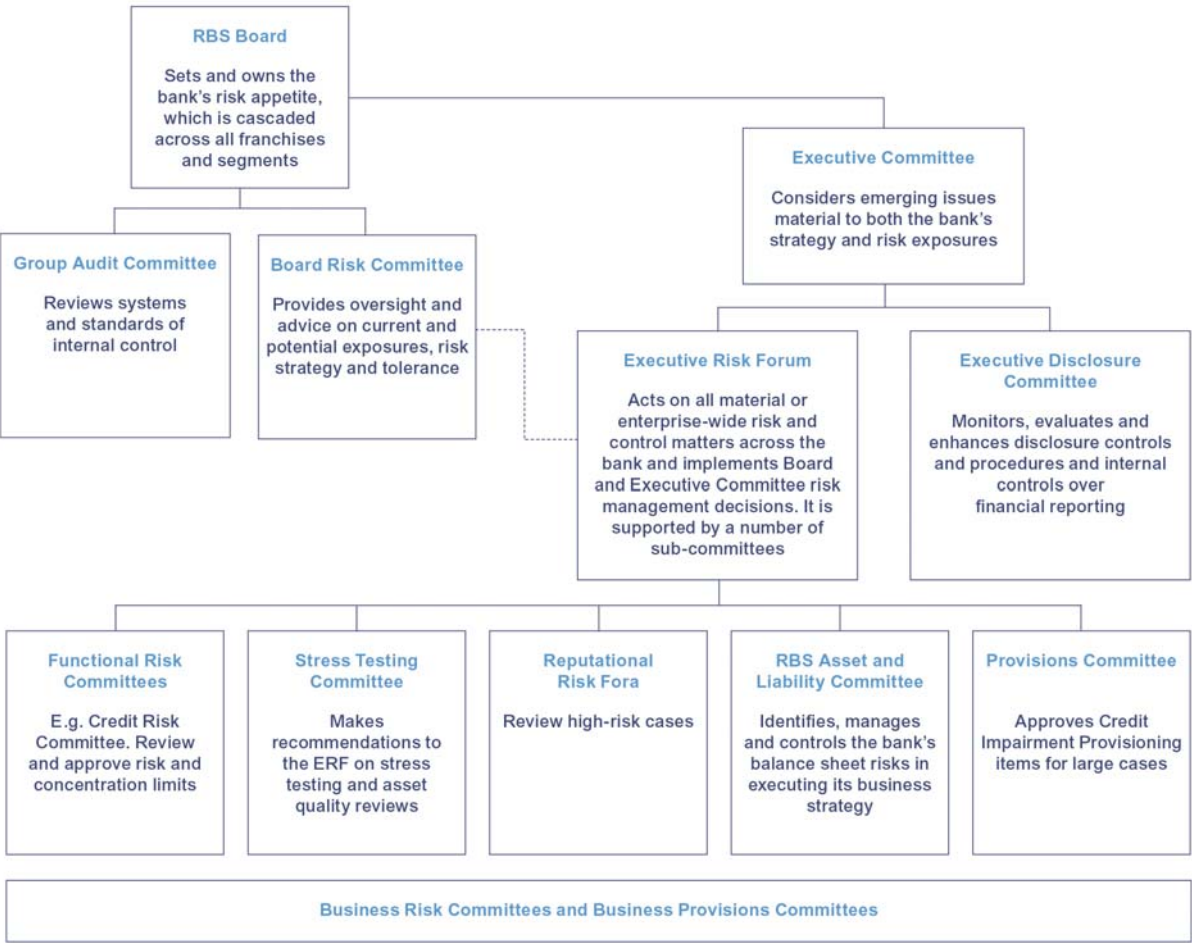
Risk governance	
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Risk governance*

Governance structure

RBS Group is committed to achieving the highest standards of corporate governance in every aspect of its business, including risk management. A key aspect of the RBS Group Board's responsibility as the main decision-making body is the setting of risk appetite (refer to page 46 for more information on risk appetite) to ensure that the levels of risk RBS Group is willing to accept in the attainment of its strategic business and financial objectives are clearly understood. The RBS Group Board delegates authority for risk management to specific committees.

The risk governance structure and the main purposes of each of the committees is illustrated below:



*unaudited

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 defines 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 and Communications.

Responsibilities include:

- Owning, managing and supervising, within a defined risk appetite, the risks which exist in the business area.
- Ensuring appropriate controls are in place to mitigate risk: balancing control, cost, 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 and Regulatory Affairs.

Responsibilities include:

- Owning and developing 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 design, development and communication of the bank's risk culture and appetite.
- Analysing the aggregate risk profile and ensuring that risks are being managed to the desired level (risk appetite).
- Providing expert support and advice to the business on risk management.
- Providing senior executives with relevant management information and reports and escalating concerns where appropriate.
- Undertaking assurance.

Third line of defence - Internal Audit

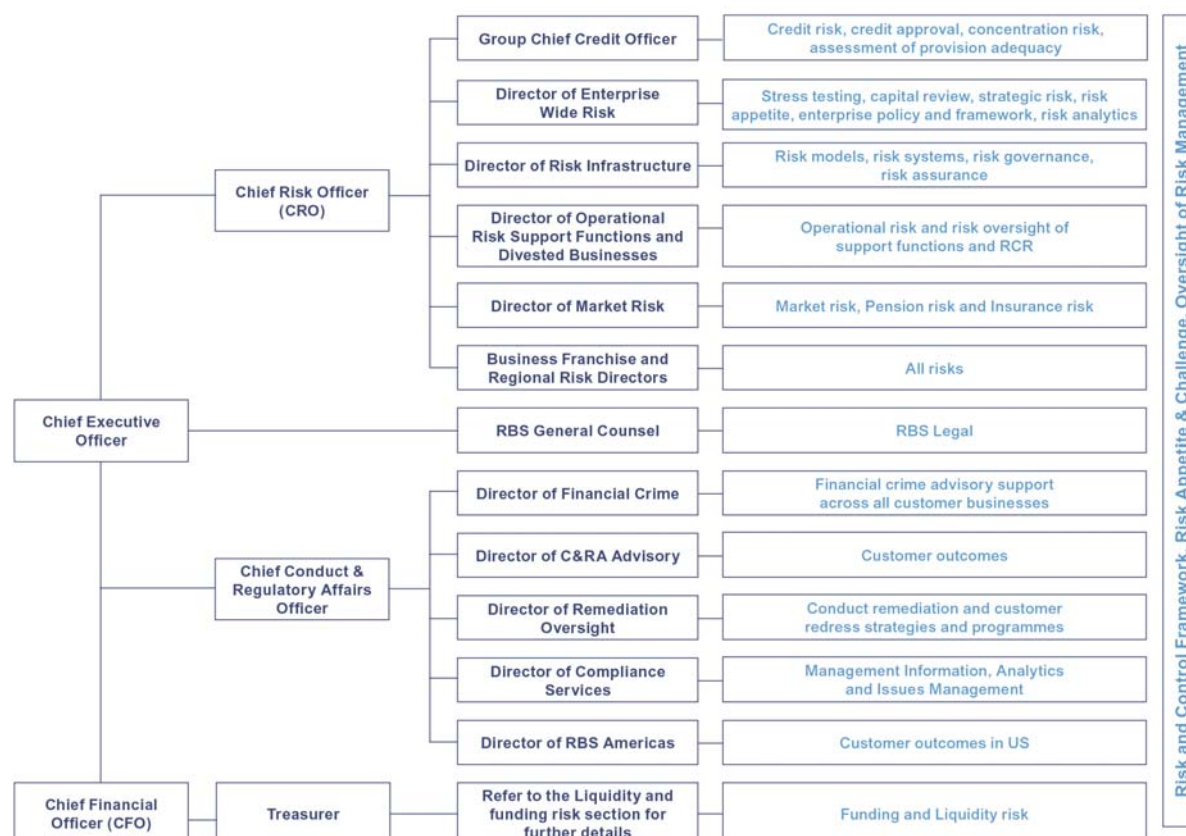
Responsibilities include:

- Providing assurance on the key risks to the organisation by assessing the entire control framework.
- Holding RBS Group Risk Management accountable for establishing an appropriate risk management framework.

Risk governance* continued

Management structure

RBS Group's management structure and the main elements of each role are illustrated 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 RBS Group Chief Executive and the RBS Group Board Risk Committee, with a right of access to the Chairman of the Board Risk Committee.

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

In 2014, Risk Management, which had previously been spread across the different business segments, re-organised itself into five functional areas: Operational Risk, Support Functions & Divested Businesses; Credit Risk; Market Risk; Enterprise-Wide Risk Management and Risk Infrastructure. Directors of Risk were also appointed for each of the franchises and for Services. The 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 directly 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 oversee risk exposures arising from their business activities and focus on ensuring that they are adequately monitored and controlled.

(2) Conduct and Regulatory Affairs

Conduct & Regulatory Affairs (C&RA) is led by the Chief Conduct & Regulatory Affairs Officer, who reports directly to the Chief Executive. It is responsible for providing oversight of conduct risk and regulatory risk at RBS Group, and does so by setting bank-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 bank's relationships with its regulators.

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

A Chief Compliance Officer in each franchise, reporting to the Director of C&RA Advisory, provides advisory support to assist businesses in their management of conduct, regulatory affairs and financial crime.

Risk appetite and culture	
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Risk appetite and culture*

Risk appetite

Risk appetite is both a key business tool and an integral part of risk management. It is aligned with RBS Group’s strategic objectives, aiming to strike an optimal balance between building a sustainable risk profile and creating long-term value for customers, investors and wider stakeholders. The risk appetite framework seeks to ensure that each business can withstand significant deteriorations in economic and market conditions.

The RBS Group Board reviews and approves the risk appetite framework and targets annually, which establishes the level and types of risks RBS 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 RBS 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 cascaded and embedded across RBS Group. The risk appetite framework provides each business with a greater understanding of acceptable risk levels, aligning commercial strategies with the most effective use of financial resources, such as capital and funding. The risk appetite framework allows RBS Group to focus on its key business strengths and competitive advantages over the long term.



Strategic risk objectives

Risk management plays an integral role in the delivery of strategic goals. The implementation of a stronger and more effective culture of risk management and control provides the platform necessary to address vulnerabilities, rebuild on core strengths and position RBS Group on a sustainable and profitable path for future growth.

Financial strength and resilience are at the heart of the strategic plan. RBS Group has defined this level of robustness as that which is capable of achieving and sustaining a standalone credit rating (i.e. without government support) that is in line with those of its strongest international peers.

Given this central aim, the RBS Group Board has set out four key strategic objectives, aligned with the strategic plan:

- *Maintain capital adequacy.* To ensure there is sufficient capital resources to meet regulatory requirements and to cover the potential for unexpected losses in its asset portfolio.
- *Deliver stable earnings growth.* To ensure that strategic growth is based around a longer-term risk-versus reward consideration, with significantly lower volatility in underlying profitability than was seen during the financial crisis.
- *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 stakeholders have confidence in RBS Group’s ability to attain its strategic objectives and establish and maintain an appropriate business culture and operational controls.

Each objective is essential in its own right, but also mutually supportive of the others. 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.

*unaudited

Risk appetite measures

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

The risk appetite framework is based on four main pillars:

- Business and financial targets - RBS Group has set long-term targets for capital ratio, leverage ratio, loan:deposit ratio, the return on tangible equity and cost:income ratio. These are the broad boundaries within which it operates.
- Quantitative risk appetite targets - Risk appetite is also aligned with potential risk exposures and vulnerabilities under severe but plausible stress conditions. Quantitative targets, to be met under stress conditions, are set around the strategic risk objectives for maintaining capital adequacy, delivering stable earnings growth and ensuring stable and efficient access to funding and liquidity.
- Qualitative risk appetite targets - The fourth strategic risk objective of maintaining stakeholder confidence covers qualitative aspects relating to the culture of risk management and controls and meeting stakeholder expectations. Stakeholders include customers, employees, investors, societies and communities.
- Risk control frameworks and limits - Risk control frameworks set detailed tolerances and limits for material risk types (e.g. credit risk and market risk) that are used to manage risk on a day-to-day basis. These limits support and are required to be consistent with the high-level risk appetite targets.

The framework is supported by a programme of communication, engagement and training rolled out across RBS Group to embed a wide understanding of the purpose and value of an effective risk appetite.

Risk appetite supports value creation in a safe, sustainable way. It is embedded within the annual planning and budgeting process. The risk implications of business strategies are assessed to ensure that those strategies will not cause RBS Group to exceed agreed risk appetite. A range of different but complementary tools has been developed to measure whether strategic plans are consistent with risk appetite, to test broader 'what if' questions and to assess the impact of changes in key assumptions:

- Stress testing - assesses how earnings, capital and funding positions change under an unfavourable, yet plausible, scenario. Stress scenarios can differ by theme, geographical location or severity.
- Economic capital - provides complementary insights, with a breadth of understanding of risk profile changes and 'tail risks' across millions of different modelled scenarios.
- Sensitivity analysis - provides 'ready reckoners' around changes in key variables. It offers a high-level view on questions such as 'what if gross domestic product worsened by a further 1%', identifying certain tipping points where the bank's risk profile moves outside appetite.

Effective processes for reporting the results have also been developed, presenting the RBS Group Board and senior management with a more holistic and dynamic view of key risk exposures.

Risk appetite statements

Risk appetite is set at RBS Group-wide level then cascaded and embedded across all business areas. Each franchise is required to develop, own and manage a risk appetite statement aligned with the bank's risk appetite that:

- Covers the limits and tolerances in place for all identified material risks; and
- Enables each business to understand its acceptable levels of risk.

By setting a clear risk appetite and embedding a strong risk culture throughout its businesses, RBS Group can identify, measure and control risk exposures and respond effectively to shocks. Each franchise is responsible for ensuring its strategic plans are consistent with its approved risk appetite.

Risk appetite and culture* continued

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 targets in day-to-day risk management decisions. The risk control frameworks manage risk by expressing a clear tolerance for material risk types that is aligned to business activities.

The RBS Group Policy Framework directly supports the qualitative aspects of risk appetite, helping to rebuild and maintain stakeholder confidence in RBS Group's risk control and governance. Its integrated approach is designed to ensure that an appropriate standard of control is 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 standard within the Group Policy Framework. This standard 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.

Culture, values and remuneration

Objectives for risk culture

The establishment of a strong risk culture is essential to the realisation of RBS Group's ambition to build "a truly customer-centric bank". A strong risk culture is a key part of ensuring risk appetite is effectively embedded across RBS Group. The link between risk appetite and strategic objectives encourages people at all levels of the business to think about risk, how they identify it and how they manage it. It incorporates the quantitative and qualitative aspects of risk and uses both absolute and relative risk measures.

Risk culture policies

A core principle behind the development of the risk appetite framework is that risk appetite contributes to a strong risk management culture, in which risk is clearly and meaningfully aligned with business behaviours and outcomes. RBS Group's values - of "serving customers", "working together", "doing the right thing" and "thinking long term" - act as a clear starting point for a strong and effective risk culture. A wide range of communication and engagement activities (detailed below) has been undertaken to discuss the meaning of each value with employees and how they affect and guide day-to-day activities.

The embedding of RBS Group's values into a strong risk culture is supported by a revised and more focused 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.

These business 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 business principles facilitates sound decision making and a clear focus on good customer outcomes in 'the moments that matter'. It is 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 RBS 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 RBS 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.

Training

Across the risk management function, a series of events and activities have been undertaken to bring alive the bank's values and culture for employees. This is supported by performance management processes that hold individuals to account for poor behaviour and reward the behaviour that supports the bank's purpose, vision and values.

RBS Group Risk Management runs a Risk Academy which helps to train staff and to spread a common risk culture across the bank. Training plans are aligned with Risk function strategy to ensure staff have the skills and capabilities to support business and to meet changing regulatory and policy requirements.

Risk-based key performance indicators

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.

Conduct risk	
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Conduct risk*

Definition

Conduct 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 breaches of regulatory rules or laws, or of failing to meet customers' or regulators' expectations.

Sources of risk

Conduct risk exists across all stages of the 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 Group does not take effective action to prevent fraud, bribery and money laundering.

Governance

Effective conduct risk management is a commercial imperative for the bank: customers, clients and counterparties demand it as a precursor to building trust. It also reflects the developing regulatory environment in the UK, as well as the increasing focus of overseas regulators on conduct risk.

RBS Group Conduct and Regulatory Affairs (C&RA) is responsible for defining appropriate standards of conduct, and for designing the framework for managing conduct risk, driving adherence, and 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 the C&RA strategy, and implements RBS Group Board and Executive Committee risk management policy decisions; and
- 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.

Controls and assurance

Under the RBS Group Policy Framework, C&RA owns 26 conduct risk policies, grouped under employee, corporate and market conduct, and; and conduct towards customers. Each policy is designed to provide both high-level direction and RBS Group-wide requirements. The policies and chapters are designed to ensure RBS Group meets its regulatory obligations; and to provide the necessary clarity for staff on their conduct obligations.

Assurance and monitoring activities are essential to help measure the extent to which the Group manages its delivery of specific customer outcomes. During 2014, in addition to the provision of risk-based assurance over key conduct, financial crime, systems and infrastructure topics, the C&RA assurance function provided RBS Group-wide assurance in support of Financial Conduct Authority (FCA) attestations, principally those relating to complaints and anti money laundering (AML). Assurance activities are pre-emptive in highlighting conduct issues and influencing the business to re-consider the impact of their approach; and are flexible so as to achieve the right customer outcomes.

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 controls are tested to verify that they operate effectively.

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

RBS Group has articulated a customer-focused vision to be the leading UK bank for trust, customer service and advocacy by 2020. In line with this, C&RA has evolved from focusing on policy compliance towards considering the wider business implications of placing customers at the heart of the business.

A conduct risk appetite framework is being developed to ensure that the Group's risk profile is based on its strategic risk objectives, with quantitative targets supplemented by qualitative criteria focused on attaining good customer outcomes, upholding market integrity, meeting stakeholder expectations and promoting a strong risk culture. Work to refine and embed the risk appetite framework and associated control processes continues in 2015.

*unaudited

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.

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

An annual Money Laundering Reporting Officer's Report is submitted to the RBS Group Board and the FCA. Covering the operation and effectiveness of the systems and controls in place to comply with Anti-Money Laundering law and regulation, it also describes the 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 RBS 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) category, identifies underlying causal and subject trends, and highlights the outcome of investigations and actions taken.

C&RA is working with the business franchises to define the data required to ensure appropriate customer outcomes are delivered and are compliant with the Basel Committee on Banking Supervision principles for effective risk data aggregation and risk reporting. The Group's ability to aggregate, analyse and report conduct risk internally is being enhanced so it can assess the effectiveness of mitigating actions.

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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 as evidenced by customer complaints made in connection with Payment Protection Insurance.

Sources of risk

Operational risk may arise from a failure to manage operations, transactions and assets appropriately. It may arise from forms of 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.

Governance

A strong operational risk management function is vital to support the Group's profitability. Better management of operational risk directly supports RBS Group's strategic 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 risk management framework and culture across the bank. The Director of Operational Risk, Support Functions and Divested Businesses, who leads the function, reports to the Chief Risk Officer.

The operational risk function is responsible for the design and maintenance of the operational risk management framework. The Operational Risk Policy and associated standards are incorporated in the Group Policy Framework and provide direction for the consistent identification, assessment, management, monitoring and reporting of operational risk.

The Operational Risk Executive Committee (OREC), which is a sub-committee of the Executive Risk Forum, acts on all operational risk matters. This includes reviewing the 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

Control Environment Certification (CEC) is used to review and assess the internal control framework. Members of the senior management team are required to provide a bi-annual assessment of the robustness of the internal control environment including:

- Compliance with the requirements of the UK Corporate Governance Code;

- Appropriateness of the risk frameworks and governance structures of each customer-facing business and support function to help ensure RBS Group operates within risk appetite;
- Adequacy of reporting on the material risks for the business against appetite; and
- Action plans to mitigate those risks outside of appetite.

CEC outcomes are reported to the RBS Group Board, the Group Audit Committee and Board Risk Committee, and are shared with external auditors.

Risk appetite

The objective of operational risk management is not to remove operational risk altogether, but to manage it to an acceptable level, taking into account the customer journey and the cost of minimising the risk against the resultant reduction in exposure. Strategies to manage operational risk include avoiding undertaking a particular type of activity or operating in a particular market; transferring the risk to a third party; accepting the risk as a cost of doing business; or mitigating the risk by implementing controls.

Operational risk appetite measures and frameworks are reviewed annually by the RBS Group Executive Risk Forum (ERF). The operational risk appetite statement comprises a number of specific measures of risk, including operational risk capital adequacy and earnings volatility based on the relationship between operational risk losses and the bank's estimated gross income. It also includes metrics covering control environment performance. To confirm that the RBS Group operates within the set risk appetite, the high-level statement is aligned with strategic risk objectives.

Operational risk appetite measures will be further refined in 2015, with particular focus on developing an integrated operational risk appetite framework which will be used to translate high-level objectives into achievable risk appetite measures across the Group.

Risk identification and assessment

Risk assessments are used to identify and assess material operational risks and key controls across all business areas. To provide a consistent categorisation of risks and controls across RBS Group and to support identification of risk concentrations, all risks and controls are mapped to the risk taxonomy and the control catalogue. 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 frequently to verify that they remain fit for purpose and operate effectively. Risk assessments are typically commenced in a workshop, bringing together subject matter experts and key stakeholders from across the bank. Financial and non-financial risk impacts are captured and a risk appetite decision is made.

*unaudited

Operational risk* continued

In 2014 there was a continued focus on implementing and embedding risk assessments across the bank. This included the strengthening of links between risk assessments and other elements of the operational risk framework.

In 2015, the risk framework will be further enhanced by the introduction of end-to-end risk assessments which will help provide a fuller understanding of the risk profile of the bank's key services and products.

The New Product Risk Assessment (NPRA) 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. Further enhancements to the NPRA process are under review and are expected to be introduced in 2015.

Risk mitigation

Risks are mitigated by a suite of regularly assessed controls but, where the residual exposure is outside of risk appetite, the relevant customer business must decide how to reduce it. This is carried out in accordance with the operational risk management process, the objective of which is the adoption of a consistent approach to the management of issues and actions to mitigate risks outside appetite. The process continues to be enhanced, with analysis of common issues on an aggregated basis across the bank, to identify emerging trends and to make improvements to the quality of data.

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 Group's operational risk management processes, which aim to ensure that risks and issues are identified, escalated and managed quickly. Emerging risks, and actions taken to mitigate them, are discussed at OREC. These are reported to the RBS Group Board and the ERF. Exposures specific to each business are communicated through monthly risk and control reports that are discussed at business risk committees.

Risk measurement

Scenario analysis is used to assess the impact of extreme but plausible operational risks and is a key input to the capital model. It provides a forward-looking basis for managing risk exposures, with a structured and consistent approach to scenario scoping and measurement. Coupled with internal and external loss data, it has a major impact on the estimated capital requirements. Scenarios, along with internal and external loss data, are a key input into the capital model and influence the capital required significantly.

Scenarios are run in their own dedicated workshops, bringing business and risk and control experts together, thereby providing management with a deeper understanding of risk exposures.

RBS Group further refined its approach to assessing the impact of the economic cycle on its operational risk losses by assessing the impact of the Prudential Regulations Authority's published Anchor 6 scenario.

This describes the impact of a series of country-specific shocks on levels of operational risk losses, and also capital adequacy requirements for operational risk.

The impact of the Prudential Regulations Authority's Anchor 6 scenario on operational risk capital, as calculated under the standardised approach, was also projected based on the outputs of the bank's stress-testing exercises. Operational risk impacts are also assessed based on additional economic stress scenarios developed internally. This is used as part of the overall stress input to capital planning and internal capital adequacy assessment process (ICAAP).

Operational risk is measured utilising an economic Capital model. This model is also included within the ICAAP assessment to ensure that capital requirements are appropriately calculated using internal loss, external loss and scenario data. As a true risk sensitive measurement, this model is being rolled out across RBS to ensure better information is available to businesses to help manage their risk profile.

Event and loss data management

The event and loss data management process aims to ensure compliance with standard requirements for the management of operational risk events and the capture of loss data. It also entails reporting operational risk events that meet defined threshold criteria to senior management. RBS Group has continued to focus on the timely and accurate capture of operational risk losses; the use of a single RBS-Group wide repository of operational risk events; and the escalation of material operational risk events.

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 2014 may relate to events that occurred, or were identified in, prior years.

Capital

The Group calculates the Pillar 1 capital requirement for operational risk using the standardised approach. For 2014, the Group's minimum Pillar 1 capital requirement was £2.8 billion (2013 - £3.0 billion).

*unaudited

Regulatory risk	
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Regulatory risk*

Definition

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

Sources of risk

Regulatory risk arises from the regulatory, business or operating environment and from the Group's response to it.

Governance

RBS Group C&RA maintains well-established policies and supporting processes to ensure timely identification of, and effective responses to, changes in official requirements affecting the bank. C&RA also maintains a structured and open engagement with regulators. That engagement underpins a range of other policies and processes that address on-going compliance with regulatory obligations (refer to the section on Conduct risk on page 49 for further information).

To help manage the risks, the Mandatory Change Advisory Committee (MCAC), chaired by C&RA, was established. The MCAC reports to the Bank-Wide Investment Committee, and comprises representatives of the bank's customer businesses and functions. The MCAC acts as the 'reception committee' for reviewing externally mandated changes that may affect 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.

Board and Executive Committee oversight of changes to regulatory requirements is supported by the MCAC.

C&RA's Regulatory Developments team maintains and develops RBS Group Political, Legislative and Regulatory Environment Policy and supporting documents, together with associated processes, tools and governance. It also oversees the regulatory developments operating framework, to ensure it meets the needs of all businesses and functions, and maintains the Relationships with Regulators Policy.

Risk appetite

The RBS Group believes that maintaining a strong regulatory risk framework is fundamental to ensuring sustainable growth, rebuilding its reputation and maintaining stakeholder confidence. Accordingly, its stated regulatory risk and compliance risk appetite is for no material or widespread breaches of rules, expectations, regulations or laws, individually or in aggregate. However, it also recognises that genuine errors occur, and so it accepts limited, non-material regulatory risk and subsequent loss.

Risk monitoring and measurement

C&RA ensures appropriate reporting of all material regulatory reviews and other regulatory developments worldwide to the appropriate bank-wide committees, including the RBS Group Board, the Group Audit Committee, and the Board Risk Committee. Half-yearly reporting to the Group Audit Committee also captures all material investigations and tracks the status of, and trends in, key regulatory relationships.

The level of regulatory risk remained high during 2014, as policymakers and regulators continued to strengthen regulation and supervision in response to the events of 2007 and 2008. This resulted in high levels of interaction between RBS Group and supervisory authorities through meetings, requests for information, visits and investigations, as well as in policy developments and proposals for new rules.

Risk mitigation

C&RA also communicates information on regulatory developments and follow-up engagement with customer-facing businesses and functions, helping them identify and execute any required mitigating changes to strategy or business models. The key regulatory policies are reviewed annually.

Early identification and effective management of changes in legislation and regulation, as well as other requirements, is critical to the successful mitigation of 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.

*unaudited

Reputational risk	
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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.

Sources of risk

Reputational risk can arise from the conduct of either the 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 Group offers and the transactions it supports; and from its operations and infrastructure.

Governance

Managing reputational risk is taken very seriously, with the RBS Group Board-level oversight reinforced by a Reputational Risk Policy, and by governance frameworks across business franchises.

The RBS Group Board and the Executive Committee have the ultimate responsibility for managing RBS Group's reputation although all staff have some responsibility. The Board has set RBS Group's Purpose, Vision and Values which outline the objective, which is "to be trusted, respected and valued by our customers, shareholders and communities". Refer to the Risk governance section on page 41.

The Sustainable Banking Committee is responsible for overseeing and challenging how management is addressing sustainable banking and reputation issues including risk appetite for environmental, social and ethical (ESE) issues.

The RBS Group Board's oversight of reputational issues is supported by the senior RBS Group-wide Reputational Risk Forum (RRF) which opines on cases that represent a material reputational risk to the whole organisation. The RRF, which has delegated authority from the Executive Risk Forum, also acts as a central forum to review thematic issues and risk appetite positions. Business franchises also have in place reputational risk approval fora to deliberate on customers, transactions, products or issues that may present a reputational risk for their businesses. An example is the Global Reputational Risk Committee in CIB.

Risk appetite

The Reputational and Environmental, Social and Ethical (ESE) Risk management team assists business franchises, as well as other control functions, to articulate risk appetite to manage reputational risk. Risk appetite positions for certain issues or markets, for example tax or money remitters, are developed through conducting research on legislation, regulation and potential reputational risk factors, undertaking peer analysis and engaging with internal and external stakeholders to discuss the issues.

The risk appetite positions classify risks associated with a particular area into Normal, Sensitive and Prohibited. Customers or transactions designated Sensitive require enhanced due diligence and escalation to a reputational risk forum or individual while those rated Normal can be approved by the business without additional escalation. The team also helps set risk appetite to manage reputational risk related to business engagements and customer relationships in some sensitive industry sectors, such as mining and defence, through the ESE policy framework.

A Reputational Risk Policy has also been developed to help employees, businesses and functions effectively identify, assess and manage issues that potentially represent a reputational risk. In addition, other policies, such as those related to conduct, address key sources of reputational risk. These policies are implemented in accordance with the Policy Framework through business and functional policy standard owners. The effectiveness of these policies within each franchise is reported on through the Control Environment Certification process (Refer to the Operational risk section on page 52). Reputational aspects also form a core part of the RBS Group conduct risk framework, with a series of enhanced policies developed in line with conduct risk appetite.

Risk monitoring and measurement

Emerging reputational issues are identified by the business and relevant teams, including the RBS Group's Sustainability and Enterprise Wide Risk team, which assess new and emerging business, sector and country risks. The RBS Group Risk Management Monthly Report, provided to the RBS Group Executive Committee (ExCo) and RBS Group BRC, may also discuss reputational risks, and the annual RBS Group Sustainability Report covers progress on sustainability principles.

ESE ratings of customers and transactions are captured and analysed centrally by the Reputational and ESE Risk Team.

Risk mitigation

Reputational risk is mitigated through governance frameworks and training of staff to ensure early identification, assessment and escalation of customers, transactions or products 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 senior level approval. Effective communication channels and incident response planning also ensure that cases that result 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.

Capital management	
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Capital management*

Definition

The Group aims to maintain an appropriate level of capital to meet its business needs and regulatory requirements, and operates within an agreed risk appetite. The appropriate level of capital is determined based on the dual aims of: (i) meeting minimum regulatory capital requirements; and (ii) ensuring the Group maintains sufficient capital to uphold customer, investor and rating agency confidence in the organisation, thereby supporting its business franchises and funding capacity.

Overview

- The Group's Common Equity Tier 1 (CET1) ratio was 9.9% at 31 December 2014 on a PRA transitional basis compared with 9.8% on a Basel 2.5 basis as at 31 December 2013.
- Key milestones achieved in 2014 include:
 - partial IPO of CFG; and
 - run down of RCR and CIB assets.
- Going forward, the Group is focused on delivering a capital plan in line with its strategic objectives which includes the divestment of CFG by the end of 2016 and further run down of RCR and CIB assets.

Regulatory developments

The European Union has implemented the Basel III proposals through the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), collectively known as CRD IV. CRD IV was implemented on 1 January 2014. The European Banking Authority's technical standards which will provide clarification of the CRD IV, are either in progress to be finalised through adoption by the European Commission and implemented within the UK, or delegated regulation now adopted.

CRD IV imposes 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%;
- Capital buffers: capital conservation buffer of 2.5% of RWAs; countercyclical capital buffer of up to 2.5%; Global-Systemically Important Bank (G-SIB) surcharge of 1.5%; and
- Minimum Tier 1 leverage ratio of 3%.

In December 2013 the PRA issued its policy statement (PS7/13) outlining changes to its Rulebook as a result of CRD IV, and finalising requirements for the minimum level of CET1 capital as follows:

- Firms must meet a 4% Pillar 1 CET1 requirement in 2014, rising to 4.5% from 1 January 2015. Similarly, the Tier 1 capital ratio will be 5.5%, rising to 6% from 1 January 2015 onwards. Total capital remains at 8%.

- All Pillar 2A risks, including pension risk, must be met with at least 56% CET1 capital from 1 January 2015 onwards. 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.
- All regulatory deductions from capital must align CET1 with the end-point definition from January 2014, effectively making fully loaded Basel III the regulatory definition, a stricter approach than the CRR transitional arrangements.

On 31 October 2014 the Financial Policy Committee (FPC) published its recommendation on the overall leverage ratio framework for the UK banking system as follows:

- Minimum Tier 1 leverage ratio of 3%. To be met 75% by CET1 and a maximum 25% AT1;
- A supplementary leverage buffer applying to G-SIBs 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%.

Governance

RBS plc operates within the overall RBS Group governance framework, Material Integrated Risk Assessment, ICAAP, capital planning and stress testing.

The Board is the main decision making forum. It sets the strategic direction and ensures the Group manages risk effectively by approving and monitoring the Group's strategic risk appetite, considering the RBS Group-wide stress scenarios and agreed mitigants, as well as identifying longer-term strategic threats to the business operations. The Board approves the ICAAP.

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 RBS Group and future risk strategy, including determination of risk appetite and tolerance. The RBS Group BRC will review the performance of RBS Group relative to risk appetite, provide oversight of the effectiveness of key RBS Group-wide policies and provide risk input to remuneration decisions. The BRC has responsibility for promoting risk awareness within RBS Group. Authority is delegated to the BRC by the Board and the BRC reports and makes recommendations to the Board as required.

The RBS Group ExCo is responsible for managing strategic, financial, capital, risk and operational issues affecting the Group. It reviews and debates relevant items before they are submitted to the Board and relevant board committees. It also considers recommendations from the RBS Group Executive Risk Forum (ERF) in relation to risk management matters, including recommendations on risk appetite, risk policies and risk management strategies. The RBS Group ERF oversees stress testing approach, processes and results.

*unaudited

RBS Group Asset and Liability Committee (ALCo) is a sub-committee of ERF. RBS Group ALCo is responsible for identifying, managing and controlling balance sheet risks in executing its business strategy. Treasury is responsible for managing the Group balance sheet in accordance with ALCo policy and direction. RBS Group ALCo is the body with responsibility in determining that financial balance sheet risk limits and for ensuring the asset and liability management functions manage their balance sheets within the limits set by RBS Group ALCo.

The RBS Group Stress Testing Committee (STC) takes its delegated authority from ERF and makes recommendations to the ERF on asset quality reviews and stress testing, including the key vulnerabilities and scenario themes identified, the results from the generated scenarios and expanded metrics to be used in both internal and regulatory enterprise-wide stress tests. STC ensures these are relevant and reflect RBS Group business model vulnerabilities, and the results of internal stress, reverse stress and regulatory enterprise-wide stress tests (including mitigants).

Assessing, monitoring and maintaining adequate capital

It is the Group's policy to build and sustain a strong capital base and to use it efficiently throughout its activities to support strategic objectives and ultimately optimise shareholder returns while maintaining a prudent relationship between its capital base and the underlying risks of the business. In carrying out this policy, the Group follows the regulatory requirements of the "twin peaks" regulatory structure in the UK under the supervision of the FCA and the PRA, also having regard to other regulators, rating agencies, its peer group and market expectations.

Each business in RBS Group is subject to performance metrics respecting regulatory capital requirements to ensure that relevant Individual Capital Guidance or minimum CET1 levels are met. RBS Group has a control framework in place to guard against accidental breaches in capital ratios.

Monitoring

RBS Group continually reviews the potential impact on capital adequacy of emerging regulatory developments and actively assesses headroom against a range of stress scenarios. Recovery plans are dynamically maintained and contingency or remediation options are calibrated to determine scope to address potential capital shortfalls. All authorised institutions in RBS Group are required to ensure adequate capital is maintained at all times; they must also monitor and report regulatory capital and RWAs on a regular basis. The level and appropriateness of internal capital buffers at CET1, Tier 1, Tier 2 and total capital levels, is reviewed by RBS Group ALCo and reset as considered appropriate, at least annually.

Capital allocation

Capital resources are allocated to businesses based on key performance parameters agreed by the Board in the annual strategic planning process. Principal among these is a profitability metric, which assesses the effective use of the capital allocated to the business. Projected and actual return on equity is assessed against strategic objectives. The allocations also reflect strategic priorities, the intensity of regulatory capital use and the usage of other key resources such as balance sheet liquidity and funding.

Economic profit is also planned and measured for each business annually. It is calculated by deducting the cost of equity utilised in the particular business from its operating profit after tax and measures the value added over and above the cost of equity.

RBS Group aims to deliver sustainable returns across the portfolio of businesses with projected business returns stressed to test key vulnerabilities.

The franchises use return on capital metrics when making pricing decisions on products and transactions, to ensure customer activity is appropriately aligned with RBS Group and segmental targets.

Risk identification and material integrated risk assessment (MIRA)

- MIRAs are annual 'top down' processes to:
 - help identify material risks;
 - understand the nature and magnitude of these risks clearly; and
 - appraise associated risk management frameworks robustly.
- MIRAs provide a process to assess the size and nature of exposure to all risk types in the risk taxonomy, which is an exhaustive, structured list of the types of risk that the Group can and could face.
- MIRAs consider whether capital should be set aside against each risk type and, if so, under which pillar, how much and of what type. If capital is not appropriate, MIRAs outline how risk types are otherwise managed. In so doing, MIRAs form a key input to the ICAAP.
- To focus risk management on areas of greatest benefit, MIRAs consider in depth risks whose potential impact is 'material', that is exceeding appropriately chosen financial or non-financial thresholds. The key framework elements used to manage material risks (owners, governing committees, limit or tolerance frameworks including risk appetites, control policies and key reports) are specified clearly and assessed for appropriateness and effectiveness.

Stress testing

Stress testing is used to evaluate the capital position under severe but plausible stress scenarios. Stress testing also refers to the broader framework under which these tests are developed, evaluated and used within the bank's decision-making process in the context of the wider economic environment.

RBS Group stress testing framework is designed to embed stress testing as a key risk management technique into mainstream risk reporting, capital planning and business processes at business, legal entity and RBS Group-wide levels.

Capital management* continued

Internal capital adequacy assessment process (ICAAP)

The ICAAP assesses material risks and determines how much capital is required to cover these risks.

The ICAAP consists of two types of internal capital assessment:

- Point-in-time capital assessment as at the financial year end:
 - Pillar 1 - CET1 4.5% of credit, market and operational RWAs at the financial year end.
 - Pillar 2A - additional capital requirements for risks not captured or not adequately captured in Pillar 1. A MIRA is performed to ensure that all material risks are identified, appropriately managed and adequately capitalised where appropriate.
- Forward-looking stress capital assessment:
 - Pillar 2B - Capital planning buffer is set to ensure the Group maintains adequate capital resources in stress to allow it to continue to meet the minimum capital requirements. Current capital planning buffer will be replaced by the PRA buffer from 1 January 2016.

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

Capital planning

The Group aims to maintain an appropriate level of capital to meet its business needs and regulatory requirements, and operates within an agreed risk appetite.

The Group uses the budgeting cycle to forecast the future levels of capital required at CET1, Tier 1, Tier 2 and total capital levels including bail-in or gone-concern capital at both RBS Group level and for each of the major operating entities. Those forecasts are then measured against minimum regulatory requirements as well as specific regulatory guidance such as the Individual Capital Guidance. Operating entities such as UBIL, and CFG also go through a similar planning process to ensure that they are compliant with local regulatory rules. These plans are reviewed and challenged to ensure that they are consistent with RBS Group risk appetite, policies and strategic targets.

Stress testing is an integral part of capital planning.

The capital plan outputs are subject to executive and Board review and approval. The capital plan and performance against capital metrics are reviewed each month at ALCo.

Total loss absorbing capital (TLAC) is a new requirement announced by the Financial Stability Board (FSB) at its meeting in October 2014. TLAC is intended to ensure that a bank group maintains sufficient consolidated resources not only to reduce the likelihood of insolvency but also to allow for orderly resolution and recapitalisation of insolvent operating subsidiaries in the event of a banking group's insolvency.

Impacts for capital planning

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:

- Absolute capital levels will need to be higher earlier;
- Higher relative risk-weighted assets will exacerbate the absolute capital required and the stress impact; and
- Inclusion of PRA (and/or firm) stress buffers making stress a key driver of bank target CET1 ratios. Recovery and resolution planning.

Recovery and resolution planning

In line with regulatory requirements, RBS Group prepares regular recovery plans, 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.

RBS Group's 2014 Recovery Plan was prepared in line with PRA policy Statement PS8/13, requiring firms to prepare, maintain and review recovery plans. These rules were supplemented by a supervisory statement (SS18/13), (2), which sets out in more detail what the PRA expects firms to consider in their recovery planning. Previous Recovery Plans were submitted to the Financial Services Authority (the PRA's predecessor body) in December 2011 and June 2012, and to the PRA in June 2013.

Economic capital

Economic capital is an internal measure of the risks to which RBS Group is exposed and is used as a supplement to other risk and capital management tools, such as stress testing and regulatory capital. The measure includes risk exposures for credit, market, business, operational, pension, fixed asset and interest rate risk in the banking book. These models capture risks not fully addressed within the Pillar 1 regulatory framework e.g. concentration, pension, interest rate, business and diversification.

The characteristics of the models are consistent across risks, business lines and throughout the economic cycle, but are also flexible to allow outcomes to be employed for a number of purposes e.g. severity level/confidence interval, time horizon and correlations. Models have been developed internally but are subject to rigorous governance including external benchmarking, independent validation and extensive internal review and challenge. Models are regularly reviewed and continue to be updated for new data sources and improvements in risk modelling methodology.

The ability to change severity levels supports management of earnings volatility and capital risk. Economic models are used in the ICAAP assessing risk profiles within the risk appetite framework, functional risk management e.g. credit exposures at both RBS Group and business levels, assessing business line profitability on a risk adjusted basis and the management and allocation of capital.

*unaudited

Future regulatory developments

Resolution and recovery directive

In addition to the capital requirements under CRD IV, the bank resolution and recovery directive (BRRD) introduces requirements for banks to maintain at all times a sufficient aggregate amount of own funds and eligible liabilities (that is, 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 UK government has transposed the BRRD's provisions into law with a requirement that the Bank of England adopt further secondary legislation to implement MREL requirements by 2016 which will take into account the regulatory technical standards to be developed by the EBA specifying the assessment criteria that resolution authorities should use to determine the minimum requirement for own funds and eligible liabilities for individual firms.

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

As the implementation of the capital requirements under BRRD is the subject to the adoption of secondary legislation and implementation in the UK and overall capital requirements will be subject to the exercise of certain discretion by the PRA, RBS Group is currently unable to predict the impact such rules will have on the overall capital requirements or how they will affect compliance with applicable capital and loss absorbency requirements.

Pillar 2

The PRA launched a consultation paper in January 2015 on the Pillar 2 capital requirements for UK banks. Proposed 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

The PRA estimates that the total impact of proposals will increase overall P2A requirements by 0.23% of RWAs. Implementation will be from 1 January 2016 in line with the CRD IV capital conservation and systemic buffers and the EBA's Supervisory Review and Evaluation Process guidelines.

Domestic Systemically Important Banks

Regulatory proposals relating to domestic systemically important banks (D-SIBs) 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 RBS plc. The EBA published in December 2014 a quantitative methodology as to how European regulators could quantify which firms would qualify as D-SIBs. In addition the Financial Policy Committee (FPC) of the Bank of England intends to consult with firms in the UK on the UK framework during 2015.

Systemic risk buffer

In January 2015, HM Treasury issued an explanatory memorandum on the systemic risk buffer for banks, building societies and investment forms. 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 Independent Commission on Banking (ICB) and agreed by the UK Government.

The purpose of the systemic risk buffer 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 systemic risk buffer 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.

The FPC will set out the framework for determining which institutions fall into scope and the size of the buffer to be held. A consultation paper will be published in 2015 and methodology by 31 May 2016. 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.

Total loss absorbing capital (TLAC) and maximum distributable amounts (MDA)

The FSB has issued policy proposals for public consultation on TLAC. The new proposal is intended to replace the gone-concern loss absorbing capital concept previously expected to be the template within the G-SIB's resolution strategies.

Capital management* continued

The proposed minimum TLAC requirements are as follows:

- Between 16% and 20% of RWAs and at least double the Basel III Tier 1 leverage ratio requirements - 16% represents roughly twice the minimum capital requirement (8%) under Basel III;
- A certain minimum (currently undefined) amount of the TLAC requirement will need to be met with non-equity instruments - AT1, Tier 2 or even Tier 3 or bail-in able debt;
- Minimum TLAC requirements will sit below the combined buffer requirements which may lead to consequences on MDA restrictions;
- The loss absorption should be legally enforceable and should not give rise to systemic risk or disruption to the provision of critical functions. Therefore, to prevent a G-SIB resolution to spread contagion into the banking system, internationally active banks will be prevented from holding TLAC issued by other G-SIBs;
- TLAC will be distributed by resolution entities to material subsidiaries which are themselves not resolution entities. Sufficient internal TLAC will be prepositioned on the balance sheet of material subsidiaries; and
- Under the policy proposal TLAC is now defined as an additional rather than a parallel capital requirement to the Basel III framework and a breach of the minimum TLAC could trigger the same restrictions set out in the Basel III framework for MDA. However, this would technically be the consequence of a direct breach of the CRD IV buffer rather than the TLAC due to the no double counting principle.

The FSB is currently working on draft principles with the rule expected to be in force by 1 January 2019. RBS plc is a material subsidiary of the holding company.

Other developments

The following developments will also impact the Group's capital:

- The Basel Committee on Banking Supervision:
 - Has proposed a recalibration of the credit risk standardised approach with implementation in 2017 with initial view of the new rules due in 2015.
 - Are reviewing the calibration of the operational risk calculation, with revised rules due in 2015 and applicable from 2017.
 - Has instigated a fundamental review of the trading book which will impact how the risk of trading book activity is measured. Initial consultation papers on this are due in 2015.
- The PRA and FPC are looking at placing a floor on the risk-weight applied to mortgages in calculating the risk-weight. The level of the floor is currently being debated and current expectations are application in 2015.
- The Financial Services (Banking Reform) Act passed into UK law in December 2013 implementing recommendations of the ICB; and
- The US Federal Reserve Board's final rule issued in February 2014, establishing enhanced prudential standards for foreign banking organisations.

*unaudited

Financial review Capital and risk management

Measurement

Capital and ratios

Capital, RWAs and risk asset ratios, on the basis of transitional rules and end-point CRR, calculated in accordance with PRA definitions, are set out below.

	2014		2013 Basel 2.5 basis	2012 Basel 2.5 basis
	End-point CRR basis (1) £bn	PRA transitional basis £bn		
Capital				
CET1 (2)	34.0	33.7	36.0	41.6
Tier 1	34.0	37.4	41.8	48.3
Total	52.8	58.8	63.9	67.6

RWAs

Credit risk				
- non-counterparty	252.6	252.6	277.7	310.0
- counterparty	29.9	29.9	22.5	47.4
Market risk	22.8	22.8	28.8	39.3
Operational risk	35.3	35.3	37.5	41.4
	340.6	340.6	366.5	438.1

Risk asset ratios

	%	%	%	%
CET1 (2)	10.0	9.9	9.8	9.5
Tier 1	10.0	11.0	11.4	11.0
Total	15.5	17.2	17.4	15.4

Notes:

(1) Capital Requirements Regulation (CRR) as implemented by the Prudential Regulation Authority in the UK, with effect from 1 January 2014.

(2) Common Equity Tier 1 (CET1) ratio with effect from 1 January 2014.

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 basis) with the exception of unrealised gains on AFS securities which will be included from 2015 (PRA transitional basis).

CRD IV and Basel III impose a minimum CET1 ratio of 4.5%. Further, CET1 requirements will be imposed through buffers in the CRD. There are three buffers that will affect the Group: the capital conservation buffer set at 2.5% of RWAs; the counter-cyclical capital buffer (up to 2.5% of RWAs), which will be calculated as the weighted average of the countercyclical capital buffer rates applied in the countries where the Group has relevant credit exposures; and the highest of D-SIB, Other-Systemically Important Institution or systemic risk buffers set by the supervisory authorities. The regulatory target capital requirements will be phased in through CRR, and are expected to apply in full from 1 January 2019. Until then, using national discretion the PRA can apply a top-up. As set out in the PRA's Supervisory Statement SS3/13, the Group and other major UK banks and building societies are required to maintain a CET1 ratio of 7%, after taking into account certain adjustments set by the PRA.

From 1 January 2015, the Group 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 the Group 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:

- Own funds are based on shareholders' equity.
- The adjustment arising from the application of the prudent valuation requirements to all assets measured at fair value, has been included in full. The prudential 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.
- 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.
- 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.
- Based on our current interpretations of the Commission Delegated Regulation issued in December 2013 on credit risk adjustments, the Group's standardised latent provision has been reclassified to specific provision and is not included in Tier 2 capital.

Risk-weighted assets (RWAs):

- Current securitisation positions are shown as risk-weighted at 1,250%.
- RWA uplifts include the impact of credit valuation adjustments and asset valuation correlation on banks and central counterparties.
- RWAs reflect implementation of the full internal model method suite, and include methodology changes that took effect immediately on CRR implementation.
- Non-financial counterparties and sovereigns that meet the eligibility criteria under CRR are exempt from the credit valuation adjustments volatility charges.
- 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

	2014		2013	2012
	End-point CRR basis £m	PRA transitional basis £m	Basel 2.5 basis £bn	Basel 2.5 basis £bn
Shareholders' equity (excluding non-controlling interests)				
Shareholders' equity	46,786	46,786	48,786	59,288
Preference shares - equity	(1,421)	(1,421)	(1,421)	(1,421)
	45,365	45,365	47,365	57,867
Non-controlling interests	—	—	79	137
Regulatory adjustments and deductions				
Own credit	1,300	1,300	1,519	1,563
Defined benefit pension fund adjustment	(238)	(238)	362	913
Net unrealised available-for-sale (AFS) gains	—	—	(359)	(1,750)
Cash flow hedging reserve	(1,026)	(1,026)	86	(1,815)
Deferred tax assets	(1,222)	(1,222)	—	—
Prudential valuation adjustments	(359)	(359)	—	—
Goodwill and other intangible assets	(7,765)	(7,765)	(12,352)	(12,403)
Expected losses less impairments	(1,535)	(1,535)	(54)	(1,954)
50% of securitisation positions	—	—	(722)	(1,001)
Other regulatory adjustments	(471)	(841)	50	10
	(11,316)	(11,686)	(11,470)	(16,437)
CET1 capital	34,049	33,679	35,974	41,567
Additional Tier 1 capital				
Preference shares - debt	—	—	2,745	2,759
Innovative/hybrid Tier 1 securities	—	—	3,502	3,551
Qualifying instruments and related share premium subject to phase out	—	3,503	—	—
Qualifying instruments issued by subsidiaries and held by third parties	—	202	—	—
	—	3,705	6,247	6,310
Tier 1 deductions				
50% of material holdings	—	—	(409)	(239)
Tax on expected losses less impairments	—	—	16	634
	—	—	(393)	395
Tier 1 capital	34,049	37,384	41,828	48,272

*unaudited

Financial review Capital and risk management

	2014		2013	2012
	End-point CRR basis £m	PRA Transitional Basis £m	Basel 2.5 basis £bn	Basel 2.5 basis £bn
Qualifying Tier 2 capital			£bn	
Undated subordinated debt	—	—	4,716	4,814
Dated subordinated debt - net of amortisation	—	—	18,371	18,121
Qualifying instruments and related share premium	18,723	20,427	—	—
Qualifying instruments issued by subsidiaries and held by third parties	—	944	—	—
Unrealised gains on AFS equity shares	—	—	111	40
Collectively assessed impairment provisions	—	—	375	379
	18,723	21,371	23,573	23,354
Tier 2 deductions				
50% of securitisation positions	—	—	(722)	(1,001)
Expected losses less impairments	—	—	(70)	(2,588)
50% of material holdings	—	—	(409)	(239)
	—	—	(1,201)	(3,828)
Tier 2 capital	18,723	21,371	22,372	19,526
Supervisory deductions				
Unconsolidated investments	—	—	(36)	(37)
Other deductions	—	—	(217)	(193)
	—	—	(253)	(230)
Total regulatory capital	52,772	58,755	63,947	67,568

*unaudited

Liquidity and funding risk	
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Liquidity and funding risk

Definition

Liquidity and funding 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.

The risk arises through the maturity transformation role that banks perform. It is dependent on RBS 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.

Overview

- The liquidity position strengthened with the liquidity portfolio of £148.6 billion at 31 December 2014 covering wholesale funding more than 1.5 times. Wholesale funding decreased by £17.3 billion to £93.8 billion mainly due to the buy-back and maturity of medium-term notes primarily in CIB.
- The liquidity portfolio increased by £5.9 billion in the year, primarily reflecting the proceeds from the Citizens Partial IPO. It includes £56.5 billion of secondary liquidity being assets eligible for discounting at central banks. The costs associated with maintaining the secondary liquidity portfolio are minimal being largely administrative and operational costs.
- The customer loan:deposit ratio remained broadly stable at 95% compared with 94% at the end of 2013 with an increase in the funding surplus in PBB of £4.4 billion (UK PPB - £1.4 billion; Ulster Bank - £3.0 billion) being offset by a decrease in the funding surplus in CPB of £6.6 billion (Commercial Banking - £5.7 billion; Private Banking - £0.9 billion).

Liquidity risk

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 Group Board as a percentage of the Individual Liquidity Adequacy Assessment (ILAA) stressed outflows, and is managed on a daily basis by legal entity, country, region and business. In setting risk limits the Group Board takes into account the nature of RBS Group various activities, the overall risk appetite, market best practice and regulatory compliance.
- *Has in place strategies, policies and practices to ensure that 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 bank's risk appetite. RBS Group maintains an adequate liquid asset portfolio appropriate to the business activities of RBS Group and its risk profile.

Incorporates liquidity costs, benefits and risks in product pricing and

performance management: The Group uses internal Funds Transfer Pricing (FTP) 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 Liquidity Committee, oversees the implementation of liquidity management across the bank. RBS Group Treasury conducts the review, challenge and reporting of the bank's liquidity performance, while the Liquidity Committee's management of liquidity risk is overseen by ALCo, the Executive Risk Forum, Executive Committee and the Board.

Regulatory oversight and liquidity framework*

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

The principal regulator, the UK Prudential Regulation Authority (PRA), has a comprehensive set of liquidity regulations, the cornerstone of which is BIPRU 12 (until 30 September 2015). To comply with the PRA regulatory process, RBS Group undertakes the following:

- An annual exercise to complete the ILAA; and
- An annual Focused Liquidity Review (FLR) process with the PRA - a comprehensive review of the RBS Group ILAA, liquidity policies and risk management framework. This results in the settings of the Individual Liquidity Guidance (ILG), which influences the size and overall composition of RBS Group's liquid asset portfolio.

In addition, The Group's US operations meet liquidity requirements set out by the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Financial Industry Regulatory Authority. In Europe, Ulster Bank Ireland Limited is subject to oversight by the European Central Bank with effect from 1 November 2014.

The Basel Committee on Banking Supervision (BCBS) has introduced a new liquidity regime for banks, Basel III, which includes two liquidity metrics - the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) - to be used by banks to monitor their liquidity risk.

In January 2013, the BCBS published its final guidance for calculating the LCR. This will be implemented in law across the EU by the European Commission (EC), who published a final Delegated Act for the LCR in the EU Journal in January 2015. The Delegated Act will introduce the LCR as a regulatory minimum standard from 1 October 2015 on a phased basis, such that banks are required to meet a 100% LCR ratio by 1 January 2018. In November 2014, the PRA confirmed in a consultation paper that the current BIPRU 12 regime will be revoked on 1 October 2015 in favour of the LCR, and that UK banks will be required to maintain a minimum ratio of 80% from this point. The LCR will be a 'Pillar 1' metric, meaning that the PRA will apply firm-specific Pillar 2 liquidity add-ons above and beyond the minimum LCR requirement. The PRA has invited feedback from UK banks on the consultation paper, but has not released any guidance on the detailed calculation of LCR.

*unaudited

Liquidity risk continued

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%. The EC has stated that it shall, if appropriate, submit a legislative proposal to the European Parliament by the end of 2016 for implementing NSFR in the EU.

Several regulatory regimes outside the EU where the Group operates, including the Joint Banking Supervisors of the US, have also published consultation papers with guidance for their local implementation of the LCR. RBS Group anticipates further guidance for LCR to be published across other jurisdictions during the course of 2015.

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 Asset and Liability Management Committees 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).

RBS Group actively monitors a range of market-wide and firm-specific early warning indicators of emerging liquidity stresses. Indicators include such areas as customer deposit outflows, market funding costs and movements in the bank's credit default swap premiums and debt spreads. Early warning indicators and regulatory metrics are reported daily to senior management, including the Chief Financial Officer and Treasurer.

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 early warning indicators. 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 Contingency Liquidity Team would be convened to identify the likely impact of the stress event and determine the appropriate management response.

Stress testing*

Under the liquidity risk management framework 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 or a combination of both 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 RBS Group's liquidity risk management. The stressed outflows are measured over certain time periods which extend from two weeks to three months. RBS Group is expected to be able to withstand the stressed outflows through its own resources (primarily through the use of the liquidity portfolio) without having to resort to extraordinary central bank or governmental assistance.

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 RBS Group's experiences 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 RBS Group's liquidity position. In the past these have included credit rating changes and political and economic conditions changing in particular countries.

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

Key liquidity risk stress testing assumptions

- **Net wholesale funding** - Outflows at contractual maturity of wholesale funding, with no rollover/new issuance, prime brokerage, 100% loss of excess client derivative margin and 100% loss of excess client cash.
- **Secured financing and increased haircuts** - Loss of secured funding capacity at contractual maturity date and incremental haircut widening, depending upon collateral type.
- **Retail and commercial bank deposits** - Substantial outflows as RBS Group could be seen as a greater credit risk than competitors.
- **Intra-day cash flows** - Liquid collateral held against intra-day requirement at clearing and payment systems is regarded as encumbered with no liquidity value assumed. Liquid collateral is held against withdrawal of unsecured intra-day lines provided by third parties.
- **Intra-group commitments and support** - Risk of cash within subsidiaries becoming unavailable to the wider bank and contingent calls for funding on RBS Treasury from subsidiaries and affiliates.
- **Funding concentrations** - Additional outflows recognised against concentration of providers of wholesale secured financing.

*unaudited

- **Off-balance sheet activities** - Collateral outflows due to market movements, and all collateral owed by RBS Group to counterparties but not yet called; anticipated increase in firm's derivative initial margin requirement in stress scenarios; collateral outflows contingent upon a multi-notch credit rating downgrade of RBS Group entities; drawdown on committed facilities provided to corporates, based on counterparty type, creditworthiness and facility type; and drawdown on retail commitments.
- **Franchise viability** - Liquidity stress testing includes additional liquidity in order to meet outflows that are non-contractual in nature, but are necessary in order to support valuable franchise businesses.
- **Management action** - Unencumbered marketable assets that are held outside of the central liquidity portfolio and are of verifiable liquidity value to the firm, are assumed to be monetised (subject to haircut/valuation adjustment).

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 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 Defined Liquidity Group (UK DLG) comprising the Group's five UK banks: The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Co and Adam & Company.

Certain of RBS plc's significant operating subsidiaries. Citizens Financial Group Inc. (CFG) and Ulster Bank Ireland Limited - hold locally managed portfolios of liquid assets that comply with local regulations that differ from PRA rules. These portfolios are the responsibility of the local Treasurer who reports to the Treasurer.

The UK DLG liquidity portfolio accounted for 85% of the total liquidity portfolio, this portion is available to meet liquidity needs as they arise across the Group. The remaining liquidity reserves are held locally within non-UK bank subsidiaries, the majority of this portion (11%) is restricted by regulatory requirements and therefore assumed to only be available for use locally.

Separately from the liquidity portfolio, the Group holds high quality assets to meet payment systems collateral requirements, these are managed by Treasury but are not freely available to other areas of the Group.

The Group categorises its liquidity portfolio, including its locally managed liquidity portfolios, into primary and secondary liquid assets.

- Primary liquid assets that are eligible liquid assets, such as cash and balances at central banks, treasury bills and other high quality government and US agency bonds.
- Secondary liquid assets that are eligible as collateral for local central bank liquidity facilities but do not meet the core local regulatory definition. These assets include own-issued securitisations or whole loans that are retained on balance sheet and pre-positioned with a central bank so that they may be converted into additional sources of liquidity at very short notice.

The composition of the liquidity portfolio is subject to policies and limits set by the Board, ALCo and the Liquidity Committee, it is influenced by quality of counterparty, maturity mix and currency mix. The liquidity value of the portfolio is determined with reference to current market prices and the haircuts necessary to generate cash from the asset.

The Group efficiently manages the liquidity portfolio to optimise the risk and rewards whilst not compromising its liquidity position. This optimisation can lead to changes in the composition of the portfolio.

Financial review Capital and risk management

Liquidity risk continued

The table below analyses the Group's liquidity portfolio by product, liquidity value and by carrying value. Liquidity value is lower than carrying value as it is stated after the discounts applied by the Bank of England and other central banks to instruments, within the secondary liquidity portfolio, eligible for discounting.

	Liquidity value									
	UK DLG (1)	CFG (1)	Other	Total	Average	2013		2012		
2014	£m	£m	£m	£m	£m	Total	Average	Total	Average	£m
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	66,409	1,368	—	67,777	60,951	71,989	77,196	65,751	71,290	
Central and local government bonds										
AAA rated governments	5,609	—	2,289	7,898	5,928	3,320	4,784	9,338	18,133	
AA- to AA+ rated governments and US agencies	6,902	9,281	226	16,409	12,634	12,191	12,130	9,189	8,026	
Treasury bills	—	—	—	—	—	—	395	750	202	
Primary liquidity	78,920	10,649	2,515	92,084	79,513	87,500	94,505	85,028	97,651	
Secondary liquidity (2)	53,055	2,290	1,189	56,534	55,424	55,213	56,040	55,416	40,001	
Total liquidity value	131,975	12,939	3,704	148,618	134,937	142,713	150,545	140,444	137,652	
Total carrying value	167,016	13,914	3,955	184,885	—	180,694	—	180,207	—	

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

Total liquidity portfolio	GBP £m	USD £m	EUR £m	Other £m	Total £m
2014	93,861	40,556	14,201	—	148,618
2013	100,849	32,531	7,844	1,489	142,713
2012	84,570	32,525	22,518	831	140,444

Notes:

- (1) The PRA regulated UK Defined Liquidity Group (UK DLG) comprises the 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. In addition, certain of the Group's significant operating subsidiaries - Citizens Financial Group Inc. (CFG) and Ulster Bank Ireland Limited - hold liquidity portfolios of liquid assets that comply with local regulations that may differ from PRA rules.
- (2) Includes assets eligible for discounting at the Bank of England and other central banks.

Funding risk

Funding markets

The Group's primary funding source is its customer deposit base, primarily built through its retail and commercial franchises in the UK, Ireland and the US. These deposits form a stable base which fully funds the bank's customer lending activities.

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, geographies and maturities. These include long-term secured and unsecured debt, short-term money markets and repurchase agreements. RBS Group has set policies for the prudent use of wholesale funding, as part of its wider liquidity policies.

The 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.

At 31 December 2014, the Group's participation in central bank financing operations amounted to £0.8 billion under European Central Bank's Targeted Long Term Refinancing Operations (TLTRO). The Group remains committed to supporting the objectives of the Funding for Lending scheme.

Analysis

Sources and uses of funding

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.

As set out below, the Group's asset and liability types broadly match. Customer deposits provide more funding than customer loans utilise; repurchase agreements are largely covered by reverse repurchase agreements; interbank lending and funding largely nets off and this gap has narrowed over the past 5 years; and derivative assets are largely netted against derivative liabilities.

Key funding metrics

The table below summarises the key funding metrics.

	Short-term wholesale funding (1)		Total wholesale funding		Net inter-bank funding (2)		
	Excluding derivative collateral £bn	Including derivative collateral £bn	Excluding derivative collateral £bn	Including derivative collateral £bn	Deposits £bn	Loans (3) £bn	Net inter-bank funding £bn
2014	23.9	48.5	93.8	118.5	15.3	(12.0)	3.3
2013	29.8	48.1	111.1	129.4	15.8	(15.3)	0.5
2012	33.7	61.3	147.4	175.1	24.2	(14.3)	9.9

Notes:

(1) Short-term wholesale balances denote those with a residual maturity of less than one year.

(2) Excludes derivative cash collateral.

(3) Primarily short-term balances.

Financial review Capital and risk management

Funding risk continued

Funding sources

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

	2014			2013			2012		
	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	Third Party £m	Amounts due to holding company and fellow subsidiaries £m	Total £m
By product									
Deposits by banks									
derivative cash collateral	24,687	—	24,687	18,300	—	18,300	27,631	—	27,631
other deposits	15,299	4,208	19,507	15,788	2,463	18,251	24,243	6,063	30,306
	39,986	4,208	44,194	34,088	2,463	36,551	51,874	6,063	57,937
Debt securities in issue									
commercial paper (CP)	58	—	58	435	—	435	806	—	806
certificates of deposit (CDs)	1,843	—	1,843	2,276	—	2,276	2,907	—	2,907
medium-term notes (MTNs)	29,362	—	29,362	40,657	—	40,657	58,152	—	58,152
covered bonds	7,114	—	7,114	9,041	—	9,041	10,139	—	10,139
securitisations	5,244	—	5,244	7,337	—	7,337	11,274	—	11,274
	43,621	—	43,621	59,746	—	59,746	83,278	—	83,278
Subordinated liabilities	11,056	19,639	30,695	13,309	19,825	33,134	15,667	18,184	33,851
Notes issued	54,677	19,639	74,316	73,055	19,825	92,880	98,945	18,184	117,129
Wholesale funding	94,663	23,847	118,510	107,143	22,288	129,431	150,819	24,247	175,066
Customer deposits									
derivative cash collateral	12,994	—	12,994	7,048	—	7,048	7,941	—	7,941
other deposits	399,362	5,843	405,205	406,782	5,207	411,989	417,499	5,778	423,277
Total customer deposits	412,356	5,843	418,199	413,830	5,207	419,037	425,440	5,778	431,218
Total funding excluding repos	507,019	29,690	536,709	520,973	27,495	548,468	576,259	30,025	606,284
Included in disposal group above									
Banks			5,128			—			—
Debt securities in issue			1,625			—			—
Subordinated liabilities			226			—			—
Customers			60,550			3,190			18
			67,529			3,190			18

Financial review Capital and risk management

Notes issued

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

	Debt securities in issue					Subordinated liabilities £m	Total notes in issue £m	Total notes in issue %
	CP and CDs £m	MTNs £m	Covered bonds £m	Securitisations £m	Total £m			
2014								
Less than 1 year	1,752	5,712	1,284	10	8,758	2,563	11,321	15
1-3 years	144	9,180	2,229	—	11,553	879	12,432	17
3-5 years	—	4,520	812	3	5,335	7,041	12,376	17
More than 5 years	5	9,950	2,789	5,231	17,975	20,212	38,187	51
	1,901	29,362	7,114	5,244	43,621	30,695	74,316	100

2013								
Less than 1 year	2,647	9,748	1,853	514	14,762	1,378	16,140	17
1-3 years	59	11,051	3,621	—	14,731	3,244	17,975	19
3-5 years	—	5,427	867	—	6,294	3,455	9,749	11
More than 5 years	5	14,431	2,700	6,823	23,959	25,057	49,016	53
	2,711	40,657	9,041	7,337	59,746	33,134	92,880	100

2012								
Less than 1 year	3,323	9,425	1,038	761	14,547	2,385	16,932	15
1-3 years	384	17,684	2,948	500	21,516	4,624	26,140	22
3-5 years	1	12,300	2,380	—	14,681	1,055	15,736	13
More than 5 years	5	18,743	3,773	10,013	32,534	25,787	58,321	50
	3,713	58,152	10,139	11,274	83,278	33,851	117,129	100

Repos

The table below analyses the Group's repos by counterparty type.

	2014 £m	2013 £m	2012 £m
Financial institutions			
- central and other banks	26,450	28,583	44,323
- other	28,703	52,945	86,940
Other corporate	9,353	3,541	1,057
	64,506	85,069	132,320

Customer deposits insured through deposit guarantee scheme totalled £160 billion (2013 - £161 billion), the more material of them being the UK Financial Services Compensation Scheme £112 billion, US Federal Deposit Insurance Corporation scheme £37 billion and Republic of Ireland's Deposit Guarantee Schemes £7 billion.

Customer loan:deposit ratios and funding surplus

The table below shows customer loans, deposits, loan:deposit ratios (LDR) and customer funding surplus.

	Loans (1) £m	Deposits (2) £m	LDR %	Funding Surplus £m
2014	391,234	412,356	95	21,122
2013	388,272	413,830	94	25,558
2012	423,191	425,440	99	2,249

Notes:

- (1) Excludes reverse repo agreements and net of impairment provisions.
(2) Excludes repo agreements.

Funding risk continued

Encumbrance

The Group reviews all assets against the criteria of being able to finance them 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.

From time to time the Group encumbers assets to serve as collateral to support certain wholesale funding initiatives. The three principal forms of encumbrance are own asset securitisations, covered bonds and securities repurchase agreements.

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.
- Not currently encumbered but can for instance be used to access funding from market counterparties or central bank facilities as part of 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 balance sheet encumbrance ratios are set out below.

Encumbrance ratios	2014 %	2013 %	2012 %
Total	13	17	18
Excluding balances relating to derivative transactions	14	19	22
Excluding balances relating to derivative and securities financing transactions	11	12	12

Financial review Capital and risk management

Balance sheet encumbrance

2014	Encumbered assets relating to:						Encumbered assets as a % of related assets %	Unencumbered					Balances with holding company and fellow subsidiaries		Total £bn
	Debt securities in issue		Other secured liabilities		Secured balances (1) £bn	Total encumbered assets (2) £bn		Readily realisable (3)			Total third party £bn	and fellow subsidiaries £bn			
	Securitisations and conduits £bn	Covered bonds £bn	Derivatives £bn	Repos £bn				Liquidity portfolio £bn	Other (4) realisable £bn	Cannot be (5) encumbered £bn					
Cash and balances at central banks	—	—	—	—	2.4	2.4	3	66.1	6.1	—	—	74.6	—	74.6	
Loans and advances to banks	4.6	0.3	11.3	—	0.5	16.7	72	1.7	1.1	3.8	—	23.3	2.3	25.6	
Loans and advances to customers															
- UK residential mortgages	12.0	13.4	—	—	—	25.4	22	69.9	10.2	7.7	0.1	113.3	—	113.3	
- Irish residential mortgages	8.6	—	—	—	—	8.6	62	0.9	4.3	—	0.1	13.9	—	13.9	
- US residential mortgages	—	—	—	—	11.2	11.2	53	2.2	—	0.7	7.0	21.1	—	21.1	
- UK credit cards	2.7	—	—	—	—	2.7	52	—	2.3	0.2	—	5.2	—	5.2	
- UK personal loans	—	—	—	—	—	—	—	—	6.4	2.9	—	9.3	—	9.3	
- other	5.6	—	21.7	—	1.3	28.6	13	8.0	17.1	106.5	68.3	228.5	1.3	229.8	
Reverse repurchase agreements and stock borrowing	—	—	—	—	—	—	—	—	—	—	64.7	64.7	—	64.7	
Debt securities	—	—	5.9	25.3	5.6	36.8	37	23.4	38.7	0.6	—	99.5	—	99.5	
Equity shares	—	—	0.3	2.6	—	2.9	50	—	2.1	0.2	0.6	5.8	—	5.8	
Settlement balances	—	—	—	—	—	—	—	—	—	—	4.7	4.7	—	4.7	
Derivatives	—	—	—	—	—	—	—	—	—	—	352.3	352.3	2.7	355.0	
Intangible assets	—	—	—	—	—	—	—	—	—	—	8.3	8.3	—	8.3	
Property, plant and equipment	—	—	—	—	0.4	0.4	6	—	—	4.2	2.1	6.7	—	6.7	
Deferred tax	—	—	—	—	—	—	—	—	—	—	1.5	1.5	—	1.5	
Prepayments, accrued income and other assets	—	—	—	—	—	—	—	—	—	—	5.9	5.9	0.2	6.1	
	33.5	13.7	39.2	27.9	21.4	135.7		172.2	88.3	126.8	515.6	1,038.6	6.5	1,045.1	
Securities retained								12.7							
Total liquidity portfolio								184.9							
Liabilities secured															
Intra-Group - secondary liquidity	(13.1)	—	—	—	—	(13.1)									
Intra-Group - other	(11.6)	—	—	—	—	(11.6)									
Third party (6)	(5.2)	(7.1)	(39.2)	(64.5)	(10.5)	(126.5)									
	(29.9)	(7.1)	(39.2)	(64.5)	(10.5)	(151.2)									

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

Financial review Capital and risk management

Funding risk continued

Balance sheet encumbrance

2013	Encumbered assets relating to:						Encumbered assets as a % of related assets %	Unencumbered				Total third party £bn	Balances with holding company and fellow subsidiaries £bn	Total £bn
	Debt securities in issue		Other secured liabilities			Total encumbered assets (2) £bn		Readily realisable (3)						
	Securitisations and conduits £bn	Covered bonds £bn	Derivatives £bn	Repos £bn	Secured balances (1) £bn			Liquidity portfolio £bn	Other (4) realisable £bn	Cannot be (5) encumbered £bn				
Cash and balances at central banks	—	—	—	—	—	—	—	71.9	8.1	—	—	80.0	—	80.0
Loans and advances to banks	5.8	0.5	9.7	—	—	16.0	64	0.1	8.9	—	—	25.0	15.1	40.1
Loans and advances to customers														
- UK residential mortgages	14.6	16.2	—	—	—	30.8	28	60.8	18.6	—	—	110.2	—	110.2
- Irish residential mortgages	9.3	—	—	—	1.2	10.5	70	0.7	3.8	—	0.1	15.1	—	15.1
- US residential mortgages	—	—	—	—	3.5	3.5	18	9.5	6.7	—	—	19.7	—	19.7
- UK credit cards	3.4	—	—	—	—	3.4	52	—	3.1	—	—	6.5	—	6.5
- UK personal loans	3.4	—	—	—	—	3.4	38	—	5.5	—	—	8.9	—	8.9
- other	12.9	—	17.8	—	0.8	31.5	14	4.4	9.6	172.2	10.2	227.9	1.6	229.5
Reverse repurchase agreements and stock borrowing	—	—	—	—	—	—	—	—	—	—	76.3	76.3	—	76.3
Debt securities	0.9	—	5.2	52.0	2.3	60.4	60	15.9	24.3	—	—	100.6	0.1	100.7
Equity shares	—	—	0.5	5.1	—	5.6	67	—	2.7	—	—	8.3	—	8.3
Settlement balances	—	—	—	—	—	—	—	—	—	—	5.6	5.6	—	5.6
Derivatives	—	—	—	—	—	—	—	—	—	—	286.0	286.0	3.4	289.4
Intangible assets	—	—	—	—	—	—	—	—	—	—	12.4	12.4	—	12.4
Property, plant and equipment	—	—	—	—	0.4	0.4	5	—	—	7.5	—	7.9	—	7.9
Deferred tax	—	—	—	—	—	—	—	—	—	—	3.4	3.4	—	3.4
Prepayments, accrued income and other assets	—	—	—	—	—	—	—	—	—	—	5.9	5.9	—	5.9
	50.3	16.7	33.2	57.1	8.2	165.5		163.3	91.3	179.7	399.9	999.7	20.2	1,019.9
Securities retained								17.4						
Total liquidity portfolio								180.7						
Liabilities secured														
Intra-Group - secondary liquidity	(19.1)	—	—	—	—	(19.1)								
Intra-Group - other	(18.4)	—	—	—	—	(18.4)								
Third party (6)	(7.3)	(9.0)	(40.7)	(85.1)	(6.0)	(148.1)								
	(44.8)	(9.0)	(40.7)	(85.1)	(6.0)	(185.6)								

Notes:

- (1) Includes cash, coin and nostro balance held with the Bank of England as collateral against deposits and notes in circulation.
- (2) Encumbered assets are those 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.
- (3) Unencumbered readily realisable assets are those assets on the balance sheet that can be readily used to meet funding or collateral requirements and comprise:
 - (a) Liquidity portfolio: 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.
 - (b) Other readily realisable assets: including assets that have been enabled for use with central banks; and unencumbered debt securities.
- (4) Unencumbered other realisable assets are those assets on the balance sheet that are available 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 include:
 - (a) Derivatives, 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 those relating to date of origination and level of documentation.
 - (d) Non-recourse invoice financing balances and certain shipping loans whose terms and structure prohibit their use as collateral.
- (6) In accordance with market practice, the Group employs securities recognised on the balance sheet, and securities received under reverse repo transactions as collateral for repos. Secured derivative liabilities reflect net positions that are collateralised by balance sheet assets.

Credit risk

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Credit risk

Definition

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

Sources of credit risk

The Group is exposed to credit risk as a result of a wide range of business activities. The most significant source of credit risk is lending. The Group offers a number of lending products where it has an obligation to provide credit facilities to a customer. 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 or bonds. Exposures arising from leasing activities are also included in lending.

The second most significant source of credit risk arises from activities in the derivatives and securities financing transaction markets. 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.

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

The Group is also exposed to credit risk from off-balance sheet products such as trade finance activities and guarantees as well as through committed but undrawn lending facilities.

Through its global activities in foreign exchange, trade finance and payments, the Group is exposed to settlement risk.

Key developments

Credit quality and impairment - The Group's credit risk portfolio continued to improve with an overall reduction in exposure, an improvement in credit quality and a material provision release in 2014. These improvements were driven by supportive economic and market conditions in the UK and Ireland, better liquidity and increased collateral values, and also reflected improvements in credit risk measurement. Through the credit risk appetite frameworks the credit risk management function maintained a continued focus on key portfolios and concentrations.

UK personal lending - The growth in UK PBB gross mortgage lending was within credit risk appetite and against a backdrop of house price increases over most of the year. Due to the withdrawal of products with promotional rates in line with strategy, credit card exposure declined during the year. Refer to Key portfolios - UK PBB on page 100.

Ulster Bank - Following the creation of RCR, exposure to personal customers now represents 68% of the total Ulster Bank exposure. In the personal portfolio, Ulster Bank's proactive offers of forbearance to help customers through financial difficulties saw significant uptake in the Republic of Ireland with an increasing trend towards customers opting for longer-term solutions (though mortgage recoveries stock remains high). The quality of the Ulster Bank wholesale portfolio improved following the transfer of commercial real estate (CRE) assets to RCR, with an associated material decrease in impairments. Refer to Segment performance - Ulster Bank on page 16.

CFG - 2014 was a year of growth in both the personal and wholesale CFG portfolios. This was in line with business strategy to expand personal mortgage lending and auto finance organically as well as through acquisition. The growth in wholesale exposures has been across a broad range of industry sectors and customer types, reflecting improving economic conditions in the US and specific focus on areas such as asset finance, CRE and franchise finance. Changes to strategy or the risk appetite framework are subject to review in accordance with CFG's and RBS Group's risk governance frameworks, so that risks are understood and accepted. Refer to Segment performance - Citizens Financial Group on page 26.

Oil prices - In the second half of 2014, oil prices reduced significantly, driven by the growth in supply from non-OPEC producers, the return of supply from Libya, Iran and Iraq and reduced demand expectations from Europe and China. Exposures to this sector continue to be closely managed through the sector concentration framework as well as ongoing customer and sub-sector reviews, with stress testing highlighting specific sub-sectors or customers particularly vulnerable to sustained low oil prices. Risk appetite to the overall oil and gas sector was reduced during the year, and action continues to mitigate exposure where possible. For further information, refer to the Key credit portfolios section on page 94.

Russia/Ukraine - Ongoing tensions in Russia and Ukraine as well as the imposition of sanctions, particularly in the oil and gas, defence, and financial sectors, have adversely affected the credit risk profile of customers who have exposure to or dealings with Russian or Ukrainian entities. Accordingly, RBS Group reduced limits to customers affected by those developments, including tightening transactional controls to mitigate credit risk while ensuring sanctions compliance. For further information regarding exposure to Russia, refer to the Country risk section on page 152.

Credit risk appetite - Credit risk appetite is continuously reviewed to ensure that it remains relevant in light of changing economic conditions and strategic objectives. Revisions were made to the sector credit risk appetite framework to reflect the altered composition of the credit portfolio following the creation of RCR. The asset and product class framework was also revised to reflect changes in the portfolio together with market developments. These included a revision of the credit risk appetite framework relating to sponsor owned corporate transactions in order to maintain portfolio credit quality following a weakening in terms and conditions within the leverage market.

Risk governance

A strong credit risk management function is vital to support ongoing profitability. The potential for loss is mitigated through a robust credit risk culture and a focus on sustainable lending practices.

Operating model

The RBS Group's credit risk management function, which is led by the RBS Group Chief Credit Officer (GCCO), acts as the ultimate authority for the approval of credit and is responsible for ensuring that credit risk is within the risk appetite set by the Board. The function is also responsible for managing concentration risk and credit risk control frameworks as well as developing and ensuring compliance with credit risk policies. In addition, the function conducts RBS Group-wide assessments of provision adequacy.

The RBS Group Executive Risk Forum (ERF) has delegated approval authority to the Credit Risk Committee (CRC) to act on credit risk matters. These include, but are not limited to, credit risk appetite and limits (within the overall risk appetite set by the RBS Group Board and the ERF), credit risk strategy and frameworks, credit risk policy and the oversight of the credit profile across RBS Group. There are separate CRCs for the wholesale and personal portfolios. These are chaired by the GCCO or delegate.

The ERF has delegated approval authority to the RBS Group Provisions Committee to manage provisions adequacy, both individual and collective. The Group Provisions Committee, which is chaired by either the Chief Risk Officer or the GCCO, approves recommendations from lower-level provisions committees, which in turn have delegated approval thresholds for certain provision adequacy decisions.

Key trends in the credit risk profile of the Group's performance against limits and emerging risks are set out in the RBS Risk Management Monthly Report provided to the Executive Committee, the Board Risk Committee and the Group Board.

The Risk Infrastructure function provides a variety of services that enable the credit risk management function to operate. These include reporting of credit risk data, risk assurance, provision of credit risk models, systems strategy and change management.

Controls and assurance

The credit control and assurance framework has three key components: credit policy; policy compliance assessment; and independent assurance. These apply to both wholesale and personal credit risk at both portfolio and individual customer level.

The first component is the Group Credit Policy Standard, which is part of the Group Policy Framework. It sets out the rules that must be followed to ensure that credit risks are identified and effectively managed through the credit lifecycle.

The second component is a policy compliance assessment activity that credit risk undertakes to provide the GCCO with evidence of the effectiveness of credit risk management controls in place across the Group. The results of these reviews support the self-certification that credit risk must complete every six months.

The third component of the Group's credit assurance framework is the credit quality assurance activity carried out independently by Risk Assurance, which is part of the RBS Group's Risk Infrastructure function. Risk Assurance independently reviews lending activities to identify control breaches, assess portfolio quality and recommend process improvements. These findings are escalated to senior management and plans to address shortcomings are recorded and tracked in RBS Group's operational risk system. Risk Assurance's credit quality assurance activities are overseen by the Group Audit Committee and the results of its reviews are regularly shared with the regulators.

In addition, controls and processes are regularly reviewed by the RBS Group's Internal Audit (IA) function. IA provides assurance to the Group Audit Committee and senior executive that the main business risks have been identified and that effective controls are in place to manage these risks.

Risk management*

Credit risk management is split into wholesale and personal, reflecting the distinction between business types and the different risk management approaches, metrics and issues these involve. Wholesale focuses on activities with corporate and SME customers as well as banks and financial institutions (these customers tend to be grouped by sector and geography as well as by product/asset class). Personal covers personal customers across UK PBB, Ulster Bank and CFG as well as personal lending activities in Private Banking.

Risk appetite

Risk appetite across all risk types is set using specific quantitative targets under stress, including earnings volatility and capital adequacy. The credit risk appetite framework has been designed to reflect the factors that influence the ability to meet those targets. These include product and asset class, industry sector, single name and country concentrations. Any of these factors could generate higher earnings volatility under stress and, if not adequately controlled, they could undermine capital adequacy. Tools such as stress testing and economic capital are used to measure credit risk volatility and develop links between risk appetite targets and the credit risk appetite framework. The frameworks are supported by a suite of policies that set out the risk parameters within which franchises must operate. Impairments, and associated key metrics such as loan loss rates and provision coverage, are an integral part of standard credit risk portfolio reviews and are presented to CRC monthly. These metrics are also fully considered as part of the sector and product class appetite reviews. The RBS Group also manages its exposures to counterparty credit risk closely, using portfolio limits and specific tools to control more volatile or capital-intensive business areas.

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

Risk monitoring and problem debt management

A key aspect of credit risk management relates to problem debt management, from early problem identification through to litigation and recovery of cash when there is no realistic potential for rehabilitation. Various tools and techniques are deployed during this part of the credit cycle including the offering of forbearance. Practices differ across the wholesale and personal portfolios. For further information refer to the Wholesale credit risk management and Personal credit risk management sub-sections.

*unaudited

Credit risk continued

Impairments and write-offs

Internal measures of credit risk are stated gross of impairments. However, impairments and write-offs are used as key indicators of credit quality as part of the overall assessment of credit risk incurred by the RBS Group. These are estimated as follows:

Impaired definition

A financial asset is impaired if there is objective evidence that an event or events since initial recognition of the asset has adversely affected the amount or timing of future cash flows from it. The loss is measured as the difference between the carrying value of the asset and the present value of estimated future cash flows discounted at the original effective interest rate.

For both wholesale and personal exposures, days-past-due measures are typically used to identify evidence of impairment. In both corporate and personal portfolios, a period of 90 days past due is used. In sovereign portfolios, the period used is 180 days past due. Other factors are considered including: the borrower's financial condition; a forbearance event; a loan restructuring; the probability of bankruptcy; or any evidence of diminished cash flows.

Provisioning

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset carrying amount and the present value of the estimated future cash flows discounted at the financial asset's original effective interest rate. The current net realisable value of the collateral will be taken into account in determining the need for a provision. This includes cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable. No impairment provision is recognised in cases where amounts due are expected to be settled in full on realisation of the security. The Group uses one of the following three different methods to assess the amount of provision required: individual; collective; and latent.

Individually-assessed provisions

Loans and securities above a defined threshold deemed to be individually significant are assessed on a case-by-case basis. Assessments of future cash flows take into account the impact of any guarantees or collateral held. Estimating the amount and timing of future cash flows involves judgement based on the facts available at the time and assumptions related to the future financial performance of the customer or counterparty and any guarantors as well as future economic conditions and the value of collateral. Projected cash flows are reviewed on subsequent assessment dates as new information becomes available.

Collectively-assessed provisions

Provisions on impaired credits below an agreed threshold are assessed on a portfolio basis, reflecting the homogeneous nature of the assets. Such portfolios may be either wholesale or retail.

The Group segments them according to product type, such as credit cards, personal loans and mortgages. The approach taken to assess impaired assets in collections differs from the approach taken to assess those in recoveries. For further details on the collections and recoveries functions refer to the Problem debt management sub-section on page 86.

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

Latent loss provisions

In the performing portfolio, latent loss provisions are held against losses incurred but not identified before the balance sheet date. Latent loss provisions reflect probability of default (PD) and loss given default (LGD) as well as emergence periods. The emergence period is the period between the occurrence of the impairment event and the identification and reporting of a loan as impaired.

Emergence periods are estimated at a portfolio level and reflect the portfolio product characteristics such as coupon period and repayment terms, and the duration of the administrative process required to report and identify an impaired loan as such. Emergence periods vary across different portfolios from 120 to 270 days (365 days for forborne exposures). They are based on actual experience within the particular portfolio and are reviewed regularly.

The Group's personal businesses segment their performing loan books into homogeneous portfolios such as mortgages, credit cards or unsecured loans, to reflect their different credit characteristics. Latent provisions are computed by applying portfolio-level LGDs, PDs and emergence periods. The wholesale calculation is based on similar principles but there is no segmentation into portfolios. PDs and LGDs are calculated individually.

Refer to pages 129 to 136 for analysis of impaired loans, related provisions and impairments.

Available-for-sale portfolios

The Group reviews its portfolios of available-for-sale financial assets for evidence of impairment, which includes: 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. However, the disappearance of an active market because an entity's financial instruments are no longer publicly traded is not evidence of impairment. Furthermore, a downgrade of an entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortised cost is not necessarily evidence of impairment. Determining whether evidence of impairment exists requires the exercise of management judgement. Unrecognised losses on the Groups's available-for-sale debt securities are concentrated in its portfolios of asset-backed securities. Such losses reflect the widening of credit spreads as a result of the reduced market liquidity in these securities and the current uncertain macroeconomic outlook in the US and Europe. The underlying securities remain unimpaired.

Sensitivity of impairments to assumptions

Key assumptions relating to impairment levels of secured lending relate to the valuation of the security and collateral held, the timing of asset disposals based on the underlying market depth and liquidity and customer cooperation. Assumptions on timing also include an assessment of the ease and timing of the enforceability of loan agreements in varying legal jurisdictions. Assumptions are made on a case by case basis in the case of individually assessed provisions and are often based on judgement.

Key assumptions relating to impairment levels of unsecured lending relate to economic conditions and the interest rate environment, which have a direct impact on customers' debt servicing capabilities. For individual impairments greater than £1 million, oversight is provided by the Provisions Committee.

Write-offs

Impaired loans and receivables are written-off, that is, the impairment provision is applied in writing down the loan's carrying value partially or in full, when 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-offs may be prompted by bankruptcy, insolvency, forbearance and similar events.

Except for US personal portfolios, where the write-off of the irrecoverable amount takes place within 60-180 days, the typical time frames from initial impairment to write-off for collectively-assessed portfolios are:

- Personal mortgages: Write-off usually occurs within five years of default and is accelerated where accounts are closed earlier.
- Credit cards: Write-off of the irrecoverable amount usually occurs at 12 months in arrears; the rest is expected to be recovered over a further three years following which any remaining amounts outstanding are written off.
- Overdrafts and other unsecured loans: Write-off usually occurs within six years of default.
- Business loans: Write-off usually occurs within five years.
- Commercial loans: Write-off generally occurs within five years but is determined in the light of individual circumstances.

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

Risk measurement*

Risk exposure measurement

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

- Lending exposure - measured using drawn balances and includes cash balances at central banks and loans and advances to banks and customers (including overdraft facilities, instalment credit and finance leases).

- Counterparty exposures - measured using the marked-to-market value of derivatives after the effect of enforceable netting agreements and regulator-approved models but before the effect of collateral. Counterparty exposures include rate risk management, which includes those arising from foreign exchange transactions, interest rate swaps, credit default swaps and options.
- 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 Group uses the output of credit risk models 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 three categories:

Probability of default (PD)

PD models assess the probability of a customer failing its credit obligations over a one-year period.

- **Wholesale models** - A number of credit grading models consider risk characteristics relevant to different customer types. These models use a combination of quantitative inputs, such as recent financial performance, and qualitative inputs such as management performance or sector outlook. As part of the credit assessment process, the Group assigns each customer an internal credit grade based on its PD.
- **Personal models** - Each customer account is scored and models are used to assign a PD. 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.

Exposure at default (EAD)

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. Exposure can be reduced by a legally enforceable netting agreement.

Loss given default (LGD)

LGD models estimate the amount that cannot be recovered in the event of 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.

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Credit risk continued

Changes to credit models

The Group reviews and updates models on an ongoing basis, reflecting the impact of more recent data, changes to products and portfolios, and new regulatory requirements. Extensive changes were made to wholesale models in 2012 and 2013. This continued in 2014 with further changes, notably in the corporate exposure class.

New PD models are being implemented for large corporate customers. The roll-out will be completed by mid-2015. The updated calibrations associated with these new models, which reference over 20 years of rating agency default experience, may result in downwards rating migrations across internal asset quality bands.

Model changes affect year-on-year comparisons of risk measures in certain disclosures. Where meaningful, in its commentary the Group has differentiated 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.

Economic capital

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).

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

Wholesale credit risk management

Wholesale credit risk management focuses on the credit risks arising from activities with corporate and SME clients as well as banks, other financial institutions and sovereigns.

Risk appetite frameworks*

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

Single name concentration

A single name concentration (SNC) framework addresses the risk of outsized loss arising from a concentration of credit risk to a single borrower or borrower group. The framework includes elevated approval authority, additional reporting and monitoring, and the requirement for plans to address exposures in excess of appetite.

SNC excesses are reviewed on a gross basis as well as on a net basis after taking mitigation into account. All net excesses are managed through an approved, customer specific, exposure management plan. To reduce its SNC exposures, the Group may decide to sell excess amounts or rely on mitigation. To be considered effective under the framework, mitigation must be "eligible". Examples of eligible credit risk mitigants include cash collateral, government or bank guarantees, credit default swaps or trade insurance. Eligible credit risk mitigants must also be structurally effective, legally certain, enforceable and characterised by an appropriate maturity profile.

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Aggregate SNC exposures remain outside of the Group's longer-term appetite. However, material reductions have been achieved since the framework was introduced. This trend continued during the year, with a 52% decrease in the number of excesses. The top ten SNC excesses comprise 95% of the Group's total SNC excesses. Total SNC exposure was reduced by 43%.

Sector concentration

Sector concentration risk is the risk of an outsized loss arising from a concentration of credit risk to customers in the same sector or across sectors that are susceptible to similar stress events. The sector concentration framework enables the Group to manage this risk and acts as one of the primary mechanisms for cascading the board-approved risk appetite to business franchises. It also details the controls for managing and reporting credit exposure to industry sectors.

The sector concentration framework was revised in 2014. Previously, sectors were classified according to size. Under the revised sector framework, sectors are classified according to their risk (based on EC and various qualitative factors) as well as size. This classification drives the level of oversight and frequency of sector reviews. Reviews may include an assessment of business strategy, credit risk profile, key risks and mitigants, the current and expected future external environment, vulnerability to stress events, regulatory developments and economic capital usage to derive a proposed risk appetite along with transaction acceptance standards.

As a result of the reviews carried out in 2014, the Group further reduced its risk appetite in its most material corporate sector, CRE, as well as a number of other corporate sectors such as retail, leisure and oil and gas. This was in addition to the reduction of RCR exposures. For further details on sector-specific strategies, exposure reduction and key credit risks, refer to pages 90 to 111.

Product and asset class concentration framework

Product and asset class concentration risk is the risk of an outsized loss arising from a concentration in certain products or asset classes. The product and asset class framework monitors specific credit risk types such as settlement or wrong-way risk and products such as long-dated derivatives or securitisations. These product and asset classes may require specific policies and expertise as well as tailored monitoring and reporting measures. In some cases specific limits and thresholds are deployed to ensure that the credit risk inherent in these lines of business and products is adequately controlled. Exposures are reviewed regularly in accordance with the product and asset class concentration framework. The reviews consider the risks inherent in each product or asset class, the risk controls applied, monitoring and reporting of the risk, the client base, and any emerging risks to ensure risk appetite remains appropriate.

Country concentration

The country concentration framework is described in the Country risk section on pages 152 to 158.

Risk assessment

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

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

Assessments of credit risk must, at a minimum, specifically address the following elements:

- The amount, terms, tenor, structure, conditions, purpose and appropriateness of all credit facilities;
- Compliance with applicable Group-wide and/or franchise-level credit policies;
- The customer's ability to meet obligations, based on an analysis of financial information and a review of payment and covenant compliance history;
- The source of repayment and the customer's risk profile, including its sector and sensitivity to economic and market developments, and any credit risk mitigation;
- Refinancing risk - that is 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.

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.

Credit risk *continued*

Risk mitigation

The Group mitigates credit risk through the use of netting, collateral and the use of market standard documentation.

The types of collateral the Group takes to mitigate the credit risk arising from wholesale lending varies according to the nature of the counterparty and its assets. The most common types are:

- Commercial real estate - Refer to the CRE section on page 90.
- Other physical assets - These may include 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 different ways, depending on the type of asset concerned 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.
- Financial collateral - Refer to Counterparty credit risk section on page 96.

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, credit officers within the business franchise may decide to place the customer on the Watchlist.

Watchlist*

For customers not managed in RCR, 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 usually by Restructuring (formerly known as Global Restructuring Group). The Watch Black portfolio includes AQ10 exposures.

Once on the Watchlist, 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 accordance with RBS Group-wide policies, a number of mandatory actions are taken, including a review of the customer's credit grade and facility and security documentation.

*unaudited

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.

For all Watch Red cases, credit specialists in the relevant business are required to consult with their counterparts in Restructuring on whether the relationship should be transferred to Restructuring (for more information on Restructuring, refer to the section below). Watch Red customers that continue to be managed by the business tend to be those requiring subject matter expertise that is available in the business rather than in Restructuring.

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

Restructuring

Separately to the Credit Risk management function, the Restructuring team manages the RBS Group's wholesale problem debt portfolio in cases where its exposure to the customer exceeds £1 million. In addition, Restructuring has a specialist credit function, the Strategy Management Unit, for distressed bilateral lending where the exposure is between £250,000 and £1 million.

The factor common to all customers managed by Restructuring 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 its 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 repayment, refinancing or transfer to another bank if that is the customer's preferred option.

The specialists 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, various options are discussed with the customer (which may involve debt restructuring or forbearance or both) and bespoke solutions are developed.

If the customer's finances are not viable and a mutually agreed exit 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

Definition

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.

A number of options are available. These are tailored to the customer's individual circumstances. The aim is to restore the customer to financial health and to minimise risk to the Group. To ensure that forbearance is appropriate for the needs and financial profile of the customer, minimum standards are applied when assessing, recording, monitoring and reporting forbearance.

Types of wholesale forbearance

Wholesale forbearance may involve the following types of concessions:

Payment concessions and loan rescheduling, including extensions in contractual maturity, may be granted to improve the customer's liquidity. Concessions may also be granted 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 may be forgiven, or exchanged for equity, 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 are 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.

The 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. As set out above, the Group would seek to obtain a return commensurate to the risk that it is required to take and this can be structured as set out above.

A temporary 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 forbearance disclosures.

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 a 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. Where forbearance is no longer viable, the Group will consider other options such as the enforcement of security, insolvency proceedings or both.

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. 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.

The data presented in the forbearance disclosures include loans forbore during 2012 and 2013 which individually exceeded thresholds set at franchise or reportable segment level. The Group continues to refine its reporting processes for forbore loans. During 2012 the reporting threshold ranged from nil to £10 million and from 2013 until April 2014 thresholds ranged from nil to £3 million. From April 2014 no thresholds were in use.

Credit risk continued

Impairments for forbearance

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.

Provisions for forbore wholesale loans are assessed in accordance with normal provisioning policies. 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.

All wholesale 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 incorporated in the calculation of the impairment loss provisions for the Group's wholesale exposures.

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 Credit Risk function in Restructuring. 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.

Impairments

Impairments in the wholesale portfolio decreased compared with 2013. This reflected a better economic environment as well as improvements in asset values in core markets.

There was a significant amount of credit impairment release during 2014, in particular in RCR where the favourable environment and efficient deal execution supported the disposal strategy. Improved market appetite and greater liquidity was demonstrated, particularly in Ireland, where assets have been realised more quickly and at better prices, than previously anticipated.

Lower underlying customer defaults in the business and commercial elements of PBB and CPB, resulted in modest new impairments in the wholesale portfolio. The majority of provisions in the wholesale portfolio relate to CRE. For further analysis of the provisions in the CRE portfolio refer to page 90.

Watchlist*

At 31 December 2014, exposures to customers reported as Watchlist Red and managed by Restructuring were £2.8 billion (2013 - £12.4 billion) and those managed in the business were £1.1 billion (2013 - £3.2 billion).

The following table shows a sector breakdown of Watchlist Red customers managed by Restructuring.

	2014 Total excluding RCR £m	2013			2012		
		Group excluding Non-Core £m	Non-Core £m	Total £m	Group excluding Non-Core £m	Non-Core £m	Total £m
<i>Watch Red CRA by current exposure</i>							
Property	917	3,176	1,841	5,017	5,605	4,373	9,978
Transport	188	1,778	376	2,154	2,212	331	2,543
Retail and leisure	386	1,085	237	1,322	1,481	412	1,893
Services	511	955	39	994	869	82	951
Other	757	2,304	646	2,950	3,066	1,099	4,165
Total	2,759	9,298	3,139	12,437	13,233	6,297	19,530

Key points

- The number of Watchlist Red customers decreased significantly in 2014 as a result of the transfer of exposures to RCR. Customers managed in RCR are subject to heightened scrutiny and regular review against specific disposal plans.
- The remaining Restructuring population decreased during the year both in number and value. This reflects a reduced flow of cases into Restructuring, repayments and cases improving from Watchlist Red.

*unaudited

Financial review Capital and risk management

Forbearance

The table below shows the value of loans (excluding those where the Group has initiated recovery procedures) where forbearance was completed during the year, by sector and type.

<i>Wholesale forbearance during the year by sector</i>	2014				2013				2012			
	Performing £m	Non- performing £m	Total £m	Provision coverage (1) %	Performing £m	Non- performing £m	Total £m	Provision coverage (1) %	Performing £m	Non- performing £m	Total £m	Provision coverage (1) %
Property	1,052	4,363	5,415	66	1,759	4,802	6,561	60	3,365	3,899	7,264	16
Transport	265	233	498	32	1,016	229	1,245	34	1,174	130	1,304	23
Retail and leisure	431	553	984	51	455	390	845	37	732	113	845	34
Services	475	352	827	53	405	234	639	77	324	51	375	30
Other	811	252	1,063	56	670	510	1,180	27	1,575	550	2,125	40
	3,034	5,753	8,787	62	4,305	6,165	10,470	55	7,170	4,743	11,913	20

Note:

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

Forbearance arrangements

The table below analyses the incidence of the main types of wholesale forbearance arrangements by loan value.

<i>Wholesale forbearance during the year by arrangement type (1)</i>	2014 %	2013 %	2012 %
Payment concessions and loan rescheduling	73	78	49
Covenant-only concessions	20	16	30
Forgiveness of all or part of the outstanding debt	4	9	21
Variation in margin	4	2	6
Other (2)	7	31	14

Notes:

(1) The total exceeds 100% as an individual case can involve more than one type of forbearance.

(2) The main types of 'other' concessions include formal 'standstill' agreements and release of security.

Key points

- Forbearance completed on loans decreased during 2014 compared with 2013. This was in line both with improving market conditions and the RCR disposal strategy.
- Year-on-year analysis of forborne loans may be skewed by individual material cases during a given year. This is particularly relevant when comparing the value of forbearance completed in the property and transport sectors in 2014 with previous years.
- Loans totalling £4.3 billion were granted credit approval for forbearance but had not yet reached legal completion at 31 December 2014 (2013 - £9.4 billion). These loans are referred to as "in process" and are not included in the tables above. 84% of these were non-performing loans, with associated provision coverage of 48%; and 16% were performing loans. The principal types of arrangements offered were payment concessions and loan rescheduling.
- Forbearance in the transport sector was historically driven by exposure to shipping. There has been lower forbearance in the shipping portfolio in 2014 as asset values have improved, reducing the instances of minimum security covenant breaches.
- The value of loans forborne during 2013 and 2014 and still outstanding at 31 December 2014 was £12.2 billion (2013 - £18.4 billion; 2012 - £17.7 billion), of which £3.4 billion related to arrangements completed during 2013 (2012 - £8.0 billion; 2011 - £9.3 billion).
- Additional provisions charged in 2014 relating to loans forborne during 2013 totalled £0.6 billion, predominantly driven by RCR and Restructuring cases. Provision coverage of these loans at 31 December 2014 was 77%.
- Non-RCR customers managed by Restructuring were granted forbearance on loan facilities totalling £1.3 billion during 2014. This equates to 34.1% of loans managed by Restructuring (excluding loans to customers where recovery procedures have commenced).
- Of the loans granted forbearance by Restructuring (excluding those transferred to RCR) in 2013, 24% returned to performing portfolios managed by the originating businesses by 31 December 2014. Some non-forborne loans were also returned from Restructuring to performing portfolios managed by the originating businesses.
- £4.8 billion of completed forbearance granted during the year was to customers managed by RCR. RCR uses forbearance as a tool to assist with the orderly realisation of assets. By value, 94% of the performing non-RCR loans granted forbearance in 2013 remained performing at 31 December 2014.
- Provisions for the non-performing loans disclosed above are individually assessed and therefore not directly comparable across periods. Provision coverage increased in 2014, driven by the provision coverage level in Ulster Bank (including Ulster Bank RCR cases).

Financial review Capital and risk management

Credit risk continued

Key credit portfolios

Commercial real estate*

The commercial real estate (CRE) sector comprised exposures to entities involved in the development of, or investment in, commercial and residential properties (including house builders). The analysis of lending utilisations below is gross of impairment provisions and excludes rate risk management and contingent obligations.

By segment	2014			2013			2012		
	Investment £m	Development £m	Total £m	Investment £m	Development £m	Total £m	Investment £m	Development £m	Total £m
UK PBB	3,757	501	4,258	3,931	510	4,441	4,793	618	5,411
Ulster Bank	952	336	1,288	3,419	718	4,137	3,575	729	4,304
Personal & Business Banking	4,709	837	5,546	7,350	1,228	8,578	8,368	1,347	9,715
Commercial Banking	15,145	2,775	17,920	16,616	2,957	19,573	17,711	3,473	21,184
Private Banking	1,051	244	1,295	n/a	n/a	n/a	n/a	n/a	n/a
Commercial & Private Banking	16,196	3,019	19,215	16,616	2,957	19,573	17,711	3,473	21,184
Corporate & Institutional Banking	721	255	976	898	183	1,081	1,479	372	1,851
Citizens Financial Group	5,017	—	5,017	4,018	—	4,018	3,857	3	3,860
RCR	6,169	6,394	12,563	n/a	n/a	n/a	n/a	n/a	n/a
Non-Core	n/a	n/a	n/a	11,624	7,704	19,328	17,686	8,744	26,430
	32,812	10,505	43,317	40,506	12,072	52,578	49,101	13,939	63,040

By geography (1)	Investment		Development		Total £m	Investment Group excluding RCR £m		Development Group excluding RCR £m		Total £m
	Commercial £m	Residential £m	Commercial £m	Residential £m		RCR £m	RCR £m	RCR £m	RCR £m	
2014										
UK (excluding NI (2))	17,327	4,757	600	3,446	26,130	19,882	2,203	3,506	539	26,130
Ireland (ROI and NI (2))	2,864	740	1,499	4,469	9,572	770	2,834	329	5,639	9,572
Western Europe (other)	1,222	53	189	24	1,488	232	1,042	4	210	1,488
US	4,063	1,358	—	59	5,480	5,376	45	53	6	5,480
RoW (2)	406	22	34	185	647	383	45	219	—	647
	25,882	6,930	2,322	8,183	43,317	26,643	6,169	4,111	6,394	43,317

2013	Investment		Development		Total £m	Group excluding Non-Core		Group excluding Non-Core		Total £m
	Commercial £m	Residential £m	Commercial £m	Residential £m		Non-Core	Non-Core	Non-Core	Non-Core	
UK (excluding NI (2))	20,861	5,008	678	3,733	30,280	21,297	4,572	3,500	911	30,280
Ireland (ROI and NI (2))	4,405	1,028	1,919	5,532	12,884	2,763	2,670	686	6,765	12,884
Western Europe (other)	4,068	183	22	17	4,290	223	4,028	11	28	4,290
US	3,563	1,076	—	8	4,647	4,313	326	8	—	4,647
RoW (2)	314	—	30	133	477	286	28	163	—	477
	33,211	7,295	2,649	9,423	52,578	28,882	11,624	4,368	7,704	52,578

2012	Investment		Development		Total £m	Group excluding Non-Core		RBS excluding Non-Core		Total £m
	Commercial £m	Residential £m	Commercial £m	Residential £m		Non-Core	Non-Core	Non-Core	Non-Core	
UK (excluding NI (2))	25,864	5,567	839	4,777	37,047	23,312	8,119	4,184	1,432	37,047
Ireland (ROI and NI (2))	4,651	989	2,234	5,712	13,586	2,877	2,763	665	7,281	13,586
Western Europe (other)	5,995	370	22	33	6,420	403	5,962	24	31	6,420
US	4,230	981	—	15	5,226	4,629	582	15	—	5,226
RoW (2)	454	—	65	242	761	194	260	307	—	761
	41,194	7,907	3,160	10,779	63,040	31,415	17,686	5,195	8,744	63,040

For the notes to these tables refer to the following page.

*unaudited

Financial review Capital and risk management

By sub-sector (1)	UK (excl NI (2)) £m	Ireland (ROI and NI (2)) £m	Western Europe (other) £m	US £m	RoW (2) £m	Total £m
2014						
Residential	8,203	5,209	78	1,417	206	15,113
Office	3,297	504	609	81	137	4,628
Retail	4,909	809	173	157	91	6,139
Industrial	2,588	367	32	2	29	3,018
Mixed/other	7,133	2,683	596	3,823	184	14,419
	26,130	9,572	1,488	5,480	647	43,317
2013						
Residential	8,740	6,560	200	1,085	133	16,718
Office	4,557	813	1,439	32	121	6,962
Retail	6,979	1,501	967	84	73	9,604
Industrial	3,078	454	43	30	13	3,618
Mixed/other	6,926	3,556	1,641	3,416	137	15,676
	30,280	12,884	4,290	4,647	477	52,578
2012						
Residential	10,344	6,701	403	996	242	18,686
Office	6,112	1,132	1,851	99	176	9,370
Retail	7,529	1,492	1,450	117	129	10,717
Industrial	3,550	476	143	4	39	4,212
Mixed/other	9,512	3,785	2,573	4,010	175	20,055
	37,047	13,586	6,420	5,226	761	63,040

Notes:

- (1) Data at 31 December 2014 includes CRE lending from Private Banking in CPB of £1.3 billion that was excluded from 2013 and 2012 data. At 31 December 2013 CRE lending in Private Banking totalled £1.4 billion (2012 - £1.4 billion).
- (2) ROI: Republic of Ireland; NI: Northern Ireland; RoW: Rest of World.

Key points

- The overall gross lending exposure to CRE fell by £9.3 billion (18%) to £43.3 billion. Most of the decrease occurred in RCR exposure originated by Ulster Bank, CPB and CIB and was due to repayments, asset sales and write-offs.
- The increase in US exposure was predominantly driven by improved economic conditions, which contributed to increased business volumes in CFG, in line with risk appetite and business strategy.
- The RCR portfolio of £12.6 billion represented 29% of RBS Group's CRE portfolio. Geographically, 67% of the RCR portfolio was held in Ireland, 22% in the UK, 10% in Western Europe and 1% in the US and the rest of world.

*unaudited

Financial review Capital and risk management

Credit risk continued

Maturity profile of portfolio	UK PBB £m	Ulster Bank £m	Commercial Banking £m	Private Banking £m	Cooperate & Institutional Banking £m	Citizens Financial Group £m	RCR £m	Total £m
2014								
<= 1 year (1)	808	493	4,297	495	122	857	9,318	16,390
1-2 years	299	63	2,730	228	140	988	1,629	6,077
2-3 years	575	58	2,516	181	80	940	463	4,813
> 3 years	2,552	627	8,081	391	623	2,232	858	15,364
Not classified (2)	24	47	296	—	11	—	295	673
	4,258	1,288	17,920	1,295	976	5,017	12,563	43,317
2013							Non-Core	
<= 1 year (1)	821	2,740	5,995	n/a	469	602	14,860	25,487
1-2 years	427	360	3,009	n/a	203	669	1,891	6,559
2-3 years	490	177	4,231	n/a	123	739	474	6,234
> 3 years	2,680	860	5,941	n/a	286	2,008	1,968	13,743
Not classified (2)	23	—	397	n/a	—	—	135	555
	4,441	4,137	19,573	n/a	1,081	4,018	19,328	52,578
2012							Non-Core	
<= 1 year (1)	1,501	3,000	7,138	n/a	275	797	16,335	29,046
1-2 years	449	284	3,550	n/a	413	801	5,225	10,722
2-3 years	410	215	3,407	n/a	505	667	1,317	6,521
> 3 years	2,861	805	6,736	n/a	658	1,595	3,339	15,994
Not classified (2)	190	—	353	n/a	—	—	214	757
	5,411	4,304	21,184	n/a	1,851	3,860	26,430	63,040

Notes:

(1) Includes on-demand and past-due assets.

(2) Predominantly comprises overdrafts for which there is no single maturity date.

(3) The UK PBB portfolio comprises Business Banking and Williams & Glyn CRE exposure. Williams & Glyn accounts for £3.3 billion (79%).

Key points

- The overall maturity profile has changed, with the proportion of short-term (1 year) maturities reducing in favour of more medium term (> 3 years) maturities. This reflected the reductions in RCR as well as new lending activity in Commercial Banking and CFG.
- Reductions in the Ulster Bank less than one year band between 2013 and 2014 are predominantly the result of transfers to RCR.

By asset quality band	AQ1-AQ2 £m	AQ3-AQ4 £m	AQ5-AQ6 £m	AQ7-AQ8 £m	AQ9 £m	AQ10 £m	Total £m
2014							
Group excluding RCR	758	9,431	13,857	3,873	215	2,620	30,754
RCR	—	228	556	502	87	11,190	12,563
	758	9,659	14,413	4,375	302	13,810	43,317
2013							
Group excluding Non-Core	441	7,801	13,396	5,199	665	5,748	33,250
Non-Core	—	376	1,433	1,341	176	16,002	19,328
	441	8,177	14,829	6,540	841	21,750	52,578
2012							
Group excluding Non-Core	767	6,011	16,592	6,575	1,283	5,382	36,610
Non-Core	177	578	3,680	3,200	1,029	17,766	26,430
	944	6,589	20,272	9,775	2,312	23,148	63,040

Key points

- The overall asset quality of the portfolio has improved, including a significant reduction in the proportion rated AQ10. This was a result of reductions in RCR, improving general market conditions and the quality of new lending activity which is subject to the policies and controls put in place in recent years.
- The increase in AQ3-AQ4 exposure was predominantly driven by new lending in CFG and Commercial Banking.

*unaudited

Financial review Capital and risk management

Credit risk mitigation for commercial real estate

The market value of the collateral typically exceeds the loan amount at origination date. The market value is defined as the estimated amount for which the asset could be sold in an arm's length transaction by a willing seller to a willing buyer. External valuations for CRE lending are required at the inception of the loan. In addition to external valuations at inception, the Group uses a range of other types of information to value such collateral, including expert judgement and indices. External valuations may be sought should an adverse credit event occur - this requirement is assessed as part of the Watchlist process. The table below shows CRE (Non-RCR and RCR) lending split by loan-to-value ratio, which represents loan value before provisions relative to the value of the property financed.

Commercial real estate loan-to-value ratio	RCR			Group excluding RCR			Total		
	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m
2014									
<= 50%	300	45	345	9,833	220	10,053	10,133	265	10,398
> 50% and <= 70%	602	173	775	8,750	301	9,051	9,352	474	9,826
> 70% and <= 90%	220	554	774	2,285	409	2,694	2,505	963	3,468
> 90% and <= 100%	41	116	157	343	134	477	384	250	634
> 100% and <= 110%	56	211	267	168	148	316	224	359	583
> 110% and <= 130%	49	438	487	326	201	527	375	639	1,014
> 130% and <= 150%	6	404	410	135	128	263	141	532	673
> 150%	65	4,160	4,225	305	495	800	370	4,655	5,025
Total with LTVs	1,339	6,101	7,440	22,145	2,036	24,181	23,484	8,137	31,621
Minimal security (1)	—	3,168	3,168	33	38	71	33	3,206	3,239
Other	34	1,921	1,955	5,956	546	6,502	5,990	2,467	8,457
Total	1,373	11,190	12,563	28,134	2,620	30,754	29,507	13,810	43,317
Total portfolio average LTV (2)	75%	338%	291%	56%	133%	62%	57%	287%	116%
2013									
	Non-Core			Group excluding Non-Core			Total		
<= 50%	419	142	561	7,589	143	7,732	8,008	285	8,293
> 50% and <= 70%	867	299	1,166	9,366	338	9,704	10,233	637	10,870
> 70% and <= 90%	1,349	956	2,305	2,632	405	3,037	3,981	1,361	5,342
> 90% and <= 100%	155	227	382	796	295	1,091	951	522	1,473
> 100% and <= 110%	168	512	680	643	327	970	811	839	1,650
> 110% and <= 130%	127	1,195	1,322	444	505	949	571	1,700	2,271
> 130% and <= 150%	13	703	716	356	896	1,252	369	1,599	1,968
> 150%	69	7,503	7,572	400	1,864	2,264	469	9,367	9,836
Total with LTVs	3,167	11,537	14,704	22,226	4,773	26,999	25,393	16,310	41,703
Minimal security (1)	51	3,069	3,120	9	88	97	60	3,157	3,217
Other	108	1,396	1,504	5,266	888	6,154	5,374	2,284	7,658
Total	3,326	16,002	19,328	27,501	5,749	33,250	30,827	21,751	52,578
Total portfolio average LTV (2)	75%	292%	245%	64%	187%	85%	65%	261%	142%

For notes to this table refer to the following page

*unaudited

Financial review Capital and risk management

Credit risk continued

Commercial real estate loan-to-value ratio	Non-Core			Group excluding Non-Core			Total		
	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m
2012									
<= 50%	727	142	869	6,624	157	6,781	7,351	299	7,650
> 50% and <= 70%	2,231	708	2,939	10,239	346	10,585	12,470	1,054	13,524
> 70% and <= 90%	3,038	750	3,788	3,802	456	4,258	6,840	1,206	8,046
> 90% and <= 100%	711	1,570	2,281	1,235	712	1,947	1,946	2,282	4,228
> 100% and <= 110%	295	1,635	1,930	835	357	1,192	1,130	1,992	3,122
> 110% and <= 130%	599	1,078	1,677	642	610	1,252	1,241	1,688	2,929
> 130% and <= 150%	263	1,261	1,524	412	426	838	675	1,687	2,362
> 150%	569	7,841	8,410	1,026	1,471	2,497	1,595	9,312	10,907
Total with LTVs	8,433	14,985	23,418	24,815	4,535	29,350	33,248	19,520	52,768
Minimal security (1)	7	1,573	1,580	4	55	59	11	1,628	1,639
Other	225	1,207	1,432	6,406	795	7,201	6,631	2,002	8,633
Total	8,665	17,765	26,430	31,225	5,385	36,610	39,890	23,150	63,040
Total portfolio average LTV (2)	84%	223%	173%	67%	148%	80%	71%	206%	122%

Notes:

- (1) Total portfolio average LTV is quoted net of loans with minimal security given that the anticipated recovery rate is less than 10%. Provisions are marked against these loans where required to reflect the relevant asset quality and recovery profile.
- (2) Weighted average by exposure.

Key points

- The average LTV for the performing book improved from 65% to 57% over the past year. The LTV for the performing portfolio in the UK was 56%. The reductions in the higher LTV bands occurred mainly in the RCR book originated by Ulster Bank and CIB, reflecting reductions through repayments, asset sales and write-offs.
- Interest on performing investment property secured loans was covered 1.6x and 2.9x within RCR and Group excluding RCR, respectively. Performing loans include general corporate loans, typically unsecured, to CRE companies (including real estate investment trusts), and major UK house builders, in addition to facilities supported by guarantees. The credit quality of these exposures was consistent with that of the performing portfolio overall. Non-performing loans are subject to standard provisioning policies.

Credit quality

Credit quality metrics relating to CRE lending were as follows:

	Total			RCR 2014	Non-Core	
	2014	2013	2012		2013	2012
Lending (gross)	£43,317m	£52,578m	£63,040m	£12,563m	£19,328m	£26,430m
Of which REIL	£13,345m	£20,129m	£22,108m	£11,112m	£14,305m	£17,052m
Provisions	£9,027m	£13,209m	£10,077m	£8,067m	£10,639m	£8,349m
REIL as a % of gross loans to customers	30.8%	38.3%	35.1%	88.5%	74.0%	64.5%
Provisions as a % of REIL	68%	66%	46%	73%	74%	49%

Notes:

- (1) Excludes property related lending to customers in other sectors managed by Real Estate Finance.
- (2) Data at 31 December 2014 includes CRE lending from Private Banking in CPB of £1.3 billion that was excluded from 2013 and 2012 data. At 31 December 2013 CRE lending in Private Banking totalled £1.4 billion (2012 - £1.4 billion).

Oil and gas*

The Group has £10.7 billion of credit risk assets (CRA) to the oil and gas sector. Including committed but undrawn facilities, the exposure to the sector is £24.1 billion.

The price of crude oil is subject to global demand and supply factors and therefore determined globally. It has fallen by more than 50% since June 2014. This steep decline has been driven by excess supply fears resulting from a combination of factors. These include the growth in US shale production and OPEC maintaining current production levels, as well as weaker demand in Europe and slower growth in China.

The price of natural gas is determined regionally. US natural gas prices have been relatively stable compared with the recent price of crude oil. The price of natural gas is not highly correlated to oil prices.

Exposures to this sector continue to be closely managed through the sector concentration framework and through ongoing customer and sub-sector reviews including stress testing. Risk appetite to the overall oil and gas sector was reduced during 2014. Further action is ongoing to mitigate exposure where possible.

*unaudited

Financial review Capital and risk management

The table below provides a breakdown of oil and gas sector exposure on both a CRA basis and total exposure (including committed but undrawn exposure and contingent obligations) basis by business segment.

	2014				2013			
	CRA £m	%	Total £m	%	CRA £m	%	Total £	%
Commercial Banking	671	6	1,035	4	772	8	1,203	5
Corporate & Institutional Banking	8,297	78	20,278	84	8,264	82	20,924	88
Citizens Financial Group	1,251	12	2,134	9	819	8	1,284	5
Others	101	1	243	1	144	1	276	1
RCR	352	3	457	2	145	1	147	1
	10,672	100	24,147	100	10,144	100	23,834	100
Of which: lending exposure	7,744	73	17,695	73	6,996	69	16,693	70

During 2014, CFG's exposure to this sector increased, partly due to the transfer of £0.4 billion (total exposure) of oil and gas exposures from CIB.

The committed lending exposure included legal commitments to syndicated bank facilities, with tenors up to five years. These committed facilities are for general corporate purposes including funding of operating needs and capital expenditures. These facilities are available as long as counterparties remain compliant with the terms of the credit agreement. Contingent obligations relate to guarantees, letters of credit and suretyships provided to customers.

The Group had no high-yield bond underwriting positions as at 31 December 2014; it had a simple sub investment grade loan underwriting of \$86 million in the Americas which, subsequent to year end, had been syndicated.

At the year end, the Group's exposure to commodities financing was £1.0 billion, predominantly in relation to oil (£0.7 billion), metals (£0.2 billion) and coal (£0.1 billion).

CIB oil and gas*

Sub-sector and geography

The tables below provide a breakdown of CIB's oil and gas sector exposure which represents 84% of the Group's exposure to this sector (including committed but undrawn exposure) split by sub-sector and geography. The analysis is based on the Group's sector concentration framework.

	UK £m	Western Europe (excl. UK) £m	North America £m	Asia Pacific £m	Latin America £m	CEEMA (1) £m	Total £m
2014							
Producers (incl. integrated oil companies)	833	1,101	4,822	263	115	848	7,982
Oilfield service providers	153	675	1,007	742	—	535	3,112
Other wholesale and trading activities	295	794	683	907	—	122	2,801
Refineries	1	177	2,700	591	141	67	3,677
Pipelines	96	48	2,359	49	33	121	2,706
	1,378	2,795	11,571	2,552	289	1,693	20,278

Including committed undrawn exposures

Of which: exploration and production	145	3	3,118	115	150	37	3,568

2013							
Producers (incl. integrated oil companies)	748	1,065	5,333	459	5	748	8,358
Oilfield service providers	180	835	1,078	507	61	323	2,984
Other wholesale and trading activities	297	915	553	893	—	147	2,805
Refineries	1	135	2,203	993	131	231	3,694
Pipelines	188	95	2,563	41	—	196	3,083
	1,414	3,045	11,730	2,893	197	1,645	20,924

Note:
(1) Includes exposures to Central and Eastern Europe as well as the Middle East and Africa.

*unaudited

Financial review Capital and risk management

Credit risk continued

The sub-sector within which a customer operates is a primary consideration for assessing the credit risk of a customer. Current areas of focus are towards customers involved in exploration and production principally in producers (E&P) and oilfield service providers (OFS). E&P customers represent approximately 18% of CIB's exposure to the oil and gas sector and OFS customers represent 15%.

E&P is most immediately exposed to the oil price decline and E&P companies are the primary customers for the service providers and are experiencing an adverse impact on their financial performance from a reduced level of contracts and lower contract rates as well as pressure to re-price existing services.

Asset quality - AQ band

	2014	
	£m	%
AQ1	3,948	20
AQ2	1,999	10
AQ3	3,455	17
AQ4	7,521	37
AQ5	2,035	10
AQ6	1,025	5
AQ7	293	1
Other	2	—
	20,278	100

At the year end 83%, of the portfolio exposure was investment grade (AQ1-AQ4).

The impact of continuing low oil prices on the credit quality of the portfolio is subject to ongoing review, including stress testing. The Group is in regular contact with customers to understand the impacts on them of a sustained low oil price. This activity is backed up by a suite of early warning indicators used to identify customers who may be experiencing financial difficulty.

At the year end, the proportion of the total oil and gas portfolio, excluding RCR, designated as Watchlist Red (performing customers who show signs of declining creditworthiness and so require active management) was 0.4%, of which 0.02% was managed by Restructuring.

Counterparty credit risk

Counterparty credit risk arising from both derivatives and repurchase agreements is mitigated through the use of netting, collateral and market standard documentation.

The other principal components of the Group's exposure to producers are Integrated Oil Companies (IOC) and National Oil Companies (NOC). IOC and NOC are less vulnerable to the oil price decline due to scale, diversification and in the case of NOC, explicit support from governments.

Asset quality

The table below provides a breakdown of the asset quality of CIB's oil and gas sector portfolios.

Amounts owed by the Group to a counterparty are netted against amounts the same counterparty owes it, 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 and, to a much lesser extent, equity securities at the outset. However, if the value of collateral falls relative to that of 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 the Group's 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 limits counterparty credit exposures by setting limits which take into account the potential adverse movement of an exposure after adjusting for the impact of netting and collateral where applicable.

Mitigation of counterparty credit risk

	2014 £bn	2013 £bn	2012 £bn
Reverse repurchase agreements	64.7	76.3	104.5
Securities received as collateral (1,2)	(64.7)	(76.3)	(104.5)
Derivative assets gross exposure			
- balances with holding company and fellow subsidiaries	2.7	3.4	7.2
- balances with third parties	351.8	286.0	437.9
Counterparty netting	(295.2)	(242.8)	(373.8)
Cash collateral held (2)	(32.6)	(23.6)	(33.4)
Securities received as collateral (2)	(7.0)	(6.0)	(5.6)

Notes:

(1) In accordance with normal market practice, at 31 December 2014 £60.2 billion (2013 - £63.6 billion; 2012 - £100.9 billion) had been resold or re-pledged as collateral for the Group's own transactions.

(2) At fair value.

*unaudited

Financial review Capital and risk management

Personal credit risk management

Personal credit risk management focuses on the Group's personal customers in UK PBB, Ulster Bank and CFG as well as personal lending activities in Private Banking.

Risk appetite

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, 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.

Risk assessment

Personal lending entails making a large number of small-value loans. To ensure that these lending decisions are made consistently, the Group analyses credit information, 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.

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 the Halifax Quarterly Regional House Price Index in the UK, the Case-Shiller Home Price Index in the US, the Central Statistics Office Residential Property Price Index in the ROI, and the Nationwide House Price Index in Northern Ireland. For automobile lending in the US, new vehicles are valued at cost and used vehicles at the average trade-in value.

Problem debt management

Collections

Collections functions in each of the Group's personal businesses provide support to customers who cannot meet their obligations to the Group. 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 may use 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. For further details on recoveries, refer to page 98.

Forbearance

Definition

Forbearance takes place when a concession is made on the contractual terms of a loan in response to a customer's financial difficulties. Forbearance is granted either permanently or temporarily, following an assessment of the customer's circumstances.

Identification

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.

Types of personal forbearance

Forbearance is granted principally to customers with mortgages and less frequently to customers with unsecured loans.

Mortgage portfolios

Forbearance options include, but are not limited:

- 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 and CFG also offer 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 only, temporary basis.

Credit risk continued

Unsecured portfolios

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

Monitoring of forbearance

Forborne loans may be either performing or impaired and are subject to the same impairment triggers as the rest of the portfolio (refer to impairment section). A loan is deemed impaired if the borrower has failed to make repayments of principal, payments of interest or both for 90 days or more, or in the case of forborne loans, the borrower has been granted a payment concession such as interest forgiveness.

The granting of forbearance does not generally change the delinquency status of the loan affected. An exception is a loan for which the Group has agreed to capitalise arrears. Capitalisation of principal and interest in arrears brings the loan up to date. If it remains up to date for six months and is deemed likely to continue to do so, it is transferred to the performing book. In Ulster Bank, if a customer makes payments that reduce loan arrears below 90 days, the loan is transferred to the performing book. In addition, a small portfolio of loans past due 90 days is managed by PBB's collections function. Loans in this portfolio may also be transferred to the performing book if the customer makes payments that reduce arrears below 90 days. In CFG, all forborne loans are included in the non-performing book regardless of whether or not the Group has agreed to capitalise interest past due for 90 days or more.

Mortgages granted forbearance are reviewed regularly to ensure that customers are meeting the agreed terms. Key metrics have been developed to record the proportion of loans that fail to meet the agreed terms over time, as well as the proportion of loans that return to performing with no arrears. Personal forbearance loans can be modified more than once.

Impairments for forbearance

Performing loans in UK PBB and Ulster Bank are subject to a latent loss provision but form a separate risk pool (for 24 months in UK PBB and for the period of forbearance in Ulster Bank). The higher of the observed default rates, or PD, is used in UK PBB in the latent provisioning calculations for these loans to ensure that appropriate provision is held. In Ulster Bank, 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. Furthermore, for these portfolios the latent provision incorporates extended emergence periods. 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 methodology described above.

Provisions for all non-performing personal loans are collectively assessed. The loans are grouped by asset type. Characteristics such as LTVs, arrears status and default vintage are also considered when assessing recoverable amount and calculating the related provision requirement. Ulster Bank personal non-performing loans in the Republic of Ireland form a separate risk pool where specific LGDs are allocated using observed performance of these loans. While non-performing forbearance personal loans in the UK (10% of portfolio) do not form a separate risk pool, the LGD models used to calculate the collective impairment provision are affected by forbearance agreements.

In CFG, personal loans subject to forbearance are assessed individually, taking into account the value of any collateral, for impairment loss throughout their lives until repaid or fully written off. If there is no collateral the impairment amount considers the excess of the loans' carrying amount over the present value of expected future cash flows. Any confirmed losses are charged off immediately.

Recoveries

Once a loan has been identified as impaired it is managed by recoveries teams in the relevant businesses. They seek to reduce 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.

Impairments

Impairments in the personal portfolios decreased compared with 2013. Ulster Bank was a significant driver of this decrease as a result of the better economic environment and higher asset prices, which led to the release of credit impairments during the year. Outside of Ulster Bank, impairments in the UK portfolio decreased which also saw provision releases owing to rising asset prices and strong recoveries. The level of new impairments in the UK portfolio decreased by 26% compared to 2013. Retail impairments in CFG reduced during 2014 by 29% owing to improved asset quality in the real estate portfolios.

Financial review Capital and risk management

Key portfolios

Overview of personal portfolios split by product type and segment*

	2014					2013				
	UK PBB £m	Ulster Bank £m	Private Banking £m	CFG £m	Total £m	UK PBB £m	Ulster Bank £m	Private Banking £m	CFG £m	Total £m
Mortgages (1)	103,235	17,506	8,889	21,122	150,752	99,338	19,034	8,701	19,584	146,657
of which: interest only	24,287	1,263	6,357	9,929	41,836	25,439	2,069	5,968	9,272	42,748
buy-to-let	11,602	2,091	1,388	147	15,228	9,073	2,242	1,024	241	12,580
forbearance	4,873	3,880	100	409	9,262	5,446	2,782	127	373	8,728
Other lending (2)	12,335	591	5,186	10,924	29,036	13,760	740	5,353	8,302	28,155
of which: credit cards	4,951	192	124	952	6,219	5,766	212	129	945	7,052
loans	5,020	322	4,298	1,933	11,573	5,357	421	4,656	1,712	12,146
overdrafts	2,364	77	365	91	2,897	2,637	107	355	100	3,199
auto loans	—	—	—	7,947	7,947	—	—	—	5,545	5,545
Total	115,570	18,097	14,075	32,046	179,788	113,098	19,774	14,054	27,886	174,812
Non-performing %	3.3%	20.3%	1.0%	1.4%	4.5%	3.9%	18.3%	0.7%	1.5%	4.9%

Notes:

(1) It is possible for a mortgage loan to appear in more than one category.

(2) There are other less material categories of personal lending not listed.

Overview of impairments and REIL

	2014				2013			
	UK PBB	Ulster Bank	Private Banking	CFG	UK PBB	Ulster Bank	Private Banking	CFG
Loan impairment charge as a % of gross customer loans and advances								
Mortgages	—	(1.0%)	0.1%	0.2%	—	1.2%	—	0.5%
Other lending	2.0%	2.9%	(0.1%)	0.8%	1.8%	2.2%	0.6%	1.0%
Loan impairment provisions (£m)								
Mortgages	217	1,413	27	146	259	1,726	33	123
Other lending	1,515	104	35	49	1,671	187	50	33
Risk elements in lending (£m)								
Mortgages	1,218	3,362	95	949	1,702	3,235	116	761
Other lending	1,520	110	80	195	1,863	193	80	148

*unaudited

Financial review Capital and risk management

Credit risk continued

UK PBB

Overview

The majority of the UK PBB Personal portfolio consists of mortgages. Total gross personal lending of £115.6 billion comprised 64% of the Group's gross personal lending of £179.8 billion. £103.2 billion related to mortgage lending and £12.3 billion to unsecured lending (loans, credit cards and overdrafts).

Mortgages

Risk mitigation

The table below shows LTVs for the UK PBB personal residential mortgage portfolio split between performing (AQ1-AQ9) and non-performing (AQ10), with the average LTV calculated on a weighted-value basis. Loan balances are shown as at the end of the year whereas property values are calculated using property index movements since the last formal valuation.

Loan-to-value ratio by value	2014				2013				2012			
	Performing £m	Non- performing £m	Total £m	Of which: IOL (1) £m	Performing £m	Non- performing £m	Total £m	Of which: IOL (1) £m	Performing £m	Non- performing £m	Total £m	Of which: IOL (1) £m
<= 50%	34,889	430	35,319	7,802	26,392	313	26,705	5,977	22,306	327	22,633	5,702
> 50% and <= 70%	38,355	783	39,138	9,935	34,699	591	35,290	9,280	27,408	457	27,865	7,921
> 70% and <= 90%	23,660	705	24,365	4,978	28,920	854	29,774	6,909	34,002	767	34,769	9,267
> 90% and <= 100%	2,837	187	3,024	1,071	4,057	315	4,372	1,846	7,073	366	7,439	2,370
> 100% and <= 110%	609	73	682	413	1,790	182	1,972	1,039	3,301	290	3,591	1,666
> 110% and <= 130%	143	29	172	104	552	100	652	382	1,919	239	2,158	1,091
> 130% and <= 150%	27	2	29	4	37	5	42	6	83	26	109	45
> 150%	—	—	—	—	—	—	—	—	—	—	—	—
Total with LTVs	100,520	2,209	102,729	24,307	96,447	2,360	98,807	25,439	96,092	2,472	98,564	28,062
Other (2)	486	20	506	(20)	511	20	531	—	486	12	498	7
Total	101,006	2,229	103,235	24,287	96,958	2,380	99,338	25,439	96,578	2,484	99,062	28,069
Total portfolio average LTV (3)	57%	67%	57%		62%	75%	62%		66%	80%	67%	
Average LTV on new originations during the year (3)			71%				67%				65%	

Notes:

(1) Interest only loans.

(2) Where no indexed LTV is held.

(3) Average LTV weighted by value is calculated using the LTV on each individual mortgage and applying a weighting based on the value of each mortgage.

Key points

- The UK personal mortgage portfolio increased by 4% to £103.2 billion, of which £91.6 billion (2013 - £90.3 billion) was owner-occupied and £11.6 billion (2013 - £9.0 billion) buy-to-let.
- Based on the Halifax Price Index at September 2014, the portfolio average indexed LTV by volume was 50.4% (2013 - 54.1%) and 57.3% by weighted value of debt outstanding (2013 - 62.0%). The ratio of total outstanding balances to total indexed property valuations was 41.5% (2013 - 45.1%).
- Fixed interest rate products of varying time durations accounted for approximately 56%, with 3% a combination of fixed and variable rates and the remainder variable rate. Approximately 19% of owner-occupied mortgages were on interest only terms with a bullet repayment and 7% were on a combination of interest only and capital and interest.
- During 2014 buy-to-let balances increased by £2.6 billion (28.2%) in support of UK PBB's growth strategy with new business subject to rental cover and loan-to-value risk appetite requirements. Approximately 63% of buy-to-let mortgages were on interest only lending terms with a bullet repayment, 34% repayable by regular capital and interest repayments and the remaining 3% a combination of interest only and capital and interest. Buy-to-let lending includes lending to customers who were originally owner occupiers who subsequently, with the Group's agreement, let out the property to a third party, this represents 26.5% of buy-to-let mortgages.
- The portfolio average indexed LTV improved from 62.0% to 57.3%. Within owner-occupied, the average LTV by weighted value improved from 61.6% to 57.0% and within buy-to-let from 66.0% to 59.6%.

Financial review Capital and risk management

- Gross new mortgage lending of £19.7 billion (2013 - £14.4 billion) had an average LTV by weighted value of 70.5%, which was higher than 2013 (66.6%), reflecting growth in the market and the Group's strong support for the Help To Buy scheme. Within this: owner-occupier lending was £16.6 billion (2013 - £13.2 billion) and had an average LTV by weighted value of 71.7% (2013 - 66.9%). Buy-to-let lending was £3.1 billion (2013 - £1.3 billion) with an average LTV by weighted value of 63.9% (2013 - 63.0%).
- All new mortgage business is subject to a comprehensive assessment which includes: i) an affordability test; ii) credit scoring; iii) a maximum loan-to-value of 90% (75% on buy-to-let), with the exception of government-backed schemes, for example Help to Buy and New Buy, where lending of up to 95% is provided; and iv) a range of policy rules that restrict the availability of credit to riskier borrowers.
- The arrears rate (more than three payments in arrears, excluding repossessions and shortfalls after property sale), fell from 1.3% to 1.0%. The number of repossessions was also lower (1,129 compared with 1,532 in 2013). The arrears rate for buy-to-let mortgages was 0.6% (2013 - 0.9%).
- There was an overall release of impairment provision of £26 million. This compares to a charge of £31 million in 2013 and reflects improvements in underlying asset quality, including house price increases.

Arrears status and provisions

The mortgage arrears information for accounts in forbearance and related provision are shown in the tables below.

	No missed payments		1-3 months in arrears		>3 months in arrears		Total		Forborne balances (1) %
	Balance £m	Provision £m	Balance £m	Provision £m	Balance £m	Provision £m	Balance £m	Provision £m	
2014	4,158	15	364	16	351	26	4,873	57	4.7
2013	4,596	17	426	23	424	51	5,446	91	5.5
2012	4,006	20	388	16	450	64	4,844	100	4.9

Notes:

- As a percentage of mortgage loans.
- Until June 2014, forbearance in UK PBB included all changes to the contractual payment terms, including those where the customer was up-to-date on payments and there was no obvious evidence of financial difficulty. From July 2014, only customers exhibiting signs of financial stress are reported in forbearance disclosures.
- Includes the current stock position of forbearance deals agreed since early 2008 for UK PBB.

The incidence of the main types of personal forbearance on the balance sheet are analysed below.

	2014 £m	2013 £m	2012 £m
Interest only conversions - temporary and permanent	1,632	1,784	1,220
Term extensions - capital repayment and interest only	2,308	2,478	2,271
Payment concessions	228	241	215
Capitalisation of arrears	876	907	932
Other	223	366	452
Total (1)	5,267	5,776	5,090

Note:

- As an individual case can include more than one type of arrangement, the analysis above exceeds the total value of cases subject to forbearance.

Financial review Capital and risk management

Credit risk continued

The table below shows forbearance agreed during the year split between performing and non-performing.

	2014 £m	2013 £m	2012 £m
Performing forbearance	785	1,332	1,809
Non-performing forbearance	148	186	184
Total forbearance (1,2)	933	1,518	1,993

Notes:

(1) An individual case can include more than one type of arrangement.

(2) Includes all arrangements agreed during the year (new customers and renewals) including those deals that have expired at the year end. Balances are as at the year end.

Key points

- At 31 December 2014, forbearance balances where the forbearance treatment was provided in the last 24 months amounted to £1.2 billion, representing 1.2% of total mortgage stock.
- The flow of new forbearance was £367 million in the second half of 2014. This compared to £748 million in the first half 2014, which included changes in contractual terms for both financially stressed and non-financially stressed customers. The underlying flow of new forbearance continued on a downward trend and, on a like-for-like basis, was 18% lower in 2014 compared to 2013.
- Since January 2008, 4.7% of total mortgage assets (£4.9 billion) have been subject to a forbearance arrangement with stock levels decreasing by 10.5% since the end of 2013. The year-on-year reduction partly reflects the change in definition to report only financially stressed customers from July 2014 onwards. On a like-for-like basis underlying stock was down by 5.3%.
- The majority (91%) 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 most frequently granted forbearance types were term extensions (44% of forbearance loans at 31 December 2014), interest only conversions (31%) and capitalisations of arrears (17%).
- Conversions to interest only have only been permitted on a very exceptional basis since the fourth quarter of 2012 and have not been permitted for customers in financial difficulty since 2009.
- Approximately 85% of forbearance loans (2013 - 85%) were up to date with payments compared with approximately 98% of assets not subject to forbearance activity. The impairment provision cover on forbearance loans remained significantly higher than that on assets not subject to forbearance as a result of a bespoke provisioning methodology.

Interest only*

UK PBB stopped offering interest only terms for owner-occupier mortgages from 1 December 2012. This policy is reviewed periodically. Interest only repayment remains an option for buy-to-let mortgages. Exposure to interest only reduced by 5% during 2014.

	2014 Mortgages £m	2013 Mortgages £m
Variable rate	15,165	18,400
Fixed rate	9,122	7,039
Interest only loans	24,287	25,439
Mixed repayment (1)	6,820	7,665
Total	31,107	33,104

Note:

(1) Mortgages with partial interest only and partial capital repayments.

*unaudited

Financial review Capital and risk management

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

2014	2015 (1) £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)	503	1,086	3,853	5,300	6,965	6,277	303	24,287

2013	2014 (3) £m	2015-16 £m	2017-21 £m	2022-26 £m	2027-31 £m	2032-41 £m	After 2041 £m	Total £m
Bullet principal repayment (2)	460	1,006	4,045	5,255	7,194	7,109	370	25,439

Notes:

(1) 2015 includes pre-2015 maturity exposure.

(2) Includes £1.6 billion (2013 - £1.8 billion) of repayment mortgages that have been granted interest only concessions (forbearance).

(3) 2014 includes pre-2014 maturity exposure.

The table below shows the arrears status of the personal mortgage portfolio by mortgage type.

	2014			2013		
	Interest only Bullet principal repayment £m	Other £m	Total £m	Interest only Bullet principal repayment £m	Other £m	Total £m
Arrears status						
Current	23,445	77,056	100,501	24,395	71,629	96,024
1 to 90 days in arrears	514	1,214	1,728	612	1,390	2,002
90+ days in arrears	328	678	1,006	432	880	1,312
Total	24,287	78,948	103,235	25,439	73,899	99,338

Key points

- UK PBB's interest only mortgages require full principal repayment (also known as a bullet payment) at the time of maturity. Typically such loans have remaining terms of between 10 and 20 years. Customers are reminded of the need to have an adequate repayment vehicle in place during the mortgage term.
- Of the £24.3 billion interest only mortgages, £17.0 billion (70.0%) were residential owner occupied mortgages (2013 - £19.9 billion) and £7.3 billion (30.0%) related to buy-to-let lending (2013 - £5.6 billion).
- Of the bullet loans that matured in the six months to 30 June 2014, 60.3% had been fully repaid by 31 December 2014. The unpaid balance totalled £58.8 million, of which 94.4% continued to meet agreed payment arrangements (including balances with a term extension agreed on either a capital and interest or interest only basis). Of the £58.8 million unpaid balance, 84.1% of the loans had an indexed LTV of 70% or less with 2.6% above 90%.
- Customers may be offered an extension to the term of an interest only mortgage or a conversion of an interest only mortgage to one featuring repayment of both capital and interest, subject to affordability and characteristics such as the customers' income and ultimate repayment vehicle. These term extensions are considered forbearance and are subject to a bespoke provision methodology resulting in a higher provision rate.

- UK PBB personal recognises impairment provisions in respect of interest-only mortgages that are due to mature within five years. The impairment calculation is based on historical analysis coupled with data obtained from a sample of customers who were asked about how they intended to repay their borrowing at the end of term. The impairment provision held recognises that a proportion of customers may not be able to fulfil their contractual obligation to repay the debt. The analysis is updated as new trends and data become available.

Personal lending

The UK PBB personal lending portfolio comprised credit cards, unsecured loans and overdrafts, and totalled £12.3 billion at 31 December 2014 (2013 - £13.8 billion). Credit card balances fell by 14.1% reflecting the Group's withdrawal from the 0% interest rate balance transfer market. Unsecured loans fell by 6.3% and overdrafts fell by 10.3%.

The impairment charge on unsecured lending was £241 million for the year, down 17.6% on 2013. The reduction reflects continued strong underlying credit quality together with fortuitous recoveries from aged defaulted debt.

Forbearance levels are low and comprise reduced or deferred payments. Arrangements for the repayment of overdraft excesses or loan arrears can be agreed dependent on affordability. Where repayment arrangements are not affordable debt consolidation loans can be provided to customers in collections. £100 million of balances (0.83% of the total unsecured balances) were subject to forbearance at the 2014 year end.

*unaudited

Financial review Capital and risk management

Credit risk continued

Ulster Bank

Overview

The majority (97%) of the Ulster Bank personal portfolio related to mortgage lending. Total gross lending of £18.1 billion comprised 10.1% of the Group's gross lending of £179.8 billion. £17.5 billion related to mortgage lending and £0.6 billion to unsecured lending (loans and overdrafts).

Mortgages

Risk mitigation

The table below shows LTVs for the Ulster Bank personal residential mortgage portfolio split between performing (AQ1-AQ9) and non-performing (AQ10), with the average LTV calculated on a weighted value basis. Loan balances are shown as at the end of the year whereas property values are calculated using property index movements since the last formal valuation.

Loan-to-value ratio by value	2014				2013				2012			
	Performing £m	Non-performing £m	Total £m	Of which: IOL (1) £m	Performing £m	Non-performing £m	Total £m	Of which: IOL (1) £m	Performing £m	Non-performing £m	Total £m	Of which: IOL (1) £m
<= 50%	2,529	188	2,717	100	2,025	170	2,195	113	2,182	274	2,456	166
> 50% and <= 70%	2,316	203	2,519	118	1,837	195	2,032	118	1,635	197	1,832	170
> 70% and <= 90%	2,856	276	3,132	184	2,326	288	2,614	206	2,019	294	2,313	271
> 90% and <= 100%	1,406	174	1,580	101	1,214	162	1,376	122	1,119	156	1,275	169
> 100% and <= 110%	1,404	203	1,607	127	1,302	182	1,484	129	1,239	174	1,413	181
> 110% and <= 130%	2,382	512	2,894	295	2,509	461	2,970	332	2,412	397	2,809	457
> 130% and <= 150%	1,554	547	2,101	218	2,202	549	2,751	425	2,144	474	2,618	613
> 150%	481	475	956	120	2,385	1,227	3,612	624	3,156	1,290	4,446	1,110
Total	14,928	2,578	17,506	1,263	15,800	3,234	19,034	2,069	15,906	3,256	19,162	3,137
Total portfolio average LTV (2)	88%	115%	92%		103%	130%	108%		108%	132%	112%	
Average LTV on new originations during the year (2)			75%				73%				74%	

Notes:

(1) Interest only loans.

(2) Average LTV weighted by value is calculated using the LTV on each individual mortgage and applying a weighting based on the value of each mortgage.

Key points

- Of Ulster Bank's portfolio of £17.5 billion, 86% was in the Republic of Ireland and 14% in Northern Ireland. At constant exchange rates, the portfolio decreased 2.4% during the year as a result of amortisation.
- The assets included £2.1 billion (12%) of residential buy-to-let loans.
- The interest rate product mix was approximately 64% on tracker rate products, 23% on variable rate products and 13% on fixed rate.
- Interest only represented 7% of the total portfolio.
- Ulster Bank stopped offering interest only loans as a standard mortgage offering for new lending in the Republic of Ireland in 2010 and in Northern Ireland in 2012.
- The average individual LTV on new originations was 75% in 2014, (2013 - 73%); the volume of new business increased from £438 million in 2013 to £618 million in 2014. The maximum LTV available to Ulster Bank customers was 90%.
- Indexed loan to value, excluding 2014 new business, was 93% as at 31 December 2014.
- The assets included £2.1 billion (12%) of residential buy-to-let loans.
- The average LTV of new business for owner occupier mortgages was 75%, compared to 69% for buy-to-let.
- Based on updated house price indices as at October 2014, the portfolio average indexed LTV improved from 108% to 92% during 2014, reflecting positive house price index trends over the last 12 months. In particular, the Republic of Ireland house price index increased by 16% during 2014, with the Irish market being led by the Dublin area, where the index increased by 22% during the year. The Republic of Ireland house price index is 38% below its peak, which was in September 2007.
- Repossessions increased to 497 in 2014 from 262 in 2013.
- Ulster Bank provisioning methodology used a point-in-time provision rate based on the latest available house price index prepared by the Central Statistics Office. This is used to create an indexed valuation at property level, which also takes into account costs of realisation and a discount for forced sales, and is one of the primary factors used in the determination of the likely size of the loss upon crystallisation. Loss likelihood rates are also determined and (amongst other considerations) assess whether an active forbearance arrangement is in place. The provision rate is then a combination of these measures and is updated as required depending on the movement of the drivers applied as part of the methodology.
- REIL increased from £3.2 billion to £3.4 billion primarily reflecting higher forbearance arrangements. Provision coverage was lower at 41% (2013 - 53%) reflecting an increase in collateral values.

Financial review Capital and risk management

Arrears status and provisions

The mortgage arrears information for accounts in forbearance and related provision are shown in the tables below.

	No missed payments		1-3 months in arrears		>3 months in arrears		Total		Forborne balances (1)
	Balance £m	Provision £m	Balance £m	Provision £m	Balance £m	Provision £m	Balance £m	Provision £m	%
2014	2,231	299	689	110	960	267	3,880	676	22.2
2013	1,362	166	631	76	789	323	2,782	565	14.6
2012	915	100	546	60	527	194	1,988	354	10.4

Notes:

- (1) As a percentage of mortgage loans.
- (2) Forbearance in Ulster Bank includes all changes to the contractual payment terms, including those where the customer is up-to-date on payments and there is no obvious evidence of financial difficulty.
- (3) Includes the current stock position of forbearance deals agreed since early 2009 for Ulster Bank.

The incidence of the main types of personal forbearance on the balance sheet are analysed below.

	2014 £m	2013 £m	2012 £m
Interest only conversions - temporary and permanent	346	512	924
Term extensions - capital repayment and interest only	501	325	183
Payment concessions (1)	2,305	1,567	762
Capitalisation of arrears	1,364	494	119
Total (2)	4,516	2,898	1,988

Notes:

- (1) Includes £77 million of loans (2013 - £365 million; 2012 - £10 million) where an interest rate discount has been agreed resulting in a reduction of contractual cash flows through forgiveness of interest.
- (2) As an individual case can include more than one type of arrangement, the analysis above exceeds the total value of cases subject to forbearance.

The table below shows forbearance agreed during the year split between performing and non-performing.

	2014 £m	2013 £m	2012 £m
Performing forbearance	2,177	2,223	2,111
Non-performing forbearance	1,053	1,213	1,009
Total forbearance (1,2)	3,230	3,436	3,120

Notes:

- (1) An individual case can include more than one type of arrangement.
- (2) Includes all arrangements agreed during the year (new customers and renewals) including those deals that have expired at the year end. Balances are as at the year end.

Key points

- At 31 December 2014, 22.2% of total mortgage assets (£3.9 billion) were subject to a forbearance arrangement (agreed since early 2009), an increase of 40% (£2.8 billion) from 31 December 2013. This reflects Ulster Bank's proactive strategies to contact customers in financial difficulty to offer assistance.
- Although the forbearance stock increased by 40% during the year, the number of customers approaching Ulster Bank for assistance for the first time has declined through 2014. This can be attributed to a greater number of mortgages being moved to longer-term arrangements, and therefore not exiting forbearance.
- The majority of loans subject to forbearance arrangements (75%) were less than 90 days in arrears.
- The mix of forbearance treatments in Ulster Bank changed, with an increase in longer-term solutions. A total of 61% of forbearance loans were subject to a long-term arrangement at 31 December 2014 (2013 - 41%). These long-term arrangements were comprised of: i) Capitalisations which represented 30% of forbearance stock at 31 December 2014 (2013 - 17%); ii) Term extensions - 11% (unchanged from 2013); and iii) economic concessions - 20% (2013 - 13%). Economic concessions are offered for periods up to eight years and incorporate different levels of repayment based on customer circumstances.
- The remaining forbearance loans were short-term arrangements accounting for 39% of the forbearance portfolio.
- Temporary interest only arrangements decreased during 2014 to 8% of forbearance loans at 31 December 2014 (2013 - 18%). This reflects Ulster Bank's strategy to transition customers in financial difficulty to long-term arrangements.
- Payment concessions represented the remaining 31%, comprising: arrangements where payments amortised the outstanding balance (26%); a diminishing portfolio of arrangements that negatively amortised (4%); and payment holidays (1%).
- The impairment provision cover on forbearance loans remained significantly higher than that on assets not subject to forbearance.

Financial review Capital and risk management

Credit risk continued

Interest only*

Ulster Bank stopped offering interest only loans as a standard mortgage offering for new lending in the Republic of Ireland in 2010 and in Northern Ireland in 2012. Interest only mortgages are now granted only to high net worth customers or customers in need of forbearance.

	2014 Mortgages £m	2013 Mortgages £m
Variable rate	1,238	2,031
Fixed rate	25	38
Interest only loans	1,263	2,069
Mixed repayment (1)	204	277
Total	1,467	2,346

Note:

(1) Mortgages with partial interest only and partial capital repayments.

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

	2015 (1) £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 (2)	9	30	80	109	250	152	26	656
Conversion to amortising (2,3)	366	206	29	2	4	—	—	607
Bullet principal repayment	375	236	109	111	254	152	26	1,263
	2014 (4) £m	2015-16 £m	2017-21 £m	2022-26 £m	2027-31 £m	2032-41 £m	After 2041 £m	Total £m
2013								
Bullet principal repayment (2)	10	25	85	106	224	200	28	678
Conversion to amortising (2,3)	864	350	120	9	13	27	8	1,391
Total	874	375	205	115	237	227	36	2,069

Notes:

(1) 2015 includes pre-2015 maturity exposure.

(2) Includes £0.3 billion (2013 - £0.5 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) 2014 includes pre-2014 maturity exposure.

The table below shows the arrears status of the personal mortgage portfolio by mortgage type.

	2014				2013			
	Interest only		Other £m	Total £m	Interest only		Other £m	Total £m
	Bullet principal repayment £m	Conversion to amortising £m			Bullet principal repayment £m	Conversion to amortising £m		
Arrears status								
Current	561	474	12,756	13,791	565	1,053	12,642	14,260
1 to 90 days in arrears	25	54	1,058	1,137	35	152	1,352	1,539
90+ days in arrears	70	79	2,429	2,578	78	186	2,971	3,235
Total	656	607	16,243	17,506	678	1,391	16,965	19,034

Key points

- Ulster Bank's interest only mortgages require full principal repayment (bullet) at the time of maturity; or payment of both capital and interest from the end of the interest only period, typically seven years, so that customers meet their contractual repayment obligations. For bullet customers, contact strategies are in place to remind them of the need to repay principal at the end of the mortgage term.
- Typically interest only mortgages have a remaining term of 16 years.
- Of the bullet mortgages that matured in the six months to 30 June 2014 (£3.3 million), 37% had been fully repaid by 31 December 2014 leaving residual balances of £2.1 million, 81% of which were meeting the terms of a revised repayment schedule. Of the amortising loans that matured in the six months to 30 June 2014 (£232.6 million), 66% were either fully repaid or meeting the terms of a revised repayment schedule.
- Of the £1.3 billion interest only mortgages £0.9 billion related to owner-occupier mortgages and £0.3 billion related to buy-to-let mortgages.

Personal lending

The Ulster Bank personal lending portfolio comprised credit cards, unsecured loans and overdrafts, and totalled £591 million at 31 December 2014 (2013 - £740 million). Loans decreased by 24%.

The impairment charge on unsecured lending was £19.9 million for the year, down 12% on 2013.

Unsecured retail forbearance was £4 million in 2014 (out of £591 million unsecured loans).

*unaudited

Financial review Capital and risk management

Private Banking

Overview

The majority of the Private Banking personal lending portfolio relates to mortgage lending. Total gross lending of £14.1 billion comprised 7.8% of the Group's gross personal lending of £179.8 billion. £8.9 billion related to mortgage lending and £5.2 billion to other lending (loans, overdrafts and current accounts).

Mortgages

Risk mitigation

The table below shows LTVs for the Private Banking residential mortgage portfolio split between performing (AQ1-AQ9) and non-performing (AQ10), with the average LTV calculated on a weighted value basis. Loan balances are shown as at the end of the year whereas property values are calculated using property index movements since the last formal valuation.

Loan-to-value ratio by value	2014				2013				2012			
	Performing £m	Non-performing £m	Total £m	Of which: IOL (1) £m	Performing £m	Non-performing £m	Total £m	Of which: IOL (1) £m	Performing £m	Non-performing £m	Total £m	Of which: IOL (1) £m
<= 50%	3,493	14	3,507	2,727	3,400	16	3,416	2,561	3,905	9	3,914	2,982
> 50% and <= 70%	3,667	14	3,681	2,711	3,397	20	3,417	2,332	2,790	12	2,802	1,897
> 70% and <= 90%	1,379	24	1,403	679	1,337	44	1,381	660	1,080	27	1,107	474
> 90% and <= 100%	64	9	73	44	87	7	94	65	93	7	100	74
> 100% and <= 110%	33	5	38	35	87	15	102	96	69	13	82	75
> 110% and <= 130%	15	9	24	22	27	6	33	30	49	7	56	50
> 130% and <= 150%	12	1	13	12	4	4	8	7	16	3	19	19
> 150%	22	3	25	22	24	6	30	26	29	3	32	22
Total with LTVs	8,685	79	8,764	6,252	8,363	118	8,481	5,777	8,031	81	8,112	5,593
Other (2)	124	1	125	105	215	5	220	191	674	—	674	245
Total	8,809	80	8,889	6,357	8,578	123	8,701	5,968	8,705	81	8,786	5,838
Total portfolio average LTV (3)	51%	80%	51%		51%	77%	51%		51%	78%	51%	
Average LTV on new originations during the year (3)			48%				52%					

Notes:

(1) Interest only loans.

(2) Where no indexed LTV is held.

(3) Average LTV weighted by value is calculated using the LTV on each individual mortgage and applying a weighting based on the value of each mortgage.

Forbearance

Forbearance is offered to private banking customers on a limited basis and represents less than 1.1% of the total mortgage portfolio. The main types of forbearance offered are in the form of term extensions.

Arrears status and provisions

The mortgage arrears information for accounts in forbearance and related provision are shown in the tables below.

	No missed payments		1-3 months in arrears	>3 months in arrears		Total		
	Balance £m	Provision £m	Balance £m	Balance £m	Provision £m	Balance £m	Provision £m	Forborne balances (1) %
2014	91	1	3	6	1	100	2	1.1
2013	112	3	6	9	—	127	3	1.5
2012	38	—	—	7	—	45	—	0.5

Note:

(1) As a percentage of mortgage loans.

	2014 £m	2013 £m	2012 £m
Interest only conversions - temporary and permanent	1	—	6
Term extensions - capital repayment and interest only	46	29	27
Payment concessions	18	12	9
Other	35	86	3
Total (1)	100	127	45

Note:

(1) As an individual case can include more than one type of arrangement, the analysis above exceeds the total value of cases subject to forbearance.

Financial review Capital and risk management

Credit risk continued

The table below shows forbearance agreed during the year split between performing and non-performing.

	2014 £m	2013 £m	2012 £m
Performing forbearance	89	41	18
Non-performing forbearance	22	22	2
Total forbearance (1,2)	111	63	20

Notes:

(1) An individual case can include more than one type of arrangement.

(2) Includes all arrangements agreed during the year (new customers and renewals) including those deals that have expired at the year end. Balances are as at the year end.

Interest only*

Private Banking portfolios offer interest only mortgages to high net worth customers.

The table below shows interest only mortgages by interest rate and repayment type.

	2014		2013	
	Mortgages £m	Other loans £m	Mortgages £m	Other loans £m
Variable rate	4,810	1,779	5,062	1,276
Fixed rate	1,547	99	906	71
Interest only loans	6,357	1,878	5,968	1,347
Mixed repayment (1)	—	11	375	6
Total	6,357	1,889	6,343	1,353

Note:

(1) Mortgages with partial interest only and partial capital repayments.

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

2014	2015 (1) £m	2016-17 £m	2018-22 £m	2023-27 £m	2028-32 £m	2033-42 £m	After 2042 £m	Total £m
Bullet principal repayment	1,290	1,634	2,284	630	356	162	1	6,357

2013	2014 (2) £m	2015-16 £m	2017-21 £m	2022-26 £m	2027-31 £m	2032-41 £m	After 2041 £m	Total £m
Bullet principal repayment	239	911	1,853	2,250	492	159	48	5,952
Conversion to amortising (3)	1	—	—	2	4	9	—	16
Total	240	911	1,853	2,252	496	168	48	5,968

Notes:

(1) 2015 includes pre-2015 maturity exposure.

(2) 2014 includes pre-2014 maturity exposure.

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

The table below shows the arrears status of Private Banking's personal mortgage portfolio by mortgage type.

	2014			2013			
	Interest only Bullet principal repayment £m	Other £m	Total £m	Interest only Bullet principal repayment £m	Conversion to amortising £m	Other £m	Total £m
Arrears status							
Current	6,311	2,497	8,808	5,839	16	2,694	8,549
1 to 90 days in arrears	13	19	32	33	—	17	50
90+ days in arrears	33	16	49	80	—	22	102
Total	6,357	2,532	8,889	5,952	16	2,733	8,701

*unaudited

Financial review Capital and risk management

CFG

Overview

The majority of the CFG personal portfolio relates to mortgage lending. Total gross lending of £32.0 billion comprised 17.8% of the Group's gross personal lending of £179.8 billion. £21.1 billion related to mortgage lending and £10.9 billion to unsecured lending (loans and overdrafts) and auto loans.

Mortgages

Risk mitigation

The table below shows LTVs for CFG personal residential mortgages split between performing (AQ1-AQ9) and non-performing (AQ10), with the average LTV calculated on a weighted value basis. Loan balances are shown as at the end of the year whereas property values are calculated using property index movements since the last formal valuation.

Loan-to-value ratio by value (1)	2014				2013				2012			
	Performing £m	Non- performing £m	Total £m	Of which: IOL (2) £m	Performing £m	Non- performing £m	Total £m	Of which: IOL (2) £m	Performing £m	Non- performing £m	Total £m	Of which: IOL (2) £m
<= 50%	4,498	77	4,575	1,792	4,669	98	4,767	2,146	4,167	51	4,218	1,433
> 50% and <= 70%	6,601	105	6,706	3,436	5,529	89	5,618	2,929	4,806	76	4,882	2,363
> 70% and <= 90%	6,350	141	6,491	3,372	5,553	110	5,663	3,019	6,461	114	6,575	3,595
> 90% and <= 100%	1,256	48	1,304	624	1,309	39	1,348	525	2,011	57	2,068	959
> 100% and <= 110%	672	24	696	311	752	22	774	223	1,280	43	1,323	509
> 110% and <= 130%	516	17	533	191	637	17	654	144	1,263	42	1,305	431
> 130% and <= 150%	119	4	123	32	183	5	188	32	463	14	477	123
> 150%	64	3	67	14	102	4	106	20	365	14	379	98
Total with LTVs	20,076	419	20,495	9,772	18,734	384	19,118	9,038	20,816	411	21,227	9,511
Other (3)	624	3	627	157	463	3	466	234	292	19	311	30
Total	20,700	422	21,122	9,929	19,197	387	19,584	9,272	21,108	430	21,538	9,541
Total portfolio average LTV (4)	67%	73%	67%		67%	69%	67%		75%	86%	75%	
Average LTV on new originations during the year (4)			68%				68%				64%	

Notes:

(1) Includes residential mortgages and home equity loans and lines.

(2) Interest only loans.

(3) Where no indexed LTV is held.

(4) Average LTV weighted by value is calculated using the LTV on each individual mortgage and applying a weighting based on the value of each mortgage.

Key points

- The mortgage portfolio consisted of £7.8 billion of residential mortgages (1% in second lien position) and £13.3 billion of home equity loans and lines of credit (HELOC) - first and second liens. Home equity consisted of 45% in first lien position. A Serviced By Others (SBO) portfolio, which is predominantly (95%) second lien, is included in the home equity book.
- CFG continued to focus on its 'footprint states' of New England, Mid-Atlantic and Mid-West regions. At 31 December 2014, the portfolio consisted of £17.1 billion (82% of the total portfolio) within footprint.
- The SBO portfolio, which was closed to new purchases in the third quarter of 2007, decreased from £1.4 billion to £1.3 billion.
- The overall mortgage portfolio credit characteristics are stable with a weighted average LTV of 67% at 31 December 2014. The weighted average LTV of the portfolio, excluding SBO, was 65%.

Arrears status and provisions

The mortgage arrears information for accounts in forbearance and related provision are shown in the tables below.

	No missed payments		1-3 months in arrears		>3 months in arrears		Total		Forborne balances (1) %
	Balance £m	Provision £m	Balance £m	Provision £m	Balance £m	Provision £m	Balance £m	Provision £m	
2014	310	25	34	4	65	—	409	29	1.9
2013	287	26	33	3	53	—	373	29	1.9
2012	—	—	179	25	160	10	339	35	1.6

Note:

(1) As a percentage of mortgage loans.

Financial review Capital and risk management

Credit risk continued

The incidence of the main types of personal forbearance on the balance sheet are shown below.

	2014 £m	2013 £m	2012 £m
Term extensions - capital repayment and interest only	56	35	—
Payment concessions (1)	254	246	339
Other	99	92	—
Total (2)	409	373	339

Notes:

(1) Includes £18 million of loans (2013 - £62 million) where an interest rate discount has been agreed resulting in a reduction of contractual cash flows through forgiveness of interest.

(2) As an individual case can include more than one type of arrangement, the analysis above exceeds the total value of cases subject to forbearance.

The table below shows forbearance agreed during the year split between performing and non-performing.

	2014 £m	2013 £m	2012 £m
Performing forbearance	—	—	88
Non-performing forbearance	76	101	71
Total forbearance (1,2)	76	101	159

Notes:

(1) An individual case can include more than one type of arrangement.

(2) Includes all arrangements agreed during the year (new customers and renewals) including those deals that have expired at the year end. Balances are as at the year end.

Key point

- CFG participates in the US-government mandated Home Affordable Modification Program, as well as its own proprietary programme. Both feature a combination of term extensions, capitalisations of arrears, interest rate reductions and loan conversions from interest only to amortising. These tend to be permanent changes to contractual terms. In order to qualify for either of these programmes, customers must meet government-specified or internal criteria that provide evidence of financial difficulty and demonstrate a willingness to pay. The 12-month default rate, on a value basis, for forbearance was 15% in 2014.

Interest only*

The table below shows the interest only mortgage and HELOC portfolios by interest rate and repayment type.

	2014		2013	
	Mortgages £m	Other loans £m	Mortgages £m	Other loans £m
Variable rate	9,637	59	9,221	23
Fixed rate	292	34	51	40
Interest only loans	9,929	93	9,272	63
Mixed repayment	788	—	1,149	—
Total	10,717	93	10,421	63

*unaudited

Financial review Capital and risk management

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

	2015 (1) £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 (2)	93	70	9	—	—	—	—	172
Conversion to amortising (2,3)	1,156	1,879	4,432	2,147	19	9	115	9,757
Total	1,249	1,949	4,441	2,147	19	9	115	9,929
2013								
Bullet principal repayment (2)	133	193	13	13	17	17	17	403
Conversion to amortising (2,3)	997	5,609	2,123	133	—	7	—	8,869
Total	1,130	5,802	2,136	146	17	24	17	9,272

Notes:

(1) 2015 includes pre-2015 maturity exposure.

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

(3) 2014 includes pre-2014 maturity exposure.

	2014				2013			
	Interest only		Other £m	Total £m	Interest only		Other £m	Total £m
	Bullet principal repayment £m	Conversion to amortising £m			Bullet principal repayment £m	Conversion to amortising £m		
Arrears status								
Current	145	9,365	10,247	19,757	348	8,529	10,002	18,879
1 to 90 days in arrears	17	314	612	943	37	260	65	362
90+ days in arrears	10	78	334	422	18	80	245	343
Total	172	9,757	11,193	21,122	403	8,869	10,312	19,584

Key points

- CFG has a portfolio of interest only bullet repayment HELOC loans (£0.2 billion at 31 December 2014) for which repayment of principal is due at maturity, and an interest only portfolio that comprises loans that convert to amortising after an interest only period (typically ten years). The majority of the bullet loans are due to mature in 2015.
- Of the bullet repayment loans that matured in the six months to 30 June 2014, 48.9% had been fully repaid by 31 December 2014. The unpaid balance totalled £103 million, 90.8% of which continued to meet agreed payment arrangements. Of the amortising loans that matured in the six months to 30 June 2014, 64.3% had been fully repaid by 31 December 2014. The unpaid balance totalled £15 million, 83.2% of which continued to meet agreed payment arrangements.

Personal lending

CFG's credit card portfolio is comprised of good quality consumer loans originated in-footprint through the branch network and totalled £952 million at 31 December 2014 (2013 - £945 million). The product portfolio credit quality continued to improve with weighted average credit scores for new originations throughout 2014 higher than the portfolio average.

The auto portfolio totalled £7.9 billion at 31 December 2014 of which £6.9 billion has been originated through dealer networks and £1.0 billion of purchased pools of prime auto loans. CFG increased its exposure to auto loans during the year, within the risk appetite set as part of CFG's strategy.

For loans secured by vehicles and credit cards, CFG may offer temporary interest rate modifications, but no principal reductions. Forbearance may also be offered to student loan customers consistent with the policy guidelines of the US Office of the Comptroller of the Currency. £140 million (1.3% of the unsecured balances) were subject to forbearance at 31 December 2014 (includes auto and recreational vehicle marine portfolios and excludes small business loans as these are included as part of wholesale reporting).

*unaudited

Balance sheet analysis

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Financial review Capital and risk management

Balance sheet analysis

Financial assets exposure summary

The table below analyses the Group's financial asset 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 £m
2014					
Cash and balances at central banks	73,983	—	73,983	—	73,983
Reverse repos	95,517	(30,822)	64,695	(5,016)	59,679
Lending	356,100	(2,921)	353,179	(40,011)	313,168
Debt securities	84,274	—	84,274	—	84,274
Equity shares	5,203	—	5,203	—	5,203
Derivatives	597,262	(245,418)	351,844	(327,807)	24,037
Settlement balances	6,662	(1,997)	4,665	—	4,665
Total excluding disposal groups	1,219,001	(281,158)	937,843	(372,834)	565,009
Disposal groups (3)	78,240	—	78,240	—	78,240
Total including disposal groups	1,297,241	(281,158)	1,016,083	(372,834)	643,249
Amounts due from holding company and fellow subsidiaries	6,440	—	6,440	(979)	5,461
Gross of short positions	1,303,681	(281,158)	1,022,523	(373,813)	648,710
Short positions	(23,028)	—	(23,028)	—	(23,028)
Net of short positions	1,280,653	(281,158)	999,495	(373,813)	625,682
2013					
Cash and balances at central banks	79,993	—	79,993	—	79,993
Reverse repos	116,994	(40,658)	76,336	(11,379)	64,957
Lending	414,721	(2,152)	412,569	(36,349)	376,220
Debt securities	100,595	—	100,595	—	100,595
Equity shares	8,278	—	8,278	—	8,278
Derivatives	551,699	(265,709)	285,990	(264,562)	21,428
Settlement balances	8,252	(2,672)	5,580	(262)	5,318
Total excluding disposal groups	1,280,532	(311,191)	969,341	(312,552)	656,789
Disposal groups	705	—	705	—	705
Total including disposal groups	1,281,237	(311,191)	970,046	(312,552)	657,494
Amounts due from holding company and fellow subsidiaries	20,246	—	20,246	(1,591)	18,655
Gross of short positions	1,301,483	(311,191)	990,292	(314,143)	676,149
Short positions	(28,004)	—	(28,004)	—	(28,004)
Net of short positions	1,273,479	(311,191)	962,288	(314,143)	648,145
2012					
Cash and balances at central banks	74,524	—	74,524	—	74,524
Reverse repos	142,864	(38,377)	104,487	(17,439)	87,048
Lending	448,676	—	448,676	(40,604)	408,072
Debt securities	136,406	—	136,406	—	136,406
Equity shares	13,872	—	13,872	—	13,872
Derivatives	811,349	(373,448)	437,901	(407,752)	30,149
Settlement balances	8,173	(2,456)	5,717	(1,760)	3,957
Total excluding disposal groups	1,635,864	(414,281)	1,221,583	(467,555)	754,028
Disposal groups	304	—	304	—	304
Total including disposal groups	1,636,168	(414,281)	1,221,887	(467,555)	754,332
Amounts due from holding company and fellow subsidiaries	31,120	—	31,120	—	31,120
Gross of short positions	1,667,288	(414,281)	1,253,007	(467,555)	785,452
Short positions	(27,541)	—	(27,541)	—	(27,541)
Net of short positions	1,639,747	(414,281)	1,225,466	(467,555)	757,911

For the notes to these tables refer to the following page.

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Balance sheet analysis continued

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

			Bank		
	Gross exposure £m	IFRS offset (1) £m	Carrying value £m	Balance sheet offset (2) £m	Exposure post offset £m
2014					
Cash and balances at central banks	70,952	—	70,952	—	70,952
Reverse repos	61,717	(14,951)	46,766	(4,751)	42,015
Lending	162,798	(2,921)	159,877	(33,149)	126,728
Debt securities	70,898	—	70,898	—	70,898
Equity shares	4,880	—	4,880	—	4,880
Derivatives	595,970	(245,413)	350,557	(327,548)	23,009
Settlement balances	3,029	(156)	2,873	—	2,873
Total	970,244	(263,441)	706,803	(365,448)	341,355
Amounts due from holding company and fellow subsidiaries	92,507	—	92,507	(4,998)	87,509
Gross of short positions	1,062,751	(263,441)	799,310	(370,446)	428,864
Short positions	(16,590)	—	(16,590)	—	(16,590)
Net of short positions	1,046,161	(263,441)	782,720	(370,446)	412,274
2013					
Cash and balances at central banks	75,792	—	75,792	—	75,792
Reverse repos	60,913	(17,151)	43,762	(7,319)	36,443
Lending	170,477	(2,152)	168,325	(28,081)	140,244
Debt securities	65,484	—	65,484	—	65,484
Equity shares	7,301	—	7,301	—	7,301
Derivatives	549,399	(265,486)	283,913	(264,398)	19,515
Settlement balances	3,264	(62)	3,202	—	3,202
Total	932,630	(284,851)	647,779	(299,798)	347,981
Amounts due from holding company and fellow subsidiaries	127,155	—	127,155	(3,870)	123,285
Gross of short positions	1,059,785	(284,851)	774,934	(303,668)	471,266
Short positions	(17,898)	—	(17,898)	—	(17,898)
Net of short positions	1,041,887	(284,851)	757,036	(303,668)	453,368
2012					
Cash and balances at central banks	70,374	—	70,374	—	70,374
Reverse repos	78,686	(10,097)	68,589	(14,762)	53,827
Lending	191,392	—	191,392	(33,539)	157,853
Debt securities	89,150	—	89,150	—	89,150
Equity shares	12,766	—	12,766	—	12,766
Derivatives	808,149	(373,264)	434,885	(407,727)	27,158
Settlement balances	3,562	(472)	3,090	(360)	2,730
Total	1,254,079	(383,833)	870,246	(456,388)	413,858
Amounts due from holding company and fellow subsidiaries	169,389	—	169,389	—	169,389
Gross of short positions	1,423,468	(383,833)	1,039,635	(456,388)	583,247
Short positions	(14,074)	—	(14,074)	—	(14,074)
Net of short positions	1,409,394	(383,833)	1,025,561	(456,388)	569,173

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) 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) Disposal Groups at 31 December 2014 principally relates to Citizens and includes lending of £61 billion and debt securities of £15 billion.

Key points

- Financial assets net exposure including disposal groups fell by £14.2 billion or 2% principally reflecting lower funded assets as both CIB and RCR implemented strategic balance sheet reductions through wind-down and disposals.
- The major components of net exposure that are uncollateralised are cash and balances at central banks, unsecured commercial, corporate and bank loans and debt securities.
- Of the £84 billion of debt securities, £25 billion are asset-backed but underlying collateral is not reflected above as the Group only has access to cash flows from the collateral.

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Sector concentration

The following tables analyse financial assets by industry sector.

2014	Group								Exposure post offset £m
	Reverse repos £m	Lending £m	Securities		Derivatives £m	Other financial assets £m	Balance sheet value £m	Offset (1) £m	
			Debt £m	Equity £m					
Central and government	10	8,472	62,361	—	4,832	251	75,926	(5,041)	70,885
Financial institutions - banks	20,708	21,591	4,846	373	239,408	73,983	360,909	(247,477)	113,432
- other (2)	43,682	37,660	14,904	1,253	92,442	4,284	194,225	(108,898)	85,327
Personal - mortgages	—	129,671	—	—	—	—	129,671	—	129,671
- unsecured	—	17,980	—	—	—	2	17,982	(3)	17,979
Property	—	46,507	165	101	2,347	8	49,128	(903)	48,225
Construction	—	5,287	11	53	366	—	5,717	(896)	4,821
Manufacturing	265	15,696	665	1,602	2,149	48	20,425	(2,024)	18,401
Finance leases and instalment credit	—	11,265	21	—	26	—	11,312	(1)	11,311
Retail, wholesale and repairs	—	15,582	252	438	733	13	17,018	(1,735)	15,283
Transport and storage	—	13,120	214	57	2,116	—	15,507	(1,027)	14,480
Health, education and leisure	—	12,392	59	25	670	—	13,146	(709)	12,437
Hotels and restaurants	—	6,084	4	37	180	—	6,305	(198)	6,107
Utilities	—	4,516	242	127	4,330	—	9,215	(1,150)	8,065
Other	30	24,760	631	1,204	2,245	59	28,929	(2,772)	26,157
Total third party	64,695	370,583	84,375	5,270	351,844	78,648	955,415	(372,834)	582,581
Amounts due from holding company and fellow subsidiaries	—	3,657	—	—	2,738	45	6,440	(979)	5,461
Total gross of provisions	64,695	374,240	84,375	5,270	354,582	78,693	961,855	(373,813)	588,042
Provisions	—	(17,404)	(101)	(67)	—	—	(17,572)	n/a	(17,572)
Total excluding disposal groups	64,695	356,836	84,274	5,203	354,582	78,693	944,283	(373,813)	570,470
Disposal groups	—	61,351	15,293	572	402	622	78,240	—	78,240
Total including disposal groups	64,695	418,187	99,567	5,775	354,984	79,315	1,022,523	(373,813)	648,710

2013

Central and government	247	7,976	64,993	—	4,012	573	77,801	(4,411)	73,390
Financial institutions - banks	26,439	25,048	4,248	661	198,868	79,993	335,257	(206,495)	128,762
- other (2)	49,156	34,875	29,135	2,185	69,391	4,855	189,597	(89,354)	100,243
Personal - mortgages	—	148,111	—	—	—	—	148,111	—	148,111
- unsecured	—	28,096	—	—	—	3	28,099	(3)	28,096
Property	—	62,219	216	274	2,784	—	65,493	(689)	64,804
Construction	—	6,310	24	112	448	7	6,901	(1,370)	5,531
Manufacturing	466	20,613	701	2,154	1,209	43	25,186	(2,526)	22,660
Finance leases and instalment credit	—	13,503	14	5	13	—	13,535	(17)	13,518
Retail, wholesale and repairs	—	19,330	244	438	881	11	20,904	(1,962)	18,942
Transport and storage	—	16,427	299	72	2,085	—	18,883	(866)	18,017
Health, education and leisure	—	16,080	103	85	656	14	16,938	(853)	16,085
Hotels and restaurants	—	6,936	5	57	218	—	7,216	(165)	7,051
Utilities	—	4,810	176	284	3,194	23	8,487	(1,064)	7,423
Other	28	27,280	577	2,050	2,231	51	32,217	(2,777)	29,440
Total third party	76,336	437,614	100,735	8,377	285,990	85,573	994,625	(312,552)	682,073
Amounts due from holding company and fellow subsidiaries	—	16,678	101	—	3,413	54	20,246	(1,591)	18,655
Total gross of provisions	76,336	454,292	100,836	8,377	289,403	85,627	1,014,871	(314,143)	700,728
Provisions	—	(25,045)	(140)	(99)	—	—	(25,284)	n/a	(25,284)
Total excluding disposal groups	76,336	429,247	100,696	8,278	289,403	85,627	989,587	(314,143)	675,444
Disposal groups	—	704	—	—	1	—	705	—	705
Total including disposal groups	76,336	429,951	100,696	8,278	289,404	85,627	990,292	(314,143)	676,149

For the notes to these tables refer to page 117.

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Balance sheet analysis continued

2012	Group								Exposure post offset £m
	Reverse repos £m	Lending £m	Securities		Derivatives £m	Other £m	Balance sheet value £m	Offset (1) £m	
			Debt £m	Equity £m					
Central and government	441	9,126	86,891	—	5,746	589	102,793	(5,142)	97,651
Financial institutions - banks	34,444	25,862	5,203	1,469	334,323	74,524	475,825	(340,372)	135,453
- other (2)	69,254	41,037	40,846	2,249	79,076	4,712	237,174	(103,733)	133,441
Personal - mortgages	—	149,210	—	—	—	—	149,210	(1)	149,209
- unsecured	—	31,219	—	—	—	4	31,223	(7)	31,216
Property	—	72,109	661	313	4,056	—	77,139	(1,333)	75,806
Construction	—	8,010	17	257	799	—	9,083	(1,687)	7,396
Manufacturing	325	21,928	173	1,545	1,606	144	25,721	(3,775)	21,946
Finance leases and instalment credit	—	13,520	49	1	4	—	13,574	—	13,574
Retail, wholesale and repairs	—	21,425	258	1,676	896	41	24,296	(1,785)	22,511
Transport and storage	—	17,822	375	373	3,055	2	21,627	(3,240)	18,387
Health, education and leisure	—	16,685	224	552	891	59	18,411	(964)	17,447
Hotels and restaurants	—	7,820	96	51	493	11	8,471	(348)	8,123
Utilities	—	6,288	398	572	2,929	46	10,233	(2,766)	7,467
Other	23	27,422	1,623	4,926	4,027	109	38,130	(2,402)	35,728
Total third party	104,487	469,483	136,814	13,984	437,901	80,241	1,242,910	(467,555)	775,355
Amounts due from holding company and fellow subsidiaries	—	23,741	179	—	7,200	—	31,120	—	31,120
Total gross of provisions	104,487	493,224	136,993	13,984	445,101	80,241	1,274,030	(467,555)	806,475
Provisions	—	(20,807)	(408)	(112)	—	—	(21,327)	n/a	(21,327)
Total excluding disposal groups	104,487	472,417	136,585	13,872	445,101	80,241	1,252,703	(467,555)	785,148
Disposal groups	—	283	—	5	3	13	304	—	304
Total including disposal groups	104,487	472,700	136,585	13,877	445,104	80,254	1,253,007	(467,555)	785,452

2014	Bank								Exposure post offset £m
	Reverse repos £m	Lending £m	Securities		Derivatives £m	Other financial assets £m	Balance sheet value £m	Offset (1) £m	
			Debt £m	Equity £m					
Central and government	—	6,957	53,322	—	4,829	14	65,122	(4,013)	61,109
Financial institutions - banks	14,821	15,281	4,018	371	239,331	70,952	344,774	(247,475)	97,299
- other (2)	31,650	31,535	11,827	1,121	92,143	2,809	171,085	(107,580)	63,505
Personal - mortgages	—	32,817	—	—	—	—	32,817	—	32,817
- unsecured	—	3,811	—	—	—	—	3,811	(3)	3,808
Property	—	19,928	164	70	1,973	3	22,138	(595)	21,543
Construction	—	2,476	9	53	363	—	2,901	(150)	2,751
Manufacturing	265	9,798	517	1,599	2,104	37	14,320	(1,525)	12,795
Finance leases and instalment credit	—	134	10	—	26	—	170	(1)	169
Retail, wholesale and repairs	—	6,523	217	438	689	10	7,877	(781)	7,096
Transport and storage	—	10,623	189	52	2,095	—	12,959	(813)	12,146
Health, education and leisure	—	5,492	45	25	481	—	6,043	(157)	5,886
Hotels and restaurants	—	2,644	4	17	135	—	2,800	(56)	2,744
Utilities	—	3,793	230	127	4,245	—	8,395	(951)	7,444
Other	30	11,529	447	1,030	2,143	—	15,179	(1,348)	13,831
Total third party	46,766	163,341	70,999	4,903	350,557	73,825	710,391	(365,448)	344,943
Amounts due from holding company and fellow subsidiaries	—	66,035	16,696	—	9,268	508	92,507	(4,998)	87,509
Total gross of provisions	46,766	229,376	87,695	4,903	359,825	74,333	802,898	(370,446)	432,452
Provisions	—	(3,464)	(101)	(23)	—	—	(3,588)	n/a	(3,588)
Total including provisions	46,766	225,912	87,594	4,880	359,825	74,333	799,310	(370,446)	428,864

For the notes to these tables refer to the following page.

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	Reverse repos		Securities		Bank	Other	Balance		Exposure
	£m	£m	Debt £m	Equity £m	Derivatives £m	financial assets £m	sheet value £m	Offset (1) £m	post offset £m
2013									
Central and government	—	6,110	47,879	—	3,986	128	58,103	(3,191)	54,912
Financial institutions - banks	19,111	17,609	3,655	495	198,813	75,792	315,475	(206,495)	108,980
- other (2)	24,159	27,754	12,699	1,635	68,781	3,010	138,038	(83,941)	54,097
Personal - mortgages	—	35,925	—	—	—	—	35,925	—	35,925
- unsecured	—	4,326	—	—	—	—	4,326	(3)	4,323
Property	—	25,971	374	207	2,422	—	28,974	(422)	28,552
Construction	—	2,804	22	104	440	—	3,370	(272)	3,098
Manufacturing	466	10,462	347	2,152	1,153	24	14,604	(1,728)	12,876
Finance leases and instalment credit	—	186	6	4	13	—	209	(3)	206
Retail, wholesale and repairs	—	6,031	157	438	754	—	7,380	(603)	6,777
Transport and storage	—	13,160	223	64	2,055	—	15,502	(639)	14,863
Health, education and leisure	—	5,945	39	83	477	—	6,544	(248)	6,296
Hotels and restaurants	—	2,846	1	50	176	—	3,073	(81)	2,992
Utilities	—	3,435	138	282	3,113	23	6,991	(774)	6,217
Other	26	11,997	84	1,810	1,730	17	15,664	(1,398)	14,266
Total third-party	43,762	174,561	65,624	7,324	283,913	78,994	654,178	(299,798)	354,380
Amounts due from holding company and fellow subsidiaries	—	91,055	26,843	—	8,967	290	127,155	(3,870)	123,285
Total gross of provisions	43,762	265,616	92,467	7,324	292,880	79,284	781,333	(303,668)	477,665
Provisions	—	(6,236)	(140)	(23)	—	—	(6,399)	n/a	(6,399)
Total including provisions	43,762	259,380	92,327	7,301	292,880	79,284	774,934	(303,668)	471,266
2012									
Central and government	441	7,317	66,740	—	5,723	89	80,310	(4,498)	75,812
Financial institutions - banks	25,594	18,414	4,710	1,151	334,278	70,374	454,521	(340,372)	114,149
- other (2)	42,210	30,452	16,343	2,555	78,317	2,700	172,577	(100,162)	72,415
Personal - mortgages	—	39,299	—	—	—	—	39,299	—	39,299
- unsecured	—	4,706	—	—	—	—	4,706	(5)	4,701
Property	—	31,905	315	235	3,375	—	35,830	(514)	35,316
Construction	—	4,009	14	256	782	—	5,061	(608)	4,453
Manufacturing	325	11,006	19	1,530	1,529	95	14,504	(2,327)	12,177
Finance leases and instalment credit	—	278	49	—	4	—	331	—	331
Retail, wholesale and repairs	—	7,476	200	1,675	805	40	10,196	(558)	9,638
Transport and storage	—	14,061	220	373	3,017	2	17,673	(2,836)	14,837
Health, education and leisure	—	6,575	56	552	609	28	7,820	(264)	7,556
Hotels and restaurants	—	3,196	73	51	421	11	3,752	(223)	3,529
Utilities	—	4,496	295	556	2,838	39	8,224	(2,231)	5,993
Other	19	13,828	523	3,855	3,187	86	21,498	(1,790)	19,708
Total third party	68,589	197,018	89,557	12,789	434,885	73,464	876,302	(456,388)	419,914
Amounts due from holding company and fellow subsidiaries	—	121,139	33,297	—	14,953	—	169,389	—	169,389
Total gross of provisions	68,589	318,157	122,854	12,789	449,838	73,464	1,045,691	(456,388)	589,303
Provisions	—	(5,626)	(407)	(23)	—	—	(6,056)	n/a	(6,056)
Total including provisions	68,589	312,531	122,447	12,766	449,838	73,464	1,039,635	(456,388)	583,247

Notes:

- (1) This shows the amount by which the Group's credit risk exposure is reduced through arrangements, such as master netting agreements and cash management pooling, which give the Group a legal right to set off the financial asset against a financial liability due to the same counterparty. In addition, the Group holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade 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.
- (2) Includes loans made by the Group's consolidated conduits to asset owning companies.

Balance sheet analysis continued

For geographic concentrations refer to:

- Lending: Loans and related credit metrics
- Debt securities: IFRS measurement and issue and Country risk
- Equity shares

Key points

- Overall exposure before impairment provision post offset fell by £112.7 billion or 16.1% in 2014 to £588 billion. This was in line with the Group's continued focus on reducing exposure concentrations, running down assets in RCR and winding down certain portfolios in CIB.
- Mortgage lending fell by £18.4 billion primarily reflecting the transfer to disposal groups of £21.2 billion and by £1.5 billion in Ulster Bank where repayments outstripped new lending offset by a £3.9 billion increase in UK PBB. CFG which is included in disposal groups in 2014 also saw an increase reflecting portfolio acquisition as well as through foreign currency movements
- Property and construction exposure fell by £17.3 billion, £9.3 billion of which was in commercial real estate lending.
- There has been a significant increase in CFG which is included in disposal groups in 2014 lending across a broad range of industry sectors reflecting in line with business strategy and risk appetite

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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's 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 table and are set out on page 123 to 126.

The following table details, for illustrative purposes only, the relationship between the Group's master grading scale and AQ bands, on the one hand, and external ratings published by S&P, on the other hand. 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.

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%	A- 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 shown above and in the following tables 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 issuers.

	Group														
	Loans and advances										Settlement				
	Cash and balances at central banks	Banks (1)				Customers				assets	Derivatives	Commitments	Contingent liabilities	Total	Total %
	£m	Reverse repos £m	Derivative cash collateral £m	Bank loans £m	Total £m	Reverse repos £m	Derivative cash collateral £m	Customer loans £m	Total £m	£m	£m	£m	£m	£m	%
2014															
AQ1	72,592	2,479	3,683	3,556	9,718	27,007	12,436	25,873	65,316	1,610	65,520	52,862	4,779	272,397	25.0
AQ2	—	4,143	4,564	598	9,305	400	1,601	16,332	18,333	146	100,032	17,438	2,184	147,438	13.5
AQ3	1,296	2,538	1,240	2,649	6,427	8,664	4,262	24,366	37,292	459	123,791	29,665	2,744	201,674	18.5
AQ4	90	8,336	1,391	2,563	12,290	5,124	2,798	103,817	111,739	852	48,757	55,815	5,521	235,064	21.6
AQ5	—	2,076	225	529	2,830	1,902	520	58,517	60,939	438	10,490	35,507	2,438	112,642	10.3
AQ6	—	636	58	88	782	42	45	34,373	34,460	43	986	13,260	1,174	50,705	4.7
AQ7	—	500	90	238	828	848	34	22,134	23,016	26	1,104	6,966	909	32,849	3.0
AQ8	5	—	1	40	41	—	6	5,508	5,514	12	510	839	149	7,070	0.6
AQ9	—	—	6	30	36	—	9	4,282	4,291	—	171	404	241	5,143	0.5
AQ10	—	—	—	—	—	—	—	979	979	31	483	1,120	55	2,668	0.2
Balances with holding company and fellow subsidiaries	—	—	—	2,333	2,333	—	—	1,323	1,323	44	2,738	76	721	7,235	0.7
Past due	—	—	—	—	—	—	—	6,060	6,060	1,049	—	—	—	7,109	0.7
Impaired	—	—	—	42	42	—	—	25,040	25,040	—	—	—	—	25,082	2.3
Impairment provision	—	—	—	(40)	(40)	—	—	(17,364)	(17,364)	—	—	—	—	(17,404)	(1.6)
Total excluding disposal groups	73,983	20,708	11,258	12,626	44,592	43,987	21,711	311,240	376,938	4,710	354,582	213,952	20,915	1,089,672	100
Disposal groups	622	—	—	1,745	1,745	—	—	59,606	59,606	—	402	—	—	62,375	—
Total including disposal groups	74,605	20,708	11,258	14,371	46,337	43,987	21,711	370,846	436,544	4,710	354,984	213,952	20,915	1,152,047	100

For the note to this table refer to page 122.

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Balance sheet analysis continued

	Group														
	Cash and balances at central banks £m	Loans and advances								Settlement balances and other financial assets £m	Derivatives £m	Commitments £m	Contingent liabilities £m	Total £m	Total %
		Banks (1)				Customers									
2013		Reverse repos £m	Derivative cash collateral £m	Bank loans £m	Total £m	Reverse repos £m	Derivative cash collateral £m	Customer loans £m	Total £m						
AQ1	77,876	5,881	1,948	5,456	13,285	30,233	9,942	33,644	73,819	2,707	71,008	64,299	6,545	309,539	27.7
AQ2	1	4,743	4,830	527	10,100	996	1,899	17,471	20,366	192	69,817	28,695	2,888	132,059	11.8
AQ3	1,648	2,121	1,141	2,157	5,419	1,857	3,711	28,789	34,357	745	94,133	22,865	3,498	162,665	14.6
AQ4	465	9,798	1,384	6,161	17,343	10,642	1,845	98,008	110,495	460	38,318	40,564	3,988	211,633	18.9
AQ5	—	1,774	368	538	2,680	5,403	271	76,476	82,150	717	8,807	33,380	1,908	129,642	11.6
AQ6	—	1,821	1	152	1,974	82	38	38,760	38,880	59	1,480	14,114	1,405	57,912	5.2
AQ7	—	301	—	237	538	684	40	30,125	30,849	22	973	7,428	729	40,539	3.6
AQ8	3	—	—	45	45	—	10	8,383	8,393	58	132	1,170	100	9,901	0.9
AQ9	—	—	—	34	34	—	41	16,488	16,529	—	636	1,010	298	18,507	1.7
AQ10	—	—	—	—	—	—	—	721	721	—	686	1,236	137	2,780	0.2
Balances with holding company and fellow subsidiaries	—	—	—	15,058	15,058	—	—	1,620	1,620	54	3,413	34	797	20,976	1.9
Past due	—	—	—	—	—	—	—	9,068	9,068	620	—	—	—	9,688	0.9
Impaired	—	—	—	69	69	—	—	36,836	36,836	—	—	—	—	36,905	3.3
Impairment provision	—	—	—	(62)	(62)	—	—	(24,983)	(24,983)	—	—	—	—	(25,045)	(2.3)
Total excluding disposal groups	79,993	26,439	9,672	30,372	66,483	49,897	17,797	371,406	439,100	5,634	289,403	214,795	22,293	1,117,701	100
Disposal groups	—	—	—	15	15	—	—	689	689	—	1	—	—	705	—
Total including disposal groups	79,993	26,439	9,672	30,387	66,498	49,897	17,797	372,095	439,789	5,634	289,404	214,795	22,293	1,118,406	100
2012															
AQ1	73,643	17,600	3,107	7,551	28,258	42,963	14,822	38,389	96,174	1,911	100,028	62,501	6,295	368,810	27.5
AQ2	12	3,556	4,351	494	8,401	710	704	12,804	14,218	185	108,092	19,260	2,455	152,623	11.4
AQ3	839	5,703	2,144	2,588	10,435	2,886	3,801	23,268	29,955	539	152,300	22,855	3,318	220,241	16.4
AQ4	29	6,120	1,509	2,333	9,962	14,079	2,111	102,129	118,319	1,202	56,917	39,589	5,119	231,137	17.2
AQ5	—	1,183	403	632	2,218	8,163	657	90,532	99,352	614	12,909	28,049	2,469	145,611	10.9
AQ6	—	282	39	356	677	86	50	39,359	39,495	72	2,165	13,762	1,271	57,442	4.3
AQ7	—	—	—	113	113	1,133	12	36,017	37,162	191	3,193	18,790	856	60,305	4.5
AQ8	—	—	—	28	28	—	2	12,653	12,655	8	237	5,652	179	18,759	1.4
AQ9	1	—	—	80	80	23	7	17,261	17,291	—	1,357	1,340	74	20,143	1.5
AQ10	—	—	—	—	—	—	—	760	760	—	703	1,402	236	3,101	0.2
Balances with holding company and fellow subsidiaries	—	—	—	21,875	21,875	—	—	1,866	1,866	—	7,200	538	2,901	34,380	2.6
Past due	—	—	—	—	—	—	249	10,281	10,530	995	—	—	—	11,525	0.9
Impaired	—	—	—	133	133	—	—	37,754	37,754	—	—	—	—	37,887	2.8
Impairment provision	—	—	—	(113)	(113)	—	—	(20,694)	(20,694)	—	—	—	—	(20,807)	(1.6)
Total excluding disposal groups	74,524	34,444	11,553	36,070	82,067	70,043	22,415	402,379	494,837	5,717	445,101	213,738	25,173	1,341,157	100
Disposal groups	—	—	—	20	20	—	—	263	263	—	3	—	—	286	—
Total including disposal groups	74,524	34,444	11,553	36,090	82,087	70,043	22,415	402,642	495,100	5,717	445,104	213,738	25,173	1,341,443	100

For the note to these tables refer to page 122.

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	Bank														
	Loans and advances										Settlement				
	Banks (1)					Customers					balances and other financial				
	Cash and balances at central banks £m	Reverse repos £m	Derivative cash collateral £m	Bank loans £m	Total £m	Reverse repos £m	Derivative cash collateral £m	Customer loans £m	Total £m	assets £m	Derivatives £m	Commitments £m	Contingent liabilities £m	Total £m	Total %
2014															
AQ1	69,790	441	3,275	1,179	4,895	22,717	12,436	9,652	44,805	695	65,082	32,724	4,412	222,403	26.2
AQ2	—	3,949	4,564	367	8,880	400	1,601	8,246	10,247	97	99,921	13,048	1,928	134,121	15.8
AQ3	1,079	1,563	1,234	648	3,445	2,000	4,262	11,426	17,688	363	123,726	23,303	2,332	171,936	20.2
AQ4	78	5,960	1,391	1,612	8,963	4,670	2,798	38,963	46,431	596	48,584	32,333	4,020	141,005	16.6
AQ5	—	1,772	225	331	2,328	1,274	520	25,395	27,189	330	10,337	15,270	1,386	56,840	6.7
AQ6	—	636	58	27	721	42	45	12,194	12,281	28	900	4,178	609	18,717	2.2
AQ7	—	500	90	175	765	842	34	9,355	10,231	26	926	2,321	493	14,762	1.7
AQ8	5	—	1	29	30	—	6	1,888	1,894	4	496	220	34	2,683	0.3
AQ9	—	—	6	27	33	—	9	541	550	—	168	247	192	1,190	0.1
AQ10	—	—	—	—	—	—	—	335	335	4	417	372	27	1,155	0.1
Balances with holding company and subsidiaries	—	—	—	24,839	24,839	—	—	41,196	41,196	467	9,268	4,177	721	80,668	9.5
Past due	—	—	—	—	—	—	—	1,933	1,933	771	—	—	—	2,704	0.3
Impaired	—	—	—	42	42	—	—	6,135	6,135	—	—	—	—	6,177	0.7
Impairment provision	—	—	—	(40)	(40)	—	—	(3,138)	(3,138)	—	—	—	—	(3,178)	(0.4)
Total	70,952	14,821	10,844	29,236	54,901	31,945	21,711	164,121	217,777	3,381	359,825	128,193	16,154	851,183	100
2013															
AQ1	74,071	1,935	1,326	2,245	5,506	12,464	9,942	12,537	34,943	1,285	70,456	49,213	5,839	241,313	29.2
AQ2	—	4,742	4,830	438	10,010	716	1,899	8,328	10,943	88	69,700	19,079	2,295	112,115	13.6
AQ3	1,530	2,121	1,141	709	3,971	1,464	3,711	12,747	17,922	588	94,084	17,587	2,673	138,355	16.8
AQ4	188	6,703	1,384	4,431	12,518	7,086	1,845	32,124	41,055	352	37,955	20,713	2,775	115,556	14.0
AQ5	—	1,719	368	410	2,497	2,188	271	29,686	32,145	490	8,421	12,390	897	56,840	6.9
AQ6	—	1,821	1	56	1,878	59	38	12,565	12,662	—	1,265	4,554	664	21,023	2.6
AQ7	—	70	—	177	247	674	40	9,624	10,338	22	793	2,758	335	14,493	1.8
AQ8	3	—	—	7	7	—	10	3,062	3,072	46	65	250	16	3,459	0.4
AQ9	—	—	—	17	17	—	41	4,930	4,971	—	560	330	156	6,034	0.7
AQ10	—	—	—	—	—	—	—	297	297	—	614	607	126	1,644	0.2
Balances with holding company and subsidiaries	—	—	—	41,110	41,110	—	—	49,945	49,945	290	8,967	5,046	797	106,155	12.9
Past due	—	—	—	—	—	—	—	1,902	1,902	331	—	—	—	2,233	0.3
Impaired	—	—	—	69	69	—	—	11,353	11,353	—	—	—	—	11,422	1.4
Impairment provision	—	—	—	(62)	(62)	—	—	(6,174)	(6,174)	—	—	—	—	(6,236)	(0.8)
Total excluding disposal groups	75,792	19,111	9,050	49,607	77,768	24,651	17,797	182,926	225,374	3,492	292,880	132,527	16,573	824,406	100
Disposal groups	—	—	—	—	—	—	—	37	37	—	—	—	—	37	—
Total including disposal groups	75,792	19,111	9,050	49,607	77,768	24,651	17,797	182,963	225,411	3,492	292,880	132,527	16,573	824,443	100

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

Financial review Capital and risk management

Balance sheet analysis continued

2012	Bank														
	Loans and advances										Settlement balances and other financial assets £m				
	Banks (1)					Customers									
	Cash and balances at central banks £m	Reverse repos £m	Derivative cash collateral £m	Bank loans £m	Total £m	Reverse repos £m	Derivative cash collateral £m	Customer loans £m	Total £m	Derivatives £m					
AQ1	69,498	9,956	3,107	3,619	16,682	27,334	14,822	16,072	58,228	979	99,307	50,040	5,585	300,319	28.2
AQ2	12	3,556	4,351	466	8,373	700	704	6,542	7,946	4	107,908	16,396	2,255	142,894	13.5
AQ3	836	4,676	2,142	928	7,746	2,221	3,801	12,202	18,224	536	152,178	18,143	2,793	200,456	18.9
AQ4	28	5,941	1,503	874	8,318	8,696	2,111	34,550	45,357	918	56,644	20,557	3,285	135,107	12.7
AQ5	—	1,183	403	503	2,089	2,919	657	37,358	40,934	243	12,243	11,044	1,249	67,802	6.4
AQ6	—	282	39	252	573	13	50	13,685	13,748	63	1,800	3,934	593	20,711	2.0
AQ7	—	—	—	57	57	1,089	12	12,323	13,424	173	2,943	7,956	496	25,049	2.4
AQ8	—	—	—	8	8	—	2	4,149	4,151	—	76	2,027	63	6,325	0.6
AQ9	—	—	—	35	35	23	7	4,545	4,575	—	1,162	541	20	6,333	0.6
AQ10	—	—	—	—	—	—	—	413	413	—	624	771	131	1,939	0.2
Balances with holding company and subsidiaries	—	—	—	65,671	65,671	—	—	55,468	55,468	—	14,953	5,515	2,901	144,508	13.6
Past due	—	—	—	—	—	—	249	2,030	2,279	174	—	—	—	2,453	0.2
Impaired	—	—	—	127	127	—	—	12,320	12,320	—	—	—	—	12,447	1.2
Impairment provision	—	—	—	(108)	(108)	—	—	(5,518)	(5,518)	—	—	—	—	(5,626)	(0.5)
Total	70,374	25,594	11,545	72,432	109,571	42,995	22,415	206,139	271,549	3,090	449,838	136,924	19,371	1,060,717	100

Note:

(1) Excluding items in the course of collection from other banks of £237 million (2013 - £349 million; 2012 - £303 million).

Financial review Capital and risk management

Debt securities

Issuer and IFRS measurement classification

The table below analyses debt securities by issuer and IFRS measurement classifications and includes disposal groups. 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).

	Central and local government			Other financial institutions		Corporate	Total	Of which ABS
	UK £m	US £m	Other £m	Banks £m	£m	£m	£m	£m
2014								
Held-for-trading (HFT)	6,218	7,709	24,448	1,391	7,383	1,979	49,128	3,559
Designated as at fair value	—	—	—	—	1	—	1	—
Available-for-sale	4,747	11,011	9,472	3,276	14,281	46	42,833	18,763
Loans and receivables	—	—	—	179	2,751	138	3,068	2,714
Held to Maturity	4,537	—	—	—	—	—	4,537	—
Long positions	15,502	18,720	33,920	4,846	24,416	2,163	99,567	25,036
Of which US agencies	—	6,222	—	—	10,860	—	17,082	16,053
Short positions (HFT)	(4,167)	(6,413)	(10,276)	(557)	(673)	(730)	(22,816)	—
Available-for-sale								
Gross unrealised gains	451	210	300	8	337	6	1,312	389
Gross unrealised losses	(1)	(117)	(1)	—	(81)	(2)	(202)	(193)
2013								
Held-for-trading	6,764	10,945	22,557	1,608	12,407	1,977	56,258	10,674
Designated as at fair value	—	—	—	—	14	—	14	14
Available-for-sale	6,436	11,456	6,824	2,531	13,290	145	40,682	16,976
Loans and receivables	10	1	—	169	3,426	136	3,742	3,423
Long positions	13,210	22,402	29,381	4,308	29,137	2,258	100,696	31,087
Of which US agencies	—	5,599	—	—	13,132	—	18,731	18,048
Short positions (HFT)	(1,784)	(6,790)	(16,087)	(888)	(1,373)	(826)	(27,748)	(36)
Available-for-sale								
Gross unrealised gains	201	272	106	2	333	9	923	361
Gross unrealised losses	(69)	(86)	(25)	(1)	(196)	(1)	(378)	(252)
2012								
Held-for-trading	7,692	17,303	26,344	2,036	21,722	1,933	77,030	18,619
Designated as at fair value	—	—	—	86	610	1	697	516
Available-for-sale	7,950	17,514	10,083	2,933	15,967	114	54,561	18,953
Loans and receivables	5	—	—	327	3,683	282	4,297	3,663
Long positions	15,647	34,817	36,427	5,382	41,982	2,330	136,585	41,751
Of which US agencies	—	5,380	—	—	21,566	—	26,946	24,847
Short positions (HFT)	(1,538)	(10,658)	(11,333)	(1,035)	(1,578)	(798)	(26,940)	(17)
Available-for-sale								
Gross unrealised gains	944	861	579	17	582	8	2,991	647
Gross unrealised losses	—	(1)	—	(1)	(122)	—	(124)	(124)

Key points

- **HFT** - Holdings of US government and ABS (primarily in the US) decreased reflecting sales and continued focus on balance sheet reduction and capital management in CIB. The increase in other government bonds reflected higher activity and timing of auctions. There was an increase in German, French and Austrian government bonds, partially offset by reductions in Italian, Spanish and Japanese bonds. The decrease in short positions reflects positions settled due to increased prices resulting from low yields due to economic volatility in the eurozone.
- **AFS** - The 2.6 billion increase in other government bonds mainly reflects the investment in French and German government bonds by Ulster Bank for liquidity purposes.

Financial review Capital and risk management

Balance sheet analysis continued

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			Group			Total £m	Total (1) %	Of which ABS £m
	UK £m	US £m	Other £m	Banks £m	Other financial institutions £m	Corporate £m			
2014									
AAA	—	6	15,495	1,319	6,085	64	22,969	23	4,762
AA to AA+	15,502	18,714	9,520	282	12,145	118	56,281	57	16,956
A to AA-	—	—	4,413	2,542	2,414	340	9,709	10	568
BBB- to A-	—	—	4,120	282	1,186	672	6,260	6	853
Non-investment grade	—	—	275	51	1,148	603	2,077	2	1,060
Unrated	—	—	97	370	1,438	366	2,276	2	837
	15,502	18,720	33,920	4,846	24,416	2,163	99,567	100	25,036
Issued by holding company and fellow subsidiaries	—	—	—	6	17	3	26		—
	15,502	18,720	33,920	4,852	24,433	2,166	99,593		25,036
2013									
AAA	—	18	13,026	1,327	7,245	149	21,765	22	5,783
AA to AA+	13,210	22,382	6,600	300	15,311	110	57,913	58	19,431
A to AA-	—	—	3,339	1,564	1,256	282	6,441	6	1,160
BBB- to A-	—	—	6,113	820	1,501	855	9,289	9	1,044
Non-investment grade	—	—	297	165	2,212	427	3,101	3	2,215
Unrated	—	2	6	72	1,610	396	2,086	2	1,454
	13,210	22,402	29,381	4,248	29,135	2,219	100,595	100	31,087
Issued by holding company and fellow subsidiaries	—	—	—	60	2	39	101		—
	13,210	22,402	29,381	4,308	29,137	2,258	100,696		31,087
2012									
AAA	15,647	31	15,988	1,645	7,843	17	41,171	30	7,390
AA to AA+	—	34,785	5,951	344	25,054	234	66,368	49	27,059
A to AA-	—	—	9,997	2,103	2,792	153	15,045	11	2,242
BBB- to A-	—	—	4,046	882	1,677	1,002	7,607	6	1,582
Non-investment grade	—	—	443	95	3,077	603	4,218	3	2,391
Unrated	—	1	2	134	1,539	321	1,997	1	1,087
	15,647	34,817	36,427	5,203	41,982	2,330	136,406	100	41,751
Issued by holding company and fellow subsidiaries	—	—	—	179	—	—	179		—
	15,647	34,817	36,427	5,382	41,982	2,330	136,585		41,751

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

Financial review Capital and risk management

	Central and local government			Bank			Total £m	Total (1) %	Of which ABS £m
	UK £m	US £m	Other £m	Banks £m	Other financial institutions £m	Corporate £m			
2014									
AAA	—	—	13,667	1,075	4,985	65	19,792	28	3,655
AA to AA+	15,382	6,353	9,170	244	1,237	107	32,493	46	980
A to AA-	—	—	4,300	2,025	2,376	307	9,008	13	544
BBB- to A-	—	—	4,078	261	1,129	311	5,779	8	838
Non-investment grade	—	—	275	43	699	593	1,610	2	634
Unrated	—	—	97	370	1,401	348	2,216	3	800
	15,382	6,353	31,587	4,018	11,827	1,731	70,898	100	7,451
Issued by holding company and fellow subsidiaries	—	—	—	—	16,696	—	16,696		16,049
	15,382	6,353	31,587	4,018	28,523	1,731	87,594		23,500
2013									
AAA	—	12	12,822	1,153	6,039	139	20,165	31	4,656
AA to AA+	13,206	7,938	6,590	279	1,926	101	30,040	46	1,227
A to AA-	—	—	1,056	1,510	781	158	3,505	5	768
BBB- to A-	—	—	5,950	484	1,264	256	7,954	12	881
Non-investment grade	—	—	297	161	1,170	294	1,922	3	1,183
Unrated	—	2	6	68	1,519	303	1,898	3	1,372
	13,206	7,952	26,721	3,655	12,699	1,251	65,484	100	10,087
Issued by holding company and fellow subsidiaries	—	—	—	9	26,795	39	26,843		26,137
	13,206	7,952	26,721	3,664	39,494	1,290	92,327		36,224
2012									
AAA	15,642	24	15,690	1,501	7,100	12	39,969	45	6,586
AA to AA+	—	18,138	5,950	344	3,203	213	27,848	31	2,029
A to AA-	—	—	7,091	2,012	1,658	68	10,829	12	1,317
BBB- to A-	—	—	3,767	644	1,380	451	6,242	7	1,335
Non-investment grade	—	—	435	90	1,777	395	2,697	3	1,123
Unrated	—	1	2	119	1,225	218	1,565	2	805
	15,642	18,163	32,935	4,710	16,343	1,357	89,150	100	13,195
Issued by holding company and fellow subsidiaries	—	—	—	147	33,150	—	33,297		32,486
	15,642	18,163	32,935	4,857	49,493	1,357	122,447		45,681

Note:
(1) Percentage calculated before balances with Group companies.

Financial review Capital and risk management

Balance sheet analysis continued

Asset-backed securities

The table below summarises the ratings of asset-backed securities on the balance sheet.

	RMBS (1)				CMBS (1) £m	CDOs £m	CLOs £m	Other ABS £m	Total £m
	Government sponsored or similar (2) £m	Prime £m	Non- conforming £m	Sub-prime £m					
2014									
AAA	—	2,417	775	14	30	29	4	1,493	4,762
AA to AA+	12,906	5	657	17	3,154	6	72	139	16,956
A to AA-	—	83	27	3	41	6	11	397	568
BBB- to A-	—	92	137	12	18	4	59	531	853
Non-investment grade (3)	—	211	261	135	65	240	52	96	1,060
Unrated (3)	—	22	—	24	474	9	31	277	837
	12,906	2,830	1,857	205	3,782	294	229	2,933	25,036
2013									
AAA	3	2,974	790	24	165	66	313	1,448	5,783
AA to AA+	14,867	192	634	28	3,224	—	308	178	19,431
A to AA-	—	151	227	34	60	60	167	461	1,160
BBB- to A-	—	126	162	95	102	25	88	446	1,044
Non-investment grade (3)	—	559	369	492	160	258	144	233	2,215
Unrated (3)	—	100	16	225	498	21	118	476	1,454
	14,870	4,102	2,198	898	4,209	430	1,138	3,242	31,087
2012									
AAA	18	2,853	1,487	11	396	92	1,181	1,352	7,390
AA to AA+	22,460	613	88	26	2,541	7	887	437	27,059
A to AA-	—	299	275	33	799	74	146	616	2,242
BBB- to A-	—	41	141	86	441	32	217	624	1,582
Non-investment grade (3)	—	638	454	330	301	299	133	236	2,391
Unrated (3)	—	107	8	297	23	95	389	168	1,087
	22,478	4,551	2,453	783	4,501	599	2,953	3,433	41,751

Notes:

(1) Residential mortgage-backed securities; Commercial mortgage-backed securities.

(2) Includes US agency and Dutch government guaranteed securities.

(3) Includes held-for-trading.

Financial review Capital and risk management

Equity shares

The table below analyses holdings of equity shares for eurozone countries and other countries with balances of more than £100 million by country, issuer and measurement classification. The HFT positions in CIB, primarily in run-off and recovery businesses, are used mainly for economic hedging of debt issuances and equity derivatives. The AFS portfolios include capital stock in the Federal Home Loan Bank (a government sponsored entity, included in other financial institutions) and the Federal Reserve Bank, which together amounted to £0.6 billion (2013 - £0.6 billion; 2012 - £0.7 billion) that CFG are required to hold. The remaining AFS balances are individually small holdings in unlisted companies, mainly acquired through debt for equity transactions in Restructuring.

Countries	2014										
	HFT				HFT short positions	AFS/DFV (1)				Total	AFS reserves
	Banks	Other financial institutions (2)	Corporate	Total HFT		Banks	Other financial institutions (2)	Corporate	AFS/DFV		
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Spain	—	—	19	19	—	—	—	1	1	20	—
Ireland	—	20	16	36	—	—	6	20	26	62	—
Italy	—	—	3	3	—	—	5	4	9	12	—
Portugal	—	—	1	1	—	—	—	—	—	1	—
Eurozone periphery	—	20	39	59	—	—	11	25	36	95	—
Luxembourg	—	133	5	138	—	—	—	—	—	138	—
Other	3	43	88	134	(15)	5	—	3	8	142	(4)
Total eurozone	3	196	132	331	(15)	5	11	28	44	375	(4)
US	1	159	123	283	—	—	63	—	63	346	17
UK	287	389	1,458	2,134	—	—	160	137	297	2,431	49
Japan	4	161	1,509	1,674	—	—	1	—	1	1,675	—
Australia	39	34	36	109	—	—	—	—	—	109	—
Other	33	33	127	193	(197)	—	46	28	74	267	37
Total excluding disposal groups	367	972	3,385	4,724	(212)	5	281	193	479	5,203	99
Disposal groups	—	—	—	—	—	305	263	4	572	572	(2)
Total including disposal groups	367	972	3,385	4,724	(212)	310	544	197	1,051	5,775	97
2013	488	1,515	4,980	6,983	(256)	173	670	452	1,295	8,278	140
2012	1,127	1,707	9,477	12,311	(601)	342	542	682	1,566	13,877	55

Notes:

(1) Designated as at fair value through profit or loss balances are £239 million (2013 - £312 million; 2012 - £484 million), of which £69 million are other financial institutions (2013 - £66 million; 2012 - £13 million) and £170 million are corporate (2013 - £246 million; 2012 - £471 million).

(2) Includes government sponsored entities.

Derivatives

Summary

The table below analyses the fair value of the Group's derivatives by type of contract. Master netting arrangements in respect of mark-to-market (mtm) positions and collateral shown below do not result in a net presentation in the Group's balance sheet under IFRS.

	2014			2013			2012		
	Notional £bn	Assets £m	Liabilities £m	Notional £bn	Assets £m	Liabilities £m	Notional £bn	Assets £m	Liabilities £m
Interest rate (1)	27,302	268,482	259,518	35,571	216,574	207,583	33,368	360,928	343,328
Exchange rate	4,642	78,407	83,279	4,529	61,389	64,993	4,637	61,707	69,102
Credit	124	2,238	2,609	252	5,241	5,375	551	10,918	10,290
Equity and commodity	78	3,119	3,516	80	2,787	5,597	112	4,348	7,785
		352,246	348,922		285,991	283,548		437,901	430,505
Counterparty mark-to-market netting		(295,177)	(295,177)		(240,895)	(240,895)		(374,190)	(374,190)
Cash collateral		(32,629)	(30,016)		(23,667)	(24,508)		(33,558)	(30,297)
Securities collateral		(7,005)	(14,433)		(5,990)	(8,257)		(5,620)	(11,702)
Net exposure		17,435	9,296		15,439	9,888		24,533	14,316
Balances with Group companies	43	2,738	2,005	56	3,413	2,586	134	7,200	5,580

Note:

(1) Interest rate notional includes £18,451 billion (2013 - £22,563 billion; 2012 - £15,863 billion) relating to contracts with central clearing houses.

Financial review Capital and risk management

Balance sheet analysis continued

Credit derivatives

The Group trades credit derivatives to meet client needs and to mitigate its own credit risk. Credit derivative exposures relating to proprietary trading are minimal. The table below analyses bought and sold protection.

Group	2014				2013				2012			
	Notional		Fair value		Notional		Fair value		Notional		Fair value	
	Bought £bn	Sold £bn	Bought £bn	Sold £bn	Bought £bn	Sold £bn	Bought £bn	Sold £bn	Bought £bn	Sold £bn	Bought £bn	Sold £bn
Client-led trading/residual risk (1)	52.0	49.9	0.9	1.4	124.4	111.7	1.2	1.5	250.5	240.4	3.4	3.2
Credit hedging - banking book (2)	1.8	—	0.1	—	2.3	0.2	0.2	—	5.4	0.4	0.1	—
Credit hedging - trading book												
- rates	13.8	5.8	0.2	0.3	5.1	4.0	0.1	0.1	9.4	5.8	0.1	0.1
- credit and mortgage markets	0.4	—	0.2	—	2.2	1.4	0.5	0.3	21.6	15.6	0.9	0.6
- other	0.4	—	—	—	0.8	0.1	—	—	1.2	0.4	—	—
	68.4	55.7	1.4	1.7	134.8	117.4	2.0	1.9	288.1	262.6	4.5	3.9

	2014		2013		2012	
	Notional £bn	Net exposure £bn	Notional £bn	Net exposure £bn	Notional £bn	Net exposure £bn
Of which:						
Monoline insurers (3)	0.1	—	1.4	0.1	4.2	0.3
CDPCs (3)	15.2	—	18.9	0.1	21	0.2

Notes:

(1) Residual risk relates to legacy positions in RCR in 2014 and in Non-Core in 2013 and 2012.

(2) Credit hedging in the banking book principally relates to portfolio management in RCR and Non-Core.

(3) Credit valuation relating to monoline insurers and credit derivative product companies (CDPCs) were £47 million (2013 - £99 million; 2012 - £506 million).

Key points

- Interest rate contracts: notional balances were £8.3 trillion lower due to increased participation in trade compression cycles in 2014. The fair value increased due to significant downward shifts in major yields following further rate cuts by the European Central Bank, European instability including Germany as well as concerns over falling oil prices. This was partially offset by the impact of strengthening of sterling against the euro and participation in tear ups.
- Foreign exchange contracts: the increase in fair value is driven by the strengthening of the US dollar against the Japanese yen as the portfolio was materially positioned long US dollar and short Japanese yen.
- Credit derivatives: notional and fair value decreased reflecting participation in trade compression cycles and reduction in the US Agency business within CIB. Tightening of credit spreads in Europe and long dated spreads in the US also contributed to decrease in fair values.
- Uncollateralised derivatives predominantly comprise:
 - Corporates: predominantly large corporates with whom the Group may have netting arrangements in place, but operational capability does not support collateral posting. Transactions include foreign exchange hedges and interest rate swaps.
 - Banks: transactions with certain counterparties with whom the Group has netting arrangements but collateral is not posted on a daily basis; certain transactions with specific terms that may not fall within netting and collateral arrangements; derivative positions in certain jurisdictions for example China which are either uncollateralised or the collateral agreements are not deemed to be legally enforceable.
 - Other financial institutions: transactions with securitisation structured purpose entities and funds where collateral posting is contingent on the Group's external rating.
 - Government: sovereigns and supranational entities with one way collateral agreements in their favour.

Financial review Capital and risk management

REIL, provisions and AFS reserves

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 subject 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 reportable segment.

	Group								
	Gross loans to		REIL	Provisions	Credit metrics			Impairment charge/(release)	Amounts written-off
	Banks	Customers			REIL as a % of gross loans to customers	Provisions as a % of REIL	Provisions as a % of gross loans to customers		
	£m	£m	£m	£m	%	%	%	£m	£m
2014									
UK Personal & Business Banking	522	129,848	3,778	2,604	2.9	69	2.0	268	728
Ulster Bank	1,381	24,719	4,775	2,711	19.3	57	11.0	(365)	131
Personal & Business Banking	1,903	154,567	8,553	5,315	5.5	62	3.4	(97)	859
Commercial Banking	486	86,008	2,506	955	2.9	38	1.1	77	436
Private Banking	972	16,572	226	76	1.4	34	0.5	(5)	37
Commercial & Private Banking	1,458	102,580	2,732	1,031	2.7	38	1.0	72	473
Corporate & Institutional Banking	15,883	70,458	166	194	0.2	117	0.3	—	—
Central items	1,992	162	—	—	—	nm	—	(12)	55
Citizens Financial Group	1,728	60,142	1,330	536	2.2	40	0.9	194	300
RCR	372	21,225	15,271	10,864	71.9	71	51.2	(1,289)	3,566
Total third-party	23,336	409,134	28,052	17,940	6.9	64	4.4	(1,132)	5,253
Amounts due from holding company and fellow subsidiaries	2,333	1,323	—	—	—	—	—	—	—
	25,669	410,457	28,052	17,940	6.8	64	4.4	(1,132)	5,253
2013									
UK Personal & Business Banking	716	127,781	4,663	2,957	3.6	63	2.3	497	967
Ulster Bank	591	31,446	8,466	5,378	26.9	64	17.1	1,774	277
Personal & Business Banking	1,307	159,227	13,129	8,335	8.2	63	5.2	2,271	1,244
Commercial Banking	701	85,071	4,276	1,617	5.0	38	1.9	652	587
Private Banking	1,531	16,743	277	120	1.7	43	0.7	29	15
Commercial & Private Banking	2,232	101,814	4,553	1,737	4.5	38	1.7	681	602
Corporate & Institutional Banking	18,884	66,697	1,615	949	2.4	59	1.4	606	338
Central items	1,942	357	—	65	—	nm	18.2	65	—
Citizens Financial Group	406	50,551	1,034	272	2.0	26	0.5	151	284
Non-Core	292	34,618	18,795	13,696	54.3	73	39.6	4,691	1,756
Total third-party	25,063	413,264	39,126	25,054	9.5	64	6.1	8,465	4,224
Amounts due from holding company and fellow subsidiaries	15,058	1,620	—	—	—	—	—	—	—
	40,121	414,884	39,126	25,054	9.4	64	6.0	8,465	4,224
2012									
UK Personal & Business Banking	640	129,193	5,735	3,467	4.4	60	2.7	740	745
Ulster Bank	632	32,652	7,533	3,910	23.1	52	12.0	1,364	72
Personal & Business Banking	1,272	161,845	13,268	7,377	8.2	56	4.6	2,104	817
Commercial Banking	746	85,243	4,007	1,547	4.7	39	1.8	543	357
Private Banking	1,545	17,062	248	109	1.5	44	0.6	46	15
Commercial & Private Banking	2,291	102,305	4,255	1,656	4.2	39	1.6	589	372
Cooperate & Institutional Banking	19,679	76,264	1,031	684	1.4	66	0.9	201	357
Central items	2,021	140	—	—	—	—	—	—	—
Citizens Financial Group	435	51,271	1,146	285	2.2	25	0.6	83	391
Non-Core	164	51,796	20,824	10,805	40.2	52	20.9	2,304	1,950
Total third-party	25,862	443,621	40,524	20,807	9.1	51	4.7	5,281	3,887
Amounts due from holding company and fellow subsidiaries	21,875	1,866	—	—	—	—	—	—	—
	47,737	445,487	40,524	20,807	9.1	51	4.7	5,281	3,887

Balance sheet analysis continued

Key points

- Third party loans to banks decreased by £1.7 billion in the year to £23.3 billion. This reflected RWA focused reduction in trade finance being partially offset by derivative collateral increase, both in CIB, as well as Ulster Bank's increased cash deposits with Central Bank of Ireland ahead of new regulatory liquidity requirements.
- Overall third party customer loans fell by £4.1 billion to £409.1 billion reflecting RCR disposal strategy being partly offset by increases in CFG and UK PBB.
- There has been a significant increase in CFG lending across a broad range of industry sectors, including residential mortgages, auto loans and commercial loans, in line with business strategy and risk appetite. Exchange rate movements also contributed to the increase.
- UK PBB's mortgage book grew strongly by £3.9 billion to £103.2 billion as advisor capacity increased (refer to Key portfolios on page 100 for more details). This was partially offset by lower unsecured lending.
- Property and construction lending fell by £11.4 billion, of which £9.3 billion related to commercial real estate lending. Refer to Key credit portfolios - Commercial real estate on page 90 for more details.
- REIL decreased by £11.1 billion to £28.1 billion, a 28% reduction in the year from £39.1 billion, across all segments except CFG. REIL as a proportion of gross loans improved to 6.9% from 9.5% in 2013 reflecting sales and repayments of £10.0 billion (£6.7 billion in RCR), write-offs of £5.3 billion (£3.6 billion in RCR), transfers to performing book of £1.5 billion, partially off set by new impaired loans of £6.9 billion (£2.8 billion in RCR). The execution of RCR strategy, resulted in a number of disposals of REIL in the year, primarily in the fourth quarter.
- Loan impairment provision coverage of REIL remained stable at 64% and now stands at £17.9 billion, a £7.1 billion reduction in the year. Provision coverage of gross loans has declined steadily during 2014 and is now 4.4% compared with 6.1% at the end of 2013, the latter reflecting the creation of RCR. The reduction in provision reflected write-off of £5.3 billion (£3.6 billion in RCR) impairment net releases of £1.1 billion (£1.3 billion in RCR) currency and other movements.
- Disposal of assets by RCR, primarily in the second half of the year, at higher than anticipated sale prices together with favourable market conditions in Ireland and the UK resulted in impairment releases. Overall, there was a net loan impairment release of £1.1 billion, £1.3 billion in RCR for 2014.
- Commercial real estate (CRE) gross lending reduced by £9.3 billion to £43.3 billion, related REIL is almost half of total the Group REIL and has a provision coverage of 68%. Of the total CRE REIL of £13.3 billion, £11.1 billion is in RCR.

Within the business segments:

- RCR REIL decreased by £8.6 billion or 36% to £15.3 billion from £23.9 billion at 1 January 2014 primarily due to a mixture of asset disposals and write-offs. Provision coverage of REIL and REIL as a proportion of loans were both around 70%.
- In Ulster Bank, REIL as a proportion of loans decreased to 19% from 27% in 2013 and provision coverage of REIL reduced to 57% from 64% in 2013 mainly reflecting asset transfers to RCR on 1 January 2014 but also due to improved market conditions and higher collateral values also contributed.
- Commercial Banking REIL as a proportion of loans decreased to 2.9% from 5.0% in 2013, and REIL decreased by 41% (£1.8 billion) to £2.5 billion, with £0.6 billion of the reduction due to the creation of RCR. REIL reductions in the year were mainly due to lower individual cases, albeit some increases were seen in the fourth quarter and reductions in collectively assessed due to improved credit conditions.

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.

	Group							
	Gross loans £m	REIL £m	Provisions £m	Credit metrics				Amounts written-off £m
				REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge/(release) £m	
2014								
Central and local government	8,544	1	1	—	100	—	(1)	—
Finance	38,788	333	227	0.9	68	0.6	2	23
Personal - mortgages	150,568	5,631	1,518	3.7	27	1.0	53	234
- unsecured	29,144	1,964	1,585	6.7	81	5.4	401	737
Property	51,513	12,993	8,895	25.2	68	17.3	(1,083)	2,615
Construction	5,647	971	612	17.2	63	10.8	76	200
<i>of which: Commercial real estate</i>	<i>43,317</i>	<i>13,345</i>	<i>9,027</i>	<i>30.8</i>	<i>68</i>	<i>20.8</i>	<i>(1,067)</i>	<i>2,750</i>
Manufacturing	21,388	439	302	2.1	69	1.4	(25)	181
Finance leases and instalment credit	14,005	156	113	1.1	72	0.8	—	75
Retail, wholesale and repairs	18,242	936	637	5.1	68	3.5	107	158
Transport and storage	13,963	1,142	497	8.2	44	3.6	35	211
Health, education and leisure	15,932	734	366	4.6	50	2.3	9	349
Hotels and restaurants	7,960	1,094	574	13.7	52	7.2	(40)	109
Utilities	4,781	105	64	2.2	61	1.3	28	3
Other	28,659	1,511	1,206	5.3	80	4.2	(13)	349
Latent	—	—	1,303	—	—	—	(671)	—
Total third-party	409,134	28,010	17,900	6.8	64	4.4	(1,122)	5,244
Amounts due from holding company and fellow subsidiaries	1,323	—	—	—	—	—	—	—
	410,457	28,010	17,900	6.8	64	4.4	(1,122)	5,244
Geographic regional analysis								
UK								
- residential mortgages	113,520	1,394	191	1.2	14	0.2	(23)	76
- personal lending	15,923	1,674	1,452	10.5	87	9.1	290	546
- property	37,536	6,018	3,675	16.0	61	9.8	(221)	1,906
- construction	4,098	676	361	16.5	53	8.8	(1)	175
- other	113,024	3,283	2,458	2.9	75	2.2	(140)	848
Europe								
- residential mortgages	15,629	3,268	1,178	20.9	36	7.5	7	9
- personal lending	1,046	76	66	7.3	87	6.3	9	66
- property	8,021	6,907	5,197	86.1	75	64.8	(862)	699
- construction	1,055	289	245	27.4	85	23.2	78	24
- other	18,861	2,759	2,321	14.6	84	12.3	(426)	559
US								
- residential mortgages	21,200	954	147	4.5	15	0.7	69	149
- personal lending	11,164	195	49	1.7	25	0.4	102	125
- property	5,332	64	19	1.2	30	0.4	2	7
- construction	413	1	1	0.2	100	0.2	—	1
- other	31,337	200	342	0.6	171	1.1	1	39
RoW								
- residential mortgages	219	15	2	6.8	13	0.9	—	—
- personal lending	1,011	19	18	1.9	95	1.8	—	—
- property	624	4	4	0.6	100	0.6	(2)	3
- construction	81	5	5	6.2	100	6.2	(1)	—
- other	9,040	209	169	2.3	81	1.9	(4)	12
Total third-party	409,134	28,010	17,900	6.8	64	4.4	(1,122)	5,244
Amounts due from holding company and fellow subsidiaries	1,323	—	—	—	—	—	—	—
	410,457	28,010	17,900	6.8	64	4.4	(1,122)	5,244
Banks	25,669	42	40	—	95	—	(10)	9

Financial review Capital and risk management

Balance sheet analysis continued

	Group							
	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
2013								
Central and local government	7,976	2	2	—	100	—	2	—
Finance	34,875	535	278	1.5	52	0.8	13	43
Personal - mortgages	148,347	6,004	1,781	4.0	30	1.2	407	436
- unsecured	28,152	2,409	1,909	8.6	79	6.8	408	855
Property	62,249	20,244	13,156	32.5	65	21.1	5,125	1,640
Construction	6,310	1,330	772	21.1	58	12.2	291	160
<i>of which: Commercial real estate</i>	52,578	20,129	13,209	38.3	66	25.1	5,212	1,749
Manufacturing	20,613	700	529	3.4	76	2.6	196	78
Finance leases and instalment credit	13,503	263	190	1.9	72	1.4	16	121
Retail, wholesale and repairs	19,330	1,167	773	6.0	66	4.0	270	128
Transport and storage	16,427	1,490	634	9.1	43	3.9	484	178
Health, education and leisure	16,080	1,322	770	8.2	58	4.8	360	120
Hotels and restaurants	6,936	1,427	812	20.6	57	11.7	281	194
Utilities	4,810	65	45	1.4	69	0.9	60	23
Other	27,656	2,099	1,343	7.6	64	4.9	494	208
Latent	—	—	1,998	—	—	—	73	—
Total third-party	413,264	39,057	24,992	9.5	64	6.0	8,480	4,184
Amounts due from holding company and fellow subsidiaries	1,620	—	—	—	—	—	—	—
	414,884	39,057	24,992	9.4	64	6.0	8,480	4,184
Geographic regional analysis								
UK								
- residential mortgages	110,515	1,901	318	1.7	17	0.3	38	178
- personal lending	17,098	2,050	1,719	12.0	84	10.1	263	680
- property	44,232	9,776	5,176	22.1	53	11.7	2,011	948
- construction	4,691	940	515	20.0	55	11.0	195	159
- other	109,474	4,687	3,201	4.3	68	2.9	1,090	537
Europe								
- residential mortgages	17,354	3,135	1,286	18.1	41	7.4	196	26
- personal lending	1,267	135	129	10.7	96	10.2	13	24
- property	13,174	10,373	7,951	78.7	77	60.4	3,129	659
- construction	977	351	228	35.9	65	23.3	72	—
- other	22,213	3,921	3,421	17.7	87	15.4	1,041	403
US								
- residential mortgages	19,901	950	173	4.8	18	0.9	176	230
- personal lending	8,722	207	44	2.4	21	0.5	115	151
- property	4,279	85	19	2.0	22	0.4	(11)	25
- construction	313	34	24	10.9	71	7.7	24	1
- other	27,853	198	589	0.7	297	2.1	71	102
RoW								
- residential mortgages	577	18	4	3.1	22	0.7	(3)	2
- personal lending	1,065	17	17	1.6	100	1.6	17	—
- property	564	10	10	1.8	100	1.8	(4)	8
- construction	329	5	5	1.5	100	1.5	—	—
- other	8,666	264	163	3.0	62	1.9	47	51
Total third-party	413,264	39,057	24,992	9.5	64	6.0	8,480	4,184
Amounts due from holding company and fellow subsidiaries	1,620	—	—	—	—	—	—	—
	414,884	39,057	24,992	9.4	64	6.0	8,480	4,184
Banks	40,121	69	62	0.2	90	0.2	(15)	40

Financial review Capital and risk management

	Group							
	Gross loans £m	REIL £m	Provisions £m	Credit metrics			Impairment charge/(release) £m	Amounts written-off £m
2012				REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %		
Central and local government	9,126	—	—	—	—	—	—	—
Finance	41,037	503	218	1.2	43	0.5	88	205
Personal - mortgages	149,210	6,498	1,779	4.4	27	1.2	943	434
- unsecured	31,219	2,820	2,340	9.0	83	7.5	617	785
Property	72,109	21,179	9,822	29.4	46	13.6	2,232	1,043
Construction	8,010	1,480	647	18.5	44	8.1	92	174
<i>of which: Commercial real estate</i>	63,040	22,108	10,077	35.1	46	16.0	(2,016)	1,186
Manufacturing	21,928	616	349	2.8	57	1.6	108	146
Finance leases and instalment credit	13,520	442	294	3.3	67	2.2	44	263
Retail, wholesale and repairs	21,425	1,117	624	5.2	56	2.9	222	170
Transport and storage	17,822	832	334	4.7	40	1.9	288	77
Health, education and leisure	16,685	1,187	520	7.1	44	3.1	144	95
Hotels and restaurants	7,820	1,597	726	20.4	45	9.3	176	102
Utilities	6,288	35	13	0.6	37	0.2	—	—
Other	27,422	2,084	1,106	7.6	53	4.0	329	379
Latent	—	—	1,921	—	—	—	(13)	—
Total third-party	443,621	40,390	20,693	9.1	51	4.7	5,270	3,873
Amounts due from holding company and fellow subsidiaries	1,866	—	—	—	—	—	—	—
	445,487	40,390	20,693	9.1	51	4.6	5,270	3,873
Geographical regional analysis								
UK								
- residential mortgages	109,530	2,439	456	2.2	19	0.4	122	32
- personal lending	19,691	2,477	2,152	12.6	87	10.9	479	610
- property	53,704	10,495	3,935	19.5	37	7.3	960	490
- construction	6,507	1,166	481	17.9	41	7.4	100	158
- other	120,808	3,719	2,608	3.1	70	2.2	675	823
Europe								
- residential mortgages	17,451	3,060	1,125	17.5	37	6.4	521	24
- personal lending	1,727	143	139	8.3	97	8.0	29	12
- property	14,571	10,349	5,758	71.0	56	39.5	1,288	404
- construction	1,109	300	160	27.1	53	14.4	(13)	4
- other	25,099	4,231	2,834	16.9	67	11.3	816	331
US								
- residential mortgages	21,911	972	190	4.4	20	0.9	298	376
- personal lending	8,748	199	48	2.3	24	0.5	109	162
- property	3,343	170	29	5.1	17	0.9	(11)	83
- construction	388	8	1	2.1	13	0.3	—	12
- other	28,959	316	597	1.1	189	2.1	(107)	135
RoW								
- residential mortgages	318	27	8	8.5	30	2.5	2	2
- personal lending	1,053	1	1	0.1	100	0.1	—	1
- property	491	165	100	33.6	61	20.4	(5)	66
- construction	6	6	5	100.0	83	83.3	5	—
- other	8,207	147	66	1.8	45	0.8	2	148
Total third-party	443,621	40,390	20,693	9.1	51	4.7	5,270	3,873
Amounts due from holding company and fellow subsidiaries	1,866	—	—	—	—	—	—	—
	445,487	40,390	20,693	9.1	51	4.6	5,270	3,873
Banks	47,737	134	114	0.3	85	0.2	11	14

Financial review Capital and risk management

Balance sheet analysis continued

Risk elements in lending

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

	2014			2013			2012		
	Group excluding RCR £m	RCR £m	Total £m	Group excluding Non-Core £m	Non-Core £m	Total £m	Group excluding Non-Core £m	Non-Core £m	Total £m
Impaired loans									
- UK	5,526	6,024	11,550	9,288	8,173	17,461	9,323	9,054	18,377
- overseas	5,807	9,055	14,862	9,098	10,346	19,444	8,163	11,347	19,510
	11,333	15,079	26,412	18,386	18,519	36,905	17,486	20,401	37,887
Accruing loans past due 90 days or more									
- UK	1,418	117	1,535	1,709	253	1,962	1,758	248	2,006
- overseas	30	75	105	236	23	259	456	175	631
	1,448	192	1,640	1,945	276	2,221	2,214	423	2,637
Total REIL	12,781	15,271	28,052	20,331	18,795	39,126	19,700	20,824	40,524
REIL as a % of gross loans and advances (1)	3.3%	71.9%	6.8%	5.4%	54.3%	9.4%	5.0%	40.2%	9.1%
Provisions as a % of REIL	55%	71%	64%	56%	73%	64%	51%	52%	51%

Note:

(1) Gross loans and advances to customers includes disposal groups but excludes reverse repos.

REIL flow statement

REIL are stated without giving effect to any security held that could reduce the eventual loss should it occur or to any provisions marked.

	UK PBB £m	Ulster Bank £m	Commercial Banking £m	Private Banking £m	CIB £m	CFG £m	Group excluding RCR £m	RCR £m	Non-Core £m	Total £m
At 31 December 2013	4,663	8,466	4,276	277	1,615	1,034	20,331	—	18,795	39,126
Impact of dissolution of Non-Core and creation of RCR	137	(3,547)	(560)	—	(1,421)	289	(5,102)	23,897	(18,795)	—
At 1 January 2014	4,800	4,919	3,716	277	194	1,323	15,229	23,897	—	39,126
Currency translation and other adjustments	—	(250)	—	(3)	(11)	75	(189)	(851)	—	(1,040)
Additions	1,353	555	1,716	58	100	335	4,117	2,812	—	6,929
Transfers (1)	(309)	—	31	(15)	—	—	(293)	36	—	(257)
Transfers to performing book	(326)	(120)	(582)	(3)	(92)	—	(1,123)	(337)	—	(1,460)
Disposals and repayments	(1,012)	(198)	(1,884)	(51)	(25)	(103)	(3,273)	(6,720)	—	(9,993)
Amounts written-off	(728)	(131)	(491)	(37)	—	(300)	(1,687)	(3,566)	—	(5,253)
At 31 December 2014	3,778	4,775	2,506	226	166	1,330	12,781	15,271	—	28,052

	UK PBB £m	Ulster Bank £m	Commercial Banking £m	Private Banking £m	CIB £m	CFG £m	Group excluding Non-Core £m	Non-Core £m	Total £m
At 1 January 2013	5,735	7,533	4,007	248	1,031	1,146	19,700	20,824	40,524
Transfers to fellow subsidiaries	—	—	—	—	—	—	—	58	58
Currency translation and other adjustments	8	134	8	2	(6)	(21)	125	291	416
Additions	1,638	2,479	3,597	132	1,310	282	9,438	3,364	12,802
Transfers (1)	(445)	—	355	—	196	—	106	(1)	105
Transfer to performing book and repayments	(1,306)	(1,403)	(3,104)	(90)	(578)	(89)	(6,570)	(3,985)	(10,555)
Amounts written-off	(967)	(277)	(587)	(15)	(338)	(284)	(2,468)	(1,756)	(4,224)
At 31 December 2013	4,663	8,466	4,276	277	1,615	1,034	20,331	18,795	39,126

Notes:

(1) Represents transfers between REIL and potential problem loans.

(2) For details on impairment methodology refer to Credit risk on page 79 and Accounting policy 15 Impairment of financial assets on page 180.

Financial review Capital and risk management

Impairment provisions flow statement

The movement in loan impairment provisions by segment is shown in the table below.

	UK PBB £m	Ulster Bank £m	Commercial Banking £m	Private Banking £m	CIB £m	Central items £m	CFG £m	Group excluding RCR £m	RCR £m	Non-Core £m	Total £m
At 31 December 2013	2,957	5,378	1,617	120	949	65	272	11,358	—	13,696	25,054
Impact of dissolution of Non-Core and creation of RCR (1)	150	(1,985)	(301)	—	(766)	(6)	246	(2,662)	16,358	(13,696)	—
At 1 January 2014	3,107	3,393	1,316	120	183	59	518	8,696	16,358	—	25,054
Currency translation and other adjustments	—	(172)	5	(1)	10	8	21	(129)	(554)	—	(683)
Amounts written-off	(728)	(131)	(436)	(37)	—	(55)	(300)	(1,687)	(3,566)	—	(5,253)
Recoveries of amounts previously written-off	24	23	12	2	1	—	103	165	36	—	201
Charged to income statement											
- continuing operations	268	(365)	77	(5)	—	(12)	—	(37)	(1,289)	—	(1,326)
- discontinued operations	—	—	—	—	—	—	194	194	—	—	194
Unwind of discount (recognised in interest income)	(67)	(37)	(19)	(3)	—	—	—	(126)	(121)	—	(247)
At 31 December 2014	2,604	2,711	955	76	194	—	536	7,076	10,864	—	17,940
Individually assessed											
- banks	—	—	—	—	1	—	—	1	39	—	40
- customers	14	42	493	69	102	—	83	803	10,447	—	11,250
Collectively assessed	2,319	2,355	366	—	—	—	157	5,197	150	—	5,347
Latent	271	314	96	7	91	—	296	1,075	228	—	1,303
	2,604	2,711	955	76	194	—	536	7,076	10,864	—	17,940

Note:

(1) Transfers in Non-Core dissolution and RCR creation includes amounts in relation to latent.

	UK PBB £m	Ulster Bank £m	Commercial Banking £m	Private Banking £m	CIB £m	Central items £m	CFG £m	Group excluding Non-Core £m	Non-Core £m	Total £m
At 1 January 2013	3,467	3,910	1,546	109	685	—	285	10,002	10,805	20,807
Currency translation and other adjustments	(2)	51	17	—	(12)	—	31	85	29	114
Transfers from fellow subsidiaries	—	—	—	—	—	—	—	—	33	33
Amounts written-off	(967)	(277)	(587)	(15)	(338)	—	(284)	(2,468)	(1,756)	(4,224)
Recoveries of amounts previously written-off	47	1	14	—	15	—	89	166	83	249
Charge to income statement										
- continuing operations	497	1,774	652	29	606	65	—	3,623	4,535	8,158
- discontinuing operations	—	—	—	—	—	—	151	151	156	307
Unwind of discount (recognised in interest income)	(85)	(81)	(25)	(3)	(7)	—	—	(201)	(189)	(390)
At 31 December 2013	2,957	5,378	1,617	120	949	65	272	11,358	13,696	25,054
Individually assessed										
- banks	—	—	—	—	62	—	—	62	—	62
- customers	2	2,078	1,116	109	747	65	60	4,177	12,512	16,689
Collectively assessed	2,742	2,596	283	—	—	—	118	5,739	566	6,305
Latent	213	704	218	11	140	—	94	1,380	618	1,998
	2,957	5,378	1,617	120	949	65	272	11,358	13,696	25,054

Financial review Capital and risk management

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.

	2014 £m	2013 £m	2012 £m
Past due 1-29 days	4,811	4,765	5,599
Past due 30-59 days	1,054	1,260	1,117
Past due 60-89 days	667	822	1,177
Past due 90 days or more	1,640	2,221	2,637
	8,172	9,068	10,530

Past due analysis by sector

Personal	4,837	5,173	5,508
Property and construction	1,340	1,373	1,875
Financial institution	86	368	101
Other corporate	1,909	2,154	3,046
	8,172	9,068	10,530

Impairment charge analysis

The table below analyses the impairment charge for loans and securities.

	2014 £m	2013 £m	2012 £m
Individually assessed	(765)	6,952	3,100
Collectively assessed	314	1,455	2,183
Latent loss	(671)	73	(13)
Loans to customers	(1,122)	8,480	5,270
Loans to banks	(10)	(15)	11
Securities	(8)	(16)	(67)
(Release)/charge to income statement	(1,140)	8,449	5,214
(Release)/charge as a % of gross loans (1)	(0.3%)	2.0%	1.2%

Note:

(1) Customer loan impairment charge as a percentage of gross loans and advances to customers including assets of disposal groups and excluding reverse repurchase agreements.

	2014			2013			2012		
	Group excluding RCR £m	RCR £m	Total £m	Group excluding Non-Core £m	Non-Core £m	Total £m	Group excluding Non-Core £m	Non-Core £m	Total £m
Loan impairment losses									
- customers	157	(1,279)	(1,122)	3,789	4,691	8,480	2,966	2,304	5,270
- banks	—	(10)	(10)	(15)	—	(15)	11	—	11
	157	(1,289)	(1,132)	3,774	4,691	8,465	2,977	2,304	5,281
Impairment losses on securities									
- debt securities	1	(9)	(8)	23	(39)	(16)	15	(112)	(97)
- equity securities	—	—	—	—	—	—	13	17	30
	1	(9)	(8)	23	(39)	(16)	28	(95)	(67)
Charge/(release) to income statement	158	(1,298)	(1,140)	3,797	4,652	8,449	3,005	2,209	5,214

AFS reserves by issuer

The table below analyses available-for-sale debt securities and related reserves, gross of tax.

	2014				2013				2012			
	UK £m	US £m	Other £m	Total £m	UK £m	US £m	Other £m	Total £m	UK £m	US £m	Other £m	Total £m
Central and local government	4,747	5,230	9,472	19,449	6,436	11,456	6,824	24,716	7,950	17,514	10,083	35,547
Banks	501	—	2,775	3,276	327	44	2,160	2,531	509	56	2,368	2,933
Other financial institutions	1,491	400	2,878	4,769	2,297	8,327	2,666	13,290	2,815	10,571	2,581	15,967
Corporate	16	—	30	46	21	71	53	145	29	—	85	114
Total	6,755	5,630	15,155	27,540	9,081	19,898	11,703	40,682	11,303	28,141	15,117	54,561
Of which ABS	1,478	350	1,660	3,488	2,284	13,101	1,591	16,976	2,913	14,117	1,923	18,953
AFS reserves (gross)	44	260	106	410	92	133	63	288	603	1,123	546	2,272

Market risk	
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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 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, as described in this section, largely in line with the regulatory definitions of the trading and non-trading books.

Sources of risk

Traded market risk

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

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

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

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 96.

Non-traded market risk

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

Non-traded market risk largely comprises non-traded interest rate risk and non-traded foreign exchange risk, which are the most significant categories, and non-traded equity 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. Therefore, 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 rise and fall.

NTIRR comprises four primary risk factors: repricing risk, yield curve risk, basis risk and optionality risk. For more information, refer to page 148.

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 associates 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 160 and 161.

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 in the RBS Group, refer to the Risk governance section on page 41.

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.

Traded market risk

Controls and assurance

The RBS Group's market risk control and assurance framework has three key components: market risk policy; assurance approach policy; and independent assurance.

The RBS Group Market Risk Policy Standard is part of the RBS Group Policy Framework. It sets out the rules that the RBS Group's businesses must follow to ensure that market risks are identified, measured and effectively managed.

The assurance approach policy comprises various elements, including the Risk and Control Assurance Framework process. This process ensures that, on an ongoing basis, specifically designed controls are in place for the risks that the RBS Group faces to ensure that its exposure does not exceed its appetite. The adequacy and effectiveness of these controls are tested according to their rating, at least annually. The results of this testing are shared regularly at the RBS Group's Market Risk Governance and Control Committee.

Market Risk Assurance forms part of Risk Assurance. This independent second line of defence function provides assurance on the robustness of the market risk framework within the RBS Group, via centralised analysis of the control framework, complemented by the application of expert judgement through qualitative reviews. These findings are escalated to senior management and plans to address any shortcomings are recorded and tracked in the operational risk system. Market Risk Assurance activities are also reported directly and independently to the Group Audit Committee.

For information on valuation controls, independent price verification and model validation, refer to page 147.

Risk appetite*

Market risk appetite is the level of market risk that the Group accepts when pursuing its business objectives, taking into account stressed scenarios. A comprehensive structure and controls are in place aimed at ensuring that this appetite is not exceeded.

The RBS Group's qualitative market risk appetite is set out in policy statements. These define the governance, responsibilities, control framework and requirements for the identification, measurement, analysis, management and reporting of market risk arising from trading and non-trading activities. These policies are also cascaded, as appropriate, to the legal entities, franchises and businesses to ensure there is a consistent control framework throughout.

The quantitative market risk appetite is expressed in terms of limits for the trading and non-trading activities. These limits, which establish a set of comprehensive boundaries within which business activities are conducted and monitored based on business plans, are proposed by the Director of Market Risk.

Once RBS Group-level limits are approved by the RBS Group Executive Risk Forum (ERF), the Director of Market Risk may cascade 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 the 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 140 to 145). The limit framework at the lower levels 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.

Limit breaches at RBS Group level require escalation by the Director of Market Risk, as appropriate, to the ERF. Limit breaches at the lower levels require escalation by the head of the relevant market risk segment to the Director of Market Risk, as appropriate.

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 ERF is sent to the RBS Group Chief Risk Officer and market risk managers across the segments.

The market risk functions also prepare 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 positions 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 functions, senior management and the front office.

Risk control

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.

*unaudited

Traded market risk continued

Risk measurement

The RBS Group uses a comprehensive and complementary set of methodologies and techniques to measure traded market risk that collectively ensure a complete approach to the measurement of material market risks.



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.

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.

The Group's internal VaR assumes a time horizon of one trading day and a confidence level of 99%. The Group's VaR model is based on a historical simulation, utilising 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. From February 2014, credit and funding valuation adjustments were included in the internal measure of VaR. For an explanation of the distinction between internal VaR and regulatory VaR, refer to page 144.

The internal VaR model captures the 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 factors noted above are sufficient to define the Group's overall market risk exposures. Other types of risk, which are components of the above-mentioned factors, are also monitored by individual businesses to identify and address any material concentrations.

Examples of such risk types include:

- 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 two years 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 Stressed VaR 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.

*unaudited

Financial review Capital and risk management

- When ten-day risk factor changes are used in the calculation of the regulatory VaR, the ten-day periods overlap, which can introduce an autocorrelation bias in the 99% confidence level VaR statistic. The analysis performed has shown the bias to be small and acceptable for a ten-day period.
- The VaR of trading positions is computed at the close of business. Positions may change substantially during the course of the trading day and so intra-day price volatility and trading may not be captured by the model.
- The data used in the model are collected from global sources. For some sources, local end-of-day, rather than London end-of-day, data may be used, resulting in a timing mismatch. This timing mismatch is more material for 1-day return periods than for 10-day periods (which are used for capitalisation purposes) as the overlaps are inherently smaller across shorter periods. When deciding whether or not to use local end-of-day timing, the internal model review committee balances the principle of aligning the treatment of positions and their associated hedges against the goal of using London end-of-day timing consistently.
- Risk factors relevant to a specific portfolio may be omitted, due to a lack of reliable data, or the use of proxy risk factors, for example. The RNIV framework has been developed to address these issues.

1-day 99% traded internal VaR

The table below analyses internal VaR for the Group's trading portfolios, segregated by type of market risk exposure.

	2014				2013				2012			
	Average £m	Period end £m	Maximum £m	Minimum £m	Average £m	Period end £m	Maximum £m	Minimum £m	Average £m	Period end £m	Maximum £m	Minimum £m
Interest rate	16.1	18.5	35.6	9.7	37.5	44.8	79.1	19.6	63.3	75.7	95.7	41.4
Credit spread	21.4	14.4	38.3	13.8	59.9	37.3	86.6	33.1	69.4	74.4	94.7	45.0
Currency	5.0	6.5	9.5	1.4	8.8	6.6	21.5	3.8	10.7	8.0	23.7	2.9
Equity	3.0	3.6	6.4	1.2	5.8	4.1	12.8	3.2	5.9	3.9	12.3	1.9
Commodity	0.6	0.4	2.5	0.3	0.9	0.5	3.8	0.3	1.7	1.4	5.2	0.6
Diversification (1)		(22.7)				(24.2)				(55.6)		
Total	26.5	20.7	55.8	16.9	79.6	69.1	118.9	42.9	98.2	107.8	139.7	68.3

Note:

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

Key points

- The total traded VaR decreased significantly in 2014 compared with 2013, on both a period-end and average basis, for the following two key reasons:
 - The inclusion of CVA and FVA trades in the internal VaR measure in February 2014, which primarily affected Q1 2014. Prior to this change, VaR was higher as only the associated hedges, which had a risk-additive impact on overall trading book exposures, were captured in the internal risk management framework.
 - The decision to exit the US ABP trading business and the unwinding of equity positions in Run-off & Recovery (RoR) within CIB in line with the exit strategy, which largely affected the last three quarters of the year.
- The declines in interest rate and credit spread VaR were also affected by specific factors:
 - Interest rate VaR declined in Q1 2014 due to reduced risk appetite for flow market-making in the Rates business in CIB.
 - Credit spread VaR declined in H2 2014, because the volatile credit spread series rolled out of the 500-day window for VaR.

*unaudited

Traded market risk continued

VaR validation*

A dedicated model-testing team in Market Risk works with the risk managers to:

- Test the accuracy of the valuation methods used in the VaR model on appropriately chosen test portfolios and trades;
- Apply in-house models to perform advanced internal back-testing to complement the regulatory back-testing;
- Identify risks not adequately captured in VaR, and ensure that such risks are addressed via the RNIV framework (refer to page 143);
- Identify any model weaknesses or scope limitations and their impact;
- Identify and give early warning of any market or portfolio weakness that may become significant; and
- In addition, independent VaR model reviews are carried out by Model Risk (as detailed on page 147).

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 145 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 model performance is back-testing, which counts the number of days when a loss exceeds the corresponding daily VaR estimate, measured at a 99% confidence level.

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

The Clean 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;
- Additions to, and releases from, reserves that are not directly related to market risk; and
- Any Day 1 P&L exceeding an amount of £500,000 (per transaction).

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

A portfolio is said to produce a back-testing exception when the Clean 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 Clean and Hypo back-testing exceptions.

Regulatory back-testing is performed and reported on a daily basis for legal entities and major business portfolios. Market risk teams also perform back-testing at the lower levels as part of the internal ongoing VaR model validation.

The back-testing described above primarily applies to CIB and RCR models, which are approved by the regulators. However, where appropriate, back-testing is also performed for other portfolios that are not subject to regulatory approval.

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

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

Description	Back-testing exceptions		Model status
	Clean	Hypo	
The Royal Bank of Scotland plc	—	—	Green
National Westminster Bank Plc	3	3	Green
RBS Securities Inc (RBSSI)	1	1	Green
RBS Financial Products Inc	—	—	Green

Key points

- Statistically the Group would expect to see back-testing exceptions 1% of the time over a one-year period. 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 12 month period. The Group's VaR model has maintained a green status for its regulated legal entities and hence has considered that no action is required to rectify or adapt its VaR models.

- The exception at the NatWest level was driven by: the re-marking in August of certain inflation products following independent price verification; losses on euro and sterling positions as foreign exchange spot rates moved significantly in September; and a one-day delay in booking by a trader in September.
- The exception at the RBSSI level resulted from losses in the US Credit business relating to the mining and chemical sectors and from losses on inflation securities.

*unaudited

*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 260-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%.

*Risks not in VaR (RNIVs)**

The RNIV approach is used for market risks that fall within the scope of VaR and SVaR but that are insufficiently captured by the model methodology, 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 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. Since the introduction of the RNIV framework, progress has been made in transitioning RNIVs into the VaR model.

The RBS Group adopts two approaches for the quantification of RNIVs:

- A standalone VaR 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 stressed 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 stressed RNIV. In each of these categories, potential diversification benefits between RNIVs are ignored.

*Stress testing**

The RBS 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 a similar technical framework to VaR, the current portfolio is stressed using historical data since 1 January 2005. The methodology simulates the impact of the worst loss that would be incurred by historical risk factor movements over the period, assuming a holding period specific to the risk factors and the businesses. At present, a holding period of 60 business days is applied for credit risk factors (including in the case of asset-backed securities (ABS) and for the available-for-sale (AFS) portfolios that are held by CIB Treasury and generally a period of 10 business days for other risk factors. The RBS Group reviews the holding periods annually.

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 RBS Group 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 such as the PRA Anchor and the Federal Reserve Comprehensive Capital Analysis and Review and macroeconomic scenarios identified by the firm such as a euro crisis and a China hard landing.

*unaudited

Traded market risk continued

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, forward-looking, macroeconomic or 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

A market risk economic capital framework was developed by the RBS Group in 2013 and was introduced in internal reporting in 2014.

The associated models calculate the market and default risk in the trading book and 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.

Other risk measures

In addition to SVaR and stress tests, the Group uses a range of other risk measures to complement VaR. These measures often represent local (small-amplitude) risk calculations which provide valuable additional controls, often at individual desk or business unit level. They mainly include, but are not limited to, sensitivity and position-based risk measures.

Sensitivity measures 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.

Position-based measures are also used and are stated in terms that relate directly to the business activity they are applied to. Examples of such measures include the aggregate open foreign exchange position or the long, short and net amount of security or currency held and aged inventory in trading books.

Calculation of 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.

Firms can choose from two broad methodologies to calculate their market risk capital charge: (i) the standard rules, whereby regulator-prescribed rules must be applied, and (ii) the internal model approach, where, subject to regulatory approval, a model such as VaR is used to calculate the capital charge.

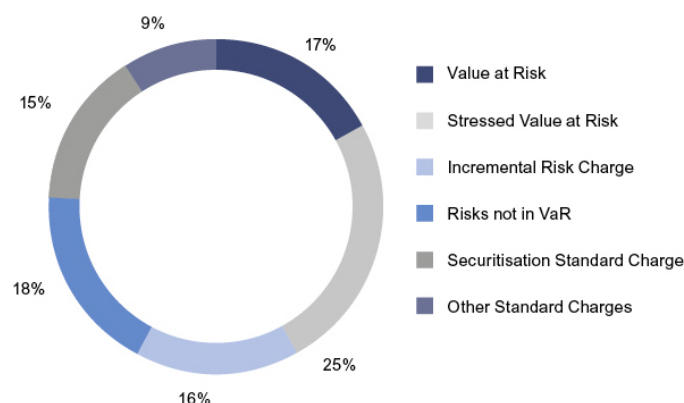
The Group uses both methods, with the internal model approach being used to calculate about 76% (2013 - 87%) of its capital charge.

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, three 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.
- The all price risk model covers the generally lower-liquidity correlation trades and their liquid hedges (such as first-to-default basket trades). The Group ceased using an internal model for all price risk during Q2 2014, refer to page 145.
- Securitisation and re-securitisation risks in the trading book are treated with the non-trading book standardised capitalisation approach.

RWAs by regulatory approach*

The Group's market risk RWAs of £23 billion and minimum capital requirement of £1.8 billion are analysed below.



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 The Royal Bank of Scotland plc, RBS Securities Inc, RBS Financial Products Inc, and National Westminster Bank Plc. As from 1 December 2014, this approval takes the form of an internal model approach permission, replacing the earlier VaR waiver.

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

*unaudited

Financial review Capital and risk management

VaR back-testing*

For the Group's trading book, a green model status was maintained throughout 2014. For details of back-testing results for regulatory VaR, refer to the table on page 142.

Regulatory SVaR*

The Group's SVaR model has also been approved by the PRA for use in the capital requirement calculation. The regulatory SVaR differs from internal SVaR as it covers only regulator-approved products, locations and legal entities.

Risks not in VaR

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

The RNIV framework does not include tail event risks; these risks are covered indirectly by the regulatory multiplier applied to VaR and directly by relevant charges, notably the IRC discussed below.

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, which facilitates an efficient calculation of the charge using numerical integration.

IRC is mainly driven by three-month 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.

The model has distinct parameter sets for sovereign and corporate exposures. It reflects the overall liquidity of each position referencing an entity, using product type, product maturity and product concentration characteristics.

The constant level of risk requirement is met by replacing positions that default or migrate in one period with equivalent positions in the next. The average liquidity horizon by position at the year end for RBS plc was 3.3 months (2013 - 3.2 months).

All price risk (APR)*

Until Q2 2014, the APR model was used to determine the capital that should be held against all material price risks, including those arising from defaults and credit rating changes affecting securities in the hedged portfolio, using a 99.9% confidence level over a one year time horizon.

This model was applied to the correlation trading portfolio subject to certain eligibility criteria (principally that the underlying names be liquid corporate CDS positions).

Given the reduction in the size of the correlation trading portfolio, the Group ceased using an internal model for all price risk during Q2 2014. With the PRA's approval, all remaining open risk is now capitalised under standardised rules.

Market risk capital*

Minimum capital requirements

The following table analyses the total market risk minimum capital requirement, calculated in accordance with the Capital Requirements Regulation (CRR). For 2013 and 2012, the capital requirements were calculated in accordance with Basel 2.5.

	CRR 2014 £m	Basel 2.5 2013 £m	2012 £m
Interest rate position risk requirement	106	122	224
Equity position risk requirement	—	1	1
Option position risk requirement	2	1	9
Commodity position risk requirement	2	13	2
Foreign currency position risk requirement	60	37	10
Specific interest rate risk of securitisation positions	270	123	156
Total (standard method)	440	297	402
Pillar 1 model based position risk requirement	1,385	2,009	1,739
Total market risk minimum capital requirement	1,825	2,306	2,141

*unaudited

Financial review Capital and risk management

Traded market risk continued

The following table analyses the principal contributors to the Pillar 1 model based PRR presented in the previous table. Following the implementation of the CRR on 1 January 2014, credit hedges eligible for CVA are no longer included in the modelled market risk capital charges. Such hedges are now included in the CVA capital charge, which forms part of the capital calculation for counterparty credit risk.

	CRR				Basel 2.5	
	Average £m	Maximum £m	Minimum £m	Period end £m	2013 Period end £m	2012 Period end £m
Value-at-risk	304	514	212	311	563	793
Stressed VaR	625	797	461	461	789	1,115
Incremental risk charge	395	520	294	294	431	390
All price risk	4	6	—	—	8	12
Risk not in VaR	412	472	319	319	218	429
Total				1,385	2,009	2,739

Key points

- The Group's total market risk minimum capital requirement fell in 2014, largely driven by the decreases in the Pillar 1 model-based contributors (primarily VaR, SVaR and the IRC). The standard method requirement rose, chiefly driven by the rise in the specific interest rate risk of securitisation positions.
- The interest rate position risk requirement decreased, primarily due to the closure of the interest rate trading business in Japan and the associated disposal of bond positions.
- The decrease in the commodity position risk requirement was driven by a change in the treatment of options under the CRR standardised approach.
- The foreign currency position risk requirement increased, reflecting increased foreign currency cash positions over the period.
- Specific interest rate risk of securitisation positions: This charge rose, reflecting the change in treatment regarding securitisation exposures with a risk weight of 1,250%.
- Overall, the Pillar 1 model-based PRR declined 31% during 2014, driven by reductions in the VaR and SVaR charges and the IRC, offset somewhat by an increase in the RNIV charge.
- The decrease in the VaR and SVaR charges was primarily driven by the removal of the CVA eligible hedges (as noted above) in Q1 and ongoing risk reduction in Q2 and Q3 relating to the asset backed product portfolio as part of the risk reduction strategy.
- The IRC declined by 32%, notably in Q4 reflecting a reduced exposure to the eurozone periphery and continued risk reduction in the US ABP portfolio.
- Given the reduction in the size of the correlation trading portfolio, RBS Group ceased using an internal model for all price risk during Q2 2014. With the PRA's approval, all remaining open risk is now capitalised under standardised rules.
- The RNIV charge increased by 46% year on year. This was primarily due to the removal of the materiality threshold in Q1, and hence all RNIVs are now subject to capital requirements, following an agreement with the PRA. This initial increase was partially offset by risk reductions across the portfolio in H2.

*unaudited

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.

For more information on valuation controls, refer to page 138. The validation of pricing models is discussed below.

Model validation

The independent model validation framework governing both pricing models and risk models (including VaR) is described below.

The Group uses a variety of models to manage and measure market risk, as described below. These models comprise pricing models (used for valuation of positions) and risk models (for risk measurement and capital calculation purposes). These are subject to independent review and sign-off.

A dedicated independent model review and challenge function - Model Risk - performs reviews of relevant 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 no longer fit for purpose or a new product requires a new methodology or model to quantify the risk appropriately. Amendments are usually made when a weakness is identified during use of a model or following analysis either by the model developers or by Model Risk.

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

Risk models*

All new risk models are subject to review and sign-off by Model Risk.

All model changes are approved through model governance at the 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 Model Risk review and sign-off as are all model changes that require regulator approval before implementation.

Model Risk'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, Model Risk 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 market risks have been sufficiently captured;
- Re-applying the proposed approach to verify that the same outcome is achieved;
- 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.

*unaudited

Traded market risk *continued*

Based on the review and findings from Model Risk, an internal model governance committee with appropriate delegated authority considers 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 PRA approval before implementation.

Model Risk also reassesses the appropriateness of approved risk models on a periodic basis according to the approved Periodic Review Policy. Each periodic review consists of a quick scan assessment and a subsequent decision by an internal model governance committee with appropriate delegated authority to re-ratify a model based on the quick scan assessment or to perform additional work prior to making a decision whether or not to re-ratify a model. In the quick scan assessment Model Risk assesses changes since the last approval along the following dimensions: 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.

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

The model testing team in Market Risk also performs regular VaR model testing, which is discussed in more detail under Risk measurement - value-at-risk on page 140.

Non-traded market risk

Risk governance

The RBS Group Chief Risk Officer delegates responsibility for day-to-day control of non-traded interest rate risk and foreign exchange risk to the Director of Market Risk.

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

Controls and assurance

The RBS Group 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 models used for managing non-traded market risk are subject to the validation process described on page 147.

Risk appetite*

The ERF sets the RBS Group's appetite for non-traded market risk and approves appropriate risk limits as recommended by the Director of Market Risk and the RBS Group ALCo. Further information on the process and the limit framework can be found on pages 60 to 64.

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).
- 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. This risk primarily arises in the US mortgage business in CFG where long-term fixed-rate loans are the norm and prepayment penalties are rare.

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 RBS Group 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 CFG and 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.

*unaudited

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 RBS Group 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 RBS Group ALCo at least quarterly.

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

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 charges 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.

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.

	Average £m	Period end £m	Maximum £m	Minimum £m
2014	96	72	132	66
2013	100	108	130	73
2012	132	59	183	59
		2014 £m	2013 £m	2012 £m
Euro		1	4	24
Sterling		24	27	33
US dollar		48	114	67
Other		3	2	1

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 decline in VaR between end-2013 and end-2014 reflects RBS Group policy to reduce economic exposure to changes in interest rates. This notably related to US dollar and sterling interest rate exposures.
- The reduction in exposure was achieved through both hedging and the utilisation of naturally arising balance sheet offsets, such as the increase in net free reserves following the partial IPO of CFG.

Financial review Capital and risk management

Non-traded market risk continued

Foreign exchange risk

The Group does not maintain material non-traded open currency positions other than the structural foreign currency translation exposures arising from its investments in foreign subsidiaries and associated undertakings and their related currency funding.

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

	Net assets of overseas operations £m	Non-controlling interests (NCI) £m	Net assets of overseas operations excluding NCI £m	Net investment hedges £m	Structural foreign currency exposures £m
2014					
US dollar	10,495	(2,321)	8,174	(2,713)	5,461
Euro	4,337	—	4,337	(184)	4,153
Swiss franc	930	—	930	(902)	28
Other non-sterling	1,406	—	1,406	(898)	508
	17,168	(2,321)	14,847	(4,697)	10,150
2013					
US dollar	15,079	—	15,079	(765)	14,314
Euro	4,280	—	4,280	(194)	4,086
Swiss franc	1,068	—	1,068	(969)	99
Other non-sterling	1,483	—	1,483	(1,015)	468
	21,910	—	21,910	(2,943)	18,967
2012					
US dollar	16,194	—	16,194	(1,386)	14,808
Euro	7,271	—	7,271	(199)	7,072
Swiss franc	1,122	—	1,122	(1,045)	77
Other non-sterling	1,439	—	1,439	(1,011)	428
	26,026	—	26,026	(3,641)	22,385

Key points

- The Group's structural foreign currency exposure at 31 December 2014 was £10.2 billion, £8.8 billion lower than at 31 December 2013, of which £7.5 billion related to CFG. Movements in structural foreign currency exposure result from changes in the net assets of overseas operations, non-controlling interests and net investment hedges.
- Net assets of overseas operations declined by £4.7 billion, largely due to write-downs relating to CFG and US deferred tax assets.
- Non-controlling interests increased by £2.3 billion, largely as a result of the partial disposal of CFG during the year.
- Net investment hedges increased by £1.8 billion, primarily due to an increase in US dollar hedging to manage the disposal of CFG.
- Changes in foreign currency exchange rates affect equity in proportion to structural foreign currency exposure. For example, a 5% strengthening in foreign currencies against sterling would result in a gain of £0.5 billion in equity (2013 - £1.0 billion), while a 5% weakening would result in a loss of £0.5 billion in equity (2013 - £0.9 billion).

Financial review Capital and risk management

VaR for selected AFS non-trading portfolios

Available-for-sale portfolios in CIB and RCR, other than the structured credit portfolio, do not typically form part of the structural interest rate framework due to the short-term nature of the interest rate risks they carry. They are thus monitored and managed through the same framework and using the same metrics as portfolios in the trading book.

	2014				2013				2012			
	Average £m	Period end £m	Maximum £m	Minimum £m	Average £m	Period end £m	Maximum £m	Minimum £m	Average £m	Period end £m	Maximum £m	Minimum £m
Interest rate	1.8	1.8	5.5	1.1	1.9	0.9	4.7	0.8	6.3	4.6	9.1	4.1
Credit spread	2.8	2.4	4.1	1.7	5.2	2.3	9.1	2.3	9.8	8.7	12.5	6.7
Currency	0.3	0.4	0.7	—	0.5	0.3	2.6	0.1	2.3	0.4	4.0	0.2
Equity	—	—	—	—	—	—	—	—	—	—	0.1	—
Diversification (1)	(1.9)				(1.1)				(4.3)			
Total	3.2	2.7	6.4	2.0	5.3	2.4	9.4	2.4	9.6	9.4	12.1	7.8

Notes:

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

Key points

- The average total and credit spread VaR declined in 2014 compared with 2013. This was largely driven by a decline in the credit spread VaR in Q1, which partly reflected a decision to switch some of the securities held as collateral from floating-rate notes issued by financial institutions to government bonds during March as part of RWA reductions.
- A further driver of the decline, which largely affected the last three quarters of the year, was the decision to reduce the US ABP business in line with the exit strategy.

Structured credit portfolio

The structured credit portfolio is measured on a notional and fair value basis because of its illiquid nature. Notional and fair value decreased to £0.4 billion and £0.3 billion respectively (2013 - £0.7 billion and £0.5 billion), reflecting the sale of underlying assets, primarily consumer ABS, RMBS and CLOs/CDOs, in line with RCR strategy.

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 the RBS Group's NTIRR is captured under the Pillar 2A process. This is calculated by considering the potential impact on 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.

Non-traded equity risk is captured in credit risk RWAs.

The capital calculations under internal capital adequacy assessment process are also used for economic capital purposes.

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Country risk

Definition

Country risk is the risk of losses occurring as a result of either a country event or unfavourable country operating conditions. As country events may simultaneously affect all or many individual exposures to a country, country event risk is a concentration risk. For other types of concentration risks such as product, sector or single-name concentration, refer to the Credit risk section.

Sources of risk

Country risk has the potential to affect all parts of RBS plc's portfolio across wholesale and retail activities that are directly or indirectly linked to the country in question. It arises from possible economic or political events in each country to which RBS plc has exposure, and from unfavourable conditions affecting daily operations in a country.

Country events may include a sovereign default, a political conflict, a banking crisis or a deep and prolonged recession leading to possible counterparty defaults. Transfer or convertibility restrictions imposed by a country's government to stem the loss of foreign currency reserves may temporarily prevent counterparties from meeting their foreign currency payment obligations. Major currency depreciation may also affect a customer's income or debt burden, leading to default.

Unfavourable operating conditions may include the risk that a weak or creditor-unfriendly legal system within a country makes it difficult for RBS plc to recover its claims in the event of customer default. An unreliable or unstable political system may lead to sudden compliance or reputational issues, or even expropriation without proper compensation.

Overview*

The conflict between Ukraine and Russia and the consequent escalating tensions between Russia and the West triggered an internal review of credit grades. Limits for both countries were adjusted, additional credit restrictions were placed on new business and exposures were reviewed against international sanctions.

The eurozone region emerged from recession, with some of the periphery countries recovering but growth in other countries, including Germany mostly sluggish. The EU's Single Supervisory Mechanism (SSM) commenced in November 2014 when the European Central Bank (ECB) assumed supervisory responsibility for the 130 largest banks of the eurozone, after concluding a detailed Asset Quality Review of their books, adjusting balance sheets and stress testing their capital positions.

Outlook for 2015*

In 2015, recovery in the advanced economies will likely remain uneven, with widening differentials between the US and Europe in growth, price levels and policies. The policy divergence will be amplified by the January 2015 ECB announcement of a €1,000 billion quantitative easing programme.

The Chinese economy continues its structural slowdown; broad reforms aim at ensuring more sustainable long-term growth, but accumulated financial vulnerabilities bear downside risks.

*unaudited

Governance*

All country exposures in the Group are covered by RBS Group's country risk framework.

The RBS Group Executive Risk Forum (ERF) delegates authority to set sovereign ratings, sovereign loss given default rates, and country watchlist colours to the RBS Group Chief Credit Officer (CCO), who may further delegate this authority to Strategic Risk. The ERF delegates authority to decide on country risk matters such as risk appetite, risk management strategy and framework, and risk exposure and policy to the RBS Group Credit Risk Committee (CRC), which may further delegate it to Country Risk Management (CoRM). This includes the setting of country limits, where appropriate including allocations for specific product groups. The CCO and CRC can escalate issues to the ERF when necessary.

For further information on governance, refer to the Risk governance section on page 41.

Risk appetite*

RBS Group's country risk appetite framework has "top-down" and "bottom-up" components.

The top-down component is guided by RBS Group's global risk appetite; each country's internal sovereign rating; its strategic importance to the bank; the composition of the bank's portfolio; the funding profile; and an assessment of the potential for losses arising from possible key country risk events. This component provides a clear structure for the consideration of downside scenarios, the identification of countries that pose material concentration risks to the bank, and possible management actions.

Bottom-up analysis includes the risk/return relationship as well as reputational and regulatory risk.

RBS Group country limits are set for almost all countries. The UK is an exception, given its home country status. The US is another exception because of the specific local risk management structure, the size of the local portfolio and corresponding role in RBS Group-wide risk management, together with the country's strong ratings.

Risk mitigation*

Part of RBS plc's exposure is mitigated by guarantors or insurers (including export credit agencies), credit default swap (CDS) protection providers, or collateral in third countries, which will not be directly affected by a country event in the obligor's country. Further details on credit mitigation instruments are provided in the Credit risk section.

CDS contracts are used to hedge either entire portfolios or specific individual exposures. These transactions are subject to regular margining, which usually takes the form of cash collateral. For European peripheral sovereigns, credit protection is purchased from a number of major European banks, mostly outside the country of the reference entity. In a few cases where protection was bought from banks in the country of the reference entity, giving rise to wrong-way risk, this risk is mitigated through specific collateralisation and monitored weekly.

Country risk *continued*

Risk monitoring*

The CoRM team monitors and reports on RBS Group-level exposures to all countries, and follows up with the customer businesses in the event of limit excesses. CoRM has delegated authority up to specified levels to decide on country limit increases; any such decision must be reported to the CRC. Persistent excesses are escalated to the CRC.

A country risk watchlist process identifies emerging issues, facilitating the development of mitigation strategies. Monthly reports discussing RBS Group's main country risks and trends are sent to the CRC leadership team, with any key risks reported to RBS Group ExCo and the Board Risk Committee.

Countries watchlisted Amber are monitored closely. Appetite for countries watchlisted Red is limited to short-term business in areas such as trade finance and derivatives, unless the country is deemed a strategic priority country.

Detailed portfolio reviews are conducted to ensure that the composition of country portfolios remains aligned with RBS Group's country risk appetite in light of economic and political developments. Changes in sovereign ratings or country watchlist status trigger a review of appetite and, where appropriate, are referred to the CRC for discussion.

Measurement*

In this section, country exposure includes wholesale and retail net on-balance sheet exposure (drawn amounts under lending facilities, net of provisions, mark-to-market derivatives positions and issuer-risk debt securities positions in the banking book and trading book) together with off-balance sheet exposure (contingent obligations and undrawn commitments).

The bank also estimates its funding mismatches at risk of redenomination in vulnerable eurozone countries. These mismatches are defined as the exposures (net of provisions) that would be expected to convert to a new national currency minus the liabilities that would be expected to redenominate at the same time. Exposures exclude balances at low risk of redenomination, as identified through consideration of the relevant documentation, particularly the currency of exposure, governing law, court of jurisdiction, precise definition of the contract currency (for euro facilities), and location of payment.

Basis of preparation

The tables on pages 155 and 156 show the Group's exposure at 31 December 2014, 2013 and 2012. Exposures are reported by country of operation of the obligor, except exposures to governments and individuals, which are shown by country of residence.

The country of operation is the country where the main operating assets of a legal entity are held, or where its main cash flows are generated, taking account of the entity's dependency on subsidiaries' activities.

Countries shown are those which had ratings of A+ or below from Standard and Poor's, Moody's or Fitch at 31 December 2014, where RBS plc's balance sheet exposure (as defined in this section) to counterparties operating (or individuals residing) in them exceeded £1 billion. Also included are selected eurozone countries.

The exposures are stated before taking into account risk mitigants such as guarantees, insurance or collateral (with the exception of reverse repos) which may have been put in place to reduce or eliminate exposure to country risk events. The tables show CDS positions separately, as RBS plc may be either a net buyer or a net seller of protection.

Exposures relating to ocean-going vessels are not included as they cannot be meaningfully assigned to specific countries from a country risk perspective.

*unaudited

Financial review Capital and risk management

Summary of country exposures

2014	Net balance sheet exposure						Analysis of net balance sheet exposures						Off-balance sheet exposure £m	Total exposure £m	CDS notional less Gross		
	Sovereign £m	Banks £m	Other			Total £m	Net lending £m	Debt securities		Net		SFT £m			fair value £m	Gross	
			FI £m	Corporate £m	Personal £m			AFS/LAR £m	HFT (net) £m	Derivatives £m	SFT £m					Derivatives £m	SFT £m
Eurozone																	
Ireland	826	726	839	5,611	14,593	22,595	21,134	56	413	991	1	2,913	25,508	(48)	2,135	1,464	
Italy	22	1,968	241	1,186	25	3,442	987	44	5	2,406	—	2,031	5,473	(472)	8,641	823	
Spain	210	583	164	2,182	88	3,227	2,022	6	364	835	—	1,920	5,147	(310)	3,913	422	
Portugal	111	220	90	319	8	748	282	20	152	294	—	222	970	(155)	338	613	
Greece	8	258	1	92	17	376	63	—	8	305	—	23	399	(8)	416	—	
Cyprus	—	—	—	80	14	94	75	—	—	19	—	16	110	—	19	—	
Eurozone periphery																	
Germany	14,872	3,936	5,475	2,041	86	26,410	4,562	6,992	5,653	8,308	895	6,008	32,418	(1,736)	39,262	8,547	
France	5,008	7,085	1,924	1,764	81	15,862	2,930	1,743	4,034	6,389	766	8,471	24,333	(2,384)	41,094	17,442	
Netherlands	330	5,511	5,406	2,082	29	13,358	2,831	1,493	2,509	6,441	84	6,155	19,513	(798)	20,588	3,573	
Belgium	554	2,215	88	389	21	3,267	566	15	375	2,227	84	855	4,122	(218)	3,264	932	
Luxembourg	18	554	645	781	5	2,003	966	329	70	461	177	1,475	3,478	(52)	696	2,628	
Other	1,540	762	44	533	16	2,895	612	200	930	1,148	5	1,047	3,942	(560)	4,818	302	
Total eurozone																	
Japan	4,264	1,889	514	322	33	7,022	1,595	—	3,043	2,358	26	842	7,864	(25)	10,129	10,005	
China	126	783	135	1,253	41	2,338	1,978	—	62	185	113	304	2,642	(4)	243	4,770	
Russia	53	711	101	915	50	1,830	1,673	39	—	118	—	167	1,997	(166)	202	—	
South Korea	325	507	108	397	3	1,340	639	203	167	331	—	426	1,766	106	600	29	
Turkey	161	216	103	715	19	1,214	1,158	44	5	7	—	130	1,344	(36)	40	1,209	
2013																	
Eurozone																	
Ireland	164	641	561	8,973	15,821	26,160	24,893	46	248	900	73	2,710	28,870	(166)	2,476	2,329	
Italy	1,270	738	752	1,171	26	3,957	1,444	91	1,240	1,182	—	1,958	5,915	(574)	7,183	527	
Spain	814	638	89	3,085	293	4,919	3,076	1	853	989	—	1,930	6,849	(440)	4,128	2,126	
Portugal	35	238	87	307	6	673	290	22	43	318	—	280	953	(163)	418	614	
Greece	1	227	1	103	14	346	87	—	—	259	—	25	371	(12)	455	—	
Cyprus	2	1	—	108	10	121	103	—	2	16	—	18	139	—	16	—	
Eurozone periphery																	
Germany	10,469	5,002	4,265	3,457	90	23,283	7,958	4,792	2,524	7,408	601	7,017	30,300	(1,327)	35,529	1,128	
France	2,447	6,713	1,717	2,427	79	13,383	4,196	1,218	1,678	5,660	631	9,583	22,966	(1,723)	30,644	7,536	
Netherlands	1,095	4,486	2,927	2,267	22	10,797	2,875	1,598	819	5,398	107	6,280	17,077	(75)	15,388	835	
Belgium	(336)	1,877	127	431	21	2,120	592	1	(480)	2,005	2	1,158	3,278	(122)	2,966	594	
Luxembourg	10	480	659	385	4	1,538	741	75	97	537	88	1,043	2,581	(56)	1,373	253	
Other	814	606	56	757	18	2,251	879	50	330	918	74	1,181	3,432	(475)	3,554	622	
Total eurozone																	
Japan	1,470	2,240	830	688	35	5,263	2,797	72	(172)	2,364	202	351	5,614	4	9,057	16,445	
China	191	1,888	45	1,066	33	3,223	2,918	—	5	300	—	1,023	4,246	(14)	372	830	
Russia	189	754	6	873	53	1,875	1,705	149	2	19	—	364	2,239	(65)	33	27	
South Korea	239	755	129	576	2	1,701	1,125	179	151	246	—	680	2,381	176	541	50	
Turkey	232	166	126	1,077	24	1,625	1,414	50	67	94	—	324	1,949	(32)	119	998	

Financial review Capital and risk management

Country risk continued

Summary of country exposures

2012	Net balance sheet exposure						Analysis of net balance sheet exposures						Off-balance sheet exposure £m	Total exposure £m	CDS notional less fair value				
	Sovereign £m	Banks £m	Other			Total £m	Net lending £m	Debt securities		Net		Derivatives £m			SFT £m	Total exposure £m	fair value £m	Gross	
			FI £m	Corporate £m	Personal £m			AFS/LAR £m	HFT (net) £m	Derivatives £m	SFT £m							Derivatives £m	SFT £m
Eurozone																			
Ireland	140	1,287	922	12,315	16,205	30,869	28,752	46	362	1,206	503	2,817	33,686	(70)	2,884	4,915			
Italy	667	1,075	1,115	2,257	23	5,137	2,384	357	630	1,766	—	2,610	7,747	(402)	9,062	3			
Spain	407	1,279	201	4,455	313	6,655	4,374	23	503	1,755	—	1,511	8,166	(372)	5,694	610			
Portugal	30	335	141	365	7	878	397	42	35	404	—	302	1,180	(125)	498	26			
Greece	33	298	(7)	185	13	522	162	—	1	359	—	28	550	(30)	606	—			
Cyprus	3	11	1	28	14	57	21	—	4	32	—	14	71	—	33	—			
Eurozone periphery																			
Germany	30,642	6,328	4,130	4,659	85	45,844	25,626	7,106	3,500	9,353	259	7,264	53,108	(1,438)	57,141	8,135			
France	3,984	8,736	2,191	3,128	71	18,110	5,483	975	3,581	7,373	698	9,226	27,336	(2,267)	44,963	16,632			
Netherlands	870	7,782	3,415	3,054	26	15,147	3,533	2,028	668	8,583	335	7,117	22,264	(1,012)	23,163	4,602			
Belgium	662	2,635	294	603	22	4,216	668	1	564	2,983	—	969	5,185	(214)	4,753	476			
Luxembourg	13	720	960	597	4	2,294	1,208	58	192	709	127	1,176	3,470	(204)	2,012	3,844			
Other	1,453	1,057	99	1,056	14	3,679	1,269	—	666	1,736	8	1,346	5,025	(436)	5,974	1,431			
Total																			
eurozone	38,904	31,543	13,462	32,702	16,797	133,408	73,877	10,636	10,706	36,259	1,930	34,380	167,788	(6,570)	156,783	40,674			
Japan	7,128	2,646	884	506	36	11,200	1,752	1,483	4,890	2,876	199	577	11,777	(71)	13,262	15,047			
China	699	586	8	360	31	1,684	798	5	1	879	1	507	2,191	45	219	1,818			
Russia	54	901	14	570	54	1,593	1,434	—	139	20	—	369	1,962	(251)	24	15			
South Korea	25	780	136	7	3	951	826	—	53	46	26	196	1,147	(58)	213	94			
Turkey	459	38	94	1,047	12	1,650	1,376	56	125	93	—	442	2,092	(37)	111	449			

Notes:

- (1) Net lending - Comprises loans and advances, including cash balances and risk elements in lending - net of provisions.
- (2) Debt securities - Comprise securities classified as available-for-sale (AFS), loans and receivables (LAR), held-for-trading (HFT) and designated as at fair value through profit or loss (DFV). All debt securities other than LAR securities are carried at fair value. LAR debt securities are carried at amortised cost less impairment. HFT debt securities are presented as long positions (including DFV securities) net of short positions per country. Impairment losses and exchange differences relating to AFS debt securities, together with interest, are recognised in the income statement. Other changes in the fair value of AFS securities are reported in AFS reserves.
- (3) Derivatives (net) - Comprise the mark-to-market (mtm) value of such contracts after the effect of legally enforceable netting agreements in line with the corresponding regulatory capital models, but before the effect of collateral.
- (4) Securities financing transactions (SFT) (net) - Comprise the mtm value of the cash and securities that are due to RBS plc at a future date under repurchase agreements, reverse repurchase agreements, stock borrowing, stock lending and equity financing transactions, after the effect of collateral intrinsic to the transaction and legally enforceable netting agreements. Counterparty netting is applied as per the corresponding regulatory capital approach. Additional collateral called to offset mtm positions (variation margin) is not included.
- (5) Net balance sheet exposure - Comprises net lending, debt securities, derivatives (net) and SFT (net) exposures, as defined above.
- (6) Off-balance sheet - Comprises letters of credit, guarantees, other contingent obligations and legally committed undrawn facilities.
- (7) Total exposure - Comprises net balance sheet exposure and off-balance sheet exposure, as defined above.
- (8) Credit default swaps (CDSs) - Under a CDS contract, the credit risk on the reference entity is transferred from the buyer to the seller. 'Fair value' (or 'mtm value') represents the balance sheet carrying value of the resulting exposure. The mtm value of CDSs is included in derivatives against the counterparty of the trade, as opposed to the reference entity. The notional is the par value of the credit protection bought or sold and is included against the reference entity of the CDS contract. The column 'CDS notional less fair value' represents the net effect on exposure should the CDS contracts be triggered by a credit event, assuming a zero recovery rate on the reference exposure. This net effect would be the increase in exposure arising from sold positions netted against the decrease arising from bought positions. For a sold position, the change in exposure equals the notional less the fair value amount; this represents the amount RBS plc would owe to its CDS counterparties if the reference entity defaulted. Positive recovery rates would tend to reduce the gross components (increases and decreases) of those numbers. Exposures relating to credit derivative product companies (CDPCs) and related hedges as well as Nth-to-default basket swaps have been excluded, as they cannot be meaningfully attributed to a particular reference entity or country. Exposures to CDPCs are disclosed on page 128.
- (9) Sovereign - Comprises central, regional and local government, and central banks.
- (10) Eurozone periphery - Ireland, Italy, Spain, Portugal, Greece and Cyprus.
- (11) Other eurozone - Austria, Estonia, Finland, Latvia, Malta, Slovakia and Slovenia.

Key points*

- The comments below relate to changes in country exposures in 2014 unless indicated otherwise.
 - Net balance sheet and off-balance sheet exposure to most countries declined across most products. The bank maintained a cautious stance and many clients continued to reduce debt levels. The euro depreciated against sterling by 6.5% while the US dollar appreciated by 5.9%.
 - Total eurozone net balance sheet exposure increased by £4.7 billion or 5% to £94.3 billion. Reductions in eurozone periphery countries and in net lending in other countries were more than offset by increases in debt securities and derivatives exposure, particularly in Germany, France and the Netherlands. The main reductions were in lending to corporate clients (mostly in Ireland, Germany, Spain and France) and to the Irish personal sector, and in net held-for-trading (HFT) government bond positions in Italy and Spain. Net HFT debt securities in Germany, France, the Netherlands, Belgium and a few other countries increased, driven by trading activity and auctions. Notional bought and sold CDS decreased significantly, primarily as a result of novations. On balance, net bought CDS protection on eurozone exposures increased by £1.6 billion. This largely related to hedging of the credit valuation adjustment on uncollateralised or under-collateralised positions, the fair value of which increased driven by much lower interest rates and a stronger US dollar.
 - Eurozone periphery net balance sheet exposure decreased by £5.7 billion to £30.5 billion.
 - Ireland - net balance sheet exposure fell by £3.6 billion or 14% to £22.6 billion, with exposure to corporates and households decreasing by £3.4 billion and £1.2 billion respectively, reflecting sales, repayments and write-offs (partly offset by impairment write-backs) plus currency movements. Provisions fell by £2.2 billion to £8.5 billion, reflecting improved collateral values. Cash deposits with the Central Bank of Ireland increased by £0.5 billion as part of Ulster Bank's preparations for the new Capital Requirements Regulation liquidity coverage ratio requirements which come into effect in 2015.
 - Italy - exposure fell by £0.5 billion to £3.4 billion, largely reflecting fluctuations in net HFT. Most AFS government bonds were sold, and lending and derivatives exposure to non-bank financial institutions fell by £0.5 billion. Net derivatives exposure to banks increased by £1.2 billion, driven by the acquisition of a fully cash-collateralised exposure from another bank.
 - Spain - exposure decreased by £1.7 billion to £3.2 billion, driven by reductions in net HFT debt exposure and in lending to the construction, telecommunications and other sectors.
 - Portugal - exposure was stable at £0.7 billion. HFT debt securities increased as trading returned but remained small.
 - Greece - exposure was essentially unchanged at £0.4 billion. This comprised mostly collateralised derivatives exposure to banks and corporate lending, including exposure to local subsidiaries of international companies. Net of collateral held under credit support annex and reflecting the effect of credit agency cover and parental guarantees, total committed exposure was £0.1 billion net of provisions, mostly in RCR. Contingency planning, including any potential operational and system changes, has been refreshed to ensure readiness for any downside scenario.
 - Funding mismatches - material estimated funding mismatches at risk of redenomination at 31 December 2014 were:
 - Ireland £4.0 billion (down from £6.0 billion due to reduced lending).
 - Spain £0.5 billion (down from £2.0 billion, largely due to the reduction in AFS securities).
 - Italy £1.0 billion (up from minimal due to higher derivatives exposure, lower euro deposits and as the central bank funding line was no longer used).
 - Portugal £0.5 billion (slightly up due to higher debt trading).
- The net positions for Greece and Cyprus were minimal. With the possible exception of Greece, risks of eurozone break-up (redenomination events) have materially receded since 2011-2012, owing to major improvements in liquidity conditions, driven by the availability of substantial new tools for the European Central Bank, the establishment of the European Stability Mechanism and member countries' progress on reducing imbalances.
- Germany - net balance sheet exposure rose by £3.1 billion to £26.4 billion, as a result of increases in net HFT exposure, AFS debt securities and derivatives exposure to non-bank financial institutions. This was partially offset by decreases in corporate lending (particularly in CRE) and to securitisation vehicles, and in cash deposits with the Bundesbank. Off-balance exposure decreased by £1.0 billion, mostly in the insurance and corporate sectors. Government bond holdings were £12.1 billion (AFS - £6.6 billion; HFT net long positions - £5.5 billion) at the end of the year.

*unaudited

Country risk continued

- France - net balance sheet exposure rose by £2.5 billion to £15.9 billion, mainly reflecting debt trading fluctuations and increased derivatives exposure to banks and SFT. Lending to the public, CRE and telecommunications sectors decreased. The bank had £4.5 billion government bond holdings at 31 December 2014 (AFS - £0.9 billion; HFT net long positions - £3.6 billion). Off-balance exposure fell by £1.1 billion to £8.5 billion, particularly in the corporate and government sectors.
- Netherlands - net balance sheet exposure increased by £2.6 billion to £13.4 billion, as net HFT exposure rose by £1.7 billion through normal market fluctuations while derivatives exposure increased by £1.0 billion to £6.4 billion, largely driven by business with a few major banks.
- Belgium - net balance sheet exposure increased by £1.1 billion to £3.3 billion, mostly in HFT government bonds and derivatives exposure to banks.
- Other eurozone - net HFT government bonds increased by £0.6 billion to £0.9 billion, reflecting increased long positions.
- Japan - HFT government bond exposure increased by £3.2 billion to £3.0 billion, driven by market fluctuations. This rise was partly offset by reductions in central bank deposits, in corporate and bank lending, and in derivatives and SFT exposure to financial institutions. In 2015, the bank will be closing its onshore trading business and withdrawing from Japanese government primary bonds dealership activity.
- China - lending to banks and off-balance sheet exposure decreased by £1.2 billion and £0.7 billion respectively to £0.6 billion and £0.3 billion, mostly in trade finance, driven by more stringent capital requirements and an effort by the bank to improve average returns in a highly competitive environment. Given concerns about economic risks, the bank undertook stress testing across both financial institutions and corporate portfolios and started setting early warning indicators and action plans.
- Russia - net balance sheet exposure was £1.8 billion and included £0.9 billion of corporate lending and £0.7 billion bank lending, around half of which was fully hedged. Internal ratings were reviewed, additional credit restrictions placed on new business, and limits adjusted downwards. Exposures were reviewed against all international sanctions.
- South Korea - net lending to banks and corporate clients decreased by £0.4 billion, reflecting a greater focus on capital efficiency. Net balance sheet exposure was £1.3 billion.
- Turkey - net balance sheet exposure fell by £0.4 billion to £1.2 billion, mainly reflecting lower lending to corporates.
- Shipping - exposures relating to ocean-going vessels are not included in the country risk disclosures as they cannot be meaningfully assigned to specific countries. The bank's shipping portfolio of £10.4 billion is predominantly US dollar-denominated and under English law, and is not expected to be affected by specific country events.

Other risks	
160	Pension risk
162	Business risk
162	Strategic risk

Other risks*

Pension risk

Definition

Pension risk is the risk arising from contractual or other obligations to, or with respect to, the Group's pension schemes, whether established for its employees or for those of a related company. It is also the risk that the Group may make payments or other contributions to, or with respect to, a pension scheme because of a moral obligation, or for any other reason.

Sources of risk

The Group has exposure to pension risk through its defined benefit schemes worldwide. The five largest schemes, which represent around 96% of the bank's pension liabilities, are the Royal Bank of Scotland Group Pension Fund ('Main scheme'), the Ulster Bank Pension Scheme (Republic of Ireland), the Ulster Bank Pension Scheme, the Royal Bank of Scotland Americas Pension Plan and the Royal Bank of Scotland International Pension Trust. The Main scheme is the principal source of pension risk.

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.

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 RBS Group and four directors nominated by members. The trustee is supported by RBS Investment Executive Ltd (RIEL), a team specialising in pension investment and risk management.

The Pension Risk Committee (PRC), acting as a sub-committee of the RBS Group Asset and Liability Committee (ALCo), formulates RBS's view of pension risk. The PRC considers mechanisms that could potentially be used for managing risk within the funds 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 RBS Group's approach to pension risk where risk management, asset strategy and financing issues are reviewed and monitored on behalf of RBS Group. The PRC also serves as a formal link between RBS Group, RIEL and the trustee.

For further information on risk governance, refer to page 41.

Risk appetite and monitoring

Investment policy for the schemes is defined by the trustee with quantitative and qualitative 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 RBS Group on material changes to risk appetite and investment policy.

As the sponsor of its defined benefit pension schemes, the Group manages the risk it faces using a pension risk management framework. This encompasses risk monitoring, modelling, stress testing and reporting. As sponsor, RBS Group maintains an independent view of the risk inherent in its pension funds. In addition to the scrutiny provided by the PRC, the Group also achieves this through regular pension risk monitoring and reporting to the Board, the Executive Committee and the Board Risk Committee on the material pension schemes that the Group has an obligation to support. If agreement is not reached between the Group and the trustee, the Pensions Regulator can take action by appointing independent trustees, or by serving a contribution notice on the employer requiring payment to the scheme.

Risk mitigation

The trustee has taken measures to mitigate inflation and interest rate risks both by investing in suitable physical 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 88% of the Group's pension plan assets at 31 December 2014, 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.

Risk is also mitigated in other ways. In October 2006, the Main scheme was closed to new employees. In November 2009, the Group confirmed that it was making changes to the Main scheme and a number of other defined benefit schemes, including the introduction of a limit of 2% per annum (or the annual change in the Consumer Price Index, if lower) to the amount of any salary increase that will count for pensionable purposes.

In October 2012, the Group confirmed that it was offering employees in the Main scheme the choice between an increase to the charge, made through its flexible benefits programme, of 5% of salaries and an increase in Normal Pension Age from 60 to 65 in respect of service from October 2012 with no additional charge.

*unaudited

Financial review Capital and risk management

Risk measurement

Pension risk reporting is submitted monthly to the 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 and estimated capital requirements, and an assessment of the sensitivities of the pension schemes to interest rates, inflation and credit spreads.

The 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 European Banking Authority and the PRA. 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 (one that cannot be predicted precisely) and deterministic stresses over time horizons from one 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 Group's balance sheet, income statement and capital position are incorporated into the overall enterprise-wide stress test results.

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.

	Change in value of assets £m	Change in value of liabilities £m	Increase in net pension obligations £m
At 31 December 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)
At 31 December 2013			
Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields	217	333	(116)
Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields	595	895	(300)
Fall in credit spreads of 0.25% at all durations with no change in nominal or real swap yields	60	1,245	(1,185)
Fall in equity values of 10%	(894)	—	(894)
At 31 December 2012			
Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields	76	255	(179)
Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields	578	995	(417)
Fall in credit spreads of 0.25% at all durations with no change in nominal or real swap yields	71	1,261	(1,190)
Fall in equity values of 10%	(862)	—	(862)

*unaudited

Other risks* continued

Business risk

Definition

Business risk is the risk that the Group suffers losses as a result of adverse variances in its revenues, costs or both as a result of its business plan and strategy. Such variances may be caused by a variety of specific factors such as volatility in pricing, sales volumes, and input costs as well as more general factors such as exposure to macroeconomic, regulatory and industry risks.

Sources of risk

Business risk exists at all levels of the organisation and is generated at the transaction level. It is affected by other risks the Group faces, which could contribute to any adverse changes in revenues or costs. Refer to pages 36 to 38 for a full list of risks.

Governance

The Board has ultimate responsibility for business risk. Refer to the Risk governance section on page 41.

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 appetite

RBS Group assesses volatility in revenues and costs in determining whether RBS Group and its underlying businesses are within risk appetite. Each franchise is responsible for the implementation of its business plan and the management of associated risks within approved risk appetite targets.

Risk identification and monitoring

Business risk is identified and managed at the product and transaction level. Estimated revenue and costs, 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.

Business risk is reported, assessed and challenged at every governance level within the organisation. Each franchise monitors its revenues and costs relative to plans, reporting this on a regular basis to the finance directors of each franchise and to bank-wide functions. The Finance function challenges financial results and reports performance against plan to the Board and executive committees, focusing on revenue generation, cost management initiatives and risk mitigation.

Business risk is reviewed and assessed through the Group's planning cycles, which are discussed with RBS Group Risk Management, and performance management processes.

In the planning cycles, expected and potential scenarios for revenues and costs are determined, on a bottom-up basis, through plans reflecting expectations of the external environment and the bank's 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

RBS Group operates a forecasting process to identify projected changes in, or risks to, key financial metrics, and ensures appropriate actions are taken. RBS Group responded to business risk challenges by designing cost management programmes to deliver substantial savings in 2014 and beyond. RBS Group Risk Management was also involved in these discussions.

Risk measurement

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.

Strategic risk

Definition

Strategic risk is the risk that the Group will make inappropriate strategic choices, or that there will be changes in the external environment to which the Group fails to adapt its strategies.

Sources of risk

Strategic risk arises from decisions that fail to reflect the operating environment, or which do not take adequate account of execution challenges. These include decisions related to RBS Group products and services which have implications for profitability, risk, the customer base, and for business growth.

Failure to manage this risk could have a wide-ranging impact. It could lower revenues, profitability and returns to shareholders, and severely impair the Group's ability to meet other financial and non-financial objectives.

Governance

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

The Board has ultimate responsibility for approving strategic plans, initiatives and changes to strategic direction. In addition to the annual cycle, each customer business presents a more detailed individual "Deep Dive" review of key dimensions of its strategy at a Board meeting at different points during the year.

Risk appetite and identification

Strategic plans are assessed against, and must comply with, RBS Group's strategic risk objectives (refer to Risk appetite section, page 46). These objectives are intended to ensure that the Group's chosen strategies do not expose it to an inappropriate degree of financial and non-financial risk. These therefore represent the appetite for strategic risk.

The Group employs robust strategy development processes which consider the implications of economic, industrial, market, technological and customer developments and trends. RBS Group's Risk Management is involved in defining risk appetite for the customer businesses, and in challenging and reviewing strategic plans.

In addition, there are "Top Risks" and "Emerging Risks" processes in place which aim to identify early, monitor closely and avoid or otherwise manage effectively strategic risks that have the highest likelihood of impacting strategic plans.

Risk monitoring

Top and emerging risks processes monitor the most material risks to strategic objectives. Strategic progress is monitored through quarterly performance review meetings between customer business CEOs and the RBS Group CE, CFO, and Director of Strategy and Corporate Finance.

Individual customer businesses bear much of the responsibility for managing strategic risks. The senior leadership of the customer businesses track progress on the initiatives and action plans to deliver the strategy through a range of key performance indicators such as financial performance, risk metrics, market shares and numbers of customers, and satisfaction scores.

Risk mitigation

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.

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 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 Group may decide not to pursue the opportunity as a result of a perceived strategic risk.

RBS Group also undertakes strategic reviews to decide how to react to specific developments. It is now considering, for instance, how best to react to the Independent Commission on Banking's proposals for ring-fencing of retail banking operations.

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.

Report of the directors

The directors present their report together with the audited accounts for the year ended 31 December 2014.

Group structure

The Royal Bank of Scotland plc (the 'Bank') is a wholly-owned subsidiary of The Royal Bank of Scotland Group plc (the 'holding company'), which is incorporated in Great Britain and has its registered office at 36 St Andrew Square, Edinburgh EH2 2YB. The 'Group' comprises the Bank and its subsidiary and associated undertakings. Details of the principal subsidiary undertakings and their activities are shown in Note 17 on the accounts. 'RBS Group' comprises the holding company and its subsidiary and associated undertakings.

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

Following placing and open offers in December 2008 and in April 2009, HM Treasury (HMT) owned approximately 70.3% of the enlarged ordinary share capital of the holding company. In December 2009, the holding company issued a further £25.5 billion of new capital to HMT. This new capital took the form of B shares, which do not generally carry voting rights at general meetings of ordinary shareholders but are convertible into ordinary shares and qualify as Core Tier 1 capital.

At 31 December 2014, HMT's holding in the holding company's ordinary shares was 62.3%.

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

In 2007, RFS Holdings B.V., which was jointly owned by the Group, the Dutch State (successor to Fortis) and Santander (together, the "Consortium Members") completed the acquisition of ABN AMRO Holding N.V.

On 1 April 2010, the businesses acquired by the Dutch State were transferred to ABN AMRO Group N.V., itself owned by the Dutch State. In connection with the transfer ABN AMRO Holding N.V. was renamed RBS Holdings N.V. and its banking subsidiary was renamed The Royal Bank of Scotland N.V. ("RBS N.V.").

In October 2011, the Group completed the transfer of a substantial part of the UK activities of RBS N.V. to the Royal Bank. Substantially all of the Netherlands and EMEA businesses were transferred to the Royal Bank in September 2012. Russia, Korea and the North American businesses were transferred to the Royal Bank in 2013. During 2014, the Thailand business was transferred to the Royal Bank. Certain assets of RBS N.V. continue to be shared by the Consortium Members.

Results and dividends

The loss attributable to the ordinary shareholders of the Bank for the year ended 31 December 2014 amounted to £3,234 million compared with a loss of £7,309 million for the year ended 31 December 2013, as set out in the consolidated income statement on page 170.

The Bank did not pay a dividend on ordinary shares in 2014, 2013, or 2012.

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 divisions and the competitive markets in which they operate, are contained in the Financial review on pages 4 to 6.

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. Certain risk factors the Group faces are summarised in the Financial review on pages 7 to 9. Fuller details of these and other risk factors are set out on pages 288 to 307.

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 184 to 186.

The Group's approach to risk management, including its financial risk management objectives and policies and information on the Group's exposure to price, credit, liquidity and cash flow risk, is discussed in the Capital and risk management section of the Financial review on pages 33 to 163.

Financial performance

A review of the Group's performance during the year ended 31 December 2014, including details of each operating segment, and the Group's financial position as at that date is contained in the Financial review on pages 10 to 32.

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 2014, the Bank and its subsidiaries employed 81,200 employees (full time equivalent basis) throughout the world. Details of employee related costs are included in Note 3 on the accounts.

Leadership

Developing great leaders with the capability to deliver our ambition to be number one for customer service, trust and advocacy is a key priority, aligned to our People and Leadership Standards. In 2014 we rolled out Team Effectiveness sessions for new executive teams to help them role model our values and lead the transition to a new RBS Group.

Employee engagement

For RBS Group, building an engaged, healthy and inclusive workforce is crucial. Every year since 1999, through the Our View survey, people in all our businesses have shared their thoughts about what it's like to work at RBS Group. The survey enables our people leaders to monitor levels of engagement and work with their teams to make improvements to the working environment. It also provides a mechanism for RBS Group to track employee perception of our culture and the progress we're making.

Report of the directors

Living our values

The ways that we recruit, promote, reward, and manage our people are all aligned to our values, and this coherent approach is making a difference within the organisation – with more people (year on year) believing our values are making a difference to the way we work.

How we behave forms the character of our company and dictates how others see us. RBS Group's code of conduct, Our Code, reflects our values and applies to everyone who works here. It is supported by the YES Check: a simple decision-making framework to help our people translate Our Code into their day-to-day roles. The YES check has been designed to meet the Financial Conduct Authority's standard of conduct and is underpinned by ethical principles.

Our Code lets everyone know what to expect of each other, what to do when unsure of a decision, and where to go for advice when needed. It's available at [rbs.com>about us>our values](http://rbs.com/about-us/our-values), or without charge, upon request, by contacting Corporate Governance and Secretariat at the telephone number listed on page 2.

Customer performance

Our approach to performance management allows us to provide clarity for our people about how their individual contribution links to our ambition, reward the behaviour that supports our values, and hold individuals to account for behaviour and performance that does not. In 2014 we completed alignment of our approach to performance management across RBS Group, so that in 2015 there is consistent bank-wide use of our balanced scorecard, People standards, Leadership standards, and online system.

Simple Organisation

RBS Group is making steady progress towards building a smaller, simpler organisation. In 2014, we defined clear principles and practices around how the organisation would work, and new role accountabilities for the top 150 roles across the RBS Group, as part of redesigning our operating model.

We've moved from seven divisions to three customer franchises, redesigning our supporting functions and services to remove duplication and unnecessary management layers. In addition to supporting our strategic direction, this work has strengthened accountabilities across RBS Group, with robust governance in place to ensure future organisation designs are in line with these principles, positioning us to respond to ongoing regulatory requirements.

Employee consultation

RBS Group recognises employee representatives such as trade unions and work councils in a number of businesses and countries. Our European Employee Council provides an opportunity for elected representatives and management to discuss developments in RBS Group's European operations. Discussions have continued to take place with employee representatives where appropriate on the progress of our strategic plans.

Employee learning and development

RBS Group maintains a strong commitment to providing all our people with the opportunity to grow through learning and development, which in turn helps to achieve business objectives and drive excellent customer service.

Supporting the professionalisation of our front line staff, all of our customer-facing employees are aware of the professional standards expected of them, and as at the end of 2014, 86% have completed related professional development programmes, giving colleagues the skills they need to do their job and serve customers well. Building the capability of our people is also crucial to ensure effective compliance behaviour. RBS Group has mandatory training modules for all employees to improve their understanding of the processes and controls required to properly manage key risks.

Diversity and inclusion

RBS Group's ambition is to be number one for customer service, trust and advocacy in every one of our chosen business areas by 2020, supported by a people commitment to make RBS Group a great place to work. Valuing difference is therefore essential for our customers and colleagues. Our inclusion policy standard applies to all our people globally; and our strategy for diversity and inclusion sits with the Board and Executive Committee.

Our approach during 2014/15 focuses on building inclusion into all stages of the employee lifecycle. In 2014 we started rolling out bank-wide unconscious bias learning for all employees, which will continue across 2015. We've introduced a gender target to increase the number of women in senior roles across RBS Group. And we continue to support our employee-led networks, with membership across RBS Group at over 15,000 people.

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

Wellbeing

Ensuring and supporting the wellbeing of our people is an important responsibility for RBS Group. A wide range of health benefits and services is in place to help them maintain good physical and psychological health, and support them if they do become unwell, including Lifematters, RBS Group's Employee Assistance Programme. We continue to enhance and promote these services, targeting those issues that we know affect our people's ability to bring the best of themselves to work. In 2014, Lifematters Online activity improved significantly through promotion via road shows, wellbeing fairs, and internal communications; and the popularity of the Lifematters App, which was launched in late 2013, continued to grow. In 2014 RBS Group also signed up to Time to Change: the UK's biggest programme to challenge mental health stigma.

Sustainability

Sustainability at RBS Group means building our business around long term thinking and support for our customers and the communities in which they live. Our core responsibility is to obey the law and to ensure that our business is built on safe and secure financial foundations, and we have worked hard in the years since the financial crisis to achieve this position. This underpins everything that RBS Group does and enables people to run their daily lives and businesses. Our position as a provider of credit supports economic growth and brings wider benefits to society.

Report of the directors

But our ambition is to go further, to shape the world around us in a positive way. We recognise that we still have a long way to go to achieve this position across our business. Sustainability is therefore not just about the many responsibilities and obligations that RBS Group has, but about taking leadership on a broad range of issues that are important to our Stakeholders.

The Sustainable Banking Committee is responsible for overseeing and challenging how management is addressing sustainable banking and reputation issues, considering the long term interests of all stakeholder groups.

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

Going concern

The Group's business activities and financial position, the factors likely to affect its future development and performance and its objectives and policies in managing the financial risks to which it is exposed and its capital are discussed in the Financial review. The risk factors which could materially affect the Group's future results are set out on pages 288 to 307. The Group's regulatory capital resources and significant developments in 2014 and anticipated future developments are detailed on pages 59 to 67. The liquidity and funding section on pages 68 to 78 describes the Group's funding and liquidity profile, including changes in key metrics and the build up of liquidity reserves.

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

Corporate governance

Internal control over financial reporting

The internal controls over financial reporting for the Group are consistent with those at the RBS Group level. The RBS Group is required to comply with Section 404 of the US Sarbanes-Oxley Act of 2002 and assess the effectiveness of internal control over financial reporting as of 31 December 2014.

The RBS Group assessed the effectiveness of its internal control over financial reporting as of 31 December 2014 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in 'Internal Control - Integrated Framework'.

Based on its assessment, management has concluded that, as of 31 December 2014, the RBS Group's internal control over financial reporting is effective.

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

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

Board of directors

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

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

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

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

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

Report of the directors

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

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

Share capital

Details of the ordinary and preference share capital at 31 December 2014 are shown in Note 26 on the accounts.

Directors

The current members of the Board are shown on page 2.

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

Tony di Iorio stepped down from the Board on 26 March 2014.

Nathan Bostock stepped down from the Board on 28 May 2014.

Phillip Scott stepped down from the Board on 31 October 2014.

Morten Friis was appointed to the Board on 10 April 2014.

Ewen Stevenson was appointed to the Board on 19 May 2014.

On 25 February 2015 the Board approved the appointment of Howard Davies as a non-executive director with effect from the end of June and as Chairman from 1 September 2015. Philip Hampton will step down as a director and Chairman with effect from 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 holding company at 31 December 2014 are disclosed in the Report and Accounts of that company. None of the directors held an interest in the loan capital of the holding company or in the shares or loan capital of the Bank or any of the subsidiaries of the Bank, during the period from 1 January 2014 to 25 March 2015.

Directors' indemnities

In terms of section 236 of the Companies Act 2006 (the "Companies Act"), Qualifying Third Party Indemnity Provisions have been issued by the holding company to 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 as discussed in Note 42, 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 additional disclosure in the accounts.

Political donations

During 2014, no political donations were made in the UK or EU, nor any political expenditure incurred in the UK or EU.

Directors' disclosure to auditors

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

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

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

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

Auditors

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

Following a tender process, Ernst & Young LLP will be appointed as the company's auditors for the financial year ending 31 December 2016, replacing Deloitte.

By order of the Board

Aileen Taylor
Secretary
25 March 2015

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

Statement of directors' responsibilities

This statement should be read in conjunction with the responsibilities of the auditor set out in their report on pages 169.

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

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

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

The directors confirm that to the best of their knowledge:

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

By order of the Board

Philip Hampton
Chairman

Ross McEwan
Chief Executive

Ewen Stevenson
Chief Financial Officer

25 March 2015

Board of directors

Chairman
Philip Hampton

Executive directors
Ross McEwan
Ewen Stevenson

Non-executive directors
Sandy Crombie
Alison Davis
Morten Friis
Robert Gillespie
Penny Hughes
Brendan Nelson
Baroness Noakes

Independent auditor's report to the members of The Royal Bank of Scotland plc

We have audited the financial statements of The Royal Bank of Scotland plc ("the Bank") and its subsidiaries (together the "Group") for the year ended 31 December 2014 which comprise the accounting policies, the balance sheets as at 31 December 2014, 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 2014, the related notes 1 to 42 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 the reasonableness of significant accounting estimates made by the directors in the preparation of the financial statements; whether the accounting policies are appropriate to the circumstances of the Bank and the Group and have been consistently applied and adequately disclosed; 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. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion

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 2014 and of the Group's loss for the year then ended;
- the Group's financial statements have been properly prepared in accordance with IFRS as adopted by the European Union;
- the Bank's financial statements have been properly prepared in accordance with IFRS as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Separate opinion in relation to IFRS as issued by the IASB

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

In our opinion the Group financial statements comply with IFRS 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
25 March 2015

Neither an audit nor a review provides assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular on whether any changes may have occurred to the financial information since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

Consolidated income statement for the year ended 31 December 2014

	Note	2014 £m	2013 £m	2012 £m
Interest receivable		12,805	14,151	15,109
Interest payable		(3,939)	(5,521)	(6,523)
Net interest income	1	8,866	8,630	8,586
Fees and commissions receivable		4,320	4,598	4,747
Fees and commissions payable		(842)	(892)	(947)
Income from trading activities		1,190	2,860	1,295
Gain on redemption of own debt		6	162	454
Other operating income		1,078	1,397	1,127
Non-interest income	2	5,752	8,125	6,676
Total income		14,618	16,755	15,262
Staff costs		(5,683)	(5,929)	(6,547)
Premises and equipment		(2,059)	(1,994)	(1,799)
Other administrative expenses		(4,361)	(6,530)	(4,804)
Depreciation and amortisation		(926)	(1,109)	(1,415)
Write down of goodwill and other intangible assets		(523)	(423)	(51)
Operating expenses	3	(13,552)	(15,985)	(14,616)
Profit before impairment releases/(losses)		1,066	770	646
Impairment releases/(losses)	13	1,337	(8,137)	(4,945)
Operating profit/(loss) before tax		2,403	(7,367)	(4,299)
Tax charge	6	(2,033)	(307)	(51)
Profit/(loss) from continuing operations		370	(7,674)	(4,350)
(Loss)/profit from discontinued operations, net of tax		(3,486)	410	490
Loss for the year		(3,116)	(7,264)	(3,860)
Attributable to:				
Non-controlling interests		57	(13)	19
Preference shareholders	7	61	58	58
Ordinary shareholders		(3,234)	(7,309)	(3,937)
		(3,116)	(7,264)	(3,860)

The accompanying notes on pages 188 to 284, the accounting policies on pages 176 to 186 and the audited sections of the Financial review: Capital and risk management on pages 33 to 163 form an integral part of these financial statements.

Consolidated statement of comprehensive income for the year ended 31 December 2014

	Note	2014 £m	2013 £m	2012 £m
Loss for the year		(3,116)	(7,264)	(3,860)
Items that do not qualify for reclassification				
Actuarial (losses)/gains on defined benefit plans	4	(100)	443	(2,130)
Tax		(36)	(246)	373
		(136)	197	(1,757)
Items that do qualify for reclassification				
Available-for-sale financial assets		132	(1,907)	(680)
Cash flow hedges		1,412	(2,485)	1,022
Currency translation		434	(197)	(787)
Tax		(401)	1,101	(20)
		1,577	(3,488)	465
Other comprehensive income/(loss) after tax		1,441	(3,291)	(2,222)
Total comprehensive (loss)/income for the year		(1,675)	(10,555)	(6,082)
Attributable to:				
Non-controlling interests		194	(10)	15
Preference shareholders		61	58	58
Ordinary shareholders		(1,930)	(10,603)	(6,155)
		(1,675)	(10,555)	(6,082)

The accompanying notes on pages 188 to 284, the accounting policies on pages 176 to 186 and the audited sections of the Financial review: Capital and risk management on pages 33 to 163 form an integral part of these financial statements.

Balance sheet as at 31 December 2014

	Note	Group			Bank		
		2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Assets							
Cash and balances at central banks	10	73,983	79,993	74,524	70,952	75,792	70,374
Amounts due from subsidiaries	10	2,333	15,058	21,875	24,839	41,110	65,671
Other loans and advances to banks	10	42,259	51,425	60,192	30,062	36,658	43,900
Loans and advances to banks	10	44,592	66,483	82,067	54,901	77,768	109,571
Amounts due from holding company and subsidiaries	10	1,323	1,620	1,866	41,196	49,945	55,468
Other loans and advances to customers	10	375,615	437,480	492,971	176,581	175,429	216,081
Loans and advances to customers	10	376,938	439,100	494,837	217,777	225,374	271,549
Debt securities subject to repurchase agreements	29	22,923	51,970	87,159	14,332	30,546	55,320
Other debt securities		61,351	48,726	49,426	73,262	61,781	67,127
Debt securities	15	84,274	100,696	136,585	87,594	92,327	122,447
Equity shares	16	5,203	8,278	13,872	4,880	7,301	12,766
Investments in Group undertakings	17	—	—	—	39,857	42,328	40,262
Settlement balances		4,710	5,634	5,717	3,381	3,492	3,090
Amounts due from holding company and subsidiaries	14	2,738	3,413	7,200	9,268	8,967	14,953
Other derivatives	14	351,844	285,990	437,901	350,557	283,913	434,885
Derivatives	14	354,582	289,403	445,101	359,825	292,880	449,838
Intangible assets	18	7,765	12,352	12,403	917	1,127	1,033
Property, plant and equipment	19	6,123	7,866	9,694	1,976	2,284	2,430
Deferred tax	24	1,510	3,435	3,066	733	2,298	2,878
Prepayments, accrued income and other assets	20	4,413	5,904	6,104	2,203	3,246	4,433
Assets of disposal groups	21	81,033	790	304	—	—	—
Total assets		1,045,126	1,019,934	1,284,274	844,996	826,217	1,090,671
Liabilities							
Amounts due to subsidiaries	10	4,208	2,463	6,063	121,489	133,215	130,126
Other deposits by banks	10	59,642	62,700	96,197	52,966	47,078	79,457
Deposits by banks	10	63,850	65,163	102,260	174,455	180,293	209,583
Amounts due to holding company and subsidiaries	10	5,843	5,207	5,778	29,240	47,399	84,992
Other customers accounts	10	389,156	467,097	513,419	144,276	146,154	171,342
Customer accounts	10	394,999	472,304	519,197	173,516	193,553	256,334
Debt securities in issue	10	41,996	59,746	83,278	36,743	51,538	71,494
Settlement balances		4,498	5,245	5,832	3,098	2,274	2,878
Short positions	22	23,028	28,004	27,541	16,590	17,898	14,074
Amounts due to holding company and subsidiaries	14	2,005	2,586	5,580	6,585	5,675	9,321
Other derivatives	14	348,778	283,547	430,505	348,162	282,832	429,831
Derivatives	14	350,783	286,133	436,085	354,747	288,507	439,152
Accruals, deferred income and other liabilities	23	12,262	14,753	12,027	5,622	7,201	7,355
Retirement benefit liabilities	4	2,550	3,188	3,854	192	65	56
Deferred tax	24	236	189	789	—	—	—
Amounts due to holding company	10	19,639	19,825	18,184	18,535	19,399	18,184
Other subordinated liabilities	10	10,830	13,309	15,667	8,945	11,167	13,451
Subordinated liabilities	25	30,469	33,134	33,851	27,480	30,566	31,635
Liabilities of disposal groups	21	71,284	3,210	135	—	—	—
Total liabilities		995,955	971,069	1,224,849	792,443	771,895	1,032,561
Non-controlling interests		2,385	79	137	—	—	—
Owners' equity	26	46,786	48,786	59,288	52,553	54,322	58,110
Total equity		49,171	48,865	59,425	52,553	54,322	58,110
Total liabilities and equity		1,045,126	1,019,934	1,284,274	844,996	826,217	1,090,671

The accompanying notes on pages 188 to 284, the accounting policies on pages 176 to 186 and the audited sections of the Financial review: Capital and risk management on pages 33 to 163 form an integral part of these financial statements.

The accounts were approved by the Board of directors on 25 March 2015 and signed on its behalf by:

Philip Hampton
Chairman

Ross McEwan
Chief Executive

Ewen Stevenson
Chief Financial Officer

The Royal Bank of Scotland plc
Registration No. SC90312

Statement of changes in equity for the year ended 31 December 2014

	Group			Bank		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Called-up share capital						
At 1 January and 31 December	6,609	6,609	6,609	6,609	6,609	6,609
Share premium account						
At 1 January	26,290	26,081	25,375	26,290	26,081	25,375
Redemption of preference shares classified as debt	517	—	—	517	—	—
Ordinary share issued on cross-border merger ⁽¹⁾	—	209	706	—	209	706
At 31 December	26,807	26,290	26,081	26,807	26,290	26,081
Merger reserve						
At 1 January	10,800	10,881	10,881	(81)	—	—
Unwind of merger reserve	34	—	—	34	—	—
Merger reserve created on cross-border merger ⁽¹⁾	—	(81)	—	—	(81)	—
At 31 December	10,834	10,800	10,881	(47)	(81)	—
Available-for-sale reserve						
At 1 January	359	1,750	2,220	302	1,443	1,925
Unrealised gains/(losses)	504	(844)	1,200	261	(558)	1,088
Realised gains	(409)	(1,063)	(1,880)	(323)	(939)	(1,781)
Tax	(45)	516	210	12	356	211
Transfer to retained earnings	(9)	—	—	—	—	—
At 31 December	400	359	1,750	252	302	1,443
Cash flow hedging reserve						
At 1 January	(86)	1,815	1,018	350	1,767	1,307
Amount recognised in equity	2,869	(1,082)	2,107	1,625	(566)	1,700
Amount transferred from equity to earnings	(1,457)	(1,403)	(1,085)	(1,119)	(1,291)	(1,146)
Tax	(334)	584	(225)	(101)	440	(94)
Transfer to retained earnings	34	—	—	—	—	—
At 31 December	1,026	(86)	1,815	755	350	1,767
Foreign exchange reserve						
At 1 January	1,842	2,041	2,829	(357)	(291)	(302)
Retranslation of net assets	403	(287)	(930)	110	(66)	11
Foreign currency (losses)/gains on hedges of net assets	(82)	87	150	1	—	—
Tax	(9)	1	(5)	—	—	—
Recycled to profit or loss on disposal of business (nil tax)	—	—	(3)	—	—	—
Transfer to retained earnings	(392)	—	—	—	—	—
At 31 December	1,762	1,842	2,041	(246)	(357)	(291)

Statement of changes in equity for the year ended 31 December 2014

	Group			Bank		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Retained earnings						
At 1 January	2,972	10,111	12,794	21,209	22,501	20,423
Profit/(loss) attributable to ordinary and equity preference shareholders						
- continuing operations	365	(7,661)	(4,369)	(2,058)	(1,199)	(781)
- discontinued operations	(3,538)	410	490	—	—	—
Equity preference dividends paid	(61)	(58)	(58)	(61)	(58)	(58)
Citizens Financial Group initial public offering:						
- transfer from available-for-sale reserve	9	—	—	—	—	—
- transfer from cash flow hedging reserve	(34)	—	—	—	—	—
- transfer from foreign exchange reserve	392	—	—	—	—	—
Costs relating to Citizens Financial Group initial public offering	(45)	—	—	—	—	—
Actuarial (losses)/gains recognised in retirement benefit schemes						
- gross	(100)	443	(2,130)	(107)	(13)	(126)
- tax	(36)	(246)	373	16	6	26
Shares in holding company issued under employee share schemes	(91)	(76)	30	(91)	(76)	30
Capital contribution	—	—	2,870	—	—	2,870
Redemption of preference shares classified as debt	(517)	—	—	(517)	—	—
Share-based payments						
- gross	29	48	117	29	48	117
- tax	3	1	(6)	3	—	—
At 31 December	(652)	2,972	10,111	18,423	21,209	22,501
Owners' equity at 31 December	46,786	48,786	59,288	52,553	54,322	58,110
Non-controlling interests						
At 1 January	79	137	128	—	—	—
Currency translation adjustments and other movements	113	3	(4)	—	—	—
Profit/(loss) attributable to non-controlling interests						
- continuing operations	5	(13)	19	—	—	—
- discontinued operations	52	—	—	—	—	—
Dividends paid	(4)	(5)	—	—	—	—
Movements in available-for-sale securities						
- unrealised gains	37	—	—	—	—	—
- tax	(13)	—	—	—	—	—
Movements in cash flow hedging reserve						
- amount recognised in equity	18	—	—	—	—	—
- recycled to profit or loss on disposal of discontinued operations	(18)	—	—	—	—	—
Equity raised (2)	2,117	—	17	—	—	—
Equity withdrawn and disposals	(1)	(43)	(23)	—	—	—
At 31 December	2,385	79	137	—	—	—
Total equity at 31 December	49,171	48,865	59,425	52,553	54,322	58,110
Total equity is attributable to:						
Non-controlling interests	2,385	79	137	—	—	—
Ordinary shareholders	46,786	48,786	59,288	52,553	54,322	58,110
	49,171	48,865	59,425	52,553	54,322	58,110

Notes:

(1) See Note 26.

(2) Relating to initial public offering of Citizens Financial Group.

The accompanying notes on pages 188 to 284, the accounting policies on pages 176 to 186 and the audited sections of the Financial review: Capital and risk management on pages 33 to 163 form an integral part of these financial statements.

Cash flow statement for the year ended 31 December 2014

		Group			Bank		
		2014	2013	2012	2014	2013	2012
	Note	£m	£m	£m	£m	£m	£m
Operating activities							
Operating profit/(loss) before tax from continuing operations		2,403	(7,367)	(4,299)	(959)	8	(818)
(Loss)/profit before tax from discontinued operations		(3,258)	606	775	—	—	—
Adjustments for:							
Depreciation and amortisation		1,105	1,272	1,614	511	634	763
Write down of goodwill and other intangible assets		533	423	51	393	227	21
Write down of investment in subsidiaries		—	—	—	4,353	86	(120)
Impairment (releases)/losses		(1,140)	8,449	5,214	(46)	2,536	1,548
Loans and advances written-off net of recoveries		(5,052)	(3,975)	(3,555)	(2,567)	(1,892)	(1,823)
Interest on subordinated liabilities		1,302	1,314	1,207	1,234	1,241	1,134
Charge for defined benefit pension schemes		463	513	512	13	11	(3)
Pension scheme curtailment and settlement gains		—	(3)	(38)	—	(3)	—
Cash contribution to defined benefit pension schemes		(1,063)	(817)	(888)	(28)	(41)	(26)
Other provisions charged net of releases		2,478	4,407	2,853	1,453	913	1,590
Other provisions utilised		(3,254)	(2,046)	(1,496)	(1,606)	(1,103)	(665)
Gain on redemption of own debt		(6)	(162)	(454)	—	(77)	(454)
Loss on reclassification to disposal groups		3,994	—	—	—	—	—
Elimination of foreign exchange differences		(881)	807	6,111	123	182	4,933
Other non-cash items		(137)	(5,208)	(1,778)	(384)	(2,483)	538
Net cash (outflow)/inflow from trading activities		(2,513)	(1,787)	5,829	2,490	239	6,618
Changes in operating assets and liabilities		(11,605)	(18,983)	(36,173)	(30,276)	(22,151)	(56,567)
Net cash flows from operating activities before tax		(14,118)	(20,770)	(30,344)	(27,786)	(21,912)	(49,949)
Income taxes (paid)/received		(302)	(195)	(92)	135	322	(84)
Net cash flows from operating activities	32	(14,420)	(20,965)	(30,436)	(27,651)	(21,590)	(50,033)
Investing activities							
Sale and maturity of securities		17,631	33,741	35,388	22,926	33,660	64,031
Purchase of securities		(19,945)	(21,667)	(17,724)	(12,022)	(14,310)	(14,161)
Sale of property, plant and equipment		1,161	888	2,099	164	83	137
Purchase of property, plant and equipment		(810)	(697)	(1,356)	(273)	(321)	(531)
Net (investment in)/divestment of business interests and intangible assets	33	(2,947)	4,237	8,245	(2,358)	1,646	(129)
Net cash flows from investing activities		(4,910)	16,502	26,652	8,437	20,758	49,347
Financing activities							
Issue of subordinated liabilities		1,438	2,285	2,968	833	1,864	2,754
Proceeds of non-controlling interests issued		2,117	—	17	—	—	—
Capital contribution		—	—	2,870	—	—	2,870
Redemption of non-controlling interests		(1)	(43)	(23)	—	—	—
Repayment of subordinated liabilities		(4,181)	(1,868)	(264)	(4,121)	(1,868)	—
Dividends paid		(65)	(63)	(58)	(61)	(58)	(58)
Interest on subordinated liabilities		(1,308)	(1,395)	(1,114)	(1,236)	(1,325)	(1,031)
Net cash flows from financing activities		(2,000)	(1,084)	4,396	(4,585)	(1,387)	4,535
Effects of exchange rate changes on cash and cash equivalents		682	402	(3,347)	541	604	(2,938)
Net (decrease)/increase in cash and cash equivalents		(20,648)	(5,145)	(2,735)	(23,258)	(1,615)	911
Cash and cash equivalents at 1 January		127,956	133,101	135,836	124,628	126,243	125,332
Cash and cash equivalents at 31 December	36	107,308	127,956	133,101	101,370	124,628	126,243

The accompanying notes on pages 188 to 284, the accounting policies on pages 176 to 186 and the audited sections of the Financial review: Capital and risk management on pages 33 to 163 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 166) and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the IFRS Interpretations Committee of the IASB as adopted by the European Union (EU) (together IFRS). The EU has not adopted the complete text of IAS 39 'Financial Instruments: Recognition and Measurement'; it has relaxed some of the standard's hedging requirements. The Group has not taken advantage of this relaxation: its financial statements are prepared in accordance with IFRS as issued by the IASB.

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

Citizens was classified as a disposal group on 31 December 2014; its assets and liabilities at that date have been aggregated and presented in separate balance sheet captions. It has been treated as a discontinued operation and prior periods re-presented.

The Group adopted a number of new and revised IFRSs effective 1 January 2014:

'Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)' adds application guidance to IAS 32 to address inconsistencies identified in the application of the standard's criteria for offsetting financial assets and financial liabilities.

'Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)' applies to investment entities; such entities should account for their subsidiaries (other than those that provide services related to the entity's investment activities) at fair value through profit or loss.

IFRIC 21 'Levies' provides guidance on accounting for levies payable to public authorities if certain conditions are met on a particular date.

IAS 36 'Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)' aligns the recoverable amount disclosure requirements in IAS 36 with IASB's original intentions.

IAS 39 'Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)' provides relief from discontinuing hedge accounting on novation of a derivative designated as a hedging instrument.

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 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.

Accounting policies

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

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

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

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

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

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

4. Assets held for sale and discontinued operations

A non-current asset (or disposal group) is classified as held for sale if the Group will recover its carrying amount principally through a sale transaction rather than through continuing use. A non-current asset (or disposal group) classified as held for sale is measured at the lower of its carrying amount and fair value less costs to sell. If the asset (or disposal group) is acquired as part of a business combination it is initially measured at fair value less costs to sell. Assets and liabilities of disposal groups classified as held for sale and non-current assets classified as held for sale are shown separately on the face of the balance sheet. The results of discontinued operations - comprising the post-tax profit or loss of discontinued operations and the post-tax gain or loss recognised either on measurement to fair value less costs to sell or on disposal of the discontinued operation - are shown as a single amount on the face of the income statement; an analysis of this amount is presented in Note 20 on the accounts. A discontinued operation is a cash generating unit or a group of cash generating units that either has been disposed of, or is classified as held for sale, and (a) represents a separate major line of business or geographical area of operations, (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or (c) is a subsidiary acquired exclusively with a view to resale.

5. Employee benefits

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

Accounting policies

6. Intangible assets and goodwill

Intangible assets acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to profit or loss over the assets' estimated economic lives using methods that best reflect the pattern of economic benefits and is included in Depreciation and amortisation. These estimated useful economic lives are:

Computer software	3 to 12 years
Other acquired intangibles	5 to 10 years

Expenditure on internally generated goodwill and brands is written-off as incurred. Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have been established. These costs include payroll, the costs of materials and services, and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred as are all training costs and general overheads. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

Intangible assets include goodwill arising on the acquisition of subsidiaries and joint ventures. Goodwill on the acquisition of a subsidiary is the excess of the fair value of the consideration transferred, the fair value of any existing interest in the subsidiary and the amount of any non-controlling interest measured either at fair value or at its share of the subsidiary's net assets over the Group's interest in the net fair value of the subsidiary's identifiable assets, liabilities and contingent liabilities. Goodwill arises on the acquisition of a joint venture when the cost of investment exceeds the Group's share of the net fair value of the joint venture's identifiable assets and liabilities. Goodwill is measured at initial cost less any subsequent impairment losses. Goodwill arising on the acquisition of associates is included within their carrying amounts. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

7. Property, plant and equipment

Items of property, plant and equipment (except investment property - see Accounting policy 9) are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, these are accounted for separately.

Depreciation is charged to profit or loss on a straight-line basis so as to write-off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases) over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Freehold land is not depreciated.

The estimated useful lives of the Group's property, plant and equipment are:

Freehold buildings	50 years
Long leasehold property (leases with more than 50 years to run)	50 years
Short leaseholds	unexpired period of the lease
Property adaptation costs	10 to 15 years
Computer equipment	up to 5 years
Other equipment	4 to 15 years

The residual value and useful life of property, plant and equipment are reviewed at each balance sheet date and updated for any changes to previous estimates.

8. Impairment of intangible assets and property, plant and equipment

At each 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.

Accounting policies

10. Foreign currencies

The Group's consolidated financial statements are presented in sterling which is the functional currency of the company.

Group entities record transactions in foreign currencies in their functional currency - the currency of the primary economic environment in which they operate - at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the foreign exchange rates ruling at the balance sheet date. Foreign exchange differences arising on the settlement of foreign currency transactions and from the translation of monetary assets and liabilities are reported in income from trading activities except for differences arising on cash flow hedges and hedges of net investments in foreign operations (see Accounting policy 23).

Non-monetary items denominated in foreign currencies that are stated at fair value are translated into the relevant functional currency at the foreign exchange rates ruling at the dates the values are determined. Translation differences arising on non-monetary items measured at fair value are recognised in profit or loss except for differences arising on available-for-sale non-monetary financial assets, for example equity shares, which are recognised in other comprehensive income unless the asset is the hedged item in a fair value hedge.

Assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into sterling at foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of a foreign operation are recognised in other comprehensive income. The amount accumulated in equity is reclassified from equity to profit or loss on disposal of a foreign operation.

11. Leases

As Lessor

Contracts with customers to lease assets are classified as finance leases if they transfer substantially all the risks and rewards of ownership of the asset to the customer; all other contracts with customers to lease assets are classified as operating leases.

Finance lease receivables are included in the balance sheet, within Loans and advances to customers, at the amount of the net investment in the lease being the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Finance lease income is allocated to accounting periods so as to give a constant periodic rate of return before tax on the net investment and included in Interest receivable. Unguaranteed residual values are subject to regular review; if there is a reduction in their value, income allocation is revised and any reduction in respect of amounts accrued is recognised immediately.

Rental income from operating leases is recognised in income on a straight-line basis over the lease term unless another systematic basis better represents the time pattern of the asset's use. Operating lease assets are included within Property, plant and equipment and depreciated over their useful lives (see Accounting policy 7). Operating lease rentals receivable are included in Other operating income.

As lessee

The Group's contracts to lease assets are principally operating leases. Operating lease rental expense is included in Premises and equipment costs and recognised as an expense on a straight-line basis over the lease term unless another systematic basis better represents the benefit to the Group.

12. Provisions

The Group recognises a provision for a present obligation resulting from a past event when it is more likely than not that it will be required to transfer economic benefits to settle the obligation and the amount of the obligation can be estimated reliably.

Provision is made for restructuring costs, including the costs of redundancy, when the Group has a constructive obligation to restructure. An obligation exists when the Group has a detailed formal plan for the restructuring and has raised a valid expectation in those affected by starting to implement the plan or by announcing its main features.

If the Group has a contract that is onerous, it recognises the present obligation under the contract as a provision. An onerous contract is one where the unavoidable costs of meeting the Group's contractual obligations exceed the expected economic benefits. When the Group vacates a leasehold property, a provision is recognised for the costs under the lease less any expected economic benefits (such as rental income).

Contingent liabilities are possible obligations arising from past events, whose existence will be confirmed only by uncertain future events, or present obligations arising from past events that are not recognised because either an outflow of economic benefits is not probable or the amount of the obligation cannot be reliably measured. Contingent liabilities are not recognised but information about them is disclosed unless the possibility of any outflow of economic benefits in settlement is remote.

13. Tax

Income tax expense or income, comprising current tax and deferred tax, is recorded in the income statement except income tax on items recognised outside profit or loss which is credited or charged to other comprehensive income or to equity as appropriate.

Current tax is income tax payable or recoverable in respect of the taxable profit or loss for the year arising in profit or loss, other comprehensive income or equity. Provision is made for current tax at rates enacted or substantively enacted at the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that they will be recovered. Deferred tax is not recognised on temporary differences that arise from initial recognition of an asset or a liability in a transaction (other than a business combination) that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is calculated using tax rates expected to apply in the periods when the assets will be realised or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, at the balance sheet date.

Deferred tax assets and liabilities are offset where the Group has a legally enforceable right to offset and where they relate to income taxes levied by the same taxation authority either on an individual Group company or on Group companies in the same tax group that intend, in future periods, to settle current tax liabilities and assets on a net basis or on a gross basis simultaneously.

14. Financial assets

On initial recognition, financial assets are classified into held-to-maturity investments; held-for-trading; designated as at fair value through profit or loss; loans and receivables; or available-for-sale financial assets. 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.

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 11.

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.

Accounting policies

Financial assets carried at amortised cost - if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables or as held-to-maturity investments has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition. For collateralised loans and receivables, estimated future cash flows include cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

Where, in the course of the orderly realisation of a loan, it is exchanged for equity shares or property, the exchange is accounted for as the sale of the loan and the acquisition of equity securities or investment property. Where the Group's interest in equity shares following the exchange is such that the Group controls an entity, that entity is consolidated. Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant. In making collective impairment assessments, financial assets are grouped into portfolios on the basis of similar risk characteristics. Future cash flows from these portfolios are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted, on the basis of observable data, to reflect current conditions not affecting the period of historical experience. Impairment losses are recognised in profit or loss and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses. If, in a subsequent period, the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

Impaired loans and receivables are written off, i.e. the impairment provision is applied in writing down the loan's carrying value partially or in full, when the Group concludes that there is no longer any realistic prospect of recovery of part or all of the loan. For loans that are individually assessed for impairment, the timing of write off is determined on a case-by-case basis. Such loans are reviewed regularly and write off will be prompted by bankruptcy, insolvency, renegotiation and similar events.

Except for US retail portfolios, where write off of the irrecoverable amount takes place within 60 - 180 days, 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.

Accounting policies

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).

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 11.

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.

Accounting policies

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. 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 11.

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.

Accounting policies

24. Share-based compensation

The Group operates a number of share-based compensation schemes under which it awards RBSG shares and share options to its employees. Such awards are generally subject to vesting conditions: conditions that vary the amount of cash or shares to which an employee is entitled. Vesting conditions include service conditions (requiring the employee to complete a specified period of service) and performance conditions (requiring the employee to complete a specified period of service and specified performance targets to be met). Other conditions to which an award is subject are non-vesting conditions (such as a requirement to save throughout the vesting period).

The cost of employee services received in exchange for an award of shares or share options granted is measured by reference to the fair value of the shares or share options on the date the award is granted and takes into account non-vesting conditions and market performance conditions (conditions related to the market price of RBSG shares): an award is treated as vesting irrespective of whether any market performance condition or non-vesting condition is met. The fair value of options granted is estimated using valuation techniques which incorporate exercise price, term, risk-free interest rates, the current share price and its expected volatility. The cost is expensed on a straight-line basis over the vesting period (the period during which all the specified vesting conditions must be satisfied) with a corresponding increase in equity in an equity-settled award, or a corresponding liability in a cash-settled award. The cost is adjusted for vesting conditions (other than market performance conditions) so as to reflect the number of shares or share options that actually vest.

If an award is modified, the original cost continues to be recognised as if there had been no modification. Where modification increases the fair value of the award, this increase is recognised as an expense over the modified vesting period. A new award of shares or share options is treated as the modification of a cancelled award if, on the date the new award is granted, the Group identifies them as replacing the cancelled award. The cancellation of an award through failure to meet non-vesting conditions triggers an immediate expense for any unrecognised element of the cost of an award.

25. Cash and cash equivalents

In the cash flow statement, cash and cash equivalents comprises cash and deposits with banks with an original maturity of less than three months together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

26. Shares in Group entities

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

Critical accounting policies and key sources of estimation uncertainty

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law and IFRS require the directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's 'Conceptual Framework for Financial Reporting'. The judgements and assumptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results.

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 £295 million and a liability of £2,550 million were recognised on the balance sheet at 31 December 2014 (2013 - asset £214 million, liability £3,188 million; 2012 - asset £144 million, liability £3,854 million).

Accounting policies

Goodwill

The Group capitalises goodwill arising on the acquisition of businesses, as discussed in Accounting policy 6. The carrying value of goodwill as at 31 December 2014 was £6,255 million (2013 - £10,130 million; 2012 - £10,423 million).

Goodwill is the excess of the cost of an acquired business over the fair value of its net assets. Goodwill is not amortised but is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

Impairment testing in accordance with Accounting policy 8 above inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of cash-generating units; and the valuation of their separable assets. The sensitivity of the assessment to changes in assumptions is discussed in Note 18 on page 239.

Provisions for liabilities

As set out in Note 23, at 31 December 2014 the Group recognised provisions for liabilities in respect of Payment Protection Insurance, £799 million (2013 - £926 million; 2012 - £895 million), Interest Rate Hedging Products, £424 million (2013 - £1,077 million; 2012 - £676 million), foreign exchange investigations, £320 million (2013 and 2012 - nil), LIBOR investigations, nil (2013 - £416 million; 2012 - £381 million) and other regulatory proceedings and litigation, £1,955 million (2013 - £2,113 million; 2012 - £284 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 23.

Interest Rate Hedging Products - following an industry-wide review conducted in 2012 in conjunction with the Financial Services Authority (now being dealt with by the Financial Conduct Authority (FCA)), the Group agreed to provide redress to customers in relation to certain interest rate hedging products sold to small and medium-sized businesses classified as retail clients under FSA rules. There remain uncertainties over the eventual cost of redress, including any consequential loss claims. Estimating the liability depends on a number of assumptions. These are discussed in Note 23.

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 31.

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.

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 £1,510 million were recognised as at 31 December 2014 (2013 - £3,435 million; 2012 - £3,066 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 2014 and concluded that it is recoverable based on future projections. Deferred tax assets of £3,778 million (2013 - £2,723 million; 2012 - £1,295 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 24.

Accounting policies

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 16. 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.

At 31 December 2014, loans and advances to customers classified as loans and receivables totalled £306,911 million (2013 - £363,555 million; 2012 - £392,901 million) and customer loan impairment provisions amounted to £17,364 million (2013 - £24,983 million; 2012 - £20,693 million). Customer loan impairment releases in 2014 amounted to £1,316 million (2013 - £8,173 million losses; 2012 - £5,005 million losses). The losses in 2013 include loan impairment provisions in respect of loans transferred to RBS Capital Resolution Group. These loans are expected to be exited within three years and impairment provisions in respect of these loans have been reassessed in the light of this change in recovery strategy.

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.

Fair value - financial instruments

In accordance with Accounting policies 14, 16 and 23, financial instruments classified as held-for-trading or designated as at fair value through profit or loss and financial assets classified as available-for-sale are recognised in the financial statements at fair value. All derivatives are measured at fair value.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. It also uses the assumptions that market participants would use when pricing the asset or liability. In determining fair value the Group maximises the use of relevant observable inputs and minimises the use of unobservable inputs.

Where the Group manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, it measures the fair value of a group of financial assets and financial liabilities on the basis of the price that it would receive to sell a net long position (i.e. an asset) for a particular risk exposure or to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction at the measurement date under current market conditions.

Credit valuation adjustments are made when valuing derivative financial assets to incorporate counterparty credit risk. Adjustments are also made when valuing financial liabilities measured at fair value to reflect the Group's own credit standing.

Where the market for a financial instrument is not active, fair value is established using a valuation technique. These valuation techniques involve a degree of estimation, the extent of which depends on the instrument's complexity and the availability of market-based data. Further details about the Group's valuation methodologies and the sensitivity to reasonably possible alternative assumptions of the fair value of financial instruments valued using techniques where at least one significant input is unobservable are given in Note 11 on pages 211 to 222.

Accounting policies

Accounting developments

International Financial Reporting Standards

A number of IFRSs and amendments to IFRS were in issue at 31 December 2014 that would affect RBS Group from 1 January 2015 or later.

Effective for 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.

Implementation of these changes is not expected to have a material effect on the Group's financial statements.

Effective after 2015

In July 2014 the IASB published IFRS 9 'Financial Instruments'. IFRS 9 replaces the current financial instruments standard IAS 39, setting out new accounting requirements in a number of areas. First, there are revisions to the classification and measurement of financial instruments. There are new restrictions on the ability to account for financial assets at amortised cost and a prohibition on the bifurcation of embedded derivatives from financial assets. Accounting for financial liabilities is largely unchanged except for the treatment of changes in the fair value of liabilities designated as at fair value through profit or loss attributable to own credit risk; these are recognised in other comprehensive income. Secondly, there are amended requirements for hedge accounting designed to align the accounting more closely to the risk management framework and remove or simplify some of the rule-based requirements of IAS 39. The basic mechanics of hedge accounting: fair value, cash flow and net investment hedges are retained. Finally, there is a new approach to credit impairment provisions moving from IAS 39's incurred loss model to an expected loss model. An expected loss model will result in the recognition of credit impairment losses earlier than an incurred loss model. Subject to EU endorsement, IFRS 9 is applicable for periods beginning on or after 1 January 2018.

IFRS 9 makes major and fundamental changes to accounting for financial instruments. The Group is continuing its assessment of its effect on the Group's financial statements.

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 2017.

'Accounting for Acquisitions of interests in Joint Operations' issued in May 2014 amends IFRS 11 'Joint Arrangements' to clarify that the donor of assets and liabilities to a joint operation should hold its continuing interest in them at the lower of cost and recoverable amount. 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 effective date of these amendments is 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.

The Group is assessing the effects of these new standards

Notes on the accounts

1 Net interest income

	2014 £m	2013 £m	2012 £m
Loans and advances to customers	12,143	12,987	13,496
Loans and advances to banks	358	481	518
Debt securities	304	683	1,095
Interest receivable	12,805	14,151	15,109
Customer accounts: demand deposits	589	659	743
Customer accounts: savings deposits	719	1,281	1,519
Customer accounts: other time deposits	379	631	745
Deposits by banks	85	204	302
Debt securities in issue	788	1,104	1,780
Subordinated liabilities	1,292	1,305	1,199
Internal funding of trading businesses	87	337	235
Interest payable	3,939	5,521	6,523
Net interest income	8,866	8,630	8,586

Notes on the accounts

2 Non-interest income

	2014 £m	2013 £m	2012 £m
Fees and commissions receivable			
Payment services	987	1,079	929
Credit and debit card fees	822	888	882
Lending (credit facilities)	1,242	1,279	1,346
Brokerage	318	389	450
Investment management	342	385	405
Trade finance	268	243	195
Other	341	335	540
	4,320	4,598	4,747
Fees and commissions payable	(842)	(892)	(947)
Income from trading activities (1)			
Foreign exchange	368	905	597
Interest rate	58	489	1,598
Credit	451	1,296	795
Changes in fair value of own debt and derivative liabilities attributable to own credit			
- debt securities in issue	44	133	(1,471)
- derivative liabilities	(77)	(84)	(302)
Equities and other	346	121	78
	1,190	2,860	1,295
Gain on redemption of own debt	6	162	454
Other operating income			
Operating lease and other rental income	379	483	876
Changes in the fair value of own debt designated as at fair value through profit or loss attributable to own credit risk (2)			
- debt securities in issue	(86)	(35)	(1,998)
- subordinated liabilities	(9)	(39)	(133)
Other changes in the fair value of securities and other financial assets and liabilities designated as at fair value through profit or loss and related derivatives	53	(44)	76
Changes in the fair value of investment properties	(25)	(281)	(148)
Profit on sale of securities	387	942	1,696
Profit on sale of property, plant and equipment	138	36	19
Profit on sale of subsidiaries and associates	(30)	179	150
Dividend income (3)	20	63	212
Share of profits of associated entities	30	(1)	(5)
Other income (4)	221	94	382
	1,078	1,397	1,127

Notes:

- (1) The analysis of income from trading activities is based on how the business is organised and the underlying risks managed. Income from trading activities comprises gains and losses on financial instruments held for trading, both realised and unrealised, interest income and dividends and the related funding costs. The types of instruments include:
- Foreign exchange: spot foreign exchange contracts, currency swaps and options, emerging markets and related hedges and funding.
 - Interest rate: interest rate swaps, forward foreign exchange contracts, forward rate agreements, interest rate options, interest rate futures and related hedges and funding.
 - Credit: asset-backed securities, corporate bonds, credit derivatives and related hedges and funding.
 - Equities and other: equities, equity derivatives and related hedges and funding. Commodities: commodity contracts and related hedges and funding.
- (2) Measured as the charge in fair value from movements in the year in the credit risk premium payable by the Group.
- (3) Dividend income includes £179 million in 2012 arising from investments in fellow subsidiaries of the RBS Group and consequently subject to the RBS Group's capital management policy (see Note 30).
- (4) Includes income from activities other than banking.

Notes on the accounts

3 Operating expenses

	2014 £m	2013 £m	2012 £m
Wages, salaries and other staff costs	4,722	4,904	5,448
Social security costs	376	414	469
Share-based compensation	43	49	126
Pension costs			
- defined benefit schemes (see Note 4)	459	504	526
- curtailment and settlement gains (see Note 4)	—	(3)	(38)
- defined contribution schemes	83	61	16
Staff costs	5,683	5,929	6,547
Premises and equipment	2,059	1,994	1,799
Other administrative expenses	4,361	6,530	4,804
Property, plant and equipment (see Note 19)	664	746	954
Intangible assets (see Note 18)	262	363	461
Depreciation and amortisation	926	1,109	1,415
Write-down of goodwill and other intangible assets (see Note 18)	523	423	51
	13,552	15,985	14,616

Other administrative expenses include:

- Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs, and other litigation and conduct costs. Further details are provided in Note 23.

- The UK bank levy, which was charged at a rate of 0.156% on chargeable liabilities in excess of £20 billion, and amounted to £250 million for 2014 (2013 - 0.13%, £200 million; 2012 - 0.088%, £175 million).

Integration, restructuring and divestment costs

Included in operating expenses are the following integration, restructuring and divestment costs.

	Staff £m	Premises £m	Other £m	Depreciation £m	Continuing £m	Discontinued operations £m	Total £m
Restructuring							
2014	261	266	268	3	798	103	901
2013	173	96	130	6	405	16	421
2012	574	126	210	142	1,052	(2)	1,050
Divestment							
2014	120	3	233	—	356	—	356
2013	86	2	77	—	165	—	165
2012	111	(2)	62	—	171	—	171
Integration							
2014	—	—	—	—	—	—	—
2013	—	1	1	—	2	—	2
2012	—	3	2	—	5	—	5

Notes on the accounts

The average number of persons employed, rounded to the nearest hundred, by the Group during the year, excluding temporary staff, was 84,200 (2013 - 87,900; 2012 - 89,800); on the same basis there were 18,200 people employed in discontinued operations (2013 - 19,200; 2012 - 19,700). The number of persons employed by the Group at 31 December, excluding temporary staff, was as follows:

	Group		
	2014	2013*	2012*
UK Personal & Business Banking	26,700	28,500	30,400
Ulster Bank	4,400	4,700	4,400
Personal & Business Banking	31,100	33,200	34,800
Commercial Banking	6,100	7,000	6,700
Private Banking	3,400	3,500	3,400
Commercial & Private Banking	9,500	10,500	10,100
Corporate & Institutional Banking	3,200	4,100	4,300
Centre	10,000	10,600	10,700
RCR	500	n/a	n/a
Non-Core	n/a	800	1,300
Services	26,900	27,900	27,500
Total	81,200	87,100	88,700
UK	63,400	68,700	71,200
USA	2,000	2,300	2,500
Europe	7,400	8,200	8,100
Rest of the World	8,400	7,900	6,900
Total	81,200	87,100	88,700

*Restated

There were 17,400 people employed in discontinued operations at 31 December 2014 (2013 - 19,000; 2012 - 19,400).

Share-based payments

As described in the Remuneration report in the RBS Group Annual Report and Accounts 2014, the RBS Group grants share-based awards to employees principally on the following bases:

Award plan	Eligible employees	Nature of award (1)	Vesting conditions (2)	Settlement
Sharesave	UK, Republic of Ireland, Channel Islands, Gibraltar and Isle of Man	Option to buy shares under employee savings plan	Continuing employment or leavers in certain circumstances	2015 to 2020
Deferred performance awards	All	Awards of ordinary shares	Continuing employment or leavers in certain circumstances	2015 to 2018
Long-term incentives (3)	Senior employees	Awards of conditional shares or share options	Continuing employment or leavers in certain circumstances and/or achievement of performance conditions	2019 to 2020

Notes:

(1) Awards are equity-settled unless international comparability is better served by cash-settled awards.

(2) All awards have vesting conditions and therefore some may not vest.

(3) Long-term incentives include the Executive Share Option Plan, the Long-Term Incentive Plan and the Medium-Term Performance Plan.

Sharesave

	2014		2013		2012	
	Average exercise price £	Shares under option (million)	Average exercise price £	Shares under option (million)	Average exercise price £	Shares under option (million)
At 1 January	2.90	62	2.86	57	3.36	64
Granted	3.43	12	2.96	13	2.49	14
Exercised	2.34	(6)	2.36	—	2.37	—
Cancelled	3.61	(17)	3.38	(8)	3.76	(21)
At 31 December	2.85	51	2.90	62	2.86	57

Notes on the accounts

3 Operating expenses continued

The fair value of options granted in 2014 was determined using a pricing model that included: expected volatility of shares determined at the grant date based on historical volatility over a period of up to seven years; expected option lives that equal the vesting period; no dividends on equity shares; and risk-free interest rates determined from UK gilts with terms matching the expected lives of the options.

The strike price of options and the fair value on granting awards of fully paid shares is the average market price over the five trading days preceding grant date.

Options are exercisable within six months of vesting; 1.9 million options were exercisable at 31 December 2014 (2013 - 1.3 million; 2012 - 0.2 million). The weighted average share price at the date of exercise of options was £3.65 (2013 - £3.36; 2012 - £2.78). At 31 December 2014, exercise prices ranged from £2.33 to £39.27 (2013 and 2012 - £2.33 to £39.27) and the average contractual life was 3.7 years (2013 - 3.5 years; 2012 - 3.9 years). The fair value of options granted in 2014 was £18 million (2013 - £25 million; 2012 - £28 million).

Deferred performance awards

	2014		2013		2012	
	Value at grant £m	Shares awarded (million)	Value at grant £m	Shares awarded (million)	Value at grant £m	Shares awarded (million)
At 1 January	180	55	261	73	756	191
Granted	311	95	113	36	141	50
Forfeited	(28)	(7)	(48)	(14)	(98)	(25)
Vested	(170)	(51)	(146)	(40)	(538)	(143)
CFG awards	(21)	(7)	—	—	—	—
At 31 December	272	85	180	55	261	73

The awards granted in 2014 vest evenly over the following three anniversaries.

Long-term incentives

	2014			2013			2012		
	Value at grant £m	Shares awarded (million)	Options over shares (million)	Value at grant £m	Shares awarded (million)	Options over shares (million)	Value at grant £m	Shares awarded (million)	Options over shares (million)
At 1 January	320	94	13	375	98	20	345	58	37
Granted	72	22	—	109	35	—	157	59	—
Exercised	(61)	(14)	(5)	(51)	(11)	(3)	(15)	(4)	(1)
Lapsed	(85)	(22)	(1)	(113)	(28)	(4)	(112)	(15)	(16)
CFG awards	(32)	(11)	—	—	—	—	—	—	—
At 31 December	214	69	7	320	94	13	375	98	20

In conjunction with the Initial Public Offering of Citizens Financial Group, Inc. (CFG), incentive awards of over 11 million RBSG shares and a convertible bond were replaced with awards of over 3 million CFG shares having the same market value.

The market value of awards exercised in 2014 was £44 million (2013 - £37 million; 2012 - £10 million). There are vested options over 7 million shares exercisable up to 2019 (2013 - 13 million; 2012 - 18 million).

At 31 December 2014, a provision of £1 million had been made in respect of 0.1 million options over shares that may be cash-settled (2013 - £1 million in respect of 0.1 million share awards; 2012 - £1 million in respect of 0.1 million share awards and 0.3 million options over shares).

Notes on the accounts

4 Pensions

The Group sponsors a number of pension schemes in the UK and overseas.

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 87% (2013 - 86%; 2012 - 85%) 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 make a contribution 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 the US 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.

There is no contractual agreement or policy on the way that the cost of The Royal Bank of Scotland Group defined benefit pension schemes and healthcare plans are allocated to the Bank. The Bank therefore accounts for the charges it incurs as payments to a defined contribution scheme.

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:

Principal actuarial assumptions (weighted average)	2014	2013	2012
	%	%	%
Discount rate	3.6	4.5	4.4
Expected return on plan assets	3.6	4.5	4.4
Rate of increase in salaries	1.8	1.8	1.7
Rate of increase in pensions in payment	2.7	2.9	2.6
Inflation assumption	2.8	3.2	2.8

Notes on the 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 91% 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.

Discount rates for other currencies are derived using a variety of methodologies. In the case of US dollar defined benefit obligations, a matching portfolio of high-quality 'AA' corporate bonds is used for the first 30 years' cash flows; cash flows beyond 30 years are discounted using a yield curve determined in a similar way to the UK. For euro defined benefit obligations, a similar approach to the UK has been used at 31 December 2014. However, at longer durations, rates are derived by extrapolating yields on 'A' and 'AAA' corporate bonds to derive equivalent 'AA' yields.

Major classes of plan assets as a percentage of total plan assets	2014 %	2013 %	2012 %
Quoted assets			
Quoted equities			
- Consumer industry	5.5	4.3	4.4
- Manufacturing industry	2.8	4.1	6.0
- Energy and utilities	2.7	3.6	4.4
- Financial institutions	3.5	3.9	4.4
- Technology and telecommunications	3.8	4.7	5.3
- Other	4.6	3.7	0.5
Private equity	3.8	4.4	4.7
Index-linked bonds	26.6	28.3	28.7
Government fixed interest bonds	5.0	2.2	2.9
Corporate fixed interest bonds	15.6	19.6	19.5
Unquoted assets			
Corporate and other bonds	2.0	1.9	1.5
Hedge funds	1.5	5.1	2.5
Real estate	5.5	4.0	4.2
Derivatives	9.8	2.8	2.0
Cash and other assets	7.3	7.1	9.0
Equity exposure of equity futures	1.6	8.0	8.4
Cash exposure of equity futures	(1.6)	(7.7)	(8.4)
	100.0	100.0	100.0

The assets of the Main scheme, which represent 88% of plan assets at 31 December 2014 (2013 and 2012 - 85%), 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 also employs derivative instruments, where appropriate, to achieve a desired asset class exposure or to match assets more closely to liabilities. The value of assets shown reflects the actual physical assets held by the scheme, with any derivative holdings valued on a mark-to-market basis.

Notes on the accounts

The Main scheme's holdings of derivative instruments are summarised in the table below:

	2014			2013			2012		
	Notional amounts £m	Fair value Assets £m	Liabilities £m	Notional amounts £m	Fair value Assets £m	Liabilities £m	Notional amounts £m	Fair value Assets £m	Liabilities £m
Inflation rate swaps	8,467	73	415	6,273	258	141	5,474	20	335
Interest rate swaps	23,858	6,055	3,305	22,108	3,283	2,867	19,304	3,424	2,811
Total return swaps	181	1	—	187	1	—	515	6	—
Currency swaps	782	223	191	2,196	813	720	2,539	326	259
Credit default swaps	875	427	435	900	13	16	709	11	12
Equity and bond futures	599	14	2	1,904	71	2	2,109	16	17
Currency forwards	8,562	2	—	9,182	66	—	8,551	41	—
Equity and bond call options	7,382	846	48	4,102	108	63	963	94	—
Equity and bond put options	7,409	1	61	4,071	11	90	963	13	31

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. The majority of swaps are with The Royal Bank of Scotland plc and National Westminster Bank Plc (the "banks"). At 31 December 2014, the gross notional value of the swaps was £34,163 million (2013 - £31,664 million; 2012 - £28,541 million) and had a net positive fair value of £2,433 million (2013 - £624 million; 2012 - £370 million).

Collateral is required on all swap transactions with those between the banks and the Main scheme on terms that do not allow the banks to re-hypothecate. The banks had delivered £2,908 million of collateral at 31 December 2014 (2013 - £633 million; 2012 - £521 million).

Ordinary shares of the company with a fair value of £2 million (2013 and 2012 - £4 million) and other financial instruments issued by the Group with a value of £2,172 million (2013 - £416 million; 2012 - £610 million) are held by the Main scheme.

Post-retirement mortality assumptions (Main scheme)

	2014	2013	2012
Longevity at age 60 for current pensioners (years)			
Males	28.0	27.6	27.3
Females	30.0	29.5	29.2
Longevity at age 60 for future pensioners currently aged 40 (years)			
Males	29.3	28.6	29.4
Females	31.6	30.8	31.0

Notes on the accounts

4 Pensions continued

	Fair value of plan assets £m	Present value of defined benefit obligations £m	Net pension deficit £m
Changes in value of net pension deficit			
At 1 January 2013	26,359	30,069	3,710
Currency translation and other adjustments	(8)	2	10
Income statement			
Net interest expense	1,173	1,314	141
Current service cost		376	376
Less: direct contributions from other scheme members		(5)	(5)
Past service cost		1	1
Gains on settlements		(3)	(3)
	1,173	1,683	510
Statement of comprehensive income			
- Return on plan assets above recognised interest income	1,097	—	(1,097)
- Experience gains and losses	—	(177)	(177)
- Actuarial gains and losses due to changes in financial assumptions	—	593	593
- Actuarial gains and losses due to changes in demographic assumptions	—	238	238
	1,097	654	(443)
Transfers from fellow subsidiaries		4	4
Contributions by employer	817		(817)
Contributions by plan participants and other scheme members	14	14	—
Benefits paid	(981)	(981)	—
At 1 January 2014	28,471	31,445	2,974
Currency translation and other adjustments	(63)	(86)	(23)
Income statement			
Net interest expense	1,314	1,419	105
Current service cost		356	356
Past service cost		2	2
	1,314	1,777	463
Statement of comprehensive income			
- Return on plan assets above recognised interest income	5,171	—	(5,171)
- Experience gains and losses	—	(18)	(18)
- Actuarial gains and losses due to changes in financial assumptions	—	4,799	4,799
- Actuarial gains and losses due to changes in demographic assumptions	—	490	490
	5,171	5,271	100
Contributions by employer	1,063		(1,063)
Contributions by plan participants and other scheme members	5	5	—
Benefits paid	(1,026)	(1,026)	—
Transfers to disposal groups	(594)	(790)	(196)
At 31 December 2014	34,341	36,596	2,255
Net pension deficit comprises			
	2014 £m	2013 £m	2012 £m
Net assets of schemes in surplus (included in Prepayments, accrued income and other assets, Note 20)	(295)	(214)	(144)
Net liabilities of schemes in deficit	2,550	3,188	3,854
	2,255	2,974	3,710

The income statement charge comprises:

	2014 £m	2013 £m	2012 £m
Continuing operations	459	501	488
Discontinued operations	4	9	(14)
	463	510	474

Notes on the accounts

The weighted average duration of the Main Scheme's defined benefit obligation at 31 December 2014 is 20.0 years (2013 - 18.0 years; 2012 - 19.2 years).

The defined benefit obligation is attributable to the different classes of scheme members in the following proportions (Main scheme):

	2014 %	2013 %	2012 %
Active	18.8	19.5	23.8
Deferred	41.0	38.4	32.4
Pensioner	40.2	42.1	43.8
	100.0	100.0	100.0

	Group				
	2014 £m	2013 £m	2012 £m	2011 £m	2010 £m
History of defined benefit schemes					
Fair value of plan assets	34,341	28,471	26,359	23,830	21,687
Present value of defined benefit obligations	36,596	31,445	30,069	25,994	23,877
Net deficit	2,255	2,974	3,710	2,164	2,190
Experience gains/(losses) on plan liabilities	18	177	(202)	(224)	(851)
Experience gains on plan assets	5,171	1,097	476	812	1,931
Actual return on pension schemes assets	6,485	2,270	1,662	1,973	3,000
Actual return on pension schemes assets - %	22.8%	8.6%	7.0%	9.1%	16.0%

Triennial funding valuation

In May 2014, the triennial funding valuation of The Royal Bank of Scotland Group Pension Fund 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 will pay annual 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.

The table below sets out the sensitivities of the pension cost for the year and the present value of defined benefit obligations at 31 December to a change in the principal actuarial assumptions:

	(Decrease)/increase in pension cost for year			(Decrease)/increase in obligation at 31 December		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
0.25% increase in the discount rate	(79)	(80)	(80)	(1,695)	(1,379)	(1,392)
0.25% increase in inflation	63	58	66	1,334	1,000	1,129
0.25% additional rate of increase in pensions in payment	49	48	45	1,107	844	782
0.25% additional rate of increase in deferred pensions	24	21	23	476	383	342
0.25% additional rate of increase in salaries	12	12	9	131	110	125
Longevity increase of one year	42	39	38	1,053	801	727

Pension costs and liabilities are calculated on the central assumptions and under the relevant sensitivity scenarios. The sensitivity to pension costs/liabilities is the difference between these calculations.

The sensitivity analysis presented above may not be representative of the actual change in the pension cost or 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 the accounts

5 Auditor's remuneration

Amounts paid to the Group's auditors for statutory audit and other services are set out below:

	Group	
	2014 £m	2013 £m
Fees payable for the audit of the Group's annual accounts	6.7	5.4
Fees payable to the auditor and its associates for other services to the Group		
- the audit of the Bank's subsidiaries pursuant to legislation	10.4	9.2
Total audit and audit-related assurance service fees	17.1	14.6

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		
	2014 £m	2013 £m	2012 £m
Current tax			
Charge for the year	(275)	(237)	(298)
Over/(under) provision in respect of prior years	75	(50)	50
	(200)	(287)	(248)
Deferred tax			
(Charge)/credit for the year	(355)	499	425
Reduction in the carrying value of deferred tax assets	(1,472)	(701)	(203)
(Under)/over provision in respect of prior year	(6)	182	(25)
Tax charge for the year	(2,033)	(307)	(51)

The actual tax charge differs from the expected tax (charge)/ credit computed by applying the standard rate of UK corporation tax of 21.5% (2013 - 23.25%; 2012 - 24.5%) as follows:

	2014 £m	2013 £m	2012 £m
Expected tax (charge)/credit	(517)	1,713	1,053
Losses in year where no deferred tax asset recognised	(11)	(670)	(253)
Foreign profits taxed at other rates	100	(122)	(292)
UK tax rate change impact ⁽¹⁾	—	(338)	(152)
Unrecognised timing differences	(3)	(8)	59
Non-deductible goodwill impairment	(28)	(49)	(10)
Items not allowed for tax			
- losses on disposal and write-downs	(19)	(19)	(36)
- UK bank levy	(54)	(47)	(43)
- regulatory and legal action	(182)	(144)	(93)
- other disallowable items	(148)	(177)	(218)
Non-taxable items			
- gain on sale of RBS Aviation Capital	—	—	26
- gain on sale of WorldPay (Global Merchant Services)	—	37	—
- other non-taxable items	37	74	55
Taxable foreign exchange movements	(23)	12	31
Losses brought forward and utilised	218	—	—
(Reduction)/increase in carrying value of deferred tax asset in respect of:			
- UK losses	(850)	(701)	—
- US losses and temporary differences	(775)	—	—
- Ireland losses	153	—	(203)
Adjustments in respect of prior years ⁽²⁾	69	132	25
Actual tax charge	(2,033)	(307)	(51)

Notes:

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

(2) Prior year tax adjustments include releases of tax provisions in respect of structured transactions and adjustments to reflect submitted tax computations in the UK and overseas.

Notes on the accounts

7 Profit attributable to preference shareholders

	Group		
	2014 £m	2013 £m	2012 £m
Non-cumulative preference shares of US\$0.01	43	40	41
Non-cumulative preference shares of €0.01	18	18	17
Total	61	58	58

Note:

(1) Between 1 January 2015 and the date of approval of these accounts, dividends amounting to US\$10 million have been declared in respect of equity preference shares for payment on 31 March 2015.

8 Ordinary dividends

The Bank did not pay an ordinary dividend in 2014, 2013 or 2012.

9 Loss dealt with in the accounts of the Bank

As permitted by section 408(3) of the Companies Act 2006, no income statement for the Bank has been presented as a primary financial statement. Of the loss attributable to ordinary shareholders, £2,119 million loss (2013 - £1,257 million loss; 2012 - £839 million loss) has been dealt with in the accounts of the Bank.

Notes on the accounts

10 Financial instruments - classification

The following tables show the Group's financial assets and liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown separately.

	Group									
	Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available- for-sale £m	Loans and receivables £m	Held-to- maturity £m	Amortised cost £m	Finance leases £m	Other assets/ liabilities £m	Total £m
2014										
Assets										
Cash and balances at central banks	—	—		—	73,983	—				73,983
Loans and advances to banks										
- amounts due from fellow subsidiaries	672	—		—	1,661	—				2,333
- reverse repos	18,129	—		—	2,579	—				20,708
- other ⁽¹⁾	11,483	—		—	10,068	—				21,551
Loans and advances to customers										
- amounts due from holding company and fellow subsidiaries	—	—		—	1,323	—				1,323
- reverse repos	43,018	—		—	969	—				43,987
- other	22,830	61		—	304,619	—		4,118		331,628
Debt securities ⁽²⁾	49,128	1		27,540	3,068	4,537				84,274
Equity shares	4,724	240		239	—	—				5,203
Settlement balances	—	—		—	4,710	—				4,710
Derivatives										
- amounts due from holding company and fellow subsidiaries	2,738		—							2,738
- other	346,677		5,167							351,844
Intangible assets									7,765	7,765
Property, plant and equipment									6,123	6,123
Deferred tax									1,510	1,510
Prepayments, accrued income and other assets									4,413	4,413
Assets of disposal groups									81,033	81,033
	499,399	302	5,167	27,779	402,980	4,537		4,118	100,844	1,045,126
Liabilities										
Deposits by banks										
- amounts due to fellow subsidiaries	219	1					3,988			4,208
- repos	23,990	—					794			24,784
- other ⁽³⁾	25,234	—					9,624			34,858
Customer accounts										
- amounts due to holding company	—	—					5,843			5,843
- repos	35,985	—					1,365			37,350
- other ⁽⁴⁾	15,048	4,731					332,027			351,806
Debt securities in issue ⁽⁵⁾	6,487	9,607					25,902			41,996
Settlement balances	—	—					4,498			4,498
Short positions	23,028	—								23,028
Derivatives										
- amounts due to holding company and fellow subsidiaries	2,005		—							2,005
- other	345,524		3,254							348,778
Accruals, deferred income and other liabilities	—	—					1,815		10,447	12,262
Retirement benefit liabilities									2,550	2,550
Deferred tax									236	236
Subordinated liabilities										
- amounts due to holding company	—	—					19,639			19,639
- other	—	345					10,485			10,830
Liabilities of disposal groups									71,284	71,284
	477,520	14,684	3,254				415,980	—	84,517	995,955
Equity										49,171
										1,045,126

For the notes to this table refer to page 203.

Notes on the accounts

	Group								
	Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available- for-sale £m	Loans and receivables £m	Amortised Cost £m	Finance leases £m	Other assets/ liabilities £m	Total £m
2013									
Assets									
Cash and balances at central banks	—	—		—	79,993				79,993
Loans and advances to banks									
- amounts due from fellow subsidiaries	3,773	—		—	11,285				15,058
- reverse repos	25,781	—		—	658				26,439
- other (1)	9,279	—		—	15,707				24,986
Loans and advances to customers									
- amounts due from holding company and fellow subsidiaries	—	—			1,620				1,620
- reverse repos	49,897	—		—	—				49,897
- other	18,849	49		—	361,935		6,750		387,583
Debt securities (2)	56,258	14		40,682	3,742				100,696
Equity shares	6,983	313		982	—				8,278
Settlement balances	—	—		—	5,634				5,634
Derivatives									
- amounts due from holding company and fellow subsidiaries	3,413	—	—						3,413
- other	281,655		4,335						285,990
Intangible assets								12,352	12,352
Property, plant and equipment								7,866	7,866
Deferred tax								3,435	3,435
Prepayments, accrued income and other assets								5,904	5,904
Assets of disposal groups								790	790
	455,888	376	4,335	41,664	480,574		6,750	30,347	1,019,934
Liabilities									
Deposits by banks									
- amounts due to fellow subsidiaries	435	10				2,018			2,463
- repos	23,121	—				5,491			28,612
- other (3)	18,909	—				15,179			34,088
Customer accounts									
- amounts due to holding company	46	—				5,161			5,207
- repos	52,300	—				4,157			56,457
- other (4)	9,636	5,862				395,142			410,640
Debt securities in issue (5)	8,570	14,998				36,178			59,746
Settlement balances	—	—				5,245			5,245
Short positions	28,004	—							28,004
Derivatives									
- amounts due to holding company and fellow subsidiaries	2,586	—	—						2,586
- other	280,428		3,119						283,547
Accruals, deferred income and other liabilities	—	—				1,759	19	12,975	14,753
Retirement benefit liabilities								3,188	3,188
Deferred tax								189	189
Subordinated liabilities									
- amounts due to holding company	—	—				19,825			19,825
- other	—	358				12,951			13,309
Liabilities of disposal groups								3,210	3,210
	424,035	21,228	3,119			503,106	19	19,562	971,069
Equity									48,865
									1,019,934

For the notes to this table refer to page 203.

Notes on the accounts

10 Financial instruments - classification continued

	Group								
2012	Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available- for-sale £m	Loans and receivables £m	Amortised Cost £m	Finance leases £m	Other assets/ liabilities £m	Total £m
Assets									
Cash and balances at central banks	—	—		—	74,524				74,524
Loans and advances to banks									
- amounts due from fellow subsidiaries	4,401	1		—	17,473				21,875
- reverse repos	33,388	—		—	1,056				34,444
- other (1)	12,022	—		—	13,726				25,748
Loans and advances to customers									
- amounts due from holding company and fellow subsidiaries	31	—		—	1,835				1,866
- reverse repos	70,010	—		—	33				70,043
- other	24,474	189		—	391,033		7,232		422,928
Debt securities (2)	77,030	697		54,561	4,297				136,585
Equity shares	12,311	484		1,077	—				13,872
Settlement balances	—	—		—	5,717				5,717
Derivatives									
- amounts due from holding company and fellow subsidiaries	7,200	—	—						7,200
- other	429,688		8,213						437,901
Intangible assets								12,403	12,403
Property, plant and equipment								9,694	9,694
Deferred tax								3,066	3,066
Prepayments, accrued income and other assets								6,104	6,104
Assets of disposal groups								304	304
	670,555	1,371	8,213	55,638	509,694		7,232	31,571	1,284,274
Liabilities									
Deposits by banks									
- amounts due to fellow subsidiaries	2,188	—				3,875			6,063
- repos	36,361	—				7,962			44,323
- other (3)	29,505	—				22,369			51,874
Customer accounts									
- amounts due to holding company and fellow subsidiaries	123	—				5,655			5,778
- repos	82,213	—				5,784			87,997
- other (4)	11,314	6,323				407,785			425,422
Debt securities in issue (5)	10,820	22,183				50,275			83,278
Settlement balances	—	—				5,832			5,832
Short positions	27,541	—							27,541
Derivatives									
- amounts due to holding company and fellow subsidiaries	5,580	—	—						5,580
- other	426,863		3,642						430,505
Accruals, deferred income and other liabilities	—	—				1,684	12	10,331	12,027
Retirement benefit liabilities								3,854	3,854
Deferred tax								789	789
Subordinated liabilities									
- amounts due to holding company	—	—				18,184			18,184
- other	—	538				15,129			15,667
Liabilities of disposal groups								135	135
	632,508	29,044	3,642			544,534	12	15,109	1,224,849
Equity									59,425
									1,284,274

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

Notes on the accounts

The above includes amounts due from/to:

	2014		Group 2013		2012	
	Holding company £m	Fellow subsidiaries £m	Holding company £m	Fellow subsidiaries £m	Holding company £m	Fellow subsidiaries £m
Assets						
Loans and advances to customers	938	385	1,490	130	1,455	411
Derivatives	30	2,708	53	3,360	7	7,193
Liabilities						
Customer accounts	5,843	—	5,207	—	5,777	1
Derivatives	179	1,826	153	2,433	511	5,069

Notes:

- (1) Includes items in the course of collection from other banks of £980 million (2013 - £1,454 million; 2012 - £1,531 million).
- (2) Debt securities balances with Group companies are shown on pages 123 to 126.
- (3) Includes items in the course of transmission to other banks of £513 million (2013 - £826 million; 2012 - £521 million).
- (4) The carrying amount of other customer accounts designated as at fair value through profit or loss is £432 million (2013 - £412 million; 2012 - £305 million) higher than the principal amount. No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial, 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 £40,760 million (2013 - £57,035 million; 2012 - £79,565 million) and certificates of deposit and other commercial paper of £1,236 million (2013 - £2,711 million; 2012 - £3,713 million).

Amounts included in the consolidated income statement:

	Group		
	2014 £m	2013 £m	2012 £m
Gains/(losses) on financial assets/liabilities designated as at fair value through profit or loss			
- continuing operations	43	(88)	(1,973)
(Losses)/gains on disposal or settlement of loans and receivables			
- continuing operations	(236)	(137)	1
- discontinued operations	(48)	(69)	(77)

Notes on the accounts

10 Financial instruments - classification continued

The following tables show the Bank's financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown separately.

	Bank										
	Held-for- trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available- for-sale £m	Loans and receivables £m	Held-to- maturity £m	Amortised Cost £m	Finance leases £m	Non financial assets/ liabilities £m	Total £m	
2014											
Assets											
Cash and balances at central banks	—	—		—	70,952					70,952	
Loans and advances to banks											
- amounts due from subsidiaries	2,172	—		—	22,667					24,839	
- reverse repos	12,791	—		—	2,030					14,821	
- other (1)	11,070	—		—	4,171					15,241	
Loans and advances to customers											
- amounts due from holding company											
- and subsidiaries	11,652	—		9	29,535					41,196	
- reverse repos	30,976	—		—	969					31,945	
- other	22,645	60		—	121,888			43		144,636	
Debt securities (2)	39,210	—		24,725	19,122	4,537				87,594	
Equity shares	4,714	40		126	—					4,880	
Investment in Group undertakings	—	—		—	—				39,857	39,857	
Settlement balances	—	—		—	3,381					3,381	
Derivatives											
- amounts due from holding company and subsidiaries	9,268		—							9,268	
- other	346,727		3,830							350,557	
Intangible assets									917	917	
Property, plant and equipment									1,976	1,976	
Deferred tax									733	733	
Prepayments, accrued income and other assets	—	—	—	—	—				2,203	2,203	
	491,225	100	3,830	24,860	274,715	4,537		43	45,686	844,996	
Liabilities											
Deposits by banks											
- amounts due to subsidiaries	3,567	9					117,913			121,489	
- repos	21,254	—					794			22,048	
- other (3)	24,824	—					6,094			30,918	
Customer accounts											
- amounts due to holding company and subsidiaries	2,821	—					26,419			29,240	
- repos	32,326	—					1,364			33,690	
- other (4)	15,035	681					94,870			110,586	
Debt securities in issue (5)	6,487	8,950					21,306			36,743	
Settlement balances	—	—					3,098			3,098	
Short positions	16,590	—					—			16,590	
Derivatives											
- amounts due to holding company and subsidiaries	6,585		—							6,585	
- other	346,079		2,083				—			348,162	
Accruals, deferred income and other liabilities	—	—					1,143		4,479	5,622	
Retirement benefit liabilities							—		192	192	
Deferred tax							—		—	—	
Subordinated liabilities											
- amounts due to holding company	—	—	—				18,535			18,535	
- other	—	345	—				8,600			8,945	
	475,568	9,985	2,083				300,136	—	4,671	792,443	
Equity										52,553	
										844,996	

For the notes to this table refer to page 207.

Notes on the accounts

	Bank								
	Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available- for-sale £m	Loans and receivables £m	Amortised Cost £m	Finance leases £m	Non financial assets/ liabilities £m	Total £m
2013									
Assets									
Cash and balances at central banks	—	—		—	75,792				75,792
Loans and advances to banks									
- amounts due from subsidiaries	8,142	—		—	32,968				41,110
- reverse repos	18,684	—		—	427				19,111
- other (1)	9,278	—		—	8,269				17,547
Loans and advances to customers									
- amounts due from holding company and subsidiaries	20,529	—		8	29,408				49,945
- reverse repos	24,651	—		—	—				24,651
- other	18,525	49		—	132,169		35	—	150,778
Debt securities (2)	34,412	456		28,251	29,208			—	92,327
Equity shares	6,949	107		245	—			—	7,301
Investment in Group undertakings	—	—		—	—			42,328	42,328
Settlement balances	—	—		—	3,492			—	3,492
Derivatives									
- amounts due from holding company and subsidiaries	8,967		—						8,967
- other	280,300		3,613						283,913
Intangible assets								1,127	1,127
Property, plant and equipment								2,284	2,284
Deferred tax								2,298	2,298
Prepayments, accrued income and other assets	—	—	—	—	—			3,246	3,246
	430,437	612	3,613	28,504	311,733		35	51,283	826,217
Liabilities									
Deposits by banks									
- amounts due to subsidiaries	4,198	20				128,997			133,215
- repos	16,199	—				3,588			19,787
- other (3)	18,601	—				8,690			27,291
Customer accounts									
- amounts due to holding company and subsidiaries	12,550	495				34,354			47,399
- repos	23,531	—				3,490			27,021
- other (4)	9,594	829				108,710			119,133
Debt securities in issue (5)	8,570	14,063				28,905			51,538
Settlement balances	—	—				2,274			2,274
Short positions	17,898	—				—			17,898
Derivatives									
- amounts due to holding company and subsidiaries	5,675		—						5,675
- other	281,079		1,753			—			282,832
Accruals, deferred income and other liabilities	—	—				1,124		6,077	7,201
Retirement benefit liabilities								65	65
Deferred tax									
Subordinated liabilities									
- amounts due to holding company	—	—	—			19,399			19,399
- other	—	358	—			10,809			11,167
	397,895	15,765	1,753			350,340		6,142	771,895
Equity									54,322
									826,217

For the notes to this table refer to page 207.

Notes on the accounts

10 Financial instruments - classification continued

	Bank							Total £m
	Held-for- trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available- for-sale £m	Loans and receivables £m	Amortised Cost £m	Non financial assets/ liabilities £m	
2012								
Assets								
Cash and balances at central banks	—	—		—	70,374			70,374
- amounts due from subsidiaries	7,111	1		—	58,559			65,671
- reverse repos	25,594	—		—	—			25,594
- other (1)	12,015	—		—	6,291			18,306
Loans and advances to customers								
- amounts due from holding company and subsidiaries	19,254	—		12	36,202			55,468
- reverse repos	42,972	—		—	23			42,995
- other	23,555	134		—	149,397			173,086
Debt securities (2)	42,899	1,242		43,059	35,247			122,447
Equity shares	12,278	274		214	—			12,766
Investment in Group undertakings							40,262	40,262
Settlement balances	—	—		—	3,090			3,090
Derivatives								
- amounts due from holding company and subsidiaries	14,953							14,953
- other	428,261		6,624					434,885
Intangible assets							1,033	1,033
Property, plant and equipment							2,430	2,430
Deferred tax							2,878	2,878
Prepayments, accrued income and other assets							4,433	4,433
	628,892	1,651	6,624	43,285	359,183		51,036	1,090,671
Liabilities								
Deposits by banks								
- amounts due to subsidiaries	6,897	84				123,145		130,126
- repos	27,499	—				6,078		33,577
- other (3)	29,087	—				16,793		45,880
Customer accounts								
- amounts due to holding company and subsidiaries	18,900	567				65,525		84,992
- repos	37,460	—				4,727		42,187
- other (4)	11,299	1,024				116,832		129,155
Debt securities in issue (5)	10,820	21,220				39,454		71,494
Settlement balances	—	—				2,878		2,878
Short positions	14,074	—				—		14,074
Derivatives								
- amounts due to holding company and subsidiaries	9,321		—					9,321
- other	428,082		1,749					429,831
Accruals, deferred income and other liabilities	—	—				1,106	6,249	7,355
Retirement benefit liabilities							56	56
Deferred tax								
Subordinated liabilities								
- amounts due to holding company	—	—				18,184		18,184
- other	—	538				12,913		13,451
	593,439	23,433	1,749	—	—	407,635	6,305	1,032,561
Equity								58,110
								1,090,671

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

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The above includes amounts due from/to:

	2014			Bank 2013			2012		
	Holding company £m	Fellow subsidiaries £m	Subsidiaries £m	Holding company £m	Fellow subsidiaries £m	Subsidiaries £m	Holding company £m	Fellow subsidiaries £m	Subsidiaries £m
Assets									
Loans and advances to banks	—	3,370	21,469	—	15,671	25,439	—	21,875	43,796
Loans and advances to customers	938	69	40,190	1,490	130	48,325	1,455	290	53,723
Derivatives	30	2,708	6,530	53	3,359	5,555	7	7,186	7,760
Liabilities									
Deposits by banks	—	12,452	109,037	—	2,734	130,481	—	5,015	125,111
Customer accounts	5,843	—	23,397	5,207	—	42,192	5,777	1	79,214
Derivatives	179	1,826	4,580	153	2,433	3,089	511	5,069	3,741

Notes:

- (1) Includes items in the course of collection from other banks of £237 million (2013 - £349 million; 2012 - £303 million).
- (2) Debt securities balances with Group companies are shown on page 125.
- (3) Includes items in the course of transmission to other banks of £367 million (2013 - £348 million; 2012 - £63 million).
- (4) The carrying amount of other customer accounts designated as at fair value through profit or loss is £54 million higher (2013 - £65 million; 2012 - £43 million) higher than the principal amount. No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial 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 £35,517 million (2013 - £49,697 million; 2012 - £68,530 million) and certificates of deposit and other commercial paper of £1,226 million (2013 - £1,841 million; 2012 - £2,964 million).

The tables below present information on financial assets and liabilities that are offset in the balance sheet under IFRS or subject to enforceable master netting agreements only, together with financial collateral received or given.

	Group						
	Gross	IFRS offset	Balance sheet	Effect of master	Cash	Other financial	Net amount after
	£m	£m	£m	netting agreements	collateral	collateral	the effect of netting
2014				and similar	£m	£m	arrangements and
				arrangements			related collateral
				£m			£m
Assets							
Derivatives	590,716	(245,418)	345,298	(296,156)	(32,629)	(7,005)	9,508
Reverse repurchase agreements	95,392	(30,822)	64,570	(5,016)	—	(59,505)	49
Loans to customers	2,921	(2,921)	—	—	—	—	—
Settlement balances	2,094	(1,997)	97	—	—	—	97
	691,123	(281,158)	409,965	(301,172)	(32,629)	(66,510)	9,654
Liabilities							
Derivatives	584,561	(241,235)	343,326	(296,156)	(30,015)	(14,433)	2,722
Repurchase agreements	91,887	(30,822)	61,065	(5,016)	—	(56,049)	—
Customer accounts	7,104	(7,104)	—	—	—	—	—
Settlement balances	1,998	(1,997)	1	—	—	—	1
	685,550	(281,158)	404,392	(301,172)	(30,015)	(70,482)	2,723

Notes on the accounts

10 Financial instruments - classification continued

	Gross £m	IFRS offset £m	Balance sheet £m	Group Effect of master netting agreements and similar arrangements £m	Cash collateral £m	Other financial collateral £m	Net amount after the effect of netting arrangements and related collateral £m
2013							
Assets							
Derivatives	548,743	(265,709)	283,034	(242,486)	(23,667)	(5,990)	10,891
Reverse agreements	115,715	(40,658)	75,057	(11,379)	—	(63,589)	89
Loans to customers	2,152	(2,152)	—	—	—	—	—
Settlement balances	2,950	(2,672)	278	(262)	—	—	16
	669,560	(311,191)	358,369	(254,127)	(23,667)	(69,579)	10,996
Liabilities							
Derivatives	543,393	(262,655)	280,738	(242,486)	(24,540)	(8,257)	5,455
Repurchase agreements	120,639	(40,658)	79,981	(11,379)	—	(68,602)	—
Customer accounts	5,206	(5,206)	—	—	—	—	—
Settlement balances	4,006	(2,672)	1,334	(262)	—	—	1,072
	673,244	(311,191)	362,053	(254,127)	(24,540)	(76,859)	6,527
2012							
Assets							
Derivatives	801,520	(373,448)	428,072	(374,190)	(33,558)	(5,620)	14,704
Reverse repurchase agreements	117,153	(38,377)	78,776	(17,439)	—	(61,337)	—
Settlement balances	3,680	(2,456)	1,224	(345)	—	—	879
	922,353	(414,281)	508,072	(391,974)	(33,558)	(66,957)	15,583
Liabilities							
Derivatives	796,908	(373,448)	423,460	(374,190)	(30,297)	(11,702)	7,271
Repurchase agreements	106,885	(38,377)	68,508	(17,439)	—	(51,069)	—
Settlement balances	4,270	(2,456)	1,814	(345)	—	—	1,469
	908,063	(414,281)	493,782	(391,974)	(30,297)	(62,771)	8,740

Notes on the accounts

				Bank Effect of master netting agreements and similar arrangements £m	Cash collateral £m	Other financial collateral £m	Net amount after the effect of netting arrangements and £m
2014	Gross £m	IFRS offset £m	Balance sheet £m				
Assets							
Derivatives	595,932	(245,413)	350,519	(299,930)	(32,616)	(6,978)	10,995
Reverse repurchase agreements	61,651	(14,951)	46,700	(4,751)	—	(41,949)	—
Loans to customers	2,921	(2,921)	—	—	—	—	—
Settlement balances	228	(156)	72	—	—	—	72
	660,732	(263,441)	397,291	(304,681)	(32,616)	(48,927)	11,067
Liabilities							
Derivatives	588,399	(241,230)	347,169	(299,930)	(30,015)	(14,433)	2,791
Repurchase agreements	69,620	(14,951)	54,669	(4,751)	—	(49,918)	—
Customer accounts	7,104	(7,104)	—	—	—	—	—
Settlement balances	156	(156)	—	—	—	—	—
	665,279	(263,441)	401,838	(304,681)	(30,015)	(64,351)	2,791
2013							
Assets							
Derivatives	553,861	(265,486)	288,375	(244,598)	(23,667)	(5,990)	14,120
Reverse repurchase agreements	59,872	(17,151)	42,721	(7,319)	—	(35,402)	—
Loans to customers	2,152	(2,152)	—	—	—	—	—
Settlement balances	62	(62)	—	—	—	—	—
	615,947	(284,851)	331,096	(251,917)	(23,667)	(41,392)	14,120
Liabilities							
Derivatives	546,002	(262,432)	283,570	(244,598)	(24,540)	(8,257)	6,175
Repurchase agreements	62,120	(17,151)	44,969	(7,319)	—	(37,650)	—
Customer accounts	5,206	(5,206)	—	—	—	—	—
Settlement balances	62	(62)	—	—	—	—	—
	613,390	(284,851)	328,539	(251,917)	(24,540)	(45,907)	6,175
2012							
Assets							
Derivatives	816,278	(373,264)	443,014	(379,814)	(33,440)	(5,616)	24,144
Reverse repurchase agreements	83,018	(10,097)	72,921	(14,762)	—	(58,159)	—
Settlement balances	515	(472)	43	(43)	—	—	—
	899,811	(383,833)	515,978	(394,619)	(33,440)	(63,775)	24,144
Liabilities							
Derivatives	806,043	(373,264)	432,779	(379,814)	(24,593)	(8,264)	20,108
Repurchase agreements	86,920	(10,097)	76,823	(14,762)	—	(62,061)	—
Settlement balances	515	(472)	43	(43)	—	—	—
	893,478	(383,833)	509,645	(394,619)	(24,593)	(70,325)	20,108

Notes on the accounts

10 Financial instruments - classification continued

Reclassification of financial instrument

In 2014, UK Government bonds with a fair value of £3.6 billion were reclassified from available-for-sale (AFS) to held-to-maturity (HTM). In 2008 and 2009, the Group reclassified financial assets from held-for-trading (HFT) and AFS categories into loans and receivables (LAR) and from HFT into AFS. The tables below show the carrying value, fair value and the effect on profit or loss of these reclassifications.

	Group					Reduction/ (increase) in profit or loss as a result of reclassification £m
	Carrying value £m	Fair value £m	Amount recognised in income statement		Amount that would have been recognised had reclassification not occurred £m	
			Income £m	Impairment (losses) releases/ £m		
2014						
Reclassified from HFT to LAR						
Loans	671	561	33	(76)	65	108
Debt securities	835	787	(18)	—	129	147
	1,506	1,348	15	(76)	194	255
Reclassified from HFT to AFS ⁽¹⁾						
Debt securities	64	64	7	—	7	—
Reclassified from AFS to HTM ⁽²⁾						
Debt securities	3,625	3,766	68	—	67	(1)
	5,195	5,178	90	(76)	268	254
2013						
Reclassified from HFT to LAR						
Loans	1,417	1,160	(28)	(13)	42	83
Debt securities	1,284	892	(23)	3	(88)	(68)
	2,701	2,052	(51)	(10)	(46)	15
Reclassified from HFT to AFS ⁽¹⁾						
Debt securities	62	62	34	1	45	10
Reclassified from AFS to LAR ⁽³⁾						
Debt securities	—	—	4	7	—	(11)
	2,763	2,114	(13)	(2)	(1)	14
2012						
Reclassified from HFT to LAR						
Loans	2,892	2,546	42	15	517	460
Debt securities	1,548	1,232	(107)	(2)	184	293
	4,440	3,778	(65)	13	701	753
Reclassified from HFT to AFS ⁽¹⁾						
Debt securities	891	891	38	8	13	(33)
Reclassified from AFS to LAR ⁽³⁾						
Debt securities	167	90	7	—	7	—
	5,498	4,759	(20)	21	721	720

Notes:

- (1) Nil (2013 - £51 million; 2012 - £77 million) was taken to AFS reserves.
- (2) £155 million would have been taken to AFS reserves if reclassification had not occurred.
- (3) £1 million in 2013 and 2012 would have been taken to AFS reserves if reclassification had not occurred.

Notes on the accounts

The table below shows the carrying value and fair value of reclassifications undertaken by the Bank in 2008 and 2009 and 2014.

	2014		Bank 2013		2012	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Reclassified from HFT to LAR						
Loans	496	390	1,207	964	2,555	2,215
Debt securities	835	787	1,284	892	1,548	1,232
	1,331	1,177	2,491	1,856	4,103	3,447
Reclassified from HFT to AFS ⁽¹⁾						
Debt securities	64	64	62	62	891	891
Reclassified from AFS to LAR ⁽²⁾						
Debt securities	—	—	—	—	167	90
Reclassified from AFS to HTM ⁽³⁾						
Debt securities	3,625	3,766	—	—	—	—
	5,020	5,007	2,553	1,918	5,161	4,428

Notes:

- (1) Nil (2013 - £51 million; 2012 - £77 million) was taken to AFS reserves.
(2) £1 million in 2013 and 2012 would have been taken to AFS reserves if reclassification had not occurred.
(3) £155 million would have been taken to AFS reserves if reclassification had not occurred.

11 Financial instruments - valuation

Valuation of financial instruments carried at fair value

Control environment

Common valuation policies, procedures, frameworks and models apply across 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 RBS Group ensures that appropriate attention is given to bespoke transactions, structured products, illiquid products and other instruments which are difficult to price.

A key element of the control environment is the independent price verification (IPV) process. 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.

IPV takes place at least monthly, at month end date, for exposures in the regulatory trading book and at least quarterly for exposures in the regulatory banking book. Monthly meetings are held between the business and the support functions to discuss the results of the IPV and pricing reserves. 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.

Valuation models are subject to a review process which requires different levels of model documentation, testing and review, depending on the complexity of the model and the size of the Group's exposure. A key element of the control environment for model use is a Modelled Product Review Committee, made up of valuations experts from several functions within the Group. This committee sets the policy for model documentation, testing and review, and prioritises models with significant exposure for review by the Group's Pricing Model Risk team. Potential valuation uncertainty is a key input in determining model review priorities at these meetings. The Pricing Model Risk team within Risk Management, which is independent of the trading businesses, assesses the appropriateness of the application of the model to the product, the mathematical robustness of the model, and where appropriate, considers alternative modelling approaches.

11 Financial instruments - valuation *continued*

The CIB and RCR Valuation Control Committees meet formally on a monthly basis to discuss independent pricing, reserving and valuation issues. All material methodology changes require review and ratification by these committees. The committees, which include valuation specialists representing several independent review functions, comprise Market Risk, Pricing Model Risk, Finance and senior business representatives.

The Executive Valuation Committee discusses the issues escalated by the CIB and RCR Valuations Committees and other relevant issues including prudential valuation. This committee covers key material and subjective valuation issues within the trading businesses and provides ratification to the appropriateness of areas with high levels of residual valuation uncertainty. Committee members include the Chief Financial Officer, the Financial Controller, the Chief Accountant and other senior mentors with finance and risk.

The CIB Valuation Committee operates under delegated authority of the CIB Risk Committee. The CIB Valuation Committee submits a quarterly paper covering the key areas that are governed by them to the CIB Risk Committee. Additionally, the CIB Valuation Committee may escalate items to the CIB Risk Committee on a more frequent basis as appropriate.

Market risk metrics such as value-at-risk (VaR), Incremental Risk Charge and stressed value-at-risk (SVaR) cover financial instruments in CIB and RCR. The RBS Group has a framework for quantify those market risks not adequately captured by standard market risk framework such as VaR and SVaR - refer to pages 140 to 144 for details.

Valuation hierarchy

There is a process to review and control the classification of financial instruments into the three level hierarchy established by IFRS 13. Some instruments may not easily fall into a level of the fair value hierarchy and judgment may be required as to which level the instrument is classified.

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 and are typically valued 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 rate (OIS) and other quoted interest rates in the swap, bond and futures markets.
- Foreign currency exchange rates - there are observable markets both for spot and forward contracts and futures in the world's major currencies.
- Equity and equity index prices - quoted prices are generally readily available for equity shares listed on the world's major stock exchanges and for major indices on such shares.
- Commodity prices - many commodities are actively traded in spot and forward contracts and futures on exchanges in London, New York and other commercial centres.

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- Price volatilities and correlations - volatility is a measure of the tendency of a price to change with time. Correlation measures the degree to which two or more prices or other variables are observed to move together. If they move in the same direction there is positive correlation; if they move in opposite directions there is negative correlation. Volatility is a key input in valuing options and the valuation of certain products such as derivatives with more than one underlying variable that are correlation-dependent. Volatility and correlation values are obtained from broker quotations, pricing services or derived from option prices.
- 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.

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 and RCR 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 is 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 process 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 provided 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 certain 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 any known 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. The following table shows the Group's credit valuation adjustments and other valuation reserves.

	2014 £m	2013 £m	2012 £m
Credit valuation adjustments	1,372	1,728	3,655
- of which monoline insurers and credit derivative product companies (CDPC)	47	93	2,046
Other valuation reserves			
- bid-offer	395	512	787
- funding valuation adjustment	708	424	552
- product and deal specific	613	753	1,313
	1,716	1,689	2,652
Valuation reserves	3,088	3,417	6,307

11 Financial instruments - valuation continued

Credit valuation adjustments

Credit valuation adjustments represent an estimate of the adjustment to fair value that a market participant would make to incorporate the counterparty credit risk inherent in derivative exposures. CVA is actively managed by a credit and market risk hedging process, and therefore movements in CVA are partially offset by trading revenue on the hedges.

The CVA is calculated on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the credit risk.

Where a positive exposure exists to a counterparty that is considered to be close to default, the CVA is calculated by applying expected losses to the current level of exposure. Otherwise, expected losses are applied to estimated potential future positive exposures which are modelled to reflect the volatility of the market factors which drive the exposures and the correlation between those factors.

Potential future positive exposures arising from vanilla products (including interest rate and foreign exchange derivatives, as well as some inflation derivatives) are modelled using RBS Group's core counterparty risk systems. The majority of CVA arises on these vanilla products together with exposures to counterparties which are considered to be close to default. The exposures arising from all other product types are modelled and assessed separately. The potential future positive exposure to each counterparty is the aggregate of the exposures arising on the underlying product types.

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.

The correlation between exposure and counterparty risk is also incorporated within the CVA calculation where this risk is considered significant. The risk primarily arises on credit derivative trades where the default risk of the referenced entity is correlated with the counterparty risk. The risk also arises on trades with emerging market counterparties where the gross mark-to-market value of the trade, and therefore the counterparty exposure can increase based on weakening of the local currency.

Collateral held under a credit support agreement is factored into the CVA calculation. In such cases where RBS Group holds collateral against counterparty exposures, CVA is held to the extent that residual risk remains.

Bid-offer, liquidity and other reserves

Fair value positions are adjusted to bid (long positions) or offer (short positions) levels, by marking individual cash positions directly to bid or offer or by taking bid-offer reserves calculated on a portfolio basis for derivatives exposures. The bid-offer approach is based on current market spreads and standard market bucketing of risk.

Risk data are used as the primary sources of information within bid-offer calculations and are aggregated when they are more granular than market standard buckets. Bid-offer adjustments for each risk factor (including delta (the degree to which the price of an instrument changes in response to a change in the price of the underlying), vega (the degree to which the price of an instrument changes in response to the volatility in the price of the underlying), correlation (the degree to which prices of different instruments move together)) are determined by aggregating similar risk exposures arising on different products. Additional basis bid-offer reserves are taken where these are charged in the market. Risk associated with non-identical underlying exposures is not netted down unless there is evidence that the cost of closing the combined risk exposure is less than the cost of closing individual exposures.

Bid-offer spreads vary by maturity and risk type to reflect different spreads in the market. For positions where there is no observable quote, the bid-offer spreads are widened in comparison to proxies to reflect reduced liquidity or observability. Bid-offer methodologies may also incorporate liquidity triggers whereby wider spreads are applied to risks above pre-defined thresholds.

As permitted by IFRS 13, netting is applied on a portfolio basis to reflect the value at which the Group believes it could exit the portfolio, rather than the sum of exit costs for each of the portfolio's individual trades. This is applied where the asset and liability positions are managed as a portfolio for risk and reporting purposes. For example, netting is applied where long and short risk in two different maturity buckets can be closed out in a single market transaction at lower cost than two separate transactions (calendar netting). This reflects the fact that to close down the portfolio, the net risk can be settled rather than each long and short trade individually.

Vanilla risk on exotic products is typically reserved as part of the overall portfolio based calculation e.g. delta and vega risk on exotic products are included within the delta and vega bid-offer calculations. Aggregation of risk arising from different models is in line with RBS Group's risk management practices; the model review control process considers the appropriateness of model selection in this respect.

Product related risks such as correlation risk, attract specific bid-offer reserves. Additional reserves are provided for exotic products to ensure overall reserves match market close-out costs. These market close-out costs inherently incorporate risk decay and cross-effects (taking into account how changes in one risk factor may affect other inputs rather than treating all risk factors independently) that are unlikely to be adequately reflected in a static hedge based on vanilla instruments. Where there is limited bid-offer information for a product, the pricing approach and risk management strategy are taken into account when assessing the reserve.

The discount rates applied to derivative cash-flows in determining fair value reflect any underlying collateral agreements. Collateralised derivatives are generally discounted at the relevant OIS rates at an individual trade level. Uncollateralised derivatives are discounted with reference to funding levels by applying a funding spread over benchmark interest rates on a portfolio basis (funding valuation adjustment).

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Funding valuation adjustment (FVA)

Funding valuation adjustments represent an estimate of the adjustment to fair value that a market participant would make to incorporate funding costs and benefits that arise in relation to uncollateralised derivative exposures.

Funding levels are applied to estimated potential future exposures, the modelling of which is consistent with the approach used in the calculation of CVA relating to Other counterparties. The counterparty contingent nature of the exposures is reflected in the calculation.

Amounts deferred on initial recognition

On initial recognition of financial assets and liabilities valued using valuation techniques incorporating information other than observable market data, any difference between the transaction price and that derived from the valuation technique is deferred. Such amounts are recognised in profit or loss over the life of the transaction; when market data becomes observable; or when the transaction matures or is closed out as appropriate. At 31 December 2014, net gains of £86 million (2013 - £205 million; 2012 - £150 million) were carried forward. During the year, net gains of £40 million (2013 - £137 million; 2012 - £38 million) were deferred and £139 million (2013 - £82 million; 2012 - £44 million) were recognised in the income statement.

Own credit

The Group takes into account the effect of its own credit standing when valuing financial liabilities recorded at fair value in accordance with IFRS. Own credit spread adjustments are made when valuing issued debt held at fair value, including issued structured notes, and derivatives. An own credit adjustment is applied to positions where it is believed that counterparties would consider the Group's creditworthiness when pricing trades.

For issued debt and structured notes this adjustment is based on debt issuance spreads above average inter-bank rates (at a range of tenors). Secondary senior debt issuance spreads are used in the calculation of the own credit adjustment applied to senior debt.

The fair value of the Group's derivative financial liabilities is also adjusted to reflect the Group's own credit risk (DVA). Expected gains are applied to estimated potential future negative exposures, the modelling of which is consistent with the approach used in calculation of CVA relating to other counterparties. Expected gains are determined from market implied probabilities of default and recovery levels. FVA is considered the primary adjustment applied to derivative liabilities. The extent to which DVA and FVA overlap is eliminated from DVA.

The own credit adjustment for fair value does not alter cash flows, is not used for performance management, is disregarded for regulatory capital reporting processes and will reverse over time as the liabilities mature.

The reserve movement between periods will not equate to the reported profit or loss for own credit. The balance sheet reserves are stated by conversion of underlying currency balances at spot rates for each period whereas the income statement includes intra-period foreign exchange sell-offs.

The effect of change in credit spreads could reverse in future periods provided the liability is not repaid at a premium or a discount.

The cumulative own credit adjustment (OCA) recorded on securities held-for-trading (HFT), designated as at fair value through profit or loss (DFV) and derivative liabilities are set out below.

Cumulative own credit adjustment (CR)/DR (1)	Debt securities in issue (2)			Subordinated liabilities	Total	Derivatives (3)	Total
	HFT £m	DFV £m	Total £m	DFV £m			
2014	(397)	(107)	(504)	53	(451)	8	(443)
2013	(467)	(23)	(490)	67	(423)	76	(347)
2012	(648)	41	(607)	104	(503)	240	(263)

Carrying values of underlying liabilities

	£bn	£bn	£bn	£bn	£bn
2014	6.5	9.6	16.1	0.3	16.4
2013	8.6	15	23.6	0.4	24
2012	10.8	22.2	33	0.5	33.5

Notes:

(1) The OCA does not alter cash flows and is not used for performance management.

(2) Includes wholesale and retail note issuances.

(3) The reserve movement between periods will not equate to the reported profit or loss for own credit. The balance sheet reserve is stated by conversion of underlying currency balances at spot rates for each period, whereas the income statement includes intra-period foreign exchange sell-offs.

Notes on the accounts

11 Financial instruments - valuation continued

Valuation hierarchy

The following tables show financial instruments carried at fair value on the Group's balance sheet by valuation hierarchy - level 1, level 2 and level 3.

	2014				2013				2012			
	Level 1 £bn	Level 2 £bn	Level 3 £bn	Total £bn	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	—	95.6	0.6	96.2	—	107.1	0.5	107.6	—	143.6	0.9	144.5
Debt securities												
Government	53.0	4.9	—	57.9	54.7	10.2	0.1	65.0	77.4	9.4	—	86.8
Other	2.0	15.6	1.2	18.8	1.4	28.6	2.0	32.0	2.5	38.1	4.9	45.5
	55.0	20.5	1.2	76.7	56.1	38.8	2.1	97.0	79.9	47.5	4.9	132.3
Of which ABS	—	6.2	0.8	7.0	—	26.0	1.7	27.7	—	33.8	4.3	38.1
Equity shares	4.5	0.3	0.4	5.2	6.9	1.0	0.4	8.3	12.3	1.1	0.5	13.9
Derivatives												
Credit	—	1.8	0.4	2.2	—	4.4	0.9	5.3	—	9.3	1.7	11.0
Other	—	349.7	2.6	352.3	0.1	281.3	2.7	284.1	0.4	431.5	2.2	434.1
	—	351.5	3.0	354.5	0.1	285.7	3.6	289.4	0.4	440.8	3.9	445.1
	59.5	467.9	5.2	532.6	63.1	432.6	6.6	502.3	92.6	633.0	10.2	735.8
Proportion	11.2%	87.8%	1.0%	100.0%	12.6%	86.1%	1.3%	100.0%	12.6%	86.0%	1.4%	100.0%
Liabilities												
Deposits	—	105.0	0.2	105.2	—	110.1	0.2	110.3	—	168.0	—	168.0
Debt securities in issue	—	14.9	1.2	16.1	—	22.3	1.3	23.6	—	31.7	1.3	33.0
Short positions	19.9	3.1	—	23.0	23.9	4.1	—	28.0	23.6	4.0	—	27.6
Derivatives												
Credit	—	2.0	0.6	2.6	—	4.5	0.9	5.4	—	9.5	0.8	10.3
Other	—	345.8	2.5	348.3	0.1	278.4	2.2	280.7	0.8	422.3	2.7	425.8
	—	347.8	3.1	350.9	0.1	282.9	3.1	286.1	0.8	431.8	3.5	436.1
Subordinated liabilities	—	0.3	—	0.3	—	0.4	—	0.4	—	0.5	—	0.5
	19.9	471.1	4.5	495.5	24.0	419.8	4.6	448.4	24.4	636.0	4.8	665.2
Proportion	4.0%	95.1%	0.9%	100.0%	5.4%	93.6%	1.0%	100.0%	3.7%	95.6%	0.7%	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.

The type of instruments that trade in markets that are not considered to be active, but are based on quoted market prices, broker dealer quotations, or alternative pricing sources with reasonable levels of price transparency and those instruments valued using techniques include 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. Where inputs can be observed from market data without undue cost and effort, the observed input is used. Otherwise, the Group determines a reasonable level for the input. Financial instruments 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, the majority of 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 see Capital and risk management - Balance sheet analysis - derivatives, which includes balances relating to disposal groups.

Notes on the accounts

The following table analyses level 3 balances and related sensitivities.

	2014			2013			2012		
	Balance £bn	Sensitivity (1) Favourable £m Unfavourable £m		Balance £bn	Sensitivity (1) Favourable £m Unfavourable £m		Balance £bn	Sensitivity (1) Favourable £m Unfavourable £m	
Assets									
Loans and advances	0.6	30	(30)	0.5	50	(40)	0.9	140	(70)
Debt securities									
Government	—	—	—	0.1	—	—	—	—	—
Other	1.2	50	(40)	2.0	150	(110)	4.9	360	(200)
	1.2	50	(40)	2.1	150	(110)	4.9	360	(200)
Equity shares	0.4	50	(50)	0.4	70	(60)	0.5	70	(80)
Derivatives									
Credit	0.4	40	(40)	0.8	70	(110)	1.6	230	(230)
Other	2.6	250	(250)	2.8	310	(150)	2.3	420	(300)
	3.0	290	(290)	3.6	380	(260)	3.9	650	(530)
	5.2	420	(410)	6.6	650	(470)	10.2	1,220	(880)
Of which ABS	0.8	30	(30)	1.7	120	(90)	4.3	290	(120)
Liabilities									
Deposits	0.2	—	(10)	0.2	—	(10)	—	30	(30)
Debt securities in issue	1.2	30	(40)	1.3	40	(60)	1.3	50	(60)
Derivatives									
Credit	0.6	60	(60)	1.0	40	(60)	0.8	40	(90)
Other	2.5	160	(180)	2.1	90	(60)	2.7	110	(70)
	3.1	220	(240)	3.1	130	(120)	3.5	150	(160)
	4.5	250	(290)	4.6	170	(190)	4.8	230	(250)

Note:

- (1) Sensitivity represents the favourable and unfavourable effect on the income statement or the statement of comprehensive income due to reasonably possible changes to valuations using reasonably possible alternative inputs in the Group's valuation techniques or models. Level 3 sensitivities are calculated at a sub-portfolio level and hence these aggregated figures do not reflect the correlation between some of the sensitivities. In particular, for some portfolios, the sensitivities may be negatively correlated where a downward movement in one asset would produce an upward movement in another, but due to the additive presentation above, this correlation cannot be shown.

Notes on the accounts

11 Financial instruments - valuation continued

Valuation techniques

The table below shows a breakdown of valuation techniques and the ranges for those unobservable inputs used in valuation models and techniques that have a material impact on the valuation of Level 3 financial instruments. The table excludes unobservable inputs where the impact on valuation is less significant. Movements in the underlying input may have a favourable or unfavourable impact on the valuation depending on the particular terms of the contract and the exposure. For example an increase in the credit spread of a bond would be favourable for the issuer and unfavourable for the note holder. Whilst we indicate where we consider that there are significant relationships between the inputs, these inter-relationships will be affected by macro economic factors including interest rates, foreign exchange rates or equity index levels.

Financial instruments	Level 3 (Ebn)		Valuation technique	Unobservable inputs	Range	
	Assets	Liabilities			Low	High
Debt securities						
	1.2		Price based	Price (2)	0%	96%
			DCF	Yield (2)	0%	40%
Derivatives						
Credit	0.4	0.6	DCF based on recoveries	Recovery rates (3)	0%	100%
				Credit spreads (4)	80bps	700bps
Other	2.6	2.5	Option pricing model	Correlation (5)	(40%)	85%
				Volatility (6)	15%	83%

Notes:

- (1) Level 3 structured issued debt securities of £1.2 billion are not included in the table above as valuation is consistent with the valuation of the embedded derivative component.
- (2) Price and yield: There may be a range of price based information used for evaluating the value of an instrument. This may be a direct comparison of one instrument or portfolio with another or movements in a more liquid instrument may be used to indicate the movement in the value of less liquid instrument. The comparison may also be indirect in that adjustments are made to the price to reflect differences between the pricing source and the instrument being valued, for example different maturity, credit quality, seniority or expected payouts. Similarly to price, an instrument's yield may be compared to other instruments either directly or indirectly. Prices move inversely to yields.
- (3) Recovery rate: Reflects market expectations about the return of principal for a debt instrument or other obligations after a credit event or on liquidation. Recovery rates tend to move conversely to credit spreads.
- (4) Credit spreads and discount margins: Credit spreads and margins express the return required over a benchmark rate or index to compensate for the credit risk associated with a cash instrument. A higher credit spread would indicate that the underlying instrument has more credit risk associated with it. Consequently, investors require a higher yield to compensate for the higher risk. The discount rate comprises credit spread or margin plus the benchmark rate; it is used to value future cash flows.
- (5) Correlation: Measures the degree by which two prices or other variables are observed to move together. If they move in the same direction there is positive correlation; if they move in opposite directions there is negative correlation. Correlations typically include relationships between: default probabilities of assets in a basket (a group of separate assets), exchange rates, interest rates and other financial variables.
- (6) Volatility: A measure of the tendency of a price to change with time.
- (7) The Group does not have any material liabilities measured at fair value that are issued with an inseparable third party credit enhancement.

The Level 3 sensitivities above are calculated at a trade or low level portfolio basis. They are not calculated on an overall portfolio basis and therefore do not reflect the likely potential uncertainty on the portfolio as a whole. The figures are aggregated and do not reflect the correlated nature of some of the sensitivities. In particular, for some of the portfolios the sensitivities may be negatively correlated where a downwards movement in one asset would produce an upwards movement in another, but due to the additive presentation of the above figures this correlation cannot be displayed. The actual potential downside sensitivity of the total portfolio may be less than the non-correlated sum of the additive figures as shown in the above table.

Judgemental issues

The diverse range of products traded by the Group results in a wide range of instruments that are classified into Level 3 of the hierarchy. Whilst the majority of these instruments naturally fall into a particular level, for some products an element of judgment is required. The majority of the Group's financial instruments carried at fair value are classified as Level 2: inputs are observable either directly (i.e. as a price) or indirectly (i.e. derived from prices).

Active and inactive markets

A key input in the decision making process for the allocation of assets to a particular level is liquidity. In general, the degree of valuation uncertainty depends on the degree of liquidity of an input.

Where markets are liquid or very liquid, little judgment is required. However, when the information regarding the liquidity in a particular market is not clear, a judgment may need to be made. This can be more difficult as assessing the liquidity of a market is not always be straightforward. For an equity traded on an exchange, daily volumes of trading can be seen, but for an over-the counter (OTC) derivative assessing the liquidity of the market with no central exchange is more difficult.

A key related issue is where a market moves from liquid to illiquid or vice versa. Where this change is considered to be temporary, the classification is not changed. For example, if there is little market trading in a product on a reporting date but at the previous reporting date and during the intervening period the market has been considered to be liquid, the instrument will continue to be classified in the same level in the hierarchy. This is to provide consistency so that transfers between levels are driven by genuine changes in market liquidity and do not reflect short term or seasonal effects.

Interaction with the IPV process

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.

Notes on the accounts

As part of the Group's IPV process, data are gathered at a trade level from market trading activity, trading systems, pricing services, consensus pricing providers, brokers and research material amongst other sources.

The breadth and depth of the IPV data allows for a rules based quality assessment to be made of market activity, liquidity and pricing uncertainty, which assists with the process of allocation to an appropriate level. Where suitable independent pricing information is not readily available, the quality assessment will result in the instrument being assessed as Level 3.

Modelled products

For modelled products the market convention is to quote these trades through the model inputs or parameters as opposed to a cash price equivalent. A mark-to-market is derived from the use of the independent market inputs calculated using the Group's model.

The decision to classify a modelled asset as Level 2 or 3 will be dependent upon the product/model combination, the currency, the maturity, the observability and quality of input parameters and other factors. All these must be assessed to classify the asset.

An assessment is made of each input into a model. There may be multiple inputs into a model and each is assessed in turn for observability and quality. As part of the process of classifying the quality of IPV results the IPV quality classifications have been designed to follow the accounting level classifications, although with a further level of granularity. For example there are a number of different IPV quality levels that equate to a Level 2 classification and so on.

If an input fails the observability or quality tests then the instrument is considered to be in Level 3 unless the input can be shown to have an insignificant effect on the overall valuation of the product.

The majority of derivative instruments for example vanilla interest rate swaps, foreign exchange swaps and liquid single name credit derivatives are classified as Level 2 as they are vanilla products valued using observable inputs. The valuation uncertainty on these is considered to be low and both input and output testing may be available.

Non-modelled products

Non-modelled products are generally quoted on a price basis and can therefore be considered for each of the three levels. This is determined by the market activity, liquidity and valuation uncertainty of the instruments which is in turn measured from the availability of independent data used by the IPV process to allocate positions to IPV quality levels.

The availability and quality of independent pricing information is considered during the classification process. An assessment is made regarding the quality of the independent information. For example, where consensus prices are used for non-modelled products, a key assessment of the quality of a price is the depth of the number of prices used to provide the consensus price. If the depth of contributors falls below a set hurdle rate, the instrument is considered to be Level 3. This hurdle rate is that used in the IPV process to determine the IPV quality rating. However, where an instrument is generally considered to be illiquid, but regular quotes from market participants exist, these instruments may be classified as Level 2 depending on frequency of quotes, other available pricing and whether the quotes are used as part of the IPV process or not.

For some instruments with a wide number of available price sources, there may be differing quality of available information and there may be a wide range of prices from different sources. In these situations the highest quality source is used to determine the classification of the asset. For example, a tradable quote would be considered a better source than a consensus price.

Level 3 portfolios and sensitively methodologies

Reasonably possible alternative assumptions of unobservable inputs are determined based on a 90% confidence interval. The assessments recognise different favourable and unfavourable valuation movements where appropriate. Each unobservable input within a product is considered separately and sensitivity is reported on an additive basis.

Alternative assumptions are determined with reference to all available evidence including consideration of the following: quality of independent pricing information taking into account consistency between different sources, variation over time, perceived tradability or otherwise of available quotes; consensus service dispersion ranges; volume of trading activity and market bias (e.g. one-way inventory); day 1 profit or loss arising on new trades; number and nature of market participants; market conditions; modelling consistency in the market; size and nature of risk; length of holding of position; and market intelligence.

Other considerations

Valuation adjustments

CVA applied to derivative exposures to other counterparties and own credit adjustments applied to derivative liabilities (DVA) are calculated on a portfolio basis. Whilst the methodology used to calculate each of these adjustments references certain inputs which are not based on observable market data, these inputs are not considered to have a significant effect on the net valuation of the related portfolios. The classification of the derivative portfolios which the valuation adjustments are applied to is not determined by the observability of the valuation adjustments, and any related sensitivity does not form part of the Level 3 sensitivities presented.

Funding related adjustments

The discount rates applied to derivative cash-flows in determining fair value reflect any underlying collateral agreements. Collateralised derivative exposures are generally discounted at the relevant OIS rates whilst funding valuation adjustments are applied to uncollateralised derivative exposures. Whilst these adjustments reference certain inputs which are not based on observable market data, these inputs are not considered to have a significant effect on the valuation of the individual trades. The classification of derivatives is not determined by the observability of these adjustments, and any related sensitivity does not form part of the Level 3 sensitivities presented.

Own credit - issued debt

For structured notes issued the own credit adjustment is based on debt issuance spreads above average inter-bank rates at the reporting date (at a range of tenors). Whilst certain debt issuance spreads are not based on observable market data, these inputs are not considered to have a significant effect on the valuation of individual trades. Neither the classification of structured notes issued nor any related valuation sensitivities are determined by the observability of the debt issuance spreads.

Notes on the accounts

11 Financial instruments - valuation continued

Movement in Level 3 table

2014	At	Amounts recorded in the		Level 3 transfers		Issuances	Purchases	Settlements	Sales	Foreign exchange and other	At	Amounts recorded in the	
	1 January	Income statement (1)	SOCI (2)	In	Out						31 December	Unrealised	Realised
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets													
FVTPL assets (3)	5,183	98	—	1,088	(967)	—	858	(981)	(622)	8	4,665	57	(83)
AFS assets	1,380	4	(48)	6	(107)	—	7	(367)	(373)	10	512	3	3
	<u>6,563</u>	<u>102</u>	<u>(48)</u>	<u>1,094</u>	<u>(1,074)</u>	<u>—</u>	<u>865</u>	<u>(1,348)</u>	<u>(995)</u>	<u>18</u>	<u>5,177</u>	<u>60</u>	<u>(80)</u>
Liabilities													
	<u>4,575</u>	<u>51</u>	<u>—</u>	<u>1,744</u>	<u>(698)</u>	<u>109</u>	<u>59</u>	<u>(1,257)</u>	<u>(50)</u>	<u>16</u>	<u>4,549</u>	<u>(56)</u>	<u>105</u>
Net gains/(losses)		51	(48)									116	(185)
2013													
Assets													
FVTPL assets (3)	7,101	(496)	—	1,207	(356)	—	1,006	(826)	(2,426)	(27)	5,183	(796)	157
AFS assets	3,103	82	163	173	(14)	—	95	(725)	(1,458)	(39)	1,380	16	41
Total	<u>10,204</u>	<u>(414)</u>	<u>163</u>	<u>1,380</u>	<u>(370)</u>	<u>—</u>	<u>1,101</u>	<u>(1,551)</u>	<u>(3,884)</u>	<u>(66)</u>	<u>6,563</u>	<u>(780)</u>	<u>198</u>
Liabilities													
	<u>4,849</u>	<u>49</u>	<u>—</u>	<u>698</u>	<u>(451)</u>	<u>436</u>	<u>536</u>	<u>(1,262)</u>	<u>(270)</u>	<u>(10)</u>	<u>4,575</u>	<u>(105)</u>	<u>68</u>
Net (losses)/gains		(463)	163									(675)	130
2012													
Assets													
FVTPL assets (3)	9,870	(1,967)	—	1,169	(797)	—	2,810	(1,663)	(2,227)	(94)	7,101	(1,823)	115
AFS assets	5,873	106	37	408	(472)	—	92	(1,001)	(1,926)	(14)	3,103	(144)	51
Total	<u>15,743</u>	<u>(1,861)</u>	<u>37</u>	<u>1,577</u>	<u>(1,269)</u>	<u>—</u>	<u>2,902</u>	<u>(2,664)</u>	<u>(4,153)</u>	<u>(108)</u>	<u>10,204</u>	<u>(1,967)</u>	<u>166</u>
Liabilities													
	<u>6,041</u>	<u>(442)</u>	<u>—</u>	<u>858</u>	<u>(420)</u>	<u>372</u>	<u>542</u>	<u>(2,068)</u>	<u>12</u>	<u>(46)</u>	<u>4,849</u>	<u>(427)</u>	<u>2</u>
Net (losses)/gains		(1,419)	37									(1,540)	164

Notes:

- (1) Net losses on HFT instruments of £123 million (2013 - £453 million; 2012 - £1,481 million) were recorded in income from trading activities in continuing operations. Net gains on other instruments of £174 million (2013 - £10 million loss; 2012 - £62 million gain) were recorded in other operating income and interest income as appropriate in continuing operations. There were no losses (2013 - nil; 2012 - £19 million) in discontinued operations.
- (2) Consolidated statement of comprehensive income.
- (3) Fair value through profit or loss comprises held-for-trading predominantly and designated at fair value through profit of loss.

Notes on the accounts

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.

2014	Group						Bank					
	Items where fair value approximates carrying value £bn	Carrying value £bn	Fair value £bn	Fair value hierarchy level			Items where fair value approximates carrying value £bn	Carrying value £bn	Fair value £bn	Fair value hierarchy level		
				Level 1 £bn	Level 2 £bn	Level 3 £bn				Level 1 £bn	Level 2 £bn	Level 3 £bn
Financial assets												
Cash and balances at central banks	74.0						71.0					
Loans and advances to banks												
- items in the course of collection from other banks	1.0						0.2					
- other		13.3	13.3	—	6.6	6.7		28.7	29.1	—	12.8	16.3
Loans and advances to customers		311.0	302.5	—	3.3	299.2		152.4	149.5	—	24.9	124.6
Debt securities		7.6	7.5	4.7	1.9	0.9		23.7	23.3	4.7	13.0	5.6
Settlement balances	4.7						3.4					
Financial liabilities												
Deposits by banks												
- demand deposits	4.1						4.8					
- items in the course of transmission to other banks	0.5						0.4					
- other		9.8	9.8	—	3.1	6.7		119.6	120.2	—	28.0	92.2
Customer accounts												
- demand deposits	234.9						68.3					
- other		104.3	104.3	—	54.8	49.5		54.4	54.5	—	18.6	35.9
Debt securities in issue		25.9	27.2	—	24.2	3.0		21.3	22.7	—	21.3	1.4
Settlement balances	4.5						3.1					
Notes in circulation	1.8						1.1					
Subordinated liabilities		30.1	31.7	—	19.8	11.9		27.1	28.8	—	17.1	11.7

	Group						Bank					
	Fair value approximates carrying value £bn	Carrying value £bn	Fair value £bn	Fair value hierarchy level			Fair value approximates carrying value £bn	Carrying value £bn	Fair value £bn	Fair value hierarchy level		
				Level 2 £bn	Level 3 £bn					Level 2 £bn	Level 3 £bn	
2013												
Financial assets												
Cash and balances at central banks		80.0						75.8				
Loans and advances to banks												
- items in the course of collection from other banks		1.5						0.3				
- other			26.2	26.2	7.4	18.8		41.4	41.7	23.3	18.4	
Loans and advances to customers			370.3	358.9	14.8	344.1		161.6	158.6	23.3	135.3	
Debt securities			3.7	3.1	1.9	1.2		29.2	28.4	25.4	3.0	
Settlement balances		5.6						3.5				
Financial liabilities												
Deposits by banks												
- items in the course of transmission to other banks		0.8						0.3				
- other			21.9	21.9	7.2	14.7		141.0	141.0	41.5	99.5	
Customer accounts												
- demand deposits		266.9						77.0				
- other			137.6	137.7	88.9	48.8		69.6	69.2	24.8	44.4	
Debt securities in issue			36.2	37.4	33.3	4.1		28.9	30.5	27.9	2.6	
Settlement balances		5.2						2.3				
Notes in circulation		1.8						1.1				
Subordinated liabilities			32.8	33.2	33.1	0.1		30.2	30.8	30.8	—	

Notes on the accounts

11 Financial instruments - valuation continued

	Group		Bank	
	2012	2012	2012	2012
	Carrying	Fair	Carrying	Fair
	value	value	value	value
	£bn	£bn	£bn	£bn
Financial assets				
Cash and balances at central banks	74.5	74.5	70.4	70.4
Loans and advances to banks	32.3	32.2	64.9	65.5
Loans and advances to customers	400.1	380.9	185.6	178.7
Debt securities	4.3	3.9	35.2	35.3
Settlement balances	5.7	5.7	3.1	3.1
Financial liabilities				
Deposits by banks	34.2	34.2	146.0	146.1
Customer accounts	419.2	419.6	187.1	183.8
Debt securities in issue	50.3	50.1	39.5	40.3
Settlement balances	5.8	5.8	2.9	2.9
Notes in circulation	1.7	1.7	1.1	1.1
Subordinated liabilities	33.3	33.8	31.1	31.9

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, demand deposits and notes in circulation, fair value approximates to carrying value.

Loans and advances to banks and customers

In estimating the fair value of loans and advances to banks and customers measured at amortised cost, the Group's loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans. Two principal methods are used to estimate fair value:

- (a) Contractual cash flows are discounted using a market discount rate that incorporates the current spread for the borrower or where this is not observable, the spread for borrowers of a similar credit standing. This method is used for portfolios where counterparties have external ratings: large corporate loans in Commercial Banking and 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, Commercial Banking (SME loans), Ulster Bank 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'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 the accounts

12 Financial instruments - maturity analysis

Remaining maturity

The following table shows the residual maturity of financial instruments, based on contractual date of maturity.

	Group								
	2014			2013			2012		
	Less than 12 months £m	More than 12 months £m	Total £m	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	73,983	—	73,983	79,993	—	79,993	74,524	—	74,524
Loans and advances to banks	43,741	851	44,592	65,111	1,372	66,483	80,625	1,442	82,067
Loans and advances to customers	147,673	229,265	376,938	167,988	271,112	439,100	194,968	299,869	494,837
Debt securities	23,866	60,408	84,274	18,233	82,463	100,696	24,088	112,497	136,585
Equity shares	—	5,203	5,203	—	8,278	8,278	—	13,872	13,872
Settlement balances	4,710	—	4,710	5,634	—	5,634	5,717	—	5,717
Derivatives	67,151	287,431	354,582	45,001	244,402	289,403	51,248	393,853	445,101
Liabilities									
Deposits by banks	62,039	1,811	63,850	62,007	3,156	65,163	93,742	8,518	102,260
Customer accounts	387,477	7,522	394,999	457,823	14,481	472,304	493,432	25,765	519,197
Debt securities in issue	8,093	33,903	41,996	14,762	44,984	59,746	14,547	68,731	83,278
Settlement balances and short positions	6,420	21,106	27,526	10,417	22,832	33,249	8,499	24,874	33,373
Derivatives	69,090	281,693	350,783	45,434	240,699	286,133	51,958	384,127	436,085
Subordinated liabilities	2,561	27,908	30,469	1,378	31,756	33,134	2,385	31,466	33,851

	Bank								
	2014			2013			2012		
	Less than 12 months £m	More than 12 months £m	Total £m	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	70,952	—	70,952	75,792	—	75,792	70,374	—	70,374
Loans and advances to banks	43,423	11,478	54,901	67,248	10,520	77,768	89,433	20,138	109,571
Loans and advances to customers	114,765	103,012	217,777	115,478	109,896	225,374	142,109	129,440	271,549
Debt securities	26,250	61,344	87,594	23,848	68,479	92,327	38,277	84,170	122,447
Equity shares	—	4,880	4,880	—	7,301	7,301	—	12,766	12,766
Settlement balances	3,381	—	3,381	3,492	—	3,492	3,090	—	3,090
Derivatives	68,447	291,378	359,825	45,156	247,724	292,880	51,288	398,550	449,838
Liabilities									
Deposits by banks	151,740	22,715	174,455	151,007	29,286	180,293	179,390	30,193	209,583
Customer accounts	157,548	15,968	173,516	164,002	29,551	193,553	214,970	41,364	256,334
Debt securities in issue	8,028	28,715	36,743	13,381	38,157	51,538	13,285	58,209	71,494
Settlement balances and short positions	4,462	15,226	19,688	6,409	13,763	20,172	4,606	12,346	16,952
Derivatives	70,454	284,293	354,747	45,584	242,923	288,507	52,048	387,104	439,152
Subordinated liabilities	2,133	25,347	27,480	1,346	29,220	30,566	2,353	29,282	31,635

Notes on the accounts

12 Financial instruments - maturity analysis continued

On balance sheet liabilities

The following tables show, 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
2014						
Deposits by banks	12,076	784	793	8	575	140
Customers accounts	330,808	8,985	3,076	1,084	85	18
Debt securities in issue	1,889	5,375	9,958	5,511	8,884	1,924
Derivatives held for hedging	134	316	721	491	847	894
Subordinated liabilities	1,105	2,792	3,935	9,688	13,656	5,765
Settlement balances and other liabilities	6,305	5	3	—	—	—
	352,317	18,257	18,486	16,782	24,047	8,741

Guarantees and commitments - notional amount

Guarantees (1,2)	10,973	—	—	—	—	—
Commitments (3)	212,335	—	—	—	—	—
	223,308	—	—	—	—	—

2013

Deposits by banks	18,647	1,498	1,296	149	803	426
Customers accounts	390,370	9,799	5,578	2,356	654	27
Debt securities in issue	10,642	6,466	11,977	6,087	8,709	4,414
Derivatives held for hedging	54	99	541	980	1,532	240
Subordinated liabilities	488	2,244	6,356	6,189	18,029	6,240
Settlement balances and other liabilities	7,005	4	9	4	—	1
	427,206	20,110	25,757	15,765	29,727	11,348

Guarantees and commitments - notional amount

Guarantees (1,2)	15,912	—	—	—	—	—
Commitments (3)	212,353	—	—	—	—	—
	228,265	—	—	—	—	—

2012

Deposits by banks	26,107	1,075	5,489	383	1,022	395
Customers accounts	382,714	26,838	11,494	2,148	1,208	64
Debt securities in issue	13,194	10,539	20,833	12,019	18,833	4,282
Derivatives held for hedging	176	498	1,096	785	848	360
Subordinated liabilities	448	2,601	6,268	4,546	16,195	4,919
Settlement balances and other liabilities	7,500	4	8	1	—	1
	430,139	41,555	45,188	19,882	38,106	10,021

Guarantees and commitments - notional amount

Guarantees (1,2)	12,373	—	—	—	—	—
Commitments (3)	212,149	—	—	—	—	—
	224,522	—	—	—	—	—

Notes:

- (1) The Group is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Group expects most guarantees it provides to expire unused.
- (2) Guarantees exclude the Asset Protection Scheme related financial guarantee contract of £721 million (2013 - £797 million; 2012 - £2,901 million) between the Bank and a fellow subsidiary.
- (3) The Group has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Group does not expect all facilities to be drawn, and some may lapse before drawdown.

Notes on the 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
2014						
Deposits by banks	98,112	6,505	6,365	5,326	2,184	8,884
Customers accounts	101,176	8,447	4,054	3,026	4,795	4,400
Debt securities in issue	1,804	5,229	9,525	5,218	8,414	1,467
Derivatives held for hedging	90	204	477	318	539	582
Subordinated liabilities	950	2,363	3,715	9,460	11,834	5,347
Settlement balances and other liabilities	4,241	—	—	—	—	—
	206,373	22,748	24,136	23,348	27,766	20,680
Guarantees and commitments - notional amount						
Guarantees (1,2)	7,678	—	—	—	—	—
Commitments (3)	126,759	—	—	—	—	—
	134,437	—	—	—	—	—
2013						
Deposits by banks	106,951	7,727	8,897	5,105	2,375	14,900
Customers accounts	117,799	6,214	8,407	4,315	7,585	6,951
Debt securities in issue	4,349	6,339	11,687	5,774	8,243	3,892
Derivatives held for hedging	10	45	304	581	860	144
Subordinated liabilities	431	2,152	5,866	5,963	16,745	5,738
Settlement balances and other liabilities	3,377	—	—	—	—	—
	232,917	22,477	35,161	21,738	35,808	31,625
Guarantees and commitments - notional amount						
Guarantees (1,2)	12,045	—	—	—	—	—
Commitments (3)	130,207	—	—	—	—	—
	142,252	—	—	—	—	—
2012						
Deposits by banks	122,785	7,501	11,689	4,307	542	146
Customers accounts	171,495	8,984	3,114	1,212	3,155	1,050
Debt securities in issue	5,038	10,496	20,827	12,018	18,831	4,276
Derivatives held for hedging	64	217	515	397	422	199
Subordinated liabilities	433	2,513	5,714	4,400	15,307	4,473
Settlement balances and other liabilities	3,982	—	—	—	—	—
	303,797	29,711	41,859	22,334	38,257	10,144
Guarantees and commitments - notional amount						
Guarantees (1,2)	8,436	—	—	—	—	—
Commitments (3)	135,542	—	—	—	—	—
	143,978	—	—	—	—	—

Notes:

- (1) The Bank is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Bank expects most guarantees it provides to expire unused.
- (2) Guarantees exclude the Asset Protection Scheme related financial guarantee contract of £721 million (2013 - £797 million; 2012 - £2,901 million) between the Bank and a fellow subsidiary.
- (3) The Bank has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Bank does not expect all facilities to be drawn, and some may lapse before drawdown.

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.

Notes on the accounts

12 Financial instruments - maturity analysis continued

Liabilities with a contractual maturity of greater than 20 years - the principal amounts of financial liabilities that are repayable after 20 years or where the counterparty has no right to repayment of the principal, are excluded from the tables along with interest payments after 20 years.

Held-for-trading liabilities - held-for-trading liabilities of £477.5 billion (2013 - £424.0 billion; 2012 - £632.5 billion) for the Group and £475.6 billion (2013 - £397.9 billion; 2012 - £593.4 billion) for the Bank, have been excluded from the tables in view of their short-term nature.

13 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	2014 £m	2013 £m	2012 £m
At 1 January	16,751	6,305	1,989	25,045	20,807	18,554
Transfers (to)/from disposal groups	(100)	(158)	(295)	(553)	(9)	764
Currency translation and other adjustments	(620)	(21)	(16)	(657)	114	(175)
Transfers from fellow subsidiaries	—	—	—	—	33	415
Disposals	—	—	—	—	—	(1)
Amounts written-off	(3,979)	(1,274)	—	(5,253)	(4,224)	(3,887)
Recoveries of amounts previously written-off	68	133	—	201	249	332
(Release)/charge to income statement						
- continuing operations	(811)	172	(687)	(1,326)	8,158	5,016
- discontinued operations	36	142	16	194	307	265
Unwind of discount (recognised in interest income)	(138)	(109)	—	(247)	(390)	(476)
At 31 December ⁽¹⁾	11,207	5,190	1,007	17,404	25,045	20,807

Note:

(1) Includes £40 million relating to loans and advances to banks (2013 - £62 million; 2012 - £114 million).

	Bank					
	Individually assessed £m	Collectively assessed £m	Latent £m	2014 £m	2013 £m	2012 £m
At 1 January	4,736	1,001	499	6,236	5,626	4,623
Transfers (to)/from disposal groups	(17)	—	—	(17)	—	742
Currency translation and other adjustments	(110)	45	—	(65)	23	152
Transfers from fellow subsidiaries	—	—	—	—	33	415
Amounts written-off	(2,359)	(249)	—	(2,608)	(1,943)	(1,928)
Recoveries of amounts previously written-off	27	14	—	41	51	105
Charge/(release) to income statement	120	24	(180)	(36)	2,558	1,645
Unwind of discount (recognised in interest income)	(60)	(27)	—	(87)	(112)	(128)
At 31 December ⁽¹⁾	2,337	808	319	3,464	6,236	5,626

Note:

(1) Includes £40 million relating to loans and advances to banks (2013 - £62 million; 2012 - £108 million).

	Group		
	2014 £m	2013 £m	2012 £m
Impairment losses/(releases) charged to the income statement			
Loans and advances to customers	(1,316)	8,173	5,005
Loans and advances to banks	(10)	(15)	11
	(1,326)	8,158	5,016
Debt securities	(11)	(21)	(101)
Equity shares	—	—	30
	(11)	(21)	(71)
	(1,337)	8,137	4,945

Notes on the accounts

	Group		
	2014 £m	2013 £m	2012 £m
Gross income not recognised but which would have been recognised under the original terms of the impaired loans			
UK	404	570	660
Overseas	141	562	764
	545	1,132	1,424
Interest on impaired loans included in net interest income			
UK	146	196	255
Overseas	101	194	221
	247	390	476

The following tables analyse impaired financial assets.

	2014			Group 2013			2012		
	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m
Loans and receivables									
Loans and advances to banks (1)	42	40	2	69	62	7	134	114	20
Loans and advances to customers (2)	25,040	16,357	8,683	36,836	22,994	13,842	37,754	18,772	18,982
	25,082	16,397	8,685	36,905	23,056	13,849	37,888	18,886	19,002

	Group		
	Carrying value 2014 £m	Carrying value 2013 £m	Carrying value 2012 £m
Available-for-sale securities			
Debt securities	143	144	222
Equity shares	22	30	31
Loans and receivables			
Debt securities	7	528	902
	172	702	1,155

The following tables analyse impaired financial assets.

	2014			Bank 2013			2012		
	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m
Loans and receivables									
Loans and advances to banks (1)	42	40	2	69	62	7	127	108	19
Loans and advances to customers (3)	6,135	3,105	3,030	11,397	5,675	5,722	12,320	5,007	7,313
	6,177	3,145	3,032	11,466	5,737	5,729	12,447	5,115	7,332

For the notes to these tables refer to the following page.

Notes on the accounts

13 Financial assets – impairments continued

	Bank		
	Carrying value 2014 £m	Carrying value 2013 £m	Carrying value 2012 £m
Available-for-sale securities			
Debt securities	142	144	222
Equity shares	9	8	9
Loans and receivables			
Debt securities	7	528	902
	158	680	1,133

Notes:

- (1) Impairment provisions individually assessed.
- (2) Impairment provisions individually assessed on balances of £16,590 million (2013 - £26,681 million; 2012 - £26,292 million).
- (3) Impairment provisions individually assessed on balances of £4,963 million (2013 - £9,737 million; 2012 - £10,235 million).

The following tables show 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.

	Group		
	2014 £m	2013 £m	2012 £m
Residential property	—	18	67
Other property	3	13	46
Cash	40	44	49
Other assets	—	2	1
	43	77	163

	Bank		
	2014 £m	2013 £m	2012 £m
Cash	13	13	15

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.

The following loans and advances to customers were past due at the balance sheet date but not considered impaired:

	Group					Bank				
	Past due 1-29 days £m	Past due 30-59 days £m	Past due 60-89 days £m	Past due 90 days or more £m	Total £m	Past due 1-29 days £m	Past due 30-59 days £m	Past due 60-89 days £m	Past due 90 days or more £m	Total £m
2014	3,049	785	586	1,640	6,060	943	195	125	670	1,933
2013	4,765	1,260	822	2,221	9,068	563	260	142	937	1,902
2012	5,599	1,117	1,177	2,637	10,530	665	120	532	962	2,279

These balances include loans and advances to customers that are past due through administrative and other delays in recording payments or in finalising documentation and other events unrelated to credit quality.

Notes on the accounts

14 Derivatives

Companies in the Group transact derivatives as principal either as a trading activity or to manage balance sheet foreign exchange, interest rate and credit risk.

The Group enters into fair value hedges, cash flow hedges and hedges of net investments in foreign operations. The majority of the Group's interest rate hedges relate to the management of the Group's non-trading interest rate risk. The Group manages this risk within approved limits. Residual risk positions are hedged with derivatives principally interest rate swaps. Suitable larger financial instruments are fair value hedged; the remaining exposure, where possible, is hedged by derivatives documented as cash flow hedges and qualifying for hedge accounting. The majority of the Group's fair value hedges involve interest rate swaps hedging the interest rate risk in recognised financial assets and financial liabilities. Cash flow hedges relate to exposures to the variability in future interest payments and receipts on forecast transactions and on recognised financial assets and financial liabilities. The Group hedges its net investments in foreign operations with currency borrowings and forward foreign exchange contracts.

For cash flow hedge relationships of interest rate risk, the hedged items are actual and forecast variable interest rate cash flows arising from financial assets and financial liabilities with interest rates linked to LIBOR, EURIBOR or the Bank of England Official Bank Rate. The financial assets are customer loans and the financial liabilities are customer deposits and LIBOR linked medium-term notes and other issued securities. At 31 December 2014, variable rate financial assets of £80 billion (2013 - £74 billion; 2012 - £60 billion) for the Group and £49 billion (2013 - £49 billion; 2012 - £48 billion) for the Bank, and variable rate financial liabilities of £14 billion (2013 - £10 billion; 2012 - £8 billion) for the Group and £6 billion (2013 - £3 billion; 2012 - £4 billion) for the Bank were hedged in such cash flow hedge relationships.

For cash flow hedging relationships, the initial and ongoing prospective effectiveness is assessed by comparing movements in the fair value of the expected highly probable forecast interest cash flows with movements in the fair value of the expected changes in cash flows from the hedging interest rate swap. Prospective effectiveness is measured on a cumulative basis i.e. over the entire life of the hedge relationship. The method of calculating hedge ineffectiveness is the hypothetical derivative method. Retrospective effectiveness is assessed by comparing the actual movements in the fair value of the cash flows and actual movements in the fair value of the hedged cash flows from the interest rate swap over the life to date of the hedging relationship.

For fair value hedge relationships of interest rate risk, the hedged items are typically government bonds, large corporate fixed rate loans, fixed rate finance leases, fixed rate medium-term notes or preference shares classified as debt. At 31 December 2014, fixed rate financial assets of £17 billion (2013 - £17 billion; 2012 - £16 billion) for the Group and £14 billion (2013 - £12 billion; 2012 - £9 billion) for the Bank, and fixed rate financial liabilities of £25 billion (2013 - £29 billion; 2012 - £34 billion) for the Group and £24 billion (2013 - £29 billion; 2012 - £31 billion) for the Bank were hedged by interest rate swaps in fair value hedge relationships.

The initial and ongoing prospective effectiveness of fair value hedge relationships is assessed on a cumulative basis by comparing movements in the fair value of the hedged item attributable to the hedged risk with changes in the fair value of the hedging interest rate swap. Retrospective effectiveness is assessed by comparing the actual movements in the fair value of the hedged items attributable to the hedged risk with actual movements in the fair value of the hedging derivative over the life to date of the hedging relationship.

The following table shows the notional amounts and fair values of the Group's derivatives:

	2014			Group 2013			2012		
	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m
Exchange rate contracts									
Spot, forwards and futures	2,013	32,912	33,361	2,040	24,392	24,087	2,243	23,083	22,700
Currency swaps	860	22,297	26,776	949	18,514	22,656	1,051	21,785	29,993
Options purchased	896	23,456	—	791	18,826	—	682	17,558	—
Options written	881	—	23,451	766	—	18,721	684	—	17,487
Interest rate contracts									
Interest rate swaps	20,164	220,328	212,195	27,501	181,043	172,998	25,465	303,697	287,515
Options purchased	1,471	49,248	—	1,568	37,437	—	1,934	61,794	—
Options written	1,552	—	47,909	1,514	—	35,436	1,884	—	58,336
Futures and forwards	4,133	886	739	5,025	712	669	4,191	748	653
Credit derivatives	125	2,248	2,612	253	5,359	5,422	552	10,995	10,363
Equity and commodity contracts	79	3,207	3,740	81	3,120	6,144	116	5,441	9,038
		354,582	350,783		289,403	286,133		445,101	436,085

Notes on the accounts

14 Derivatives continued

	2014		Group 2013		2012	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m	£m	£m
Amounts above include:						
Due from/to holding company	30	179	53	153	7	511
Due from/to fellow subsidiaries	2,708	1,826	3,360	2,433	7,193	5,069

Included in the table above are derivatives held for hedging purposes as follows:

	2014		Group 2013		2012	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m	£m	£m
Fair value hedging						
Interest rate contracts	1,870	1,961	1,917	1,495	3,398	2,554
Cash flow hedging						
Interest rate contracts	3,240	1,291	2,390	1,602	4,814	1,074
Net investment hedging						
Exchange rate contracts	57	1	28	21	1	14

Hedge ineffectiveness recognised in other operating income in continuing operations comprised:

	2014 £m	2013 £m	2012 £m
Fair value hedging			
Gains/(losses) on the hedged items attributable to the hedged risk	644	134	(141)
(Losses)/gains on the hedging instruments	(682)	(164)	188
Fair value hedging ineffectiveness	(38)	(30)	47
Cash flow hedging ineffectiveness	(33)	(64)	24
	(71)	(94)	71

Hedge ineffectiveness recognised in other operating income in discontinued operations was £1 million in 2012.

Notes on the accounts

The following table shows when hedged cash flows are expected to occur and when they will affect income for designated cash flow hedges.

	Group					
	0-1 years £m	1-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
2014						
Hedged forecast cash flows expected to occur						
Forecast receivable cash flows	278	844	227	—	—	1,349
Forecast payable cash flows	(49)	(100)	(61)	(92)	(12)	(314)
Hedged forecast cash flows affect on profit or loss						
Forecast receivable cash flows	303	826	218	—	—	1,347
Forecast payable cash flows	(52)	(97)	(62)	(92)	(12)	(315)
2013						
Hedged forecast cash flows expected to occur						
Forecast receivable cash flows	303	877	271	—	—	1,451
Forecast payable cash flows	(33)	(69)	(64)	(101)	(19)	(286)
Hedged forecast cash flows affect on profit or loss						
Forecast receivable cash flows	302	859	261	—	—	1,422
Forecast payable cash flows	(32)	(69)	(64)	(101)	(19)	(285)
2012						
Hedged forecast cash flows expected to occur						
Forecast receivable cash flows	282	794	186	—	—	1,262
Forecast payable cash flows	(32)	(56)	(58)	(103)	(29)	(278)
Hedged forecast cash flows affect on profit or loss						
Forecast receivable cash flows	274	775	176	—	—	1,225
Forecast payable cash flows	(31)	(54)	(59)	(103)	(29)	(276)

	2014			Bank 2013			2012		
	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m
<i>Exchange rate contracts</i>									
Spot, forwards and futures	2,064	34,189	34,670	2,056	24,454	24,692	2,248	23,125	22,737
Currency swaps	868	22,616	26,725	960	19,110	22,654	1,067	22,733	29,990
Options purchased	897	23,474	—	792	18,844	—	683	17,571	—
Options written	882	—	23,469	767	—	18,740	684	—	17,500
<i>Interest rate contracts</i>									
Interest rate swaps	20,269	223,893	214,793	27,238	183,892	174,682	25,512	307,523	290,431
Options purchased	1,459	49,281	—	1,564	37,398	—	1,918	61,659	—
Options written	1,530	—	47,930	1,516	—	35,476	1,888	—	58,385
Futures and forwards	4,124	881	739	4,869	648	612	4,156	721	644
<i>Credit derivatives</i>	125	2,262	2,612	254	5,402	5,416	552	11,062	10,363
<i>Equity and commodity contracts</i>	80	3,229	3,809	81	3,132	6,235	116	5,444	9,102
		<u>359,825</u>	<u>354,747</u>		<u>292,880</u>	<u>288,507</u>		<u>449,838</u>	<u>439,152</u>

Notes on the accounts

14 Derivatives continued

	Bank					
	2014		2013		2012	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Amounts above include:						
Due from/to holding company	30	179	53	153	7	511
Due from/to fellow subsidiaries	2,708	1,826	3,359	2,433	7,186	5,069
Due from/to subsidiaries	6,530	4,580	5,555	3,089	7,760	3,741

Included in the table above are derivatives held for hedging purposes as follows:

	Bank					
	2014		2013		2012	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedging						
Exchange rate contracts	26	—	23	8	1	5
Interest rate contracts	1,797	1,337	1,818	864	2,945	1,189
Cash flow hedging						
Interest rate contracts	2,004	744	1,767	880	3,678	554
Net investment hedging						
Exchange rate contracts	2	1	5	1	—	1

The following table shows when hedged cash flows are expected to occur and when they will affect income for designated cash flow hedges.

	Bank					
	0-1 years £m	1-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
2014						
Hedged forecast cash flows expected to occur						
Forecast receivable cash flows	155	448	97	—	—	700
Forecast payable cash flows	(26)	(49)	(41)	(67)	(4)	(187)
Hedged forecast cash flows affect on profit or loss						
Forecast receivable cash flows	172	436	93	—	—	701
Forecast payable cash flows	(26)	(48)	(42)	(67)	(4)	(187)
2013						
Hedged forecast cash flows expected to occur						
Forecast receivable cash flows	199	546	129	—	—	874
Forecast payable cash flows	(11)	(31)	(39)	(71)	(9)	(161)
Hedged forecast cash flows affect on profit or loss						
Forecast receivable cash flows	198	531	123	—	—	852
Forecast payable cash flows	(10)	(32)	(39)	(71)	(9)	(161)
2012						
Hedged forecast cash flows expected to occur						
Forecast receivable cash flows	226	623	148	—	—	997
Forecast payable cash flows	(21)	(34)	(39)	(72)	(15)	(181)
Hedged forecast cash flows affect on profit or loss						
Forecast receivable cash flows	219	606	141	—	—	966
Forecast payable cash flows	(20)	(33)	(40)	(72)	(15)	(180)

Notes on the accounts

15 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					
2014								
Held-for-trading	6,218	7,709	24,448	1,391	7,383	1,979	49,128	3,559
Designated as at fair value through profit or loss	—	—	—	—	1	—	1	—
Available-for-sale	4,747	5,230	9,472	3,276	4,769	46	27,540	3,488
Loans and receivables	—	—	—	179	2,751	138	3,068	2,714
Held to maturity	4,537	—	—	—	—	—	4,537	—
	15,502	12,939	33,920	4,846	14,904	2,163	84,274	9,761

Available-for-sale

Gross unrealised gains	451	144	300	8	142	6	1,051	128
Gross unrealised losses	(1)	(5)	(1)	—	(56)	(2)	(65)	(56)

2013

Held-for-trading	6,764	10,945	22,557	1,608	12,407	1,977	56,258	10,674
Designated as at fair value through profit or loss	—	—	—	—	14	—	14	14
Available-for-sale	6,436	11,456	6,824	2,531	13,290	145	40,682	16,976
Loans and receivables	10	1	—	169	3,426	136	3,742	3,423
	13,210	22,402	29,381	4,308	29,137	2,258	100,696	31,087

Available-for-sale

Gross unrealised gains	201	272	106	2	333	9	923	361
Gross unrealised losses	(69)	(86)	(25)	(1)	(196)	(1)	(378)	(252)

2012

Held-for-trading	7,692	17,303	26,344	2,036	21,722	1,933	77,030	18,619
Designated as at fair value through profit or loss	—	—	—	86	610	1	697	516
Available-for-sale	7,950	17,514	10,083	2,933	15,967	114	54,561	18,953
Loans and receivables	5	—	—	327	3,683	282	4,297	3,663
	15,647	34,817	36,427	5,382	41,982	2,330	136,585	41,751

Available-for-sale

Gross unrealised gains	944	861	579	17	582	8	2,991	647
Gross unrealised losses	—	(1)	—	(1)	(122)	—	(124)	(124)

Note:

(1) Includes asset-backed securities issued by US federal agencies and government sponsored entities, and covered bonds.

Gross gains of £314 million (2013 - £1,044 million; 2012 - £1,696 million) and gross losses of £20 million (2013 - £48 million; 2012 - £30 million) were realised on the sale of available-for-sale securities in continuing operations.

Gross gains of £20 million (2013 and 2012 - nil) and gross losses of £3 million (2013 and 2012 - nil) were realised on the sale of available-for-sale securities in discontinued operations.

Notes on the accounts

15 Debt securities *continued*

	Bank							
	Central and local government			Banks	Other financial institutions	Corporate	Total	Of which ABS (1)
	UK	US	Other					
2014	£m	£m	£m	£m	£m	£m	£m	£m
Held-for-trading	6,218	1,283	24,373	1,316	4,447	1,573	39,210	1,390
Available-for-sale	4,627	5,070	7,214	2,523	5,271	20	24,725	3,348
Loans and receivables	—	—	—	179	18,805	138	19,122	18,762
Held to maturity	4,537	—	—	—	—	—	4,537	—
	15,382	6,353	31,587	4,018	28,523	1,731	87,594	23,500

Available-for-sale

Gross unrealised gains	450	144	298	5	141	—	1,038	126
Gross unrealised losses	(1)	(5)	—	—	(56)	—	(62)	(56)

2013

Held-for-trading	6,764	1,234	20,269	1,356	3,745	1,044	34,412	2,150
Designated as at fair value through profit or loss	—	—	—	—	456	—	456	456
Available-for-sale	6,436	6,718	6,452	2,139	6,396	110	28,251	4,725
Loans and receivables	6	—	—	169	28,897	136	29,208	28,893
	13,206	7,952	26,721	3,664	39,494	1,290	92,327	36,224

Available-for-sale

Gross unrealised gains	201	240	105	2	224	—	772	220
Gross unrealised losses	(69)	(29)	(25)	(1)	(112)	—	(236)	(112)

2012

Held-for-trading	7,692	4,174	23,458	1,615	4,974	986	42,899	2,446
Designated as at fair value through profit or loss	—	—	—	86	1,156	—	1,242	1,062
Available-for-sale	7,950	13,989	9,477	2,829	8,725	89	43,059	7,555
Loans and receivables	—	—	—	327	34,638	282	35,247	34,618
	15,642	18,163	32,935	4,857	49,493	1,357	122,447	45,681

Available-for-sale

Gross unrealised gains	944	775	577	17	326	6	2,645	307
Gross unrealised losses	—	—	—	(1)	(122)	—	(123)	(123)

Note:

(1) Includes asset-backed securities issued by US federal agencies and government sponsored entities, and covered bonds.

Notes on the accounts

16 Equity shares

	Group			Group			Group		
	2014	2014	2014	2013	2013	2013	2012	2012	2012
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Held-for-trading	4,699	25	4,724	6,904	79	6,983	12,255	56	12,311
Designated as at fair value									
through profit or loss	10	230	240	141	172	313	243	241	484
Available-for-sale	15	224	239	195	787	982	182	895	1,077
	4,724	479	5,203	7,240	1,038	8,278	12,680	1,192	13,872

Available-for-sale

Gross unrealised gains	5	86	91	73	96	169	56	86	142
Gross unrealised losses	(4)	(8)	(12)	(9)	(10)	(19)	(53)	(13)	(66)

Gross gains of £172 million (2013 - £51 million; 2012 - £89 million) and gross losses of £63 million (2013 - £12 million; 2012 - £1 million) were realised on the sale of available-for-sale equity shares within continuing operations. Gross gains of £49 million in 2012 were realised on the sale of available-for-sale equity shares in discontinued operations.

Dividend income from available-for-sale equity shares in continuing operations was £20 million (2013 - £62 million; 2012 - £212 million). Dividend income from available-for-sale equity shares in discontinued operations was £22 million (2013 - £21 million; 2012 - £22 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 capital stock (redeemable at cost) in the Federal Home Loan Bank and the Federal Reserve Bank of nil (2013 - £0.6 billion; 2012 - £0.7 billion) that the Group's banking subsidiaries in the US are required to hold; and a number of individually small shareholdings in unlisted companies. Disposals in the year generated no gains or losses (2013 - nil; 2012 - gains of £2 million) in continuing operations.

	Bank			Bank			Bank		
	2014	2014	2014	2013	2013	2013	2012	2012	2012
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Held-for-trading	4,697	17	4,714	6,901	48	6,949	12,230	48	12,278
Designated as at fair value									
through profit or loss	—	40	40	84	23	107	214	60	274
Available-for-sale	4	122	126	142	103	245	140	74	214
	4,701	179	4,880	7,127	174	7,301	12,584	182	12,766

Available-for-sale

Gross unrealised gains	2	36	38	36	28	64	30	21	51
Gross unrealised losses	—	—	—	(6)	(1)	(7)	(51)	(1)	(52)

17 Investments in Group undertakings

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

	Bank		
	2014 £m	2013 £m	2012 £m
At 1 January	42,328	40,262	32,164
Currency translation and other adjustments	115	(94)	(103)
Additional investments in Group undertakings	2,668	2,300	8,287
Redemption of investments in Group undertakings	—	—	(123)
Disposals	(904)	(54)	(83)
(Impairment)/write-back of investments	(4,350)	(86)	120
At 31 December	39,857	42,328	40,262

Notes on the accounts

17 Investments in Group undertakings continued

The principal subsidiary undertakings of the Bank are shown below. Their capital consists of ordinary and preference shares, which are unlisted with the exception of certain preference shares issued by NatWest and the common stock of Citizens Financial Group, Inc. (CFG Inc.). All of the subsidiary undertakings are owned directly, or indirectly through intermediate holding companies, and are all wholly-owned with the exception of CFG Inc (70.5% held). 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 operation
National Westminster Bank Plc ⁽¹⁾	Banking	Great Britain
Citizens Financial Group, Inc. ⁽²⁾	Banking	US
Coutts & Company ^(2, 3)	Private Banking	Great Britain
RBS Securities Inc ⁽²⁾	Broker dealer	US
Ulster Bank Limited ^(2, 4)	Banking	Northern Ireland

Notes:

- (1) The Bank does not hold any of the NatWest preference shares in issue.
(2) Shares are not directly held by the Bank.
(3) Coutts & Company is incorporated with unlimited liability. Its registered office is 440 Strand, London WC2R 0QS.
(4) Ulster Bank Limited and its subsidiary undertakings also operate in the Republic of Ireland.

The above information is provided in relation to the principal related undertakings as permitted by section 410(2) of the Companies Act 2006. Full information on all related undertakings will be included in the Annual Return delivered to the Registrar of Companies for Scotland.

18 Intangible assets

	Group			
	Goodwill £m	Purchased intangibles £m	Internally generated software £m	Total £m
2014				
Cost				
At 1 January	17,728	433	4,477	22,638
Transfers from fellow subsidiaries	—	—	4	4
Transfers to disposal groups	(8,055)	(394)	(730)	(9,179)
Currency translation and other adjustments	408	27	9	444
Additions	—	10	618	628
Disposals and write-off of fully amortised assets	(20)	—	(1,460)	(1,480)
At 31 December	10,061	76	2,918	13,055
Accumulated amortisation and impairment				
At 1 January	7,598	316	2,372	10,286
Transfers from fellow subsidiaries	—	—	4	4
Transfers to disposal groups	(4,098)	(284)	(248)	(4,630)
Currency translation and other adjustments	196	19	(11)	204
Disposals and write-off of fully amortised assets	(20)	—	(1,449)	(1,469)
Charge for the year				
- continuing operations	—	—	262	262
- discontinued operations	—	21	79	100
Write down of goodwill and other intangible assets				
- continuing operations	130	2	391	523
- discontinued operations	—	—	10	10
At 31 December	3,806	74	1,410	5,290
Net book value at 31 December	6,255	2	1,508	7,765

Notes on the accounts

	Group			
	Goodwill £m	Purchased intangibles £m	Internally generated software £m	Total £m
2013				
Cost				
At 1 January	17,910	412	4,792	23,114
Transfers from fellow subsidiaries	—	—	70	70
Currency translation and other adjustments	(164)	(7)	(14)	(185)
Additions	—	29	935	964
Disposals and write-off of fully amortised assets	(18)	(1)	(1,306)	(1,325)
At 31 December	17,728	433	4,477	22,638
Accumulated amortisation and impairment				
At 1 January	7,487	302	2,922	10,711
Transfers from fellow subsidiaries	—	—	54	54
Currency translation and other adjustments	(80)	(20)	(16)	(116)
Disposals and write-off of fully amortised assets	(17)	(1)	(1,200)	(1,218)
Charge for the year				
- continuing operations	—	29	334	363
- discontinued operations	—	6	63	69
Write down of goodwill and other intangible assets				
- continuing operations	208	—	215	423
At 31 December	7,598	316	2,372	10,286
Net book value at 31 December	10,130	117	2,105	12,352
2012				
Cost				
At 1 January	18,224	785	4,900	23,909
Transfers from/(to) fellow subsidiaries	5	(7)	242	240
Transfers from disposal groups	80	—	—	80
Currency translation and other adjustments	(294)	(25)	(21)	(340)
Additions	—	39	797	836
Disposals and write-off of fully amortised assets	(105)	(380)	(1,126)	(1,611)
At 31 December	17,910	412	4,792	23,114
Accumulated amortisation and impairment				
At 1 January	7,562	658	3,324	11,544
Transfers (to)/from fellow subsidiaries	—	(5)	215	210
Transfers from disposal groups	80	—	—	80
Currency translation and other adjustments	(119)	(20)	(10)	(149)
Disposals and write-off of fully amortised assets	(72)	(380)	(1,123)	(1,575)
Charge for the year				
- continuing operations	—	1	460	461
- discontinued operations	—	40	49	89
Write down of goodwill and other intangible assets				
- continuing operations	36	8	7	51
- discontinued operations	—	—	—	—
At 31 December	7,487	302	2,922	10,711
Net book value at 31 December	10,423	110	1,870	12,403

Notes on the accounts

18 Intangible assets continued

		Bank	
	Goodwill	Internally generated software	Total
	£m	£m	£m
2014			
Cost			
At 1 January	113	1,059	1,172
Currency translation and other adjustments	(1)	(19)	(20)
Transfers to subsidiaries	—	(127)	(127)
Additions	—	494	494
Disposals and write-off of fully amortised assets	(12)	(115)	(127)
At 31 December	100	1,292	1,392
Accumulated amortisation and impairment			
At 1 January	28	17	45
Currency translation and other adjustments	(1)	(24)	(25)
Disposals and write-off of fully amortised assets	(12)	(70)	(82)
Charge for the year	—	145	145
Write down of goodwill and other intangible assets	—	392	392
At 31 December	15	460	475
Net book value at 31 December	85	832	917
2013			
Cost			
At 1 January	131	1,652	1,783
Currency translation and other adjustments	1	2	3
Transfers to subsidiaries	—	(80)	(80)
Additions	—	779	779
Disposals and write-off of fully amortised assets	(19)	(1,294)	(1,313)
At 31 December	113	1,059	1,172
Accumulated amortisation and impairment			
At 1 January	30	720	750
Currency translation and other adjustments	1	5	6
Transfers from fellow subsidiaries	—	22	22
Disposals and write-off of fully amortised assets	(19)	(1,193)	(1,212)
Charge for the year	—	252	252
Write down of goodwill and other intangible assets	16	211	227
At 31 December	28	17	45
Net book value at 31 December	85	1,042	1,127
2012			
Cost			
At 1 January	126	1,988	2,114
Transfers from subsidiary	5	160	165
Additions	—	627	627
Disposals and write-off of fully amortised assets	—	(1,123)	(1,123)
At 31 December	131	1,652	1,783
Accumulated amortisation and impairment			
At 1 January	12	1,226	1,238
Transfers from fellow subsidiaries	—	229	229
Disposals and write-off of fully amortised assets	—	(1,123)	(1,123)
Charge for the year	—	385	385
Write down of goodwill and other intangible assets	18	3	21
At 31 December	30	720	750
Net book value at 31 December	101	932	1,033

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The Group's goodwill acquired in business combinations is reviewed annually at 30 September for impairment by comparing the recoverable amount of each cash-generating unit (CGU) to which goodwill has been allocated with its carrying value.

Impairment testing involves the comparison of the carrying value of a CGU or group of CGUs with its recoverable amount. Recoverable amount is the higher of fair value and value in use. Value in use is the present value of expected future cash flows from the CGU or group of CGUs. Fair value is the price that would be received to sell an asset in an orderly transaction between market participants.

Impairment testing inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of CGUs; and the valuation of the separable assets of each business whose goodwill is being reviewed. Sensitivity to the more significant variables in each assessment are presented in the tables below.

The recoverable amounts for all CGUs at 30 September 2014 were based on the value in use test, using management's latest five-year forecasts. The long-term growth rates have been based on respective country nominal GDP growth rates. The risk discount rates are based on observable market long-term government bond yields and average industry betas adjusted for an appropriate risk premium.

The results of the annual impairment test for 2013 and 2012 are presented using the reportable segments for those years which differ as a result of the changes to RBS Group's structure implemented in 2014.

Following the change in reportable segments in 2014, the £2.8 billion goodwill attributed to UK Corporate was allocated to Commercial Banking (£2.1 billion), UK Personal & Business Banking (£0.6 billion) and Corporate & Institutional Banking (£0.1 billion). All UK Retail, Wealth and US Retail & Commercial goodwill was allocated to UK Personal & Business Banking, Private Banking and Citizens Financial Group respectively. The goodwill allocated to Corporate & Institutional Banking was written off immediately following re-segmentation. The change in reportable segments in 2014 did not impact the impairment tests performed in 2013 and 2012.

The analysis of goodwill by operating segment is shown in Note 37.

The carrying value of goodwill and amount by which it is exceeded by the recoverable amount is set out below by division along with the key assumptions applied in calculating the recoverable amount and sensitivities to changes in those assumptions.

		Assumptions		Recoverable	Consequential impact of 1% adverse movement in		Consequential impact of 5% adverse movement in forecast pre-tax earnings
	Goodwill	Terminal	Pre-tax	amount exceeded	Discount	Terminal	
	£bn	growth rate	discount rate	carrying value	rate	growth rate	
		%	%	£bn	£bn	£bn	£bn
September 2014							
UK Personal & Business Banking	3.3	4.5	11.5	17.6	(3.6)	(2.5)	(1.6)
Commercial Banking	2.1	4.5	11.7	3.0	(1.9)	(0.9)	(1.0)
Private Banking	0.8	4.5	11.4	0.7	(0.5)	(0.3)	(0.2)
Citizens Financial Group	3.8	5.0	14.4	0.3	(1.1)	(0.7)	(0.7)
September 2013							
UK Retail	2.8	4.4	10.4	20.4	(4.2)	(3.3)	(1.7)
UK Corporate	2.8	4.4	10.5	7.3	(3.3)	(2.1)	(1.6)
Wealth	0.8	4.4	12.0	0.7	(0.4)	(0.3)	(0.2)
US Retail & Commercial	3.8	4.8	12.8	4.1	(1.5)	(0.8)	(0.8)
September 2012							
UK Retail	2.8	4.7	13.5	13.8	(2.5)	(2.4)	(1.3)
UK Corporate	2.8	4.7	13.5	6.3	(2.3)	(1.8)	(1.4)
Wealth	0.8	4.7	14.8	1.9	(0.5)	(0.4)	(0.3)
International Banking	0.2	4.7	12.2	0.3	(1.1)	(1.2)	(0.6)
US Retail & Commercial	3.8	5.3	16.9	2.0	(1.2)	(0.8)	(0.7)

Other intangible assets are reviewed for indicators of impairment. In 2014, £401 million (2013 - £215 million; 2012 - £7 million) of previously capitalised software were written off.

Notes on the accounts

19 Property, plant and equipment

	Group						
	Investment properties £m	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Operating lease assets £m	Total £m
2014							
<i>Cost or valuation</i>							
At 1 January	2,633	2,942	240	1,709	4,192	1,899	13,615
Transfers to disposal groups	—	(131)	—	(275)	(1,034)	(210)	(1,650)
Transfers from fellow subsidiaries	—	—	—	2	6	—	8
Currency translation and other adjustments	(175)	17	(3)	10	52	23	(76)
Reclassifications	—	(8)	—	—	8	—	—
Additions	117	52	2	59	314	230	774
Expenditure on investment properties	13	—	—	—	—	—	13
Change in fair value of investment properties							
- continuing operations	(25)	—	—	—	—	—	(25)
Disposals and write-off of fully depreciated assets	(630)	(48)	(26)	(185)	(602)	(391)	(1,882)
At 31 December	1,933	2,824	213	1,320	2,936	1,551	10,777
<i>Accumulated impairment, depreciation and amortisation</i>							
At 1 January	—	942	137	961	2,939	770	5,749
Transfers to disposal groups	—	(41)	—	(205)	(800)	(55)	(1,101)
Transfers from fellow subsidiaries	—	—	—	1	5	—	6
Currency translation and other adjustments	—	2	(3)	7	42	7	55
Write down of property, plant and equipment	—	4	—	2	4	—	10
Disposals and write-off of fully depreciated assets	—	(20)	(22)	(95)	(437)	(234)	(808)
Charge for the year							
- continuing operations	—	95	9	95	300	165	664
- discontinued operations	—	4	—	19	47	9	79
At 31 December	—	986	121	785	2,100	662	4,654
Net book value at 31 December	1,933	1,838	92	535	836	889	6,123
2013							
<i>Cost or valuation</i>							
At 1 January	3,111	2,952	240	1,670	4,341	3,324	15,638
Transfers to disposal groups	—	(30)	—	(12)	(22)	—	(64)
Transfers from fellow subsidiaries	3	8	—	14	41	—	66
Currency translation and other adjustments	31	(9)	3	(9)	(49)	—	(33)
Reclassifications	—	6	(2)	4	(8)	—	—
Additions	95	49	9	100	382	60	695
Expenditure on investment properties	13	—	—	—	—	—	13
Change in fair value of investment properties							
- continuing operations	(281)	—	—	—	—	—	(281)
Disposals and write-off of fully depreciated assets	(339)	(34)	(10)	(58)	(493)	(1,485)	(2,419)
At 31 December	2,633	2,942	240	1,709	4,192	1,899	13,615
<i>Accumulated impairment, depreciation and amortisation</i>							
At 1 January	—	830	127	879	2,975	1,123	5,934
Transfers to disposal groups	—	(6)	—	(9)	(16)	—	(31)
Transfers from fellow subsidiaries	—	3	—	10	25	—	38
Currency translation and other adjustments	—	2	3	(6)	(22)	(5)	(28)
Write down of property, plant and equipment	—	15	3	—	—	—	18
Disposals and write-off of fully depreciated assets	—	(12)	(6)	(46)	(399)	(559)	(1,022)
Charge for the year							
- continuing operations	—	104	10	111	316	205	746
- discontinued operations	—	6	—	22	60	6	94
At 31 December	—	942	137	961	2,939	770	5,749
Net book value at 31 December	2,633	2,000	103	748	1,253	1,129	7,866

Notes on the accounts

2012	Group						Total £m
	Investment properties £m	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Operating lease assets £m	
Cost or valuation							
At 1 January	4,413	2,690	192	1,708	4,114	3,892	17,009
Transfers from disposal groups	—	107	12	93	41	—	253
Transfers from fellow subsidiaries	48	12	35	39	58	—	192
Currency translation and other adjustments	(49)	(29)	(2)	(21)	(57)	(54)	(212)
Reclassifications	24	(22)	(4)	(6)	8	—	—
Additions	238	226	8	111	453	402	1,438
Expenditure on investment properties	10	—	—	—	—	—	10
Change in fair value of investment properties							
- continuing operations	(148)	—	—	—	—	—	(148)
Disposals and write-off of fully depreciated assets	(1,425)	(32)	(1)	(254)	(276)	(916)	(2,904)
At 31 December	3,111	2,952	240	1,670	4,341	3,324	15,638
Accumulated impairment, depreciation and amortisation							
At 1 January	—	697	93	775	2,779	1,187	5,531
Transfers from disposal groups	—	43	6	66	26	—	141
Transfers from fellow subsidiaries	—	1	16	15	85	—	117
Currency translation and other adjustments	—	(4)	—	(11)	(50)	(21)	(86)
Write down of property, plant and equipment	—	9	1	—	—	—	10
Disposals and write-off of fully depreciated assets	—	(12)	—	(96)	(263)	(462)	(833)
Charge for the year							
- continuing operations	—	88	10	108	339	409	954
- discontinued operations	—	6	—	23	73	8	110
At 31 December	—	828	126	880	2,989	1,121	5,944
Net book value at 31 December	3,111	2,124	114	790	1,352	2,203	9,694

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 - 78% (2013 - 46%); otherwise investment property fair value measurements are categorised as level 3 - 22% (2013 - 54%).

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 £932 million was valued by independent valuers.

The fair value of investment properties includes £235 million of depreciation since purchase (2013 - £271 million; 2012 - £186 million).

Rental income from investment properties was £217 million (2013 - £244 million; 2012 - £267 million). Direct operating expenses of investment properties were £81 million (2013 - £91 million; 2012 - £125 million).

Property, plant and equipment, excluding investment properties, include £2 million (2013 - £42 million; 2012 - £35 million) assets in the course of construction.

Notes on the accounts

19 Property, plant and equipment continued

	Bank				
	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Total £m
2014					
<i>Cost or valuation</i>					
At 1 January	1,303	96	723	2,664	4,786
Transfers from fellow subsidiaries	—	—	2	2	4
Currency translation and other adjustments	(1)	(1)	(1)	(4)	(7)
Additions	15	—	29	210	254
Disposals and write-off of fully depreciated assets	(3)	(19)	(125)	(389)	(536)
At 31 December	1,314	76	628	2,483	4,501
<i>Accumulated impairment, depreciation and amortisation</i>					
At 1 January	361	58	335	1,748	2,502
Transfers to fellow subsidiaries	—	—	1	2	3
Currency translation and other adjustments	(1)	—	(2)	(6)	(9)
Disposals and write-off of fully depreciated assets	(1)	(19)	(45)	(272)	(337)
Charge for the year	50	5	46	265	366
At 31 December	409	44	335	1,737	2,525
Net book value at 31 December	905	32	293	746	1,976
2013					
<i>Cost or valuation</i>					
At 1 January	1,297	91	687	2,712	4,787
Transfers from fellow subsidiaries	—	—	8	13	21
Currency translation and other adjustments	1	2	(3)	(3)	(3)
Reclassifications	(3)	—	5	(2)	—
Additions	10	3	55	258	326
Disposals and write-off of fully depreciated assets	(2)	—	(29)	(314)	(345)
At 31 December	1,303	96	723	2,664	4,786
<i>Accumulated impairment, depreciation and amortisation</i>					
At 1 January	303	49	296	1,709	2,357
Transfers from fellow subsidiaries	—	—	4	8	12
Currency translation and other adjustments	6	4	(1)	(1)	8
Write down of property, plant and equipment	2	—	—	—	2
Disposals and write-off of fully depreciated assets	(2)	—	(20)	(237)	(259)
Charge for the year	52	5	56	269	382
At 31 December	361	58	335	1,748	2,502
Net book value at 31 December	942	38	388	916	2,284

Notes on the accounts

			Bank		
	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Total £m
2012					
Cost or valuation					
At 1 January	1,018	48	708	2,409	4,183
Transfers from disposal groups	80	9	90	40	219
Transfers from fellow subsidiaries	7	35	35	52	129
Currency translation and other adjustments	(1)	—	(2)	—	(3)
Reclassifications	2	(4)	(2)	4	—
Additions	195	3	53	329	580
Disposals and write-off of fully depreciated assets	(4)	—	(195)	(122)	(321)
At 31 December	1,297	91	687	2,712	4,787
Accumulated impairment, depreciation and amortisation					
At 1 January	232	24	232	1,451	1,939
Transfers from disposal groups	33	4	63	23	123
Transfers from fellow subsidiaries	—	16	13	81	110
Currency translation and other adjustments	—	—	—	(3)	(3)
Disposals and write-off of fully depreciated assets	(2)	—	(64)	(124)	(190)
Charge for the year	40	5	52	281	378
At 31 December	303	49	296	1,709	2,357
Net book value at 31 December	994	42	391	1,003	2,430

20 Prepayments, accrued income and other assets

	Group			Bank		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Prepayments	621	608	862	516	366	2,093
Accrued income	429	475	463	181	254	242
Tax recoverable	304	189	171	52	71	41
Pension schemes in net surplus (see Note 4)	295	214	144	159	119	99
Interests in associates	292	223	317	62	67	185
Other assets	2,472	4,195	4,147	1,233	2,369	1,773
	4,413	5,904	6,104	2,203	3,246	4,433

Notes on the accounts

21 Discontinued operations and assets and liabilities of disposal groups

In accordance with a commitment to the EC to sell Citizens Financial Group, Inc. (Citizens) by 31 December 2016, RBS Group disposed of 29.5% of its interest in Citizens during the second half of 2014 primarily through an initial public offering in the USA. RBS Group plans to cede control by the end of 2015 and therefore Citizens is classified as a disposal group and its results presented as discontinued operations, with comparatives re-presented.

On reclassification to disposal groups at 31 December 2014, the carrying value of Citizens exceeded its fair value less costs to sell (Fair Value Hierarchy level 2: based on the quoted price of shares in Citizens Financial Group, Inc.) by £3,994 million and the carrying value of the assets and liabilities of the disposal group has been adjusted by this amount. This loss has been attributed to the intangible assets of the disposal group.

(a) Loss/(profit) from discontinued operations, net of tax

	2014 £m	2013 £m	2012 £m
Citizens			
Interest income	2,204	2,252	2,447
Interest expense	(191)	(288)	(401)
Net interest income	2,013	1,964	2,046
Other income	1,043	1,056	1,180
Total income	3,056	3,020	3,226
Operating expenses	(2,123)	(2,102)	(2,182)
Profit before impairment losses	933	918	1,044
Impairment losses	(197)	(312)	(269)
Operating profit before tax	736	606	775
Tax charge	(228)	(196)	(285)
Profit after tax	508	410	490
Loss on reclassification to disposal groups	(3,994)	—	—
(Loss)/profit from Citizens discontinued operations, net of tax	(3,486)	410	490

(b) Cash flows attributable to discontinued operations

Included within the Group's cash flows are the following amounts attributable to discontinued operations.

	2014 £m	2013 £m	2012 £m
Net cash flows from operating activities	3,997	258	(1,571)
Net cash flows from investing activities	(4,194)	(1,217)	2,186
Net cash flows from financing activities	596	(9)	(52)
Net increase/(decrease) in cash and cash equivalents	129	(8)	(108)

Notes on the accounts

(c) Assets and liabilities of disposal groups

	Citizens £m	Other £m	2014 £m	2013 £m	2012 £m
Assets of disposal groups					
Cash and balances at central banks	622	—	622	—	—
Loans and advances to banks	1,728	17	1,745	15	20
Loans and advances to customers	59,606	—	59,606	689	263
Debt securities and equity shares	15,865	—	15,865	—	5
Derivatives	402	—	402	1	3
Intangible assets	555	—	555	—	—
Property, plant and equipment	503	46	549	32	—
Other assets	1,686	3	1,689	53	13
	80,967	66	81,033	790	304
Liabilities of disposal groups					
Deposits by banks	6,794	—	6,794	—	—
Customer accounts	61,256	—	61,256	3,190	18
Debt securities in issue	1,625	—	1,625	—	—
Derivatives	144	—	144	1	3
Subordinated liabilities	226	—	226	—	—
Other liabilities	1,223	16	1,239	19	114
	71,268	16	71,284	3,210	135

Citizens is included in disposal groups at 31 December 2014.

Disposal groups at 31 December 2013 primarily comprised the Chicago area retail branches, small business operations and select middle market relationships in the Chicago market which form part of Citizens Financial Group.

Notes on the accounts

21 Discontinued operations and assets and liabilities of disposal groups continued

(d) Financial instruments: Classification and valuation hierarchy

			2014		
	Carrying value £bn	Fair value £bn	Fair value approximates carrying value £bn	Level 2 £bn	Level 3 £bn
Citizens					
Assets					
Cash and balances at central banks - loans and receivables	0.6	0.6	0.6		
Loans and advances to banks - loans and receivables	1.7	1.7		1.7	
Loans and advances to customers					
- held-for-trading	0.2	0.2		0.2	
- loans and receivables	56.7				
- finance leases	2.7				
	59.4	59.4		—	59.4
Debt securities - available-for-sale	15.3	15.3		15.3	
Equity shares - available-for-sale	0.6	0.6		0.6	
Derivatives	0.4	0.4		0.4	
Liabilities					
Deposits by banks - held-for-trading	1.7	1.7		1.7	
Deposits by banks - amortised cost					
- demand deposits	0.1	0.1	0.1		
- other	5.0	5.0		5.0	
Customer accounts - amortised cost					
- demand deposits	28.9	28.9	28.9		
- other	32.4	32.4		32.4	
Debt securities in issue - amortised cost	1.6	1.6		1.6	
Derivatives	0.1	0.1		0.1	
Subordinated liabilities - amortised cost	0.2	0.2		0.2	

Fair values have been established in accordance with Accounting policy 14 (page 180) and 16 (pages 181 and 182), and Note 11 (page 211).

22 Short positions

	Group			Bank		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Debt securities						
- Government	20,856	24,661	23,529	15,193	15,838	11,984
- Other issuers	1,960	3,087	3,411	1,186	1,807	1,489
Equity shares	212	256	601	211	253	601
	23,028	28,004	27,541	16,590	17,898	14,074

Note:

(1) All short positions are classified as held-for-trading.

23 Accruals, deferred income and other liabilities

	Group			Bank		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Notes in circulation	1,803	1,759	1,684	1,129	1,124	1,106
Current tax	714	510	323	540	492	526
Accruals	2,649	2,860	3,276	1,666	1,803	2,019
Deferred income	448	515	718	290	326	505
Provisions for liabilities and charges (see tables below)	4,762	5,420	3,061	1,570	1,721	1,895
Other liabilities (1)	1,886	3,689	2,965	427	1,735	1,304
	12,262	14,753	12,027	5,622	7,201	7,355

Note:

(1) Other liabilities include £28 million (2013 - £25 million; 2012 - £24 million) in respect of share-based compensation.

Notes on the accounts

Provisions for liabilities and charges	Group								
	Regulatory and legal actions							Property and other (7) £m	Total £m
	Payment Protection Insurance (1) £m	Interest Rate Hedging Products (2) £m	Other customer redress (3) £m	LIBOR (4) £m	investigations (5) £m	FX £m	Other regulatory provisions (5) £m		
At 1 January 2014	926	1,077	336	416	—	150	1,963	552	5,420
Transfer from accruals and other liabilities	—	—	52	—	—	—	—	10	62
Transfer to disposal groups	—	—	(53)	—	—	—	(4)	—	(57)
Currency translation and other movements	—	—	(9)	(2)	2	4	119	(1)	113
Charge to income statement									
- continuing operations	650	208	435	—	720	100	112	428	2,653
- discontinued operations	—	—	—	—	—	—	4	—	4
Releases to income statement									
- continuing operations	—	(23)	(18)	—	—	—	(33)	(75)	(149)
- discontinued operations	—	—	—	—	—	—	(30)	—	(30)
Provisions utilised	(777)	(838)	(175)	(414)	(402)	(71)	(359)	(218)	(3,254)
At 31 December 2014	799	424	568	—	320	183	1,772	696	4,762

	Bank								
	Regulatory and legal actions								
	Payment Protection Insurance (1) £m	Interest Rate Hedging Products (2) £m	Other customer redress (3) £m	LIBOR (4) £m	FX investigations (5) £m	Other regulatory provisions (5) £m	Litigation (6) £m	Property and other (7) £m	Total £m
Provisions for liabilities and charges									
At 1 January 2014	369	395	58	416	—	61	40	382	1,721
Currency translation and other movements	—	—	(5)	(2)	2	(4)	21	(10)	2
Charge to income statement	210	23	89	—	720	96	17	392	1,547
Releases to income statement	—	—	(5)	(30)	—	—	(10)	(49)	(94)
Provisions utilised	(267)	(264)	(33)	(384)	(402)	(56)	(33)	(167)	(1,606)
At 31 December 2014	312	154	104	—	320	97	35	548	1,570

Notes:

- (1) To reflect current experience of PPI complaints received, the Group increased its provision for PPI by £650 million in 2014 (2013 - £900 million; 2012 - £1,110 million), bringing the cumulative charge to £3.7 billion, of which £2.9 billion (79%) in redress had been paid by 31 December 2014. Of the £3.7 billion cumulative charge, £3.4 billion relates to redress and £0.3 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	49%	52%	+/-5	+/-56
Uphold rate (1)	90%	89%	+/-5	+/-25
Average redress	£1,700	£1,660	+/-5	+/-26

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. The Group expects the majority of the cash outflows associated with the remaining provision to have occurred by Q2 2016. 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.

Background information in relation to PPI claims is given in Note 31.

Notes on the accounts

23 Accruals, deferred income and other liabilities continued

(2) The Group has estimated £1,435 million for its liability in respect of the sale of Interest Rate Hedging Products based on experience, having now agreed all outcomes with the independent skilled person appointed to review all decisions. 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 2014, the Group increased its provision by £185 million (2013 - £550 million; 2012 - £700 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 £1.4 billion, of which £1.1 billion relates to redress and £0.3 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
- 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 31.

- (3) The Group has provided for other customer redress, primarily in relation to investment advice in retail and private banking (£190 million) and packaged accounts (£150 million).
- (4) On 6 February 2013, the Group reached agreement with the FSA, the US Department of Justice and the Commodity Futures Trading Commission in relation to the setting of LIBOR and other trading rates, including financial penalties of £381 million. In December 2013, the Group agreed to pay settlement penalties of approximately €260 million and €131 million to resolve investigations by the European Commission into Yen LIBOR competition infringements and EURIBOR competition infringements respectively. For further details see Note 31.
- (5) The Group is party to certain legal proceedings and regulatory investigations and continues to co-operate with a number of regulators. All such matters are periodically reassessed with the assistance of external professional advisers, where appropriate, to determine the likelihood of the Group incurring a liability and to evaluate the extent to which a reliable estimate of any liability can be made. An additional charge of £820 million was booked in 2014 (2013 - £124 million; 2012 - £75 million), primarily relating to investigations into the foreign exchange market, regulatory fines in connection with the June 2012 technology incident and other conduct and regulatory matters. Details of these investigations and a discussion of the nature of the associated uncertainties are given in Note 31.
- (6) 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 £2,050 million was recorded in 2013 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 31.
- (7) The property provisions principally comprise provisions for onerous lease contracts. Provision is made for future rentals payable in respect of vacant leasehold property and for any shortfall where leased property is sub-let at a rental lower than the lease rentals payable by the Group.

24 Deferred tax

	Group			Bank		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Deferred tax liability	236	189	789	—	—	—
Deferred tax asset	(1,510)	(3,435)	(3,066)	(733)	(2,298)	(2,878)
Net deferred tax asset	(1,274)	(3,246)	(2,277)	(733)	(2,298)	(2,878)

Notes on the accounts

Net deferred tax asset comprised:

	Group												
	Pension £m	Accelerated capital allowances £m	Provisions £m	Deferred gains £m	IFRS transition £m	Fair value of financial instruments £m	Available- for-sale financial assets £m	Intangibles £m	Cash flow hedging £m	Share schemes £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2013	(823)	1,783	(1,117)	56	(148)	(22)	136	186	575	(13)	(2,879)	(11)	(2,277)
(Disposals)/acquisitions of subsidiaries	—	(21)	—	—	—	—	—	1	—	—	—	—	(20)
Charge/(credit) to income statement													
- continuing operations	54	(529)	(442)	(13)	61	10	(4)	6	2	1	1,034	(160)	20
- discontinued operations	—	48	33	—	—	—	(23)	39	51	—	—	57	205
Charge/(credit) to other comprehensive income	245	—	(3)	—	—	—	(127)	—	(632)	(1)	(348)	—	(866)
Currency translations and other adjustments	(3)	(20)	26	—	—	—	3	(7)	3	—	(303)	(7)	(308)
At 1 January 2014	(527)	1,261	(1,503)	43	(87)	(12)	(15)	225	(1)	(13)	(2,496)	(121)	(3,246)
Transfer to disposal groups	28	(579)	423	—	—	—	52	(276)	48	—	—	28	(276)
Charge/(credit) to income statement													
- continuing operations	80	(186)	904	(4)	45	(40)	16	—	(55)	(14)	1,019	68	1,833
- discontinued operations	(6)	33	(38)	—	—	—	(2)	51	6	—	—	38	82
Charge/(credit) to other comprehensive income	81	—	—	—	—	—	1	—	282	(3)	(12)	—	349
Currency translations and other adjustments	—	11	(27)	—	—	—	(4)	—	—	—	10	(6)	(16)
At 31 December 2014	(344)	540	(241)	39	(42)	(52)	48	—	280	(30)	(1,479)	7	(1,274)

	Bank									
	Pension £m	Accelerated capital allowances £m	Provisions £m	Deferred gains £m	IFRS transition £m	Cash flow hedging £m	Share schemes £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2013	(3)	(394)	(304)	31	(64)	537	(26)	(2,654)	(1)	(2,878)
Charge/(credit) to income statement	20	(96)	111	(8)	27	3	1	1,608	—	1,666
Credit to other comprehensive income	(6)	—	—	—	—	(440)	—	(348)	—	(794)
Currency translations and other adjustments	—	—	7	—	—	—	—	(299)	—	(292)
At 1 January 2014	11	(490)	(186)	23	(37)	100	(25)	(1,693)	(1)	(2,298)
Charge/(credit) to income statement	2	(89)	(9)	(1)	19	7	(1)	1,216	—	1,144
(Credit)/charge to other comprehensive income	(16)	—	—	—	—	101	(3)	(12)	—	70
Acquisitions of businesses	—	350	—	—	—	—	—	—	—	350
Currency translations and other adjustments	—	—	—	—	—	—	—	—	1	1
At 31 December 2014	(3)	(229)	(195)	22	(18)	208	(29)	(489)	—	(733)

Deferred tax assets in respect of unused tax losses are recognised if the losses can be used to offset probable future taxable profits after taking into account the expected reversal of other temporary differences. Recognised deferred tax assets in respect of tax losses are analysed below.

	2014 £m	2013 £m	2012 £m
UK tax losses carried forward			
- The Royal Bank of Scotland plc	489	1,693	2,654
- National Westminster Bank Plc	768	718	66
	1,257	2,411	2,720
Overseas tax losses carried forward			
- Ulster Bank Ireland	222	74	72
- Citizens Financial Group, Inc.	—	11	87
	222	85	159
	1,479	2,496	2,879

Notes on the accounts

24 Deferred tax continued

UK tax losses

Under UK tax rules, tax losses do not expire and can be carried forward indefinitely. In his 2014 Autumn Statement, the UK Chancellor of the Exchequer announced proposals to restrict the use of losses carried forward by UK banks to a maximum of 50% of profits in periods from April 2015 onwards. A longer recovery period of the DTA associated with UK tax losses will therefore arise, assuming that these proposals are enacted by Parliament in 2015. International Accounting Standards require the recoverability of DTAs to be considered by reference to legislation in force at the balance sheet reporting date.

The Royal Bank of Scotland plc - the deferred tax asset in respect of tax losses brought forward at 1 January 2014 related mainly to trading losses that arose in the UK branch of RBS N.V. These were transferred following the transfer of activities of the UK Branch of RBS N.V. to The Royal Bank of Scotland plc. The UK Branch tax losses attributable to credit market write-downs during the financial crisis were principally incurred between 2007 and 2009.

The Royal Bank of Scotland plc reported a taxable profit in 2011 and tax losses in 2012 and 2013. The taxable loss for 2012 reflected the reversal of previous own credit gains offset by core banking profitability. In 2013 UK tax losses were largely attributable to loan impairment charges arising from the RCR accelerated recovery strategy recorded in the final quarter of the period. In 2014, core profitability remained strong and a taxable profit arises. A reduction in the carrying value of deferred tax assets of £701 million was recorded in 2013. In addition, deferred tax of £150 million was not recognised in respect of excess 2013 UK taxable losses. CIB restructuring will constrain the utilisation of carried forward tax losses in the near-term. Consequently, a further reduction in the carrying value of deferred tax assets of £850 million has been recorded in 2014. The bank expects that the recognised deferred tax asset of £489 million in respect of tax losses amounting to £2,445 million will be recovered by the end of 2019. The proposed UK tax law change referred to above, if enacted, is expected to extend the recovery period by approximately one year.

National Westminster Bank Plc - the deferred tax asset in respect of tax losses at 31 December 2014 relates to residual unrelieved trading losses that arose between 2009 and 2014. 60% of the losses that arose were relieved against taxable profits arising in other UK Group companies. Based on the Group's strategic plan, the bank expects that the recognised deferred tax asset of £768 million in respect of tax losses amounting to £3,838 million will be recovered by the end of 2018. The proposed UK tax law change referred to above, if enacted, is expected to extend the recovery period by approximately two years.

Overseas tax losses

Ulster Bank Ireland - a deferred tax asset of £222 million has been recognised in respect of losses of £1,776 million (2013 - £592 million; 2012 - £575 million) of total tax losses of £8,599 million (2013 - £11,575 million; 2012 - £7,627 million) carried forward at 31 December 2013. These losses arose principally as a result of significant impairment charges that arose between 2008 and 2013 reflecting the challenging economic conditions in the Republic of Ireland during that period. Impairment charges have reduced and Ulster Bank Ireland returned to profitability during 2014. Based on the Group's strategic plan, the losses on which a deferred tax asset has been recognised will be utilised against future taxable profits of the company by the end of 2021.

Unrecognised deferred tax

Deferred tax assets of £3,778 million (2013 - £2,723 million; 2012 - £1,295 million) have not been recognised in respect of tax losses and other temporary differences carried forward of £18,760 million (2013 - £19,145 million; 2012 - £10,230 million) in jurisdictions where doubt exists over the availability of future taxable profits. Of these losses and other temporary differences, £15 million expire within five years and £2,735 million thereafter. The balance of tax losses and other temporary differences carried forward has no time limit.

Deferred tax liabilities of £186 million (2013 - £186 million; 2012 - £214 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.

25 Subordinated liabilities

	Group			Bank		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Dated loan capital	19,459	20,566	21,442	17,639	19,132	20,383
Undated loan capital	8,170	9,422	9,118	7,312	8,576	8,267
Preference shares	2,840	3,146	3,291	2,529	2,858	2,985
	30,469	33,134	33,851	27,480	30,566	31,635

Notes on the accounts

	Group						
	2015 £m	2016 £m	2017-2019 £m	2020-2024 £m	Thereafter £m	Perpetual £m	Total £m
2014 - final redemption							
Sterling	715	—	4,999	381	—	4,668	10,763
US dollar	530	—	400	5,326	1,222	4,703	12,181
Euro	791	—	2,502	2,416	—	195	5,904
Other	525	—	19	796	—	281	1,621
	2,561	—	7,920	8,919	1,222	9,847	30,469

	Group							
2014 - call date	Currently £m	2015 £m	2016 £m	2017-2019 £m	2020-2024 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	2,559	5,699	57	1,712	495	45	196	10,763
US dollar	1,841	1,766	—	3,019	4,049	1,506	—	12,181
Euro	—	955	834	3,728	338	—	49	5,904
Other	8	526	273	814	—	—	—	1,621
	4,408	8,946	1,164	9,273	4,882	1,551	245	30,469

	Group						
	2014 £m	2015 £m	2016-2018 £m	2019-2023 £m	Thereafter £m	Perpetual £m	Total £m
2013 - final redemption							
Sterling	60	608	60	5,365	—	4,825	10,918
US dollar	729	621	1,064	4,442	210	5,848	12,914
Euro	194	657	2,953	1,717	—	1,539	7,060
Other	395	617	119	813	—	298	2,242
	1,378	2,503	4,196	12,337	210	12,510	33,134

	Group							
	Currently	2014	2015	2016-2018	2019-2023	Thereafter	Perpetual	Total
2013 - call date	£m	£m	£m	£m	£m	£m	£m	£m
Sterling	1	5,119	695	1,791	518	43	2,751	10,918
US dollar	2,401	2,518	426	2,856	3,235	1,387	91	12,914
Euro	1,041	915	657	4,068	329	—	50	7,060
Other	761	794	292	395	—	—	—	2,242
	4,204	9,346	2,070	9,110	4,082	1,430	2,892	33,134

	Group						
	2013 £m	2014 £m	2015-2017 £m	2018-2022 £m	Thereafter £m	Perpetual £m	Total £m
2012 - final redemption							
Sterling	244	—	629	5,471	—	4,587	10,931
US dollar	625	664	1,497	3,254	—	5,898	11,938
Euro	1,474	—	1,713	3,607	219	1,507	8,520
Other	42	425	751	909	—	335	2,462
	2,385	1,089	4,590	13,241	219	12,327	33,851

	Group							
	Currently	2013	2014	2015-2017	2018-2022	Thereafter	Perpetual	Total
2012 - call date	£m	£m	£m	£m	£m	£m	£m	£m
Sterling	—	464	5,060	826	2,221	135	2,225	10,931
US dollar	1,469	3,300	664	3,128	1,939	1,345	93	11,938
Euro	—	2,914	289	2,833	2,220	219	45	8,520
Other	9	715	—	1,174	564	—	—	2,462
	1,478	7,393	6,013	7,961	6,944	1,699	2,363	33,851

Notes on the accounts

25 Subordinated liabilities continued

The following tables analyse the remaining contractual maturity of subordinated liabilities by the final redemption date and by the next call date.

	Bank						Total £m
	2015 £m	2016 £m	2017-2019 £m	2020-2024 £m	Thereafter £m	Perpetual £m	
2014 - final redemption							
Sterling	292	—	4,999	—	—	4,415	9,706
US dollar	526	—	400	4,454	1,008	4,084	10,472
Euro	790	—	2,502	2,416	—	—	5,708
Other	525	—	—	796	—	273	1,594
	2,133	—	7,901	7,666	1,008	8,772	27,480

	Bank							Total £m
	Currently £m	2015 £m	2016 £m	2017-2019 £m	2020-2024 £m	Thereafter £m	Perpetual £m	
2014 - call date								
Sterling	2,559	5,277	57	1,712	26	45	30	9,706
US dollar	1,841	1,143	—	3,019	3,177	1,292	—	10,472
Euro	—	808	834	3,728	338	—	—	5,708
Other	—	525	273	796	—	—	—	1,594
	4,400	7,753	1,164	9,255	3,541	1,337	30	27,480

	Bank						Total £m
	2014 £m	2015 £m	2016-2018 £m	2019-2023 £m	Thereafter £m	Perpetual £m	
2013 - final redemption							
Sterling	37	275	—	5,000	—	4,473	9,785
US dollar	720	621	1,064	4,027	—	5,284	11,716
Euro	194	657	2,953	1,717	—	1,331	6,852
Other	395	617	99	813	—	289	2,213
	1,346	2,170	4,116	11,557	—	11,377	30,566

	Bank							Total £m
	Currently £m	2014 £m	2015 £m	2016-2018 £m	2019-2023 £m	Thereafter £m	Perpetual £m	
2013 - call date								
Sterling	1	5,095	275	1,731	65	43	2,576	9,786
US dollar	2,402	1,938	426	2,855	2,826	1,177	91	11,715
Euro	1,041	757	657	4,068	329	—	—	6,852
Other	752	794	292	375	—	—	—	2,213
	4,196	8,584	1,650	9,029	3,220	1,220	2,667	30,566

	Bank						Total £m
	2013 £m	2014 £m	2015-2017 £m	2018-2022 £m	Thereafter £m	Perpetual £m	
2012 - final redemption							
Sterling	217	—	276	5,007	—	4,078	9,578
US dollar	620	664	1,497	3,040	—	5,462	11,283
Euro	1,474	—	1,713	3,607	219	1,308	8,321
Other	42	425	751	909	—	326	2,453
	2,353	1,089	4,237	12,563	219	11,174	31,635

	Bank							Total £m
	Currently £m	2013 £m	2014 £m	2015-2017 £m	2018-2022 £m	Thereafter £m	Perpetual £m	
2012 - call date								
Sterling	—	217	5,060	386	1,725	135	2,055	9,578
US dollar	1,469	2,859	664	3,127	1,726	1,345	93	11,283
Euro	—	2,760	289	2,833	2,220	219	—	8,321
Other	—	715	—	1,174	564	—	—	2,453
	1,469	6,551	6,013	7,520	6,235	1,699	2,148	31,635

Notes on the accounts

Issuances and redemptions during the year (value at date of transaction).

	Capital treatment	2014 £m	2013 £m	2012 £m
New issues				
<i>The Royal Bank of Scotland plc</i>				
€1,000 million 3.625% subordinated notes 2024	Tier 2	833	—	—
US\$389 million 6.1% subordinated notes 2023	Tier 2	—	256	—
US\$2,000 million 6% subordinated notes 2023	Tier 2	—	1,210	—
AUD883 million 13.125% subordinated notes 2022	Tier 2	—	—	590
CAD420 million 10.5% subordinated notes 2022	Tier 2	—	—	268
CHF124 million 9.375% subordinated notes 2022	Tier 2	—	—	86
€564 million 10.5% subordinated notes 2022	Tier 2	—	—	469
US\$2,132 million 9.5% subordinated notes 2022	Tier 2	—	—	1,346
<i>Charter One Financial, Inc (1)</i>				
US\$333 million 4.153% subordinated notes 2024	Tier 2	195	—	—
US\$333 million 4.023% subordinated notes 2024	Tier 2	201	—	—
US\$334 million 4.082% subordinated notes 2025	Tier 2	209	—	—
US\$333 million 4.771% subordinated notes 2023	Tier 2	—	206	—
US\$334 million 4.691% subordinated notes 2024	Tier 2	—	204	—
US\$350 million 4.150% subordinated notes 2022	Ineligible	—	—	214
<i>RBS Poland S.A.</i>				
Polish Zloty 101 million floating rate subordinated notes 2018	Tier 2	—	20	—
		1,438	1,896	2,973
Redemptions				
<i>The Royal Bank of Scotland plc</i>				
US\$750 million 5% subordinated notes 2014	Tier 2	463	—	—
US\$250 million 5% subordinated notes 2014	Tier 2	154	—	—
AUD397 million floating rate subordinated notes	Tier 2	217	—	—
AUD265 million floating rate subordinated notes	Tier 2	145	—	—
CAD217 million floating rate subordinated notes	Tier 2	94	—	—
US\$322 million floating rate subordinated notes	Tier 2	177	—	—
US\$229 million floating rate subordinated notes	Tier 2	144	—	—
US\$686 million floating rate subordinated notes	Tier 2	431	—	—
€227 million floating rate subordinated notes	Tier 2	179	—	—
CHF34 million floating rate subordinated notes	Tier 2	23	—	—
£56 million 6% undated notes	Tier 2	56	—	—
€176 million floating rate undated notes	Tier 2	138	—	—
€170 million floating rate undated notes	Tier 2	133	—	—
£1 million floating rate undated notes	Tier 2	1	—	—
AUD32 million floating rate notes 2017 (partial redemption)	Tier 2	17	—	—
AUD53.7 million floating rate subordinated notes 2017 (partial redemption)	Tier 2	29	—	—
€79.75 million floating rate notes 2017 (partial redemption)	Tier 2	65	—	—
US\$211.9 million floating rate subordinated notes 2017 (partial redemption)	Tier 2	129	—	—
€1,250 million perpetual regulated securities	Tier 1	1,002	—	—
US\$850 million floating rate preference shares non-cumulative, US\$0.01 face value, series M	Tier 1	524	—	—
€1,000 million 6% subordinated notes	Tier 2	—	808	—
US\$50 million floating rate subordinated notes	Tier 2	—	31	—
€500 million 6% subordinated notes	Tier 2	—	415	—
£150 million 10.5% subordinated bonds	Tier 2	—	150	—
US\$750 million 5% subordinated notes 2013	Tier 2	—	449	—
AUD193 million 6% subordinated notes 2014 (partial redemption)	Tier 2	—	—	129
AUD145 million floating rate subordinated notes (partial redemption)	Tier 2	—	—	97
CAD483 million 4.25% subordinated notes (partial redemption)	Tier 2	—	—	308
US\$428 million floating rate subordinated notes (partial redemption)	Tier 2	—	—	270
US\$271 million floating rate subordinated notes (partial redemption)	Tier 2	—	—	171

Note:

(1) Transferred to disposal groups at 31 December 2014.

Notes on the accounts

25 Subordinated liabilities continued

	Capital treatment	2014 £m	2013 £m	2012 £m
Redemptions continued				
<i>The Royal Bank of Scotland plc</i>				
US\$814 million floating rate subordinated notes (partial redemption)	Tier 2	—	—	514
€273 million 4.5% subordinated notes (partial redemption)	Tier 2	—	—	227
CHF166 million floating rate subordinated notes (partial redemption)	Tier 2	—	—	114
€398 million floating rate subordinated notes (partial redemption)	Tier 2	—	—	331
AUD400 million 6.5% subordinated notes (partial redemption)	Tier 2	—	—	267
AUD360 million floating rate subordinated notes (partial redemption)	Tier 2	—	—	241
US\$1,050 million floating rate subordinated notes (partial redemption)	Tier 2	—	—	663
<i>Ulster Banking Group</i>				
£60 million floating rate subordinated bonds 2018	Tier 2	60	—	—
<i>Charter One Financial, Inc</i>				
US\$400 million 6.375% subordinated notes	Ineligible	—	—	258
		4,181	1,853	3,590

The RBS 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.

Certain preference shares issued by the company are classified as liabilities; these securities remain subject to the capital maintenance rules of the Companies Act 2006.

26 Share capital and reserves

	Allotted, called up and fully paid		
	2014 £m	2013 £m	2012 £m
Ordinary shares of £1	6,609	6,609	6,609
	Allotted, called up and fully paid		
	2014	2013	2012
Number of shares - millions			
Ordinary shares of £1	6,609	6,609	6,609
Non-cumulative preference shares of US\$0.01	58	59	59
Non-cumulative preference shares of €0.01	1	1	1

Ordinary shares

In 2013, one ordinary share was issued at a premium of £209 million on the cross-border merger with RBS Bank (Romania) S.A. in connection with the transfer of RBS N.V.'s Romania businesses to the company.

In 2012, one ordinary share was issued at a premium of £706 million on the cross border merger with RBS II B.V. in connection with the transfer of substantially all of RBS N.V.'s Netherlands and EMEA businesses to the company.

No other ordinary shares were issued during 2014, 2013 or 2012.

Preference shares

In 2014, the 850,000 Series M non-cumulative preference shares of US\$0.01 each issued to the holding company were redeemed.

Reserves

At 31 December 2014, the merger reserve comprises the premium paid to acquire the assets and liabilities of RBS N.V.'s Korean business and the premium on shares issued to acquire NatWest less goodwill amortisation charged under previous GAAP. No share premium was recorded in the Bank financial statements through the operation of the merger relief provisions of the Companies Act 1985.

UK law prescribes that only reserves of the Bank are taken into account for the purpose of making distributions and the permissible applications of the share premium account.

The Group received capital contributions of £2,870 million in 2012 from the parent company for which no additional share capital was issued. As such this has been recorded as a capital contribution 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 the accounts

27 Leases

Year in which receipt will occur	Finance lease contracts and hire purchase agreements				Operating lease assets: future minimum lease rentals
	Gross amounts £m	Present value adjustments £m	Other movements £m	Present value £m	£m
2014					
Within 1 year	3,028	(227)	(20)	2,781	175
After 1 year but within 5 years	4,916	(445)	(85)	4,386	297
After 5 years	2,998	(1,239)	(37)	1,722	86
Total	10,942	(1,911)	(142)	8,889	558

2013					
Within 1 year	3,452	(300)	(44)	3,108	186
After 1 year but within 5 years	5,991	(534)	(251)	5,206	341
After 5 years	4,244	(1,481)	(428)	2,335	141
Total	13,687	(2,315)	(723)	10,649	668

2012					
Within 1 year	3,605	(330)	(40)	3,235	293
After 1 year but within 5 years	5,963	(600)	(197)	5,166	512
After 5 years	4,984	(1,709)	(315)	2,960	291
Total	14,552	(2,639)	(552)	11,361	1,096

Nature of operating lease assets on the balance sheet	Group		
	2014 £m	2013 £m	2012 £m
Transportation	570	822	1,501
Cars and light commercial vehicles	49	64	435
Other	270	243	267
	889	1,129	2,203

Amounts recognised as income and expense

Finance leases - contingent rental income	(85)	(94)	(110)
Operating leases - minimum rentals payable	249	389	392

Finance lease contracts and hire purchase agreements

Accumulated allowance for uncollectable minimum receivables	104	197	278

Amounts recognised as income and expense in discontinued operations was £124 million (2013 - £134 million; 2012 - £133 million) in relation to operating leases - minimum rentals payable.

Notes on the accounts

27 Leases continued

	Year in which residual value will be recovered				
	Within 1 year £m	After 1 year but within 2 years £m	After 2 years but within 5 years £m	After 5 years £m	Total £m
2014					
Operating leases					
- transportation	24	122	92	99	337
- cars and light commercial vehicles	10	4	6	—	20
- other	24	26	38	6	94
Finance lease contracts	20	24	59	37	140
Hire purchase agreements	—	1	2	—	3
	78	177	197	142	594
2013					
Operating leases					
- transportation	197	34	217	134	582
- cars and light commercial vehicles	18	8	7	—	33
- other	24	25	32	1	82
Finance lease contracts	41	53	198	429	721
Hire purchase agreements	—	1	1	—	2
	280	121	455	564	1,420
2012					
Operating leases					
- transportation	284	182	207	333	1,006
- cars and light commercial vehicles	317	44	49	1	411
- other	30	19	39	3	91
Finance lease contracts	38	47	148	318	551
Hire purchase agreements	1	—	1	—	2
	670	292	444	655	2,061

The Group provides asset finance to its customers through acting as a lessor. 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 the accounts

28 Structured entities

A structured entity (SE) is an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example, when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose, they do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions. As well as being a key element of securitisations, SEs are also used in fund management activities to segregate custodial duties from the fund management advice.

Consolidated structured entities

Securitisations

In a securitisation, assets, or interests in a pool of assets, are transferred generally to a SE which then issues liabilities to third party investors. The majority of securitisations are supported through liquidity facilities or other credit enhancements. The Group arranges securitisations to facilitate client transactions and undertakes own asset securitisations to sell or to fund portfolios of financial assets. The Group also acts as an underwriter and depositor in securitisation transactions in both client and proprietary transactions.

The Group's involvement in client securitisations takes a number of forms. It may: sponsor or administer a securitisation programme; provide liquidity facilities or programme-wide credit enhancement; and purchase securities issued by the vehicle.

Own asset securitisations

In own-asset securitisations, the pool of assets held by the SE is either originated by the Group, or (in the case of whole loan programmes) purchased from third parties.

The table below analyses the asset categories for those own-asset securitisations where the transferred assets continue to be recorded on the Group's balance sheet.

Asset type	2014				Group 2013				2012			
	Debt securities in issue				Debt securities in issue				Debt securities in issue			
	Assets	Held by third	Held by the	Total	Assets	Held by third	Held by the	Total	Assets	Held by third	Held by the	Total
	£m	parties £m	Group (1) £m	£m	£m	parties £m	Group (1) £m	£m	£m	parties £m	Group (1) £m	£m
Mortgages												
- UK	11,992	3,543	9,877	13,420	14,434	4,876	10,978	15,854	16,448	6,462	11,963	18,425
- Irish	8,593	1,697	7,846	9,543	9,300	1,890	8,751	10,641	10,587	3,217	7,634	10,851
UK credit cards	2,717	—	1,567	1,567	3,261	500	1,625	2,125	3,019	1,243	1,736	2,979
UK personal loans	—	—	—	—	3,382	—	3,677	3,677	4,658	—	4,283	4,283
Other loans (2)	4,995	4	5,245	5,249	11,848	71	12,078	12,149	17,215	352	18,064	18,416
	28,297	5,244	24,535	29,779	42,225	7,337	37,109	44,446	51,927	11,274	43,680	54,954
Cash deposits	4,616				6,245				5,366			
	32,913				48,470				57,293			

Notes:

(1) Debt securities retained by the Group may be pledged with central banks.

(2) Corporate, social housing and student loans.

Commercial paper conduits

The Group consolidates a number of asset-backed commercial paper (ABCP) conduits. A conduit is an SE that issues commercial paper and uses the proceeds to purchase or fund a pool of assets. The commercial paper is secured on the assets and is redeemed by further commercial paper issuance, repayment of assets or funding from liquidity facilities. Commercial paper is typically short-dated, usually up to three months. At 31 December 2014, assets held by the conduits totalled £0.6 billion (2013 - £1.6 billion; 2012 - £3.6 billion). At 31 December 2014, 31 December 2013 and at 31 December 2012 the conduits were funded entirely by the Group.

Covered bond programme

Certain loans and advances to customers have been assigned to bankruptcy remote limited liability partnerships to provide security for issues of debt securities by the Group. The Group retains all of the risks and rewards of these loans, the partnerships are consolidated, the loans retained on the Group's balance sheet and the related covered bonds included within debt securities in issue. At 31 December 2014, £13,401 million of mortgages provided security for debt securities in issue of £7,114 million (2013 - mortgages £16,177 million, bonds £9,041 million; 2012 - mortgages £15,990 million, bonds £10,139 million).

Notes on the accounts

28 Structured entities continued

Unconsolidated structured entities

The Group's interests in unconsolidated structured entities are analysed below.

2014	Asset backed securitisation vehicles - sponsored £m	Asset backed securitisation vehicles - not sponsored £m	Investment funds and other £m	Total £m
Held for trading				
Loans and advances to customers	—	449	22	471
Debt securities	167	3,682	3	3,852
Equity shares	—	—	310	310
Derivatives assets	—	1,670	10	1,680
Derivatives liabilities	(1)	(849)	(28)	(878)
Total	166	4,952	317	5,435

Other than held-for-trading

Loans and advances to customers	203	5,347	—	5,550
Debt securities	476	5,048	131	5,655
Total	679	10,395	131	11,205
Liquidity facilities/loan commitments	—	2,760	—	2,760
Guarantees	—	71	—	71
Maximum exposure	845	18,178	448	19,471

2013	£m	£m	£m	£m
Held for trading				
Loans and advances to customers	8	140	138	286
Debt securities	358	9,476	4	9,838
Equity shares	—	1	588	589
Derivatives assets	263	1,163	277	1,703
Derivatives liabilities	(113)	(329)	(230)	(672)
Total	516	10,451	777	11,744

Other than held-for-trading

Loans and advances to customers	—	3,967	30	3,997
Debt securities	481	15,130	9	15,620
Total	481	19,097	39	19,617
Liquidity facilities/loan commitments	4	2,830	33	2,867
Guarantees	—	83	9	92
Maximum exposure	1,001	32,461	858	34,320

Notes:

- (1) Net income arising from interests in unconsolidated structured entities include interest receivable, trading income as a result of changes in fair value, foreign exchange gains/losses and other income less impairments.
- (2) A sponsored entity is a structured entity, established by the Group where the Group provides liquidity and/or credit enhancements or provides ongoing services to the entity. The Group can act as sponsor for its own or for customers' transactions.
- (3) In 2014 the Group transferred £1,756 million (2013 - £2,119 million) of assets into sponsored structured entities which are not consolidated in the Group and for which the Group holds no interest at 31 December 2014. The income arising from these entities was £172 million (2013 - £192 million).
- (4) The 2013 interests in unconsolidated structured has been revised.

Notes on the accounts

29 Asset transfers

Under IAS 39 a financial asset is transferred if the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. Following a transfer the financial asset will be derecognised; not derecognised and retained in full on the Group's balance sheet; or continue to be recognised on the balance sheet to the extent of the Group's continuing involvement.

Transfers that do not qualify for derecognition

Securities repurchase agreements and lending transactions

The Group enters into securities repurchase agreements and securities lending transactions under which it transfers securities in accordance with normal market practice.

Generally, the agreements require additional collateral to be provided if the value of the securities falls below a predetermined level. Under standard terms for repurchase transactions in the UK and US markets, the recipient of collateral has an unrestricted right to sell or repledge it, subject to returning equivalent securities on settlement of the transaction.

Securities sold under repurchase transactions are not derecognised if the Group retains substantially all the risks and rewards of ownership. The fair value (and carrying value) of securities transferred under such repurchase transactions included on the balance sheet, are set out below. All of these securities could be sold or repledged by the holder.

	Group			Bank		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Assets subject to securities repurchase agreements or security lending transactions						
Debt securities	22,923	51,970	87,159	14,332	30,546	55,320
Equity shares	2,557	5,118	6,772	2,557	5,118	6,772

The following table provides analyses of 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	Bank		
	2014 (1) £m	2013 £m	2012 £m
UK mortgages	8,996	10,832	11,859
UK credit cards	938	1,185	1,128
UK personal loans	—	928	1,238
Other loans (2)	3,122	6,405	9,226
	13,056	19,350	23,451

Notes:

(1) The fair value of the transferred assets is £12,823 million (2013 - £18,949 million; 2012 - £22,273 million) where recourse is to these assets only.

(2) Comprises corporate, social housing and student loans.

Assets pledged as collateral

The Group pledges collateral with its counterparties in respect of derivative liabilities and bank and other borrowings.

	Group			Bank		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Assets pledged against liabilities						
Loans and advances to banks	11,723	9,672	11,553	10,845	9,050	11,545
Loans and advances to customers	22,166	23,328	24,814	21,766	17,883	23,040
Securities	9,493	8,034	16,371	9,351	5,229	12,365
	43,382	41,034	52,738	41,962	32,162	46,950
Liabilities secured by assets						
Deposits by banks	461	3,254	9,409	—	581	7,433
Customer accounts	130	2,766	3,000	—	—	—
Derivatives	38,876	40,744	56,738	38,463	40,195	56,089
	39,467	46,764	69,147	38,463	40,776	63,522

Notes on the accounts

30 Capital resources

The Group's regulatory capital resources in accordance with PRA definitions were as follows:

	PRA transitional basis 2014 £m	Basel 2.5 basis 2013 £m	2012 £m
Shareholders' equity (excluding non-controlling interests)			
Shareholders' equity	46,786	48,786	59,288
Preference shares - equity	(1,421)	(1,421)	(1,421)
	45,365	47,365	57,867
Non-controlling interests	—	79	137
Regulatory adjustments and deductions			
Own credit	1,300	1,519	1,563
Defined benefit pension fund adjustment	(238)	362	913
Net unrealised available-for-sale (AFS) gains	—	(359)	(1,750)
Cash flow hedging reserve	(1,026)	86	(1,815)
Deferred tax assets	(1,222)	—	—
Prudential valuation adjustments	(359)	—	—
Goodwill and other intangible assets	(7,765)	(12,352)	(12,403)
Expected losses less impairments	(1,535)	(54)	(1,954)
50% of securitisation positions	—	(722)	(1,001)
Other regulatory adjustments	(841)	50	10
	(11,686)	(11,470)	(16,437)
CET1 capital	33,679	35,974	41,567
Additional Tier 1 capital			
Preference shares - debt	—	2,745	2,759
Innovative/hybrid Tier 1 securities	—	3,502	3,551
Qualifying instruments and related share premium subject to phase out	3,503	—	—
Qualifying instruments issued by subsidiaries and held by third parties	202	—	—
	3,705	6,247	6,310
Tier 1 deductions			
50% of material holdings	—	(409)	(239)
Tax on expected losses less impairments	—	16	634
	—	(393)	395
Tier 1 capital	37,384	41,828	48,272

Notes on the accounts

	PRA transitional basis 2014 £m	Basel 2.5 basis 2013 £m	2012 £m
Qualifying Tier 2 capital			
Undated subordinated debt	—	4,716	4,814
Dated subordinated debt - net of amortisation	—	18,371	18,121
Qualifying instruments and related share premium	20,427	—	—
Qualifying instruments issued by subsidiaries and held by third parties	944	—	—
Unrealised gains on AFS equity shares	—	111	40
Collectively assessed impairment provisions	—	375	379
	21,371	23,573	23,354
Tier 2 deductions			
50% of securitisation positions	—	(722)	(1,001)
Expected losses less impairments	—	(70)	(2,588)
50% of material holdings	—	(409)	(239)
	—	(1,201)	(3,828)
Tier 2 capital	21,371	22,372	19,526
Supervisory deductions			
Unconsolidated investments	—	(36)	(37)
Other deductions	—	(217)	(193)
	—	(253)	(230)
Total regulatory capital	58,755	63,947	67,568

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 the accounts

31 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 2014. 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		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Contingent liabilities						
Guarantees and assets pledged as collateral security	11,694	16,709	15,413	8,399	12,842	11,412
Other contingent liabilities	9,221	5,584	9,760	7,755	3,731	7,959
	20,915	22,293	25,173	16,154	16,573	19,371
Commitments						
Undrawn formal standby facilities, credit lines and other commitments to lend						
- less than one year	74,558	77,212	82,753	21,632	22,920	28,488
- one year and over	137,777	135,141	129,396	105,127	107,287	107,054
Other commitments	1,617	2,442	1,589	1,434	2,320	1,382
	213,952	214,795	213,738	128,193	132,527	136,924
Total contingent liabilities and commitments	234,867	237,088	238,911	144,347	149,100	156,295

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.

Contingent liabilities

Guarantees - the Group gives guarantees on behalf of customers. A financial guarantee represents an irrevocable undertaking that the Group will meet a customer's specified obligations to a third party if the customer fails to do so. The maximum amount that the Group could be required to pay under a guarantee is its principal amount as in the table above. The Group expects most guarantees it provides to expire unused.

Other contingent liabilities - these include standby letters of credit, supporting customer debt issues and contingent liabilities relating to customer trading activities such as those arising from performance and customs bonds, warranties and indemnities.

Commitments

Commitments to lend - under a loan commitment the Group agrees to make funds available to a customer in the future. Loan commitments, which are usually for a specified term may be unconditionally cancellable or may persist, provided all conditions in the loan facility are satisfied or waived. Commitments to lend include commercial standby facilities and credit lines, liquidity facilities to commercial paper conduits and unutilised overdraft facilities.

Other commitments - these include documentary credits, which are commercial letters of credit providing for payment by the Group to a named beneficiary against presentation of specified documents, forward asset purchases, forward deposits placed and undrawn note issuance and revolving underwriting facilities, 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 the accounts

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		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Operating leases						
Minimum rentals payable under non-cancellable leases (1)						
- within 1 year	237	348	375	145	148	161
- after 1 year but within 5 years	784	1,143	1,213	504	524	547
- after 5 years	2,110	2,144	2,261	1,492	1,388	1,419
	3,131	3,635	3,849	2,141	2,060	2,127
Capital expenditure on property, plant and equipment	35	38	37	34	20	17
Contracts to purchase goods or services (2)	1,827	1,162	959	1,789	1,112	895
	4,993	4,835	4,845	3,964	3,192	3,039

Notes:

(1) Predominantly property leases.

(2) Of which due within 1 year: Group - £389 million (2013 - £373 million; 2012 - £444 million) and Bank - £364 million (2013 - £334 million; 2012 - £386 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 £373 million (2013 - £408 million; 2012 - £414 million) from these activities.

The Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS), the UK's statutory fund of last resort for customers of authorised financial services firms, pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the industry. In relation to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year (which runs from 1 April to 31 March), subject to annual maxima set by the Prudential Regulation Authority. In addition, the FSCS has the power to raise levies on a firm that has ceased to participate in the scheme and is in the process of ceasing to be authorised for the costs that it would have been liable to pay had the FSCS made a levy in the financial year it ceased to be a participant in the scheme.

The FSCS has borrowed from HM Treasury to fund compensation costs associated with the failure of Bradford & Bingley, Heritable Bank, Kaupthing Singer & Friedlander, Landsbanki 'Icesave' and London Scottish Bank plc. The interest rate on these borrowings is subject to a floor being the higher of 12 month LIBOR plus 100 basis points or the relevant gilt rate for the equivalent cost of borrowing from HMT. The FSCS and HM Treasury have agreed that the period of these loans will reflect the expected timetable for recoveries from the estates of Bradford & Bingley and the other failed banks. The FSCS will levy the deposit taking sector for its share of the balance of the principal outstanding for the non-Bradford & Bingley loan prior to the FSCS loan facility with HMT expiring in March 2016. In addition, the FSCS levied an interim payment relating to resolution costs for Dunfermline Building Society of £100 million. The capital element levied on the industry in 2014/15 scheme year was £399 million (£363 million in the 2013/14 scheme year).

The Group has accrued £110 million for its share of estimated FSCS levies.

31 Memorandum items continued

Litigation, investigations and reviews

RBS plc and other members of the RBS Group are party to legal proceedings and the subject of investigation and other regulatory and governmental action in the United Kingdom, the European Union, the United States 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 the legal proceedings, investigations and regulatory and governmental matters in which the RBS Group is involved is inherently uncertain, the directors believe that, based on the information available to them, appropriate provisions have been made in respect of legal proceedings, investigations and regulatory and governmental matters as at 31 December 2014 (see Note 23). The aggregate provisions for litigation and regulatory proceedings of £1,367 million recognised in 2014, included a provision of £720 million related to the foreign exchange related investigations, of which £320 million was taken in the last quarter of 2014. 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.

In many proceedings, it is not possible to determine whether any loss is probable or to estimate the amount of any loss. 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 be reasonably 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.

There are also situations where the RBS Group may enter into 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 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 for that matter.

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.

Litigation

Shareholder litigation (US)

RBSG and certain of its subsidiaries, together with certain current and former officers and directors were named as defendants in a purported class action filed in the United States District Court for the Southern District of New York involving holders of American Depositary Receipts (the ADR claims).

A consolidated amended complaint asserting claims under Sections 10 and 20 of the US Securities Exchange Act of 1934 and Sections 11, 12 and 15 of the Securities Act was filed in November 2011 on behalf of all persons who purchased or otherwise acquired RBSG's American Depositary Receipts (ADRs) from issuance through 20 January 2009. In September 2012, the Court dismissed the ADR claims with prejudice. In August 2013, the Court denied the plaintiffs' motions for reconsideration and for leave to re-plead their case. The plaintiffs appealed the dismissal of this case to the Second Circuit Court of Appeals and that appeal was heard on 19 June 2014. A decision in respect of the appeal has not yet been issued.

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 were made in connection with the rights issue announced by the RBS Group on 22 April 2008 in breach of the Financial Services and Markets Act 2000. 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. At a case management conference in December 2014 the judge ordered that trial commence in December 2016.

Other securitisation and securities related litigation in the United States

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 United States that relate to the securitisation and securities underwriting businesses. These cases include actions by individual purchasers of securities and purported class action suits. Together, the pending individual and class action cases involve the issuance of more than US\$46 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. RBS Group companies remain as defendants in more than 30 lawsuits brought by purchasers of MBS, including the purported class action identified below.

Notes on the accounts

Among these MBS lawsuits are two cases filed in September 2011 by the US Federal Housing Finance Agency (FHFA) as conservator for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). The primary FHFA lawsuit 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 approximately US\$9.5 billion were outstanding at 31 December 2014 with cumulative write downs to date of approximately US\$1.09 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. Discovery is ongoing and is scheduled to be substantially completed by the end of 2015.

The other remaining FHFA lawsuit that involves the RBS Group (in which the primary defendant is Nomura Holding America Inc. and subsidiaries) names RBS Securities Inc. as a defendant by virtue of the fact that it was an underwriter of some of the securities at issue. Trial in this matter is scheduled to commence in March 2015 in the United States District Court for the Southern District of New York. Three other FHFA lawsuits (against JP Morgan, Morgan Stanley and Countrywide) in which RBS Securities Inc. was an underwriter defendant were settled without any contribution from RBS Securities Inc. On 19 June 2014, another FHFA lawsuit in which RBS Securities Inc. was an underwriter defendant (against Ally Financial Group) was settled by RBS Securities Inc. by payment of US\$99.5 million.

Other MBS lawsuits against RBS Group companies include three cases filed by the National Credit Union Administration Board (on behalf of US Central Federal Credit Union, Western Corporate Federal Credit Union, Southwest Corporate Federal Credit Union, and Members United Corporate Federal Credit Union), five cases filed by the Federal Home Loan Banks of Boston, Chicago, Seattle and San Francisco, and a case filed by the Commonwealth of Virginia on behalf of the Virginia Retirement System.

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.

The status of the previously disclosed settlements in the other MBS class actions in which RBS Group companies were defendants is as follows: In *re IndyMac Mortgage-Backed Securities Litigation* (final court approval of settlement granted in February 2015), *New Jersey Carpenters Vacation Fund et al. v. The Royal Bank of Scotland plc et al.* (final court approval of the settlement granted in November 2014), and *Luther v. Countrywide Financial Corp. et al.* and related class action cases (final court approval of the settlement granted in December 2013). In the latter matter, 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. If such claims are asserted and were successful, the amounts involved may be material.

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, have been 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. In orders dated 29 March 2013 and 23 June 2014, the Court dismissed plaintiffs' antitrust claims and claims under RICO (Racketeer Influenced and Corrupt Organizations Act), but declined to dismiss (a) certain Commodities 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. Over 35 other USD LIBOR-related actions involving the RBS Group, including purported class actions on behalf of lenders and mortgage borrowers, are subject to motions to dismiss that are being litigated. Discovery has been stayed in all cases in the coordinated proceeding pending further order from the Court. On 21 January 2015, the U.S. Supreme Court held in *Gelboim v. Bank of America Corp.* that plaintiffs in the class action on behalf of corporate debt purchasers do not need to wait until there is a final judgment in the coordinated proceeding before they can appeal the dismissal of their antitrust claims 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 (the "Yen action"), (ii) Euribor, and (iii) Swiss Franc LIBOR, all three of which are pending in the United States District Court for the Southern District of New York. On 28 March 2014, the Court in the Yen action dismissed the plaintiffs' antitrust claims, but refused to dismiss their claims under the Commodity Exchange Act for price manipulation.

Details of LIBOR investigations and their outcomes affecting the RBS Group are set out under 'Investigations and reviews' on page 267.

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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) alleging manipulation of USD ISDAFIX rates, to the detriment of persons who entered into transactions that referenced those rates. The complaints were filed in the United States District Court for the Southern District of New York and contain claims for unjust enrichment and violations of the U.S. antitrust laws and the Commodities Exchange Act. This matter is subject to pre-discovery motions to dismiss some or all of the claims against the defendants.

Credit default swap antitrust litigation

Certain members of the RBS Group, as well as a number of other financial institutions, are defendants in a consolidated antitrust class action pending in the United States District Court for the Southern District of New York. The plaintiffs generally allege that defendants violated the U.S. antitrust laws by restraining competition in the market for credit default swaps through various means and thereby causing inflated bid-ask spreads for credit default swaps. On 4 September 2014, the Court largely denied the defendants' motion to dismiss this matter.

FX antitrust litigation

Certain members of the RBS Group, as well as a number of other financial institutions, are defendants in a consolidated antitrust class action on behalf of U.S.-based plaintiffs that is pending in the United States District Court for the Southern District of New York. The plaintiffs in this action allege that the defendants violated the U.S. antitrust laws by conspiring to manipulate the foreign exchange market by manipulating benchmark foreign exchange rates. On 28 January 2015, the court denied the defendants' motion to dismiss this action. On the same day, the court dismissed two similar class action complaints that had been filed on behalf of non-U.S. plaintiffs in Norway and South Korea on the principal ground that such claims are barred by the Foreign Trade Antitrust Improvements Act. On 23 February 2015, an additional class action complaint was filed in the United States District Court for the Southern District of New York on behalf of investors that transacted in exchange-traded foreign exchange futures contracts and/or options on foreign exchange futures contracts. The complaint contains allegations that are substantially similar to those contained in the consolidated antitrust class action, and it asserts both antitrust claims and claims under the Commodities Exchange Act.

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 U.S. 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 has commenced.

Interest rate hedging products

The RBS Group is dealing with a large number of active litigation claims in the UK in relation to the sale of interest rate hedging products. In general claimants allege that the relevant interest rate hedge 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 are being considered under the UK Financial Conduct Authority (FCA) redress programme, as well as customers who are outside of the scope of that programme. The RBS Group is encouraging those customers that are 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.

Weiss v. National Westminster Bank PLC

NatWest is defending a lawsuit filed by a number of United States 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 U.S. Antiterrorism 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 fiscal or other policies and actions of various governmental and regulatory authorities in the United Kingdom, the European Union (EU), the United States and elsewhere. Members of the RBS Group have engaged, and will continue to engage, in discussions with relevant governmental and regulatory authorities, including in the United Kingdom, the EU, the United States and elsewhere, on an ongoing and regular basis regarding operational, systems and control evaluations and issues including those related to compliance with applicable laws and regulations, including consumer protection, competition, anti-bribery, anti-money laundering and sanctions regimes. It is possible that any matters discussed or identified may result in investigatory or 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 or fines. Any of the events or circumstances mentioned 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.

Notes on the accounts

The RBS Group is co-operating fully with the investigations and reviews described below.

LIBOR and other trading rates

In February 2013, the RBS Group announced settlements with the Financial Services Authority (FSA) in the United Kingdom, the United States Commodity Futures Trading Commission 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. As part of the agreement with the DOJ, RBS plc entered into a Deferred Prosecution Agreement in relation to one count of wire fraud relating to Swiss Franc LIBOR and one count for an antitrust violation relating to Yen LIBOR. In addition, on 12 April 2013, RBS Securities Japan Limited entered a plea of guilty to one count of wire fraud relating to Yen LIBOR and on 6 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 EUR 260 million and EUR 131 million to resolve investigations by the European Commission (EC) into Yen LIBOR competition infringements and EURIBOR competition infringements respectively.

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. undertake in the Enforceable Undertaking to (a) comply with existing undertakings arising out of the February 2013 settlement with the United States Commodity Futures Trading Commission as they relate to Australian Benchmark Interest Rates, (b) implement remedial measures with respect to its trading in Australian reference bank bills and (c) appoint an independent compliance expert to review and report on RBS plc's and RBS N.V.'s implementation of such remedial measures. The remediation measures include ensuring appropriate records retention, training, communications surveillance and trading reviews are in place. As part of the Enforceable Undertaking, RBS plc and RBS N.V. also agreed to make a voluntary contribution of A\$1.6 million to fund independent financial literacy projects in Australia.

On 21 October 2014, the EC announced its findings that 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. The RBS Group agreed to settle the case with the EC and received full immunity from fines for revealing the existence of the cartel to the EC and co-operating closely with the EC's ongoing investigation. Also on 21 October 2014, the EC announced its findings that 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). Again, the RBS Group received full immunity from fines for revealing the existence of the cartel to the EC and co-operating closely with the EC's ongoing investigation.

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 and the DOJ as part of an investigation into the setting of USD, EUR and GBP ISDAFIX and related trading activities. 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, the RBS Group cannot estimate reliably what effect, if any, the outcome of these investigations may have on the RBS Group.

Foreign exchange related investigations

In November 2014, RBS plc reached a settlement with the FCA in the United Kingdom and the United States Commodity Futures Trading Commission (CFTC) in relation to investigations into failings in the bank's Foreign Exchange businesses within its Corporate & Institutional Banking (CIB) segment. RBS plc agreed to pay penalties of £217 million to the FCA and \$290 million to the CFTC to resolve the investigations. Payment of the fines was made on 19 November 2014.

As previously disclosed, the RBS Group remains in discussions with other governmental and regulatory authorities on similar issues relating to failings in the Bank's Foreign Exchange business within its CIB segment, including settlement discussions regarding the criminal investigation being conducted by the DOJ and certain other financial regulatory authorities. The timing and amounts of any further settlements and related litigation risks and consequences remain uncertain and could be material.

On 21 July 2014, the Serious Fraud Office announced that it was launching a criminal investigation into allegations of fraudulent conduct in the foreign exchange market, apparently involving multiple financial institutions.

Technology incident in June 2012

In June 2012, the RBS Group was affected by a technology incident, as a result of which the processing of certain customer accounts and payments were subject to considerable delay. The RBS Group agreed to reimburse customers for any loss suffered as a result of the incident and the RBS Group made a provision of £175 million in 2012.

In April 2013, the FCA announced that it had commenced an enforcement investigation into the incident. This was a joint investigation conducted by the FCA together with the UK Prudential Regulation Authority (PRA). Enforcement proceedings were then commenced. On 20 November 2014, the RBS Group announced that it had reached agreement with the FCA and the PRA over failings in relation to the incident. The RBS Group agreed a penalty of £42 million with the FCA and £14 million with the PRA. Separately the Central Bank of Ireland initiated an investigation and issued enforcement proceedings against Ulster Bank Ireland Limited (UBIL), an RBS Group company. On 12 November 2014, the Central Bank of Ireland announced that it had fined UBIL EUR3.5 million in relation to its investigation.

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Interest rate hedging products

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 who were 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, who is reviewing and approving all redress outcomes, and the FCA is overseeing this.

The RBS Group has reached agreement with the independent reviewer in relation to redress outcomes for in scope customers. The RBS Group and the independent reviewer are now focussing on customer responses to review outcomes, securing acceptance of offers and assessing ancillary issues such as consequential loss claims. The FCA has announced that the review and redress exercise will be closed to new entrants on 31 March 2015.

The Central Bank of Ireland also requested UBIL, along with a number of Irish banks, to undertake a similar exercise and past business review in relation to the sale of interest rate hedging products 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 review of the sale of interest rate hedging products to eligible RBS International customers is complete, and the review of the sale of interest rate hedging products to eligible Republic of Ireland customers is expected to be completed during Q1 2015.

The RBS Group has made provisions in relation to the above redress exercises totalling £1.4 billion to date for these matters, including £0.2 billion in 2014, of which £1 billion had been utilised at 31 December 2014.

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 is being conducted under section 166 of the Financial Services and Markets Act, under which a skilled person has been appointed to carry out the exercise. Redress is currently being offered to certain customers in this sample group. In addition, the RBS Group has agreed with the FCA that it will 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. A pilot customer communications exercise to certain cohorts of customers was undertaken between November 2014 and January 2015 with a further communication exercise to the remaining cohorts due to be completed by mid 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 and only exceptional cases will be dealt with prior to a final closure date for the scheme of 28 February 2015. The RBS Group has made appropriate provision based on its estimate of ultimate exposure.

Packaged accounts

As a result of an uplift in packaged account complaints, the RBS Group has proactively put in place dedicated resource to investigate and resolve complaints on an individual basis.

FCA review of GRG 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 Global Restructuring 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, Promontory Financial Group and Mazars were appointed as the skilled person. The RBS Group is fully cooperating with the FCA in its investigation.

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's Global Restructuring 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 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.

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, the EC has proposed a draft regulation on interchange fees for card payments. The draft regulation is subject to a consultation process, prior to being finalised and enacted. It is currently expected that the regulation will be enacted during the first half of 2015. The current draft regulation proposes the capping of both cross-border and domestic MIF rates for debit and credit consumer cards. The draft regulation also sets out other proposals for reform including to the Honour All Cards Rule so merchants will be required 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 4 November 2014, the successor body to the OFT, the Competition & Markets Authority (CMA), announced that it would not proceed with its investigations. The CMA took this decision primarily based on the expected implementation of the draft EC regulation on interchange fees for card payments, coupled with some commitments made by Visa and MasterCard around its implementation in the UK. Whilst not currently proceeding, the CMA's investigations do formally remain open and CMA has noted that, if the EC regulation on interchange fees did not address its concerns, it would then look again at continuing with its investigations.

The outcomes of these ongoing investigations, proceedings and proposed regulation are not yet known, 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

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 Payment Protection Insurance (PPI). The RBS Group has made provisions totalling £3.7 billion to date for this matter, including £0.7 billion in 2014, of which £2.9 billion has been utilised at 31 December 2014.

Retail banking - EC

Since initiating an inquiry into retail banking in the EU in 2005, the EC continues to keep retail banking under review. In late 2010 the EC launched an initiative pressing for greater transparency of bank fees and is currently proposing to legislate for increased harmonisation of terminology across Member States. The RBS Group cannot predict the outcome of these actions at this stage.

UK personal current accounts/retail banking

Following the OFT's publication of a market study report into the Personal Current Account (PCA) market in July 2008, the OFT launched a follow up review of the PCA market in July 2012. This review was intended to consider whether certain initiatives agreed by the OFT with banks in light of the July 2008 report, primarily around transparency, unarranged overdrafts and customers in financial difficulty, had been successful and whether the market should be referred to the Competition Commission (CC) for a fuller market investigation.

The OFT's PCA report following this July 2012 launch was published in January 2013. The OFT acknowledged some specific improvements in the market since its last review but concluded that further changes were required to tackle ongoing concerns, including a lack of switching, the ability of consumers to compare products and the complexity of overdraft charges. The OFT decided not to refer the market to the CC but said that it expected to return to the question of a referral to the CC in 2015, or earlier. The OFT also announced that it would be carrying out behavioural economic research on the way consumers make decisions and engage with retail banking service, and would study the operation of payment systems as well as the SME banking market.

On 11 March 2014, the successor body to the OFT and CC, the CMA, announced that in addition to its pending SME review (see below), it would be undertaking an update of the OFT's 2013 PCA review. On 18 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) for both the PCA and SME market studies. The provisional decision on both PCAs and SMEs was then subject to a consultation period until 17 September 2014. Following this period of consultation, on 6 November 2014, the CMA made its final decision to proceed with a MIR. The MIR will be a wide-ranging 18-24 month Phase 2 inquiry but at this stage it is not possible to estimate potential impacts on the RBS Group.

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SME banking market study

The OFT announced its market study on competition in banking for SMEs in England and Wales, Scotland and Northern Ireland on 19 June 2013. Following a consultation on the scope of the market study, the OFT published an update paper on 27 September 2013 setting out its proposed scope. On 11 March 2014, the OFT set out some competition concerns on SME banking and also announced that its successor body, the CMA, would continue the review. As discussed above, the CMA has decided to make a MIR for the SME market study in addition to the PCA study. As regards SMEs, the CMA concluded that it would be more appropriate to make a MIR than accept a set of undertakings in lieu put forward by the RBS Group, Barclays, HSBC and Lloyds. Alongside the MIR, the CMA will also be reviewing the previous undertakings given following the CC's investigation into SME banking in 2002 and whether these undertakings need to be varied. At this stage it is not possible to estimate potential impacts on the RBS Group.

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 focussed 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. The FCA now intends to undertake a market study into investment and corporate banking (to launch in Spring 2015) and potentially into asset management (to launch late 2015 if undertaken).

Credit default swaps (CDS) investigation

The RBS Group is a party to the EC's antitrust investigation into the CDS information market. The RBS Group has received and responded to a Statement of Objections from the EC and continues to co-operate fully with the EC's ongoing investigation. In general terms, the EC has raised concerns that a number of banks, Markit and ISDA may have jointly prevented exchanges from entering the CDS market. At this stage, the RBS Group cannot estimate reliably what effect the outcome of the investigation may have on the RBS Group, which may be material. Discovery is underway.

Securitisation and collateralised debt obligation business

In the United States, 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 relating to, among other things, issuance, underwriting and trading in mortgage-backed securities, collateralised debt obligations (CDOs), 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.

In November 2013, the RBS Group announced that it had settled with the US Securities and Exchange Commission (SEC) over its investigation of RBS Securities Inc. relating to due diligence conducted in connection with a 2007 offering of residential mortgage-backed securities and corresponding disclosures. Pursuant to the settlement, RBS Securities Inc., without admitting or denying the SEC's allegations, consented to the entry of a final judgment ordering certain relief, including an injunction and the payment of approximately US\$153 million in disgorgement, penalties, and interest. The settlement was subsequently approved by the United States District Court for the District of Connecticut. The RBS Group co-operated fully with the SEC throughout the investigation.

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.

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 (RMBS). 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 RMBS, 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 2014, CIB received approximately US\$741 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.

Citizens Financial Group, Inc (Citizens) has not been an issuer or underwriter of non-agency RMBS. However, Citizens is an originator and servicer of residential mortgages, and it routinely sells such mortgage loans in the secondary market and to GSEs. In the context of such sales, Citizens makes certain representations and warranties regarding the characteristics of the underlying loans and, as a result, may be contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of the representations and warranties concerning the underlying loans. Between the start of 2009 and 31 December 2014, Citizens received US\$257 million in repurchase demands and indemnification payment requests in respect of loans originated primarily since 2003. However, repurchase demands presented to Citizens are subject to challenge and rebuttal by Citizens.

Although there has in recent times been disruption in the ability of certain financial institutions operating in the United States to complete foreclosure proceedings in respect of US mortgage loans in a timely manner or at all (including as a result of interventions by certain states and local governments), to date, Citizens has not been materially impacted by such disruptions and the RBS Group has not ceased making foreclosures.

The RBS Group cannot currently estimate what the ultimate exposure may be with respect to repurchase demands. Furthermore, the RBS Group is unable to estimate the extent to which the matters described above will impact it, and future developments may have an adverse impact on the Group's net assets, operating results or cash flows in any particular period.

Citizens consent orders

The activities of Citizens' two US bank subsidiaries - Citizens Bank, N.A. and Citizens Bank of Pennsylvania - are subject to extensive US laws and regulations concerning unfair or deceptive acts or practices in connection with customer products. Certain of the bank subsidiaries' practices with respect to overdraft protection and other consumer products have not met applicable standards. The bank subsidiaries have implemented and are continuing to implement changes to improve and bring their practices into compliance with regulatory guidance. In April 2013, the bank subsidiaries consented to the issuance of orders by their respective primary federal banking regulators, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) (Consent Orders). In the Consent Orders (which are publicly available and will remain in effect until terminated by the regulators), the bank subsidiaries neither admitted nor denied the regulators' findings that they had engaged in deceptive marketing and implementation of the bank's overdraft protection programme, checking rewards programmes, and stop-payment process for pre-authorised recurring electronic fund transfers.

In connection with the Consent Orders, the bank subsidiaries paid a total of US\$10 million in civil monetary penalties. The Consent Orders also require the bank subsidiaries to develop plans to provide restitution to affected customers (the amount of which is anticipated to be approximately US\$8 million), to cease and desist any operations in violation of Section 5 of the Federal Trade Commission Act, and to submit to the regulators periodic written progress reports regarding compliance with the Consent Orders.

In addition, Citizens Bank, N.A. agreed to take certain remedial actions to improve its compliance risk management systems and to create a comprehensive action plan designed to achieve compliance with the relevant Consent Order. Restitution plans have been prepared and submitted for approval, and Citizens Bank, N.A. has submitted for approval and is in the process of implementing its action plan for compliance with the Consent Order, as well as updated policies, procedures and programmes related to its compliance risk management systems. In addition to the above, the bank subsidiaries could face further formal administrative enforcement actions from their federal supervisory agencies, including the assessment of civil monetary penalties and restitution, relating to issues identified by Citizens arising from other consumer products and related practices and policies, and they could face potential civil litigation.

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) to address deficiencies related to governance, risk management and compliance systems and controls in RBS plc and RBS N.V. 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 U.S. operations on an enterprise-wide and business line basis,
- an enterprise-wide risk management programme for the RBS Group's U.S. operations,
- a plan to oversee compliance by the RBS Group's U.S. operations with all applicable U.S. laws, rules, regulations, and supervisory guidance,
- a Bank Secrecy Act/anti-money laundering compliance programme for the RBS plc and RBS N.V. branches in the U.S. (the U.S. Branches) on a consolidated basis,
- a plan to improve the U.S. 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 reasonably ensure the identification and timely, accurate, and complete reporting by the U.S. 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 U.S. Branches' compliance with OFAC requirements.

31 Memorandum items continued

The Governance Order (which is publicly available) 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 fully comply 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 U.S. operations. The RBS Group continues to test the effectiveness of the remediation efforts undertaken by the RBS Group 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 United States 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 Board of Governors of the Federal Reserve System (Fed), 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 Fed (US Dollar Processing Order), which remains in effect until terminated by the Fed. 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 United States 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 of the United States, 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. The RBS Group also agreed in the US Dollar Processing Order (as part of the OFAC compliance programme) to hire an independent consultant to conduct an annual OFAC compliance review of compliance policies and their implementation and an appropriate risk-focused sampling of U.S. dollar payments.

US/Swiss tax programme

In August 2013, the DOJ announced a programme for Swiss banks (the Programme), to settle the long-running dispute between the US tax authorities and Switzerland regarding the role of Swiss banks in concealing the assets of US tax payers in offshore accounts. The Programme provides Swiss banks with an opportunity to obtain resolution, through non-prosecution agreements or non-target letters, concerning their status in connection with the DOJ's investigations.

Coutts & Co Ltd, a member of the RBS Group incorporated in Switzerland, notified the DOJ that it intended to participate in the Programme based on the possibility that some of its clients may not have declared their assets in compliance with US tax laws. The Programme required a detailed review of all US related accounts. The results of Coutts & Co Ltd's review were presented to the DOJ in June 2014. Coutts & Co Ltd has now completed the collection of evidence of the tax status of all US related account holders, including those US account holders participating in an offshore voluntary disclosure programme. The results of the review were presented by Coutts to the DOJ on 5 November 2014. Coutts continues to cooperate with the DOJ pursuant to the terms of the Programme. Coutts expects to reach resolution with the DOJ in 2015, under the terms of the Programme. Provision has been made for the estimated liability arising from this programme/review.

German prosecutor investigation into Coutts & Co Ltd

A prosecuting authority in Germany is undertaking 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 is cooperating with the authority.

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, a member of the RBS Group incorporated in England and Wales, decided to undertake a past business review into the suitability of investment advice provided to its clients. This review is ongoing. Coutts & Co is in the process of contacting clients and redress is being offered in appropriate cases. Provision has been made for the estimated liability arising from this programme/review.

Enterprise Finance Guarantee Scheme

The Enterprise Finance Guarantee (EFG) is a government lending initiative for small businesses with viable business proposals that lack security for conventional lending. 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 and will now undertake a review of affected and potentially affected customers to determine whether affected customers should be offered redress. From 2009 to the end of 2014, the RBS Group provided over £940 million of lending under the EFG scheme.

Notes on the accounts

32 Net cash flow from operating activities

	Group			Bank		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Operating profit/(loss) before tax - continuing operations	2,403	(7,367)	(4,299)	(959)	8	(818)
(Loss)/profit before tax - discontinued operations	(3,258)	606	775	—	—	—
Decrease/(increase) in prepayments and accrued income	4	267	296	(110)	1,755	585
Interest on subordinated liabilities	1,302	1,314	1,207	1,234	1,241	1,134
Decrease in accruals and deferred income	(222)	(634)	(1,123)	(157)	(394)	(658)
(Releases)/impairment losses	(1,140)	8,449	5,214	(46)	2,536	1,548
Loans and advances written-off net of recoveries	(5,052)	(3,975)	(3,555)	(2,567)	(1,892)	(1,823)
Unwind of discount on impairment losses	(247)	(389)	(476)	(87)	(112)	(128)
(Profit)/loss on sale of property, plant and equipment	(138)	(45)	(21)	1	—	—
Loss/(profit) on sale of subsidiaries and associates	30	(179)	(150)	213	(64)	174
Profit on sale of securities	(387)	(1,035)	(1,803)	(317)	(905)	(1,671)
Charge/(credit) for defined benefit pension schemes	463	513	512	13	11	(3)
Pension scheme curtailment and settlement gains	—	(3)	(38)	—	(3)	—
Cash contribution to defined benefit pension schemes	(1,063)	(817)	(888)	(28)	(41)	(26)
Other provisions charged net of releases	2,478	4,407	2,853	1,453	913	1,590
Other provisions utilised	(3,254)	(2,046)	(1,496)	(1,606)	(1,103)	(665)
Depreciation and amortisation	1,105	1,272	1,614	511	634	763
Gain on redemption of own debt	(6)	(162)	(454)	—	(77)	(454)
Loss on reclassification to disposal groups	3,994	—	—	—	—	—
Write down of goodwill and other intangible assets	533	423	51	393	227	21
Write down/(write back) of investment in subsidiaries	—	—	—	4,353	86	(120)
Elimination of foreign exchange differences	(881)	807	6,111	123	182	4,933
Other non-cash items	823	(3,193)	1,499	73	(2,763)	2,236
Net cash (outflow)/inflow from trading activities	(2,513)	(1,787)	5,829	2,490	239	6,618
Decrease in loans and advances to banks and customers	13,385	56,381	15,155	14,376	69,601	87,416
Decrease/(increase) in securities	8,199	27,877	12,765	(3,244)	15,425	7,341
Decrease/(increase) in other assets	385	(800)	24,859	1,160	(976)	20,570
(Increase)/decrease in derivative assets	(65,586)	155,771	89,336	(66,945)	157,032	89,089
Changes in operating assets	(43,617)	239,229	142,115	(54,653)	241,082	204,416
(Decrease)/increase in deposits by banks and customers	(7,609)	(88,295)	19,116	(25,750)	(95,704)	(84,117)
Decrease in debt securities in issue	(16,119)	(23,370)	(64,224)	(14,795)	(19,879)	(49,695)
(Decrease)/increase in other liabilities	(4,256)	3,660	(27,075)	(946)	416	(23,351)
Increase/(decrease) in derivative liabilities	64,795	(150,145)	(93,033)	66,241	(150,838)	(92,985)
(Decrease)/increase in settlement balances and short positions	(4,799)	(62)	(13,072)	(373)	2,772	(10,835)
Changes in operating liabilities	32,012	(258,212)	(178,288)	24,377	(263,233)	(260,983)
Income taxes (paid)/received	(302)	(195)	(92)	135	322	(84)
Net cash outflow from operating activities	(14,420)	(20,965)	(30,436)	(27,651)	(21,590)	(50,033)

Notes on the accounts

33 Analysis of the net investment in business interests and intangible assets

Acquisitions and disposals

	Group			Bank		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Fair value given for businesses acquired	(54)	—	(60)	—	—	(11)
Value recognised for business transferred from fellow subsidiary	—	3,911	8,227	—	4,096	8,051
Non-cash consideration	—	128	706	—	128	706
Additional and new investments in Group undertakings	—	—	—	(1,637)	(2,300)	(8,287)
Net (outflow)/inflow of cash in respect of purchases	(54)	4,039	8,873	(1,637)	1,924	459
Other assets sold	(2,250)	785	12	(46)	260	10
Repayment of investments	—	—	—	—	—	206
Non-cash consideration	—	3	—	—	3	—
(Loss)/profit on disposal	(30)	179	150	(213)	64	(174)
Net cash and cash equivalents disposed	8	—	—	—	—	—
Net (outflow)/inflow of cash in respect of disposals	(2,272)	967	162	(259)	327	42
Dividends received from associates	10	77	18	—	59	2
Cash expenditure on intangible assets	(631)	(846)	(808)	(462)	(664)	(632)
Net (outflow)/inflow	(2,947)	4,237	8,245	(2,358)	1,646	(129)

34 Interest received and paid

	Group			Bank		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
Interest received	13,039	17,479	17,740	6,997	11,379	16,242
Interest paid	(4,332)	(6,387)	(6,756)	(4,140)	(7,752)	(10,405)
	8,707	11,092	10,984	2,857	3,627	5,837

35 Analysis of changes in financing during the year

	Group					
	Share capital, share premium and merger reserve			Subordinated liabilities		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
At 1 January	43,699	43,571	42,865	33,134	33,851	32,324
Issue of subordinated liabilities	—	—	—	1,438	2,285	2,968
Repayment of subordinated liabilities	—	—	—	(4,181)	(1,868)	(264)
Net cash (outflow)/inflow from financing	—	—	—	(2,743)	417	2,704
Cross border merger	—	128	706	—	—	—
Redemption of preference shares	517	—	—	—	—	—
Currency translation and other adjustments	34	—	—	78	(1,134)	(1,177)
At 31 December	44,250	43,699	43,571	30,469	33,134	33,851

	Bank					
	Share capital, share premium and merger reserve			Subordinated liabilities		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
At 1 January	32,818	32,690	31,984	30,566	31,635	30,014
Issue of subordinated liabilities	—	—	—	833	1,864	2,754
Repayment of subordinated liabilities	—	—	—	(4,121)	(1,868)	—
Net cash (outflow)/inflow from financing	—	—	—	(3,288)	(4)	2,754
Cross border merger	—	128	706	—	—	—
Redemption of preference shares	517	—	—	—	—	—
Currency translation and other adjustments	34	—	—	202	(1,065)	(1,133)
At 31 December	33,369	32,818	32,690	27,480	30,566	31,635

Notes on the accounts

36 Analysis of cash and cash equivalents

	Group (1)			Bank (2)		
	2014 £m	2013 £m	2012 £m	2014 £m	2013 £m	2012 £m
At 1 January						
- cash	97,340	86,561	97,446	96,056	83,644	86,642
- cash equivalents	30,616	46,540	38,390	28,572	42,599	38,690
	127,956	133,101	135,836	124,628	126,243	125,332
Net cash (outflow)/inflow	(20,648)	(5,145)	(2,735)	(23,258)	(1,615)	911
At 31 December	107,308	127,956	133,101	101,370	124,628	126,243
Comprising:						
Cash and balances at central banks	73,983	79,993	74,524	70,952	75,792	70,374
Treasury bills and debt securities	1,821	696	756	739	429	480
Loans and advances to banks	31,504	47,267	57,821	29,679	48,407	55,389
Cash and cash equivalents	107,308	127,956	133,101	101,370	124,628	126,243

Notes:

(1) Includes cash collateral posted with bank counterparties in respect of derivative liabilities of £11,258 million (2013 - £9,672 million; 2012 - £11,553 million).

(2) Includes cash collateral posted with bank counterparties in respect of derivative liabilities of £10,845 million (2013 - £9,050 million; 2012 - £11,545 million).

Certain members of the Group are required by law or regulation to maintain balances with the central banks in the jurisdictions in which they operate. These balances are set out below.

	2014	2013	2012
Bank of England	£0.6bn	£0.6bn	£0.4bn
US Federal Reserve	\$1.3bn	\$1.2bn	\$1.2bn
De Nederlandsche Bank	€0.1bn	€0.1bn	€0.2bn

37 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, having regard to commercial demands. The segment performance measure is operating profit/(loss).

Organisational structure

On 27 February 2014, RBS Group announced a revised organisational structure comprising the following reportable segments.

UK Personal & Business Banking offers a comprehensive range of banking products and related financial services to the UK personal and small business markets. It serves customers through a number of channels including: the RBS and NatWest network of branches and ATMs in the UK, telephony, online and mobile. Small businesses include accounts having less than £2 million annual turnover and no currency transactions.

Ulster Bank is a retail and commercial bank in Northern Ireland and the Republic of Ireland. It provides a comprehensive range of financial services through both its Retail Banking division, which provides loan and deposit products through a network of branches and direct channels, and its Corporate Banking division, which provides services to businesses and corporate customers.

Commercial Banking provides banking, finance and risk management services to the commercial, mid-corporate and corporate sector in the UK. It offers a full range of banking products and related financial services through a nationwide network of relationship managers, telephone and internet channels. The product range includes invoice finance through the RBSIF brand and asset finance through the Lombard brand.

Private Banking provides banking and wealth management services in the UK through Coutts & Co and Adam & Company, offshore through RBS International and Isle of Man Bank and internationally through Coutts & Co Ltd.

Corporate & Institutional Banking serves our corporate and institutional clients primarily in the UK and Western Europe, as well as those US and Asian multinationals with substantial trade and investment links in the region. Products include debt financing, risk management and trade services, focusing on core product capabilities that are of most relevance to clients.

Central Functions comprises Group and corporate functions, such as treasury, finance, risk management, compliance, legal, communications and human resources. The Centre manages the Group's capital resources and Group-wide regulatory projects and provides services to the operating segments.

Citizens Financial Group (CFG) provides financial services primarily through the Citizens and Charter One brands. CFG is engaged in retail and corporate banking activities through its branch network in 11 states in the United States and through non-branch offices in other states.

Although CFG has been reclassified as a discontinued operation, it continues to be presented as a reportable segment.

RBS Capital Resolution (RCR) became fully operational on 1 January 2014 with a pool of c.£29 billion of assets with particularly high long-term capital intensity, credit risk and/or potentially volatile outcomes in stressed environments. RCR brings assets under common management and increases focus on managing these assets so as to release capital. No business lines were moved to RCR so comparative data has not been restated.

Non-Core Division was dissolved on 31 December 2013. It managed separately assets that RBS Group intended to run off or dispose of. The division contained a range of businesses and asset portfolios primarily from the legacy GBM businesses, higher risk profile asset portfolios including excess risk concentrations, and other illiquid portfolios. It also included a number of other portfolios and businesses including those in regional markets that were no longer strategic to RBS Group.

Reporting changes

A number of previously reported reconciling items (Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs, regulatory and legal actions, restructuring costs, amortisation of purchased intangible assets, write down of other intangible assets and bank levy) have now been allocated to the reportable segments. Consistent with the manner in which RBS Group is managed, operating profit on a non-statutory basis excludes:

- Own credit adjustments;
- Gain on redemption of own debt;
- Write down of goodwill;
- Asset Protection Scheme; and
- Strategic disposals.

and includes the results of Citizens that are included in discontinued operations in the statutory results.

In addition, during 2014 RBS Group also made changes to the method of allocating costs relating to Services and Functions.

Comparatives have been restated accordingly for the changes outlined above.

Notes on the accounts

2014	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses £m	Depreciation and amortisation £m	Impairment (losses)/ recoveries £m	Operating profit/(loss) £m
UK Personal & Business Banking	4,773	1,303	6,076	(3,763)	—	(268)	2,045
Ulster Bank	636	194	830	(517)	(1)	365	677
Personal & Business Banking	5,409	1,497	6,906	(4,280)	(1)	97	2,722
Commercial Banking	2,212	1,168	3,380	(1,381)	(141)	(76)	1,782
Private Banking	703	390	1,093	(776)	(1)	4	320
Commercial & Private Banking	2,915	1,558	4,473	(2,157)	(142)	(72)	2,102
Corporate & Institutional Banking	905	3,008	3,913	(3,777)	(21)	2	117
Central items	(550)	(415)	(965)	(2,015)	(751)	12	(3,719)
Citizens Financial Group	2,013	1,068	3,081	(1,942)	(181)	(197)	761
RCR	187	235	422	(268)	(10)	1,298	1,442
Non-statutory basis	10,879	6,951	17,830	(14,439)	(1,106)	1,140	3,425

Reconciling items

Own credit adjustments	—	(128)	(128)	—	—	—	(128)
Gain on redemption of own debt	—	6	6	—	—	—	6
Write down of goodwill	—	—	—	(130)	—	—	(130)
Strategic disposals	—	1	1	—	—	—	1
Citizens discontinued operations	(2,013)	(1,078)	(3,091)	1,943	180	197	(771)
Statutory basis	8,866	5,752	14,618	(12,626)	(926)	1,337	2,403

2013*

UK Personal & Business Banking	4,612	1,262	5,874	(4,021)	—	(501)	1,352
Ulster Bank	619	240	859	(637)	—	(1,774)	(1,552)
Personal & Business Banking	5,231	1,502	6,733	(4,658)	—	(2,275)	(200)
Commercial Banking	2,083	1,197	3,280	(1,551)	(135)	(652)	942
Private Banking	683	418	1,101	(971)	—	(29)	101
Commercial & Private Banking	2,766	1,615	4,381	(2,522)	(135)	(681)	1,043
Corporate & Institutional Banking	824	4,150	4,974	(6,188)	(18)	(619)	(1,851)
Central items	(620)	335	(285)	(873)	(880)	(64)	(2,102)
Citizens Financial Group	1,892	1,073	2,965	(1,987)	(163)	(156)	659
Non-Core	501	208	709	(379)	(76)	(4,654)	(4,400)
Non-statutory basis	10,594	8,883	19,477	(16,607)	(1,272)	(8,449)	(6,851)

Reconciling items

Own credit adjustments	—	(25)	(25)	—	—	—	(25)
Gain on redemption of own debt	—	162	162	—	—	—	162
Write down of goodwill	—	—	—	(208)	—	—	(208)
Strategic disposals	—	161	161	—	—	—	161
Citizens discontinued operations	(1,964)	(1,056)	(3,020)	1,939	163	312	(606)
Statutory basis	8,630	8,125	16,755	(14,876)	(1,109)	(8,137)	(7,367)

*Restated

Notes on the accounts

37 Segmental analysis continued

2012*	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses £m	Depreciation and amortisation £m	Impairment (losses)/ recoveries £m	Operating profit/(loss) £m
UK Personal & Business Banking	4,739	1,277	6,016	(3,997)	—	(741)	1,278
Ulster Bank	635	196	831	(539)	—	(1,364)	(1,072)
Personal & Business Banking	5,374	1,473	6,847	(4,536)	—	(2,105)	206
Commercial Banking	2,106	1,351	3,457	(1,606)	(168)	(545)	1,138
Private Banking	740	448	1,188	(784)	6	(46)	364
Commercial & Private Banking	2,846	1,799	4,645	(2,390)	(162)	(591)	1,502
Corporate & Institutional Banking	655	5,113	5,768	(4,574)	(16)	(209)	969
Central items	(1,046)	751	(295)	(1,199)	(989)	(9)	(2,492)
Citizens Financial Group	1,938	1,159	3,097	(1,984)	(199)	(91)	823
Non-Core	865	870	1,735	(465)	(248)	(2,209)	(1,187)
Non-statutory basis	10,632	11,165	21,797	(15,148)	(1,614)	(5,214)	(179)
Reconciling items							
Own credit adjustments	—	(3,904)	(3,904)	—	—	—	(3,904)
Gain on redemption of own debt	—	454	454	—	—	—	454
Asset Protection Scheme	—	(44)	(44)	—	—	—	(44)
Write down of goodwill	—	—	—	(36)	—	—	(36)
Strategic disposals	—	185	185	—	—	—	185
Citizens discontinued operations	(2,046)	(1,180)	(3,226)	1,983	199	269	(775)
Statutory basis	8,586	6,676	15,262	(13,201)	(1,415)	(4,945)	(4,299)

*Restated

	2014			2013*			2012*		
	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	7,155	14	7,169	7,246	16	7,262	7,466	819	8,285
Ulster Bank	821	76	897	1,021	67	1,088	1,078	99	1,177
Personal & Business Banking	7,976	90	8,066	8,267	83	8,350	8,544	918	9,462
Commercial Banking	3,500	26	3,526	3,547	30	3,577	3,779	46	3,825
Private Banking	931	513	1,444	986	629	1,615	1,059	821	1,880
Commercial & Private Banking	4,431	539	4,970	4,533	659	5,192	4,838	867	5,705
Corporate & Institutional Banking	4,684	3,734	8,418	6,121	4,487	10,608	7,132	5,007	12,139
Central items	1,701	3,103	4,804	2,852	7,865	10,717	3,096	12,828	15,924
Citizens Financial Group	3,328	(31)	3,297	3,217	85	3,302	3,427	118	3,545
RCR	707	113	820	n/a	n/a	n/a	n/a	n/a	n/a
Non-Core	n/a	n/a	n/a	1,207	275	1,482	2,647	611	3,258
	22,827	7,548	30,375	26,197	13,454	39,651	29,684	20,349	50,033
Eliminations	—	(7,548)	(7,548)	—	(13,454)	(13,454)	—	(20,349)	(20,349)
Non-statutory basis	22,827	—	22,827	26,197	—	26,197	29,684	—	29,684
Reconciling items									
Own credit adjustments	(128)	—	(128)	(25)	—	(25)	(3,904)	—	(3,904)
Gain on redemption of own debt	6	—	6	162	—	162	454	—	454
Asset Protection Scheme	—	—	—	—	—	—	(44)	—	(44)
Strategic disposals	1	—	1	161	—	161	185	—	185
Citizens discontinued operations	(3,307)	—	(3,307)	(3,327)	—	(3,327)	(3,643)	—	(3,643)
Statutory basis	19,399	—	19,399	23,168	—	23,168	22,732	—	22,732

*Restated

Notes on the accounts

	2014			2013*			2012*		
	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	6,091	(15)	6,076	5,881	(7)	5,874	6,185	(169)	6,016
Ulster Bank	695	135	830	757	102	859	775	56	831
Personal & Business Banking	6,786	120	6,906	6,638	95	6,733	6,960	(113)	6,847
Commercial Banking	3,695	(315)	3,380	3,595	(315)	3,280	3,881	(424)	3,457
Private Banking	716	377	1,093	617	484	1,101	537	651	1,188
Commercial & Private Banking	4,411	62	4,473	4,212	169	4,381	4,418	227	4,645
Corporate & Institutional Banking	3,877	36	3,913	4,777	197	4,974	5,476	292	5,768
Central items	(1,005)	40	(965)	(100)	(185)	(285)	(435)	140	(295)
Citizens Financial Group	3,112	(31)	3,081	2,889	76	2,965	2,988	109	3,097
RCR	639	(217)	422	n/a	n/a	n/a	n/a	n/a	n/a
Non-Core	n/a	n/a	n/a	1,061	(352)	709	2,390	(655)	1,735
Non-statutory basis	17,820	10	17,830	19,477	—	19,477	21,797	—	21,797
Reconciling items									
Own credit adjustments	(128)	—	(128)	(25)	—	(25)	(3,904)	—	(3,904)
Gain on redemption of own debt	6	—	6	162	—	162	454	—	454
Asset Protection Scheme	—	—	—	—	—	—	(44)	—	(44)
Strategic disposals	1	—	1	161	—	161	185	—	185
Citizens discontinued operations	(3,081)	(10)	(3,091)	(3,020)	—	(3,020)	(3,226)	—	(3,226)
Statutory basis	14,618	—	14,618	16,755	—	16,755	15,262	—	15,262

*Restated

	2014			2013*			2012*		
	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	134,317	150,449	—	132,024	146,233	—	132,984	136,664	—
Ulster Bank	27,596	24,658	—	28,206	27,046	11	30,728	28,769	4
Personal & Business Banking	161,913	175,107	—	160,230	173,279	11	163,712	165,433	4
Commercial Banking	89,386	89,006	217	87,889	93,206	83	88,441	94,404	345
Private Banking	20,802	36,642	22	21,518	37,355	27	21,489	39,324	51
Commercial & Private Banking	110,188	125,648	239	109,407	130,561	110	109,930	133,728	396
Corporate & Institutional Banking	574,770	542,044	25	556,934	515,674	504	783,047	753,872	344
Central items	85,695	69,466	824	92,497	84,885	762	96,335	101,464	1,063
Citizens Financial Group	84,932	71,258	217	71,738	61,695	267	72,903	63,116	308
RCR	27,628	12,432	110	n/a	n/a	n/a	n/a	n/a	n/a
Non-Core	n/a	n/a	n/a	29,128	4,975	18	58,347	7,236	169
	1,045,126	995,955	1,415	1,019,934	971,069	1,672	1,284,274	1,224,849	2,284

*Restated

Notes on the accounts

37 Segmental analysis continued

Segmental analysis of assets and liabilities included in disposal groups:

	2014		2013*		2012*	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Commercial Banking	2	—	—	—	—	—
Private Banking	—	—	3	—	—	—
Commercial & Private Banking	2	—	3	—	—	—
Corporate & Institutional Banking	18	14	—	—	—	—
Central items	—	—	1	—	—	—
Citizens Financial Group	80,967	71,268	679	3,190	—	—
RCR	46	2	n/a	n/a	n/a	n/a
Non-Core	n/a	n/a	107	20	304	135
	81,033	71,284	790	3,210	304	135

*Restated

Segmental analysis of goodwill is as follows:

	UK Personal & Business Banking £m	Commercial Banking £m	Private Banking £m	Corporate & Institutional Banking £m	Citizens Financial Group £m	Central items £m	Total £m
At 1 January 2012*	3,342	2,121	812	371	3,992	24	10,662
Transfer to disposal groups	—	—	—	5	—	—	5
Acquisitions	—	—	(9)	—	—	(24)	(33)
Currency translation and other adjustments	—	—	(3)	(3)	(169)	—	(175)
Write down of goodwill	—	—	—	(36)	—	—	(36)
At 1 January 2013*	3,342	2,121	800	337	3,823	—	10,423
Disposals	—	—	(1)	—	—	—	(1)
Currency translation and other adjustments	—	—	2	1	(87)	—	(84)
Write down of goodwill	—	—	—	(208)	—	—	(208)
At 1 January 2014*	3,342	2,121	801	130	3,736	—	10,130
Transfer to disposal groups	—	—	—	—	(3,957)	—	(3,957)
Disposals	—	—	—	—	—	—	—
Currency translation and other adjustments	—	—	(9)	—	221	—	212
Write down of goodwill	—	—	—	(130)	—	—	(130)
At 31 December 2014	3,342	2,121	792	—	—	—	6,255

*Restated

Notes on the accounts

(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.

2014	UK £m	USA £m	Europe £m	Rest of the World £m	Total £m
Total revenue	15,750	1,236	1,869	544	19,399
Net interest income	7,587	217	793	269	8,866
Net fees and commissions	2,548	285	497	148	3,478
Income from trading activities	350	547	265	28	1,190
Other operating income	958	71	75	(20)	1,084
Total income	11,443	1,120	1,630	425	14,618
Operating profit/(loss) before tax	441	382	1,626	(46)	2,403
Total assets	783,174	183,174	45,961	32,817	1,045,126
Of which assets held for sale	48	80,985	—	—	81,033
Total liabilities	755,911	167,421	40,454	32,169	995,955
Of which liabilities held for sale	2	71,282	—	—	71,284
Net assets attributable to equity shareholders and non-controlling interests	27,263	15,753	5,507	648	49,171
Contingent liabilities and commitments	104,369	88,967	37,273	4,258	234,867
Cost to acquire property, plant and equipment and intangible assets	1,025	238	133	19	1,415
2013					
Total revenue	16,541	2,099	3,208	1,320	23,168
Net interest income	7,531	248	790	61	8,630
Net fees and commissions	2,484	325	729	168	3,706
Income from trading activities	1,583	885	199	193	2,860
Other operating income	792	162	605	—	1,559
Total income	12,390	1,620	2,323	422	16,755
Operating loss before tax	(2,356)	(1,187)	(3,706)	(118)	(7,367)
Total assets	731,360	199,305	51,763	37,506	1,019,934
Of which assets held for sale	—	750	38	2	790
Total liabilities	703,711	184,286	46,139	36,933	971,069
Of which liabilities held for sale	—	3,210	—	—	3,210
Net assets attributable to equity shareholders and non-controlling interests	27,649	15,019	5,624	573	48,865
Contingent liabilities and commitments	108,274	82,758	40,961	5,095	237,088
Cost to acquire property, plant and equipment and intangible assets	1,035	412	217	8	1,672
2012					
Total revenue	14,889	2,629	3,095	2,119	22,732
Net interest income	7,757	206	631	(8)	8,586
Net fees and commissions	2,788	397	470	145	3,800
Income from trading activities	(394)	1,322	151	216	1,295
Other operating income	991	78	499	13	1,581
Total income	11,142	2,003	1,751	366	15,262
Operating (loss)/profit before tax	(3,597)	1,127	(1,540)	(289)	(4,299)
Total assets	867,353	298,593	63,992	54,336	1,284,274
Of which assets held for sale	—	304	—	—	304
Total liabilities	837,135	281,304	52,561	53,849	1,224,849
Of which liabilities held for sale	—	135	—	—	135
Net assets attributable to equity shareholders and non-controlling interests	30,218	17,289	11,431	487	59,425
Contingent liabilities and commitments	108,437	80,553	44,769	5,152	238,911
Cost to acquire property, plant and equipment and intangible assets	1,770	325	161	28	2,284

Notes on the accounts

38 Directors' and key management remuneration

The directors of the Bank are also directors of the holding company and are remunerated for their services to the RBS Group as a whole. The remuneration of the directors is disclosed in the Report and Accounts of the RBS Group.

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:

	2014 £000	2013 £000
Short-term benefits	20,917	30,590
Post-employment benefits	1,964	238
Termination benefits	3,481	2,033
Share-based payments	4,889	13,003
	31,251	45,864

In 2014, key management includes only members of the Executive Committee; in 2013 key management also included members of the Management Committee.

39 Transactions with directors and key management

(a) At 31 December 2014, amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions in the Group, as defined in UK legislation, were £654,534 in respect of loans to six persons who were directors of the company 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 Group Management Committee. The captions in the Group's primary financial statements include the following amounts attributable, in aggregate, to key management:

	2014 £000	2013 £000
Loans and advances to customers	4,089	10,750
Customer accounts	22,037	33,279

Key management have banking relationships with Group entities which are entered into in the normal course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with other persons of a similar standing or, where applicable, with other employees. These transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Key management had no reportable transactions or balances with the holding company.

Notes on the accounts

40 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.

The Group enters into transactions with many of these bodies on an arm's length basis. The principal transactions during 2014, 2013 and 2012 included: Bank of England facilities and the issue of debt guaranteed by the UK Government discussed below and the Asset Protection Scheme which the Group exited on 18 October 2012 having paid total premiums of £2.5 billion. Other transactions include the payment of: taxes principally UK corporation tax (page 198) and value added tax; national insurance contributions; local authority rates; and regulatory fees and levies (including the bank levy (page 190) and FSCS levies (page 263); 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.

National Loan Guarantee Scheme

The Group participated in the National Loan Guarantee Scheme (NLGS), providing loans and facilities to eligible customers at a discount of one percent. It did not issue any guaranteed debt under the scheme and consequently, it was not committed to providing a particular volume of reduced rate facilities. At 31 December 2014, the Group had no amounts outstanding under the scheme (2013 - nil; 2012 - £898 million). The NLGS was superseded by the Funding for Lending Scheme.

The Funding for Lending Scheme

The Funding for Lending Scheme was launched in July 2012. Under the scheme UK banks and building societies are able to borrow UK treasury bills from the Bank of England at a price that depends on the participant's net lending to the UK non-financial sector. As at 31 December 2014, the Group had no amounts outstanding under the scheme (2013 - nil; 2012 - £749 million).

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.

	2014 £m	2013 £m	2012 £m
Income			
Interest receivable	87	158	163
Interest payable	1,032	1,020	930
Fees and commissions receivable	7	13	165
Fees and commissions payable	3	79	99
Expenses			
Premises and equipment	—	—	3
Net (expense)/income from discontinued operations	(28)	6	14

Notes on the accounts

41 Ultimate holding company

The Group's ultimate holding company is The Royal Bank of Scotland Group plc which is incorporated in Great Britain and registered in Scotland. As at 31 December 2014, The Royal Bank of Scotland Group plc heads the largest group in which the Group is consolidated. Copies of the consolidated accounts may be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, PO Box 1000, Edinburgh EH12 1HQ.

Following placing and open offers by The Royal Bank of Scotland Group plc in December 2008 and April 2009, the UK Government, through HM Treasury, currently holds 62.3% of the issued ordinary share capital of the holding company and is therefore the Group's ultimate controlling party.

42 Post balance sheet events

Sale of North American loan portfolio to Mizuho

On 26 February 2015, RBS Group announced that it has entered into a definitive agreement with Mizuho Bank, Ltd. ("Mizuho"), a wholly-owned subsidiary of the Mizuho Financial Group, for the sale of a portfolio of US and Canadian loan commitments. As part of the transaction, the parties also continue to explore the transfer of certain associated derivatives, and the transition from RBS Group to Mizuho of certain coverage banking, debt capital markets, syndicate, and associated capabilities related to these commitments.

The transaction is aligned with the strategic direction RBS Group has announced for its Corporate & Institutional Banking business, which will focus mainly on UK and Western European customers, built on existing product and service strengths. RBS Group will remain engaged in the US, serving a select group of North American clients with strong links into the UK.

The portfolio sold to Mizuho comprises \$36.5 billion of loan commitments, including \$3.2 billion of drawn assets, as of 31 December 2014. The risk-weighted assets associated with the portfolio business were approximately \$8 billion as of 31 December 2014, and it generated profit after tax of \$0.1 billion in the year ended on that date. The cash consideration on that basis would be approximately \$3.0 billion, generating a loss on disposal of \$0.2 billion. Actual cash consideration and loss will depend upon settlement date portfolio balances. Sale proceeds will be used for general corporate purposes.

The transaction is expected to complete before the end of Q2 2015. RBS Group will work closely with Mizuho and our existing clients associated with these loan commitments to ensure an orderly and seamless transition at completion.

Intention to sell part of Citizens Financial Group Inc. stake

On 23 March 2015, RBS Group announced that it intends to sell part of its shareholding in Citizens Financial Group Inc. (CFG) in an underwritten public follow-on offering.

The offering is expected to comprise 115 million shares of CFG common stock, equivalent to 21% of CFG's common stock excluding an over-allotment option. A further 17.25 million shares will be made available by RBS Group under a 30 day over-allotment option.

If all the CFG shares made available in the offering are sold, assuming no exercise of the over-allotment option, RBS Group's remaining stake would comprise 269.7 million shares, equivalent to 49.3% of CFG's issued common stock. If the over-allotment option is exercised in full, RBS Group's remaining stake would be 252.5 million shares or 46.1% of CFG's common stock.

Other than as detailed above, there have been no significant events between 31 December 2014 and the date of approval of these accounts which would require a change to or additional disclosure in the accounts.

Additional information

Five year summary

Summary consolidated income statement	2014 £m	2013 £m	2012 £m	2011 £m	2010 £m
Net interest income	8,866	8,630	8,586	9,221	9,966
Non-interest income (1,2,3)	5,752	8,125	6,676	9,319	10,352
Total income	14,618	16,755	15,262	18,540	20,318
Operating expenses (4)	(13,552)	(15,985)	(14,616)	(13,523)	(12,296)
Profit before impairment losses	1,066	770	646	5,017	8,022
Impairment releases/(losses)	1,337	(8,137)	(4,945)	(6,547)	(8,300)
Operating profit/(loss) before tax	2,403	(7,367)	(4,299)	(1,530)	(278)
Tax charge	(2,033)	(307)	(51)	(519)	(711)
Profit/(loss) from continuing operations	370	(7,674)	(4,350)	(2,049)	(989)
(Loss)/profit from discontinued operations, net of tax (5)	(3,486)	410	490	303	1
Loss for the year	(3,116)	(7,264)	(3,860)	(1,746)	(988)

Attributable to:

Non-controlling interests	57	(13)	19	(8)	29
Preference shareholders	61	58	58	58	60
Ordinary and B shareholders	(3,234)	(7,309)	(3,937)	(1,796)	(1,077)

Notes:

- (1) Includes profit on strategic disposals of £1 million (2013 - £161 million profit; 2012 - £185 million profit; 2011 - £57 million loss; 2010 - £645 million profit).
(2) Includes gain on redemption of own debt of £6 million (2013 - £162 million; 2012 - £454 million; 2011 - £255 million; 2010 - £502 million).
(3) Includes own credit adjustments of £12 million loss (2013 - £25 million loss; 2012 - £3,904 million loss; 2011 - £797 million gain; 2010 - £3 million loss).
(4) Includes write down of goodwill of £130 million (2013 - £18 million; 2012 - £105 million; 2011 - nil; 2010 - nil).
(5) Includes £3,994 million loss provision relating to the transfer of Citizens to disposal groups.

Summary consolidated balance sheet	2014 £m	2013 £m	2012 £m	2011 £m	2010 £m
Loans and advances	421,530	505,583	576,904	586,539	605,826
Debt securities and equity shares	89,477	108,974	150,457	180,903	168,369
Derivatives and settlement balances	359,292	295,037	450,818	539,709	437,753
Other assets	174,827	110,340	106,095	125,630	95,382
Total assets	1,045,126	1,019,934	1,284,274	1,432,781	1,307,330
Owners' equity	46,786	48,786	59,288	61,726	57,010
Non-controlling interests	2,385	79	137	128	597
Subordinated liabilities	30,469	33,134	33,851	32,324	32,023
Deposits	458,849	537,467	621,457	581,485	557,545
Derivatives, settlement balances and short positions	378,309	319,382	469,458	575,060	470,600
Other liabilities	128,328	81,086	100,083	182,058	189,555
Total liabilities and equity	1,045,126	1,019,934	1,284,274	1,432,781	1,307,330

Additional information

Other contractual cash obligations

The table below summarises the Group's 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
2014						
Operating leases	62	175	424	360	695	1,415
Contractual obligations to purchase goods or services	104	285	703	734	1	—
	166	460	1,127	1,094	696	1,415
2013						
Operating leases	90	258	630	513	786	1,358
Contractual obligations to purchase goods or services	107	266	189	588	12	—
	197	524	819	1,101	798	1,358
	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
2014						
Operating leases	38	107	265	239	510	982
Contractual obligations to purchase goods or services	92	273	696	728	—	—
	130	380	961	967	510	982
2013						
Operating leases	38	110	275	249	487	901
Contractual obligations to purchase goods or services	104	230	185	581	12	—
	142	340	460	830	499	901

Additional information

Cross border exposures

Cross border exposures are loans and advances including finance leases and instalment credit receivables and other monetary assets, such as debt securities and net derivatives, including non-local currency claims of overseas offices on local residents.

The Group monitors the geographical breakdown of these exposures based on the country of domicile of the borrower or guarantor of ultimate risk. Cross border exposures exclude exposures to local residents in local currencies.

The table below sets out the Group's cross border exposures greater than 0.5% of the Group's total assets. None of these countries have experienced repayment difficulties that have required restructuring of outstanding debt.

	Government £m	Banks £m	Other £m	Total £m	Short positions £m	Net of short positions £m
2014						
France	7,222	11,654	4,234	23,110	2,226	20,884
United States	393	2,500	18,231	21,124	7,029	14,095
Germany	12,837	5,045	2,437	20,319	2,166	18,153
Netherlands	5,050	1,037	6,891	12,978	1,391	11,587
Japan	3,093	3,623	2,125	8,841	66	8,775
Italy	3,379	989	766	5,134	3,029	2,105
Spain	772	913	2,442	4,127	565	3,562
Republic of Ireland	180	1,454	1,793	3,427	11	3,416
2013						
France	4,432	10,033	4,182	18,647	2,352	16,295
United States	7,592	1,917	24,354	33,863	7,984	25,879
Germany	11,975	2,521	4,802	19,298	4,440	14,858
Netherlands	4,979	1,548	5,927	12,454	1,192	11,262
Japan	34	4,866	1,876	6,776	2,556	4,220
Italy	4,922	635	1,089	6,646	3,302	3,344
Spain	1,417	2,813	3,486	7,716	801	6,915
Republic of Ireland	30	2,554	2,698	5,282	51	5,231
2012						
France	6,132	13,029	5,616	24,777	2,156	22,621
United States	17,411	1,331	30,713	49,455	12,080	37,375
Germany	13,198	3,594	6,696	23,488	1,955	21,533
Netherlands	5,350	2,077	10,700	18,127	1,123	17,004
Japan	4,338	6,822	1,409	12,569	2,326	10,243
Italy	3,359	247	1,099	4,705	2,301	2,404
Spain	857	1,490	4,652	6,999	514	6,485
Republic of Ireland	89	3,384	2,982	6,455	59	6,396

Additional information

Risk factors

Set out below are certain risk factors which 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 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 the principal operating subsidiary of The Royal Bank of Scotland Group ("RBSG", together with its subsidiaries the "RBS Group"). Accordingly, risk factors below which relate to RBSG and the RBS Group will also be applicable to the Bank and the Group and the occurrence of any such risks could have a material adverse effect on the Group's business, reputation, results of operations, financial condition and/or cash flows.

The RBS Group's ability to achieve its capital targets will depend on the success of the RBS Group's plans to further reduce the size of its business through the restructuring of its corporate and institutional banking business and make further divestments of certain of its portfolios and businesses including its remaining stake in Citizens Financial Group Inc (CFG).

In response to the global economic and financial crisis that began in 2008 and the weak economic environment that followed, the RBS Group engaged in a financial and core business restructuring focused on achieving appropriate risk-adjusted returns under these changed circumstances, reducing reliance on wholesale funding, lowering exposure to capital-intensive businesses and meeting new capital standard requirements. In November 2013, following HM Treasury's assessment of the merits of creating an external "bad bank" to hold certain assets of the RBS Group, the RBS Group committed to take a series of actions to further derisk its business and strengthen its capital position. In order to strengthen its capital position and CET1 ratio, the RBS Group decided to accelerate the divestment of Citizens Financial Group (CFG), the RBS Group's US banking subsidiary, by selling off 28.75 per cent in an initial public offering in September 2014, and selling a further 24.7 per cent. of its interest in a public offering in March 2015 (with an over - allotment option representing a total of 28.4 per cent of CFG's common shares), and fully divesting its interest in CFG by the end of 2016; and to intensify management actions to reduce risk weighted assets (including through an accelerated divestment of certain of the non-core assets transferred to RBS Capital Resolution ("RCR")).

In the first quarter of 2015, the RBS Group announced its intention to restructure its corporate and institutional banking ("CIB") business to focus on UK corporate and financial institutions with a targeted presence in selected western European customer segments. The future CIB model will:

- focus on the RBS Group's leading positions in UK rates, debt capital markets and foreign exchange;
- retain two trading hubs in the US and Singapore to support the main London trading operation; exit central and eastern Europe, the Middle East and Africa, and substantially reduce its presence in Asia and in the US; and
- complete the run-down of US asset-backed products.

Following the decision to refine the CIB business model, the RBS Group has decided to lift its capital targets and move to a CET1 ratio of around 13% during the restructuring period (higher than the targets of 11% by 31 December 2015 and above 12% by the end of 2016 previously announced).

In addition, the RBS Group is in the process of implementing the new divisional and functional structure put into place in 2014 and, as a result of the restructuring of its CIB business, is now taking further steps to implement a number of strategic initiatives which will result in a further reduction of the RBS Group's balance sheet as well as the scope of its activities. Implementation by the RBS Group of these initiatives will require significant restructuring of the RBS Group at the same time that it will also be implementing structural changes to comply with regulatory changes including those introduced under the UK Financial Services (Banking Reform) Act 2013 (the "Banking Reform Act 2013"), including its ring-fencing requirements (the "ring-fence"). See also *'Implementation of the ring-fence in the UK which will begin in 2015 will result in material structural changes to the RBS Group's business. These changes could have a material adverse effect on the RBS Group and/or the Group'*.

There can be no assurance that the RBS Group will be able to successfully implement this restructuring programme together with other changes required of the RBS Group in the time frames contemplated or at all, and, as a result, the RBS Group may not be able to meet its capital targets.

The RBS Group's ability to dispose of businesses and certain portfolios, including the further disposal of its remaining stake in CFG and potential disposals associated with the restructuring of its CIB business, 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 RBS Group will be able to sell or run-down (as applicable) the businesses it is now planning to sell or exit or asset portfolios it is seeking to sell either on favourable economic terms to the RBS Group or at all. 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 RBS Group may be exposed to deteriorations in the businesses or portfolios being sold between the announcement of the disposal and its completion, which period may span many months. In addition, the RBS 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.

The occurrence of any of the risks described above could negatively affect the RBS Group's ability to implement its strategic plan and achieve its capital targets and could have a material adverse effect on the RBS Group's and/or the Group's business, reputation, results of operations, financial condition and cash flows. There can also be no assurance that if the RBS Group is able to execute its new strategic plan that the new strategy will ultimately be successful or beneficial to the RBS Group's and/or the Group.

Additional information

Implementation of the ring-fence in the UK which will begin in 2015 will result in material structural changes to the RBS Group's business. These changes could have a material adverse effect on the RBS Group and/or the Group.

The UK Government's White Paper on Banking Reform published in September 2012 outlined material structural reforms in the UK banking industry. The measures were drawn in large part from the recommendations of the Independent Commission on Banking ("ICB"), which in its final report published in 2012, included the implementation of a ring-fence of retail banking operations. The implementation of the ring-fencing of retail banking operations was introduced under the Banking Reform Act 2013. The Banking Reform Act 2013 provided primary enabling legislation in the short term with a view to completing the legislative framework for the ring-fence of retail banking operations by May 2015, requiring compliance as soon as practicable thereafter and setting a final deadline for full implementation by 2019. In June 2014, HM Treasury published two statutory instruments, which were passed by Parliament in July 2014, setting out the detail of the ring-fencing regime, specifying which entities will be "ring-fenced banks" and the activities and services that ring-fenced banks can, and cannot, conduct which came into force on 1 January 2015. The third and final statutory instrument on pensions regulation was passed by Parliament on 4 March 2015. In October 2014, the PRA published its first consultation paper (CP19/14) on the PRA's ring-fencing rules, focusing on legal structure, governance and continuity of services and facilities. The PRA requested that all firms expected to be affected by ring-fencing, including the RBS Group, submit a preliminary plan of their anticipated legal and operating structures to their supervisors by 6 January 2015, which the RBS Group has done. The PRA will carry out further consultations during 2015 with the RBS Group and other affected UK banks and is expected publish its final rules and supervisory statements during 2016.

Although final rules and supervisory statements will not be available until 2016, based on the proposals put forward by the RBS Group to the PRA and the FCA to implement the ring-fence, the RBS Group has identified a number of material risks associated with such implementation in addition to the uncertainty associated with starting to plan implementation before final rules and guidance are in place.

These risks will be exacerbated by the RBS Group's other ongoing restructuring efforts.

- The RBS Group intends to establish a ring-fence bank ("RFB") for its banking services while the non-ring-fence group ("NRFB") will hold the RBS Group's remaining CIB activities, the operations of RBS International and some corporate banking activities that are not permitted activities for the RFB and will be the remaining businesses following completion of the restructuring of the RBS Group's CIB business. The establishment of the RFB and the NRFB will require a significant legal and organisational restructuring of the RBS Group and the transfer of large numbers of customers between legal entities. The scale and complexity of completing this process and the operational and legal challenges that will need to be overcome will pose significant execution risks for the RBS Group. The legal restructuring and migration of customers will have a material impact on how the RBS Group conducts its business and the RBS Group is unable to predict how some customers may react to any requirement to deal with both the RFB and NRFB to obtain certain products and services. Such implementation will be costly and although final implementation is not required until 2019, there is no certainty that the RBS Group will be able to complete the legal restructuring and migration of customers to the RFB or NRFB, as applicable, such that the ring-fence exercise is completed on time or in accordance with future regulatory rules for which there is currently significant uncertainty.
- As part of the establishment of the RFB, it will be necessary for the RFB to operate independently from the NRFB and an entirely new corporate governance structure will need to be put in place by the RBS Group to ensure the RFB's independence. These requirements have implications for how the RBS Group sets up its board and committee corporate governance structure and the RBS Group cannot predict how the Group will function as a public listed company with a subsidiary (the RFB) that will have an independent board and committee structure. In addition, the RBS Group will need to revise its operations infrastructure so as to establish an appropriate level of segregation of the infrastructure of the RFB in areas such as information technology ("IT") infrastructure, human resources and the management of treasury operations, including capital and liquidity. The RBS Group will also need to evaluate, among other things, the tax exposure of each of the RFB and NRFB, as well as the impact of the ring-fence on intra group funding and the credit ratings and external funding arrangements of each of these entities. As this structure has never been tested, the RBS Group cannot provide any assurances regarding its ability to successfully implement such a structure. Although the intention is to establish corporate governance and operations in accordance with applicable rules (although not yet finalised) that are as cost efficient as possible, the effects of operating the RBS Group, the RFB and the NRFB in this manner could have a material adverse effect on the RBS Group's business, financial condition and results of operations.

Additional information

Risk factors continued

- In order to comply with the ring-fence requirements, from 2026 it will not be possible for the RFB and the NRFB to participate in the same pension plan. As a result, it will be necessary for either the RFB or NRFB to leave the pension plan which will trigger certain legal and regulatory obligations. Although the RBS Group will have a number of options available to it to meet its obligations resulting from the separation, it is expected that the costs of separation will be material, including possibly increasing annual cash contributions required to be made into the RBS Group's pension plans. See 'The RBS Group may be required to make further contributions to its pension schemes if the value of pension fund assets is not sufficient to cover potential obligations and to satisfy ring-fencing requirements'.
- Implementation of the ring-fence proposals in the UK will result in major changes to the RBS Group's corporate structure, to the delivery of its business activities conducted in the UK and other jurisdictions where the RBS Group will operate, as well as changes to the RBS Group's business model. The steps required to implement the ring-fence of its retail and certain other core banking activities in the UK from other activities of the RBS Group as well as restructuring other operations within the RBS Group in order to comply with the new rules and regulations are extraordinarily complex and will take an extended period of time to put into place. Implementation will be costly and there can be no assurance that the ring-fence of the RFB and the NRFB will be completed on time to meet the regulatory deadline in 2019. As a result, the implementation of the ring-fence could have a material adverse effect on the RBS Group's and/or the Group's reputation, results of operations, financial condition and prospects.

The RBS Group continues to implement certain divestment and restructuring activities announced in 2013 and 2014 as part of its 2013/2014 Strategic Plan but will now enter a further period of major restructuring through the implementation of the regulatory regime relating to the ring-fence of financial institutions by 2019 and the restructuring of the RBS Group's CIB business. Although the goals of this long period of restructuring are to emerge as a less complex and safer bank there can be no assurance that the final results will be successful and that the RBS Group and/or the Group will be a viable, competitive, customer focused and profitable bank.

In the third quarter of 2013 and in 2014, the RBS Group revised its strategic plan by implementing its new divisional and functional structure and embarked on a major investment program to upgrade the RBS Group's operations and IT infrastructure (the "2013/2014 Strategic Plan"). The 2013/2014 Strategic Plan built on the core business restructuring implemented by the RBS Group after the financial crisis which initially focused on reducing the size of the RBS Group's balance sheet, disposing of the "higher risk and capital intensive assets" in RCR and strengthening the RBS Group's capital position, including through the full divestment of the RBS Group's interest in CFG. The 2013/2014 Strategic Plan was intended to reduce the size of the RBS Group's business, mainly within the Markets division, and further strengthen its capital position in response to continuing regulatory change and simplifying the RBS Group by replacing the previous divisional structure with three customer facing franchises focused on the UK and a smaller group of UK based customers.

The 2013/2014 Strategic Plan, the restructuring of the RBS Group's CIB business, the implementation of a ring-fence compliant structure and the IT and operational investment programme (as described below) hereinafter collectively referred to as the "Transformation Plan". With the implementation of the Transformation Plan, and in particular the restructuring of the RBS Group's CIB business and implementation of the regulatory ring-fence regime coming into force in the UK, the RBS Group is entering a further period of major restructuring, that will require significant resource and management attention over the next four years, with the intent to continue simplifying the RBS Group's business, making the bank safer by narrowing its business focus, further strengthening its capital position and improving its customer offering.

Each aspect of the implementation of the Transformation Plan carries material risks. See also '*Implementation by the RBS Group of the various initiatives and programmes which form part of the RBS Group's Transformation Plan subjects the RBS Group to increased and material execution risk*'. In addition, although the goal is to emerge as a simpler, safer, customer focused and profitable bank, the aggregate business of the RBS Group will be materially smaller and different than the institution that entered the financial crisis as one of the largest and most diverse financial institutions in the world. On completion of the Transformation Plan in 2019 the RBS Group will be primarily a UK and Western Europe focused bank with a much less diverse group of businesses, products and services. It will service a much smaller group of customers, including large corporate and financial institutions, with its focus and its potential for profitability and growth largely dependent on its success with its retail and SME customers in the UK.

This smaller customer base and geographic concentration also carry material business risks. As a result, in addition to the execution risks associated with completion of the Transformation Plan there can be no assurance that even if the RBS Group executes the Transformation Plan it will prove to be a successful strategy or that the RBS Group, on completion of the Transformation Plan, will be a viable, competitive, customer focused and profitable bank. For a further description of the risks associated with the various initiatives comprised in the Transformation Plan, See '*The RBS Group's ability to achieve its capital targets will depend on the success of the RBS Group's plans to further reduce the size of its business through the restructuring of its corporate and institutional banking business and make further divestments of certain of its portfolios and businesses including its remaining stake in Citizens Financial Group*', '*Implementation of the ring-fence in the UK which will begin in 2015 will result in material structural changes to the RBS Group's business. These changes could have a material adverse effect on the RBS Group and/or the Group*', '*The RBS Group is currently implementing a number of significant investment and rationalisation initiatives as part of the RBS Group's IT and operational investment programme. Should such investment and rationalisation initiatives fail to achieve the expected results, it could have a material adverse impact on the RBS Group's and/or the Group's operations and its ability to retain or grow its customer business*'. Failure of the Transformation Plan to result in a viable, competitive, customer focused and profitable bank would have a material adverse effect on the RBS Group's and/or the Group's business, results of operations and financial condition.

Additional information

The RBS Group is currently implementing a number of significant investment and rationalisation initiatives as part of the RBS Group's IT and operational investment programme. Should such investment and rationalisation initiatives fail to achieve the expected results, it could have a material adverse impact on the RBS Group's and/or the Group's operations and its ability to retain or grow its customer business.

The intent of the 2013/2014 Strategic Plan and of the restructuring of the RBS Group's CIB business is to further simplify and downsize the RBS Group with an increased focus on service to its customers. Such initiatives are being combined and supplemented with 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 costs: income ratio in the longer term as well as improve the resilience, accessibility and product offering of the RBS Group.

The RBS Group started implementing an investment programme of £750 million in 2013 expected to run through 2015 to materially upgrade its IT capability in the UK, to enhance the digital services provided to its bank customers and also improve the reliability and resilience of the IT systems following a number of system failures in the past couple of years. This investment in the RBS Group's IT capability is intended to address the material increase in customer use of online and mobile technology for banking over the past few years as well as provide the capability to continue to grow such services in the future. Increasingly many of the products and services offered by the RBS Group are, and will become, technology intensive and the RBS Group's ability to develop such services has become increasingly important to retaining and growing the RBS Group's customer business in the UK.

If the RBS 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 to upgrading its current IT infrastructure, the RBS Group is also undertaking a major project to rationalise its legacy IT infrastructure, aiming to lower costs and improve resilience. With the implementation of the ring-fence regulatory regime there will be further need to manage the RBS Group's IT infrastructure to comply with the regulatory requirements of such regime.

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 investment plan, including the IT investment programme on time or at all, and it may experience unexpected cost increases and delays. Any failure by the RBS Group to realise the benefits of this investment programme, whether on time or at all, could have a material adverse effect on the RBS Group's and/or the Group's business, results of operations and its ability to retain or grow its customer business.

Implementation by the RBS Group of the various initiatives and programmes which form part of the RBS Group's Transformation Plan subjects the RBS Group to increased and material execution risk.

The level of structural change intended to be implemented within the RBS Group over the medium term as a result of the Transformation Plan, taken together with the overall scale of change to make the RBS Group a smaller, more focused financial institution, will be disruptive and is likely to increase operational and people risks for the RBS Group and to impact its revenues and business. As a result of the material restructuring plans that make up the Transformation Plan, the RBS Group is subject to increased and material execution risk in many areas including:

- Implementation of the Transformation Plan is expected to result in significant costs, mainly in connection with the RBS Group's restructuring of its CIB business, which costs will be incremental to current plans and exclude potential losses on the sale of financial assets and transfer of financial liabilities. Due to material uncertainties and factors outside the RBS Group's control, the costs of implementation could be materially higher than currently contemplated. One of the objectives of the Transformation Plan is also to achieve a medium-term reduction in annual underlying costs (i.e., excluding restructuring and conduct-related charges). Due to material uncertainties and factors outside the RBS Group's control, this level of cost saving may not be achieved within the planned timescale or at any time.
- The Transformation Plan includes assumptions on levels of customer retention and revenue generation from the new business model. Due to material uncertainties and factors outside the RBS Group's control, including normal levels of market fluctuation, this level of revenue may not be achieved in the timescale envisaged or at any time.
- The RBS Group will be reliant on attracting and retaining qualified employees to manage the implementation of the Transformation Plan and, in particular, the restructuring of the RBS Group's CIB business and to oversee the implementation of the ring-fence and operate in the new ring-fence environment. No assurance can be given that it will be able to attract and retain such employees. See also 'The RBS 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 RBS Group may also suffer if it does not maintain good employee relations'.
- The significant reorganisation and restructuring resulting from the combined initiatives constituting the Transformation Plan will fundamentally change the RBS Group's business. Implementation will be disruptive and will increase operational risk. See '*Operational risks are inherent in the RBS Group's businesses and these risks could increase as the RBS Group implements its Transformation Plan*'.

Additional information

Risk factors continued

- The Transformation Plan makes certain assumptions about future regulation including, but not limited to, the rules to be issued by PRA and FCA in connection with the ring-fence regime. Material differences between the rules ultimately adopted and the assumptions made in the plan proposed to implement the ring-fence could make it impossible to execute the ring-fence as currently envisaged. The Transformation Plan is also intended to improve the RBS Group's control environment, particularly in its remaining CIB franchise. Due to material uncertainties, factors beyond the RBS Group's control, and the increased operational risk described above, there can be no guarantee that such improvements will be achieved in the timescale envisaged or at any time or that it will not result in further regulatory scrutiny.

If any of the risks outlined above were to occur, singly or in the aggregate, they could have a material adverse effect on the RBS Group's and/or the Group's business, results of operations and financial condition.

The RBS 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 RBS Group's operations, operating results, investor confidence and reputation.

The RBS Group's operations are diverse and complex, and it operates in legal and regulatory environments that expose it to potentially significant litigation, regulatory and governmental investigations and other regulatory risk. As a result, the RBS Group has recently settled a number of legal and regulatory investigations and is, and may in the future be, involved in a number of legal and regulatory proceedings and investigations in the UK, the EU, the US and other jurisdictions.

The RBS Group is involved in ongoing class action litigation, investigations into foreign exchange trading and rate setting activities, continuing LIBOR related litigation and investigations, securitisation and securities related litigation and civil and criminal investigations, and anti-money laundering, sanctions, mis-selling and compliance related investigations, in addition to a number of other matters. In November 2014, the RBS Group announced that it had reached a settlement with the FCA in the United Kingdom and with the Commodity Futures Trading Commission (CFTC) in the US in relation to investigations into failings in RBS Group's foreign exchange business within its Corporate and Institutional Banking division. The RBS Group agreed to pay penalties of £217 million to the FCA and \$290 million to the CFTC to resolve the investigations. The RBS Group continues to cooperate with these and other governmental and regulatory authorities and remains in discussion with these authorities on these issues including settlement discussions regarding the criminal investigation being conducted by the anti-trust and criminal division of the US Department of Justice and certain other financial regulatory authorities.

Settlements in relation to these ongoing investigations may result in additional financial, non-monetary penalties, and collateral consequences, which may be material, and may give rise to additional legal claims being asserted against the RBS Group. The RBS Group entered into a deferred prosecution agreement in 2013 in connection with the settlement of the charges relating to the LIBOR investigation (the "LIBOR DPA"). Findings of misconduct by the US Department of Justice relating to the RBS Group, its subsidiaries or employees, may result in a breach of the terms of the LIBOR DPA which may lead to an extension of its terms or further prosecution.

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. It is expected that the RBS Group will continue to have a material exposure to legacy litigation and governmental and regulatory proceedings and investigations in the medium term. For more detail on certain of the RBS Group's ongoing legal, governmental and regulatory proceedings, see Note 31 in this report. Adverse regulatory, governmental or law enforcement proceedings or adverse judgements in litigation could result in restrictions or limitations on the RBS Group's and/or the Group's operations or have a significant effect on the RBS Group's and/or the Group's reputation, results of operations and capital position.

The RBS Group may be required to make new or increase existing provisions in relation to legal proceedings, investigations and governmental and regulatory matters. In Q3 2014, the RBS Group booked a provision of £400 million relating to penalties incurred in connection with the investigations and reviews relating to foreign exchange trading settled with the FCA and the CFTC and during Q4 2014 an additional provision of £320 million was taken in respect of foreign exchange trading-related investigations. The RBS Group also booked during 2014 additional provisions of £650 million for Payment Protection Insurance (resulting in total provisions made for this matter of £3.7 billion, of which £2.9 billion had been utilised at 31 December 2014). The provision for interest rate hedging products redress and administration costs was also increased by £185 million in 2014, with total provisions relating to this matter totalling £1.4 billion, of which £1.0 billion had been utilised at 31 December 2014. Significant increases in provisions relating to ongoing investigations may have an adverse effect on the RBS Group's and/or the Group's reputation as well as its financial condition and results of operations.

The RBS Group, like many other financial institutions, has come under greater regulatory scrutiny in recent years and expects heightened levels of regulatory supervision to continue for the foreseeable future, particularly as it relates to compliance with historical, new and existing corporate governance, employee compensation, conduct of business, consumer protection regimes, anti-money laundering and antiterrorism laws and regulations, as well as the provisions of applicable sanctions programmes. Past, current or future failures to comply with any one or more of these laws or regulations could have a material adverse effect on the RBS Group's and/or the Group's reputation, financial condition and results of operations.

Additional information

The RBS Group is subject to political risks.

Ahead of the upcoming UK election in May 2015, there is uncertainty around how the policies of the elected government may impact the RBS Group, including a possible referendum on the UK's membership of the EU. The implementation of these policies, including the outcome of the EU referendum, could significantly impact the environment in which the RBS Group and the Group operates and the fiscal, monetary, legal and regulatory requirements to which it is subject, and in turn could have a material adverse effect on its business, financial condition and results of operations.

The RBS 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 RBS Group may also suffer if it does not maintain good employee relations.

Implementation of the RBS Group's strategy and its future success depends on its ability to attract, retain and remunerate highly skilled and qualified personnel, including senior management (which include 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). Following the implementation in the UK of provisions of CRD IV relating to compensation in the financial sector and taking into account the views of UKFI, the RBS Group is restricted from paying variable remuneration to individuals for a particular year in an amount higher than the level of his or her fixed remuneration which may place the RBS Group at a competitive disadvantage.

The RBS 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 will impose greater responsibility on such individuals. The new rules include (i) a senior managers' regime which will require such senior managers to be pre-approved either by the PRA or FCA whilst the new rules themselves also introduce a "presumption of responsibility" for those approved as such - where contraventions of a relevant regulatory requirement occur, the accountable senior manager will be presumed guilty of misconduct unless he or she shows to the satisfaction of the relevant regulator that he or she took all reasonable steps to prevent the contravention occurring (or continuing) , (ii) a certification regime which will require the RBS Group to assess the fitness and propriety of certain of its employees (other than senior managers), who are considered to pose a risk of significant harm to the RBS Group or its customers and (iii) a conduct rules regime (which as currently proposed would apply regulatory prescribed conduct rules to most employees of the RBS Group with a UK nexus).

The rules implementing the new regime are still under consultation by the PRA and the FCA and there remains uncertainty as to the final scope of the new rules and any transitional arrangements. Final rules are expected to enter into force in late 2015 (and early 2016 for the new certification regime). 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 reverse burden of proof as well as the allocation of responsibilities introduced by the new rules.

In addition to the effects of such measures on the Group's ability to retain non-executive directors, senior management and other key employees, the market for skilled personnel is increasingly competitive, thereby raising the cost of hiring, training and retaining skilled personnel.

The RBS Group's changing strategy, particularly as a result of the RBS Group's 2013/2014 Strategic Plan, including the accelerated disposal of the RBS Group's interest in CFG, led to the departure of many experienced and capable employees. The continuing restructuring of the RBS Group, including as a result of the restructuring of the RBS Group's CIB business and the implementation of the ring-fence regulatory regime, is expected to lead to the departure of additional experienced and capable employees. The lack of continuity of senior management and the loss of important personnel coordinating certain or several aspects of the Transformation Plan could have an adverse impact on the implementation of the RBS Group's Transformation Plan and regulatory commitments. The failure to attract or retain a sufficient number of appropriately skilled personnel to manage the complex restructuring required to implement the Transformation Plan, and in particular the implementation of the ring-fence and the restructuring of the RBS Group's CIB business could prevent the Group from successfully implementing its strategy. This could have a material adverse effect on the RBS Group's and/or the Group's business, financial condition and results of operations.

In addition, certain of the RBS Group's employees in the UK, continental Europe and other jurisdictions in which the RBS Group operates are represented by employee representative bodies, including trade unions. Engagement with its employees and such bodies is important to the RBS Group and a breakdown of these relationships could adversely affect the RBS Group's and/or the Group's business, reputation and results.

Operational risks are inherent in the RBS Group's businesses and these risks could increase as the RBS Group implements its Transformation Plan.

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. The RBS Group has complex and geographically diverse operations and operational risk and losses can result from 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 anti-terrorism legislation, as well as the provisions of applicable sanctions programmes), equipment failures, business continuity and data security system failures, natural disasters or the inadequacy or failure of systems and controls, including those of the RBS Group's suppliers or counterparties.

Additional information

Risk factors continued

Operational risks will be heightened as a result of the RBS Group's implementation of its Transformation Plan as described in more detail under 'Implementation by the RBS Group of the various initiatives and programmes which form part of the RBS Group's Transformation Plan subjects the RBS Group to increased and material execution risk'. 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 RBS Group's activities as well as the implementation of the RBS Group's Transformation Plan, 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 RBS Group. Ineffective management of operational risks, including the material operational risks that will arise in implementing the Transformation Plan, could have a material adverse effect on the RBS Group's and/or the Group's business, financial condition and results of operations.

The RBS Group operates in highly competitive markets that are subject to intense scrutiny by the competition authorities. Its business and results of operations may be adversely affected by increasing competitive pressures and competition rulings and other government measures. The competitive landscape for banks and other financial institutions in the UK, the US and throughout the rest of Europe is changing rapidly. Recent regulatory and legal changes are likely to result in new market participants and changed competitive dynamics in certain key areas, such as in retail banking in the UK. 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 ICB, whose final report was published in 2012 and the Parliamentary Commission on Banking Standards whose report was published in 2013. These reviews raised significant concerns about the effectiveness of competition in the banking sector.

In 2014, the CMA published two market studies about SME banking and PCAs. On the basis of its findings and following consultation, the CMA made a market investigation reference (MIR) in relation to both SME banking and PCAs. An MIR can be made only if the CMA has reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods or services prevents, restricts or distorts competition. Such investigations typically last between 15-24 months and the CMA currently expects to publish provisional findings in September 2015. While it is too early to assess the potential impact on the RBS Group of these reviews and investigations, the competitive landscape in which the RBS Group operates may be significantly affected as a result and this impact will become more significant as the RBS Group implements its Transformation Plan and its business is increasingly concentrated in the UK on retail activities.

The wholesale banking sector has also been the subject of recent scrutiny. In 2014, the FCA launched a review of competition in the wholesale sector (primarily relating to competition in wholesale securities and investment markets and related activities such as corporate banking) to identify areas which might merit in-depth market study and in February 2015 announced that it would be launching a market study to investigate competition in investment and corporate banking services. Adverse findings resulting from this study may result in the imposition of fines or restrictions on mergers and consolidations within the UK financial sector and the FCA may also refer the matter further to the CMA, which has extensive powers to take measures to restore effective competition. The competitive landscape in the UK is also likely to be affected by the UK Government's implementation of the ring-fence regime and other customer protection measures introduced by the Banking Reform Act 2013. Although final ring-fence rules will not be available until 2016, firms (including the RBS Group) have submitted plans for their legal and operational structures to implement the new ring-fence regime to the PRA. The implementation of such plans 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. This consolidation, in combination with the introduction of new entrants into the markets in which the RBS Group operates which is being actively encouraged by the UK Government is likely to increase competitive pressures on the RBS Group.

In addition, certain competitors may have more efficient operations, including better IT systems allowing them to implement innovative technologies for delivering services to their customers, and may have access to lower cost funding and/or be able to attract deposits on more favourable terms than the RBS Group. Furthermore, the RBS Group's competitors may be better able to attract and retain clients and key employees, which may negatively impact the RBS Group's and/or the Group's relative performance and future prospects. In addition, recent and future disposals and restructurings by the RBS Group in the context of its Transformation Plan as well as constraints imposed on the RBS Group's compensation structure and its ability to compensate its employees at the same level as its competitors may also have an impact on its ability to compete effectively.

These and other changes to competition could have a material adverse effect on the RBS Group's and/or the Group's business, margins, profitability, financial condition and prospects.

Additional information

The RBS Group's businesses and performance can be negatively affected by actual or perceived global economic and financial market conditions and other global risks although the RBS Group will be increasingly impacted by developments in the UK as its operations become gradually more focused on the UK.

On completion of the RBS Group's Transformation Programme its business focus will be preponderantly in the UK. However, the RBS Group's businesses and many of its customers are, and will be, affected by global economic conditions, perceptions of those conditions and future economic prospects. The outlook for the global economy over the near to medium-term is increasingly uncertain due to a number of factors including geopolitical risks, concerns around global growth and deflation. Risks to growth and stability stem mainly from continued imbalances in many countries in Europe and elsewhere, slowing growth in emerging markets and China and the potential consequences of continued sanctions and depressed oil prices on the Russian economy. Further instability may result from uncertainty as to how economies and counterparties will be affected, directly or indirectly, by lower oil prices and other commodity prices as well as to the impact of monetary policy measures adopted by the ECB, the US Federal Reserve and the Swiss Central Bank. There remains considerable uncertainty about when the Bank of England and the Federal Reserve will begin to raise policy interest rates. The RBS Group's businesses and performance are also affected by financial market conditions.

Although capital and credit markets around the world have been relatively stable since 2012, financial markets, in particular equity markets, experienced higher volatility in the last quarter of 2014 which has continued into 2015. This volatility is attributable to many of the factors noted above.

In addition, the RBS 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 RBS Group's and/or the Group's business, financial condition and results of operations.

The challenging operating environment for the RBS Group's businesses, created by uncertain economic and market conditions is characterised by:

- 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 RBS Group to access capital, funding and liquidity;
- 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 RBS Group; and
- the risk of increased volatility in yields and asset valuations as central banks start or accelerate looser monetary policies or tighten or unwind historically unprecedented loose monetary policy or extraordinary measures. The resulting environment of uncertainty for the market and consumers could lead to challenging trading and market conditions.

Developments relating to current economic conditions and the risk of a return to a volatile financial environment, including those discussed above, could have a material adverse effect on the RBS Group's and/or the Group's business, financial condition, results of operations and prospects.

As the RBS Group refocuses on its operations in the UK as a result of its Transformation Plan, and in particular the restructuring of the RBS Group's CIB business, it is increasingly exposed to the UK economy. Although the prospects for the UK and the US remain the strongest among the G-7 and Ireland's economy continues to improve, actual or perceived difficult global economic conditions, failure to meet economic growth projections, particularly in the UK and the RBS Group's key markets, the worsening of the scope and severity of the weak economic conditions currently experienced by a number of EU member states and elsewhere, potential volatility in the UK housing market and 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 RBS Group's and/or the Group's businesses.

The RBS Group is exposed to any weakening of the European economy and the renewed threat of default by certain countries in the Eurozone.

With few exceptions, countries in Europe have not yet recovered from the effects of the financial crisis. Consensus forecasts of growth in 2015 and 2016 for some of the largest European economies such as France and Italy are low. In addition, the possibility of a European sovereign default has risen due to the recent election in Greece and the outcome and impact of ongoing negotiations by the new Greek government with respect to its outstanding debt is uncertain. The risk that the effect of any sovereign default spreads by contagion to other EU economies and the UK economy remains. The euro could be abandoned as a currency by one or more countries, or in an extreme scenario, the abandonment of the euro could result in the dissolution of the European Economic and Monetary Union (EEMU). While the European Central Bank announced in January 2015 a €1.1 trillion quantitative easing programme designed to improve confidence in Eurozone equities and encourage more private bank lending, there remains considerable uncertainty as to whether such measures will be successful.

The effects on the UK, European and global economies of any potential dissolution of the EEMU or exit of one or more EU member states from the EEMU and the resulting redenomination of financial instruments from the euro to a different currency, are impossible to predict fully. However, if any such events were to occur they would likely:

- result in significant market dislocation;
- heighten counterparty risk;
- result in downgrades of credit ratings for European borrowers, giving rise to increases in credit spreads and decreases in security values;
- disrupt and adversely affect the economic activity of the UK and other European markets; and
- adversely affect the management of market risk and in particular asset and liability management due, in part, to redenomination of financial assets and liabilities and the potential for mismatches.

The occurrence of any of these events would have a material adverse effect on the RBS Group's and/or the Group's business, financial condition, results of operations and prospects.

Additional information

Risk factors continued

The RBS Group is subject to a variety of risks as a result of implementing the State Aid restructuring plan.

The RBS Group obtained State Aid approval for the aid given to the RBS Group by the UK Government as part of the placing and open offer undertaken by the RBS Group in December 2008. RBSG announced on 9 April 2014 that it had entered into an agreement ("DAS Retirement Agreement") with HM Treasury for the future retirement of the Dividend Access Share ("DAS"). The EC concluded that these new arrangements did not constitute new state aid and approved changes to RBS Group's restructuring plan in its State Aid Amendment Decision of 9 April 2014. RBSG also entered into a Revised State Aid Commitment Deed with HMT under which it undertook to do all acts and things necessary to ensure that HMT is able to comply with the revised State aid commitments made by HMT to the EC, which mainly relate to the deadline for the RBS Group's divestment of the Williams & Glyn business and the divestment of the rest of the RBS Group's interest in CFG.

Implementation of the State Aid restructuring plan exposes the RBS Group to a number of risks. The most significant risks relate to required asset disposals, a number of which are now completed. The RBS Group completed an initial public offering of CFG's common stock in September 2014. The divestment of Williams & Glyn continues to progress following the announcement of a pre-IPO investment by a consortium of investors in September 2013. The RBS Group is required, pursuant to the terms of the State Aid Amendment Decision, to dispose of its remaining interest in CFG by the end of 2016 (with a possible 12 month extension) and must divest its interest in Williams & Glyn by way of an initial public offering by the end of 2016 with the disposal of the remainder of its interest by the end of 2017. Under the terms of the State Aid Amendment Decision, a divestiture trustee may be empowered to conduct these disposals, with the mandate to complete the disposal at no minimum price, if the RBS Group fails to complete such required disposals within agreed or renegotiated time frames, which may result in the RBS Group achieving less than the full value of its investment due to then prevailing market conditions. Furthermore, if the RBS Group is unable to comply with the terms of the State Aid Amendment Decision, including the required divestments, it might constitute a misuse of aid which could have a material adverse impact on the RBS Group and/or the Group.

The occurrence of any of the risks described above could have a material adverse effect on the RBS Group's and/or the Group's business, results of operations, financial condition, capital position and competitive position.

HM Treasury (or UK Financial Investments Limited (UKFI) on its behalf) may be able to exercise a significant degree of influence over the RBS Group and any proposed offer or sale of its interests may affect the price of securities issued by the RBS Group.

The UK Government, through HM Treasury, currently holds 62.3% of the issued ordinary share capital of the RBS Group. On 22 December 2009, the RBS Group issued £25.5 billion of B Shares to the UK Government. The B Shares are convertible, at the option of the holder at any time, into ordinary shares. The UK Government has agreed that it shall not exercise the rights of conversion in respect of the B Shares if and to the extent that following any such conversion it would hold more than 75% of the total issued shares in the RBS Group. Any breach of this agreement could result in the delisting of RBSG from the Official List of the UK Listing Authority and potentially other exchanges where its securities are currently listed and traded. HM Treasury (or UKFI on its behalf) may sell all or a part of its holding of ordinary shares at any time. Any offers or sale of a substantial number of ordinary shares or securities convertible or exchangeable into ordinary shares by or on behalf of HM Treasury, or an expectation that it may undertake such an offer or sale, could negatively affect prevailing market prices for securities issued by the RBS Group and/or the Group.

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 will continue to have its own independent board of directors and management team determining its 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, dividend policy, remuneration policy, or limiting the RBS Group's operations. The manner in which HM Treasury or UKFI exercises HM Treasury's rights as majority shareholder could give rise to conflict 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 for the benefit of its members as a whole.

The RBS Group's business performance could be adversely affected if its capital is not managed effectively or as a result of changes to capital adequacy requirements.

Effective management of the RBS Group's capital is critical to its ability to operate its businesses, and to pursue its strategy of returning to standalone strength. The RBS Group is required by regulators in the UK, the EU, the US and other jurisdictions in which it undertakes regulated activities to maintain adequate capital resources. Adequate capital also gives the RBS Group financial flexibility in the face of continuing turbulence and uncertainty in the global economy and specifically in its core UK, US and European markets. From 2016, in accordance with the provisions of the Capital Requirements Regulation ("CRR"), a minimum level of capital adequacy will be required to meet new regulatory capital requirements allowing the RBS Group to make certain discretionary payments relating to CET1 (dividends), variable remuneration and payments on additional tier 1 instruments.

Additional information

The Basel Committee on Banking Supervision's package of reforms to the regulatory capital framework ("Basel III") raised the quantity and quality of capital required to be held by a financial institution with an emphasis on Common Equity Tier 1 (CET1) capital and introduces an additional requirement for both a capital conservation buffer and a countercyclical buffer to be met with CET1 capital. Global systemically important banks (GSIBs) will be subject to an additional CET1 capital requirement, depending on a bank's systemic importance. The RBS Group has been identified by the Financial Stability Board (FSB) as a GSIB. The FSB list of GSIBs is updated annually, based on new data and changes to methodology. The November 2014 update placed the RBS Group in the second from bottom category of GSIBs, subjecting it to more intensive oversight and supervision and requiring the RBS Group to have additional loss absorption capacity of 1.5% in CET1, to be phased in from the beginning of 2016.

In addition, regulatory proposals relating to domestically systemically important banks (DSIBs) continue to be progressed and could impact the level of CET1 that is required to be held by the RBS Group. The EBA published in December 2014 a quantitative methodology as to how European regulators could quantify which firms would qualify as DSIBs. In addition the Financial Policy Committee ("FPC") of the Bank of England intends to consult with firms in the UK on the UK framework.

Basel III has been implemented in the EU with a new Directive and Regulation (collectively known as "CRD IV") which became effective from 1 January 2014, subject to a number of transitional provisions and clarifications. A number of the requirements introduced under CRD IV have been and continue to be further supplemented through the Regulatory and Implementing Technical Standards ("RTSS"/"ITSs") produced by the European Banking Authority (EBA) and to be adopted by the European Commission which are not yet all finalised. The EU rules deviate from the Basel III rules in certain aspects, and provide national flexibility to apply more stringent prudential requirements than set out in the Basel framework.

Under CRD IV, the RBS Group is required, on a consolidated basis, to hold a minimum amount of regulatory capital of 8% of risk weighted assets of which at least 4.5% must be CET1 capital and at least 6% must be tier 1 capital (together, the "Pillar 1 requirements"). In addition, national supervisory authorities may add extra capital requirements to cover risks they believe are not covered or insufficiently covered by the Pillar 1 requirements (the "Pillar 2A guidance"). The PRA requires that Pillar 2A risks should be met with at least 56% CET1 capital, no more than 44% additional tier 1 capital and at most 25% tier 2 capital. CRD IV also introduces five new capital buffers that are in addition to the Pillar 1 and Pillar 2A requirements and are to be met with CET1 capital: (i) the capital conservation buffer, (ii) the institution-specific counter-cyclical buffer, (iii) the global systemically important institutions buffer, (iv) the other systemically important institutions buffer and (v) the systemic risk buffer. Some or all of these buffers may be applicable to the RBS Group as determined by the PRA.

The combination of the capital conservation buffer, the institution-specific counter-cyclical capital buffer and the higher of (depending on the institution), the systemic risk buffer, the global systemically important institutions buffer and the other systemically important institution buffer, in each case (as applicable to the institution) is referred to as the "combined buffer requirement". The PRA has also introduced a firm specific Pillar 2B buffer ("Pillar 2B buffer") which is based on various factors including firm-specific stress test results and is to be met with CET1. The PRA will assess the Pillar 2B buffer annually and UK Banks are required to meet the higher of the combined buffer requirement or Pillar 2B requirement. The PRA published a consultation in January 2015 suggesting certain changes to its Pillar 2A framework which will introduce new methodologies for determining Pillar 2A capital as well as the PRA's approach to operating the Pillar 2A buffer.

In addition, under the provisions of the CRR, which took effect from 1 January 2014, 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 is dependent on there being no adverse changes to regulatory requirements.

Under Article 141 (Restrictions on distribution) of the CRD IV Directive, member states of the EU must require that institutions that fail to meet the "combined buffer requirement" will be subject to restricted "discretionary payments" (which are defined broadly by CRD IV as payments relating to CET1 (dividends), variable remuneration and payments on additional tier 1 instruments). The restrictions will be scaled according to the extent of the breach of the "combined buffer requirement" and calculated as a percentage of the profits of the institution since the last distribution of profits or "discretionary payment". Such calculation will result in a "maximum distributable amount" (or "MDA") in each relevant period. As an example, the scaling is such that in the bottom quartile of the "combined buffer requirement", no "discretionary distributions" will be permitted to be paid. In the event of a breach of the combined buffer requirement, the RBS Group will be required to calculate its maximum distributable amount, and as a consequence it may be necessary for the RBS Group to reduce discretionary payments.

In October 2014 the FPC published its recommendation on the overall leverage ratio framework for the UK banking system. The FPC recommended a minimum leverage ratio requirement of 3% (to be met 75% by CET1 and a maximum of 25% by additional tier 1 capital), a supplementary leverage buffer applied to G-SIBs equal to 35% of the corresponding risk weighted systemic risk buffer (to be met by CET1) and a countercyclical buffer equal to 35% of the risk weighted countercyclical capital buffer (also to be met by CET1). Transition timings have been aligned to those laid out in Basel III and the exposure measure will follow that laid out by the Basel Committee for Banking Supervision. The FPC explicitly ruled out a breach of the leverage ratio resulting in an automatic constraint to capital distributions via the "maximum distributable amount", preferring to leave this linked to risk weighted assets for the purposes of simplicity.

Additional information

Risk factors *continued*

However, if a breach of the leverage buffers (both G-SIB and countercyclical) were to occur then a recovery plan would need to be discussed with the PRA. The current RBS Group leverage ratio is 4.2% fully met through CET1 leaving it above the minimum requirement while the countercyclical buffer is close to zero.

In addition to the capital requirements under CRD IV, the bank resolution and recovery directive ("BRRD") introduces requirements for banks to maintain at all times a sufficient aggregate amount of own funds and "eligible liabilities" (that is, 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 UK Government has transposed the BRRD's provisions into law with a requirement that the Bank of England implements further secondary legislation to implement MREL requirements by 2016 which will take into account the regulatory technical standards to be developed by the EBA specifying the assessment criteria that resolution authorities should use to determine the minimum requirement for own funds and eligible liabilities for individual firms. The EBA noted that the technical standards would be compatible with the proposed term sheet published by the FSB on total loss absorbing capacity ("TLAC") requirements for GSIBs but there remains a degree of uncertainty as to the extent to which MREL and TLAC requirements may differ. As the implementation of capital and loss absorption requirements under BRRD in the UK is subject to adoption of secondary legislation and subject to PRA supervisory discretion in places, and the implementation and scope of TLAC remains subject to significant uncertainty, the RBS Group is currently unable to predict the impact such rules would have on its overall capital and loss absorption requirements or its ability to comply with applicable capital or loss absorbency requirements or to make certain discretionary distributions. Building on changes made to requirements in relation to the quality and aggregate quantity of capital that banks must hold, the Basel Committee and other agencies are increasingly focussed on changes that will increase, or re-calibrate, measures of risk weighted assets as the key measure of the different categories of risk in the denominator of the risk-based capital ratio. There is no current global consensus regarding the key objectives of this further evolution of the international capital framework. One extreme position advocated by some regulators would materially deemphasise the role of a risk-based capital ratio. A more broadly held opinion among regulators seeks to retain the ratio but also reform it, in particular by addressing perceived excessive complexity and variability between banks and banking systems.

In particular, the Basel Committee on Banking Supervision published a consultation paper in December 2014, in which it recommended reduced reliance on external credit ratings when assessing risk weighted assets and to replace such ratings with certain risk drivers based on the particular type of exposure of each asset. While they are at different stages of maturity, a number of initiatives across risk types and business lines are in progress that will impact RWAs at their conclusion. While the quantum of impacts is uncertain owing to lack of clarity of definition of the changes and the timing of their introduction, the likelihood of an impact resulting from each initiative is high and such impacts could result in higher levels of risk weighted assets.

The Basel Committee changes and other future changes to capital adequacy and loss absorbency and liquidity requirements in the European Union, the UK, the US and in other jurisdictions in which the RBS Group operates, including the RBS Group's ability to satisfy the increasingly stringent stress case scenarios imposed by regulators and the adoption of the MREL and TLAC proposals, may require the RBS Group to issue Tier 1 capital (including CET1), Tier 2 capital and certain loss absorbing debt securities, and may result in existing Tier 1 and Tier 2 securities issued by the RBS Group ceasing to count towards the RBS Group's regulatory capital. The requirement to increase the RBS Group's levels of CET1 and Tier 2 capital, or loss absorbing debt securities, which could be mandated by the RBS Group's regulators, could have a number of negative consequences for the RBS Group and its shareholders, including impairing the RBS Group's 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. If the RBS Group is unable to raise the requisite amount of Tier 1 and Tier 2 capital, or loss absorbing debt securities it may be required to reduce further the amount of its 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.

On a fully loaded Basel III basis, the RBS Group's CET1 ratio was 11.2% at December 31, 2014. The RBS Group's Transformation Plan targets a fully loaded Basel III CET1 ratio of 13% over the restructuring period. The RBS Group's ability to achieve such targets depends on a number of factors, including the implementation of the ring-fence, the execution of the restructuring of the RBS Group's CIB business and the implementation of the 2013/2014 Strategic Plan, which includes plans for a further significant restructuring of the Group as well as further sales of its remaining stake in CFG in the U.S. See *'Forward looking Statements' and 'The RBS Group's ability to achieve its capital targets will depend on the success of the RBS Group's plans to further reduce the size of its business through the restructuring of its corporate and institutional banking business and make further divestments of certain of its portfolios and businesses including its remaining stake in Citizens Financial Group'*.

Any change that limits the RBS Group's ability to implement its capital plan, to access funding sources or to manage effectively its balance sheet and capital resources (including, for example, reductions in profits and retained earnings as a result of write-downs or otherwise, increases in risk-weighted assets, regulatory changes, actions by regulators, delays in the disposal of certain key assets or the inability to syndicate loans as a result of market conditions, a growth in unfunded pension exposures or otherwise) could have a material adverse effect on its and/or the Group's business, financial condition and regulatory capital position.

Additional information

The RBS Group's borrowing costs, its access to the debt capital markets and its liquidity depend significantly on its credit ratings and, to a lesser extent, on the rating of the UK Government.

The credit ratings of RBSG, and other RBS Group members 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 members, have been downgraded multiple times in recent years in connection with rating methodology changes, a review of systemic support assumptions incorporated into bank ratings and the likelihood, in the case of UK banks, that the UK Government is more likely in the future to make greater use of its resolution tools that allow burden sharing with debt holders. In 2014 credit ratings of RBSG, RBS plc and other RBS Group members were downgraded in connection with the RBS Group's creation of RCR, coupled with concerns about execution risks, litigation risk and the potential for conduct related fines. Rating agencies have continued to evaluate the rating methodologies applicable to UK and European financial institutions and any change in such rating agencies' methodologies could materially adversely affect the credit ratings of RBS Group companies. RBSG's long-term and short-term credit ratings were further downgraded by two notches in 2015 by Standard & Poor's Rating Services ("S&P") to reflect S&P's view that extraordinary government support would now be unlikely in the case of UK non-operating bank holding companies and is likely to become less predictable for bank operating companies in the UK under the newly enacted legislation implementing the bail-in provisions of the BRRD. On 17 March 2015 Moody's announced multiple rating reviews following the publication of its new bank rating methodology on 16 March 2015. The new methodology affects banking entities globally and reflects, among other things, Moody's lowered expectations about the likelihood of government support for European banks in light of the introduction of the BRRD. Moody's provided a preliminary indication of the outcome of its review which is to be completed later in 2015. Moody's preliminary indication contemplates that RBSG's long-term senior unsecured and issuer credit ratings would be downgraded by two notches to Ba1 and that the credit ratings of certain other RBS Group subsidiaries may also be downgraded. If these downgrades occur, the credit ratings of RBSG and of certain of its subsidiaries would, therefore, be considered to be below-investment grade by that credit agency.

Any further reductions in the long-term or short-term credit ratings of RBSG or of certain of its subsidiaries would increase borrowing costs, require the RBS Group, including the Group to replace funding lost due to the downgrade, which may include the loss of customer deposits, and may limit the RBS Group's and/or 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. At 31 December 2014, a simultaneous one notch long-term and associated short-term downgrade in the credit ratings of RBSG and RBS plc by the three main ratings agencies would have required the RBS Group to post estimated additional collateral of £4.5 billion, without taking account of mitigating action by management.

Any downgrade in the UK Government's credit ratings could adversely affect the credit ratings of RBS Group and or Group companies and may have the effects noted above. Credit ratings of RBSG, RBS PLC, The Royal Bank of Scotland N.V. ("RBS N.V.") and Ulster Bank Limited are also important to the Group when competing in certain markets, such as over-the-counter derivatives. Any further reductions in RBSG's long-term or short-term credit ratings or those of its subsidiaries, including RBS Plc could adversely affect the RBS Group's access to liquidity and capital markets, limit the range of counterparties willing to enter into transactions with the RBS Group and its subsidiaries, trigger additional collateral or other requirements, adversely affect its competitive position and/or increase its funding costs all of which could have a material adverse impact on the RBS Group's and/or the Group's earnings, cash flow and financial condition.

The RBS Group's ability to meet its obligations including its funding commitments depends on the RBS 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. Although credit markets continued to improve during 2014 and such markets remain accommodating in the early part of 2015 (in part as a result of measures taken by central banks around the world, including the ECB), and the RBS Group's overall liquidity position remained strong, certain European banks, in particular in the peripheral countries of Spain, Portugal, Greece, Italy and Ireland, remained reliant on central banks as one of their principal sources of liquidity. Although the measures taken by Central Banks have had a positive impact, the risk of volatility returning to the global credit markets remains.

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 significant spreads. Any uncertainty relating to the credit risk of financial institutions may lead to reductions in levels of interbank lending and may restrict the RBS Group's access to traditional sources of funding or increase the costs of accessing such funding. The ability of the RBS Group's regulator to bail-in senior and subordinated debt under the provisions of BRRD implemented in the UK since January 2015 may also increase investors' perception of risk and hence affect the availability and cost of funding for the RBS Group.

Additional information

Risk factors continued

Management of the RBS Group's liquidity and funding focuses, among other things, on maintaining a resilient funding strategy for its assets in line with the RBS Group's wider strategic plan. 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. Under certain circumstances, the RBS Group may need to seek funds from alternative sources potentially at higher costs than has previously been the case, and/or with higher collateral or may be required to consider disposals of other assets not previously identified for disposal to reduce its funding commitments. The RBS Group has, at times, been required to rely on shorter-term and overnight funding with a consequent reduction in overall liquidity, and to increase its 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 RBS Group relies on customer deposits to meet a considerable portion of its funding and it has targeted maintaining a loan to deposit ratio of around 100%. The level of deposits may fluctuate due to factors outside the RBS Group's control, such as a loss of confidence, increasing competitive pressures for retail customer deposits or the repatriation of deposits by foreign wholesale or central bank 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.

The occurrence of any of the risks described above could have a material adverse impact on the RBS Group's and/or the Group's financial condition and results of operations.

The RBS Group's businesses are subject to substantial regulation and oversight. Significant regulatory developments and increased scrutiny by the RBS Group's key regulators has had and is likely to continue to increase compliance risks and could have a material adverse effect on how the RBS Group conducts its business and on its results of operations and financial condition.

The RBS 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 changed recently and are subject to further material changes. Among others, the adoption of rules relating to ring-fencing, prohibitions on proprietary trading, the entry into force of CRD IV and the BRRD and certain other measures in the UK, the EU and the US has considerably affected the regulatory landscape in which the RBS Group operates and will operate in the future. Increasing regulatory focus in certain areas and ongoing and possible future changes in the financial services regulatory landscape (including requirements imposed by virtue of the RBS Group's participation in government or regulator-led initiatives), have resulted in the RBS Group facing greater regulation and scrutiny in the UK, the US 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 RBS Group, the enactment of legislation and regulations in the UK and the EU, the other parts of Europe in which the RBS Group operates and the US 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, products offerings and business models. See also *'Implementation of the ring-fence in the UK which will begin in 2015 will result in material structural changes to the RBS Group's business. These changes could have a material adverse effect on the RBS Group and/or the Group'*. Such changes may also result in an increased number of regulatory investigations and proceedings and have increased the risks relating to the RBS Group's ability to comply with the applicable body of rules and regulations in the manner and within the timeframes required.

Any of these developments (including failures to comply with new rules and regulations) could have an impact on how the RBS Group conducts its business, its authorisations and licences, the products and services it offers, its reputation, the value of its assets, and could have a material adverse effect on its business, funding costs and its results of operations and financial condition. See *'Implementation by the RBS Group of the various initiatives and programmes which form part of the RBS Group's Transformation Plan subjects the RBS Group to increased and material execution risk'*.

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:

- requirements to separate retail banking from investment banking (ring-fencing);
- restrictions on proprietary trading and similar activities within a commercial bank and/or a group which contains a commercial bank;
- the implementation of additional or conflicting capital, loss absorption or liquidity requirements, including those mandated under MREL or by the Financial Stability Board's recommendations on TLAC;
- restructuring certain of the RBS Group's non-retail banking activities in jurisdictions outside the UK in order to satisfy local capital, liquidity and other prudential requirements;
- the monetary, fiscal, interest rate and other policies of central banks and other governmental or regulatory bodies;
- the design and implementation of national or supra-national mandated recovery, resolution or insolvency regimes;
- additional rules and requirements adopted at the European level relating to the separation of certain trading activities from retail banking operations;
- further investigations, proceedings or fines either against the RBS Group in isolation or together with other large financial institutions with respect to market conduct wrongdoing;
- the imposition of government imposed requirements and/or related fines and sanctions with respect to lending to the UK SME market and larger commercial and corporate entities and residential mortgage lending;

Additional information

- additional rules and regulatory initiatives and review relating to customer protection, including the FCA's Treating Customers Fairly regime;
- requirements to operate in a way that prioritises objectives other than shareholder value creation;
- the imposition of restrictions on the RBS 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;
- other requirements or policies affecting the RBS Group's profitability, such as the imposition of onerous compliance obligations, further restrictions on business growth, product offering, or pricing;
- changes to financial reporting standards (including accounting standards), corporate governance requirements, corporate structures and conduct of business rules;
- reviews and investigations relating to the retail banking sector in the UK, including with respect to SME banking and PCAs;
- the introduction of, and changes to, taxes, levies or fees applicable to the RBS Group's operations (such as the imposition of a financial transaction tax or changes in tax rates or to the treatment of carry-forward tax losses that reduce the value of deferred tax assets and require increased payments of tax); and
- 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).

Changes in laws, rules or regulations, or in their interpretation or enforcement, or the implementation of new laws, rules or regulations, including contradictory laws, rules or regulations by key regulators in different jurisdictions, or failure by the RBS Group to comply with such laws, rules and regulations, may have a material adverse effect on the RBS Group's and/or 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 RBS Group's ability to engage in effective business, capital and risk management planning.

The RBS Group is subject to resolution procedures under resolution and recovery schemes which may result in various actions being taken in relation to the RBS Group and any securities of the RBS Group, including the write off, write-down or conversion of the RBS Group's securities. In the EU, the UK and the US regulators have or are in the process of implementing resolution regimes to ensure the timely and orderly resolution of financial institutions and limit the systemic risks resulting from the failure of global and complex financial groups. In the EU and the UK, the BRRD which came into force on 1 January 2015, sets out a harmonised legal framework governing the tools and powers available to national authorities to address the failure of banks and certain other financial institutions. These tools and powers include preparatory and preventive measures, early supervisory intervention powers and resolution tools.

In July 2014, the PRA published a paper on the implementation of the BRRD in the UK and in December 2014 HM Treasury published final versions of the statutory instruments transposing the BRRD which came into effect in January 2015. The PRA published its final rules and requirements implementing the BRRD in January 2015. The EBA also published final draft regulatory technical standards in December 2014 on the content of resolution plans and final guidelines on measures to reduce or remove impediments to resolvability. The implementation of the BRRD in the UK may also continue to evolve over time to ensure continued consistency with the FSB recommendations on resolution regimes and resolution planning for GSIBs, in particular with respect to TLAC requirements.

As a result of its status as a GSIB and in accordance with the PRA's resolution and recovery schemes then in place in the UK, the RBS Group was required to meet certain resolution planning requirements by the end of 2012 and 2013. The RBS Group's US businesses and CFG made their required submissions to the Federal Reserve and the FDIC by their July 1, 2014 due dates. The US supervisory agencies subsequently announced that, beginning in 2015, banks would be required to submit their annual resolution plans by 31 December of each year instead of by 1 July. Similar to other major financial institutions, both the RBS Group and its key subsidiaries remain engaged in a constructive dialogue on resolution and recovery planning with key national regulators and other authorities.

In addition to the preventive measures set out above, the UK resolution authority now has available a wide range of powers to deal with failing financial institutions. As a result of the implementation of BRRD in the UK in January 2015, the provisions of the Banking Act 2009 have been substantially amended to enable the relevant authorities to deal with and stabilise certain deposit-taking UK incorporated institutions that are failing, or are likely to fail. In addition to the existing stabilisation options available under the Banking Act 2009 being (i) the transfer of all or part of the business of the relevant entity and/or the securities of the relevant entity to a private sector purchaser, (ii) the transfer of all or part of the business of the relevant entity to a 'bridge bank' wholly owned by the Bank of England and (iii) temporary public ownership (nationalisation) of the relevant entity, the resolution entity will now be able to rely on an asset separation tool which will enable the Bank of England to use property transfer powers to transfer assets, rights and liabilities of a failing bank to an asset management vehicle. In addition, the new rules have transposed the BRRD requirement that the government stabilisation options may 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.

Additional information

Risk factors continued

Among the changes introduced by the Banking Reform Act 2013, the Banking Act 2009 was amended to insert a bail-in option as part of the powers available to the UK resolution authority. The bail-in option was introduced as an additional power available to the Bank of England to enable it to recapitalise a failed institution by allocating losses to its shareholders and unsecured creditors in a manner that seeks to respect the hierarchy of claims in liquidation. The BRRD also includes a "bail-in" tool, which gives the relevant supervisory authorities the power to write down or write off claims (including debt securities issued by RBSG and its subsidiaries) of certain unsecured creditors of a failing institution and/or to convert certain debt claims to equity or to other securities of the failing institution or to alter the terms of an existing liability. The UK Government amended the provisions of the Banking Act 2009, as amended by the Banking Reform Act 2013, to ensure the consistency of these provisions with the bail-in provisions under the BRRD which came into effect on 1 January 2015, subject to certain transition provisions effective for debt instruments as of 19 February 2015 and with the exception of provisions relating to MREL and Article 55 of the BRRD which relates to liabilities within the scope of the bail-in powers but governed by the law of a third country. Such bail-in mechanism, pursuant to which losses would be imposed on shareholders and, as appropriate, creditors (including senior creditors) of the RBS Group (through write-down or conversion into equity of liabilities including debt securities) would be used to recapitalise and restore the RBS Group to solvency. The bail-in regime adopted under the BRRD (and implemented in the UK) also provides that shareholders and creditors should not be left worse off as a result of the exercise of the stabilisation powers than they would have been had the bank not been resolved, but instead placed into insolvency. The exercise of the bail-in option will be determined by the resolution authority which will have discretion to determine whether the RBS Group has reached a point of non-viability. Because of this inherent uncertainty, it will be difficult to predict when, if at all, the exercise of the bail-in power may occur.

The methods for implementation of any resolution and recovery scheme remain the subject of debate, particularly with respect to banking group companies and for GSIBs with complex cross border activities. Such debate includes whether the bail-in tool may be exercised through a single point of entry at the holding company or at various levels of the corporate structure of a GSIB.

The potential impact of these resolution and recovery powers may include the total loss of value of securities issued by the RBS Group and, in addition for debt holders, the possible conversion into equity securities, and under certain circumstances the inability of the RBS Group to perform its obligations under its securities. The possible application of bail-in to the RBS Group's and/ or the Group's certain of their respective subsidiaries' debt securities and additional Tier 1 and Tier 2 capital securities may also make it more difficult to issue such securities in the capital markets and the cost of raising such funds may be higher than has historically been the case.

The RBS Group's operations are highly dependent on its IT systems and is increasingly exposed to cyber security threats.

The RBS Group's operations are dependent on the ability to process a very large number of transactions efficiently and accurately while complying with applicable laws and regulations where it does business. The proper functioning of the RBS Group's payment systems, financial and sanctions controls, risk management, credit analysis and reporting, accounting, customer service and other IT systems, as well as the communication networks between its branches and main data processing centres, are critical to the RBS Group's operations. In June 2012, computer system failures prevented NatWest, RBS plc and Ulster Bank customers from accessing accounts in both the UK and Ireland. Ongoing issues relating to the failure continued for several months, requiring the RBS Group to set aside a provision for compensation to customers who suffered losses as a result of the system failure. In addition, in November 2014, the RBS Group reached a settlement with the FCA and the PRA in relation to this incident and agreed a penalty of £42 million with the FCA and £14 million with the PRA. Ulster Bank, one of the RBS Group's subsidiaries, was also fined €3.5m by the Central Bank of Ireland in relation to the IT incident and IT governance failures which occurred in 2012. The vulnerabilities of the RBS Group's IT systems are due to the complexity of the RBS Group's IT infrastructure attributable in part to overlapping multiple legacy systems resulting from the RBS Group's acquisitions and the consequential gaps in how the IT systems operate, and insufficient investments in IT infrastructure in the past, creating challenges in recovering from system breakdowns. Critical system failure, any prolonged loss of service availability or any material breach of data security, particularly involving confidential customer data, could cause serious damage to the RBS Group's ability to service its customers, could result in significant compensation costs, could breach regulations under which the RBS Group operates and could cause long-term damage to the RBS Group's and/or the Group's reputation, business and brands. The Group is also currently implementing a significant IT investment programme which involves execution risks and may not be successful. See *'The RBS Group is currently implementing a number of significant investment and rationalisation initiatives as part of the RBS Group's IT and operational investment programme. Should such investment and rationalisation initiatives fail to achieve the expected results, it could have a material adverse impact on the RBS Group's and/or the Group's operations and its ability to retain or grow its customer business'*.

In addition, the RBS Group is subject to cyber-security threats which have targeted financial institutions as well as governments and other institutions and have increased in the recent years. Failure to protect the RBS Group's and/or the Group's operations from cyber-attacks could result in the loss of customer data or other sensitive information. During 2013, the RBS Group experienced a number of IT failures following a series of deliberate attacks which temporarily prevented RBS plc, CFG and NatWest customers from accessing their accounts or making payments. The Bank of England, the FCA and HM Treasury have identified cyber security as a systemic risk to the UK financial sector and highlighted the need for financial institutions to improve resilience to cyber-attacks and the RBS Group expects greater regulatory engagement on cyber security in the future. Although the RBS Group has been implementing remedial actions to improve its resilience to the increasing intensity and sophistication of cyber-attacks, the RBS Group expects to be the target of continued attacks in the future and there can be no assurance that the RBS Group will be able to prevent all threats.

Additional information

The RBS Group's operations have 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 RBS Group's conduct and performance, is inherent in the RBS Group's business.

Stakeholders include customers, investors, rating agencies, employees, suppliers, government, politicians, regulators, special interest groups, consumer groups, media and the general public. Brand damage can be detrimental to the business of the RBS 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 RBS Group conducts its business activities, the RBS Group's financial performance, ongoing investigations and proceedings and the settlement of any such investigations and proceedings, the level of direct and indirect government support or actual or perceived practices in the banking and financial industry may adversely affect the RBS Group's and/or the Group's ability to keep and attract customers and, in particular, corporate and retail depositors. Reputational risks may be increased as a result of the implementation of the RBS Group's Transformation Plan. 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 significantly enhance and accelerate the impact of damaging information and allegations. 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 RBS Group's and/or the Group's business, financial condition, results of operations and prospects.

The RBS Group may suffer losses due to employee misconduct.

The RBS Group's businesses are exposed to risk from potential non-compliance with policies, regulatory rules, employee misconduct or negligence and fraud, which could result in regulatory sanctions and serious reputational or financial harm to the RBS Group and/or the Group. In recent years, a number of multinational financial institutions, including the RBS Group, have suffered material losses due to the actions of employees, including, for example, in connection with the LIBOR and foreign exchange investigations. It is not always possible to deter employee misconduct and the precautions the RBS Group takes to prevent and detect this activity may not always be effective.

The RBS 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.

In previous years, severe market events resulted in the RBS Group, including the Group recording large write-downs on its credit market exposures. Any deterioration in economic and financial market conditions or weak economic growth could lead to further 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 RBS 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 RBS Group's assets, may result in significant changes in the fair values of the RBS Group's, including the Group's, exposures, such as credit market exposures and the value ultimately realised by the RBS Group may be materially different from the current or estimated fair value.

As part of the RBS Group's previous restructuring and capital initiatives, including the 2013/2014 Strategic Plan, it has already materially reduced the size of its balance sheet mainly through the sale and run-off of non-core assets. The assets transferred to RCR (which included assets formerly part of the RBS Group's Non-Core division together with additional assets identified as part of a HM Treasury review), became part of the RBS Group's Capital Resolution Group ("CRG") as of 1 January 2014. In connection with the establishment of CRG, the RBS Group indicated its aspiration to remove the vast majority, if not all of the assets comprising RCR within three years which resulted in increased impairments of £4.5 billion which were recognised in Q4 2013. The value of the assets in RCR, excluding derivatives, was £14.9 billion at December 31, 2014 following significant reductions during 2014. Although the RBS Group to date has successfully reduced the size of the RCR portfolio, the remaining assets in RCR may be difficult to sell and could be subject to further write-downs or, when sold, realised losses. The CRG also includes the RBS Group's stake in the Williams & Glyn business as well as its remaining stake in CFG. In addition, as part of the restructuring of the RBS Group's CIB business, the RBS Group will be exiting or disposing of substantial parts of that business. The RBS Group's interest in these businesses may be difficult to sell due to unfavourable market conditions for such assets or businesses. See also *'The RBS Group's ability to achieve its capital targets will depend on the success of the RBS Group's plans to further reduce the size of its business through the restructuring of its corporate and institutional banking business and make further divestments of certain of its portfolios and businesses including its remaining stake in Citizens Financial Group'*. Any of these factors could require the RBS Group and/or the Group to recognise further significant write-downs, realise increased impairment charges or goodwill impairments, all of which may have a material adverse effect on their financial condition, results of operations and capital ratios.

The RBS Group may be required to make further contributions to its pension schemes if the value of pension fund assets is not sufficient to cover potential obligations and to satisfy ring-fencing requirements.

The RBS Group maintains 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 do not fully match the timing and amount of the schemes' liabilities which are long-term in nature, and as a result of which, the RBS Group is required or chooses to make additional contributions to the schemes.

Pension scheme liabilities vary with changes to long-term interest rates, inflation, pensionable salaries and the longevity of scheme members as well as changes in applicable legislation. The funded schemes hold assets to meet projected liabilities to the scheme members. Risk arises from the schemes because the value of the asset portfolios, together with any additional future contributions to the schemes, may be less than expected and because there may be greater than expected increases in the estimated value of the schemes' liabilities.

Additional information

Risk factors continued

In these circumstances, the RBS Group could be obliged, or may choose, to make additional contributions to the schemes. Given the economic and financial market difficulties that arose out of the financial crisis and the risk that such conditions may occur again over the near and medium term, the RBS Group has experienced and may continue to experience increasing pension deficits or be required or elect to make further contributions to its pension schemes. Such deficits and contributions could be significant and have an adverse impact on the RBS Group's and/or the Group's results of operations or financial condition. In May 2014, the triennial funding valuation of The Royal Bank of Scotland Group Pension Fund 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 will pay annual 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.

The Banking Reform Act 2013 requires banks to ring-fence specific activities (principally retail and small business deposits) from certain other activities. Ring-fencing will require changes to the structure of the RBS Group's existing defined benefit pension schemes as ring-fenced banks may not be liable for debts to pension schemes that might arise as a result of the failure of another entity of the ring-fenced bank's group, which could affect assessments of the RBS Group's schemes deficits. The Financial Services and Markets Act 2000 (Banking Reform Pensions) Regulations 2015 requires that ring-fence banks ensure that they cannot become liable for the pension schemes of the rest of their group, or anyone else after January 1, 2026. The RBS Group is developing a strategy to meet the requirements of these regulations, which has been discussed with the PRA. The implementation of this strategy will require the agreement of pension scheme trustees. Discussions with the pension 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.

The financial performance of the RBS Group has been, and may continue to be, materially affected by counterparty credit quality and deterioration in credit quality could arise due to prevailing economic and market conditions and legal and regulatory developments.

The RBS Group has exposure to many different industries and counterparties, and risks arising from actual or perceived changes in credit quality and the recoverability of monies due from borrowers and counterparties are inherent in a wide range of the RBS Group's businesses. In particular, the RBS Group has significant exposure to certain individual counterparties in weaker business sectors and geographic markets and also has concentrated country exposure in the UK, the US and across the rest of Europe (principally Germany, The Netherlands, Ireland and France) (at 31 December 2014 credit risk assets (excluding personal finance) in the UK were £180.8 billion, in North America £81.8 billion and in Western Europe (excluding the UK) £76.3 billion); and within certain business sectors, namely personal finance, financial institutions, commercial real estate, shipping and the oil and gas sector (at 31 December 2014 personal finance lending amounted to £180.8 billion, lending to financial institutions was £91.5 billion, commercial real estate lending was £43.3 billion, lending to the oil and gas sector was £10.7 billion and lending against ocean going vessels was £10.4 billion). As the RBS Group implements its new strategy and withdraws from many geographic markets and materially scales down its activities in the United States, the RBS Group's relative exposure to the UK will increase significantly as its business becomes more concentrated in the UK.

The credit quality of the RBS Group's borrowers and 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 RBS Group's core markets, in particular the UK and Ireland, as these economies have improved. However, a further deterioration in economic and market conditions or changes to legal or regulatory landscapes could worsen borrower and counterparty credit quality and also impact the RBS Group's ability to enforce contractual security rights. In addition, the RBS Group's credit risk is exacerbated when the collateral it holds cannot be realised or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due to the RBS Group, which is most likely to occur during periods of illiquidity and depressed asset valuations, such as those experienced in recent years. This has been particularly the case with respect to large parts of the RBS Group's commercial real estate portfolio. Any such losses could have an adverse effect on the RBS Group's and/or the Group's results of operations and financial condition.

Additional information

Concerns about, or a default by, one financial institution could lead to significant liquidity problems and losses or defaults by other financial institutions, as the commercial and financial soundness of many financial institutions may be closely related as a result of credit, trading, clearing and other relationships. Even the perceived lack of creditworthiness of, or questions about, a counterparty may lead to market-wide liquidity problems and losses for, or defaults by, the RBS Group. This systemic risk may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with which the RBS Group interacts on a daily basis, all of which could have a material adverse effect on the RBS Group's access to liquidity or could result in losses which could have a material adverse effect on the RBS Group's and/or the Group's financial condition, results of operations and prospects.

In certain jurisdictions in which the RBS Group does business, particularly Ireland, additional constraints have been imposed in recent years on the ability of certain financial institutions to complete foreclosure proceedings in a timely manner (or at all), including as a result of interventions by certain states and local and national governments. These constraints have lengthened the time to complete foreclosures, increased the backlog of repossessed properties and, in certain cases, have resulted in the invalidation of purported foreclosures.

The EU, the ECB, the International Monetary Fund and various national authorities have proposed and implemented certain measures intended to address systemic financial stresses in the Eurozone, including the creation of a European Banking Union which, through a Single Resolution Mechanism (SRM) will apply the substantive rules of bank recovery and resolution set out in the BRRD. Current expectations are that the SRM will apply from 1 January 2016, subject to certain provisions which came into effect from 1 January 2015 relating to the cooperation between national resolution authorities and the financial stability board. The effectiveness of these and other actions proposed and implemented at both the EU and national level to address systemic stresses in the Eurozone is not assured.

The trends and risks affecting borrower and counterparty credit quality have caused, and in the future may cause, the RBS Group to experience further and accelerated impairment charges, increased repurchase demands, higher costs, additional write-downs and losses for the RBS Group and an inability to engage in routine funding transactions.

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 RBS Group's and/or the Group's business and results of operations.

Some of the most significant market risks the RBS Group faces are interest rate, foreign exchange, credit spread, bond, equity and commodity prices and basis, volatility and correlation risks. Changes in interest rate levels (or extended periods of low interest rates such as experienced over the past several years), yield curves (which remain depressed) 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. Changes in currency rates, particularly in the sterling-US dollar and sterling-euro exchange rates, affect the value of assets, liabilities, income and expenses denominated in foreign currencies and the reported earnings of the RBS Group's non-UK subsidiaries and may affect the RBS Group's reported consolidated financial condition or its income from foreign exchange dealing. Such changes may result from the decisions of Central Banks in Europe and of the Federal Reserve in the US and lead to sharp and sudden variations in foreign exchange rates. For accounting purposes, the RBS Group and the Group carry some of their 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 RBS Group and the Group, may result in a change to the fair value of such debt, which is recognised in their respective income statements as a profit or loss.

The performance and volatility of financial markets affects bond and equity prices, has caused, and may in the future cause, changes in the value of the Group's investment and trading portfolios. Financial markets experienced significant volatility towards the end of 2014 and this trend has continued in early 2015, resulting in further short term changes in the valuation of certain of the Group's assets. In addition, during the last quarter of 2014, oil prices fell significantly against their historical levels and other commodity prices also decreased. The Group is exposed to oil prices through its exposure to counterparties in the energy sector and oil producing countries. Further or sustained decreases in oil prices could negatively impact counterparties and the value of the Group's trading portfolios. As part of its on-going derivatives operations, the Group also faces significant basis, volatility and correlation risks, the occurrence of which are also impacted by the factors noted above.

While the Group has implemented risk management methods to mitigate and control these and other market risks to which it is exposed, it is difficult to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on the Group's financial performance and business operations.

Additional information

Risk factors continued

The value or effectiveness of any credit protection that the RBS Group has purchased depends on the value of the underlying assets and the financial condition of the insurers and counterparties.

The RBS Group has credit exposure arising from over-the-counter derivative contracts, mainly credit default swaps (CDSs), and other credit derivatives, each of which are carried at fair value. The fair value of these CDSs, as well as the RBS Group's exposure to the risk of default by the underlying counterparties, depends on the valuation and the perceived credit risk of the instrument against which protection has been bought. Many market counterparties have been adversely affected by their exposure to residential mortgage linked and corporate credit products, whether synthetic or otherwise, and their actual and perceived creditworthiness may deteriorate rapidly. If the financial condition of these counterparties or their actual or perceived creditworthiness deteriorates, the RBS Group and the Group may record further credit valuation adjustments on the credit protection bought from these counterparties under the CDSs. The RBS Group and the Group also recognise any fluctuations in the fair value of other credit derivatives. Any such adjustments or fair value changes may have a material adverse impact on the Group's financial condition and results of operations.

In the UK and in other jurisdictions, the RBS Group is responsible for contributing to compensation schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers.

In the 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 and may be required to make payments either in connection with the exercise of a stabilisation power or in exercise of the bank insolvency procedures under the Banking Act 2009.

The FSCS is funded by levies on firms authorised by the FCA, including 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.

In addition, the BRRD requires Member States to establish financing arrangements for the purpose of ensuring the effective application by national resolution authorities of the resolution tools and powers, which will require national resolution funds to raise "ex ante" contributions on banks and investment firms in proportion to their liabilities and risk profiles as well as "ex post" funding contributions. Following the adoption of the European delegated regulation on "ex-ante" contributions, the UK government confirmed that it would implement the "ex post" funding requirements through the UK bank levy of the Finance Act 2011.

To the extent that other jurisdictions where the RBS Group operates have introduced or plan to introduce similar compensation, contributory or reimbursement schemes (such as in the US with the Federal Deposit Insurance Corporation), 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.

The value of certain financial instruments recorded at fair value is determined using financial models incorporating assumptions, judgements and estimates that may change over time or may ultimately not turn out to be accurate.

Under International Financial Reporting Standards (IFRS), the RBS Group recognises at fair value: (i) financial instruments classified as held-for-trading or designated as at fair value through profit or loss; (ii) financial assets classified as available-for-sale; and (iii) derivatives.

Generally, to establish the fair value of these instruments, the RBS 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 RBS Group's internal valuation models require the RBS Group to make assumptions, judgements and estimates to establish fair value, which are complex and often relate to matters that are inherently uncertain. These assumptions, judgements and estimates also need to be updated to reflect changing facts, trends and market conditions. The resulting change in the fair values of the financial instruments has had and could continue to have a material adverse effect on the RBS Group's and/or the Group's earnings, financial condition and capital position.

The RBS Group relies on valuation, capital and stress test models to conduct its business and anticipate capital and funding requirements. Failure of these models to provide accurate results or accurately reflect changes in the micro and macro economic environment in which the RBS Group operates could have a material adverse effect on the RBS Group's and/or the Group's business, capital and results.

Given the complexity of the RBS Group's business, strategy and capital requirements, the RBS Group relies on analytical models to assess the value of its assets and its risk exposure and anticipate capital and funding requirements. The RBS Group's 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 RBS Group operates 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 risk profile of the RBS Group's financial instruments. Some of the analytical models used by the RBS Group are predictive in nature. The use of predictive models has inherent risks and may incorrectly forecast future behaviour, leading to flawed decision making and potential losses. The RBS 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 RBS Group in its forecasts or decision making. Should such models prove to be incorrect or misleading, decisions made by the RBS Group in reliance thereon could expose the RBS Group and/or the Group to business, capital and funding risk.

Additional information

The RBS Group's results could be adversely affected in the event of goodwill impairment.

The RBS Group capitalises goodwill, which is calculated as the excess of the cost of an acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Acquired goodwill is recognised initially at cost and subsequently at cost less any accumulated impairment losses. As required by IFRS, the RBS Group tests goodwill for impairment annually, or more frequently when events or circumstances indicate that it might be impaired. An impairment test involves comparing the recoverable amount (the higher of the value in use and fair value less cost to sell) of an individual cash generating unit with its carrying value. At 31 December 2014, the RBS Group carried goodwill of £6.3 billion on its balance sheet.

The value in use and fair value of the RBS Group's cash generating units are affected by market conditions and the performance of the economies in which the RBS Group operates. Where the RBS Group is required to recognise a goodwill impairment, it is recorded in the RBS Group's income statement, although it has no effect on the RBS Group's regulatory capital position. Further impairments of the RBS Group's goodwill could have an adverse effect on the RBS Group's results and financial condition.

Any significant write-down of goodwill could have a material adverse effect on the Group's results of operations.

The recoverability of certain deferred tax assets recognised by the RBS Group depends on the RBS Group's ability to generate sufficient future taxable profits and may be affected by changes to tax legislation.

In accordance with IFRS, the RBS Group has recognised deferred tax assets on losses available to relieve future profits from tax only to the extent that it is probable that they will be recovered. The deferred tax assets are quantified on the basis of current tax legislation and accounting standards and are subject to change in respect of the future rates of tax or the rules for computing taxable profits and offsetting allowable losses. Failure to generate sufficient future taxable profits or changes in tax legislation (including rates of tax) or accounting standards may reduce the recoverable amount of the recognised deferred tax assets. At 31 December 2014, the value of the RBS Group's deferred tax assets was £1.5 billion. In December 2014 the UK Government announced a proposed restriction on the use of certain brought forward tax losses of banking companies to 50% of relevant profits from 1 April 2015 which may also affect the recoverable amount of recognised deferred tax assets. In addition, the implementation of the rules relating to ring-fencing and the resulting restructuring of the RBS Group may further restrict the RBS Group's ability to recognise tax losses within the RBS Group as deferred tax assets.

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.

Bear steepener - a steepening of the yield curve caused by long-term rates increasing faster than short term rates.

BIPRU - the prudential sourcebook for banks, building societies and investment firms. The part of the Financial Conduct Authority (FCA) Handbook that sets out detailed prudential requirements for the banks that they regulate.

Bull flattener - a flattening of the yield curve in which long term rates are decreasing faster than short term rates.

Buy-to-let mortgages - mortgages to customers for the purchase of residential property as a rental investment.

Capital requirements regulation (CRR) - see 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 the cash flow hedging reserve, less specified regulatory adjustments.

Glossary of terms

Constant currency - reported results for the current reporting period are compared to results for comparative periods retranslated at exchange rates for the current period.

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.

Core Tier 1 capital - under Basel II called-up share capital and eligible reserves plus equity non-controlling interests, less intangible assets and other regulatory deductions.

Core Tier 1 capital ratio - Core Tier 1 capital as a percentage of risk-weighted assets.

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 Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), collectively known as CRD IV. CRD IV was implemented on 1 January 2014. The European Banking Authority'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. Sometimes they can also buy credit protection. 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, if any, 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 - on securitisation, 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 arrangements). 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 by an entity to the valuation of OTC derivative liabilities to reflect within fair value 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.

Glossary of terms

Deferred tax asset - income taxes recoverable in future periods as a result of deductible temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in tax deductible amounts in future periods) and the carry-forward of tax losses and unused tax credits.

Deferred tax liability - income taxes payable in future periods as a result of taxable temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in taxable amounts in future periods).

Defined benefit obligation - the present value of expected future payments required to settle the obligations of a defined benefit plan resulting from employee service.

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 index 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 impacts the transferability of the asset and can restrict its free use 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 17 European Union countries that have adopted the euro: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, 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.

Fully loaded Basel III basis - capital ratios based on the rules that will apply at the end of the Basel III transition period.

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 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, any currency or maturity mismatches between a credit risk mitigant and the underlying exposure to which it is being applied.

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 - see 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 II 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 as impaired 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.

Glossary of terms

Leveraged finance - funding (leveraged finance) provided to a business resulting in an overall level of debt in relation to cash flow that exceeds that which would be considered usual for the business or for the industry in which it operates. Leveraged finance is commonly employed to achieve a specific, often temporary, objective: to make an acquisition, to effect a buy-out or to repurchase shares.

Liquidity and funding risk - the risk that the Group is unable to meet its financial liabilities when they fall due.

Liquidity coverage ratio (LCR) - the ratio of the stock of high quality liquid assets to expected net cash outflows over the following 30 days. High quality liquid assets should be unencumbered, liquid in markets during a time of stress and, ideally, central bank eligible.

Loan:deposit ratio - the ratio of loans and advances to customers net of provision for impairment losses and excluding reverse repurchase agreements to customer deposits excluding repurchase agreements.

Loan impairment provisions - loan impairment provisions are established to recognise incurred impairment losses on a portfolio of loans classified as loans and receivables and carried at amortised cost. It has three components: individually assessed loan impairment provisions, collectively assessed loan impairment provisions and latent loss provisions.

Loan-to-value ratio - the amount of a secured loan as a percentage of the appraised value of the security e.g. the outstanding amount of a mortgage loan as a percentage of the property's value.

London Interbank Offered Rate (LIBOR) - the benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.

Loss given default (LGD) - an estimate of the amount that will not be recovered by the Group in the event of default, plus the cost of debt collection activities and the delay in cash recovery.

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

Master netting agreement - an agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.

Maximum distributable amount (MDA) - a restriction on distributions which may be made by a bank which does not meet the combined buffer requirements as set out in the PRA Supervisory Statement SS6/14 'Implementing CRD IV: capital buffers'.

Medium term notes (MTNs) - debt securities usually with a maturity of five to ten years, but the term may be less than one year or as long as 50 years. They can be issued on a fixed or floating coupon basis or with an exotic coupon; with a fixed maturity date (non-callable) or with embedded call or put options or early repayment triggers. MTNs are generally issued as senior unsecured debt.

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 the underlying physical or financial commodity, at a specific price, at an agreed date or over an agreed period. Options can be exchange-traded or traded over-the-counter.

Over-the-counter (OTC) derivatives - derivatives with tailored terms and conditions negotiated bilaterally, in contrast to exchange traded derivatives that have standardised terms and conditions.

Own credit adjustment (OCA) - the effect of the Group's own credit standing on the fair value of financial liabilities.

Past due - a financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.

Pillar 1 - the part of Basel II that sets out the process by which regulatory capital requirements should be calculated for credit, market and operational risk.

Glossary of terms

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 Basel II 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 BIPRU 7 (Market risk) 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.

Private equity investments - 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, from 1 April 2013, 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) - see 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 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 and B shareholders divided by average shareholders' equity as a percentage.

Reverse repurchase agreement (Reverse repo) - see Sale and repurchase agreements.

Risk appetite - an expression of the maximum level of risk that the Group is prepared to accept to deliver its business objectives.

Risk asset ratio (RAR) - total regulatory capital as a percentage of risk-weighted assets.

Risk elements in lending (REIL) - impaired loans and accruing loans which are contractually overdue 90 days or more as to principal or interest.

Risk-weighted assets (RWAs) - assets adjusted for their associated risks using weightings established in accordance with the Basel Capital Accord 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).

Glossary of terms

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 of Basel II. 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 Bank'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%. See also Value-at-risk below.

Structured credit portfolio (SCP) - a portfolio of certain of the Group's illiquid assets - principally CDO super senior positions, negative basis trades and monoline exposures - held within Non-Core division.

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 IRB 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 1 capital ratio - a component of regulatory capital, comprising eligible capital securities and any related share premium. Under Basel II, qualifying subordinated debt and other Tier 2 securities in issue, eligible collective impairment allowances, unrealised gains arising on the fair valuation of equity instruments held as available-for-sale, less certain regulatory deductions.

Tier 2 capital - qualifying subordinated debt and other Tier 2 securities in issue, eligible collective impairment allowances, unrealised available-for-sale equity gains and revaluation reserves less certain regulatory deductions.

Total loss absorbing capacity (TLAC) - an FSB proposal 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. These proposals are intended to facilitate an orderly resolution that minimises any impact on financial stability, ensures the continuity of critical functions, and avoids exposing taxpayers to loss.

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.

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 Transformation Plan (which includes the 2013/2014 strategic plan relating to the implementation of the new divisional and functional structure and the continuation of the balance sheet reduction programme including the proposed divestments of Williams & Glyn and Citizens, the information technology and operational investment plan, the proposed restructuring of the CIB business and the restructuring of RBSG and the Group as a result of the implementation of the regulatory ring-fencing regime), as well as restructuring, capital and strategic plans, divestments, capitalisation, portfolios, net interest margin, capital and leverage ratios, liquidity, risk-weighted assets (RWAs), RWA equivalents (RWAE), Pillar 2A, Maximum Distributable Amount (MDA), total loss absorbing capital (TLAC), minimum requirements for eligible liabilities (MREL), return on equity (ROE), profitability, cost:income ratios, loan:deposit ratios, funding and risk profile; litigation, government and regulatory investigations including investigations relating to the setting of interest rates and foreign exchange trading and rate setting activities; costs or exposures borne by the Group arising out of the origination or sale of mortgages or mortgage-backed securities in the US; the Group's future financial performance; the level and extent of future impairments and write-downs; and RBSG and the Group's exposure to political risks, 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 on pages 288 to 307. These include the significant risks for the Group presented by the execution of the Transformation Plan; the Group's ability to successfully implement the various initiatives that are comprised in the Transformation Plan, particularly the balance sheet reduction programme including the divestment of Williams & Glyn and its remaining stake in CFG, the proposed restructuring of the CIB business and the significant restructuring undertaken by RBSG and the Group as a result of the implementation of the ring fence; whether the Group will emerge from implementing the Transformation Plan as a viable, competitive, customer-focused and profitable bank; the Group's ability to achieve its capital targets which depend on the Group's success in reducing the size of its business; the cost and complexity of the implementation of the ring-fence and the extent to which it will have a material adverse effect on the Group; the risk of failure to realise the benefit of the Group's substantial investments in its information technology and operational infrastructure and systems, the significant changes, complexity and costs relating to the implementation of the Transformation Plan, the risks of lower revenues resulting from lower customer retention and revenue generation as the Group refocuses on the UK as well as increasing competition.

In addition, there are other risks and uncertainties. These include the Group's ability to attract and retain qualified personnel; uncertainties regarding the outcomes of legal, regulatory and governmental actions and investigations that the Group is subject to and any resulting material adverse effect on the Group of unfavourable outcomes; heightened regulatory and governmental scrutiny and the increasingly regulated environment in which the Group operates; uncertainty relating to how policies of the new government elected in the May 2015 UK election may impact the Group including a possible referendum on the UK's membership of the EU; operational risks that are inherent in the Group's business and that could increase as the Group implements the Transformation Plan; the potential negative impact on the Group's business of actual or perceived global economic and financial market conditions and other global risks; how the Group will be increasingly impacted by UK developments as its operations become gradually more focused on the UK; uncertainties regarding the Group's exposure to any weakening of economies within the EU and renewed threat of default by certain countries in the Eurozone; the risks resulting from the Group implementing the State Aid restructuring plan including with respect to the disposal of certain assets and businesses as announced or required as part of the State Aid restructuring plan; the achievement of capital and costs reduction targets; ineffective management of capital or changes to regulatory requirements relating to capital adequacy and liquidity; the ability to access sufficient sources of capital, liquidity and funding when required; deteriorations in borrower and counterparty credit quality; the extent of future write-downs and impairment charges caused by depressed asset valuations; the value and effectiveness of any credit protection purchased by the Group; 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; changes in the credit ratings of RBSG, the Bank or other entities of the RBS Group; changes to the valuation of financial instruments recorded at fair value; competition and consolidation in the banking sector; regulatory or legal changes (including those requiring any restructuring of RBSG or the Group's operations); changes to the monetary and interest rate policies of central banks and other governmental and regulatory bodies; changes in UK and foreign laws, regulations, accounting standards and taxes; impairments of goodwill; the high dependence of the Group's operations on its information technology systems and its increasing exposure to cyber security threats; the reputational risks inherent in the Group's operations; the risk that the Group may suffer losses due to employee misconduct; pension fund shortfalls; the recoverability of deferred tax assets by the Group; HM Treasury exercising influence over the operations of the Group; limitations on, or additional requirements imposed on, the Group's activities as a result of HM Treasury's investment in RBSG; and the success of the Group in managing the risks involved in the foregoing.

The forward-looking statements contained in this document speak only as of the date of this announcement, and the Bank does not undertake 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 solicitation of any offer to buy any securities or financial instruments or any advice or recommendation with respect to such securities or other financial instruments.

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