

Annual Report
and Accounts 2016

Financial review

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Board of directors and secretary

Chairman

Howard Davies

[Nominations \(Chairman\)](#)

Executive directors

Ross McEwan

[Executive \(Chairman\)](#)

Ewen Stevenson

[Executive](#)

Independent non-executive directors

Sandy Crombie

Senior Independent Director

[Remuneration \(Chairman\), Audit, Nominations](#)

Frank Dangeard

[Risk](#)

Alison Davis

[Nominations, Remuneration, Sustainability](#)

Morten Friis

[Audit, Risk](#)

Robert Gillespie

[Nominations, Remuneration, Sustainability](#)

Penny Hughes

[Sustainability \(Chairman\), Risk](#)

Brendan Nelson

[Audit \(Chairman\), Nominations, Risk](#)

Baroness Noakes

[Risk \(Chairman\), Audit](#)

Mike Rogers

[Remuneration, Sustainability](#)

Chief Governance Officer and Board Counsel

Aileen Taylor (Company Secretary)

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Chartered Accountants and Statutory Auditor

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The Royal Bank of Scotland plc

Registered in Scotland No. SC90312

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

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

Business structure

The RBS Group continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. On 5 December 2016 the Corporate & Institutional Banking (CIB) business was re-branded as NatWest Markets (NWM) in readiness for our future ring-fenced structure; this included the renaming of the reportable operating segment as NatWest Markets. NatWest Markets will continue to offer financing, rates, and currencies products to its customers.

During 2016 the Group's activities are organised on a franchise basis as follows:

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

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

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

Capital Resolution was established to execute the sale or wind down of most of the global footprint, from 38 countries to 13, and trade finance and cash management outside the UK and Ireland. Additionally non-strategic markets, portfolio and banking assets identified are being sold or wound down.

Williams & Glyn (W&G) refers to the business formerly intended to be divested as a separate legal entity and comprises RBS England and Wales branch-based businesses, along with certain small and medium enterprises and corporate activities across the UK. During the period presented W&G has not operated as a separate legal entity. The perimeter of the segment currently reported does not include certain portfolios that were intended to be divested such as the Scottish branch based activity of NatWest and NatWest Business Direct.

Central items & other includes corporate functions, such as RBS treasury, finance, risk management, compliance, legal, communications and human resources. Central functions manage RBS Group capital resources and RBS Group-wide regulatory projects and provides services to the reportable segments. Balances in relation to The Royal Bank of Scotland International (Holdings) Limited (RBSI Holdings), Citizens and the international private banking business that are included in disposal groups are included in Central items in the relevant periods.

RBS International

RBSI Holdings was sold to RBSG on 1 January 2017 in preparation for ring-fencing. RBSI Holdings is classified as a disposal group at 31 December 2016 and its assets and liabilities presented in aggregate in accordance with IFRS 5. RBSI Holdings which was mainly reported in the RBS International reportable operating segment, is no longer a reportable segment but presented as a discontinued operation and comparatives have been re-presented accordingly.

Citizens

The Group sold the final tranche of its interest in Citizens Financial Group, Inc. during the second half of 2015. Consequently, Citizens was classified as a disposal group at 31 December 2014 and presented as a discontinued operation until October 2015. From 3 August 2015 until the final tranche was sold in October 2015, Citizens was an associated undertaking.

RBS Group ring-fencing

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

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

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

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

Presentation of information

NatWest Holdings Limited (NatWest Holdings)

The Group introduced an intermediate holding company, NatWest Holdings, as a direct subsidiary of RBS plc. This is an interim structure as NatWest Holdings is expected to become a direct subsidiary of RBSG in mid 2018.

National Westminster Bank Plc (NatWest) and Adam & Company Group PLC (Adam & Co) transferred from being direct subsidiaries of RBS plc, and Ulster Bank (Ireland) Holdings Unlimited Company (UBIH) transferred from being a direct subsidiary of Ulster Bank Limited, to become direct subsidiaries of NatWest Holdings.

RBS International

RBSI Holdings transferred from being an indirect subsidiary of RBS plc to become a direct subsidiary of RBSG. The intention is for RBS International's operating companies to remain as subsidiaries of RBSI Holdings.

NatWest bought Lombard North Central PLC and RBS Invoice Finance (Holdings) Limited from RBS plc and some smaller companies from other members of the Group.

Top and emerging risks

Top and emerging risks

The RBS Group employs a continuous process for identifying and managing its top and emerging risks. These are defined as scenarios that could have a significant negative impact on the RBS Group's ability to operate or meet its strategic objectives. A number of scenarios attracted particular attention in 2016.

Macro-economic and political risks:

The RBS Group remains vulnerable to changes and uncertainty in the external economic and political environment, which have intensified in the past year. To mitigate these risks, the RBS Group has taken actions in 2016 with its capital, liquidity and leverage positions. A number of higher-risk portfolios have been exited or reduced. Stress testing and scenario planning is used extensively to inform strategic planning and risk mitigation relating to a range of macro-economic and political risks. Scenarios identified as having a potentially material negative impact on the RBS Group include: the impact of the UK's exit from the EU; a second Scottish independence referendum; a UK recession including significant falls in house prices; global financial market volatility linked to advanced economy interest rate increases or decreases; a protracted period of low interest rates in the UK; vulnerabilities in emerging market economies resulting in contagion in the RBS Group's core markets; a eurozone crisis; and major geopolitical instability.

Risks related to the competitive environment:

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

An increase in obligations to support pension schemes:

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

Regulatory and legal risks

The impacts of past business conduct:

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

Settlements may result in additional financial penalties, non-monetary penalties or other consequences, which may be material. More detail on these issues can be found in the Litigation, Investigations and Reviews and Risk Factors sections. To prevent future conduct from resulting in similar impacts, The RBS Group continues to embed a strong and comprehensive risk and compliance culture.

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

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

Operational and execution risks

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

The successful execution of major projects, including the transformation plan, the restructuring of NatWest Markets, meeting the final European Commission State Aid requirements relating to Williams & Glyn compliance with structural reform requirements, including the statutory ring-fencing requirements implemented as a result of the Independent Commission on Banking; delivering a robust control environment and the embedding of a strong and pervasive, customer centred organisational and risk culture, are essential to meet the RBS Group's strategic objectives. These projects cover organisational structure, business strategy, information technology systems, operational processes and product offerings. The RBS Group is working to implement change in line with its project plans while assessing the risks to implementation and is taking steps to mitigate those risks where possible.

Impact of cyber attacks:

Cyber attacks are increasing in frequency and severity across the industry. The RBS Group has participated in industry-wide cyber attack simulations in order to help test and develop defence planning. To mitigate the risks, a large scale programme to continue to improve controls, enhance protections and educate staff on the threat is underway.

Inability to recruit or retain suitable staff:

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

Failure of information technology systems:

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

Financial review

Financial summary

Summary consolidated income statement for the year ended 31 December 2016

	2016 £m	2015 £m
Net interest income	8,288	8,282
Fees and commissions receivable	3,244	3,629
Fees and commissions payable	(800)	(804)
Income from trading activities	863	912
Loss on redemption of own debt	(90)	(263)
Other operating income	618	183
Non-interest income	3,835	3,657
Total income	12,123	11,939
Operating expenses	(15,326)	(16,011)
Loss before impairment releases	(3,203)	(4,072)
Impairment releases	(529)	838
Operating loss before tax	(3,732)	(3,234)
Tax (charge)/credit	(1,148)	52
Loss from continuing operations	(4,880)	(3,182)
Profit from discontinued operations, net of tax	117	1,596
Loss for the year	(4,763)	(1,586)
Attributable to:		
Non-controlling interests	4	320
Preference shareholders	23	44
Ordinary shareholders	(4,790)	(1,950)
	(4,763)	(1,586)

2016 Highlights and key developments

The Group reported an operating loss before tax of £3,732 million, compared with an operating loss of £3,234 million in 2015, primarily driven by a decrease in operating expenses which included litigation and conduct costs of £5,168 million and restructuring costs of £2,099 million. Restructuring costs included a £750 million provision in respect of the Group's remaining State Aid obligation regarding Williams & Glyn. Total income increased to £12,123 million compared with £11,939 million primarily due to an increase in non-interest income. Impairment losses were £529 million compared with impairment releases of £838 million in 2015.

Loss attributable to shareholders of £4,790 million compared with £1,950 million, reflecting a tax charge of £1,148 million (2015 - £52 million credit). Profit from discontinued operations decreased to £117 million, compared with £1,596 million in 2015. 2016 includes the results of RBS International Holdings (RBSI Holdings) which was classified as a discontinued operation at 31 December 2016.

The RBS plc CET1 ratio decreased from 16.0% to 13.1%. This reflected the annual phasing in of the CRR end-point rules relating to significant investments, litigation and conduct charges of £2.7 billion and the £1.3 billion capital injection into NatWest Bank Plc, following the accelerated pension payment, partially offset by RWA reduction.

Risk elements in lending (REIL) of £10.2 billion were £1.8 billion lower than 31 December 2015 and represented 3.1% of gross customer loans, compared with 3.8% as at 31 December 2015.

In line with the progress to de-risk the balance sheet, exposures to the shipping and oil and gas sectors continued to reduce during 2016, with potential exposures reducing by 29% to £5.2 billion and by 22% to £5.3 billion respectively.

The Group has successfully addressed a number of the remaining legacy issues and continues to de-risk its balance sheet.

- On 17 February 2017, RBS Group announced that it had been informed by HM Treasury (HMT) that the Commissioner responsible for EU competition policy plans to propose to the College of Commissioners to open proceedings to gather evidence on an alternative plan for RBS Group to meet its remaining State Aid obligations. If adopted, this alternative plan would replace the existing requirement to achieve separation and divestment of Williams & Glyn by 31 December 2017. As previously disclosed, none of the proposals to acquire the business received by RBS Group can deliver a full separation and divestment before the 31 December 2017 deadline. RBS Group has agreed that HMT will now seek formal amendment to RBS Group's State Aid commitments to pave the way for the Commissioner to propose to open proceedings. In addition to the Commission's proceedings, HMT will carry out a market testing exercise in parallel. The opening of the Commission's proceedings does not prejudice the outcome of the investigation. The 2016 Annual Results include a £750 million restructuring provision as a consequence of this proposal.

- In June 2016, the triennial funding valuation of the Main scheme of The Royal Bank of Scotland Group Pension Fund was agreed which showed that as at 31 December 2015 the value of liabilities exceeded the value of assets by £5.8 billion. In March 2016, to mitigate this anticipated deficit, RBS Group made a cash payment of £4.2 billion. The next triennial valuation is due to occur at the end of 2018 with agreement on any additional contributions by the end of March 2020. As at 31 December 2016, the Main scheme had an unrecognised surplus reflected by a ratio of assets to liabilities of c.115% under IAS19 valuation principles.
- On 11 April 2016, the Group completed the successful transfer of the Coutts International businesses in Asia and the Middle East to Union Bancaire Privée, the final milestone in the sale of our International Private Bank. During 2016 RBS Group also completed the sale of its Russia and Kazakhstan subsidiaries.

Customer Segment Performance

UK Personal & Business Banking (UK PBB)

UK PBB operating profit increased to £1,717 million compared with £1,628 million in 2015, primarily reflecting a £142 million, 4%, reduction in operating expenses and a £37 million, 1%, increase in total income.

Net interest income increased by £78 million, to £4,341 million (2015 - £4,263 million) principally reflecting strong balance sheet growth and active deposit re-pricing, partially offset by lower current account hedge returns and lower mortgage margins. Non-interest income decreased marginally to £957 million compared with £998 million in 2015, principally reflecting lower credit card interchange fees and increased cash back payments following the launch of the Reward account in late 2015.

Operating expenses decreased to £3,498 million (2015 - £3,640 million), largely due to lower litigation and conduct costs. Staff costs decreased to £338 million (2015 - £364 million) driven by a reduction in headcount.

Impairment losses were £83 million compared with a release of £7 million in 2015, principally reflecting reduced portfolio provision releases.

Gross loans and advances to customers increased by 10% to £133.4 billion in 2016 principally driven by mortgage growth. Customer deposit balances increased by £8.0 billion, or 6%, to £145.8 billion driven by growth in personal current account balances.

Ulster Bank RoI

Ulster Bank RoI operating profit decreased to £64 million compared with £308 million in 2015, primarily due to increased operating expenses, primarily litigation and conduct costs, and lower impairment releases, partly offset by an increase in income.

Net interest income increased by £44 million to £410 million driven by exchange rate movements.

Non interest income decreased by £18 million to £167 million, principally reflecting a one-off £24 million gain realised on the closure of a foreign exchange exposure in 2015 and a £11 million interim adjustment to the pricing of FX transactions between Ulster Bank RoI and NatWest Markets in 2016, pending completion of a detailed pricing review.

Operating costs increased to £624 million, compared with £383 million in 2015, principally due to litigation and conduct costs reflecting a provision for remediation and programme costs associated with an industry wide examination of tracker mortgages and an increase in restructuring costs to £38 million (2015 - £12 million), primarily driven by asset disposals.

Net impairment releases were £112 million compared with £141 million in 2015 and included write-backs associated with asset disposal activity.

Gross loans and advances to customers increased by £1.5 billion, or 8%, to £20.1 billion, of which £3.1 billion related to exchange rate movements. Net loans and advances increased by £2.2 billion but decreased by £0.6 billion, or 3%, excluding the impact of exchange rate movements as new lending was offset by asset disposals and repayments. The low yielding tracker mortgage portfolio increased by £0.6 billion, or 7%, to £9.2 billion. Excluding the impact of exchange rate movements balances declined by £0.9 billion, or 9%, supported by repayments and asset disposals.

Commercial Banking

Commercial Banking operating profit decreased to £1,513 million compared with £1,847 million in 2015. Total income increased to £3,730 million compared with £3,470 million in 2016 largely reflecting higher asset and deposit volumes.

Operating expenses increased to £2,004 million from £1,554 million in 2015, primarily reflecting a litigation and conduct charge principally relating to a provision in respect of the FCA review of the Group's treatment of SMEs. Staff costs increased to £522 million compared with £483 million. Impairment losses were £213 million, compared with £69 million in 2015, reflecting a single name charge in respect of the oil and gas portfolio.

NatWest Markets

NatWest Markets operating loss decreased to £66 million compared with an operating loss of £504 million in 2015.

Total income was broadly stable at £1,548 million compared with £1,522 million in 2015, driven by increases in Rates and Currencies, reflecting sustained customer activity throughout the year and favourable market conditions, offset by reductions in Financing, own credit adjustments and the transfer out of the Portfolio business to Commercial Banking. Operating expenses decreased to £1,614 million compared with £2,031 million in 2015, reflecting lower staff costs and restructuring costs.

Capital Resolution

Capital Resolution reported an operating loss of £4,741 million compared with an operating loss of £3,426 million in 2015 and included litigation and conduct costs primarily in relation to matters relating to the issuance and underwriting of RMBS (£3,391 million). In addition a fair value adjustment of £170 million was incurred in 2016 resulting from market volatility following the result of the EU referendum.

Operating expenses decreased to £4,047 million compared with £4,553 million in 2016 principally driven by lower restructuring costs and staff costs reflecting a reduction in headcount partly offset by increased litigation and conduct costs.

Impairment losses were £294 million compared with impairment releases of £781 million and principally comprised charges relating to a number of shipping assets.

Performance review

Operating loss before tax

Operating loss before tax increased to £3,732 million, compared with £3,234 million in 2015, primarily driven by impairment losses of £529 million compared with impairment releases of £838 million in 2015. Loss attributable to shareholders increased to £4,790 million compared with £1,950 million in 2015, reflecting a tax charge of £1,148 million (2015 - £52 million credit) and profit from discontinued operations which decreased to £117 million, compared with £1,596 million in 2015. The 2016 results also included £300 million deferred tax asset impairment in Central items.

Net interest income

Net interest income was broadly stable at £8,288 million (2015 - £8,282 million), principally reflecting a £266 million increase in Commercial Banking offset by a £184 million reduction in Capital Resolution, in line with the planned shrinkage of the balance sheet.

Non-interest income

Non-interest income increased by £178 million, 5%, to £3,835 million compared with £3,657 million in 2015. Net fees and commissions decreased to £2,444 million compared with £2,825 million primarily due to a decrease in Capital Resolution, £145 million reflecting the planned asset run-down, a reduction in NatWest Markets of £183 million as the business continues to reshape and a £34 million reduction in UK PBB driven by lower credit card interchange fees and increased cash back payments following the launch of the Reward accounts.

Income from trading activities decreased to £863 million compared with £912 million in 2015, primarily reflecting increases in NatWest Markets, more than offset by a decrease in Capital Resolution, including a £170 million fair value adjustment.

Own credit adjustments were £176 million in 2016 compared with a gain of £329 million 2015.

Other operating income increased to £618 million (2015 - £183 million), reflecting a profit on the sale of subsidiaries of £259 million, primarily a net gain on the disposal of RBS Groups stake in Visa Europe, compared with a loss of £158 million in 2015. A loss on the disposal or settlement of loans and receivables was £182 million compared with £551 million in 2015.

Operating expenses

Operating expenses decreased to £15,326 million compared with £16,011 million in 2015. Operating expenses, excluding restructuring costs and litigation and conduct costs, decreased by £2,170 million, 21%, to £8,059 million (2015 - £10,229 million) mainly reflecting the benefits of cost savings initiatives. In addition, 2016 included a VAT recovery of £227 million in Central items and 2015 included a £498 million write down of goodwill relating to Private Banking.

Litigation and conduct costs were £5,168 million compared with £3,507 million and included a £3,391 million provision in relation to various investigations and litigation matters relating to the issuance of RMBS and an additional PPI provision of £600 million. Restructuring costs were £2,099 million (2015 - £2,275 million) and included a £750 million provision in respect of the Group's remaining State Aid obligation regarding the business previously described as Williams & Glyn as announced on 17 February 2017. In addition £706 million (2015 - £630 million) of the remaining amount relates to Williams & Glyn including £146 million of termination costs associated with the decision to discontinue the programme to create a cloned banking platform.

Tax

The tax charge of £1,148 million for the year (2015 - £35 million credit) reflects the impact of the banking surcharge, non-deductible bank levy and conduct charges for which no tax relief has been recognised, a reduction in the carrying value and impact of UK tax rate changes on deferred tax balances, and the release of tax provisions that reflect the reduction of exposures in countries where the Group is ceasing operations.

Impairment losses

Impairment losses were £529 million compared with an impairment release of £838 million in 2015. Capital Resolution impairment losses were £294 million, compared with a release of £781 million in 2015; the charge in the current year mainly related to the shipping portfolio reflecting difficult conditions in some parts of the sector. Commercial Banking impairment losses were £213 million, compared with £69 million in 2015, reflecting a single name charge in respect of the oil and gas portfolio and Ulster Bank RoI impairment releases were £112 million compared with £141 million in 2015.

Discontinued operations

Profit from discontinued operations was £117 million and includes the results of RBSI Holdings which was classified as a discontinued operation at 31 December 2016. In 2015 the profit from discontinued operations was £1,538 million reflecting a gain on disposal in relation to Citizens of £249 million and in respect of reserves of £1,001 million recycled to the income statement, together with a gain of £318 million attributable to non-controlling interests.

Financial review

Capital and leverage ratios

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

	31 December 2016			31 December 2015		
	RBS plc %	NatWest %	UBI DAC %	RBS plc %	NatWest %	UBI DAC %
Risk asset ratios						
CET1	13.1	16.1	29.0	16.0	11.6	29.6
Tier 1	14.1	16.1	29.0	17.1	11.6	29.6
Total	19.1	23.3	31.9	25.3	19.7	32.1
Capital ⁽²⁾	£bn	£bn	£bn	£bn	£bn	£bn
CET1	23.3	10.4	5.2	32.4	7.2	5.7
Tier 1	25.3	10.4	5.2	34.7	7.2	5.7
Total	34.2	15.0	5.7	51.3	12.1	6.2
Risk-weighted assets	£bn	£bn	£bn	£bn	£bn	£bn
Credit risk						
- non-counterparty	127.0	56.0	16.3	146.4	54.4	17.8
- counterparty	21.2	0.5	0.5	21.8	0.4	0.3
Market risk	15.7	0.7	—	19.1	0.6	—
Operational risk	14.9	7.2	1.2	15.6	6.4	1.1
Total RWAs	178.8	64.4	18.0	202.9	61.8	19.2
Leverage						
Leverage exposure (£bn)	447.2	169.6	27.3	502.6	153.1	23.7
Tier 1 capital (£bn)	25.3	10.4	5.2	34.7	7.2	5.7
Leverage ratio (%)	5.7	6.1	19.1	6.9	4.7	24.0

Notes:

(1) UBI DAC refers to Ulster Bank Ireland DAC.

(2) Refer to page 28.

RBS plc

The CET1 ratio decreased from 16.0% to 13.1%. This reflected the annual phasing in of the CRR end-point rules relating to significant investments, litigation and conduct charges of £2.7 billion, the £750 million provision recognised in relation to the W&G proposal, and the £1.3 billion capital injection into NatWest Plc, following the accelerated pension payment, partially offset by RWA reduction.

RWAs decreased by £24.1 billion predominantly as a result of the significant investment rule change, which reduced standardised credit risk RWAs by £14.8 billion. Market risk RWAs decreased by £3.4 billion primarily due to business mitigation activities and lower US dollar position risk.

The leverage ratio on a PRA transitional basis decreased from 6.9% to 5.7% primarily reflecting reduced Tier 1 capital.

NatWest

The CET1 ratio increased from 11.6% to 16.1% primarily reflecting the £1.3 billion capital injection from RBS plc and profit in the year, partially offset by the adverse impacts of the £4.2 billion accelerated pension payment to the Main scheme in March 2016 and the annual phasing in of the CRR end-point rules relating to significant investments.

RWAs increased by £2.6 billion primarily due to lending growth and the annual recalculation of operational risk.

The leverage ratio on a PRA transitional basis increased to 6.1% as a result of increased Tier 1 capital, offset by growth in mortgage lending.

UBI DAC

The CET1 transitional ratio decreased from 29.6% to 29.0%.

RWAs decreased from €26.2 billion to €21.0 billion as a result of decreased lending, disposals and model changes.

When translated into sterling RWAs decreased by £1.2 billion.

The leverage ratio on a CBI transitional basis decreased to 19.1% from 24.0%, reflecting higher leverage exposure, primarily due to currency movements.

Financial review

Consolidated balance sheet at 31 December 2016

	2016 £m	2015 £m
Assets		
Cash and balances at central banks	73,813	78,999
Net loans and advances to banks	17,635	18,744
Reverse repurchase agreements and stock borrowing	12,860	11,098
Loans and advances to banks	30,495	29,842
Net loans and advances to customers	316,071	306,245
Reverse repurchase agreements and stock borrowing	28,884	28,712
Loans and advances to customers	344,955	334,957
Debt securities subject to repurchase agreements	18,107	20,224
Other debt securities	53,545	59,803
Debt securities	71,652	80,027
Equity shares	445	1,069
Settlement balances	5,557	4,108
Derivatives	247,744	263,083
Intangible assets	6,165	6,526
Property, plant and equipment	4,536	4,453
Deferred tax	1,798	2,622
Prepayments, accrued income and other assets	2,288	3,019
Assets of disposal groups	8,366	3,486
Total assets	797,814	812,191
Liabilities		
Bank deposits	35,314	31,828
Repurchase agreements and stock lending	5,239	10,266
Deposits by banks	40,553	42,094
Customer deposits	348,969	346,962
Repurchase agreements and stock lending	27,096	27,112
Customer accounts	376,065	374,074
Debt securities in issue	20,362	25,804
Settlement balances	3,641	3,383
Short positions	22,076	20,808
Derivatives	237,577	255,548
Provisions for liabilities and charges	11,840	7,220
Accruals and other liabilities	6,129	6,850
Retirement benefit liabilities	321	3,764
Deferred tax	525	729
Subordinated liabilities	19,515	27,030
Liabilities of disposal groups	23,391	2,980
Total liabilities	761,995	770,284
Non-controlling interests	62	54
Owners' equity	35,757	41,853
Total equity	35,819	41,907
Total liabilities and equity	797,814	812,191

Commentary on consolidated balance sheet 2016 compared with 2015

Total assets of £797.8 billion as at 31 December 2016 were down £14.4 billion, 2%, compared with 31 December 2015. This was primarily driven by a decrease in derivatives assets, primarily reflecting Capital Resolution run-down, partly offset by loan growth in UK PBB and Commercial Banking.

Loans and advances to banks increased by £0.7 billion, 2%, to £30.5 billion. Excluding reverse repurchase agreements and stock borrowing ('reverse repos'), up £1.8 billion, 16%, to £12.9 billion, bank placings declined by £1.1 billion, 6%, to £17.6 billion.

Loans and advances to customers increased by £10.0 billion, 3%, to £345.0 billion. Customer lending increased by £9.8 billion, 3%, to £316.1 billion. This reflected increases in UK PBB reflecting growth in mortgages and positive momentum across business and unsecured personal lending, Commercial Banking due to increased business volumes, partly offset by the run down and disposals in Capital Resolution. Within this, reverse repos were up £0.2 billion, 1%, to £28.9 billion.

Debt securities were down £8.3 billion, 10%, to £71.7 billion mainly due to reductions within Capital Resolution partially offset by increases in RBS Treasury in the liquidity portfolio.

Equity shares decreased by £0.6 billion, 58%, to £0.4 billion primarily due to the continuing risk reduction and run-down in Capital Resolution.

Movements in the fair value of derivative assets, down £15.3 billion, 6%, to £247.7 billion, and liabilities down, £18.0 billion, 7%, to £237.6 billion, reflecting lower trading volumes partially offset by the impact of foreign exchange movements. Increases in trading activity in NatWest Markets was more than offset by disposals and run-off in Capital Resolution.

The increase in assets and liabilities of disposal groups up from £3.5 billion to £8.4 billion and from £3.0 billion to £23.4 billion respectively, primarily reflected the transfer of RBSI Holdings to disposal groups.

Deposits by banks increased by £1.5 billion, 1%, to £40.6 billion. Within this, bank deposits were up £3.5 billion, 11%, to £35.3 billion, reflecting increases in NatWest Markets and in RBS Treasury, partly offset by Capital Resolution run-down. Repos decreased £5.0 billion, 49%, to £5.2 billion.

Customer accounts increased by £2.0 billion, 1%, to £376.1 billion. Within this, repos were stable at £27.1 billion. Customer deposits were up £2.0 billion, 1%, at £348.7 billion, primarily reflecting growth in UK PBB offset by the run-down in Capital Resolution.

Debt securities in issue decreased by £5.4 billion, 21%, to £20.4 billion, due to a decrease in Treasury given the lower funding requirements of a reduced balance sheet.

Subordinated liabilities decreased by £7.5 billion, 28% to £19.5 billion, primarily as a result of the net decrease in dated and undated loan capital with redemptions of £6.2 billion and £4.3 billion respectively. This was offset by exchange rate movements and mark-to-market adjustments of £3.0 billion.

Owner's equity decreased by £6.1 billion, 15%, to £35.8 billion, primarily driven by the £4.8 billion attributable loss for the year and movements in other reserves.

Cash flow

	2016 £m	2015 £m
Net cash flows from operating activities	6,969	1,122
Net cash flows from investing activities	(5,398)	(5,704)
Net cash flows from financing activities	(13,532)	(1,176)
Effects of exchange rate changes on cash and cash equivalents	7,913	525
Net decrease in cash and cash equivalents	(4,048)	(5,233)

2016

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

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

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

2015

The major factors contributing to the net cash inflow from operating activities of £1,122 million were the increase of £10,787 million in operating assets and liabilities, other provisions charged net of releases of £4,470 million, write down of goodwill and other intangible assets £1,331 million, interest on subordinated liabilities £1,267 million and depreciation and amortisation of £1,173 million. These were partially offset by loans and advances written-off net of recoveries of £8,778 million, other provisions utilised of £2,159 million, elimination of foreign exchange differences of £1,476 million, the operating loss before tax of £1,403 million, profit on sale of subsidiaries and associates of £1,092 million and cash contribution to defined benefit pension schemes of £1,060 million.

Net cash outflows from investing activities of £5,704 million related to the net outflows from purchase of securities of £6,537 million and the purchase of property, plant and equipment of £761 million, offset by inflows of £53 million from disposals primarily Citizens and net cash inflows from the sale of property, plant and equipment of £1,541 million.

Net cash outflows from financing activities of £1,176 million relate primarily to the redemption of subordinated liabilities of £2,279 million and interest paid on subordinated liabilities of £1,313 million partly offset by the proceeds of non-controlling interests issued of £2,491 million.

Capital and risk management

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Presentation of information

Except as otherwise indicated by an asterisk (*), information in the Capital and risk management section (pages 14 to 106) is within the scope of the Independent auditor's report. Unless otherwise indicated, disclosures in this section include disposal groups in relevant exposures and measures.

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

Risk overview*

Risk culture and appetite

Risk culture

A strong risk culture is essential if RBS Group is to achieve its ambition to build a truly customer-focused bank.

RBS Group has measured and benchmarked its risk culture across all functions and businesses. It has set a risk culture target, making risk simply part of the way that employees work and think.

Such a culture must be built on strong risk capabilities, with robust risk practices and appropriate risk behaviours embedded across the organisation.

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

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

To embed and strengthen the required risk culture behaviours, a number of RBS Group-wide activities have been undertaken.

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

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

In addition to embedding risk culture behaviours into performance management, in 2016 an objective aligned to RBS Group's risk culture target was set for the Executive Committee and made integral to performance reviews.

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

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To track progress towards RBS Group's risk culture target, a programme of assessment commenced in 2016.

Risk-based key performance indicators

RBS Group-wide remuneration policy ensures that the remuneration arrangements for all employees reflect the principles and standards prescribed by the UK Remuneration Code.

Training

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

RBS Group offers a wide range of risk learning, both technical and behavioural, across the risk disciplines. This training can be mandatory, role-specific or for personal development.

Mandatory learning for all staff is focused on keeping employees, customers and RBS Group safe. This is easily accessed online and is assigned to each person according to their role and business area. The system allows monitoring at all levels to ensure completion.

Code of Conduct

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

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

Risk overview* continued

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

Risk appetite

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

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

Risk Appetite Framework

The Risk Appetite Framework bolsters effective risk management by promoting sound risk taking and ensuring emerging risk and risk taking activities are recognised, assessed, escalated and addressed in a timely manner.

The RBS Group Board approves the Risk Appetite Framework annually.

Strategic risks

Strategic risks are the foundations upon which RBS Group ensures it remains safe and sound while implementing its strategic business objectives. They are:

- Capital adequacy;
- Earnings volatility;
- Funding and liquidity; and
- Stakeholder confidence.

The Board sets risk appetite for strategic risks to help ensure RBS Group is well placed to meet its priorities and long-term targets even under challenging economic environments.

All other risk appetites for material risks (such as credit risk, market risk and operational risk) should align to strategic risks. Risk appetite for strategic risks is tested using a variety of stress tests.

Risk appetite statements

Risk appetite is communicated across RBS Group through risk appetite statements. Each statement provides clarity on the scale and type of activities permitted, in a manner that is easily conveyed to staff. Risk appetite statements consist of qualitative statements of appetite supported by risk limits and triggers that operate as a defence against excessive risk-taking.

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The purpose of risk appetite statements is to strengthen understanding of acceptable levels of risk.

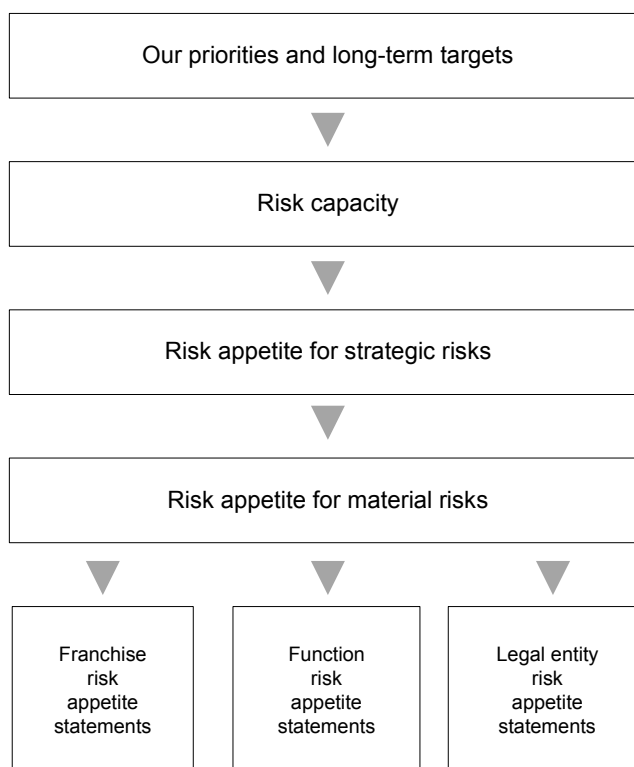
Risk appetite statements are established at a RBS Group-wide level for strategic risks and material risks, and at a franchise, function and legal entity level.

The annual process of establishing risk appetite statements is completed alongside the business and financial planning process to ensure risk appetite remains appropriate given the levels of risk expected over the planning horizon.

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

RBS Group frequently reviews its risk profile to ensure it remains within risk appetite and that management focus is brought to bear on all strategic risks, material risks, and emerging risk issues. RBS Group has effective processes in place to report against risk appetite to the RBS Group Board and senior management.

Establishing risk appetite:

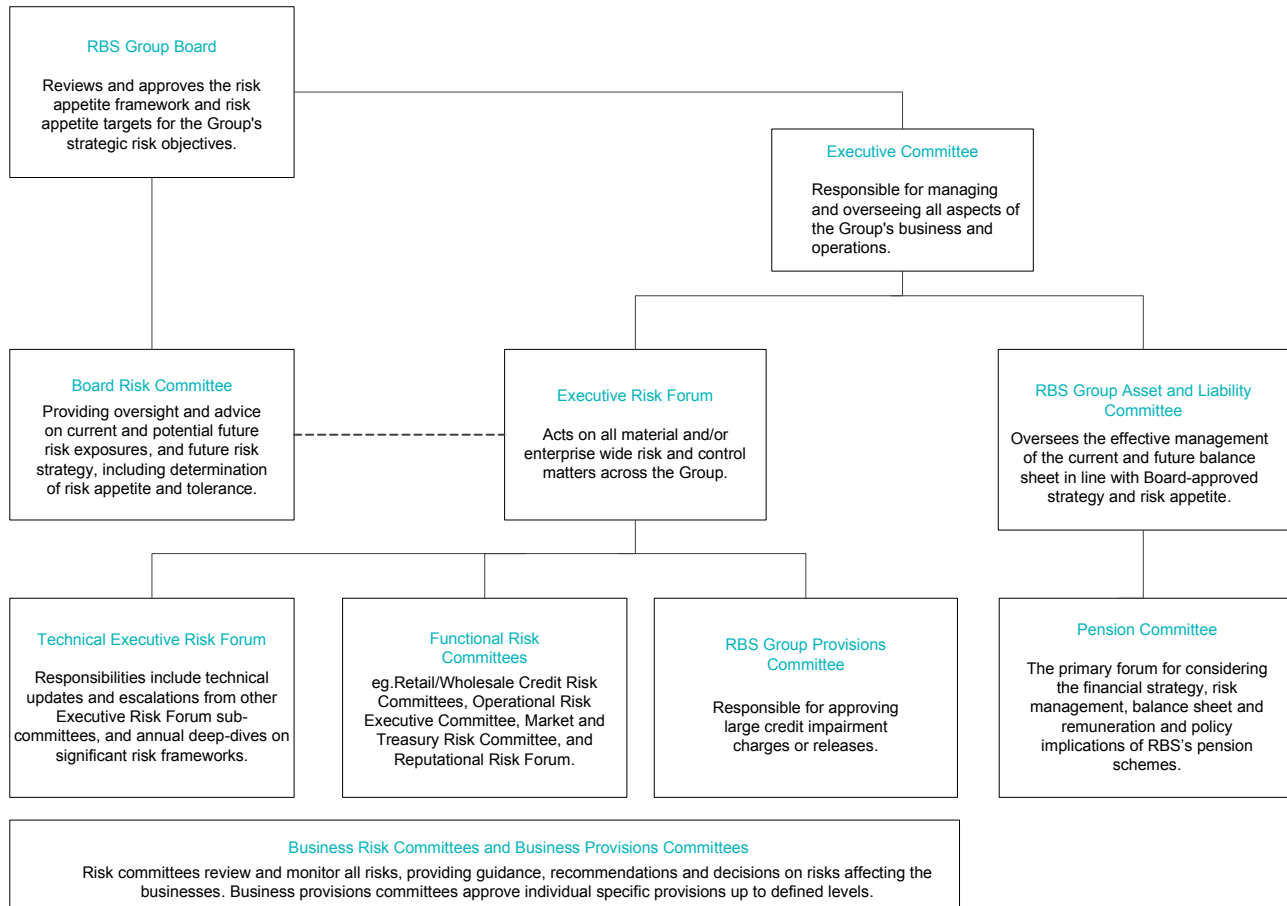


Risk overview* continued

Risk governance

Governance structure

The RBS Group risk governance structure in 2016 and the main purposes of each of the committees are illustrated below:



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Risk overview* continued

Three lines of defence

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

First line of defence - Management and supervision

The first line of defence includes customer franchises, Technology and Operations and support functions such as Human Resources, Communications and Financial Management Information. Responsibilities include:

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

Second line of defence - Oversight and control

The second line of defence in 2016 included RBS Group Risk Management and Conduct & Regulatory Affairs, (refer below for further information), Legal, and the financial control aspects of Finance. Responsibilities include:

- Working with the businesses and functions to develop the risk and control policies, limits and tools for the business to use in order to discharge its responsibilities.
- Overseeing and challenging the management of risks and controls.
- Leading the articulation, design and development of RBS Group'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 advice to the business on risk management.
- Providing senior executives with relevant management information and reports and escalating concerns where appropriate.
- Undertaking risk assurance (refer below for more information).

Third line of defence - Internal Audit

Responsibilities include:

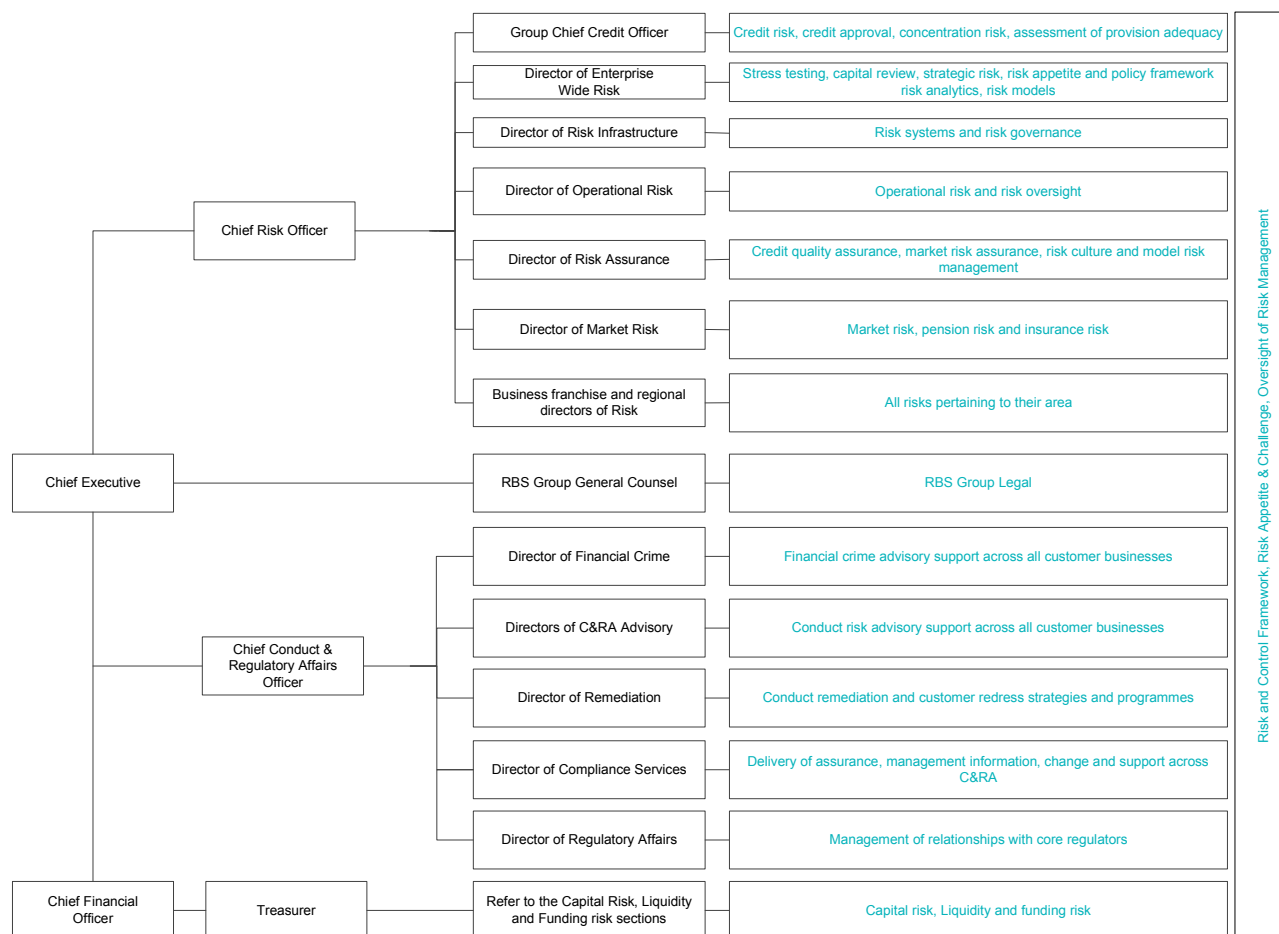
- Designing and delivering a risk-based audit plan to provide assurance on material risks and report on whether RBS Group is managing its material risks effectively.
- Monitoring, evaluating and reporting on the remediation of material risks across RBS Group.
- Engaging with management and participating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

*unaudited

Risk overview* continued

Risk management structure

RBS Group's management structure in 2016 and the main elements of each role are illustrated below.



Notes:

(1) RBS Risk Management

In 2016, the RBS Chief Risk Officer (CRO) led RBS Risk Management (since 1 January 2017 it has been known as Risk, Conduct & Restructuring). The CRO reported directly to the Chief Executive with an indirect reporting line to the Board Risk Committee and had a right of access to the Committee's chairman.

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

Risk Management was organised into six functional areas: Credit Risk; Enterprise-Wide Risk; Risk Infrastructure; Operational Risk; Risk Assurance; and Market Risk. There were also directors of risk for each of the franchises and for Services.

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

CROs were in place for certain jurisdictions and legal entities to meet local regulatory and governance requirements. Risk committees in the customer businesses and key functional risk committees oversaw risk exposures arising from management and business activities and focused on ensuring that they were adequately monitored and controlled.

(2) Conduct & Regulatory Affairs

In 2016, Conduct & Regulatory Affairs (C&RA) was led by the Chief Conduct & Regulatory Affairs Officer, who reported directly to the Chief Executive with a dotted reporting line to the Board Risk Committee and a right of access to the Committee's chairman. C&RA was responsible for providing oversight of conduct risk and regulatory risk at RBS, and did so by setting RBS Group-wide policy and standards, providing advice to each customer business, and ensuring that the mitigating controls were suitable. C&RA also provided leadership of RBS Group's relationships with its regulators.

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

(3) Plans to merge parts of the C&RA function with Risk Management were announced in December 2016. The changes, designed to take advantage of synergies across the risk, conduct and regulatory agendas, were effective from 1 January 2017. Regulatory Affairs moved to Corporate Governance & Secretariat, and Remediation and Complaints moved to Services Chief Operating Office.

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Risk overview* continued

Risk Assurance

Risk Assurance is an independent second line of defence function which provides assurance to both internal and external stakeholders including the Board, senior management, risk functions, franchises, Internal Audit and regulators. Teams within Risk Assurance perform quality assurance on both credit and market risk activity, review key controls and manage model risk. The remit of each team is summarised below.

Franchise Risk Assurance: These teams focus on credit risk and market risk assurance in the customer-facing franchises. The teams undertake qualitative reviews which assess various aspects of risk as appropriate, including: the quality of risk portfolios; the accuracy of the Basel Input and related probability of default/loss given default classification, the quality of risk management practices, policy compliance and adherence to risk appetite. This includes testing the bank's credit portfolios and market risk exposures to assist in early identification of emerging risks, as well as undertaking targeted reviews to examine specific concerns raised either by these teams or by their stakeholders.

Controls Assurance: This team tests the adequacy and effectiveness of key controls owned and operated by the Risk function (with a particular focus on credit risk and market risk controls). The team's remit includes controls within the scope of Section 404 of the US Sarbanes-Oxley Act 2002. During 2016, the team's scope extended to include testing of controls supporting risk data aggregation reporting to support compliance with Basel Committee on Banking Supervision (BCBS) 239.

Risk Assurance Committee

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

Model Risk

Model Risk Governance

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

Model Risk Management

Model Risk Management (MRM) performs independent model validation for material models where necessary. It works with individual businesses and functions to set appropriate model standards and monitor adherence to these, ensure that models are developed and implemented appropriately and that their operational environment is fit for purpose.

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

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

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

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

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

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

For specific information relating to market risk models and pricing models, refer to Model Validation in the Market Risk section.

Models used in Risk

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

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Capital risk*

Definition and sources

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

In line with paragraph 135 of IAS 1 'Presentation of Financial Statements', the Group manages capital based on regulatory requirements. Regulatory capital is monitored and reported on a regulated entity basis, each on a CRR transitional basis as relevant in the jurisdiction, other than for the RBS Group which is on a consolidated and CRR end-point basis. As such, unless otherwise specified, this section applies to those individual regulated bank legal entities ('bank entities') rather than Group.

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

Capital management is the process by which the bank entities manage their capital risk and is a key focus of risk management activities.

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

The following disclosure in this section are audited: Capital resources.

Key developments in 2016

RBS plc

13.1% CET1 ratio

- The PRA transitional CET1 ratio decreased from 16.0% to 13.1%. This reflected the annual phasing of the CRR end-point rules relating to significant investments, litigation and conduct charges of £2.7 billion, the £750 million provision recognised in relation to the W&G proposal, and the £1.3 billion capital injection into NWB Plc, following the accelerated pension payment, partially offset by RWA reduction.
- RWAs decreased by £24.1 billion to £178.8 billion, primarily as a result of the annual phasing-in of the CRR end-point rules relating to significant investments which reduced standardised credit risk RWAs by £14.8 billion. Market risk RWAs decreased by £3.4 billion primarily due to business mitigation activities and lower US dollar position risk.

5.7% leverage ratio

- The leverage ratio on a PRA transitional basis decreased from 6.9% to 5.7%, primarily reflecting reduced Tier 1 capital.

NatWest

16.1% CET1 ratio

- The PRA transitional CET1 ratio increased from 11.6% to 16.1%, primarily reflecting the £1.3 billion capital injection from RBS plc and profit in the year, partially offset by the adverse impacts of the £4.2 billion accelerated pension payment and the annual phasing of the CRR transitional rules relating to significant investments.
- RWAs increased by £2.6 billion to £64.4 billion, primarily due to lending growth and the annual recalculation of operational risk.

6.1% leverage ratio

- The leverage ratio on a PRA transitional basis increased from 4.7% to 6.1% as a result of increased Tier 1 capital, offset by growth in mortgage lending.

UBI DAC

29.0% CET1 ratio

- The CBI transitional CET1 ratio decreased from 29.6% to 29.0%.
- RWAs decreased from €26.2 billion to €21.0 billion as a result of decreased lending, disposals and model changes.
- When translated into sterling RWAs decreased by £1.2 billion.

19.1% leverage ratio

- The leverage ratio on a CBI transitional basis decreased to 19.1% from 24.0%, reflecting higher leverage exposure, primarily due to currency movements.

Determination of capital sufficiency

The minimum amount and type of capital and other loss absorbing debt instruments that the bank entities must hold is set out under applicable prudential regulation.

Regulation may be set by rule-making bodies at national level (for example in the UK) and at European level. Rule-making bodies may set regulation according to standards agreed at international level, such as those published by the BCBS.

In determining whether the bank entities hold sufficient capital and other loss absorbing instruments, the bank entities assess the amount and type of capital under two bases:

Going concern

This determination of capital sufficiency is made on the basis that the bank entities have sufficient capital to absorb losses and remain a viable going concern. A bank entity is considered a going concern if it can operate in the foreseeable future to carry out its objectives and commitments without the need or intention on the part of management to liquidate.

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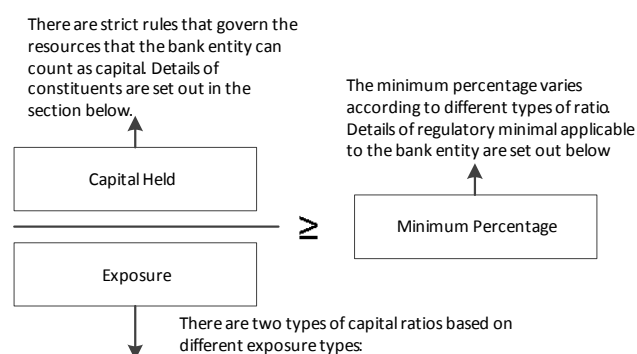
Capital risk* continued

Gone concern

This determination of capital sufficiency is made on the basis that the bank entities have sufficient capital and other loss absorbing instruments to enable an orderly resolution in the event of failure. As an example, in the UK, gone concern would apply if a bank entity had been deemed to fail by the Bank of England (BoE). Technically, the bank entity would have to fail or be likely to fail the BoE's threshold conditions for authorisation in a way that justifies the withdrawal of that authorisation and it must not be reasonably likely that action will be taken that will result in the bank entity no longer failing or likely to fail.

Capital sufficiency: going concern

The regulatory requirement for going concern capital typically takes the form of a ratio of capital compared to a defined exposure amount having to exceed a minimum percentage:



Ratio	Exposure type	Description
Capital adequacy ratio	Risk-weighted assets	Assesses capital held against both size and inherent riskiness of on and off-balance sheet exposures
Leverage ratio	Leverage exposure	Assesses capital held against the size of on and off-balance sheet exposures (largely based on accounting value with some adjustments)

Constituents of capital held

This determination of what instruments and financial resources are eligible to be counted as capital is laid down by applicable regulation.

Capital is categorised by applicable regulation under two tiers (Tier 1 and Tier 2) according to the ability to absorb losses, degree of permanency and the ranking of absorbing losses. There are three broad categories of capital across these two tiers:

- **CET1 capital.** CET1 capital must be perpetual and capable of unrestricted and immediate use to cover risks or losses as soon as these occur. This includes ordinary shares issued and retained earnings. CET1 capital absorbs losses before other types of capital and any loss absorbing instruments.

- **Additional Tier 1 (AT1) capital.** This is the second form of loss absorbing capital and must be capable of absorbing losses on a going-concern basis. These instruments are either written down or converted into CET1 capital when a pre-specified CET1 ratio is reached. Coupons on AT1 issuances are discretionary and may be cancelled at the discretion of the issuer at any time. AT1 capital may not be called, redeemed or repurchased for five years from issuance.
- **Tier 2 capital.** Tier 2 capital is the bank entities' supplementary capital and provides loss absorption on a gone concern basis. Tier 2 capital absorbs losses after Tier 1 capital. It typically consists of subordinated debt securities with a minimum maturity of five years.

In addition to capital, other specific loss absorbing instruments, including senior notes issued by RBSG, may be used to cover certain gone concern capital requirements which, in the EU, is referred to as minimum requirement for own funds and eligible liabilities (MREL).

In order for liabilities to be eligible for MREL a number of conditions must be met including, the BoE being able to apply its stabilisation powers to them, including the use of bail-in provisions.

Capital adequacy ratios

The bank entities have to hold a minimum amount and quality of capital to satisfy capital adequacy ratio regulatory requirements.

Risk-weighted assets

Capital adequacy ratios compare the amount of capital held to RWAs. RWAs are a measure of the bank's assets and off-balance sheet positions that capture both the size and risks inherent in those positions.

For regulatory purposes, RWAs are grouped into four categories:

Risk	Description
Credit	Risk of loss from a borrower failing to repay amounts due by the due date
Counterparty credit	Risk of loss from a counterparty not meeting its contractual obligations
	Also included is the risk of loss from changes in the fair value of derivative instruments
Market	Risk of loss arising from fluctuations in market prices
Operational	Risk of loss from inadequate or failed internal processes, people and systems or from external events

*unaudited

Capital risk* continued

Minimum percentage

Regulation defines a minimum percentage of capital compared to RWAs. There are two broad categories of capital requirements:

Category	Description
Minimum capital adequacy ratio	Represents the minimum amount of capital that all banks must hold at all times
Capital buffers	Comprises of: • Capital required to be held by banks that may be used in periods of stress • Capital held by banks that are deemed to be systemically important

For UK bank entities, these minimum requirements are explained in more detail on page 24. The minimum requirements for non-UK bank entities may vary and will be in line with the applicable regulation in the relevant jurisdiction. These ratios apply in full from 1 January 2019. Before this date there are transitional rules in place that mean that the minimum capital requirements that the bank entities have to comply with are lower.

The RBS Group may be required to hold capital above the minimum requirements under the Pillar 2 framework. Pillar 2 looks at capital that may need to be held against risks that are not fully captured or not captured under minimum requirements and risks across a forward-looking planning horizon.

Under the Pillar 2 framework that applies to the RBS Group, the bank entities may be required to hold capital beyond the minimum requirements.

Future changes to regulation

Throughout 2015 and 2016, UK, EU and international standard and rule-making bodies have issued proposals and final standards on revising the level and measurement of capital adequacy ratios, including the measurement of RWAs. This may affect the level of RWAs and the capital that the bank entities are required to hold in future years.

Further details of prudential regulatory changes that may impact the bank entities' capital adequacy ratio are set out on page 25.

Leverage ratios

The bank entities have to hold a minimum amount and quality of capital to satisfy the leverage ratio regulatory requirements. Unlike capital adequacy ratios, leverage ratio requirements do not consider the riskiness of the bank's positions.

The leverage exposure is broadly aligned to the accounting value of the bank entities' on and off-balance sheet exposures but subject to certain adjustments for trading positions, repurchase agreements and off balance sheet exposures.

In common with capital adequacy ratios, the leverage ratio requirements for the bank entities consist of a minimum requirement and a leverage ratio buffer. For UK bank entities, details of the leverage ratio requirements are set out on page 24.

The minimum requirements for non-UK bank entities may vary and will be in line with the applicable regulation in the relevant jurisdiction.

The leverage ratio requirements that the bank entities must meet may be subject to change from developing regulation. Further details are set out on page 25.

Capital sufficiency: gone concern

Banks are required to hold sufficient capital and other loss absorbing instruments such that, in the event of failure, there can be an orderly resolution that minimises any adverse impact on financial stability whilst preventing public funds being exposed to loss.

In November 2016, the BoE published its policy statement on its approach to setting MREL.

MREL will be set by the BoE on a case-by-case basis but it has stated that it expects institutions to meet interim MREL requirements from 1 January 2019 and end state MREL requirements from 1 January 2022. Based on the policy statement, for the RBS Group this would be as follows:

Interim MREL

1 January 2019	The minimum requirements set out in the Financial Stability Board (FSB) total loss absorbing capacity standard being the higher of: • 16% of the RBS Group's RWAs; and • 6% of the RBS Group's leverage exposures
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1 January 2020	The higher of: • The sum of two times the RBS Group's Pillar 1 requirement and one times the Group's Pillar 2A add-ons; and • Two times the applicable leverage ratio requirement for the RBS Group
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End state MREL

1 January 2022	The higher of: • Two times the sum of the RBS Group's Pillar 1 requirement and RBS Group's Pillar 2A add-ons; and • The higher of: ○ Two times the applicable leverage ratio requirement for the RBS Group; and ○ 6.75% of the RBS Group's leverage exposure
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*unaudited

Capital risk* continued

The BoE is intending to review its general approach to the calibration of MREL before the end of 2020 prior to setting end-state MRELS.

MREL may consist of capital and other loss absorbing instruments. In order for liabilities to be eligible for MREL, a number of strict conditions will be set by the BoE including the ability for the BoE to apply its stabilisation powers to those liabilities. In addition, liabilities must have an effective remaining maturity (taking into account of any rights of early repayment to investors) of greater than one year.

In order that there is sufficient loss absorbing capacity pre-positioned across the RBS Group, the proceeds of externally issued MREL will be downstreamed to material operating subsidiaries in the form of capital or other subordinated claims. This ensures that internal MREL will absorb losses before operating liabilities within operating subsidiaries.

Although the BoE continues to develop its approach to the calibration of MREL within banking groups, the BoE policy statement sets out the framework that it will use to determine the distribution of MREL within Groups. Under this framework, the BoE will set individual MRELS for all institutions within the RBS Group, which include the bank.

Minimum percentage for going concern capital requirements under applicable regulation

Capital adequacy ratios

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

Type	CET1	Total Tier 1	Total capital
Minimum capital requirements	4.50%	6.00%	8.00%
Capital conservation buffer	2.50%	2.50%	2.50%
UK countercyclical capital buffer (1)	0.00%	0.00%	0.00%
Total (2)	7.00%	8.50%	10.50%

Notes:

- (1) The countercyclical capital buffer (CCyB) applied to UK designated assets is set by the Financial Policy Committee (FPC). The UK CCyB may be set between 0% and 2.5% and is linked to the state of the UK economy. On 5 July 2016, the FPC reduced the UK CCyB from 0.5% to 0%. Foreign exposures may be subject to different CCyBs depending on the CCyB rate set in the jurisdiction of the foreign exposure. The net CCyB for the bank is non-zero but rounds to 0.00%.
- (2) The minimum requirements do not include any capital that the bank entities may be required to hold as a result of the Pillar 2 assessment for RBS Group.
- (3) Under the applicable regulatory framework set by the Central Bank of Ireland, the minimum total capital ratio with which UBI DAC must comply is 10.50% with a minimum CET1 ratio of 7.00%. At this time, the Republic of Ireland has set its countercyclical buffer to 0.00%.

Leverage ratios

The table below summarises the minimum ratios of capital to leverage exposure under the PRA UK leverage framework that the UK bank entities must meet. In November 2016, the European Commission published a proposal for the adoption of a legally binding 3% of Tier 1 capital minimum leverage ratio.

Type	CET1	Total Tier 1
Minimum ratio	2.25%	3.00%
UK countercyclical leverage ratio buffer (1)	0.00%	0.00%
Total	2.25%	3.00%

Note:

- (1) The countercyclical leverage ratio buffer is set at 35% of the UK bank entities' CCyB. As noted above this buffer may be set between 0% and 2.5% and the FPC has currently set the UK CCyB at 0%. The applicable ratio for foreign exposures may be different.
- (2) Under the applicable regulatory framework set by the Central Bank of Ireland, there is currently no binding leverage requirement. A binding 3% leverage ratio has been proposed by the European Commission as part of its proposals to amend the Capital Requirements Regulation.

Regulatory changes that may impact capital requirements

Banks face a number of changes in prudential regulation that may adversely impact the amount of capital they must hold and consequently may increase funding costs and reduce return on equity. The nature and timing of implementation of a number of these changes is not currently final.

In 2017, the UK, EU and BCBS are expected to further develop prudential regulation including the approach to calculating credit risk and operational risk RWAs, additional details on the MREL framework and a review of the leverage ratio framework.

Regulatory changes are actively monitored by the bank entities including engagement with industry associations and regulators. Monitoring the changing regulatory landscape forms a fundamental part of capital planning and management of their businesses.

The Group believes that its strategy to focus on simpler, lower risk activities within a more resilient recovery and resolution framework will enable it to manage the impact of these changes.

Key prudential regulatory developments that have been published and may impact the UK bank entities are set out in the summary table on the next page. Regulatory developments for non-UK bank entities are similar but requirements of national authorities may vary from those of the UK.

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Financial review Capital and risk management

Capital risk* continued

Summary of potential changes to regulation that may impact the bank's capital requirements

Area of development	Actual or potential key changes that might impact the bank's capital requirements	Source of changes
Capital adequacy buffers	- A new systemic risk buffer will apply to the RBS ring-fenced bank sub-group from 1 January 2019. - The buffer will be set between 0% and 3%.	Statement of Policy published by the PRA in December 2016.
Credit risk RWAs	- Restriction in the scope of using internal models. - Avoidance of mechanistic reliance on external ratings. - For model-based RWAs, potential change to capital floors based on the standardised approach. - Potential amendment of risk weights for securitisation exposures. - Revision to UK residential mortgage risk weights.	- Mostly relate to consultations published by the BCBS. - Mortgage risk weights changes proposed by the PRA for 31 March 2019.
Counterparty credit risk RWAs	- Change to exposure amounts under the standardised approach. - Increase in the number of risk factors captured in the calculation of the counterparty valuation adjustment (CVA).	- The standardised approach relates to the CRR 2⁽¹⁾ proposal to amend regulation published by the European Commission. - Changes to CVA relate to a consultation published by the BCBS.
Market risk RWAs	- Change from value at risk to expected shortfall models. - Implementation of a more risk-sensitive standardised approach. - Inclusion of risk of market illiquidity.	Relates to the CRR 2⁽¹⁾ proposal to amend regulation published by the European Commission.
Operational risk RWAs	Incorporation of bank-specific loss data into the calculation.	Consultation published by the BCBS.
Leverage ratio	- Changes to the design and calibration of the framework with a focus on derivative exposures and margining. - Recalibration of the UK leverage ratio framework to offset exclusion of central bank reserves from the calculation.	- Relates to the CRR 2⁽¹⁾ proposal to amend regulation published by the European Commission. - Statements made by the FPC and PRA.
Large exposure framework	Changes to the design and calibration of the capital base and large exposure limit.	Relates to the CRR 2⁽¹⁾ proposal to amend regulation published by the European Commission.

Note:

(1) CRR 2 relates to the European Commission publication on 23 November 2016 to amend the Capital Requirements Regulation. Additional amendments were proposed to amend the Capital Requirements Directive and Banking Recovery and Resolution Directive

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Capital risk* continued

Capital management

Capital management is the process by which the bank entities ensure that they have sufficient capital and other loss absorbing instruments to operate effectively including meeting minimum regulatory requirements, operating within Board approved RBS Group risk appetite, maintaining credit ratings and supporting strategic goals.

Capital management is critical in supporting the bank entities' businesses and is also considered at the Group level. It is enacted through an RBS Group-wide end to end framework. The key elements of the RBS Group capital management approach are set out below.

Risk appetite

Capital risk appetite is set by the RBS Group Board, reflecting the RBS Group's strategic objectives, current and future prudential regulatory requirements and market expectations.

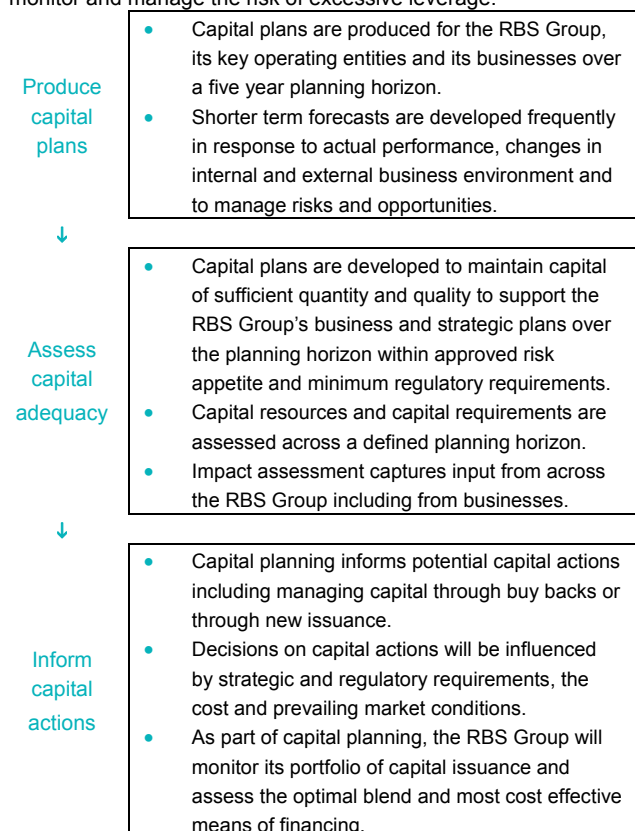
It is expressed as a set of target ratios for CET1 and leverage under both normal and stressed financial conditions.

Performance against risk appetite is regularly monitored.

Capital planning

Capital planning is integrated into the RBS Group's wider annual budgeting process and is assessed and updated at least monthly. As a key operating entity, capital plans are produced and managed for the bank. This is summarised below.

Capital planning is one of the tools that the RBS Group uses to monitor and manage the risk of excessive leverage.



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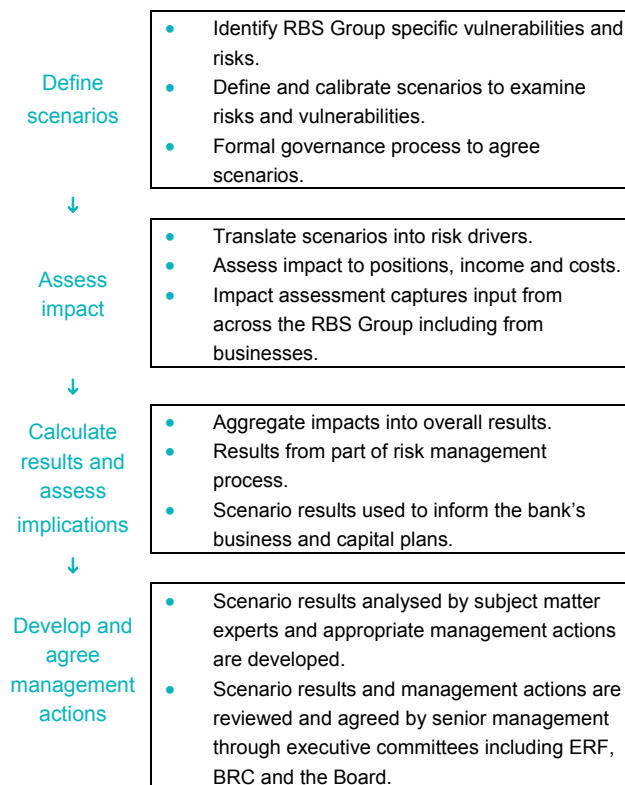
Stress testing

Stress testing is a key risk management tool used by the RBS Group, covering the bank and its businesses, and is a fundamental component of the RBS Group's approach to capital management.

Stress testing is used to quantify, evaluate and understand the potential impact on the financial strength of the RBS Group, including its capital position, given specified changes to risk factors. Stress testing includes:

- Scenario testing: examines the impact of a hypothetical future state of the world to define changes in risk factors affecting the RBS Group; and
- Sensitivity testing: examining the impact of an incremental change to one or more risk factors.

The process for stress testing consists of four broad stages:



Capital risk* continued

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



Specific areas that involve capital management include:

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

The RBS Group also undertakes regular reverse stress testing which examines circumstances that can lead to specific, defined business outcomes such as business failure. Reverse stress testing allows the RBS Group to examine potential vulnerabilities in its business model more fully.

Internal assessment of capital adequacy

The RBS Group conducts an annual internal assessment of its material risks and evaluates how much capital is required to cover these risks. This is referred to as the Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP is approved by the Board and submitted to the PRA.

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The ICAAP consists of a point in time capital assessment of the RBS Group's exposures and risks at the financial year end and a forward looking stress capital assessment.

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

Governance

Capital management is subject to substantial review and governance across the RBS Group including capital management policies that are approved by the Asset and Liability Committee or Board Risk Committee. The Board approves the RBS Group's capital plans including those of the bank.

Recovery and resolution planning

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

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

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

The recovery plan is prepared and updated annually and approved by the Board. The recovery plan is assessed for appropriateness on an ongoing basis, and is maintained in line with regulatory requirements.

Resolution is implemented if the RBS Group fails and the appropriate regulator places the RBS Group into resolution. Resolution is owned and implemented by the appropriate regulatory authority and the RBS Group has a multi-year programme in place to develop resolution capability and meet regulatory requirements.

The RBS Group is working with global regulators to ensure that the RBS Group is compliant with the principles of resolution planning, demonstrating the process by which the RBS Group and relevant regulatory bodies can develop a set of actions that would be taken to manage the failure of the RBS Group or one of its significant legal entities, including the bank, in an orderly manner.

Ring-fencing

As part of the response to the 2008 financial crisis the UK Government's Independent Commission on Banking report recommended that banks separate their retail and investment banking operations, helping to mitigate against the risk of the investment bank division running into financial difficulty.

Primary legislation and FCA/PRA regulations have been issued which must be complied with by 1 January 2019. For more details on ring-fencing, refer to page 3.

Financial review Capital and risk management

Capital risk* continued

Measurement

Capital, RWAs and leverage

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

	2016			2015		
	RBS plc £bn	NatWest £bn	UBI DAC £bn	RBS plc £bn	NatWest £bn	UBI DAC £bn
Capital (1)						
CET1	23.3	10.4	5.2	32.4	7.2	5.7
Tier 1	25.3	10.4	5.2	34.7	7.2	5.7
Total	34.2	15.0	5.7	51.3	12.1	6.2

RWAs

Credit risk						
- non-counterparty	127.0	56.0	16.3	146.4	54.4	17.8
- counterparty	21.2	0.5	0.5	21.8	0.4	0.3
Market risk	15.7	0.7	—	19.1	0.6	—
Operational risk	14.9	7.2	1.2	15.6	6.4	1.1
Total RWAs	178.8	64.4	18.0	202.9	61.8	19.2

Risk asset ratios

	%	%	%	%	%	%
CET1	13.1	16.1	29.0	16.0	11.6	29.6
Tier 1	14.1	16.1	29.0	17.1	11.6	29.6
Total	19.1	23.3	31.9	25.3	19.7	32.1

Leverage

Leverage exposure (£bn)	447.2	169.6	27.3	502.6	153.1	23.7
Tier 1 capital (£bn)	25.3	10.4	5.2	34.7	7.2	5.7
Leverage ratio (%)	5.7	6.1	19.1	6.9	4.7	24.0

Note:

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

General:

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

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

Capital base:

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

RWAs:

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

*unaudited

Financial review Capital and risk management

Capital risk continued

Capital resources (1)

	2016			2015*		
	RBS plc £m	NatWest £m	UBI DAC £m	RBS plc £m	NatWest £m	UBI DAC £m
Shareholders' equity (excluding non-controlling interests)						
Shareholders' equity	45,876	15,297	5,556	51,177	11,282	5,753
Preference shares - equity	—	—	—	(1,421)	—	—
	45,876	15,297	5,556	49,756	11,282	5,753
Regulatory adjustments and deductions						
Own credit	(152)	—	(3)	17	—	—
Defined benefit pension fund adjustment	(198)	(15)	61	(138)	—	142
Cash flow hedging reserve	(261)	—	—	(286)	1	—
Deferred tax assets	(47)	(599)	(250)	(252)	(622)	(210)
Prudential valuation adjustments	(524)	(1)	—	(349)	(1)	—
Qualifying deductions exceeding AT1 capital	—	(199)	—	—	—	—
Goodwill and other intangible assets	(521)	(477)	—	(544)	(498)	—
Expected losses less impairments	(642)	(534)	(165)	(395)	(703)	(22)
Instruments of financial sector entities where the institution has a significant investment	(20,433)	(3,019)	—	(15,680)	(2,413)	—
Significant investments in excess of secondary capital	—	(80)	—	—	(424)	—
Other regulatory adjustments	235	20	25	287	532	27
	(22,543)	(4,904)	(332)	(17,340)	(4,128)	(63)
CET1 capital	23,333	10,393	5,224	32,416	7,154	5,690
Additional Tier 1 (AT1) capital						
Qualifying instruments and related share premium subject to phase out	2,993	175	—	3,493	204	—
Tier 1 deductions						
Instruments of financial sector entities where the institution has a significant investment	(1,034)	(374)	—	(1,175)	(187)	—
Qualifying deductions exceeding AT1 capital	—	199	—	—	—	—
	(1,034)	(175)	—	(1,175)	(187)	—
Tier 1 capital	25,292	10,393	5,224	34,734	7,171	5,690
Qualifying Tier 2 capital						
Qualifying instruments and related share premium	12,161	4,735	555	19,039	5,058	492
Tier 2 deductions						
Instruments of financial sector entities where the institution has a significant investment	(3,302)	(112)	—	(2,432)	(92)	—
Other regulatory adjustments	—	—	(33)	—	—	(7)
	(3,302)	(112)	(33)	(2,432)	(92)	(7)
Tier 2 capital	8,859	4,623	522	16,607	4,966	485
Total regulatory capital	34,151	15,016	5,746	51,341	12,137	6,175

*unaudited

Note:

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

Financial review Capital and risk management

Capital risk* continued

Leverage exposure

The leverage exposure is based on the CRR Delegated Act.

	2016			2015		
	RBS plc £bn	NatWest £bn	UBI DAC £bn	RBS plc £bn	NatWest £bn	UBI DAC £bn
Leverage						
Derivatives	251.5	3.1	0.9	265.6	2.1	0.7
Loans and advances	167.2	214.7	22.5	175.9	207.6	19.9
Reverse repos	32.0	—	0.3	31.1	—	—
Other assets	182.9	11.1	2.6	196.6	10.7	2.2
Total assets	633.6	228.9	26.3	669.2	220.4	22.8
Derivatives						
- netting	(243.3)	(2.2)	(0.1)	(260.1)	(1.4)	(0.1)
- potential future exposures	67.1	0.2	0.2	76.8	0.2	0.2
Securities financing transactions gross up	3.8	—	—	5.2	—	—
Undrawn commitments	41.4	9.9	1.1	46.3	9.9	1.0
Regulatory deductions and other adjustments	(23.8)	(5.1)	(0.2)	(15.9)	(5.2)	(0.2)
Exclusion of core UK-group exposures	(31.6)	(62.1)	—	(18.9)	(70.8)	—
Leverage exposure	447.2	169.6	27.3	502.6	153.1	23.7

*unaudited

Financial review Capital and risk management

Liquidity and funding risk

Definition

Liquidity and funding risk arises when the Group is unable to meet its financial obligations, including financing wholesale maturities or customer deposit withdrawals, as and when they fall due.

All the quantitative disclosures in this section are audited.

Key developments in 2016

Liquidity position:

- The liquidity portfolio of £163 billion covered total wholesale funding, including derivative collateral, by more than two times.
- The Group's liquidity portfolio increased by £10 billion in the year driven by secondary liquidity, as the volume of mortgage assets placed into the Discount Window Facility increased during 2016.

Funding position:

- The loan:deposit ratio was 91% at the end of 2016, a 2% increase from the prior year, driven by Capital Resolution running down more deposits than loans.

Sources of liquidity and funding

Liquidity and funding risks arise through the maturity transformation role that banks perform. It is dependent on Group specific factors such as maturity profile, composition of sources and uses of funding and the quality and size of the liquidity portfolio. Broader market factors, such as wholesale market conditions and depositor and investor behaviour, are also contributing factors.

The Group's primary funding sources are as follows:

Type	Description
Customer deposits	PBB and CPB deposit taking franchises.
Wholesale markets	Short-term (less than 1 year) unsecured money markets and secured repo market funding.
Term debt	Issuance of long-term (more than 1 year) unsecured and secured debt securities.

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. Usage and repayment of available central bank facilities will fit within the overall liquidity risk appetite and concentration limits.

Policy, framework and governance

The key elements of the Group's liquidity and funding framework are as follows:

Type	Description
Risk appetite	Meeting regulatory and set internal risk limits for liquidity and funding.
Policies	How we manage liquidity and funding across the RBS Group.
Governance	Management oversight and three lines of defence.

Internal liquidity and funding policies are designed to ensure that the Group:

- **Has a clearly stated liquidity and funding risk tolerance:** The liquidity and funding risk tolerance forms part of the RBS Group's bank-wide risk appetite statement, which is overseen by the Board Risk Committee and approved by the RBS Group Board. The risk appetite statement defines key metrics, risk trigger levels and capacity for liquidity and funding management within the RBS Group. The Board also sets the appetite for funding risk to ensure that stable sources of funding are used to fund the Group's core assets. The RBS Group monitors its liquidity positions against these risk tolerances on a daily basis. In setting risk limits the Board considers the nature of the RBS Group's activities, overall risk appetite, market best practice and regulatory compliance.
- **Has in place strategies, policies and practices to ensure that the RBS Group maintains sufficient liquidity:** the risk management framework determines the sources of liquidity risks and the steps that can be taken when these risks exceed certain monitored limits. These steps include when and how to use the liquid asset portfolio, and other balance sheet actions that can be undertaken. The Asset and Liability Management Committee (ALCo), and by delegation the ALCo Technical Committee, oversees the implementation of liquidity and funding management across the RBS Group within set risk appetite.
- **Incorporates liquidity costs, benefits and risks in product pricing and performance management:** The Group uses internal funds transfer pricing to ensure liquidity costs are reflected in the measurement of business performance, and to correctly incentivise the business to source the most appropriate mix of funding.

Financial review Capital and risk management

Liquidity and funding risk continued Regulatory oversight and liquidity framework*

The RBS Group operates across multiple jurisdictions and is subject to a number of regulatory regimes, with the key metrics being:

Ratio	Exposure type	Description
Liquidity coverage ratio (LCR)	Liquidity profile	Coverage of 30 day net cash outflows in stress - effective from 1 October 2015.
Net stable funding ratio (NSFR)	Structural funding profile	Required and available stable funding sources less than and greater than 1 year timeline. Effective from 1 January 2018.

The principal regulator, the Prudential Regulation Authority (PRA), has a comprehensive set of liquidity regulations which implement the CRD IV liquidity regime in the UK. To comply with the PRA regulatory framework, the RBS Group undertakes the following:

Activity	Description
Individual Liquidity Adequacy Assessment Process (ILAAP)	An ongoing exercise to comply with best practice and regulatory standards for liquidity management.
L-SREP	An annual Liquidity Supervisory Review and Evaluation Process (L-SREP) with the PRA, that involves a comprehensive review of the RBS ILAAP, liquidity policies and risk management framework. This results in the settings of the Individual Liquidity Guidance, which influences the size and overall composition of the liquidity portfolio.

Regulatory developments

LCR is being introduced on a phased basis and UK banks are initially required to maintain a minimum 90% LCR by 1 January 2017, rising to 100% by 1 January 2018.

The BCBS published its final recommendations for implementation of the NSFR in October 2014. The proposal included an implementation date of 1 January 2018, by which time banks are expected to meet and maintain a NSFR ratio of 100%. The EC is due to submit a legislative proposal to the European Parliament during 2017 for implementing the NSFR in the EU. In the meantime, the RBS Group uses the definitions from the BCBS guidelines, and its own internal interpretations, to calculate the NSFR.

Measurement, monitoring and contingency planning

In implementing the liquidity risk management framework, a suite of tools are used to monitor, limit and stress test the risks within the balance sheet. Set 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 significant legal entity and business levels daily, with performance reported to ALCos at least monthly.

Any breach of internal metric limits will set in motion a series of actions and escalations outlined under the RBS Recovery Plan (refer to page 27), which covers all legal entities within the Group. The plan sets out credible recovery options that could be implemented in the event of a severe stress to restore the business to a stable and sustainable position, focussing on addressing the bank's capital and liquidity position.

Two significant legal entities, RBS Securities Inc and The Royal Bank of Scotland International Limited, have been requested by local regulators to maintain separate recovery plans to address specific liquidity risks. These plans will be aligned to the 2017 RBS Recovery Plan to ensure they operate consistently in the event of a stress scenario.

Stress testing*

Under the liquidity risk management framework the RBS Group maintains the ILAAP, a component of which is an assessment of net stressed liquidity outflows. The RBS Group considers a range of extreme but plausible stress scenarios on cash flows, liquidity resources, profitability, solvency, asset encumbrance and survival horizon.

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

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

*unaudited

Financial review Capital and risk management

Liquidity and funding risk continued

Liquidity portfolio

The size of the portfolio is determined under the liquidity risk management framework with reference to the RBS Group's liquidity risk appetite.

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

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

The UK DoLSub liquidity portfolio accounted for 97% of the Group's total liquidity portfolio; this portion is available to meet liquidity needs as they arise across the Group. The remaining liquidity reserves are held within non-UK bank subsidiaries for local use.

Separate from the liquidity portfolio, the Group holds high quality assets to meet payment systems collateral requirements; these are managed by RBS Group Treasury.

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

- Primary liquid assets such as cash and balances at central banks, treasury bills and other high quality government and US agency bonds.
- Secondary liquid assets are eligible as collateral for local central bank liquidity facilities, 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 Group retains a prudent approach to setting the composition of the liquidity portfolio which is subject to internal policies and limits over quality of counterparty, maturity mix and currency mix. The liquidity value of the portfolio is determined with reference to current market prices and the haircuts necessary to generate cash from the asset.

Liquidity risk

Liquidity portfolio

The table below shows 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 discounts applied by the Bank of England and other central banks to instruments, within the secondary liquidity portfolio, eligible for discounting.

	Liquidity value									
	2016					2015				
	31 December			Average		31 December			Average	
	UK			UK		UK			UK	
	DoLSub (1)	Other	Total	DoLSub (1)	Total	DoLSub (1)	Other	Total	DoLSub (1)	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	66,598	2,227	68,825	56,772	59,065	67,790	1,432	69,222	67,294	69,442
Central and local government bonds										
AAA rated governments	3,936	760	4,696	3,692	4,326	3,201	1,098	4,299	4,069	5,080
AA- to AA+ rated governments and US agencies	19,348	1,244	20,592	18,757	20,066	18,238	787	19,025	11,462	20,934
	23,284	2,004	25,288	22,449	24,392	21,439	1,885	23,324	15,531	26,014
Primary liquidity	89,882	4,231	94,113	79,221	83,457	89,229	3,317	92,546	82,825	95,456
Secondary liquidity (2)	68,007	683	68,690	65,588	66,774	59,201	1,369	60,570	54,131	57,654
Total liquidity value	157,889	4,914	162,803	144,809	150,231	148,430	4,686	153,116	136,956	153,110
Total carrying value	184,136	5,082	189,218			181,240	4,886	186,126		

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

	GBP	USD	EUR	Other	Total
	£m	£m	£m	£m	£m
2016	128,461	9,344	24,101	897	162,803
2015	109,941	18,781	24,394	—	153,116

Notes:

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

(2) Comprises assets eligible for discounting at the Bank of England and other central banks.

Financial review Capital and risk management

Liquidity and funding risk continued

Funding risk

The composition of the Group's balance sheet is a function of the broad array of product offerings and 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.

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 five 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
2016 total	13.0	33.6	54.6	75.2	12.6	(9.9)	2.7
2015 total	15.4	35.7	64.4	84.7	7.6	(6.1)	1.5

Notes:

(1) Short-term wholesale funding is funding with a residual maturity of less than one year.

(2) Excludes derivative cash collateral.

(3) Primarily short-term balances.

Funding sources

The table below shows the Group's carrying values of the principal funding sources.

	2016			2015		
	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	20,611	—	20,611	20,241	—	20,241
Other deposits	12,586	2,117	14,703	7,588	3,999	11,587
	33,197	2,117	35,314	27,829	3,999	31,828
Debt securities in issue						
Certificates of deposit (CDs)	3,208	—	3,208	944	—	944
Medium-term notes (MTNs)	11,738	—	11,738	16,833	—	16,833
Covered bonds	3,935	—	3,935	5,585	—	5,585
Securitisations	1,481	—	1,481	2,442	—	2,442
	20,362	—	20,362	25,804	—	25,804
Subordinated liabilities	8,303	11,212	19,515	8,528	18,502	27,030
Notes issued	28,665	11,212	39,877	34,332	18,502	52,834
Wholesale funding	61,862	13,329	75,191	62,161	22,501	84,662
Customer deposits						
Derivative cash collateral	11,487	—	11,487	10,360	—	10,360
Other deposits	318,954	18,528	337,482	331,581	5,021	336,602
Total customer deposits	330,441	18,528	348,969	341,941	5,021	346,962
Total disposal groups (1)	23,273	—	23,273	2,837	—	2,837
Total funding	415,576	31,857	447,433	406,939	27,522	434,461

Note:

(1) Disposal groups for 2016 are primarily RBSI which was not part of disposal groups in 2015 but are included here for comparison purposes. RBSI balances were: customer deposits £23.3 billion (2015 - £21.3 billion). Disposal groups for 2015, were predominantly international private banking customer deposits of £2.6 billion.

Repos

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

	2016 £m	2015 £m
Financial institutions		
- central and other banks	5,239	10,266
- other financial institutions	25,652	20,130
Other corporate	1,444	6,982
Total	32,335	37,378

Key point

- Reverse repos at 31 December 2016 were £41.7 billion (2015 - £39.9 billion). Fair value of securities received as collateral for reverse repos was £41.7 billion (2015 - £39.8 billion), of which £30.4 billion (2015 - £29.0 billion) had been rehypothecated for the Group's own transactions, in line with normal market practice.

Financial review Capital and risk management

Liquidity and funding risk continued

Loan:deposit ratios and funding surplus/(gap)

The table below shows loans and advances to customers, customer deposits, loan:deposit ratios (LDR) and funding surplus/(gap).

	2016				2015*			
	Loans and advances to customers (1) £m	Customer deposits (2) £m	LDR %	Funding surplus/(gap) (3) £m	Loans and advances to customers (1) £m	Customer deposits (2) £m	LDR %	Funding surplus/(gap) (3) £m
UK PBB	132,107	145,826	91	13,719	119,705	137,840	87	18,135
Ulster Bank Rol	18,930	16,109	117	(2,821)	16,673	13,102	127	(3,571)
Commercial Banking	100,069	97,886	102	(2,183)	91,286	88,859	103	(2,427)
Private Banking	12,157	26,560	46	14,403	11,193	23,084	48	11,891
NatWest Markets	17,417	8,384	nm	(9,033)	16,076	5,674	nm	(10,402)
Capital Resolution	12,587	9,333	nm	(3,254)	22,285	24,879	nm	2,594
W&G	20,546	24,166	85	3,620	20,016	24,085	83	4,069
Central items & other	1,142	2,177	nm	1,035	418	3,154	nm	2,736
Subtotal excluding disposal groups and RBSIH (2015)	314,955	330,441	95	15,486	297,652	320,677	93	23,025
RBSI Holdings (4)	7,891	23,273	34	15,382	7,337	21,264	35	13,927
International private banking & other (5)	—	—	—	—	1,639	2,805	63	1,166
Total including disposal groups	322,846	353,714	91	30,868	306,628	344,746	89	38,118

Notes:

- (1) Excludes reverse repo agreements and net of impairment provisions.
- (2) Excludes repo agreements.
- (3) Calculated as customer deposits less loans and advances to customers.
- (4) Included within disposal groups for 2016 only.
- (5) Included within disposal groups for 2015 only.
- (6) nm = not meaningful

Key points

- The customer loan:deposit ratio was 91%, up from 89% at the end of 2015 as loans grew more than deposits.
- Loan growth was driven by mortgage lending in UK PBB and corporate lending in Commercial Banking.

- Deposit growth continued in 2016, particularly in UK PBB, Commercial Banking, Private Banking and RBSI Holdings. These increases were partially offset by deposit reductions in Capital Resolution as the business continued to run down, as well as the sale of the international private banking business.

Notes issued - residual maturity profile by note type

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 %
	Commercial paper and CDs £m	MTNs £m	Covered bonds £m	Securitisations £m	Total £m			
2016								
Less than 1 year	3,205	2,552	96	—	5,853	993	6,846	17
1-3 years	3	3,916	871	—	4,790	1,817	6,607	17
3-5 years	—	3,316	1,883	—	5,199	472	5,671	14
More than 5 years	—	1,954	1,085	1,481	4,520	5,021	9,541	24
Total	3,208	11,738	3,935	1,481	20,362	8,303	28,665	72
Amounts due from holding company and fellow subsidiaries	—	—	—	—	—	11,212	11,212	28
Total	3,208	11,738	3,935	1,481	20,362	19,515	39,877	100
2015								
Less than 1 year	742	4,996	2,171	4	7,913	239	8,152	16
1-3 years	202	3,785	758	—	4,745	2,288	7,033	13
3-5 years	—	4,307	1,627	—	5,934	92	6,026	11
More than 5 years	—	3,745	1,029	2,438	7,212	5,909	13,121	25
Total	944	16,833	5,585	2,442	25,804	8,528	34,332	65
Amounts due from holding company and fellow subsidiaries	—	—	—	—	—	18,502	18,502	35
Total	944	16,833	5,585	2,442	25,804	27,030	52,834	100

*unaudited

Financial review Capital and risk management

Liquidity and funding risk continued

Encumbrance

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

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

- Already encumbered and used to support funding currently in place via own asset securitisations, covered bonds and securities repurchase agreements.
- Pre-positioned with central banks as part of funding schemes and those encumbered under such schemes.
- 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.

Balance sheet encumbrance - third party

2016	Encumbered as a result of transactions with counterparties other than central banks				Pre-positioned & encumbered assets held at central banks(4)	Unencumbered assets not pre-positioned with central banks				Total third party	Balances with holding company and fellow subsidiaries	Total
	Covered bonds and securitisations(1) £bn	Derivatives £bn	Repos and similar(2) £bn	Total (3) £bn		Readily available (5) £bn	Other available (6) £bn	Cannot be used(7) £bn	Total £bn			
Cash and balances at central banks	—	—	4.0	4.0	—	69.8	—	—	69.8	73.8	—	73.8
Loans and advances												
- banks	1.2	6.7	0.7	8.6	—	7.8	0.1	0.1	8.0	16.6	1.0	17.6
- residential mortgages												
- UK	10.1	—	—	10.1	97.9	19.8	7.8	—	27.6	135.6	—	135.6
- Irish	7.1	—	—	7.1	1.5	5.7	—	0.1	5.8	14.4	—	14.4
- US	0.3	—	—	0.3	—	—	—	—	—	0.3	—	0.3
- credit cards	—	—	—	—	—	4.0	0.3	—	4.3	4.3	—	4.3
- personal loans	—	—	—	—	—	6.2	2.6	—	8.8	8.8	—	8.8
- other	0.1	17.0	—	17.1	6.1	5.8	100.2	22.4	128.4	151.6	1.1	152.7
Reverse repos	—	—	—	—	—	—	—	41.7	41.7	41.7	—	41.7
Debt securities	—	2.8	35.4	38.2	—	32.7	0.5	0.3	33.5	71.7	—	71.7
Equity shares	—	—	0.1	0.1	—	0.2	—	0.1	0.3	0.4	—	0.4
Settlement balances	—	—	—	—	—	—	—	5.6	5.6	5.6	—	5.6
Derivatives	—	—	—	—	—	—	—	246.4	246.4	246.4	1.3	247.7
Intangible assets	—	—	—	—	—	—	—	6.2	6.2	6.2	—	6.2
Property, plant and equipment	—	—	—	—	—	—	3.1	1.4	4.5	4.5	—	4.5
Deferred tax	—	—	—	—	—	—	—	1.8	1.8	1.8	—	1.8
Other assets	—	—	—	—	—	—	—	2.3	2.3	2.3	—	2.3
Total before disposal groups	18.8	26.5	40.2	85.5	105.5	152.0	114.6	328.4	595.0	786.0	3.4	789.4
Disposal groups	—	—	—	—	—	0.2	7.8	0.4	8.4	8.4	—	8.4
Total after disposal groups	18.8	26.5	40.2	85.5	105.5	152.2	122.4	328.8	603.4	794.4	3.4	797.8

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

Liquidity and funding risk continued

2015	Encumbered as a result of transactions with counterparties other than central banks				Pre-positioned & encumbered assets held at central banks(4)	Assets encumbered at the central bank and unencumbered assets				Total third party	Balances with holding company and fellow subsidiaries		Total
	Covered bonds and securitisations(1)	Derivatives	Repos and similar(2)	Total(3)		Readily available (5)	Other available (6)	Cannot be used(7)	Total		£bn	£bn	
Cash and balances at central banks	—	—	2.5	2.5	—	76.5	—	—	76.5	79.0	—	—	79.0
Loans and advances													
- banks	1.5	11.0	0.4	12.9	—	3.9	0.3	0.1	4.3	17.2	1.6	—	18.8
- residential mortgages													
- UK	15.2	—	—	15.2	81.3	18.6	8.4	—	27.0	123.5	—	—	123.5
- Irish	7.4	—	—	7.4	1.2	4.0	—	0.1	4.1	12.7	—	—	12.7
- credit cards	—	—	—	—	—	4.4	0.2	—	4.6	4.6	—	—	4.6
- personal loans	—	—	—	—	—	6.0	3.5	—	9.5	9.5	—	—	9.5
- other	0.5	17.2	0.4	18.1	8.3	8.8	97.7	21.8	128.3	154.7	1.2	—	155.9
Reverse repos	—	—	—	—	—	—	—	39.8	39.8	39.8	—	—	39.8
Debt securities	—	2.9	31.8	34.7	—	45.2	0.1	—	45.3	80.0	—	—	80.0
Equity shares	—	—	—	—	—	0.7	0.1	0.3	1.1	1.1	—	—	1.1
Settlement balances	—	—	—	—	—	—	—	4.0	4.0	4.0	0.1	—	4.1
Derivatives	—	—	—	—	—	—	—	261.8	261.8	261.8	1.3	—	263.1
Intangible assets	—	—	—	—	—	—	—	6.5	6.5	6.5	—	—	6.5
Property, plant and equipment	—	—	0.3	0.3	—	—	3.1	1.1	4.2	4.5	—	—	4.5
Deferred tax	—	—	—	—	—	—	—	2.6	2.6	2.6	—	—	2.6
Other assets	—	—	—	—	—	—	—	3.0	3.0	3.0	—	—	3.0
Total before disposal groups	24.6	31.1	35.4	91.1	90.8	168.1	113.4	341.1	622.6	804.5	4.2	—	808.7
Disposal groups	—	—	—	—	—	0.8	2.0	0.7	3.5	3.5	—	—	3.5
Total after disposal groups	24.6	31.1	35.4	91.1	90.8	168.9	115.4	341.8	626.1	808.0	4.2	—	812.2

Notes:

- (1) Covered bonds and securitisations include securitisations, conduits and covered bonds.
- (2) Repos and other secured deposits, cash, coin and nostro balance held with the Bank of England as collateral against deposits and notes in circulation are included here rather than within those positioned at the central bank as they are part of normal banking operations.
- (3) Total assets encumbered as a result of transactions with counterparties other than central banks are those that have been pledged to provide security and are therefore not available to secure funding or to meet other collateral needs.
- (4) Assets are pre-positioned at central banks include loans provided as security as part of funding schemes and those encumbered under such schemes.
- (5) Readily available: including assets that have been enabled for use with central banks but not positioned; cash and high quality debt securities that form part of the Group's liquidity portfolio, and unencumbered debt securities.
- (6) Other assets that are capable of being encumbered 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.
- (7) Cannot be used includes:
 - (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.
- (8) 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.

Business risk*

Definition and sources of risk

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

Key developments in 2016

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

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

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

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

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

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

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

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

Market conditions have become more volatile following the EU referendum result, and the RBS Group has been closely monitoring and assessing the operating environment and its impact on business risk.

*unaudited

Reputational risk*

Definition and sources of risk

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

Key developments in 2016

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

RBS Group articulated its appetite for reputational risk through the implementation of a qualitative reputational risk appetite statement and framework. This has improved the identification, assessment and management of customers and issues that present a material reputational risk, resulting in a greater awareness and focus on the importance of this risk and an increase in the number of cases brought to franchise and RBS Group-wide Reputational Risk fora.

Reputational risk is mitigated through the policy and governance framework, with ongoing staff training to ensure early identification, assessment and escalation of material issues.

The most material threats to the Group's reputation continued to originate from historical and more recent conduct issues. As a result, the Group has been the subject of investigations and reviews by a number of its regulators, some of which have resulted in fines and public censure. Refer to the Litigation, investigations and reviews section of Note 30 on the consolidated accounts on page 201.

Conduct and regulatory risk*

Definition

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

Sources of risk

Conduct and regulatory risk exists across all stages of RBS Group's relationships with its customers, from the development of its business strategies, to post-sales processes. The activities through which conduct risk may arise are varied and include product design, marketing and sales, complaint handling, staff training, and handling of confidential Insider Information. Conduct risk also exists if RBS Group does not take effective action to prevent fraud, bribery and money laundering. Regulatory risk arises from the regulatory, business or operating environment and from RBS Group's response to it. As set out in the Litigation, investigations and reviews section in Note 30 on the consolidated accounts, RBS Group and certain members of staff are party to legal proceedings and are subject to investigation and other regulatory action in the UK, the US and other jurisdictions.

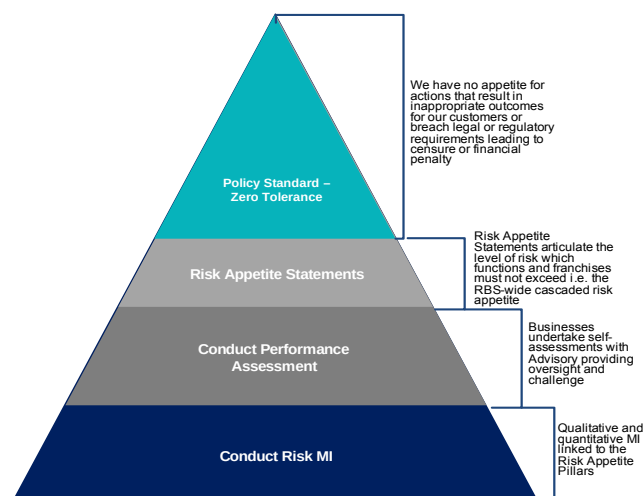
Key regulatory and conduct developments in 2016

RBS Group continued to remediate historical conduct issues, while also focusing its customer-facing businesses and support functions around the needs of its customers including the delivery of a number of regulatory change programmes. Conduct and litigation costs were £5.2 billion in 2016 compared with £3.5 billion in 2015.

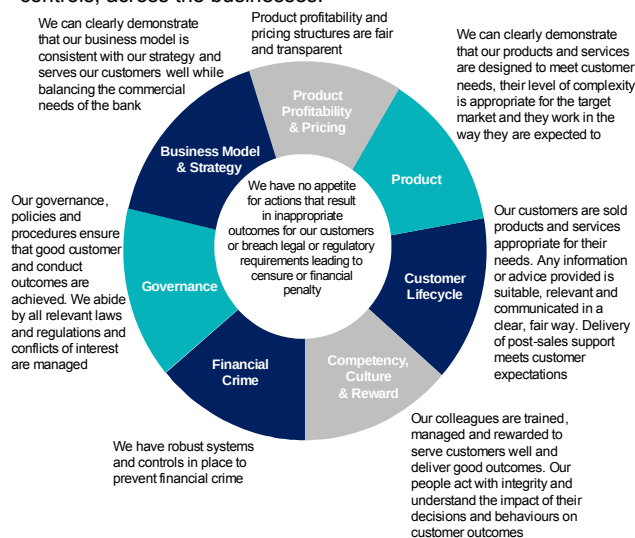
- The remediation of PPI continued, with the FCA due to update on policy during the first quarter of 2017. Provisioning was increased by £600 million principally to cover the potential pushing back of the time bar.
- On 8 November, the RBS Group announced it would be taking two steps in relation to the FCA's S166 review into GRG, firstly to implement a complaints process with independent third party oversight for all customers in scope and secondly to provide an automatic refund of complex fees paid by in-scope SME customers. The FCA review is ongoing and the final report findings are awaited.
- The RBS Group made a provision for the industry-wide review by the Central Bank of Ireland on the treatment of customers who were sold mortgages with a tracker interest rate or with a tracker interest rate entitlement.
- The application of the revised Markets in Financial Instruments Directive and Regulation (MiFID II/MiFIR) was delayed by a year to January 2018, while UK and EU regulators published several consultations on its implementation.
- The Market Abuse Regime took effect from July 2016.
- The UK's Senior Managers and Certification regime was successfully implemented.
- Work continues on the UK's ring fencing requirements.

*unaudited

The Conduct Risk Appetite Framework was established in 2015 and continues to be embedded across RBS Group.



The Conduct Risk Appetite Framework is divided into seven pillars, ensuring that conduct risk exposures are understood and managed in accordance with agreed risk appetite. The Conduct Risk Appetite Framework requires regular and consistent assessment through periodic Conduct Performance Assessment, reporting of risk exposures and the operating effectiveness of controls, across the businesses.



Other activities undertaken to address regulatory risk included:

- Migration to simpler, principle-based policies with accountable executives identified and roles, accountabilities and responsibilities defined;
- Roll-out of RBS Group-wide policies, processes and strategic systems to identify and manage conflicts of interest better;
- Enhancement of the RBS Group-wide surveillance programme; and
- Significant investment in anti-money laundering controls, governance and training.

Conduct and regulatory risk* continued

Governance

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

Key elements of the governance structure are set out below:

- The Conduct & Regulatory Affairs (C&RA) Executive Committee considers emerging material risks and issues, and implements Board and Executive Committee risk management policy decisions;
- The Financial Crime Accountable Executive Committee (accountable to the Executive Risk Forum) ensures that the customer businesses and the Services function fulfil strategic objectives by identifying and managing their financial crime risks effectively; and
- The Mandatory Change Advisory Committee, reports to the Bank-Wide Investment Committee, acting as the reception committee for reviewing externally mandated changes that may affect RBS Group. It also recommends appropriate responses, including change implementation activities. In doing so, it determines which businesses or functions own individual risks; and commissions and reviews impact assessments from customer businesses and functions.

Plans to merge parts of the C&RA function with Risk management were announced in December 2016 to take effect from 1 January 2017. The change is designed to take advantage of synergies across the risk, conduct and regulatory agendas. Regulatory Affairs will move to Corporate Governance & Secretariat, and Remediation and Complaints will move to Services' Chief Operating Office.

Controls and assurance

Under the Policy framework, there are 19 conduct risk policies. Each policy is designed to provide both high-level direction and RBS Group-wide requirements. The policies ensure RBS Group meets its regulatory obligations. They also provide the necessary clarity to staff on their conduct obligations.

RBS Group's Regulatory Affairs department separately oversees regulatory developments, interactions with regulators and regulatory approvals for individuals. Assurance and monitoring activities are essential to measure the extent to which the RBS Group manages its delivery of specific customer outcomes.

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

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

*unaudited

Risk appetite

The conduct risk appetite framework has now been embedded and the Conduct Performance Assessment, which forms part of it, facilitates a consistent approach across RBS Group for assessing conduct and regulatory risk.

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

Risk monitoring and measurement

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

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

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

The Group Audit Committee is provided with a whistleblowing report on a biannual basis. It details cases by internal reporting categories based on the definition of whistleblowing, which is contained within RBS Group's Speak Up policy.

The policy encompasses both the legislative definition contained within the Public Interest Disclosure Act 1998 and the regulatory definition within FCA and PRA regulations and guidance. It extends these to include conduct or behaviour which does not meet the expected bank standards documented in Our Code. The whistleblowing report identifies underlying trends and highlights the outcomes of investigations.

The RBS Group continues to work with each business to enhance the management information linked to their risk appetite statements. This is required to help ensure appropriate customer outcomes are delivered and that the management information is compliant with the Basel Committee on Banking Supervision's principles for effective risk data aggregation and risk reporting.

Conduct and regulatory risk* continued

Risk mitigation

The RBS Group communicates information to customer-facing businesses and functions about regulatory developments and discussions with regulators. This helps identify and execute any required mitigating changes to strategy or to business models.

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

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

All the disclosures in this section are unaudited.

Sources of risk

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

Key developments in 2016

During 2016, RBS Group's operational risk management framework was enhanced with improved links between risk appetite and risk exposures. This underpins an appropriate risk-based approach to operational risk management.

The year also saw a continued strong focus on the risks arising from the execution of major projects, including the Transformation programme, the restructuring of NatWest Markets (formerly CIB), preparations for the implementation of the Independent Commission on Banking's ring-fencing proposals, the planned divestment of Williams & Glyn, and the impact on RBS Group's control environment due to cost reduction measures. These are essential to the achievement of RBS Group's strategic objectives and, accordingly, Operational Risk continued to oversee these, ensuring the associated risks were assessed and understood with mitigating activity in place wherever possible.

*unaudited

There was also a continued strong focus on RBS Group's enhanced risk and control assessment methodology. This approach enhances understanding of the risk profile for the most critical products and services. As a core aspect of the Controls Transformation Programme, the new approach, building on design in 2015, continued to be rolled out and embedded across the organisation. A significant number of assessments were carried out during 2016 in order to identify and quantify the most material risks to key products and services. Refer to page 42 for further details.

The external fraud threat environment across the industry continued to escalate in 2016, with this trend predicted to continue. RBS Group has put in place a collective bank-wide response plan to the increased threat. This aligns fraud prevention programmes across the bank with the objective of mitigating the customer and financial impacts of external fraud. The plan successfully delivered key strategic programmes in 2016 that enhanced RBS Group's fraud prevention and detection capabilities, enabling it to limit the impact of fraudulent activity on its customers. As a result the RBS Group recorded an increase in its fraud detection rates in the second half of 2016. RBS Group is also supporting an industry-led education initiative in 2017-2018 which will offer advice to help the public protect themselves from preventable financial fraud. The initiative is led by Financial Fraud Action UK Ltd and is being delivered in conjunction with the Home Office, law enforcement and other banks.

The information and cyber security risk facing RBS Group continues to change in line with the constantly evolving threat environment in which it operates. Internal security improvement programmes continue to progress RBS-wide, developing new, and strengthening existing controls to protect the RBS Group and its customers. RBS Group continuously develops and utilises proactive threat management and intelligence processes to understand, manage and mitigate credible threats.

Throughout 2016 the RBS Group has decommissioned a number of internet-facing websites thus reducing the attack surface visible to external parties such as hackers and fraudsters. Improvements have also been made to access controls for RBS Group systems. Internal training programmes continue to ensure all employees are fully aware of the constant threats facing the RBS Group and remain vigilant to unauthorised attempts by internal or external parties to access systems and data.

Risk governance

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

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

Operational risk* continued

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

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

Controls and assurance

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

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

The CEC process helps to ensure compliance with the RBS Policy Framework, Sarbanes-Oxley 404 requirements concerning internal control over financial reporting, and certain requirements of the UK Corporate Governance Code.

Risk appetite

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

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

The aggregation of operational risk appetite drives measurement of how effectively RBS Group is managing its material risks across the core components of the operational risk management framework. It provides for an aggregate view of risk appetite, risk and control profile, loss and event data management and control environment.

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

Risk identification and assessment

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

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

During 2016, work continued on rolling out and embedding the enhanced end-to-end risk and control assessment methodology originally developed in 2015. This approach, which strengthens understanding of the risk profile of key products and services, is used to identify and quantify the most material operational risks. Subject matter experts and key stakeholders are engaged from across RBS Group to underpin management action in line with RBS Group's financial and non-financial appetite statement. Assessments were carried out on a number of critical products and services during 2016. The results of these assessments support RBS Group's ongoing journey to build on, and enhance, its control environment.

*unaudited

Operational risk* continued

Risk mitigation

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

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

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

Risk monitoring

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

Risk measurement

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

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

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

Refer to the Capital risk section for operational risk capital requirement figures.

Event and loss data management

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

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

All losses and recoveries associated with an operational risk event are reported against their financial accounting date. A single event can result in multiple losses (or recoveries) that may take time to crystallise. Losses and recoveries with a financial accounting date in 2016 may relate to events that occurred, or were identified in, prior years.

*unaudited

Pension risk*

Definition

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

Sources of risk

RBS Group has exposure to pension risk through its defined benefit schemes worldwide. The five largest schemes, which represent around 97% of RBS Group's pension liabilities are: the Main Section of The Royal Bank of Scotland Group Pension Fund (the Main scheme), the AA Section of The Royal Bank of Scotland Group Pension Fund, the Ulster Bank Pension Scheme, the Ulster Bank Pension Scheme (Republic of Ireland), and the Royal Bank of Scotland International Pension Trust. The Main scheme is the principal source of pension risk. Further detail on the Group's pension obligations can be found in Note 4 on the consolidated accounts.

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

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

Key developments in 2016

As part of the 31 December 2015 triennial valuation, RBS Group made a single £4.2 billion payment to the RBS Group Pension Fund in March 2016, instead of a series of annual contributions up to 2023, removing an element of pension risk. RBS Group and the trustee also agreed that the next valuation of the RBS Group Pension Fund will take place as at 31 December 2018, giving certainty to pension funding commitments until at least 2020.

*unaudited

Throughout 2016, various pension risk stress-testing initiatives were undertaken, focused both on internally defined scenarios and on scenarios to meet integrated Bank of England and European Banking Authority stress-testing requirements. For more information on stress testing, refer to the following page.

Governance

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

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

For further information on Risk governance, refer to page 17.

Risk appetite

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

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

Risk mitigation

The trustee has taken measures to mitigate inflation and interest rate risks, both by investing in suitable financial assets and by entering into inflation and interest rate swaps. The Main scheme also uses derivatives to manage the allocation of the portfolio to different asset classes and to manage risk within asset classes. The assets of the Main scheme, which represented around 89% of RBS Group's pension plan assets at 31 December 2016, are invested in a diversified portfolio. This includes quoted and private equity, government and corporate fixed interest and index-linked bonds, property and other alternative assets.

Pension risk* continued

Risk monitoring and measurement

Pension risk reports are submitted quarterly in the RBS Risk and Conduct Management Report. The report includes a measurement of the overall deficit or surplus position, estimated capital requirements, and an assessment of the associated assets and liabilities.

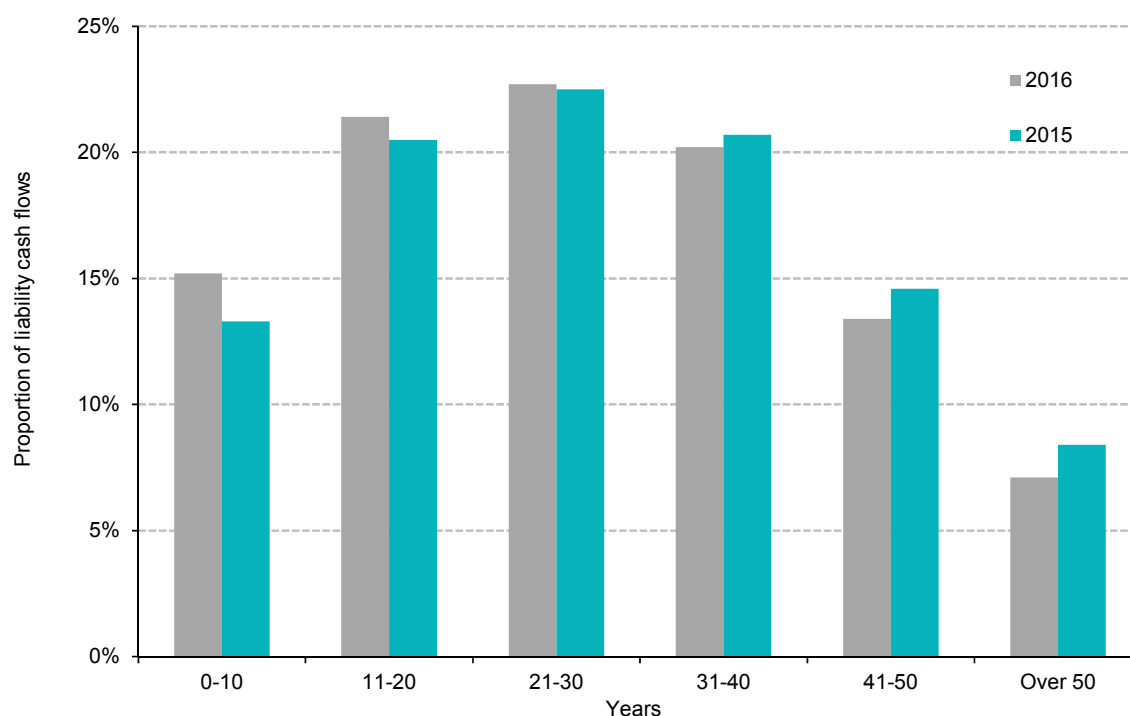
The RBS Group also undertakes stress tests and scenario analyses on its material defined benefit pension schemes each year as part of its risk measurement framework. These stress tests are also used to satisfy the requests of regulatory bodies such as the Bank of England. The stress testing framework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

Pension stress tests take the form of both stochastic and deterministic stresses over time horizons ranging from instantaneous to five years in duration. They are designed to examine the behaviour of the pension schemes' assets and liabilities under a range of financial and demographic shocks. The results of the stress tests and their consequential impact on RBS Group's balance sheet, income statement and capital position are incorporated into the overall RBS Group-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'). It includes changes in interest rates and equity values at the year-end, taking account of the current asset allocation and hedging arrangements. Asset sensitivity to changes in nominal yields increased over the year as swap yields fell at longer durations.

	Change in value of assets £m	Change in value of liabilities £m	Change in net pension obligations £m
2016			
Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields	1,048	502	546
Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields	1,485	1,552	(67)
Fall in AA credit spreads of 0.25% at all durations with no change in nominal or real swap yields or other credit spreads	9	2,074	(2,065)
Fall in equity values of 10%	(905)	—	(905)
2015			
Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields	874	363	511
Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields	1,029	1,104	(75)
Fall in AA credit spreads of 0.25% at all durations with no change in nominal or real swap yields or other credit spreads	7	1,526	(1,519)
Fall in equity values of 10%	(667)	—	(667)

The chart below shows the pension liability cash flow profile, allowing for expected indexation of future payments. The majority of expected cash flows (80%) are anticipated within the next 40 years. The profile will vary depending on the assumptions made regarding inflation expectations and mortality.



*unaudited

Credit risk: management basis

Definition

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

The following disclosures in this section are audited:

- Risk assessment and monitoring
- Portfolio overview - geography
- Wholesale credit risk management
 - Risk mitigation
 - Problem debt management - Forbearance
 - Key credit portfolios - commercial real estate LTV distribution
- Personal credit risk management
 - Problem debt management - Forbearance
 - Overview of personal portfolios - Forbearance, mortgage balances and LTV distribution

Sources of credit risk*

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

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

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

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

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

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

Credit Risk measures exclude intra-Group exposures.

Key developments in 2016

Credit quality - The portfolio was reduced due to the strategic disposals and the ongoing run-off of assets in Capital Resolution, although this was offset by the depreciation of the value of sterling relative to most major currencies. Asset quality remained stable against a backdrop of challenging economic conditions in the Shipping and Natural Resources sectors.

*unaudited

UK personal lending - The increase in the UK Personal portfolio was driven by significant mortgage lending activity. Underwriting standards are constantly monitored to ensure that they remain adequate in the current market environment and were not weakened to sustain the growth observed during the period. The UK unsecured lending portfolio remained stable during the year with no material changes to asset quality.

Shipping - RBS is winding down its shipping portfolio and has also disposed of assets during the year. RBS continues to witness difficult market conditions which are affecting vessel values and contributing to high levels of forbearance and impairments.

Natural Resources - The Oil & Gas sector continued to be affected by low oil prices which are predominantly due to over-supply. Exposures to the Oil & Gas sector were further reduced during 2016 and credit quality remained strong with the majority of the portfolio investment grade. The prolonged challenging market conditions did however result in a limited number of customers experiencing financial stress during the year, which resulted in impairments in the sector. For further information, refer to the Key credit portfolios section on page 64.

Credit risk measurement - RBS has changed its measure of credit risk exposure from Credit Risk Assets (CRA) to Current Exposure (CE) and Potential Exposure (PE). This change is discussed further on page 48.

Risk of Credit Loss - A new framework for managing problem debts in the wholesale portfolio was introduced during the year. The framework is discussed in detail on page 57.

IFRS 9 - The new IFRS 9 accounting requirement for loan impairments will draw extensively on the bank's risk models and measures in the calculation of expected credit loss required by the standard. A cross-functional programme involving teams in Finance, Risk and Services is delivering the additional capabilities in terms of models, systems and operational processes.

Credit risk management function*

Governance

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

- Approving credit for customers;
- Ensuring that credit risk is within the risk appetite set by the Board;
- Managing concentration risk and credit risk control frameworks;
- Developing and ensuring compliance with credit risk policies; and
- Conducting Group-wide assessments of provision adequacy

Financial review Capital and risk management

Credit risk: management basis continued

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

Element	Managed by	Description
Leadership	RBS GCCO	The GCCO has overall responsibility for the credit risk function. The GCCO chairs the Credit Risk Committee and, with the CRO, co-chairs the Group's Provisions Committee.
Governance	Credit Risk Committees	The Wholesale and the Retail Credit Risk Committees has authority for risk appetite (within appetite set by the board), strategy, frameworks and policy as well as oversight of the Group's credit profile.
	Provisions Committee (1,2)	The Provisions Committee has authority over provisions adequacy and to approve recommendations from business provisions committees in accordance with approval thresholds.
Risk appetite	Concentration frameworks - Wholesale ◦ Single name ◦ Sector ◦ Country ◦ Product and asset class - Personal credit risk appetite framework Reputational and environmental, social and ethical frameworks Credit policy	Wholesale frameworks are maintained to ensure that the risk of an outsized loss due to concentration to a particular borrower, sector, product type or country remains within appetite. The credit frameworks are aligned to the Group's risk appetite framework. The Group uses a product and asset class framework to control credit risk for its Personal businesses. The framework sets limits that measure and control the quality of both existing and new business for each relevant franchise or segment.
Controls and risk assurance	Risk Assurance	Credit policy standards are in place for both Wholesale and Personal portfolios and are expressed as a set of mandatory controls. Assurance activities, as defined by the RBS credit policy, are undertaken by the independent Risk Assurance function.
Credit stewardship	Credit assessment standards Credit risk mitigation and collateral Credit documentation Regular portfolio/customer review Problem debt identification and management	Credit risk stewardship takes place throughout the customer relationship, from initial credit approval and on a continuous basis thereafter. The methodology applied for assessing and monitoring credit risk varies between customer types and segments.
Customers	Segmentation	Customers are managed differently, reflecting different customer types and risks. Wholesale customers - including corporates, banks and other financial institutions - are grouped by industry sectors and geography as well as by product/asset class and are managed on an individual basis. Personal customers - usually in UK PBB and Ulster Bank RoI as well as personal lending activities in Private Banking - are grouped into portfolios of similar risk and managed on a portfolio basis.

Notes:

(1) Authority is delegated by the Executive Risk Forum.

(2) For further information on the Group's provisioning and impairment practices refer to page 126.

*unaudited

Credit risk: management basis continued

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 frameworks have been designed to reflect factors that influence the ability to meet those targets. Tools such as stress testing and economic capital are used to measure credit risk volatility and develop links between the credit risk appetite frameworks and risk appetite targets. The frameworks are supported by a suite of policies and transaction acceptance standards that set out the risk parameters within which franchises must operate. For further information on the specific frameworks for Wholesale and Personal refer to pages 55 and 69 respectively.

Risk measurements and models*

The RBS Group has changed its measure of credit risk exposure from Credit Risk Assets (CRA) to Current Exposure (CE) and Potential Exposure (PE). In these credit risk disclosures the measure used, unless otherwise stated, is Current Exposure. 2015 comparatives have been restated in Current Exposure. The table below summarises the differences between CRA, Current Exposure and Potential Exposure:

	CRA	Current Exposure	Potential Exposure (1)
Lending exposure Comprises cash balances at central banks as well as loans and advances to banks and customers.	Drawn balances (gross of impairment provisions).	Drawn balances	Legally committed limits (2)
		Measured net of individual, collective and latent provisions unless otherwise stated.	
Counterparty exposure	Measured using the mark-to-market value of derivatives after the effect of enforceable netting agreements and regulator approved models but before the effect of collateral. Calculations are gross of credit valuation adjustments (CVAs).	Measured using the mark-to-market value of derivatives after the effect of enforceable netting agreements and net of legally enforceable financial collateral. (3)	Measured using scaled credit limit utilisation, which takes into account mark-to-market movements, any collateral held and expected market movements over a specified horizon. (2,3)
		Current and Potential Exposures are measured net of CVA unless otherwise stated.	
Contingent obligations Primarily letters of credit and guarantees.	Drawn balances	Drawn balances	Legally committed amount (2)
Exclusions	- Trading book bonds - Equity securities - Settlement risk - Intra-group credit exposures - Securities financing transactions (repos) - Banking book debt securities	- Trading book bonds - Equity securities - Settlement risk - Suretyships - Intra-group credit exposures	
Other		- Net of cash and gold collateral. - Current Exposure and Potential Exposure are reported against the guarantor of a transaction to reflect the transfer of risk.	

Notes:

(1) Potential Exposure includes all drawn exposure and all legally committed undrawn exposure.

(2) Cannot be less than Current Exposure.

(3) Current Exposure and Potential Exposure for exchange-traded derivatives are defined as exposure at default (EAD).

Comparing the Current Exposure measure to the previous CRA measure, the following changes are noted:

- Exposures to the Sovereign sector are higher. This is primarily due to the inclusion of government bond exposure held in the banking book and managed in Treasury and Capital Resolution. The increased current exposure value, compared to CRA, is also a result of risk transfer related to guarantees (pledged by sovereign customers) for obligors active in other sectors.
- In the Banks & Other Financial Institutions sector, the netting of financial collateral reduced the Current Exposure value compared to CRA. Risk transfer also reduced current exposure compared to CRA.
- Outside these sectors, the impact of risk transfer is less material. However, the impact of netting impairment provisions means that for most other wholesale sectors Current Exposure is less than CRA.

*unaudited

Credit risk: management basis continued

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 are divided into different categories:

Model (1)	Calculation method	Wholesale	Personal
PD model	Individual counterparty/account	Each customer is assigned a probability of default (PD) rating and corresponding grade. PD is calculated using a combination of quantitative inputs, such as recent financial performance, and qualitative inputs such as management performance and sector outlook.	Each customer account is scored and models are used to assign a PD rating. Inputs vary across portfolios and include both internal account and customer level data, as well as data from credit bureaus. This score is used to support automated credit decision-making through the use of a statistically-derived scorecard.
LGD model	Individual counterparty/facility/product	Loss given default (LGD) models estimate the amount that would not be recovered in the event of a customer default. When estimating LGD, the RBS Group's models assess both borrower and facility characteristics, as well as any credit risk mitigants. The cost of collections and a time-discount factor for the delay in cash recovery are also incorporated.	
EAD model	Individual counterparty/facility/product	Exposure at default (EAD) models provide estimates of credit facility utilisation at the time of a customer default, recognising that customers may make further drawings on unused credit facilities prior to default or that exposures may increase due to market movements. EAD estimates for committed and uncommitted facilities are based on historic data on limit utilisation. The estimates are also gross of provisions, as well as cash and gold collateral, and as a result can be higher or lower than Potential Exposure. In accordance with regulatory requirements, EAD for Lending Exposures must always be equal to, or higher, than the drawn balance sheet amount, though it can be reduced by a legally enforceable netting agreement.	
EC model	Portfolio level	The credit economic capital model is a framework that allows for the calculation of portfolio credit loss distributions and associated metrics over a given risk horizon for a variety of business purposes. The model takes into account migration risk (the risk that credit assets will deteriorate in credit quality across multiple years), factor correlation (the assumption that groups of obligors share a common factor) and contagion risk (for example, the risk that the weakening of the sovereign's credit worthiness has a significant impact on the creditworthiness of a business operating in that country).	

*unaudited

Credit risk: management basis continued

Impact of credit model changes

The Group reviews and updates models on an ongoing basis in order to reflect the effects of more recent data, changes to products and portfolios, and new regulatory requirements. The PD models for banks, local authorities, housing associations property, house builders and mortgages were recalibrated during the year. This resulted in some downwards ratings migrations across internal asset quality bands.

Model changes affect year-on-year comparisons of risk measures in certain disclosures. Where meaningful, in 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.

For more information on model governance and review refer to the Models used in Risk section on page 20.

Asset quality*

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

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

The PD models used to assign a credit grade for the purposes of credit risk management assess the probability of a customer failing to honour its credit obligations over a one-year time period.

The AQ bands and corresponding probability of default ranges are set out below:

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

*unaudited

Risk mitigation*

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

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

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

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

Financial review Capital and risk management

Credit risk: management basis continued

Counterparty credit risk

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

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

Collateral may consist of either cash or securities. Additional collateral may be called should the net value of the obligations to RBS rise or should the value of the collateral itself fall. The majority of agreements are subject to daily collateral calls with collateral valued using the Group's internal valuation methodologies.

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

Risk assessment and monitoring

Practices for credit stewardship - including credit assessment, approval and monitoring as well as the identification and management of problem debts - differ between the Wholesale and Personal portfolios. For further information refer to the relevant sub-sections on pages 55 and 69. A key aspect of credit risk stewardship is ensuring that, when signs of impairment are identified, appropriate impairment provisions are recognised.

Impairment, provisioning and write-offs

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

Impairment

A financial asset is impaired if there is objective evidence that the amount, or timing, of future cash flows has been adversely affected. Refer to accounting policies on page 126 for details regarding the quantification of impairment losses.

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

Provisioning

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

Provision method	Asset type	Quantification method	Key factors considered
Individual	Impaired, individually significant	Case-by-case assessment of future cash flows	- Customer and guarantor performance. - Future value of collateral. - Future economic conditions based on factors available at the time.
Collective	Impaired but not individually significant, grouped into homogenous portfolios	Quantitative review of relevant portfolio	- Level of arrears. - Value of security. - Historical and projected cash recovery trends. - Current economic conditions. - Operational processes. - Latest cash collection profile.
Latent	Not impaired	$PD\% \times LGD\% \times EAD \times$ Emergence Period	- For Wholesale customers PD, LGD and EAD values are used. - For Personal, calculations are performed at portfolio level by product (e.g. mortgages, credit cards or unsecured loans). - Portfolio-level emergence periods are based on products or businesses with similar homogenous characteristics. Emergence periods range from 120 to 365 days.

Note:

(1) Refer to pages 92 to 96 for an analysis of impaired loans, related provisions and impairments. Refer to page 126 for details of accounting policies. For details on collateral, refer to the Counterparty credit risk section above as well as the Wholesale and Personal risk mitigation sections on pages 55 and 69.

Financial review Capital and risk management

Credit risk: management basis continued

Sensitivity of impairments to assumptions

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

In addition, for secured lending, key assumptions relate to the valuation of the security and collateral held, as well as the timing and cost of asset disposals based on underlying market depth and liquidity. Assessments are made by relationship managers on a case-by-case basis for individually-assessed provisions and are validated by credit teams. The Restructuring Credit team will ultimately recommend or approve any provisions that may be required under their delegated authority. For individual impairments greater than £1 million, oversight is provided by the RBS Provisions Committee.

Available-for-sale portfolios

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

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

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

Write-offs

Impaired loans and receivables are written-off when there is no longer any realistic prospect of recovery of part, or the entire loan. For loans that are individually assessed for impairment, the timing of write-off is determined on a case-by-case basis. Such loans are reviewed regularly and write-offs may be prompted by bankruptcy, insolvency, forbearance and similar events. For details of the typical time frames, from initial impairment to write off, for collectively assessed portfolios refer to the accounting policies section on 135.

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

Portfolio overview - asset quality*

The table below summarises Current and Potential Exposure, net of provisions and after risk transfer, by sector and asset quality.

2016	Wholesale (1)							Total £m
	Personal £m	Banks and other FIs £m	Sovereigns (2) £m	Property £m	Natural resources £m	Transport £m	Other £m	
AQ1-AQ4	111,899	41,585	113,992	19,057	8,697	5,450	15,862	316,542
AQ5-AQ8	47,992	4,306	135	21,719	3,335	9,087	37,157	123,731
AQ9	2,622	32	4	149	33	52	357	3,249
AQ10	3,693	325	—	1,389	303	1,004	755	7,469
Total	166,206	46,248	114,131	42,314	12,368	15,593	54,131	450,991
Potential Exposure	172,607	81,620	114,999	54,681	25,391	23,687	80,392	553,377
Risk of Credit Loss (3)	—	1	4	93	2	386	370	856
Flow into forbearance (4)	834	5	1	637	531	755	1,309	4,072
Forbearance stock	5,284	63	1	787	785	836	1,805	9,561
Provisions	2,192	55	1	695	218	469	777	4,407
- Individual and collective	1,966	50	—	658	207	454	676	4,011
- Latent	226	5	1	37	11	15	101	396
2015**								
AQ1-AQ4	96,830	39,427	119,139	21,029	8,681	7,786	16,723	309,615
AQ5-AQ8	49,684	4,100	183	18,221	2,711	10,901	35,690	121,490
AQ9	2,840	35	—	279	127	55	296	3,632
AQ10	3,765	616	1	2,282	140	395	883	8,082
Total	153,119	44,178	119,323	41,811	11,659	19,137	53,592	442,819
Potential Exposure	159,836	79,392	120,766	53,896	24,437	26,582	80,549	545,458
Watch Red	—	20	73	529	348	145	858	1,973
Flow into forbearance (4)	1,829	85	—	1,035	643	205	1,207	5,004
Forbearance stock	7,143	181	—	1,549	734	275	1,728	11,610
Provisions	3,003	70	1	2,260	116	296	1,326	7,072
- Individual and collective	2,613	59	—	2,210	107	272	1,229	6,490
- Latent	390	11	1	50	9	24	97	582

*unaudited

**restated - refer to page 48 for further details

Credit risk: management basis continued

Notes:

- (1) Includes SME customers managed in UK PBB Business Banking who are assigned a sector under RBS's sector concentration framework.
- (2) Includes exposure to central governments, central banks and sub-sovereigns such as local authorities.
- (3) Excludes Private Banking, Lombard and Invoice Finance exposures which are not material in context of the Risk of Credit Loss portfolio.
- (4) Completed during the year.
- (5) Forbearance stock: Wholesale forbearance stock represents loans that have been subject to a forbearance event in the two years up to the reported date. Personal forbearance stock is aligned to the European Banking Authority definition for forbearance reporting (refer to individual Personal section on page 72 for further details).

Key points

The following key portfolios are either designated high-oversight sectors under the sector framework or constitute a material proportion of Current Exposure and are discussed in more detail below.

Commercial Real Estate (CRE) (in Property) - refer to page 61;
Oil & Gas (in Natural Resources) - refer to page 65;
Mining & Metals (in Natural Resources) - refer to page 67;
Shipping - refer to page 68; and
Personal, including mortgages - refer to page 71.

- The Wholesale portfolio decreased by 3% on a constant currency basis (foreign exchange impact of £18.8 billion). This was predominately due to a reduction in the sovereign sector, driven by liquidity management activities, and in the transport sector in line with the exit strategy for the shipping sector.
- The quality of the Personal portfolio improved with AQ1-AQ4 making up 67% of personal lending against 63% in 2015. For the Wholesale portfolio AQ1-AQ4 made up 72% of the portfolio (2015 - 73%).
- The Risk of Credit Loss framework was fully implemented in April 2016. Exposure classified as Risk of Credit Loss decreased during 2016 due to customers who defaulted during the year and are shown in AQ10.
- For Wholesale, the flow into forbearance remained stable and continued to reflect the challenging conditions in certain sectors, notably Transport. 45% (2015 - 29%) of the total forbearance granted related to non-performing loans. Provision coverage of non-performing forborne loans was 27% (2015 - 43%). Refer to the Wholesale forbearance section (page 58) for further details.
- The reduction in defaulted exposures during the year was primarily due to specific portfolio disposals, including in the Republic of Ireland of small and medium enterprise-related exposures and buy-to-let mortgages, during the fourth quarter of 2016. This was partly offset by higher defaulted assets in Capital Resolution's Shipping portfolio.
- Credit impairment charges increased during 2016. In particular large individual charges were incurred in the Shipping, Oil & Gas and Mining & Metals sectors. Challenging economic conditions resulted in reduced global demand, oversupply and consequently volatile commodity prices, which adversely affected the shipping market and vessel values. Credit impairment releases were lower in 2016 with less asset disposal activity.
- In Personal, including mortgages, the flow into defaults was broadly stable year-on-year. Cash repayments and recoveries on previously defaulted debt remained strong.
- The bank's credit risk exposure has been affected by the significant appreciation of both the euro and US dollar against sterling. This was relevant to exposures in Ireland, Western Europe and the US and is discussed in further detail on page 54.
- The increase in credit risk exposure in the personal sector was predominantly driven by growth in UK mortgage lending. This portfolio is managed on a specific risk appetite framework and the growth observed the year was within risk appetite. For further information refer to page 71.

Financial review Capital and risk management

Credit risk: management basis continued

Portfolio overview - geography

The table below summarises both Current and Potential Exposure, net of provisions and after risk transfer, by geographic region as well as providing further detail for selected country risk exposure.

		Wholesale (1)						Current	Potential
	Personal	Banks and	Sovereigns (2)	Property	Natural	Transport	Other	Exposure	Exposure
2016	£m	other FI	£m	£m	resources	£m	£m	total	total
		£m	£m		£m			£m	£m
UK	148,882	18,911	69,390	37,994	8,358	9,324	44,517	337,376	389,820
RoI (3)	15,079	433	2,387	950	444	206	2,966	22,465	23,772
Other Western Europe	528	9,497	33,047	2,331	2,406	1,758	3,599	53,166	82,606
US	329	10,983	7,338	350	610	488	2,157	22,255	36,878
RoW (4)	1,388	6,424	1,969	689	550	3,817	892	15,729	20,301
Total	166,206	46,248	114,131	42,314	12,368	15,593	54,131	450,991	553,377
Of which:									
Southern Europe									
Spain	63	48	7	845	487	25	341	1,816	3,245
Italy	27	477	67	70	113	176	30	960	2,567
Portugal	6	90	8	13	148	2	1	268	439
Cyprus	9	—	—	—	—	—	—	9	10
Greece	13	—	—	5	—	—	12	30	30
Southern Europe total	118	615	82	933	748	203	384	3,083	6,291
Eurozone other (5)									
Germany	70	1,778	26,107	74	137	223	1,057	29,446	34,750
RoI (3)	15,079	433	2,387	950	444	206	2,966	22,465	23,772
Netherlands	32	2,045	1,185	235	230	117	563	4,407	8,299
France	69	1,835	3,170	288	563	611	578	7,114	15,298
Belgium	21	1,016	869	44	48	178	17	2,193	2,854
Luxembourg	9	703	28	490	1	41	272	1,544	2,734
Other (6)	14	328	674	47	22	72	261	1,418	2,342
Eurozone other total	15,294	8,138	34,420	2,128	1,445	1,448	5,714	68,587	90,049
Eurozone total	15,412	8,753	34,502	3,061	2,193	1,651	6,098	71,670	96,340
Japan (7)	25	466	1,008	—	—	—	146	1,645	2,612
India (7)	14	102	—	—	1	—	42	159	181
2015**									
UK	136,024	20,529	60,068	37,321	7,386	9,524	42,497	313,349	363,910
RoI (3)	13,440	433	1,623	692	427	218	2,542	19,375	20,652
Other Western Europe	548	8,878	30,825	2,406	2,134	2,549	4,251	51,591	80,285
US	301	8,110	21,820	621	864	891	2,362	34,969	53,236
RoW (4)	2,806	6,228	4,987	771	848	5,955	1,940	23,535	27,375
Total	153,119	44,178	119,323	41,811	11,659	19,137	53,592	442,819	545,458
Of which:									
Southern Europe									
Spain	80	40	6	671	525	73	324	1,719	2,938
Italy	26	358	52	62	175	67	58	798	2,200
Portugal	6	87	10	26	139	62	—	330	490
Cyprus	12	—	—	—	—	38	—	50	52
Greece	15	1	—	8	—	1	9	34	38
Southern Europe total	139	486	68	767	839	241	391	2,931	5,718
Eurozone other (5)									
Germany	64	1,433	23,801	89	150	800	1,050	27,387	32,450
RoI (3)	13,440	433	1,623	692	427	218	2,542	19,375	20,652
Netherlands	30	1,791	1,059	451	94	138	1,119	4,682	8,946
France	76	2,166	2,402	357	448	826	678	6,953	15,838
Belgium	21	662	537	158	44	138	52	1,612	2,376
Luxembourg	6	624	21	346	31	41	98	1,167	1,907
Other (6)	14	356	609	54	73	34	122	1,262	1,976
Eurozone other total	13,651	7,465	30,052	2,147	1,267	2,195	5,661	62,438	84,145
Eurozone total	13,790	7,951	30,120	2,914	2,106	2,436	6,052	65,369	89,863
Japan (7)	31	249	1,417	2	—	1	114	1,814	2,639
India (7)	11	84	—	—	8	—	95	198	243

**restated - refer to page 48 for further details. 2015 data is unaudited.

Credit risk: management basis continued

Notes:

- (1) Includes SME customers managed in UK PBB Business Banking who are assigned a sector under RBS's sector concentration framework
- (2) Includes exposures to central governments, central banks and sub-sovereigns such as local authorities.
- (3) RoI: Republic of Ireland.
- (4) Comprises Asia Pacific, Central and Eastern Europe, the Middle East, Central Asia and Africa. RoW also includes supranationals such as the World Bank and exposure relating to ocean-going vessels which cannot be meaningfully assigned to specific countries from a country risk perspective.
- (5) Countries where current exposure is greater than £1 billion.
- (6) Finland, Austria, Malta, Slovakia, Estonia, Lithuania, Latvia and Slovenia.
- (7) Non-eurozone countries displayed in the table are those that are A+ or worse and with current exposure greater than £1 billion.

Key points*

- Country Risk exposure was significantly affected by foreign exchange movements (£10.4 billion) during the year. On a constant currency basis, eurozone exposure decreased by £3.5 billion.
- Sovereign exposure to the US and RoW decreased. This is in line with RBS strategy to reduce activity in the US as well as reductions in RoW, which were partly due to reduced exposure in the shipping sector and other Capital Resolution disposals.
- The proportion of RBS' exposure to the UK is now 75% (71% - 2015).

Wholesale credit risk management

This section sets out further detail on the Group's approach to credit risk management for its Wholesale customers. Four formal frameworks are used to manage Wholesale credit concentration risks within the Group's risk appetite. These frameworks are regularly reassessed to ensure they remain appropriate for the Group's varied business franchises, economic and market conditions and to reflect refinements in risk measurement models as well as agreed risk appetite.

Wholesale credit risk framework*

A summary of the frameworks is set out below.

Concentration framework	Single name concentration (SNC)	Sector	Product and asset class	Country
Risk addressed	Concentration on a single borrower or borrower group.	Concentration in a single sector or across sectors that are susceptible to similar stress events.	Concentration on certain products or asset classes.	Concentration on a particular country.
Basis for classification	Size or LGD - based on net customer exposure for a given probability of default.	Size - based on exposure; and risk - based on Economic Capital and other qualitative factors.	Size - based on exposure to a product or asset class; and risk - based on heightened risk characteristics of a product.	Size - based on exposure to a particular country.
Limit types	Customer exposure and LGD limits relative to PD.	RBS Group-wide and franchise sector and sub-sector exposure limits.	RBS Group-wide and franchise product/asset class exposure limits and sub-limits.	RBS Group-wide country limits.
Controls within the framework	Elevated approval requirements, mandatory controls and procedures, monitoring and reporting, the requirement for regular reviews and for plans to address any exposures in excess of limit.			
Exposure measure (net/gross)	Both net and gross of "eligible" mitigants. To be eligible under the framework, mitigants must be legally enforceable, structurally effective and of appropriate maturity.	Gross exposure to a sector/sub-sector. Where PE is used, it is net of eligible collateral and provisions.	Net/gross - dependent on type of risk and limit definition. Where PE is used it is net of eligible collateral and provisions.	Net of provisions and risk transfer.

*unaudited

**restated - refer to page 48 for further details.

Credit risk: management basis continued

Risk assessment*

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

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

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

In 2016, new sector specific Transaction Acceptance Standards (TAS) were introduced to provide more detailed transactional lending and risk acceptance rules and guidelines which are one of the tools to control risk appetite at the customer/transaction level. This followed the introduction of general sector TAS in November 2015, providing full sector coverage. TAS are supplementary to the Credit Policy.

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

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

- Refinancing risk - the risk of loss arising from the failure of a customer to settle an obligation on expiry of a facility through the drawdown of another credit facility provided by the Group or by another lender;
- Consideration of other risks such as environmental, social and ethical, regulatory and reputational risks; and
- The portfolio impact of the transaction, including the impact on any credit risk concentration limits or agreed business franchise risk appetite.

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

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

Risk mitigation

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

- Commercial real estate - Refer to CRE section on page 61.
- Other physical assets - Including stock, plant, equipment, machinery, vehicles, ships and aircraft. Such assets are suitable collateral only if the Group can identify, locate, and segregate them from other assets on which it does not have a claim. The Group values physical assets in a variety of ways, depending on the type of asset and may rely on balance sheet valuations in certain cases.
- Receivables - These are amounts owed to the Group's counterparties by their own customers. The Group values them after taking into account the quality of its counterparty's receivable management processes and excluding any that are past due.
- Financial collateral - Refer to Counterparty credit risk section on page 51.

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.

*unaudited

Credit risk: management basis continued

The Group provides asset-backed lending for commercial real estate and shipping. Valuation methodologies are detailed below.

Commercial real estate valuations - The Group has a panel of chartered surveying firms that cover the spectrum of geography and property sectors in which the Group takes collateral. The Group has a programme that identifies suitable valuers for particular assets. They are contracted through a single service agreement to ensure consistency of quality and advice. Valuations are commissioned when an asset is taken as security; a material increase in a facility is requested; or an event of default is anticipated or has occurred. In the UK, the Group also applies an independent third-party market indexation to update external valuations once they are more than a year old.

Shipping valuations - Vessel valuations are obtained using several different independent sources. Valuations are usually undertaken on a desktop basis, assuming a willing buyer and willing seller. Most vessels are valued on a charter-free basis, but in certain circumstances the valuations take account of longer term committed charter income. Valuations are normally performed on a quarterly basis. From time to time, particularly for facilities showing increased signs of financial stress, a more formal valuation or specialist advice will be obtained.

Problem debt management

Early problem identification*

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

Risk of Credit Loss framework*

The Risk of Credit Loss framework which was fully implemented in April 2016, has replaced the RBS Group's previous Watchlist process for managing problem debts. The new framework focuses on Wholesale customers whose credit profiles have deteriorated since origination. Expert judgement is applied by experienced credit risk officers to classify cases into categories that reflect progressively deteriorating credit risk to the bank.

All customers that have been granted forbearance are managed under this framework. There are two classifications which apply to non-defaulted customers within the framework - Heightened Monitoring and Risk of Credit Loss. The framework also applies to those customers that have met the bank's default criteria (AQ10 exposures).

*unaudited

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

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

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

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

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

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

The Risk of Credit Loss framework does not apply to problem debt management for Business Banking customers in UK PBB. These customers are, where necessary, managed by specialised problem debt management teams, depending on the size of exposure or the Business Banking recoveries team where a loan has been impaired.

Credit risk: management basis continued Restructuring*

For the Wholesale problem debt portfolio, customer relationships are managed by the Restructuring team (this excludes customers managed by PBB). The factor common to all customers with Restructuring involvement is that RBS's exposure is outside risk appetite. The purpose of Restructuring is to protect the bank's capital. Where practicable, Restructuring do this by working with corporate and commercial customers to support their turnaround and recovery strategies and enable them to return to mainstream banking. Restructuring will always aim to recover capital in a fair and efficient manner.

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

An assessment of the viability of the business, as well as the ability of management to deal with the causes of financial difficulty, is carried out by specialists in Restructuring, focusing on both financial and operational issues. Following the assessment, options which may include forbearance and/or restructuring of facilities are developed. Credit risk decisions, including reviewing and approving any restructuring solutions in relation to these customers, are made by a dedicated Restructuring Credit team, which is part of the credit risk management function.

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

Forbearance

Forbearance 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 current risk appetite, or reflect improving credit market conditions for the customer, are not considered forbearance.

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

Types of wholesale forbearance

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

- **Covenant waiver**
A recalibration of covenants or a covenant amendment may be used to cure a potential or actual covenant breach. In return for this relief, the Group may seek to obtain a return commensurate with the risk that it is required to take. The increased return for the increased risk can be structured flexibly to take into account the customer's circumstances. For example it may be structured as either increased margin on a cash or payment-in-kind basis, deferred-return instruments or both. While the Group considers these types of concessions qualitatively different from other forms of forbearance, they constitute a significant proportion of Wholesale forbore loans and are therefore included in these disclosures.
- **Amendment to margin**
Contractual margin may be amended to assist the customer's day-to-day liquidity to help sustain its business as a going concern. This would normally be a short-term solution. The Group would seek a return commensurate to the risk that it is required to take.
- **Payment concessions and loan rescheduling (including extensions in contractual maturity)**
May be granted to improve the customer's liquidity or in the expectation that the customer's liquidity will recover when market conditions improve. In addition, they may be granted if the customer will benefit from access to alternative sources of liquidity, such as an issue of equity capital. These options have been used in CRE transactions, particularly during periods where a shortage of market liquidity has ruled out immediate refinancing and made short-term collateral sales unattractive.
- **Debt forgiveness/debt for equity swap**
May be granted where the customer's business condition or economic environment is such that it cannot meet obligations and where other forms of forbearance are unlikely to succeed. Debt forgiveness can be used for stressed corporate transactions and is typically structured on the basis of projected cash flows from operational activities, rather than underlying tangible asset values. Provided that the underlying business model, strategy and debt level are viable, maintaining the business as a going concern is the preferred option, rather than realising the value of the underlying assets.

*unaudited

Credit risk: management basis continued

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.

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

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

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

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

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

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

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

The transfer of wholesale loans subject to forbearance from impaired to performing status follows assessment by relationship managers and the Restructuring credit team. 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.

Financial review Capital and risk management

Credit risk: management basis continued

Flow into forbearance

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

Wholesale forbearance during the year by sector	2016				2015**			
	Performing £m	Non- performing £m	Total £m	Provision coverage (1) %	Performing £m	Non- performing £m	Total £m	Provision coverage (1) %
Property	330	307	637	25	474	561	1,035	45
Natural resources	365	166	531	36	610	33	643	36
Transport	141	614	755	25	147	58	205	29
Retail and leisure	424	87	511	22	269	99	368	32
Services	201	225	426	33	451	105	556	44
Other	324	54	378	8	297	71	368	46
Total	1,785	1,453	3,238	27	2,248	927	3,175	43

Note:

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

Forbearance arrangements

The table below shows the main types of Wholesale renegotiations. This includes only the forborne facility Current Exposure net of provisions and after risk transfer.

Wholesale renegotiations during the year by type (1)	2016 £m	2015** £m
Payment concessions	1,751	2,091
Non-payment concessions	1,487	1,084
Total	3,238	3,175

Note:

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

Key points

- The levels of completed forbearance in 2016 remained stable. Year-on-year comparisons of the level of forbearance within the various sectors may be impacted by individual material cases during a given year.
- Loans totalling £1.4 billion were granted approval for forbearance but had not yet reached legal completion at 31 December 2016 (2015 - £1.4 billion). These exposures are referred to as "in process" and are not included in the tables above. 61% (£0.9 billion) of these "in process" exposures related to non-performing customers and 39% (£0.5 billion) related to performing loans. The principal types of arrangements offered were payment concessions and loan rescheduling.
- Forbearance in the Transport sector has increased in 2016 driven by the Shipping sector (£0.7 billion). A number of Shipping facilities which were forborne in 2016 were included in a portfolio sale during Q4. (Refer to page 68 for further information).
- The decrease in exposure in the Natural Resources sector is reflective of forbearance being granted to defaulted customers with provisions in the Oil & Gas sector given the sector's challenges (refer to page 65 for further information). As the exposure measure is net of provisions, this reduced forborne exposure is not reported in the table above. On a gross basis, the level of forbearance granted to customers in the Natural Resources sector was consistent with 2015.
- Forbearance for performing Retail & Leisure customers increased driven by a limited number of covenant waivers for individually material cases, while the volume of customers receiving forbearance decreased.
- £1.6 billion of the facilities granted forbearance in 2016 were managed by Restructuring Credit. This equated to 48% of loans managed by Restructuring Credit (excluding loans to customers where recovery procedures have commenced).
- The value of loans forborne during 2015 and 2016 and still outstanding at 31 December 2016 was £4.3 billion (2015 - £4.5 billion), of which £1.0 billion related to arrangements completed during 2015 (2015 - £1.3 billion completed in 2014).
- By value, 77% (£1.7 billion) of the performing loans granted forbearance in 2015 (£2.2 billion) remained performing at 31 December 2016.
- Provisions for non-performing loans disclosed above are for the most part individually assessed. As a result, material provisions and associated fluctuations in coverage levels can impact direct comparison across periods. Provision coverage decreased in 2016, which is reflective of the proportion of the 2015 forborne portfolio relating to Exit portfolios where the strategy resulted in high levels of provisions. Provision coverage for non-performing "in process" loans was 29%. Additional provisions charged in 2016 and relating to loans forborne during 2015 totalled £160 million. Provision coverage of these loans at 31 December 2016 was 50%.
- The data presented above include loans forborne during 2015 and 2014. Until April 2014 a reporting threshold was in place which ranged from nil to £3 million after which no thresholds were in use. A number of immaterial portfolios have forbearance assessed under a portfolio approach.

**Restated - refer to page 48 for further details.

2015 data is unaudited.

Financial review Capital and risk management

Credit risk: management basis continued

Key credit portfolios

Commercial real estate

The CRE sector relates to lending activity for the development of, and investment in, commercial and residential properties.

A dedicated portfolio controls team is responsible for reviewing portfolio strategy, credit risk appetite and policies, as well as oversight of valuations and environmental frameworks. The sector is reviewed regularly at senior executive committees. Reviews include portfolio credit quality, capital consumption and control frameworks.

The majority of CRE lending applications are reviewed by specialist CRE transactional credit teams, including a dedicated development team. Lending guidelines and policy are informed by lessons learned from the 2008 financial crisis.

New business is monitored and controlled against agreed underwriting standards. Sub-sector and asset class limits are used to restrict exposure to emerging risks when appropriate. This activity is reviewed and monitored on a regular basis.

CRE lending exposure by geography and property type on a Current Exposure basis net of provisions and after risk transfer*

By geography (1)	Investment			Development			Overall total £m
	Commercial £m	Residential £m	Total £m	Commercial £m	Residential £m	Total £m	
2016							
UK	16,773	3,762	20,535	367	3,127	3,494	24,029
RoI	459	70	529	49	133	182	711
Other Western Europe	739	34	773	13	39	52	825
US	154	1	155	—	4	4	159
RoW	25	2	27	2	1	3	30
Total	18,150	3,869	22,019	431	3,304	3,735	25,754
Of which: Capital Resolution	953	46	999	1	74	75	1,074
Williams & Glyn	2,050	668	2,718	32	633	665	3,383
2015**							
UK	15,825	4,173	19,998	613	3,251	3,864	23,862
RoI	342	95	437	24	80	104	541
Other Western Europe	597	8	605	15	1	16	621
US	241	1	242	—	—	—	242
RoW	211	12	223	5	13	18	241
Total	17,216	4,289	21,505	657	3,345	4,002	25,507
Of which: Capital Resolution	1,318	47	1,365	50	104	154	1,519
Williams & Glyn	2,080	644	2,724	82	483	565	3,289

Note:

(1) Geography is based on country of collateral risk.

*unaudited

**Restated - refer to page 48 for further details.

Financial review Capital and risk management

Credit risk: management basis continued

CRE lending exposure by sub-sector based on Current Exposure net of provisions and after risk transfer*

By sub-sector	UK £m	Rol £m	Other Western Europe £m	US £m	RoW £m	Total £m
2016						
Residential	6,889	204	73	4	3	7,173
Office	3,322	155	518	41	15	4,051
Retail	4,970	50	56	—	2	5,078
Industrial	2,696	33	65	1	—	2,795
Mixed/other	6,152	269	113	113	10	6,657
Total	24,029	711	825	159	30	25,754
2015						
Residential	7,424	175	9	1	25	7,634
Office	2,938	76	398	85	62	3,559
Retail	4,497	93	85	19	22	4,716
Industrial	2,600	36	39	—	7	2,682
Mixed/other	6,403	161	90	137	125	6,916
Total	23,862	541	621	242	241	25,507

A breakdown of the Commercial Banking UK investment portfolio for 2016 by UK region is set out below.

UK region (1)	Proportion
Greater London	29%
Portfolio (2)	22%
Midlands	13%
South East	12%
North	11%
Scotland	7%
Rest of the UK (3)	6%

Notes:

- (1) Based on management estimates using the postcode of the security. Percentages are based on current exposure gross of provisions.
 (2) Includes lending secured against property portfolios comprising numerous properties across multiple UK locations.
 (3) Includes Northern Ireland.

Key points

- A slowdown in the UK commercial property investment market, which began in the third quarter of 2015, continued after the EU referendum result in June 2016. As a result, capital values were down by approximately 3% on average in the second half of 2016. Despite a minor recovery in the final months of 2016, forecasts suggest that values will remain under pressure during 2017. However, the sector continues to attract equity flows given its attractive yields.
- With the outlook for UK commercial property more uncertain, underwriting standards have been tightened across all commercial property investment portfolios to mitigate potential declines in property values.
- Lending to the CRE sector in the UK increased during the year as a result of CPB and PBB having appetite to support activity in the sector.
- The increase in exposure in Rol and Western Europe was primarily due to foreign exchange movements.

*unaudited

**restated - refer to page 48 for further details

Financial review Capital and risk management

Credit risk: management basis continued

CRE exposure by LTV band

The table below provides a breakdown of the CRE portfolio by LTV band.

2016	2016			2015**		
	AQ1-AQ9 £m	AQ10 £m	Total £m	AQ1-AQ9 £m	AQ10 £m	Total £m
<= 50%	10,695	53	10,748	9,896	72	9,968
> 50% and <= 70%	6,508	120	6,628	5,964	116	6,080
> 70% and <= 80%	474	67	541	685	125	810
> 80% and <= 90%	299	57	356	353	376	729
> 90% and <= 100%	130	41	171	143	150	293
> 100% and <= 110%	74	24	98	149	75	224
> 110% and <= 130%	136	357	493	221	122	343
> 130% and <= 150%	82	28	110	44	65	109
> 150%	108	61	169	253	199	452
Total with LTVs	18,506	808	19,314	17,708	1,300	19,008
Total portfolio average LTV (1)	48%	113%	51%	52%	167%	63%
Minimal security	1	—	1	2	4	6
Other	2,357	349	2,706	2,253	238	2,491
Development (2)	3,553	180	3,733	3,641	361	4,002
	24,417	1,337	25,754	23,604	1,903	25,507

Notes:

(1) Weighted average by Current Exposure gross of provisions.

(2) Relates to the development of commercial and residential properties. LTV is not a meaningful measure for this type of lending activity.

Key points

- The reduction in overall portfolio average is primarily the result of repayments, asset sales and write-offs of legacy non-performing assets from Ulster Bank Rol, CPB and NatWest Markets. Remaining exposures with LTVs greater than 100% are legacy transactions.
- The exposure in Other relates mainly to lending to large corporate entities. It is not asset-backed but lent against corporate balance sheets.
- Interest payable on outstanding loans was covered 3.7x in Commercial Banking and 1.1x in Capital Resolution (2015 - 3.4x and 1.6x respectively).

A breakdown of CRE portfolio lending, gross of provision and after risk transfer, risk elements in lending (REIL) and provisions is provided below.

CRE loans, REIL and provisions*	Total		Commercial Banking		Capital Resolution	
	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £m
Lending (gross of provisions)	26,265	27,561	18,296	18,178	1,193	2,842
Of which REIL	1,407	3,560	731	1,050	497	1,951
Provisions	511	2,054	263	305	119	1,323
REIL as a % of gross loans to customers	5.4%	12.9%	4.0%	5.8%	41.7%	68.6%
Provisions as a % of REIL	36%	58%	36%	29%	24%	68%

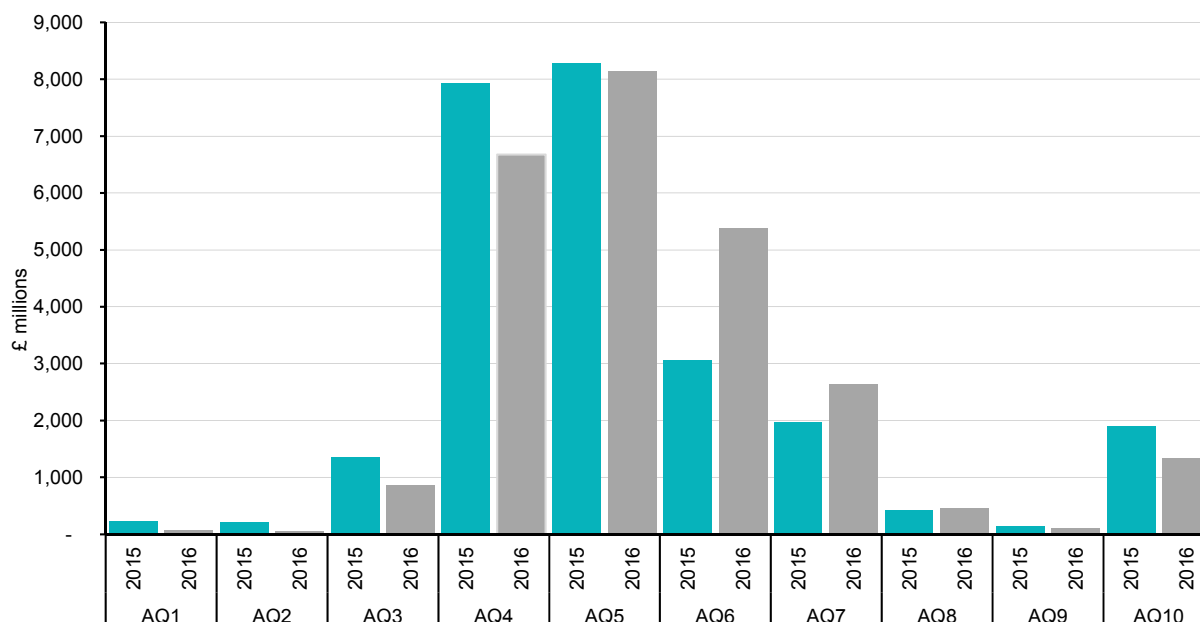
*restated - refer to page 48 for further details. 2015 data is unaudited.

Financial review Capital and risk management

Credit risk: management basis continued

Asset quality*

A breakdown of asset quality of the CRE portfolio, measured on a Current Exposure basis, net of provisions and after risk transfer, is set out below.**



Key point

- The growth in AQ6 band is the result of the introduction of a more conservative calibration of certain commercial real estate asset quality models, rather than deterioration of underlying asset quality.

Natural resources*

Exposure to the natural resources sector, measured on both a Current Exposure and Potential Exposure basis, net of provisions and after risk transfer, is summarised below.

	2016				2015**			
	CE £m	Of which: Capital Resolution £m	PE £m	Of which: Capital Resolution £m	CE £m	Of which: Capital Resolution £m	PE £m	Of which: Capital Resolution £m
Oil and gas	2,903	151	5,275	180	3,518	1,514	6,769	2,088
Mining and metals	623	32	1,887	126	712	219	1,805	373
Electricity	3,410	777	9,057	1,067	2,781	1,057	7,613	1,703
Water and waste	5,432	3,382	9,172	6,037	4,648	1,638	8,251	3,030
	12,368	4,342	25,391	7,410	11,659	4,428	24,438	7,194
Commodity traders	631	1	992	1	821	365	1,233	366
<i>Of which: Natural resources</i>	568	—	744	—	521	212	752	212

Key points

- Oil & Gas: CE and PE decreased during the year by 27% and 32% respectively on a constant currency basis, with foreign exchange impact of £0.5 billion (CE) and £1.0 billion (PE). This portfolio remains subject to active risk management (see below).
- Mining & Metals: CE and PE decreased during the year by 21% and 9% on a constant currency basis, with foreign exchange impact of £0.1 billion (CE) and £0.3 billion (PE). There was some deterioration in asset quality due to challenging market conditions and this portfolio remains subject to active risk management (see below).
- Electricity: CE and PE increased during the year by 12% and 6% on a constant currency basis, with foreign exchange impact of £0.3 billion (CE) and £1.0 billion (PE). This was mainly due to refined classification of exposure in the natural resources sector which lead to a transfer of regulated utility exposure from Oil and Gas to Electricity and an increase in Project Finance exposure as part of the RBS growth strategy.
- Water & Waste: CE and PE increased during the year by 16% and 10% on a constant currency basis, with foreign exchange impact of £0.1 billion (CE) and £0.1 billion (PE). These increases are predominately due to mark-to-market movements in long-dated inflation linked swaps driven by changes in long-term inflation outlook.

*unaudited

**restated - refer to page 48 for further details

Financial review Capital and risk management

Credit risk: management basis continued

Oil and gas*

Exposure to the oil and gas sector, split by sub-sector and geography, measured on a Potential Exposure basis, net of provisions and after risk transfer, is summarised below.

2016	UK £m	RoI £m	Other Western Europe £m	US £m	RoW (1) £m	Total £m
Producers (including international oil companies)	664	—	1,088	2	226	1,980
Oilfield service providers	701	9	630	68	5	1,413
Other wholesale and trading activities	489	43	542	46	280	1,400
Refineries	27	—	—	286	—	313
Pipelines	33	4	121	1	10	169
	1,914	56	2,381	403	521	5,275

Of which:

National oil companies	—	—	16	—	76	92
International oil companies	450	—	821	155	14	1,440
Exploration and production	302	—	154	2	141	599

2015**

Producers (including international oil companies)	1,177	41	1,028	275	246	2,767
Oilfield service providers	700	10	678	279	51	1,718
Other wholesale and trading activities	450	76	475	45	432	1,478
Refineries	21	2	1	327	8	359
Pipelines	98	—	310	31	8	447
	2,446	129	2,492	957	745	6,769

Of which:

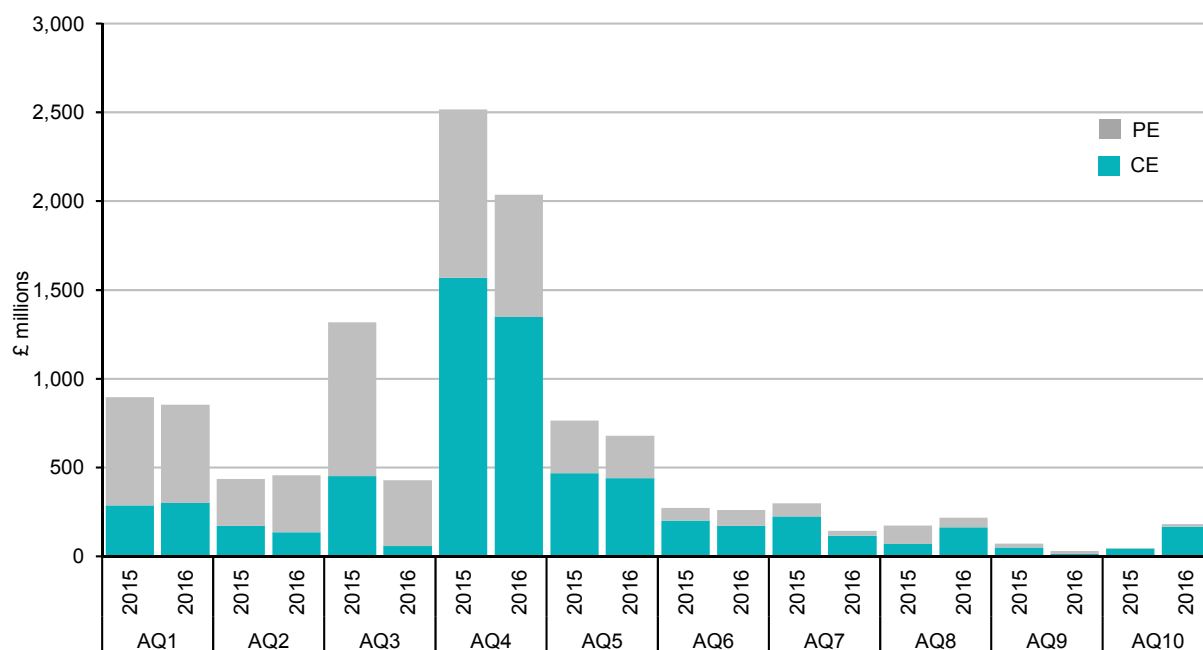
National oil companies	—	—	21	—	70	91
International oil companies	654	—	868	273	10	1,805
Exploration and production	338	—	38	130	118	624

Note:

(1) Comprises Asia Pacific, Central and Eastern Europe, the Middle East, Central Asia and Africa.

Asset quality

A breakdown of asset quality for the oil and gas portfolio, measured on both a Current Exposure and Potential Exposure basis, net of provisions and after risk transfer, is summarised below.**



*unaudited

**restated - refer to page 48 for further details

Credit risk: management basis continued

Key points

- Oil prices dipped below \$30 per barrel at the start of the year but ended the year above \$50 per barrel following positive announcements from OPEC and Non-OPEC producers around implementing production cuts of 1.8 million barrels a day. However, there is considerable market uncertainty around future oil prices and the outlook for the sector remains challenging.
- The portfolio reduced by £1.5 billion during the year or 22% (32% on a constant currency basis). Regulated gas distribution companies are no longer reported under the Oil and Gas sector and this reclassification reduced sector exposure by £724 million. The other reductions are attributable to the continued run-off of the US and APAC portfolios and active risk management in all regions.
- The risk management strategy during the year remained to focus the portfolio towards investment grade customers with robust credit profiles and strong liquidity to manage through the extended downturn. At 31 December 2016, 71% (2015 - 76%) of the portfolio exposure was investment grade (AQ1-AQ4 or equivalent to BBB- and above).
- The sub-sector in which a customer operates is a primary consideration for assessing credit risk. Customers involved in exploration and production (E&P) are most immediately exposed to low oil prices and these companies have introduced capital spending reductions and tight cost controls to conserve cash. In turn, this has impacted oilfield service providers, with E&P companies buying fewer products and services from the oilfield service providers, and demanding lower prices for those they do purchase.
- The other principal components of exposure to producers are International Oil Companies (IOCs) and National Oil Companies (NOCs). IOCs and NOCs are less vulnerable to the oil price decline due to scale, diversification and, in the case of NOCs, implicit support from governments. At 31 December 2016, 29% of the portfolio exposure was to IOCs and NOCs combined (2015 - 28%).
- Committed lending exposure included legal commitments to syndicated bank facilities and bilateral facilities with tenors up to five years. These committed facilities are for general corporate purposes - including funding operating needs and capital expenditures - and are available as long as counterparties comply with the terms of the credit agreement. Contingent obligations relate to guarantees, letters of credit and suretyships provided to customers. RBS had no high-yield bond or loan underwriting positions at 31 December 2016 (2015 - Nil).
- The number of forbearance events was consistent with 2015. In 2016 there was an increase in payment concessions granted compared to 2015 which predominantly involved the relaxation of financial covenants to give customers more financial flexibility. Most forbearance involved customers in the E&P and oilfield services sub-sectors where earnings have been more immediately and materially affected by the downturn.
- The number and value of cases on the Risk of Credit Loss framework in the Oil & Gas sector decreased during the year. The framework exposure is predominantly classified as Heightened Monitoring and the sector continues to be monitored closely. At 31 December 2016, exposures classified as Risk of Credit Loss totalled £2 million.
- The increase in AQ10 reflected ongoing challenging market conditions which resulted in a small number of customers experiencing financial stress during the year. AQ10 assets at 31 December 2016 totalled £181 million (2015 - £44 million).

*unaudited

**restated – refer to page 48 for further details

Financial review Capital and risk management

Credit risk: management basis continued

Mining and metals*

Exposure to the mining and metals sector, measured on a Potential Exposure basis, net of provisions and after risk transfer, is summarised below.

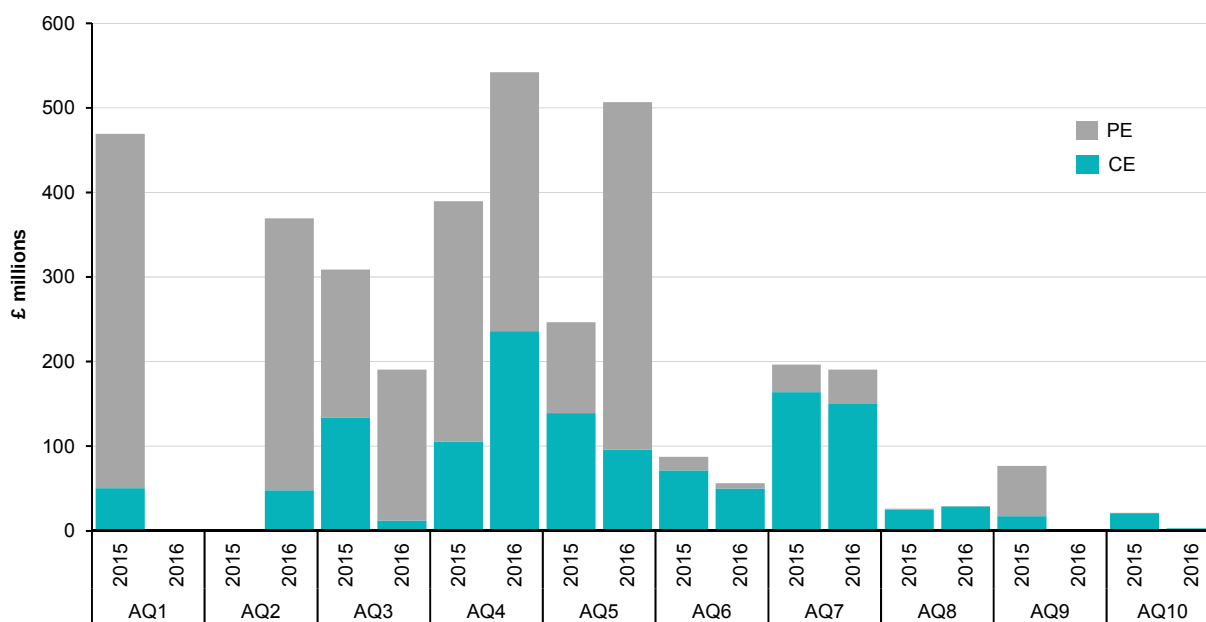
	UK £m	RoI £m	Other Western Europe £m	US £m	RoW (1) £m	Total £m
2016						
Mining	118	36	129	—	566	849
Metals - production	120	1	340	—	2	463
- wholesale	184	3	382	6	—	575
	422	40	851	6	568	1,887
2015**						
Mining	31	1	1	105	443	581
Metals - production	308	1	361	13	32	715
- wholesale	164	2	309	34	—	509
	503	4	671	152	475	1,805

Note:

(1) Comprises Asia Pacific, Central and Eastern Europe, the Middle East, Central Asia and Africa.

Asset quality

A breakdown of asset quality for the mining and metals portfolio, measured on both a Current Exposure and Potential Exposure basis, net of provisions and after risk transfer, is summarised below.**



Key point

- The deterioration in asset quality reflected the challenging operating environment in 2016.

*unaudited

**restated - refer to page 48 for further details

Financial review Capital and risk management

Credit risk: management basis continued

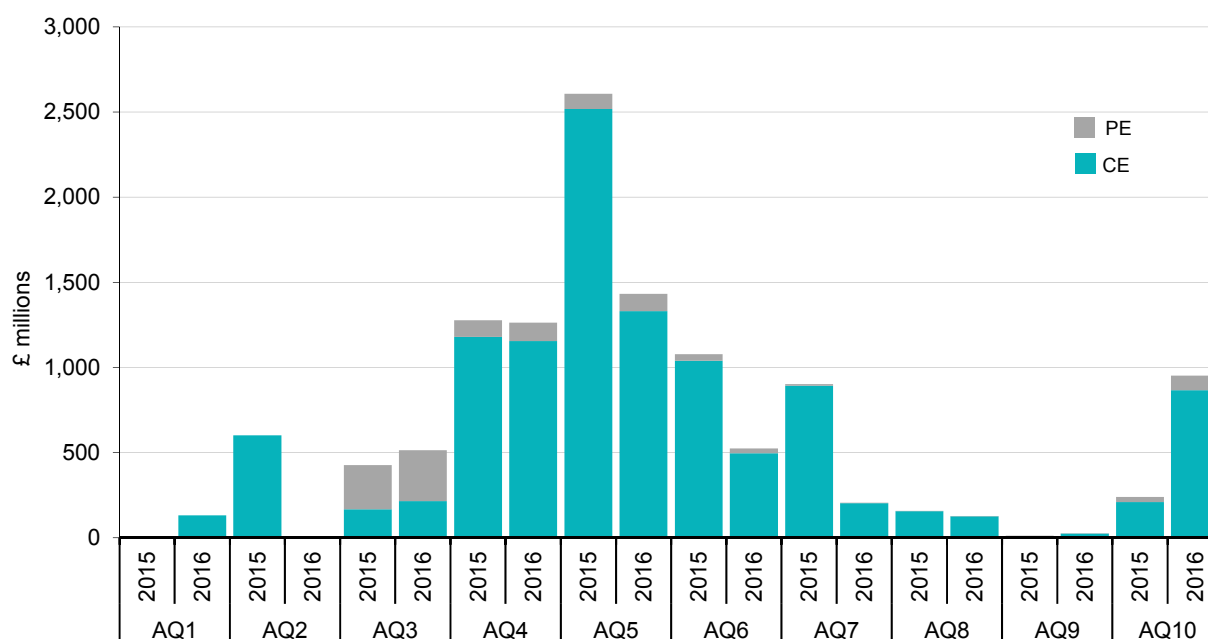
Shipping*

Exposure to the shipping sector, measured on both a Current Exposure and Potential Exposure basis net of provisions and after risk transfer, is summarised below.

	2016				2015**			
	Current Exposure £m	Of which: Capital Resolution £m	Potential Exposure £m	Of which: Capital Resolution £m	Current Exposure £m	Of which: Capital Resolution £m	Potential Exposure £m	Of which: Capital Resolution £m
Shipping	4,553	3,854	5,173	4,005	6,758	6,143	7,272	6,280

Asset quality

A breakdown of asset quality for the Shipping sector, measured on both a Current Exposure and Potential Exposure basis, net of provisions and after risk transfer, is summarised below.**



Key points

- Shipping exposure was £4.6 billion on a Current Exposure basis (down 43% or £3.4 billion on a constant currency basis compared with 2015, with foreign exchange impact of £1.2 billion) and £5.2 billion on a Potential Exposure basis (down 40% or £3.4 billion on a constant currency basis compared with 2015, with foreign exchange impact of £1.3 billion).
- Most of the Shipping portfolio is managed in Capital Resolution and is related to exposure secured by ocean-going vessels. The remaining exposure outside Capital Resolution related principally to is within the Shipbuilding and Inland Water Transport sub-sectors. The reduction in exposure was mainly driven by asset sales and debt repayments in Capital Resolution, in line with RBS's strategy.
- Within Capital Resolution, Concentrations were as follows: Containers 34% (2015 - 21%), Dry Bulk 26% (2015 - 37%), Tankers at 18% (2015 - 23%). Other vessel types included liquid petroleum gas, natural gas and roll-on/roll-off vessels at 22% of exposure (2015 - 19%).
- At 31 December 2016, exposures classified as Risk of Credit Loss totalled £363 million reflecting the prolonged market downturn in this sector.
- Conditions remained depressed in the Dry Bulk market, notwithstanding a gradual improvement during the second half of the year. The Container market also saw a marked downturn in 2016 with a significant reduction in spot rates and vessel values and this is set to continue into 2017. Tanker rates also weakened in 2016 with a general deterioration in vessel values.
- The Capital Resolution portfolio LTV at 31 December 2016 was 102% (2015 - 85%), or 92% net of the provisions outlined below. The year-on-year increase in LTV is reflective of the market and vessel value movements outlined above. The LTV calculation includes vessel security only and does not incorporate any non-vessel security such as cash or guarantees.
- Provisions, excluding latent provisions, increased from £169 million to £386 million during 2016. Again, this was due to weak market conditions, and increasing LTV, which led to an increase in the portfolio's levels of default.
- At 31 December 2016, AQ10 exposure, net of provisions was £867 million (2015 - £210 million).
- There was an increase in the number of forbearance events, mainly involving the relaxation of minimum security covenants due to deteriorating asset prices. Total forbearance for this sector was £723 million.

*unaudited

**restated - refer to page 48 for further details

Credit risk: management basis continued Personal credit risk management

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

Risk appetite*

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

Personal credit risk assessment*

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

Personal risk mitigation*

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

Region	Index used
UK	Halifax quarterly regional house price index
Northern Ireland	UK House Price Index (published by the Land Registry)
RoI	Central Statistics Office residential property price index

Problem debt management*

Personal customers in financial difficulty are managed through either collections or recoveries functions.

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 uses a range of tools to initiate contact with such customers, establish the cause of their financial difficulty and support them where possible.

*unaudited

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

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

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

Forbearance

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

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

The type of forbearance granted will differ based upon an assessment of the customer's circumstances. Forbearance is granted principally to customers with mortgages and less frequently to customers with unsecured loans. This includes instances where forbearance may be taken for customers with highly flexible mortgages.

Forbearance options include, but are not limited to:

- **Payment concessions** - A temporary reduction in, or elimination of, the periodic (usually monthly) loan repayment is agreed with the customer. At the end of the concessionary period, forborne principal and accrued interest outstanding is scheduled for repayment over an agreed period. Ulster Bank RoI also offers payment concessions in the form of discounted interest rates that involve the forgiveness of some interest.
- **Capitalisation of arrears** - The customer repays the arrears over the remaining term of the mortgage and returns to an up-to-date position.
- **Term extensions** - The loan's maturity date is extended.
- **Interest only conversions** - The loan converts from principal and interest repayment to interest only repayment. This is only available in Ulster Bank RoI and Ulster Bank North on a temporary basis. These forbearance concessions are no longer offered to customers in UK PBB, RBSI and Private Banking.

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

Credit risk: management basis continued

Monitoring of forbearance - Forborne loans are separated into a distinct population and reported on a regular basis until they exit the forborne population.

A loan is considered to have exited forbearance when it meets the criteria set out by the European Banking Authority (EBA) requirements for Financial Reporting. These include being classified as performing for two years since the last forbearance event, making regular repayments and the debtor being less than 30 days past due.

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

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

Impairments for forbearance

The methodology used for provisioning in respect of forborne loans will differ depending on whether the loans are performing or non-performing and which business is managing them due to local market conditions.

For the latent calculation, an extended emergence period is applied to account for the impact of forbearance within the portfolio. Additionally for portfolios with material forbearance, forborne loans form a separate risk pool and use different PD model:

- UK PBB (excl. NI) and W&G: forborne mortgages form a separate risk pool for 24 months after the agreement of forbearance and the calculation uses the higher of the observed default rates or PD. On unsecured loans, separate risk pools are used for the duration of the forbearance treatment.
- Ulster Bank: forborne and previously forborne mortgages form a separate risk pool taking into account the term of the forbearance treatment and applicable probationary periods. The PD model used is calibrated separately for forborne loans, using information on the historic performance of loans subject to similar arrangements.

For non-performing loans, there is no difference in treatment with the exception of Ulster Bank where forborne loans which result in an economic loss to the group form a separate risk pool where specific LGDs are allocated using observed cohort performance.

*Recoveries**

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

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

*unaudited

Financial review Capital and risk management

Credit risk: management basis continued

Overview of personal portfolio split by product type and segment on a Current Exposure basis net of provisions*

2016	UK PBB £m	Ulster Bank Rol £m	Private Banking £m	RBSIH (3) £m	W&G £m	Total £m
Mortgages	117,040	14,396	7,168	2,637	10,856	152,097
Of which:						
Interest only variable rate	11,694	349	3,625	692	1,317	17,677
Interest only fixed rate	11,132	7	2,290	81	1,186	14,696
Mixed (capital and interest only)	5,316	75	—	23	687	6,101
Buy-to-let	16,678	1,777	770	881	1,427	21,533
Provisions	151	919	2	27	23	1,122
REIL	736	3,144	23	84	101	4,088
Other lending (1)	8,962	291	1,730	64	958	12,005
Provisions	834	48	18	1	113	1,014
REIL	860	50	61	5	117	1,093
Total lending	126,002	14,687	8,898	2,701	11,814	164,102
Mortgage LTV ratios (2)						
- Total portfolio	56%	76%	56%	57%	54%	58%
- New business	69%	74%	55%	66%	69%	68%
- Buy-to-let	56%	82%	54%	49%	55%	56%
- Performing	56%	72%	56%	56%	53%	57%
- Non-performing	60%	94%	68%	105%	56%	77%
2015**						
Mortgages	104,599	12,713	6,552	2,525	10,430	136,819
Of which:						
Interest only variable rate	13,252	407	3,025	730	1,388	18,802
Interest only fixed rate	9,112	6	2,431	49	1,076	12,674
Mixed (capital and interest only)	5,380	76	7	29	745	6,237
Buy-to-let	14,098	1,762	476	835	1,150	18,321
Provisions	180	1,062	4	18	26	1,290
REIL	878	2,550	19	63	123	3,633
Other lending (1)	8,795	233	3,458	62	958	13,506
Provisions	1,028	48	22	1	129	1,228
REIL	1,028	49	53	5	140	1,275
Total lending	113,394	12,946	10,010	2,587	11,388	150,325
Mortgage LTV ratios (2)						
- Total portfolio	56%	83%	54%	57%	54%	59%
- New business	69%	77%	57%	62%	68%	68%
- Buy-to-let	57%	95%	58%	51%	57%	60%
- Performing	56%	80%	54%	57%	54%	58%
- Non-performing	63%	106%	92%	96%	60%	83%

Notes:

(1) Excludes loans guaranteed by a company and commercial real estate lending to personal customers.

(2) Weighted by current exposure gross of provisions.

(3) RBSI Holdings is classified as a disposal group at 31 December 2016.

*unaudited

**restated - refer to page 48 for further details

Financial review Capital and risk management

Credit risk: management basis continued

Overview of new mortgage lending on a Current Exposure basis net of provisions*

2016	UK PBB £m	Ulster Bank Rol £m	Private Banking £m	RBSIH (3) £m	W&G £m	Total £m
Gross new mortgage lending (1)	29,027	893	3,291	470	2,156	35,837
Of which:						
Owner occupied	25,086	876	2,819	300	1,833	30,914
Average LTV by weighted value	71%	74%	55%	69%	70%	70%
Buy-to-let	3,941	17	472	170	323	4,923
Average LTV by weighted value	62%	59%	54%	62%	62%	61%
2015						
Gross new mortgage lending	22,713	553	2,383	258	1,728	27,635
Of which:						
Owner occupied	18,884	541	2,161	179	1,412	23,177
Average LTV by weighted value	71%	77%	54%	64%	69%	69%
Buy-to-let	3,829	12	222	79	316	4,458
Average LTV by weighted value	64%	65%	64%	57%	64%	64%

(1) Excludes additional lending to existing customers.

Forbearance stock and flow on a Current Exposure basis net of provisions

2016						
Forbearance stock	1,290	3,709	65	43	177	5,284
Forbearance stock: arrears						
Current	790	2,077	65	29	107	3,068
1-3 months in arrears	286	473	—	2	41	802
>3 months in arrears	214	1,159	—	12	29	1,414
Provisions against forbearance stock	51	790	—	1	8	850
Forbearance type:						
Long-term arrangements (1)	701	1,249	63	37	111	2,161
Short-term arrangements (2)	860	2,460	2	6	110	3,438
Forbearance flow	406	316	49	10	53	834
2015*						
Forbearance stock	1,444	3,643	64	43	202	5,396
Forbearance stock: arrears						
Current	863	2,165	64	31	124	3,247
1-3 months in arrears	329	470	—	6	46	851
>3 months in arrears	252	1,008	—	6	32	1,298
Provisions against forbearance stock	59	884	—	1	8	952
Forbearance type:						
Long-term arrangements (1)	800	1,173	39	35	129	2,176
Short-term arrangements (2)	953	2,470	25	8	120	3,576
Forbearance flow	435	197	47	17	57	753

Notes:

(1) Q4 2016 forbearance calculation moved to the EBA FINREP basis.

(2) Capitalisation, term extensions, economic concessions.

(3) Payment concessions, amortising payments of outstanding balances, payment holidays and temporary interest arrangements.

*unaudited

Financial review Capital and risk management

Credit risk: management basis continued

Mortgage LTV distribution by segment on a Current Exposure basis net of provisions

LTV ratio value (1)	<=50% £m	50% <=70% £m	70% <=80% £m	80% <=90% £m	90% <=100% £m	100% <=110% £m	110% <=130% £m	130% <=150% £m	>150% £m	Total with LTVs £m	Other £m	Total £m
2016												
UK PBB												
AQ1-AQ9	43,332	41,442	15,778	10,862	2,885	175	150	76	55	114,755	705	115,460
AQ10	548	637	182	113	51	15	7	3	5	1,561	19	1,580
	43,880	42,079	15,960	10,975	2,936	190	157	79	60	116,316	724	117,040
Of which: buy-to-let	5,645	8,196	2,290	360	105	27	20	14	6	16,663	15	16,678
Ulster Bank Rol												
AQ1-AQ9	3,079	2,897	1,649	1,411	1,144	1,056	1,205	119	22	12,582	—	12,582
AQ10	252	296	169	179	177	199	340	154	48	1,814	—	1,814
	3,331	3,193	1,818	1,590	1,321	1,255	1,545	273	70	14,396	—	14,396
Private Banking												
AQ1-AQ9	2,594	3,188	820	163	29	7	2	8	13	6,824	233	7,057
AQ10	25	49	12	8	1	5	2	—	—	102	9	111
	2,619	3,237	832	171	30	12	4	8	13	6,926	242	7,168
RBSI Holdings (2)												
AQ1-AQ9	1,099	812	378	236	26	29	6	6	15	2,607	—	2,607
AQ10	(2)	11	3	4	4	3	2	—	5	30	—	30
	1,097	823	381	240	30	32	8	6	20	2,637	—	2,637
W&G												
AQ1-AQ9	4,565	3,754	1,280	867	178	6	—	—	—	10,650	10	10,660
AQ10	81	89	17	7	2	—	—	—	—	196	—	196
	4,646	3,843	1,297	874	180	6	—	—	—	10,846	10	10,856
2015**												
UK PBB												
AQ1-AQ9	38,430	38,645	14,372	7,985	2,646	255	174	90	18	102,615	251	102,866
AQ10	483	713	250	152	77	26	12	7	3	1,723	10	1,733
	38,913	39,358	14,622	8,137	2,723	281	186	97	21	104,338	261	104,599
Of which: buy-to-let	4,374	6,879	2,202	431	131	34	30	14	1	14,096	2	14,098
Ulster Bank Rol												
AQ1-AQ9	2,276	2,075	1,222	1,155	1,004	964	1,633	410	49	10,788	—	10,788
AQ10	226	258	153	163	179	178	385	264	119	1,925	—	1,925
	2,502	2,333	1,375	1,318	1,183	1,142	2,018	674	168	12,713	—	12,713
Private Banking												
AQ1-AQ9	2,431	2,846	707	147	30	15	1	12	20	6,209	323	6,532
AQ10	3	1	3	1	9	1	1	—	1	20	—	20
	2,434	2,847	710	148	39	16	2	12	21	6,229	323	6,552
RBSI Holdings												
AQ1-AQ9	985	873	339	190	40	27	19	2	14	2,489	—	2,489
AQ10	5	11	2	3	5	1	3	1	5	36	—	36
	990	884	341	193	45	28	22	3	19	2,525	—	2,525
W&G												
AQ1-AQ9	4,113	3,738	1,216	648	174	11	1	—	—	9,901	297	10,198
AQ10	71	100	27	18	8	1	—	—	—	225	7	232
	4,184	3,838	1,243	666	182	12	1	—	—	10,126	304	10,430

Note:

(1) LTV is calculated on a Current Exposure basis, gross of provisions.

(2) RBSI Holdings is classified as a disposal group at 31 December 2016

**restated - refer to page 48 for further details. 2015 data is unaudited.

Credit risk: management basis continued

Key points

UK PBB*

- The total portfolio increased by 11.9% from 31 December 2015. This was in line with the segment's growth strategy and within risk appetite. The portfolio is closely monitored and risk appetite is regularly reviewed to ensure it is appropriate for market conditions. Underwriting standards were not relaxed during the year.
- Other Personal lending remained stable during the year in the context of an upward trend in unsecured household debt in the wider UK market. Asset quality remained stable with no deterioration in the arrears rate from the prior year.
- Gross new mortgage lending amounted to £29.0 billion in 2016 with an average LTV by weighted value of 69% (2015 - 69%). Lending to owner-occupiers during this period was £25.1 billion (2015 - £18.9 billion) and had an average LTV by weighted value of 71% (2015 - 71%). Buy-to-let lending was £3.9 billion (2015 - £3.8 billion) with an average LTV by weighted value of 62% (2015 - 64%).
- Approximately 12% by value of owner-occupied mortgages were on interest-only terms with a bullet repayment and 5% were on a combination of interest-only and capital and interest. The remainder were capital and interest. 65% by value of the buy-to-let mortgages were on interest-only terms and 3% on a combination of interest only and capital and interest.
- Fixed interest rate products of varying time durations accounted for approximately 73% by value of the mortgage portfolio with 2% a combination of fixed and variable rates and the remainder variable rate. The proportion of the portfolio on fixed rate products rose due to the very high proportion of customers taking out fixed rate mortgages in 2016.
- Based on the Halifax House Price Index at September 2016, the portfolio average indexed LTV by volume was 50% (2015 - 49%) and 56% by weighted value of debt outstanding (2015 - 56%). The £2.2 billion of mortgages granted by Ulster Bank North were indexed against the UK house price index published by the Land Registry.
- The arrears rate (three or more repayments past due) fell from 0.8% (by volume) in December 2015 to 0.7% at 31 December 2016. The number of properties repossessed in 2016 was also lower at 519 compared with 727 in 2015.
- The flow of new forbearance was £406 million in 2016 compared with £435 million in 2015. The value of mortgages subject to forbearance decreased by 10.4% compared with 2015 to £1.3 billion (equivalent to 1.1% of the total mortgage book). This was mainly driven by benign market conditions.
- A release of provision on historically-impaired mortgages was the key driver in an overall provision release of £20.5 million for the year (2015 charge of £2.8 million). The value of underlying defaults was slightly lower year-on-year.

*unaudited

Financial review Capital and risk management

Credit risk: management basis continued

The table below summarises UK mortgage exposure by region and LTV.

LTV ratio value	<=50%	50% <=70%	70% <=80%	80% <=90%	90% <=100%	100% <=110%	110% <=130%	130% <=150%	>150%	Total with LTVs	WA (1) LTV %	Other	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m		£m	£m
2016													
South East	12,793	11,521	3,371	1,734	320	4	8	1	—	29,752	53%	153	29,905
Greater London	12,624	7,108	1,715	675	228	1	2	1	—	22,354	48%	158	22,512
Scotland	2,931	3,521	1,684	1,316	553	42	4	—	—	10,051	61%	51	10,102
North West	2,713	3,728	1,836	1,682	342	13	4	2	—	10,320	62%	70	10,390
South West	3,535	4,116	1,499	853	97	5	3	5	—	10,113	56%	62	10,175
West Midlands	2,033	2,960	1,334	1,001	289	3	2	2	—	7,624	61%	47	7,671
Rest of the UK (2)	7,251	9,125	4,521	3,714	1,107	122	134	68	60	26,102	62%	183	26,285
Total	43,880	42,079	15,960	10,975	2,936	190	157	79	60	116,316	56%	724	117,040
2015													
South East	10,402	10,668	3,279	1,410	318	8	7	6	—	26,098	54%	45	26,143
Greater London	11,402	6,426	1,252	418	90	1	2	1	—	19,592	47%	68	19,660
Scotland	3,198	3,775	1,497	840	323	34	2	—	—	9,669	58%	25	9,694
North West	2,475	3,548	1,662	1,162	476	47	5	—	—	9,375	61%	31	9,406
South West	2,850	3,549	1,581	851	217	8	6	5	—	9,067	58%	23	9,090
West Midlands	1,728	2,601	1,301	737	324	17	2	3	—	6,713	61%	23	6,736
Rest of the UK (2)	6,858	8,791	4,050	2,719	975	166	162	82	21	23,824	62%	46	23,870
Total	38,913	39,358	14,622	8,137	2,723	281	186	97	21	104,338	56%	261	104,599

Notes:

- (1) Weighted average.
(2) Includes Northern Ireland.

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

	2017 (1)	2018-19	2020-24	2025-29	2030-34	2035-44	After 2044	Total
	£m	£m	£m	£m	£m	£m	£m	£m
2016								
Bullet principal repayment (2)	452	956	3,528	5,320	6,015	6,096	453	22,820
Conversion to amortising (2,3)	6	—	—	—	—	—	—	6
Total	458	956	3,528	5,320	6,015	6,096	453	22,826
2015**								
	2016 (4)	2017-18	2019-23	2024-28	2029-33	2034-43	After 2043	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Bullet principal repayment (2)	461	1,028	3,413	5,006	6,362	5,743	348	22,361
Conversion to amortising (2,3)	3	—	—	—	—	—	—	3
Total	464	1,028	3,413	5,006	6,362	5,743	348	22,364

Notes:

- (1) 2017 includes pre-2017 maturity exposure.
(2) Includes £0.1 billion (2015 - £0.1 billion) of repayment mortgages that have been granted interest only concessions (forbearance).
(3) Maturity date relates to the expiry of the interest only period.
(4) 2016 includes pre-2016 maturity exposure.

*unaudited

**restated - refer to page 48 for further details

Financial review Capital and risk management

Credit risk: management basis continued

Key points

Ulster Bank Rol *

- Excluding the impact of exchange rate movements, the portfolio decreased by 2.9% from 31 December 2015 as a result of amortisation and portfolio sales (£588 million). The volume of new business has increased reflecting continuing market demand.
- Tracker-rate products accounted for approximately 64% of the portfolio, while variable rate totalled 21% and fixed rate 15%.
- The decrease in portfolio average indexed LTV reflected positive house price index trends over the last 12 months and the impacts of Central Bank of Ireland requirements for new lending.
- At 31 December 2016, 26% of total mortgage assets (£3.7 billion) were subject to a forbearance arrangement, an increase of 2% (£66 million) from 31 December 2015. Excluding the impact of exchange rate movements of £606 million, the value of mortgage assets subject to a forbearance arrangement decreased by £540 million (13%).
- The number of customers approaching Ulster Bank Rol for the first time in respect of forbearance assistance declined during 2016. The majority (69%) of forbearance arrangements were less than 90 days in arrears.
- A key driver of both reduced forbearance rates and longer average forbearance durations was the introduction of Ulster Bank Rol's sustainability policy in the fourth quarter of 2015. Under that policy customers are only eligible for forbearance as part of a sustainable solution. The use of forbearance is therefore more limited than previously, applying only to those customers who can be returned to a sustainable status through forbearance.
- The AQ10 population reduced to £1.8 billion. This was mainly the result of the disposal of a distressed portfolio. There was a very high provision coverage in relation to this portfolio and, as a result, the disposal also led to a reduction in provision coverage.

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

	2017 (1) £m	2018-19 £m	2020-24 £m	2025-29 £m	2030-34 £m	2035-44 £m	After 2044 £m	Total £m
2016								
Bullet principal repayment (2)	9	11	31	47	59	34	6	197
Conversion to amortising (2,3)	110	29	4	3	7	5	2	160
Total	119	40	35	50	66	39	8	357
	2016 (4) £m	2017-18 £m	2019-23 £m	2024-28 £m	2029-33 £m	2034-43 £m	After 2043 £m	Total £m
2015**								
Bullet principal repayment (2)	6	13	25	41	63	25	5	178
Conversion to amortising (2,3)	118	104	5	3	3	1	1	235
Total	124	117	30	44	66	26	6	413

Notes:

- (1) 2017 includes pre-2017 maturity exposure.
- (2) Includes £0.2 billion (2015 - £0.3 billion) of repayment mortgages that have been granted interest only concessions (forbearance).
- (3) Maturity date relates to the expiry of the interest only period.
- (4) 2016 includes pre-2016 maturity exposure

*unaudited

**restated - refer to page 48 for further details

Financial review Capital and risk management

Credit risk: management basis continued

Key points

Private Banking*

- The majority of the Private Banking personal lending portfolio related to mortgage lending. The net portfolio increase was £616 million (9.4%) from 31 December 2015, in line with the segment's growth strategy and risk appetite.
- Gross new mortgage lending amounted to £3.3 billion in 2016. Lending to owner-occupiers during the period was £2.8 billion (2015 - £2.2 billion) and had an average LTV by weighted value of 54.9% (2015 - 54.3%). Buy-to-let lending was £472 million (2015 - £222 million) with an average LTV by weighted value of 53.6% (2015 - 64.3%).
- Fixed interest rate products accounted for approximately 41% of the mortgage portfolio, with two-year term products accounting for 58% of all fixed deals.
- Approximately 82% of all mortgages were on interest-only terms; 82% of owner-occupied mortgages were interest-only with 90% of buy-to-let mortgages on interest-only terms.
- Provisions remained minimal during the year.

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

2016	2017 (1) £m	2018-19 £m	2020-24 £m	2025-29 £m	2030-34 £m	2035-44 £m	After 2044 £m	Total £m
Bullet principal repayment	1,399	1,081	1,452	1,111	453	415	3	5,914
2015**	2016 (2) £m	2017-18 £m	2019-23 £m	2024-28 £m	2029-33 £m	2034-43 £m	After 2043 £m	Total £m
Bullet principal repayment	846	1,585	1,658	859	296	210	2	5,456

Notes:

(1) 2017 includes pre-2017 maturity exposure.

(2) 2016 includes pre-2016 maturity exposure.

Key points

RBS International (Holdings) Limited (RBSI Holdings)*

- The total portfolio increased by 4% from £2.6 billion to £2.7 billion from 31 December 2015 in line with the franchise's growth strategy and risk appetite.
- Gross new mortgage lending amounted to £470 million in 2016. Lending to owner-occupiers during this period was £300 million (2015 - £175 million) and had an average LTV by weighted value of 69.0% (2015 - 64.0%). Buy-to-let lending was £170 million (2015 - £79 million) with an average LTV by weighted value of 61.5% (2015 - 57.1%).
- The number of customers granted forbearance in 2016 decreased by 28%. A total of £37 million of forbore loans were subject to a long-term arrangement (term extensions & covenant breaches) at 31st December 2016 (2015 - £35 million). Short term forbearance comprises payment suspensions and reduced payments.
- The arrears rate increased from 0.75% in December 2015 to 0.78% at the end of December 2016.
- There was a provision impairment charge of £8.5 million for personal mortgages in 2016 (release of £1 million in 2015).

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

2016	2017 (1) £m	2018-19 £m	2020-24 £m	2025-29 £m	2030-34 £m	2035-44 £m	After 2044 £m	Total £m
Bullet principal repayment	117	98	107	170	128	59	94	773
2015**	2016 (2) £m	2017-18 £m	2019-23 £m	2024-28 £m	2029-33 £m	2034-43 £m	After 2043 £m	Total £m
Bullet principal repayment	77	177	157	183	145	39	1	779

Notes:

(1) 2017 includes pre-2017 maturity exposure.

(2) 2016 includes pre-2016 maturity exposure.

*unaudited

**restated - refer to page 48 for further details

Financial review Capital and risk management

Credit risk: management basis continued

Key points

Williams & Glyn*

- The total portfolio increased by 3.7% from 31 December 2015, driven by gross new mortgage lending amounting to £2.2 billion in 2016 but remained within risk appetite. Lending to owner-occupiers during this period was £1.8 billion (2015 - £1.4 billion) and had an average LTV by weighted value of 70.2% (2015 - 69.5%). Buy-to-let lending was £323 million (2015 - £316 million) with an average LTV by weighted value of 62.4% (2015 - 64.2%).
- Fixed interest rate products of varying time durations accounted for approximately 65% of the mortgage portfolio with 6% a combination of fixed and variable rates and the remainder variable rate.
- The flow of new forbearance remained low during the year, with exposure totalling £53 million (2015 - £57 million) granted forbearance in 2016. The value of mortgages subject to forbearance remain low, showing a decrease of 12% in 2016 to £0.18 billion (equivalent to 1.6% of the total mortgage portfolio) as a result of improved market conditions.
- There was a reduction of impairment provision balances for personal mortgages in 2016 to £23 million compared with £26 million in 2015. The provision release resulted from revised modelling assumptions reflecting current market conditions.

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

	2017 (1) £m	2018-19 £m	2020-24 £m	2025-29 £m	2030-34 £m	2035-44 £m	After 2044 £m	Total £m
2016								
Bullet principal repayment	66	136	451	702	626	486	37	2,504
	2016 (2) £m	2017-18 £m	2019-23 £m	2024-28 £m	2029-33 £m	2034-43 £m	After 2043 £m	Total £m
2015**								
Bullet principal repayment	58	124	419	621	670	538	34	2,464

Notes:

(1) 2017 includes pre-2017 maturity exposure.

(2) 2016 includes pre-2016 maturity exposure.

*unaudited

**restated - refer to page 48 for further details

Financial review Capital and risk management

Credit risk: balance sheet analysis

Current and Potential Exposures presented in Credit risk: management basis are used by Risk Management for risk management and monitoring. However, they exclude certain exposures, primarily trading securities and take account of legal netting agreements that provide a right of legal set-off but do not meet the offset criteria in IFRS. The tables that follow are therefore provided to supplement the disclosures in the Credit risk: management basis section, to reconcile to the balance sheet. The tables in this section include balances relating to disposal groups, reflecting the total credit risk and losses faced by RBS. All the disclosures in this section are audited.

Financial assets

Exposure summary and credit mitigation

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

	Group				
	Gross exposure £m	IFRS offset (1) £m	Carrying value (2) £m	Balance sheet offset (3) £m	Exposure post offset £m
2016					
Cash and balances at central banks	73,813	—	73,813	—	73,813
Reverse repos	73,472	(31,728)	41,744	(1,053)	40,691
Lending	332,153	(600)	331,553	(29,818)	301,735
Debt securities	71,652	—	71,652	—	71,652
Equity shares	445	—	445	—	445
Derivatives	297,518	(51,080)	246,438	(225,780)	20,658
Settlement balances	7,054	(1,529)	5,525	—	5,525
Total third party excluding disposal groups	856,107	(84,937)	771,170	(256,651)	514,519
Disposal groups	7,999	—	7,999	—	7,999
Total third party including disposal groups	864,106	(84,937)	779,169	(256,651)	522,518
Amounts due from holding company and fellow subsidiaries	3,491	—	3,491	(698)	2,793
Total gross of short positions	867,597	(84,937)	782,660	(257,349)	525,311
Short positions	(22,076)	—	(22,076)	—	(22,076)
Total net of short positions	845,521	(84,937)	760,584	(257,349)	503,235
2015					
Cash and balances at central banks	78,999	—	78,999	—	78,999
Reverse repos	74,171	(34,361)	39,810	(2,499)	37,311
Lending	325,129	(2,955)	322,174	(35,568)	286,606
Debt securities	80,027	—	80,027	—	80,027
Equity shares	1,069	—	1,069	—	1,069
Derivatives	385,470	(123,662)	261,808	(242,404)	19,404
Settlement balances	5,314	(1,225)	4,089	(26)	4,063
Total third party excluding disposal groups	950,179	(162,203)	787,976	(280,497)	507,479
Disposal groups	3,356	—	3,356	—	3,356
Total third party including disposal groups	953,535	(162,203)	791,332	(280,497)	510,835
Amounts due from holding company and fellow subsidiaries	4,109	—	4,109	(393)	3,716
Total gross of short positions	957,644	(162,203)	795,441	(280,890)	514,551
Short positions	(20,808)	—	(20,808)	—	(20,808)
Total net of short positions	936,836	(162,203)	774,633	(280,890)	493,743

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

Financial review Capital and risk management

Credit risk: 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 (2) £m	Balance sheet offset (3) £m	Exposure post offset £m
2016					
Cash and balances at central banks	70,615	—	70,615	—	70,615
Reverse repos	47,507	(17,252)	30,255	(439)	29,816
Lending	124,280	(600)	123,680	(23,468)	100,212
Debt securities	65,264	—	65,264	—	65,264
Equity shares	298	—	298	—	298
Derivatives	296,412	(51,080)	245,332	(225,612)	19,720
Settlement balances	4,339	(24)	4,315	—	4,315
Total third party	608,715	(68,956)	539,759	(249,519)	290,240
Amounts due from holding company and fellow subsidiaries	54,215	—	54,215	(2,961)	51,254
Total gross of short positions	662,930	(68,956)	593,974	(252,480)	341,494
Short positions	(17,590)	—	(17,590)	—	(17,590)
Total net of short positions	645,340	(68,956)	576,384	(252,480)	323,904
2015					
Cash and balances at central banks	76,904	—	76,904	—	76,904
Reverse repos	47,285	(20,374)	26,911	(2,050)	24,861
Lending	130,672	(2,955)	127,717	(28,634)	99,083
Debt securities	72,894	—	72,894	—	72,894
Equity shares	931	—	931	—	931
Derivatives	384,537	(123,662)	260,875	(242,232)	18,643
Settlement balances	2,796	(168)	2,628	—	2,628
Total third party	716,019	(147,159)	568,860	(272,916)	295,944
Amounts due from holding company and fellow subsidiaries	61,233	—	61,233	(1,963)	59,270
Total gross of short positions	777,252	(147,159)	630,093	(274,879)	355,214
Short positions	(17,593)	—	(17,593)	—	(17,593)
Total net of short positions	759,659	(147,159)	612,500	(274,879)	337,621

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.
- (2) The carrying value on the balance sheet represents the exposure to credit risk by class of financial instrument.
- (3) The amount by which 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.

Key points

- Net exposure increased by £9.5 billion or 2% reflecting higher lending in UK PBB and Commercial Banking offset by disposals and run-down within Ulster Bank Rol and Capital Resolution.
- The majority of the £503 billion net exposure comprises cash and balances at central banks, unsecured commercial and personal bank lending and sovereign debt securities.

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

Sector concentration

The following table analyses financial assets by industry sector.

	Reverse repos £m	Lending £m	Securities		Derivatives £m	Other financial assets £m	Balance sheet value £m	Offset £m	Exposure post offset £m
			Debt £m	Equity £m					
2016									
Central and local government	219	5,810	57,917	—	2,508	63	66,517	(5,188)	61,329
Financial institutions - banks	12,860	16,598	3,330	1	145,503	73,813	252,105	(149,894)	102,211
- other	28,364	29,941	9,502	435	87,672	5,290	161,204	(91,391)	69,813
Personal - mortgages	—	151,532	—	—	—	8	151,540	—	151,540
- unsecured	—	13,780	—	—	39	—	13,819	—	13,819
Property	—	33,104	148	27	1,132	13	34,424	(1,111)	33,313
Construction	—	4,222	—	—	74	35	4,331	(779)	3,552
Manufacturing	43	9,571	198	12	2,003	18	11,845	(1,083)	10,762
Finance leases and instalment credit	—	12,177	—	—	3	—	12,180	(3)	12,177
Retail, wholesale and repairs	—	12,745	7	—	662	2	13,416	(1,610)	11,806
Transport and storage	—	6,411	28	—	1,042	—	7,481	(768)	6,713
Health, education and leisure	—	11,471	17	—	685	11	12,184	(648)	11,536
Hotels and restaurants	—	6,019	6	—	50	—	6,075	(181)	5,894
Utilities	193	3,934	159	—	3,776	15	8,077	(1,603)	6,474
Other	65	18,634	360	27	1,289	70	20,445	(2,324)	18,121
Total third party	41,744	335,949	71,672	502	246,438	79,338	775,643	(256,583)	519,060
Amounts due from holding company and fellow subsidiaries	—	2,153	—	—	1,306	32	3,491	(698)	2,793
Total gross of provisions	41,744	338,102	71,672	502	247,744	79,370	779,134	(257,281)	521,853
Provisions	—	(4,396)	(20)	(57)	—	—	(4,473)	n/a	(4,473)
Total excluding disposal groups	41,744	333,706	71,652	445	247,744	79,370	774,661	(257,281)	517,380
Disposal groups	—	7,922	—	—	15	62	7,999	—	7,999
Total	41,744	341,628	71,652	445	247,759	79,432	782,660	(257,281)	525,379
2015									
Central and local government	362	6,670	66,535	—	3,286	126	76,979	(6,346)	70,633
Financial institutions - banks	11,098	17,188	2,215	40	169,403	78,999	278,943	(177,778)	101,165
- other	28,094	31,375	10,539	712	78,168	3,750	152,638	(84,992)	67,646
Personal - mortgages	—	137,465	—	—	—	—	137,465	—	137,465
- unsecured	—	15,120	—	—	33	—	15,153	—	15,153
Property	—	35,720	124	47	1,336	—	37,227	(1,084)	36,143
Construction	—	4,411	—	3	240	—	4,654	(932)	3,722
Manufacturing	184	9,645	128	160	1,931	94	12,142	(1,593)	10,549
Finance leases and instalment credit	—	11,435	1	—	10	—	11,446	(2)	11,444
Retail, wholesale and repairs	—	12,000	156	31	570	10	12,767	(1,329)	11,438
Transport and storage	—	8,804	87	2	1,362	—	10,255	(873)	9,382
Health, education and leisure	—	10,959	4	6	641	7	11,617	(690)	10,927
Hotels and restaurants	—	5,363	11	—	81	5	5,460	(232)	5,228
Utilities	—	3,392	47	19	3,267	—	6,725	(1,689)	5,036
Other	72	19,679	237	111	1,480	97	21,676	(2,957)	18,719
Total third party	39,810	329,226	80,084	1,131	261,808	83,088	795,147	(280,497)	514,650
Amounts due from holding company and fellow subsidiaries	—	2,815	—	—	1,275	19	4,109	(393)	3,716
Total gross of provisions	39,810	332,041	80,084	1,131	263,083	83,107	799,256	(280,890)	518,366
Provisions	—	(7,052)	(57)	(62)	—	—	(7,171)	n/a	(7,171)
Total excluding disposal groups	39,810	324,989	80,027	1,069	263,083	83,107	792,085	(280,890)	511,195
Disposal groups	67	2,281	419	24	30	535	3,356	—	3,356
Total	39,877	327,270	80,446	1,093	263,113	83,642	795,441	(280,890)	514,551

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

2016	Reverse repos £m	Lending £m	Securities		Bank Derivatives £m	Other financial assets £m	Balance sheet value £m	Offset £m	Exposure post offset £m
			Debt £m	Equity £m					
Central and local government	—	4,364	52,793	—	2,507	49	59,713	(3,834)	55,879
Financial institutions - banks	8,847	12,019	2,795	1	145,429	70,615	239,706	(149,870)	89,836
- other	21,117	26,025	8,801	299	87,393	4,202	147,837	(90,033)	57,804
Personal - mortgages	—	29,046	—	—	—	—	29,046	—	29,046
- unsecured	—	3,082	—	—	—	—	3,082	—	3,082
Property	—	18,044	148	—	899	13	19,104	(859)	18,245
Construction	—	1,706	—	—	71	—	1,777	(130)	1,647
Manufacturing	43	4,156	198	1	1,906	17	6,321	(827)	5,494
Finance leases and instalment credit	—	98	—	—	3	—	101	(3)	98
Retail, wholesale and repairs	—	4,550	7	—	627	2	5,186	(684)	4,502
Transport and storage	—	4,591	28	—	1,031	—	5,650	(575)	5,075
Health, education and leisure	—	4,601	17	—	490	9	5,117	(201)	4,916
Hotels and restaurants	—	2,576	6	—	33	—	2,615	(112)	2,503
Utilities	193	3,089	159	—	3,719	15	7,175	(1,348)	5,827
Other	55	7,252	332	20	1,224	8	8,891	(1,043)	7,848
Total third party	30,255	125,199	65,284	321	245,332	74,930	541,321	(249,519)	291,802
Amounts due from holding company and fellow subsidiaries	—	45,274	2,405	—	6,144	392	54,215	(2,961)	51,254
Total gross of provisions	30,255	170,473	67,689	321	251,476	75,322	595,536	(252,480)	343,056
Provisions	—	(1,519)	(20)	(23)	—	—	(1,562)	n/a	(1,562)
Total	30,255	168,954	67,669	298	251,476	75,322	593,974	(252,480)	341,494

2015

Central and local government	—	4,994	60,982	—	3,284	20	69,280	(5,152)	64,128
Financial institutions - banks	8,724	12,536	1,880	40	169,354	76,904	269,438	(177,777)	91,661
- other	17,956	25,128	9,341	583	77,923	2,441	133,372	(83,411)	49,961
Personal - mortgages	—	30,697	—	—	—	—	30,697	—	30,697
- unsecured	—	3,373	—	—	—	—	3,373	—	3,373
Property	—	17,921	124	18	1,078	—	19,141	(807)	18,334
Construction	—	1,766	—	2	238	—	2,006	(111)	1,895
Manufacturing	184	4,346	128	157	1,897	73	6,785	(1,196)	5,589
Finance leases and instalment credit	—	103	1	—	10	—	114	(2)	112
Retail, wholesale and repairs	—	3,984	156	31	550	5	4,726	(668)	4,058
Transport and storage	—	6,842	87	2	1,351	—	8,282	(635)	7,647
Health, education and leisure	—	4,761	4	2	470	7	5,244	(205)	5,039
Hotels and restaurants	—	2,331	11	—	63	5	2,410	(114)	2,296
Utilities	—	2,623	47	19	3,215	—	5,904	(1,443)	4,461
Other	47	7,836	190	100	1,442	77	9,692	(1,395)	8,297
Total third-party	26,911	129,241	72,951	954	260,875	79,532	570,464	(272,916)	297,548
Amounts due from holding company and fellow subsidiaries	—	52,374	3,708	—	4,726	425	61,233	(1,963)	59,270
Total gross of provisions	26,911	181,615	76,659	954	265,601	79,957	631,697	(274,879)	356,818
Provisions	—	(1,524)	(57)	(23)	—	—	(1,604)	n/a	(1,604)
Total	26,911	180,091	76,602	931	265,601	79,957	630,093	(274,879)	355,214

For geographic concentrations refer to:

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

Credit risk: balance sheet analysis continued

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. Customers are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades across the Group map to both an asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across portfolios. Debt securities are analysed by external ratings and are therefore excluded from the following table and are set out on pages 91 to 93.

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

The table that follows details the relationship between the Group's internal asset quality (AQ) bands and external ratings published by Standard & Poor's (S&P), for illustrative purposes only. This relationship is established by observing S&P's default study statistics, notably the one year default rates for each S&P rating grade. A degree of judgement is required to relate the probability of default 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.

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

	Group										Balances with holding company and fellow subsidiaries	Past due	Impaired	Impairment provisions	Total
2016	AQ1 £bn	AQ2 £bn	AQ3 £bn	AQ4 £bn	AQ5 £bn	AQ6 £bn	AQ7 £bn	AQ8 £bn	AQ9 £bn	AQ10 £bn	£bn	£bn	£bn	£bn	£bn
Cash and balances at central banks	73.7	—	0.1	—	—	—	—	—	—	—	—	—	—	—	73.8
Banks															
- Reverse repos	4.7	—	—	6.4	0.6	0.4	0.4	—	0.4	—	—	—	—	—	12.9
- Derivative cash collateral	0.8	—	1.2	4.4	0.2	—	—	—	—	—	—	—	—	—	6.6
- Bank loans	6.1	—	2.7	0.8	0.2	0.1	—	—	0.1	—	1.0	—	—	—	11.0
- Total	11.6	—	3.9	11.6	1.0	0.5	0.4	—	0.5	—	1.0	—	—	—	30.5
Customers															
- Reverse repos	23.2	0.2	0.5	4.4	0.6	—	—	—	—	—	—	—	—	—	28.9
- Derivative cash collateral	8.0	0.4	1.0	7.3	0.2	—	—	—	—	—	—	—	—	—	16.9
- Customer loans	23.4	12.3	35.7	106.5	53.0	27.9	19.1	4.4	4.1	1.0	1.1	6.3	8.8	(4.4)	299.2
- Total	54.6	12.9	37.2	118.2	53.8	27.9	19.1	4.4	4.1	1.0	1.1	6.3	8.8	(4.4)	345.0
Settlement balances and other financial assets	3.8	0.2	0.2	0.9	0.1	—	0.2	—	—	0.1	0.1	—	—	—	5.6
Derivatives	37.8	1.4	25.9	168.6	9.3	1.1	2.3	—	—	—	1.3	—	—	—	247.7
Undrawn commitments	22.9	7.7	15.2	42.8	26.7	11.4	10.7	0.5	0.1	0.6	—	—	—	—	138.6
Contingent liabilities	0.7	0.4	0.9	3.1	1.5	0.7	0.4	0.1	—	0.1	—	—	—	—	7.9
Total excluding disposal groups	205.1	22.6	83.4	345.2	92.4	41.6	33.1	5.0	4.7	1.8	3.5	6.3	8.8	(4.4)	849.1
Disposal groups															7.9
Total															857.0
Total %	24.2	2.7	9.8	40.7	10.9	4.9	3.9	0.6	0.5	0.2	0.4	0.7	1.0	(0.5)	100

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

	Group										Balances with holding company and fellow subsidiaries	Past due	Impaired	Impairment provisions	Total
2015	AQ1 £bn	AQ2 £bn	AQ3 £bn	AQ4 £bn	AQ5 £bn	AQ6 £bn	AQ7 £bn	AQ8 £bn	AQ9 £bn	AQ10 £bn	£bn	£bn	£bn	£bn	£bn
Cash and balances at central banks	76.9	—	2.1	—	—	—	—	—	—	—	—	—	—	—	79.0
Banks															
- Reverse repos	0.3	0.6	3.5	4.8	1.3	0.4	0.2	—	—	—	—	—	—	—	11.1
- Derivative cash collateral	3.6	4.6	1.4	1.2	0.2	—	—	—	—	—	—	—	—	—	11.0
- Bank loans	2.0	0.6	2.7	0.1	0.3	0.1	0.1	—	0.1	—	1.6	0.1	—	—	7.7
- Total	5.9	5.8	7.6	6.1	1.8	0.5	0.3	—	0.1	—	1.6	0.1	—	—	29.8
Customers															
- Reverse repos	21.9	0.4	1.5	3.1	1.7	0.1	—	—	—	—	—	—	—	—	28.7
- Derivative cash collateral	9.2	1.1	3.6	3.0	0.2	0.1	—	—	—	—	—	—	—	—	17.2
- Customer loans	22.9	12.0	28.7	105.5	51.2	29.2	20.2	4.1	2.6	1.1	1.2	6.7	10.7	(7.1)	289.0
- Total	54.0	13.5	33.8	111.6	53.1	29.4	20.2	4.1	2.6	1.1	1.2	6.7	10.7	(7.1)	334.9
Settlement balances and other financial assets	2.3	0.1	0.1	0.6	—	—	—	—	—	—	—	1.0	—	—	4.1
Derivatives	41.4	65.6	88.9	57.5	6.2	1.1	0.8	—	0.2	0.1	1.3	—	—	—	263.1
Undrawn commitments	24.1	6.9	20.1	41.7	27.6	8.7	7.0	0.6	0.2	0.5	—	—	—	—	137.4
Contingent liabilities	0.8	1.3	1.8	4.4	1.9	0.6	0.9	0.1	0.1	0.1	0.7	—	—	—	12.7
Total excluding disposal groups	205.4	93.2	154.4	221.9	90.6	40.3	29.2	4.8	3.2	1.8	4.8	7.8	10.7	(7.1)	861.0
Disposal groups															2.9
Total															863.9
Total %	23.8	10.8	17.9	25.8	10.5	4.7	3.4	0.6	0.4	0.2	0.6	0.9	1.2	(0.8)	100

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

	Bank										Balances with holding company and fellow subsidiaries				Impaired	Impairment provisions	Total
	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10	£bn	Past due	£bn	£bn	£bn	£bn	£bn
2016	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Cash and balances at central banks	70.6	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	70.6
Banks																	
- Reverse repos	1.0	—	—	6.1	0.6	0.4	0.4	—	0.3	—	—	—	—	—	—	—	8.8
- Derivative cash collateral	0.9	—	1.2	4.4	0.2	—	—	—	—	—	—	—	—	—	—	—	6.7
- Bank loans	4.8	—	—	0.2	0.2	0.1	—	—	—	—	18.2	—	—	—	—	—	23.5
- Total	6.7	—	1.2	10.7	1.0	0.5	0.4	—	0.3	—	18.2	—	—	—	—	—	39.0
Customers																	
- Reverse repos	18.6	—	0.5	2.1	0.2	—	—	—	—	—	—	—	—	—	—	—	21.4
- Derivative cash collateral	8.0	0.4	1.0	7.3	0.2	—	—	—	—	—	—	—	—	—	—	—	16.9
- Customer loans	10.1	4.0	11.0	31.6	16.8	8.3	5.2	1.3	2.3	0.4	27.2	1.7	3.5	(1.5)	121.9		
- Total	36.7	4.4	12.5	41.0	17.2	8.3	5.2	1.3	2.3	0.4	27.2	1.7	3.5	(1.5)	160.2		
Settlement balances and other financial assets	3.0	0.1	0.2	0.9	0.1	—	—	—	—	—	0.4	—	—	—	—	—	4.7
Derivatives	37.6	1.2	25.8	168.5	9.1	1.0	2.2	—	—	—	6.1	—	—	—	—	—	251.5
Undrawn commitments	13.8	6.3	13.2	25.3	11.3	3.9	3.7	0.2	—	0.2	6.7	—	—	—	—	—	84.6
Contingent liabilities	0.5	0.4	0.6	2.2	0.9	0.4	0.2	0.1	—	—	0.2	—	—	—	—	—	5.5
Total	168.9	12.4	53.5	248.6	39.6	14.1	11.7	1.6	2.6	0.6	58.8	1.7	3.5	(1.5)	616.1		
Total %	27.3	2.0	8.7	40.4	6.4	2.3	1.9	0.3	0.4	0.1	9.5	0.3	0.6	(0.2)	100		
2015																	
Cash and balances at central banks	74.9	—	2.0	—	—	—	—	—	—	—	—	—	—	—	—	—	76.9
Banks																	
- Reverse repos	0.1	0.6	1.5	4.6	1.3	0.4	0.2	—	—	—	—	—	—	—	—	—	8.7
- Derivative cash collateral	3.4	4.6	1.4	1.2	0.2	—	—	—	—	—	—	—	—	—	—	—	10.8
- Bank loans	0.5	0.2	0.3	0.2	0.2	0.1	0.1	—	0.1	—	24.1	0.1	—	—	—	—	25.9
- Total	4.0	5.4	3.2	6.0	1.7	0.5	0.3	—	0.1	—	24.1	0.1	—	—	—	—	45.4
Customers																	
- Reverse repos	15.1	—	1.3	1.2	0.5	0.1	—	—	—	—	—	—	—	—	—	—	18.2
- Derivative cash collateral	9.2	1.1	3.6	3.0	0.2	0.1	—	—	—	—	—	—	—	—	—	—	17.2
- Customer loans	10.2	5.4	8.9	35.9	18.4	7.1	6.0	1.2	0.4	0.4	28.3	2.7	2.8	(1.5)	126.2		
- Total	34.5	6.5	13.8	40.1	19.1	7.3	6.0	1.2	0.4	0.4	28.3	2.7	2.8	(1.5)	161.6		
Settlement balances and other financial assets	1.4	0.1	0.1	0.1	—	—	—	—	—	—	0.4	1.0	—	—	—	—	3.1
Derivatives	41.0	65.5	88.9	57.4	6.1	1.0	0.7	—	0.2	0.1	4.7	—	—	—	—	—	265.6
Undrawn commitments	14.3	5.1	17.5	25.9	13.5	2.9	2.9	0.2	0.2	0.2	5.9	—	—	—	—	—	88.6
Contingent liabilities	0.8	1.0	1.4	3.5	1.4	0.3	0.6	0.1	—	0.1	0.7	—	—	—	—	—	9.9
Total	170.9	83.6	126.9	133.0	41.8	12.0	10.5	1.5	0.9	0.8	64.1	3.8	2.8	(1.5)	651.1		
Total %	26.5	12.8	19.5	20.4	6.4	1.8	1.6	0.2	0.1	0.1	9.8	0.6	0.4	(0.2)	100		

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

Loans, REIL and impairment provisions

Risk elements in lending (REIL) comprises impaired loans and accruing loans past due 90 days or more as to principal or interest. Impaired loans are all loans (including loans 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

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

	Gross loans to		REIL £m	Provisions £m	Credit metrics		Provisions as a % of gross loans to customers %	Impairment losses/ (releases) £m	Amounts written-off £m
	Banks £m	Customers £m			REIL as a % of gross loans to customers %	Provisions as a % of REIL %			
2016									
UK PBB	495	133,399	1,992	1,292	1.5	65	1.0	83	453
Ulster Bank Rol	2,418	20,130	3,513	1,200	17.5	34	6.0	(112)	2,057
Commercial Banking	582	101,824	2,026	874	2.0	43	0.9	213	578
Private Banking	111	12,188	105	31	0.9	30	0.3	(3)	3
NatWest Markets	3,313	17,419	—	1	—	—	—	—	—
Capital Resolution	3,936	13,341	2,197	753	16.5	34	5.6	301	478
W&G	—	20,791	380	245	1.8	64	1.2	42	68
Central items & other	5,743	259	—	—	—	—	—	—	22
Total third party	16,598	319,351	10,213	4,396	3.2	43	1.4	524	3,659
Amounts due from holding company and fellow subsidiaries	1,037	1,116	—	—	—	—	—	—	—
Disposal groups	31	7,902	29	11	0.4	38	0.1	2	6
Total	17,666	328,369	10,242	4,407	3.1	43	1.3	526	3,665
2015									
UK PBB	903	121,552	2,682	1,847	2.2	69	1.5	(6)	695
Ulster Bank Rol	1,971	18,584	3,503	1,911	18.8	55	10.3	(142)	168
Commercial Banking	665	92,002	1,911	749	2.1	39	0.8	69	263
Private Banking	54	11,230	115	37	1.0	32	0.3	13	7
NatWest Markets	5,696	16,076	—	1	—	nm	—	(7)	—
Capital Resolution	5,949	24,484	3,271	2,200	13.4	67	9.0	(775)	7,675
W&G	—	20,291	461	275	2.3	60	1.4	15	110
Central items & other	1,950	7,819	92	32	1.2	35	0.4	(1)	32
Total third party	17,188	312,038	12,035	7,052	3.9	59	2.3	(834)	8,950
Amounts due from holding company and fellow subsidiaries	1,557	1,258	—	—	—	—	—	—	—
Disposal groups	642	1,659	20	20	1.2	100	1.2	—	—
Total	19,387	314,955	12,055	7,072	3.8	59	2.2	(834)	8,950

Key points

- Customer loans increased by £13.4 billion (4%) mainly reflecting lending in UK PBB and Commercial Banking offset by disposals and wind downs in Capital Resolution.
- UK PBB: mortgage growth of £12.2 billion was the principal driver of the £11.4 billion gross lending increase in 2016.
- Commercial Banking: lending growth of £9.7 billion was across a variety of sectors supporting businesses in the UK and Western Europe.
- Ulster Bank Rol: customer lending increased by £1.5 billion reflecting new lending, invoice finance and foreign exchange movements, partially offset by portfolio sales and repayments.
- Private Banking: lending growth of £1.0 billion primarily mortgage lending.
- Capital Resolution: lending fell by £13.2 billion including wind downs and disposals of Markets (£4.6 billion), GTS (£2.3 billion) and Shipping (£1.8 billion).
- REIL and loan impairment provisions declined by £1.8 billion and £2.7 billion to £10.2 billion and £4.4 billion respectively. These reductions were predominantly driven by the portfolio sale of non-performing SME lending and buy-to-let mortgages in Ulster Bank Rol in Q4 2016 and related write-offs. These decreases were offset by the adverse impact of exchange rate movements of £1.0 billion in REIL and £0.5 billion in loan impairment provisions respectively.
- Net impairment charge of £526 million largely related to the Shipping portfolio within Capital Resolution.
- Amounts written off were significantly lower at £3.7 billion compared with £9.0 billion in 2015, primarily in commercial real estate (£1.5 billion in 2016 compared with £6.2 billion in 2015).

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

Sector and geographical concentration

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

2016	Gross loans £m	REIL £m	Provisions £m	Credit metrics			Impairment losses/(releases) £m	Amounts written-off £m
				REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %		
Central and local government	5,810	1	1	—	100	—	1	2
Finance	29,941	54	49	0.2	91	0.2	—	15
Personal - mortgages (1)	151,532	4,081	1,014	2.7	25	0.7	221	290
- unsecured	13,780	1,107	899	8.0	81	6.5	138	395
Property	33,104	1,366	487	4.1	36	1.5	(172)	1,457
Construction	4,222	264	137	6.3	52	3.2	8	153
of which: commercial real estate	24,675	1,403	510	5.7	36	2.1	(185)	1,480
Manufacturing	9,571	150	81	1.6	54	0.8	7	85
Finance leases and instalment credit	12,177	139	79	1.1	57	0.6	8	12
Retail, wholesale and repairs	12,745	272	171	2.1	63	1.3	38	169
Transport and storage	6,411	1,379	419	21.5	30	6.5	419	300
Health, education and leisure	11,471	381	129	3.3	34	1.1	9	75
Hotels and restaurants	6,019	211	107	3.5	51	1.8	13	116
Utilities	3,934	95	50	2.4	53	1.3	—	2
Other	18,634	713	377	3.8	53	2.0	51	588
Latent	—	—	396	—	—	—	(217)	—
Total third-party excluding disposal groups	319,351	10,213	4,396	3.2	43	1.4	524	3,659
Amounts due from holding company and fellow subsidiaries	1,116	—	—	—	—	—	—	—
Disposal groups	7,902	29	11	0.4	38	0.1	2	6
Total customers	328,369	10,242	4,407	3.1	43	1.3	526	3,665
Of which:								
UK								
Personal - mortgages (1)	135,820	937	142	0.7	15	0.1	(5)	3
- unsecured	13,497	1,056	853	7.8	81	6.3	132	361
Property and construction	36,340	1,540	536	4.2	35	1.5	(107)	676
of which: commercial real estate	23,790	1,320	425	5.5	32	1.8	(102)	600
Other	112,173	3,117	1,291	2.8	41	1.2	662	627
Latent	—	—	317	—	—	—	(12)	—
Disposal groups	7,562	29	11	0.4	38	0.1	2	3
	305,392	6,679	3,150	2.2	47	1.0	672	1,670
Europe								
Personal - mortgages (1)	15,372	3,144	872	20.5	28	5.7	226	287
- unsecured	256	51	46	19.9	90	18.0	5	11
Property and construction	980	84	83	8.6	99	8.5	(56)	930
of which: commercial real estate	879	77	77	8.8	100	8.8	(83)	876
Other	3,711	239	133	6.4	56	3.6	(149)	665
Latent	—	—	79	—	—	—	(204)	—
Disposal groups	340	2	1	0.6	50	0.3	—	3
	20,659	3,520	1,214	17.0	34	5.9	(178)	1,896
Banks excluding disposal groups	16,598	—	—	—	—	—	—	1
Amounts due from holding company and fellow subsidiaries	1,037	—	—	—	—	—	—	—
Disposal groups	31	—	—	—	—	—	—	—
Total banks	17,666	—	—	—	—	—	—	1

Note:

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

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

	Gross loans £m	REIL £m	Provisions £m	Credit metrics			Impairment losses/(releases) £m	Amounts written-off £m
				REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %		
2015								
Central and local government	6,670	1	1	—	100	—	—	—
Finance	31,375	76	57	0.2	75	0.2	(5)	165
Personal - mortgages (1)	137,465	3,634	1,002	2.6	28	0.7	(82)	171
- unsecured	15,120	1,311	1,131	8.7	86	7.5	122	513
Property	35,720	3,482	1,990	9.7	57	5.6	(555)	5,999
Construction	4,411	357	269	8.1	75	6.1	(14)	313
<i>of which: commercial real estate</i>	27,454	3,560	2,054	13.0	58	7.5	(807)	6,151
Manufacturing	9,645	255	148	2.6	58	1.5	3	140
Finance leases and instalment credit	11,435	107	79	0.9	74	0.7	(8)	37
Retail, wholesale and repairs	12,000	422	292	3.5	69	2.4	7	325
Transport and storage	8,804	559	254	6.3	45	2.9	114	370
Health, education and leisure	10,959	394	190	3.6	48	1.7	15	171
Hotels and restaurants	5,363	336	201	6.3	60	3.7	1	346
Utilities	3,392	91	46	2.7	51	1.4	11	27
Other	19,679	1,010	810	5.1	80	4.1	(37)	340
Latent	—	—	582	—	—	—	(402)	—
Total third-party excluding disposal groups	312,038	12,035	7,052	3.9	59	2.3	(830)	8,917
Amounts due from holding company and fellow subsidiaries	1,258	—	—	—	—	—	—	—
Disposal groups	1,659	20	20	1.2	100	1.2	—	—
Total customers	314,955	12,055	7,072	3.8	59	2.2	(830)	8,917
Of which:								
UK								
Personal - mortgages (1)	123,653	1,083	158	0.9	15	0.1	17	36
- unsecured	14,348	1,262	1,085	8.8	86	7.6	126	501
Property and construction	38,005	2,814	1,282	7.4	46	3.4	28	2,773
<i>of which: commercial real estate</i>	25,676	2,568	1,107	10.0	43	4.3	(118)	2,575
Other	109,717	2,194	1,180	2.0	54	1.1	125	800
Latent	—	—	330	—	—	—	(300)	—
	285,723	7,353	4,035	2.6	55	1.4	(4)	4,110
Europe								
Personal - mortgages (1)	13,776	2,550	844	18.5	33	6.1	(101)	135
- unsecured	772	49	45	6.3	92	5.8	(5)	12
Property and construction	1,993	1,008	966	50.6	96	48.5	(593)	3,539
<i>of which: commercial real estate</i>	1,628	974	935	59.8	96	57.4	(688)	3,576
Other	6,914	949	836	13.7	88	12.1	—	1,014
Latent	—	—	252	—	—	—	(102)	—
	23,455	4,556	2,943	19.4	65	12.5	(801)	4,700
Banks excluding disposal groups	17,188	1	1	—	100	—	(4)	33
Amounts due from holding company and fellow subsidiaries	1,557	—	—	—	—	—	—	—
Disposal groups	642	—	—	—	—	—	—	—
Total banks	19,387	1	1	—	100	—	(4)	33

Note:

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

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

Risk elements in lending

The tables below analyse REIL by segments.

	2016							2015	
	UK PBB £m	Ulster Bank Rol £m	Commercial Banking £m	Private Banking £m	Capital Resolution £m	W&G £m	Central items & other £m	Total £m	Total £m
At 1 January	2,682	3,503	1,911	115	3,271	461	112	12,055	28,052
Inter segment transfers	(187)	1,404	554	—	(1,685)	(28)	(58)	—	—
Currency translation and other adjustments	—	556	6	—	440	—	5	1,007	(836)
Additions	877	1,327	1,182	25	1,665	193	18	5,287	4,249
Transfers between REIL and potential problem loans	(155)	—	14	(6)	—	(20)	1	(166)	(222)
Transfer to performing book	(290)	(454)	(164)	—	(4)	(39)	(8)	(959)	(1,120)
Repayments and disposals	(482)	(766)	(900)	(26)	(1,011)	(119)	(13)	(3,317)	(8,938)
Amounts written-off	(453)	(2,057)	(577)	(3)	(479)	(68)	(28)	(3,665)	(9,130)
At 31 December	1,992	3,513	2,026	105	2,197	380	29	10,242	12,055

	2016 £m	2015 £m
Impaired Loans		
- UK	5,557	6,091
- Overseas	3,240	4,677
Total	8,797	10,768
Accruing loans contractually 90 days or more as to principal or interest		
- UK	1,122	1,262
- Overseas	323	25
Total	1,445	1,287
Total risk elements in lending (3)	10,242	12,055

Notes:

(1) REIL are stated without giving effect to any security held that could reduce the eventual loss should it occur or to any provisions marked.

(2) For details on impairment methodology refer to Credit risk on page 51 and Accounting policy 15 Impairment of financial assets on page 126.

(3) Includes disposal groups of £29 million (2015 - £55 million).

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

Provisions

The table below analyses provisions by segment.

	2016									2015
	UK PBB £m	Ulster Bank £m	Commercial Banking £m	Private Banking £m	NatWest Markets £m	Capital Resolution £m	W&G £m	Central items & other £m	Total £m	Total £m
At 1 January	1,847	1,911	749	37	1	2,200	275	52	7,072	17,940
Inter segment transfers	(173)	1,257	443	—	—	(1,527)	—	—	—	—
Currency translation and other adjustments	—	214	29	—	—	245	—	(14)	474	(559)
Repayments and disposals	—	—	—	—	—	—	—	—	—	(554)
Amounts written-off	(453)	(2,057)	(577)	(3)	—	(479)	(68)	(28)	(3,665)	(9,130)
Recoveries of amounts previously written-off	28	24	28	1	—	31	1	—	113	250
Charge/(release) to the income statement from continuing operations	83	(112)	214	(3)	—	301	42	(1)	524	(835)
Charge to the income statement from discontinued operations	—	—	—	—	—	—	—	2	2	104
Unwind of discount	(40)	(37)	(12)	(1)	—	(18)	(5)	—	(113)	(144)
At 31 December	1,292	1,200	874	31	1	753	245	11	4,407	7,072

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.

	2016 £m	2015 £m
Past due 1-29 days	3,823	4,150
Past due 30-59 days	747	769
Past due 60-89 days	509	530
Past due 90 days or more	1,434	1,287
Total excluding disposal groups	6,513	6,736
Disposal groups	49	—
Total	6,562	6,736

Past due analysis by sector		
Personal	3,554	3,437
Property and construction	1,006	1,341
Financial institution	91	187
Other corporate	1,862	1,771
Total excluding disposal groups	6,513	6,736
Disposal groups	49	—
Total	6,562	6,736

Financial review Capital and risk management

Credit risk: balance sheet analysis *continued*

Securities and available-for-sale reserves

Debt securities

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

	Central and local government				Other financial institutions			Of which
	UK £m	US £m	Other £m	Banks £m	£m	Corporate £m	Total £m	ABS £m
2016								
Held-for-trading (HFT)	2,615	4,133	14,087	818	2,299	549	24,501	886
Available-for-sale (AFS)	10,581	6,953	15,137	1,748	3,990	5	38,414	2,263
Loans and receivables	—	—	—	—	3,774	194	3,968	3,814
Held-to-maturity	4,769	—	—	—	—	—	4,769	—
Total	17,965	11,086	29,224	2,566	10,063	748	71,652	6,963
Of which US agencies	—	—	—	—	386	—	386	—
Short positions (HFT)	(2,644)	(4,989)	(13,345)	(334)	(640)	(121)	(22,073)	—
<i>Available-for-sale</i>								
AFS reserves (gross of tax)	79	(66)	190	6	122	(6)	325	41
Gross unrealised gains - total	768	56	503	8	93	2	1,430	75
Gross unrealised losses - total	(16)	(123)	(13)	(1)	(43)	(2)	(198)	(32)
Of which:								
less than 12 months	(16)	(123)	(13)	(1)	(11)	(2)	(166)	(1)
more than 12 months	—	—	—	—	(32)	—	(32)	(31)
2015								
Held-for-trading	4,107	4,627	22,222	576	3,591	636	35,759	707
Available-for-sale	9,110	10,265	11,293	1,639	4,670	15	36,992	2,252
Loans and receivables	—	—	—	—	2,221	144	2,365	2,222
Held-to-maturity	4,911	—	—	—	—	—	4,911	—
Total excluding disposal groups	18,128	14,892	33,515	2,215	10,482	795	80,027	5,181
Disposal groups	14	94	122	162	21	6	419	139
Total	18,142	14,986	33,637	2,377	10,503	801	80,446	5,320
Of which US agencies	—	—	—	—	806	—	806	—
Short positions (HFT)	(4,697)	(3,347)	(11,796)	(391)	(410)	(165)	(20,806)	—
<i>Available-for-sale</i>								
AFS reserves (gross of tax)	12	(78)	88	5	152	4	183	73
Gross unrealised gains - excluding disposal groups	383	104	267	3	105	7	869	88
Gross unrealised gains - disposal groups	—	—	1	3	—	—	4	2
Gross unrealised gains - total	383	104	268	6	105	7	873	90
Gross unrealised losses - total	(7)	(62)	(9)	(1)	(33)	(3)	(115)	(16)
Of which:								
less than 12 months	(7)	(58)	(9)	(1)	(17)	(3)	(95)	—
more than 12 months	—	(4)	—	—	(16)	—	(20)	(16)

Note:

(1) There were no debt securities in disposal groups in 2016.

Financial review Capital and risk management

Credit risk: 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.

2016	Central and local government			Group			Total £m	Of which ABS £m
	UK £m	US £m	Other £m	Banks £m	Other financial institutions £m	Corporate £m		
AAA	—	—	11,478	1,610	6,024	36	19,148	3,993
AA to AA+	17,965	11,086	5,507	377	720	34	35,689	244
A to AA-	—	—	9,727	238	2,048	150	12,163	1,627
BBB- to A-	—	—	2,197	153	698	265	3,313	645
Non-investment grade	—	—	315	69	458	31	873	381
Unrated	—	—	—	119	115	232	466	73
Total	17,965	11,086	29,224	2,566	10,063	748	71,652	6,963

2015

AAA	—	—	11,603	1,551	5,217	3	18,374	3,227
AA to AA+	18,128	14,892	6,860	102	1,424	60	41,466	261
A to AA-	—	—	8,737	420	1,881	147	11,185	335
BBB- to A-	—	—	5,973	79	845	214	7,111	363
Non-investment grade	—	—	342	32	526	200	1,100	446
Unrated	—	—	—	31	589	171	791	549
Total excluding disposal groups	18,128	14,892	33,515	2,215	10,482	795	80,027	5,181
Disposal groups	14	94	122	162	21	6	419	139
Total	18,142	14,986	33,637	2,377	10,503	801	80,446	5,320

2016	Central and local government			Bank			Total £m	Of which ABS £m
	UK £m	US £m	Other £m	Banks £m	Other financial institutions £m	Corporate £m		
AAA	—	—	10,449	1,524	5,686	36	17,695	3,909
AA to AA+	17,965	7,626	4,844	52	334	34	30,855	244
A to AA-	—	—	9,727	238	2,036	150	12,151	1,627
BBB- to A-	—	—	2,197	112	678	264	3,251	645
Non-investment grade	—	—	315	69	437	31	852	373
Unrated	—	—	—	119	114	227	460	73
	17,965	7,626	27,532	2,114	9,285	742	65,264	6,871
Issued by holding company and fellow subsidiaries	—	—	—	—	2,405	—	2,405	1,774
Total	17,965	7,626	27,532	2,114	11,690	742	67,669	8,645

2015

AAA	—	—	10,964	1,540	4,850	3	17,357	3,227
AA to AA+	18,128	10,863	5,976	51	621	55	35,694	258
A to AA-	—	—	8,736	153	1,881	136	10,906	335
BBB- to A-	—	—	5,973	73	820	198	7,064	363
Non-investment grade	—	—	342	32	524	200	1,098	446
Unrated	—	—	—	31	588	156	775	549
	18,128	10,863	31,991	1,880	9,284	748	72,894	5,178
Issued by holding company and fellow subsidiaries	—	—	—	—	3,708	—	3,708	3,069
Total	18,128	10,863	31,991	1,880	12,992	748	76,602	8,247

Financial review Capital and risk management

Credit risk: 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 & CLOs £m	Other ABS £m	£m
	Prime £m	Non- conforming £m	Sub-prime £m				
2016							
AAA	654	—	—	—	23	3,316	3,993
AA to AA+	52	155	—	—	3	34	244
A to AA-	460	2	—	22	33	1,110	1,627
BBB- to A-	84	—	—	470	21	70	645
Non-investment grade (2)	182	1	8	15	121	54	381
Unrated (2)	5	—	—	—	19	49	73
Total	1,437	158	8	507	220	4,633	6,963
2015							
AAA	266	749	2	—	77	2,133	3,227
AA to AA+	2	150	—	1	12	96	261
A to AA-	4	24	5	13	9	280	335
BBB- to A-	13	144	20	21	121	44	363
Non-investment grade (2)	23	25	143	24	169	62	446
Unrated (2)	10	—	1	470	25	43	549
Total excluding disposal groups	318	1,092	171	529	413	2,658	5,181
Disposal groups	—	—	—	—	—	139	139
Total	318	1,092	171	529	413	2,797	5,320

Notes:

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

(2) Includes held-for-trading.

(3) There were no asset-backed securities in disposal groups in 2016.

Equity shares

The table below analyses holdings of equity shares for eurozone countries and other countries with balances of more than £50 million by country, issuer and measurement classification. The HFT positions are used mainly for economic hedging of debt issuances and equity derivatives. The AFS balances are individually small holdings in unlisted companies, mainly acquired through debt for equity transactions in Restructuring.

Countries	2016										
	HFT					AFS/DFV (1)					AFS reserves £m
	Banks £m	Other financial institutions (2) £m	Corporate £m	Total £m	HFT short positions £m	Banks £m	Other financial institutions (2) £m	Corporate £m	Total £m	Total £m	
Luxembourg	—	91	—	91	—	—	—	—	—	91	—
Other	—	7	11	18	—	—	10	3	13	31	2
Total eurozone	—	98	11	109	—	—	10	3	13	122	2
UK	1	4	11	16	(3)	—	223	6	229	245	22
Other	—	1	2	3	—	—	71	4	75	78	33
Total	1	103	24	128	(3)	—	304	13	317	445	57
2015											
Total excluding disposal groups	35	236	330	601	(2)	5	443	20	468	1,069	275
Disposal groups	—	—	—	—	—	—	24	—	24	24	20
Total	35	236	330	601	(2)	5	467	20	492	1,093	295

Notes:

(1) Designated as at fair value through profit or loss balances are £88 million (2015 - £71 million), of which £83 million are other financial institutions (2015 - £61 million) and £5 million are corporate (2015 - £10 million).

(2) Includes government sponsored entities.

(3) There were no equity shares in disposal groups in 2016.

Financial review Capital and risk management

Credit risk: balance sheet analysis continued

Derivatives

Summary

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

	2016			2015		
	Notional £bn	Assets £m	Liabilities £m	Notional £bn	Assets £m	Liabilities £m
Interest rate	17,970	170,100	158,438	19,766	205,564	194,740
Exchange rate	4,450	75,323	77,080	3,697	54,789	57,946
Credit	42	682	557	66	908	839
Equity and commodity	24	333	274	18	547	740
Balance sheet	22,486	246,438	236,349	23,547	261,808	254,265
Counterparty mark-to-market netting		(197,081)	(197,081)		(214,790)	(214,790)
Cash collateral		(28,700)	(20,412)		(27,614)	(25,729)
Securities collateral		(8,435)	(11,048)		(7,535)	(8,213)
Net exposure excluding disposal groups		12,222	7,808		11,869	5,533
Disposal groups	1	15	9	2	30	28
Net exposure		12,237	7,817		11,899	5,561
Balances with Group companies	32	1,306	1,228	34	1,275	1,283

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 credit valuation adjustments (CVA) and other valuation reserves. CVA represents an estimate of the adjustment to fair value that a market participant would make to incorporate the risk inherent in derivative exposures. For details of CVA methodology, refer to Note 9 on the consolidated accounts Financial instruments - valuation.

	2016 £m	2015 £m
Funding valuation adjustments (FVA)	930	745
Credit valuation adjustments (CVA)	599	752
Bid-offer reserves	333	304
Product and deal specific	607	619
Valuation reserves	2,469	2,420

Key points

- FVA reserves increased by £185 million during 2016, primarily driven by interest rates tightening with the movements in the first half of the year partially reversing in the second half of 2016.
- The decrease in CVA reserves of £153 million, was driven by credit spreads tightening together with trade close-outs and novations.
- The increase in bid-offer reserves of £29 million mainly reflected sterling weakening against all major currencies.

Market risk

Definition

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

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

The following disclosures in this section are audited:

- Traded market risk - Internal VaR
- Non-traded market risk:
 - Internal banking book VaR; and
 - Foreign exchange risk

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

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

- Traded market risk:
 - Internal VaR
 - RWAs and minimum capital requirements

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

All other disclosures are on an overall Group basis.

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

Key developments in 2016*

Traded market risk:

- The year was characterised by higher market volatility. This was particularly notable during Q1 2016 - due to market concerns over the stability of the financial sector - and around key events, such as the UK referendum on EU membership in June and the US presidential election in November.
- NatWest Markets significantly reduced its traded market risk exposure in the run-up to these key events, reflecting market uncertainty. The focus of the risk reduction was in the Rates business.
- Market flows increased markedly following these events, supporting NatWest Markets' customer activity. Given the significant risk reduction achieved in recent years, notably in Capital Resolution, by year-end 2016 the Group's Value-at-Risk (VaR) profile was more reflective of NatWest Markets' areas of activity in line with its strategic focus.

- RBS plc's market risk RWAs fell 18% or £3.4 billion to £15.7 billion, driven by reductions under both the standardised approach and the internal model approach.
- The majority of the VaR back-testing exceptions by legal entity during the year were driven by the increased market volatility.

Non-traded market risk:

- The non-traded market risk appetite statement and metrics were revised in early 2016. The risk appetite metrics were enhanced to capture a combination of earnings-based and economic value-based metrics, as prescribed by regulatory guidelines. The appetite framework was also aligned to the capital framework and directly supports the strategic risk objectives of maintaining capital adequacy and delivering stable earnings growth.
- Hedging activity aims to reduce the RBS Group's sensitivity to potential adverse impacts of exchange rate and interest rate movements, in particular on its Common Equity Tier 1 ratio. Ahead of the EU referendum, the residual sensitivity of this ratio was low and no adverse impact from the RBS Group's economic risk exposure resulted from the outcome of the vote. However, the sensitivity of interest income to a further downward shock in interest rates increased after the referendum as interest rates fell sharply, with the UK base rate cut from 0.5% to 0.25%. This reflected the limited ability of banks, including RBS, to pass on further rate cuts to customers that already receive low nominal returns on deposits.

Sources of risk*

Traded market risk

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

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

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

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 51.

*unaudited

Market risk continued

Non-traded market risk

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

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

Interest rate risk

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

NTIRR comprises three primary risk factors: gap risk, basis risk and option risk. For more information, refer to page 103.

Credit spread risk

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

Foreign exchange risk

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

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

Equity risk

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

Accounting volatility risk

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

Pension risk

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

Risk governance*

The Group manages the key categories of traded and non-traded market risk separately. Each category is discussed in dedicated sections below.

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

Market risk positions are reported monthly to the RBS Group's Executive Risk Forum (ERF) and quarterly to the Board Risk Committee. In addition, traded market risk positions are reported monthly to the RBS Group's Treasury and Market Risk Committee and non-traded market risk positions are reported to the ALCo (monthly in the case of interest rate, credit spread and accounting volatility risks and quarterly in the case of foreign exchange and equity risks).

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

The Group's policy is to manage risk exposures within an appetite that is set by the ERF and, in the case of non-traded market risk, endorsed by the ALCo. This appetite is expressed in the form of exposure limits.

Risk appetite*

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

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

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

The limit framework at RBS Group level comprises VaR, stressed value-at-risk (SVaR) and sensitivity and stress limits (for more details on VaR and SVaR, refer to pages 98 to 101). The limit framework at trading unit level also comprises additional metrics that are specific to the market risk exposures within its scope. These additional metrics aim to control various risk dimensions such as product type, exposure size, aged inventory, currency and tenor.

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

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

For further information on risk appetite, refer to page 16.

Risk controls and assurance

For information on risk controls and assurance, refer to page 20.

*unaudited

Market risk continued

Traded market risk

Risk identification and 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 function.

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

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

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

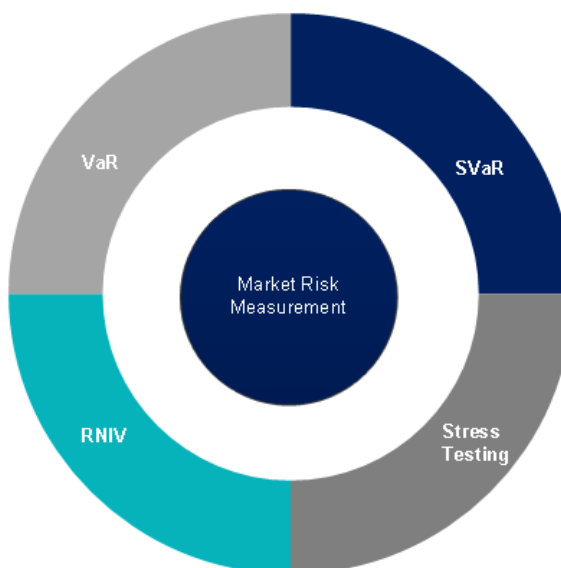
Limit reporting is supplemented with regulatory capital and stress testing information as well as ad hoc reporting.

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

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 measurement

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



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

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

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

*unaudited

Market risk continued

Value-at-risk*

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

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

The Group's internal traded VaR model captures all trading book positions including those products approved by the regulator. For an explanation of the distinction between internal VaR and regulatory VaR, refer to page 102.

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

- General 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.
- Specific interest rate 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.

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

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

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

VaR limitations*

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

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

Market data time series are updated on a daily basis, with a ten-working-day time lag.

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

Finally, where market data time series are not appropriate (due to poor quality or a lack of liquidity in the market), the Group uses proxy time series or excludes the risk factor from its VaR model and capitalises the risk through its RNIV framework.

*unaudited

Financial review Capital and risk management

Market risk continued

1-Day 99% traded internal VaR

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

	2016				2015			
	Average £m	Period end £m	Maximum £m	Minimum £m	Average £m	Period end £m	Maximum £m	Minimum £m
RBS plc								
General interest rate	12.5	14.8	22.2	7.9	14.6	12.5	26.7	9.7
Specific interest rate	9.4	10.0	13.8	5.8	10.3	7.4	16.4	6.4
Currency	4.6	5.6	13.0	1.0	5.3	5.2	9.1	1.9
Equity	0.5	1.9	2.1	0.2	1.6	0.8	6.0	0.4
Commodity	0.7	0.1	2.2	0.1	0.4	0.5	2.2	0.2
Diversification (1)		(9.3)				(9.4)		
Total	16.9	23.1	26.9	9.8	19.0	17.0	30.5	13.1

	2016				2015			
	Average £m	Period end £m	Maximum £m	Minimum £m	Average £m	Period end £m	Maximum £m	Minimum £m
RBSSI								
General interest rate	1.9	4.0	4.0	0.7	2.3	2.3	6.0	0.9
Specific interest rate	0.4	0.6	0.8	0.1	1.3	0.8	2.8	0.8
Equity	—	—	—	—	0.2	—	0.4	—
Commodity	0.2	0.3	0.5	—	0.3	—	0.5	0.1
Diversification (1)		(0.5)				(1.9)		
Total	2.0	4.4	4.5	0.7	1.3	1.2	3.2	0.6

Note:

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

Key points

RBS plc

- On an average basis, total traded VaR decreased in 2016 by 11%. The reduction was mainly driven by lower risk positions during Q1 2016, with reduced market activity reflecting concerns over the stability of the financial sector. Stronger client flows later in the year, mainly in NatWest Markets' strategic Rates and Currencies businesses, resulted in a risk increase in H2 2016.
- On a period end basis, total traded VaR increased in 2016 by 36%. The increase was mainly driven by the Rates business.
- VaR fluctuated throughout 2016, reflecting developments in US and the eurozone and other macroeconomic factors. These included, but were not limited to, the US presidential elections, the EU referendum in the UK and central bank actions. However, total traded VaR was managed within risk appetite.

RBSSI

- Total traded VaR increased, by 267% (by £3.2 million from £1.2 million) on a period end basis and by 54% (by £0.7 million from £1.3 million) on an average basis. The increase was mainly driven by the Rates US business.

*unaudited

Market risk continued

VaR validation*

In addition to being a key risk management measure used by Market Risk in its second-line-of-defence oversight of the risk arising from trading activities, VaR is also used as one of the components of the Group's market risk regulatory capital requirements (refer to page 102 for more information).

Therefore, VaR is subject not only to model management review and validation but also to regulation compliance, which includes (but is not restricted to) regulator-prescribed back-testing.

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

- Back-testing - Internal and regulatory back-testing is conducted on a daily basis.
- Ongoing model validation - VaR model performance is assessed both regularly and on an ad-hoc basis if market conditions or book constitution change significantly.
- RNIV framework - The RNIV framework ensures that all material risks outside the internal VaR models are captured by, if necessary, developing an RNIV calculation to manage the risk (refer to page 102).
- Model Risk Management review - As part of the model lifecycle, all risk models (including the VaR model) are independently reviewed to ensure that the model is still fit for purpose given current market conditions and book constitution (refer to page 20).

VaR back-testing*

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

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

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

The Hypo P&L reflects the firm's Actual P&L excluding any intraday activities.

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

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

*unaudited

Market risk continued Stressed VaR (SVaR)*

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

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

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

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

Internal traded SVaR is monitored at RBS Group level.

Risks not in VaR (RNIVs)*

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

The need for an RNIV calculation is typically identified in one of the following three circumstances: (i) as part of the New Product Risk Assessment process, when a risk manager determines that the associated risk is not adequately captured by the VaR model or system; (ii) when risks are mapped to time series that are deemed to be inadequate (for example, due to data quality problems or proxy series usage); or (iii) as a result of a recommendation made during the ongoing model validation or by Model Risk Management during its annual review of the VaR model.

RNIVs that are related specifically to instruments that have level 3 valuation hierarchy assumptions (refer to page 161) are mainly included in the following categories: proxied sensitivities or risk factors, higher-order sensitivity terms, and static pricing parameters.

The Group adopts two approaches for the quantification of RNIVs:

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

*unaudited

In each of these approaches, potential diversification benefits between RNIVs are ignored.

The RNIV calculations provide the additional capital required to capture the market risks not captured in the internal VaR model and are regularly reported to senior management and the regulator and discussed with them. The methodology used in the material RNIV calculations is internally reviewed by Model Risk Management. Where appropriate, risk managers set sensitivity limits to monitor specific risk factors. RNIV calculations form an integral part of ongoing model and data improvement efforts to capture all market risks in scope for model approval in VaR and SVaR.

Stress testing*

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.

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

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

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

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

Market risk continued

Economic capital*

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

Market risk regulatory capital*

Regulatory treatment

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

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

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

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

Regulatory VaR

The PRA renewed the RBS Group's Internal Model Approach (IMA) permission with effect from 30 November 2016, incorporating changes to the legal entity coverage of the permission (removal of RBSSI) and minor revisions to its product and trading location coverage. The changes were requested by the RBS Group, reflecting the continued simplification of its operations. IMA permission applies to the following material legal entities: RBS plc and NatWest Plc.

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

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

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

Regulatory SVaR*

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

Risks not in VaR

As discussed earlier, the RNIV framework ensures that the risks not captured in VaR are adequately covered by capital. In line with regulatory guidelines for external reporting, VaR RNIV values are reported as a subset of the VaR-based regulatory capital charge, whereas SVaR RNIV values and stress-based RNIV values are reported as subsets of the SVaR-based charge.

Incremental risk charge (IRC)*

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

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

The transition matrix is estimated using Moody's history of issuer ratings.

Market risk RWAs and minimum capital requirements*

At 31 December 2016, total market risk RWAs for RBS plc were £15.7 billion (31 December 2015 - £19.1 billion). Minimum capital requirements, which represent 8% of RWAs, were £1.3 billion (31 December 2015 - £1.5 billion).

*unaudited

Market risk continued

Model validation*

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

For general information on the independent model validation carried out by Model Risk Management (MRM), which applies also to market risk models (including VaR models), refer to page 20. Additional details relating to pricing and market risk models are presented below.

Pricing models

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

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

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

The review process comprises the following steps:

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

Risk models

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

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

In addition to MRM's independent oversight, the model testing team monitors the model performance for market risk through back-testing, which is discussed in more detail on page 100, and other processes.

Non-traded market risk

As noted earlier, the Group largely manages the key categories of non-traded market risk separately. The categories are: interest rate risk; credit spread risk; foreign exchange risk; equity risk; and accounting volatility risk.

Risk assessment, monitoring and mitigation

Interest rate risk*

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

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

*unaudited

Market risk continued

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.

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

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

Credit spread risk

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

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

Foreign exchange risk

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

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

Equity risk

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

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

Accounting volatility risk

Accounting volatility is reported to the RBS Group ALCo monthly and capitalised as part of the Internal Capital Adequacy Assessment Process.

Market risk continued

Risk measurement

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

Following the approval of an enhanced non-traded market risk appetite framework in early 2016, VaR disclosures reflect a more complete economic risk measure for the banking book.

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

	2016 £m	2015 (1)* £m
Interest rate	21	39
Credit spread	63	31
Pipeline risk	—	1
Diversification (2)	(23)	(22)
Total	61	49

Notes:

(1) Certain 2015 year end numbers have been restated for comparison purposes in light of the enhancement of the risk appetite framework in 2016.

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

Key points

- Total internal non-traded VaR rose from £49 million to £61 million on a period end basis, primarily driven by credit spread risk, which remains the largest contributor to the total VaR.
- The rise in credit spread VaR reflected the increase in the proportion of bonds held within Treasury's liquidity portfolio and the increased volatility in the market data captured in the VaR. (For more information on the liquidity bond portfolio, refer to the Liquidity and funding risk section.)
- Interest rate VaR decreased by around 50% reflecting slightly lower exposure to fixed-rate assets.

Interest rate risk*

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

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

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

NII sensitivity is calculated and monitored at RBS Group level.

Value-at-risk*

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

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

*unaudited

Financial review Capital and risk management

Market risk continued

Foreign exchange risk

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

	Net investments in foreign operations £m	Net investment hedges (1) £m	Structural foreign currency exposures £m
2016			
US dollar	(1,327)	—	(1,327)
Euro	4,957	(583)	4,374
Swiss franc	564	(440)	124
Other non-sterling	934	(506)	428
Total	5,128	(1,529)	3,599
2015			
US dollar	359	(7)	352
Euro	5,234	(573)	4,661
Swiss franc	797	(711)	86
Other non-sterling	1,035	(602)	433
Total	7,425	(1,893)	5,532

Note:

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

Key points

- Structural foreign currency exposure at 31 December 2016 was £3.6 billion, £1.9 billion lower than at 31 December 2015.
- This reduction was driven by provisions for RMBS and dividends received from EU subsidiaries. These reductions were partly offset by US dollar and euro appreciation against sterling in 2016.
- 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 £0.2 billion in equity (2015 - a gain of £0.3 billion). A 5% weakening in foreign currencies against sterling would result in a loss of £0.2 billion in equity (2015 - a loss of £0.3 billion).

Structured credit portfolio

The structured credit portfolio is no longer material.

Calculation of regulatory capital*

The RBS Group capitalises non-traded market risk as part of the Pillar 2A Internal Capital Adequacy Assessment Process (ICAAP). The approach combines both earnings based and economic value based methodologies, in accordance with regulatory guidelines. The calculation captures the principal sources of non-traded market risk - interest rate risk, credit spread risk, structural foreign exchange risk and accounting volatility risk.

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 ICAAP are also used for economic capital purposes.

*unaudited

Report of the directors

The directors present their report together with the audited accounts for the year ended 31 December 2016.

Group structure

The Royal Bank of Scotland plc (the 'Bank') is a wholly-owned subsidiary of The Royal Bank of Scotland Group plc (the 'holding company'), which is incorporated in Great Britain and has its registered office at 36 St Andrew Square, Edinburgh EH2 2YB. The 'Group' comprises the Bank and its subsidiary and associated undertakings. Details of the principal subsidiary undertakings and their activities are shown in Note 15 on the accounts. A full list of related undertakings of the company is shown in Note 42 on the accounts. 'RBS Group' comprises the holding company and its subsidiary and associated undertakings.

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

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

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

At 31 December 2016, HMT's holding in the holding company's ordinary shares was 71.3%.

Business structure

RBS International

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

RBS Group ring-fencing

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

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

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

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

NatWest Holdings Limited (NatWest Holdings)

The RBS Group introduced an intermediate holding company, NatWest Holdings, as a direct subsidiary of RBS plc. This is an interim structure as NatWest Holdings is expected to become a direct subsidiary of RBS Group in mid 2018.

National Westminster Bank Plc (NatWest) and Adam & Company Group PLC (Adam & Co) transferred from being direct subsidiaries of RBS plc, and Ulster Bank (Ireland) Holdings Unlimited Company (UBIH) transferred from being a direct subsidiary of Ulster Bank Limited, to become direct subsidiaries of NatWest Holdings.

RBS International

RBSI Holdings transferred from being an indirect subsidiary of RBS plc to become a direct subsidiary of RBS Group. The intention is for RBS International's operating companies to remain as subsidiaries of RBSI Holdings.

NatWest bought Lombard North Central PLC and RBS Invoice Finance (Holdings) Limited from RBS plc and some smaller companies from other members of the Group.

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

In 2007, RFS Holdings B.V., which was jointly owned by the RBS Group, the Dutch State (successor to Fortis) and Santander completed the acquisition of ABN AMRO Holding N.V.

Following the announcements in April 2011 by the Boards of RBS Group, RBS plc, RBS Holdings and RBS N.V., a substantial part of the business activities of RBS N.V. had been successfully transferred to RBS plc by 2014. There is continued focus on further de-risking the RBS N.V. balance sheet. Ultimately, the objective is that RBS N.V. is in a position to relinquish its banking licence in the Netherlands.

Results and dividends

The loss attributable to the ordinary shareholders of the Group for the year ended 31 December 2016 was £4,790 million compared with a loss of £1,950 million for the year ended 31 December 2015, as set out in the consolidated income statement on page 115.

The Bank did not pay a dividend on ordinary shares in 2016 or 2015.

Report of the directors

Strategic report

Activities

The Group is engaged principally in providing a wide range of banking and other financial services. Further details of the organisational structure and business overview of the Group, including the products and services provided by each of its operating segments and the competitive markets in which they operate, are contained in the Financial review on pages 3 to 4.

Risk factors

The Group's future performance and results could be materially different from expected results depending on the outcome of certain potential risks and uncertainties. Full details of these and other risk factors are set out on pages 239 to 278.

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 121 to 131.

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

Financial performance

A review of the Group's performance during the year ended 31 December 2016 and the Group's financial position as at that date is contained in the Financial review on pages 6 to 13.

Employees

Our colleagues

As at 31 December 2016, the Group employed 77,700 people (full-time equivalent basis, including temporary workers) throughout the world. Details of related costs are included in Note 3 on the accounts

Building a healthy culture

Building a healthy culture that embodies Our Values is one of our core priorities.

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

To really live our values we continue to reinforce them in our systems, our policies and processes, our communications, training and leadership role modelling.

We monitor our progress against our goals. We gather feedback from our colleagues, and through metrics and key performance indicators to assess our progress and respond accordingly. We do this in tandem with feedback from regulators and industry bodies.

Engaging our colleagues

We know that building an engaged, healthy and inclusive workforce is crucial to achieving our ambition. Every year we ask our colleagues to share their thoughts on what it's like to work here via our annual colleague survey (OurView).

The results help us monitor levels of engagement and enable our people leaders to work with their teams to make improvements. It also helps us measure the progress we are making towards our goals.

Our most recent survey, in which almost 63,000 colleagues took part, showed that we are changing the culture of the RBS Group for the better. We remain above the global financial services norm for wellbeing, our inclusion scores continue to improve and there is a strong sense that managers act consistently with Our Values. However, the choices we've had to make as we move the RBS Group forward have taken a toll on our colleagues. The scaling down of the RBS Group and the impact of dealing with some difficult legacy issues have contributed to a decline in the improvements in engagement, pride and leadership that we saw in 2015.

Rewarding our colleagues

Our approach to performance management provides clarity for our colleagues about how their contribution links to our ambition. It recognises behaviour that supports our values and holds individuals to account for behaviour and performance that does not. In 2016 we refreshed our behavioural framework to create one framework for all our colleagues.

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

At the start of 2016 we removed sales incentives and we gave every eligible frontline colleague in Personal & Business Banking an increase to their guaranteed pay. This approach remains popular with our colleagues and ensures that our customers can be certain that if they take a product from us, it has no financial impact on what our colleagues are paid.

For 2017, we have simplified how we pay our clerical colleagues, consolidating bonuses, making pay fairer and easier to understand.

We remain focused on our goals in relation to gender equality and have played an active role in the consultation process for upcoming Gender Pay Gap Reporting regulations. We intend to comply fully with the regulations and to make a public disclosure during 2017.

Developing our colleagues

In 2015, we launched 'Determined to Lead', a core management system for the RBS Group. It is the means by which leaders put our values into practice every day and is transforming the way we operate by creating a common language, consistent operating rhythm and improving the competence of our leaders across the RBS Group. It provides consistent tools to lead and engage our colleagues. This programme has continued in 2016 with over 21,000 leaders participating in the programme.

In October 2016 we launched Service Excellence training, our new customer service programme. The first module introduces our Core Service Behaviours and provides an awareness of the tools and techniques that will help us to deliver the best possible service, every time. Service Excellence gives us a shared service language and the behaviours to help us achieve our ambition. Since October over 34,000 colleagues have completed this module.

Report of the directors

Professionalising our colleagues is important to us. We work closely with the Chartered Banker Institute (CBI) and Chartered Banker Professional Standards Board (CB:PSB) to offer our colleagues professional qualifications. Over 8,000 of our colleagues completed their CBI qualification in 2016.

We are especially pleased that we achieved an Excel rating in the CB:PSB Foundation Standard review for 2015. We are one of only two CB:PSB member firms to have secured 'Earned Autonomy' - meaning we are exempt from quarterly monitoring over the next 3 years. 95% of our in-scope population have achieved the Foundation Standard. This is a great reflection of the focus we continue to place on professionalising our colleagues.

We also offer a wide range of learning which can be mandatory, role specific or related to personal development. Our mandatory learning has to be completed by everyone and is focused on keeping our customers, colleagues and the RBS Group safe.

Youth employment

In 2016 RBS Group welcomed over 500 people across our Graduate and Apprenticeship schemes, 40% being female hires.

Health and wellbeing of our colleagues

Wellbeing is a big part of how we create a great place to work.

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

In 2016, we focused on physical, mental health and social wellbeing. We participated in the Global Corporate Challenge (GCC) - more than 50,000 colleagues, across the RBS Group, took part helping us to win the GCC World Most Active Organisation Gold Award. We also continued to promote Lifeworks (RBS Group's Employee Assistance Programme) and launched our Mindfulness toolkit. We continued our support of Time to Change (the UK's biggest programme to challenge mental health stigma).

Employee consultation

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

Inclusion

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

During 2016, we continued to roll out unconscious bias learning to all our colleagues to create a solid platform for the wider inclusion agenda. Almost 30,000 colleagues participated in unconscious bias training in 2016 meaning we have trained around 66,000 colleagues across the RBS Group to date.

We continue to work towards our goal of having at least 30% senior women in our top three leadership layers across each Franchise and Function by 2020 and to be fully gender balanced (50/50) by 2030.

We have a positive action approach in place, tailored by business, according to the specific challenges they face.

Our disability plan will support us becoming a disability smart organisation by 2018. It addresses areas for improvement including branch access, accessible services, improving colleague adjustment processes and inserting disability checkpoints into our key processes and practices.

We continue to focus on building an ethnically diverse RBS Group. Our plan focuses on positive action and includes reciprocal mentoring, targeted development workshops and leadership programmes and ensuring we have a Black, Asian and Minority Ethnic (BAME) focus on recruitment, talent identification and promotion.

Our LGBT agenda continues to deliver a better experience for our LGBT colleagues and customers. We have processes in place to support updating gender and title on customers' banking records and to support colleagues undergoing gender transition. And, we continue to support our 16,000 strong employee-led networks.

We have been recognised for our work on Equality, Diversity and Inclusion by our Platinum ranking from Opportunity Now (gender), our Gold ranking for Race for Opportunity (race); retaining a position in the Times Top 50 Employers for Women; becoming a Top Ten Global Employer in Stonewall's Global Equality Index (LGBT), Silver Status from The Business Disability Forum and being rated a Top 10 Employer by Working Families.

Sustainability

Our purpose is to serve customers well. We will rebuild our reputation and earn our customers' trust by putting customers first, making the RBS Group a great place to work, supporting our communities and being mindful of environmental impacts. The Sustainable Banking Committee's role is to support the Board in overseeing, supporting and challenging actions being taken by management to run the RBS Group as a sustainable business.

For more information on our approach and progress read the RBS Group Strategic Report. More information is available on [rbs.com/sustainability](https://www.rbs.com/sustainability).

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 239 to 278. The Group's regulatory capital resources and significant developments in 2016 and anticipated future developments are detailed on pages 26 to 30. The liquidity and funding section on pages 31 to 37 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.

Report of the directors

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 2016.

The RBS Group has assessed the effectiveness of its internal control over financial reporting as of 31 December 2016 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in the 2013 publication of 'Internal Control - Integrated Framework'.

Based on its assessment, management has concluded that, as of 31 December 2016, 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 2016 Annual Report on Form 20-F.

Board of directors

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

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

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

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

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

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

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

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

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

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

Share capital

Details of the ordinary and preference share capital at 31 December 2016 are shown in Note 25 on the accounts.

Directors

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

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

Mike Rogers was appointed to the Board on 26 January 2016 and Frank Dangeard was appointed on 16 May 2016.

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

Report of the directors

Directors' interests

The interests of the directors in the shares of the holding company at 31 December 2016 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 2016 to 23 February 2017.

Directors' indemnities

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

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

Post balance sheet events

Other than the matter disclosed in Note 41 on the accounts, there have been no significant events between the year end and the date of approval of these accounts which would require a change to or disclosure in the accounts.

Political donations

During 2016, 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

Ernst & Young LLP (EY) are the auditors. EY were appointed to fill the casual vacancy arising from Deloitte LLP's resignation following the signing of the RBS Group's 2015 Annual Report on Form 20-F and appointed by shareholders at the 2016 Annual General Meeting. A resolution to reappoint EY as the company's auditors will be proposed at the forthcoming Annual General Meeting.

By order of the Board

Aileen Taylor
Company Secretary
23 February 2017

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

Statement of directors' responsibilities

This statement should be read in conjunction with the responsibilities of the auditor set out in their report on page 114.

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

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

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

The directors confirm that to the best of their knowledge:

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

By order of the Board

Howard Davies
Chairman

Ross McEwan
Chief Executive

Ewen Stevenson
Chief Financial Officer

23 February 2017

Board of directors

Chairman

Howard Davies

Executive directors

Ross McEwan

Ewen Stevenson

Non-executive directors

Sandy Crombie

Frank Dangeard

Alison Davis

Morten Friis

Robert Gillespie

Penny Hughes

Brendan Nelson

Baroness Noakes

Mike Rogers

Financial statements

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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 2016 which comprise the accounting policies, the balance sheets as at 31 December 2016, 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 2016, the related Notes 1 to 41 and the information identified as 'audited' in the Capital and risk management section of the Financial review. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the Bank's 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 ⁽¹⁾

As explained more fully in the statement of directors' responsibilities the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Bank's affairs as at 31 December 2016 and of the Group's loss for the year then ended;
- the Group's financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation; and
- the Bank's financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006.

Separate opinion in relation to IFRSs as issued by the IASB

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

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

Opinion on other matter prescribed by the Companies Act 2006

In our opinion based on the work undertaken in the course of the audit, the information given in the Strategic Report and the Report of the directors for the financial year for which the financial statements are prepared is consistent with the financial statements. The Strategic Report and the Report of the directors have been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have identified no material misstatements in the Strategic Report or Directors' Report.

Matters on which we are required to report by exception

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

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

Jonathan Bourne (Senior statutory auditor)
for and on behalf of Ernst & Young LLP
Statutory Auditor
London, United Kingdom
23 February 2017

Note:

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

Consolidated income statement for the year ended 31 December 2016

	Note	2016 £m	2015 £m	2014 £m
Interest receivable		10,994	11,563	12,612
Interest payable		(2,706)	(3,281)	(3,868)
Net interest income	1	8,288	8,282	8,744
Fees and commissions receivable		3,244	3,629	4,268
Fees and commissions payable		(800)	(804)	(839)
Income from trading activities		863	912	1,150
(Loss)/gain on redemption of own debt		(90)	(263)	6
Other operating income		618	183	1,075
Non-interest income	2	3,835	3,657	5,660
Total income		12,123	11,939	14,404
Staff costs		(4,989)	(5,586)	(5,597)
Premises and equipment		(1,361)	(1,802)	(2,044)
Other administrative expenses		(8,049)	(6,127)	(4,324)
Depreciation and amortisation		(768)	(1,165)	(917)
Write down of goodwill and other intangible assets		(159)	(1,331)	(523)
Operating expenses	3	(15,326)	(16,011)	(13,405)
(Loss)/profit before impairment releases/(losses)		(3,203)	(4,072)	999
Impairment (losses)/releases	11	(529)	838	1,329
Operating (loss)/profit before tax		(3,732)	(3,234)	2,328
Tax (charge)/credit	6	(1,148)	52	(2,007)
(Loss)/profit from continuing operations		(4,880)	(3,182)	321
Profit/(loss) from discontinued operations, net of tax	19	117	1,596	(3,437)
Loss for the year		(4,763)	(1,586)	(3,116)
Attributable to:				
Non-controlling interests		4	320	57
Preference shareholders		23	44	61
Ordinary shareholders		(4,790)	(1,950)	(3,234)
		(4,763)	(1,586)	(3,116)

The accompanying notes on pages 137 to 236, the accounting policies on pages 121 to 136 and the audited sections of the Financial review: Capital and risk management on pages 14 to 106 form an integral part of these financial statements.

Consolidated statement of comprehensive income for the year ended 31 December 2016

	Note	2016 £m	2015 £m	2014 £m
Loss for the year		(4,763)	(1,586)	(3,116)
Items that do not qualify for reclassification				
Loss on remeasurement of retirement benefit schemes	4	(1,041)	(73)	(1,849)
Tax		288	306	314
		(753)	233	(1,535)
Items that do qualify for reclassification				
Available-for-sale financial assets		(98)	13	132
Cash flow hedges		577	(740)	1,412
Currency translation		764	(1,123)	434
Tax		(87)	136	(401)
		1,156	(1,714)	1,577
Other comprehensive income/(loss) after tax		403	(1,481)	42
Total comprehensive loss for the year		(4,360)	(3,067)	(3,074)
Attributable to:				
Non-controlling interests		7	315	194
Preference shareholders		23	44	61
Ordinary shareholders		(4,390)	(3,426)	(3,329)
		(4,360)	(3,067)	(3,074)

Note:

(1) A profit of £117 million (2015 - profit £1,278 million; 2014 - loss £3,489 million) from discontinued operations was attributable to ordinary and equity preference shareholders.

The accompanying notes on pages 137 to 236, the accounting policies on pages 121 to 136 and the audited sections of the Financial review: Capital and risk management on pages 14 to 106 form an integral part of these financial statements.

Balance sheet as at 31 December 2016

		Group		Bank	
	Note	2016 £m	2015 £m	2016 £m	2015 £m
Assets					
Cash and balances at central banks	8	73,813	78,999	70,615	76,904
Amounts due from subsidiaries	8	1,037	1,557	18,152	24,091
Other loans and advances to banks	8	29,458	28,285	20,866	21,259
Loans and advances to banks	8	30,495	29,842	39,018	45,350
Amounts due from holding company and subsidiaries	8	1,116	1,258	27,122	28,283
Other loans and advances to customers	8	343,839	333,699	133,069	133,369
Loans and advances to customers	8	344,955	334,957	160,191	161,652
Debt securities subject to repurchase agreements	27	18,107	20,224	15,206	16,484
Other debt securities		53,545	59,803	52,463	60,118
Debt securities	13	71,652	80,027	67,669	76,602
Equity shares	14	445	1,069	298	931
Investments in Group undertakings	15	—	—	35,169	34,482
Settlement balances		5,557	4,108	4,707	3,053
Amounts due from holding company and subsidiaries	12	1,306	1,275	6,144	4,726
Other derivatives	12	246,438	261,808	245,332	260,875
Derivatives	12	247,744	263,083	251,476	265,601
Intangible assets	16	6,165	6,526	521	544
Property, plant and equipment	17	4,536	4,453	1,523	1,612
Deferred tax	23	1,798	2,622	272	902
Prepayments, accrued income and other assets	18	2,288	3,019	1,563	1,549
Assets of disposal groups	19	8,366	3,486	591	—
Total assets		797,814	812,191	633,613	669,182
Liabilities					
Amounts due to subsidiaries	8	2,117	3,999	107,177	116,343
Other deposits by banks	8	38,436	38,095	32,111	30,877
Deposits by banks	8	40,553	42,094	139,288	147,220
Amounts due to holding company and subsidiaries	8	18,528	5,021	31,664	16,867
Other customers accounts	8	357,537	369,053	110,554	121,907
Customer accounts	8	376,065	374,074	142,218	138,774
Debt securities in issue	8	20,362	25,804	18,881	23,361
Settlement balances		3,641	3,383	2,774	2,363
Short positions	20	22,076	20,808	17,590	17,593
Amounts due to holding company and subsidiaries	12	1,228	1,283	5,036	3,528
Other derivatives	12	236,349	254,265	235,862	253,844
Derivatives	12	237,577	255,548	240,898	257,372
Provisions for liabilities and charges	21	11,840	7,220	4,884	1,847
Accruals and other liabilities	22	6,129	6,850	3,269	3,829
Retirement benefit liabilities	4	321	3,764	65	112
Deferred tax	23	525	729	—	—
Amounts due to holding company	8	11,212	18,502	11,212	18,485
Other subordinated liabilities	8	8,303	8,528	6,658	7,049
Subordinated liabilities	24	19,515	27,030	17,870	25,534
Liabilities of disposal groups	19	23,391	2,980	—	—
Total liabilities		761,995	770,284	587,737	618,005
Non-controlling interests		62	54	—	—
Owners' equity	25	35,757	41,853	45,876	51,177
Total equity		35,819	41,907	45,876	51,177
Total liabilities and equity		797,814	812,191	633,613	669,182

The accompanying notes on pages 137 to 236, the accounting policies on pages 121 to 136 and the audited sections of the Financial review: Capital and risk management on pages 14 to 106 form an integral part of these financial statements.

The accounts were approved by the Board of directors on 23 February 2017 and signed on its behalf by:

Howard Davies
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 2016

	Group			Bank		
	2016 £m	2015 £m	2014 £m	2016 £m	2015 £m	2014 £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	26,807	26,807	26,290	26,807	26,807	26,290
Redemption of preference shares classified as debt	—	—	517	—	—	517
At 31 December	26,807	26,807	26,807	26,807	26,807	26,807
Merger reserve						
At 1 January	10,865	10,834	10,800	(16)	(47)	(81)
Unwind of merger reserve	16	31	34	16	31	34
At 31 December	10,881	10,865	10,834	—	(16)	(47)
Available-for-sale reserve						
At 1 January	366	400	359	297	252	302
Unrealised gains	261	88	504	267	121	261
Realised gains	(359)	(70)	(409)	(328)	(44)	(323)
Tax	23	(18)	(45)	13	(32)	12
Recycled to profit or loss on ceding control of Citizens (1)	—	9	—	—	—	—
Transfer to retained earnings	—	(43)	(9)	—	—	—
At 31 December	291	366	400	249	297	252
Cash flow hedging reserve						
At 1 January	423	1,026	(86)	286	755	350
Amount recognised in equity	1,626	668	2,869	643	398	1,625
Amount transferred from equity to earnings	(1,049)	(1,350)	(1,457)	(683)	(944)	(1,119)
Tax	(158)	106	(334)	15	77	(101)
Recycled to profit or loss on ceding control of Citizens (2)	—	(36)	—	—	—	—
Transfer to retained earnings	—	9	34	—	—	—
At 31 December	842	423	1,026	261	286	755
Foreign exchange reserve						
At 1 January	8	1,762	1,842	(192)	(246)	(357)
Retranslation of net assets	1,082	(79)	403	(41)	30	110
Foreign currency (losses)/gains on hedges of net assets	(276)	(74)	(82)	(49)	24	1
Tax	48	11	(9)	—	—	—
Recycled to profit or loss on disposal of businesses	(45)	4	—	—	—	—
Recycled to profit or loss on ceding of control Citizens (3)	—	(974)	—	—	—	—
Transfer to retained earnings	—	(642)	(392)	—	—	—
At 31 December	817	8	1,762	(282)	(192)	(246)

For notes to these tables refer to the following page

Statement of changes in equity for the year ended 31 December 2016

	Group			Bank		
	2016 £m	2015 £m	2014 £m	2016 £m	2015 £m	2014 £m
Retained earnings						
At 1 January	(3,225)	(2,135)	2,888	17,386	18,423	21,209
(Loss)/profit attributable to ordinary and equity preference shareholders						
- continuing operations	(4,884)	(3,184)	316	(3,451)	(1,031)	(2,058)
- discontinued operations	117	1,278	(3,489)	—	—	—
Equity preference dividends paid	(23)	(44)	(61)	(23)	(44)	(61)
Transfer from available-for-sale reserve	—	43	9	—	—	—
Transfer from cash flow hedging reserve	—	(9)	(34)	—	—	—
Transfer from foreign exchange reserve	—	642	392	—	—	—
Costs of placing Citizens equity	—	(29)	(45)	—	—	—
(Loss)/gain on remeasurement of retirement benefit schemes						
- gross	(1,041)	(67)	(1,849)	63	84	(107)
- tax	288	306	314	(21)	(20)	16
Redemption of preference shares classified as debt (4)	(1,744)	—	(517)	(1,744)	—	(517)
Shares issued under employee share schemes	(10)	(58)	(91)	(10)	(58)	(91)
Share-based payments						
- gross	32	36	29	32	36	29
- tax	—	(4)	3	—	(4)	3
At 31 December	(10,490)	(3,225)	(2,135)	12,232	17,386	18,423
Owners' equity at 31 December	35,757	41,853	45,303	45,876	51,177	52,553
Non-controlling interests						
At 1 January	54	2,385	79	—	—	—
Currency translation adjustments and other movements	3	28	113	—	—	—
Profit attributable to non-controlling interests						
- continuing operations	4	2	5	—	—	—
- discontinued operations	—	318	52	—	—	—
Dividends paid	—	(31)	(4)	—	—	—
Movements in available-for-sale securities						
- unrealised gains	—	25	37	—	—	—
- tax	—	(5)	(13)	—	—	—
Movements in cash flow hedging reserve						
- amount recognised in equity	—	32	18	—	—	—
- recycled to profit or loss on disposal of discontinued operations	—	—	(18)	—	—	—
- tax	—	(4)	—	—	—	—
Actuarial losses recognised in retirement benefit schemes	—	(6)	—	—	—	—
Equity raised (5)	—	2,491	2,117	—	—	—
Equity withdrawn and disposals	1	(24)	(1)	—	—	—
Loss of control of Citizens	—	(5,157)	—	—	—	—
At 31 December	62	54	2,385	—	—	—
Total equity at 31 December	35,819	41,907	47,688	45,876	51,177	52,553
Total equity is attributable to:						
Non-controlling interests	62	54	2,385	—	—	—
Preference shareholders	—	1,421	1,421	—	1,421	1,421
Ordinary shareholders	35,757	40,432	43,882	45,876	49,756	51,132
	35,819	41,907	47,688	45,876	51,177	52,553

Notes:

(1) 2015 Net of tax - £6 million charge.

(2) 2015 Net of tax - £16 million credit.

(3) No tax impact.

(4) Issued by RBS plc to the holding company which were redeemed in April 2016.

(5) Includes £2,491 million relating to the secondary offering of Citizens in March 2015 (2014 - £2,117 million relating to the IPO of Citizens).

The accompanying notes on pages 137 to 236, the accounting policies on pages 121 to 136 and the audited sections of the Financial review: Capital and risk management on pages 14 to 106 form an integral part of these financial statements.

Cash flow statement for the year ended 31 December 2016

		Group			Bank		
		2016	2015	2014	2016	2015	2014
	Note	£m	£m	£m	£m	£m	£m
Cash flows from operating activities							
Operating (loss)/profit before tax from continuing operations		(3,732)	(3,234)	2,328	(2,936)	(1,451)	(959)
Profit/(loss) before tax from discontinued operations		143	1,831	(3,183)	—	—	—
Adjustments for non-cash items and other adjustments included within income statement		(3,864)	(6,972)	(283)	(3,428)	6,171	3,477
Cash contribution to defined benefit pension schemes		(4,783)	(1,059)	(1,063)	(200)	(32)	(28)
Changes in operating assets and liabilities		19,191	10,787	(11,917)	9,327	992	(30,276)
Income taxes received/(paid)		14	(231)	(302)	335	(192)	135
Net cash flows from operating activities	31	6,969	1,122	(14,420)	3,098	5,488	(27,651)
Cash flows from investing activities							
Sale and maturity of securities		7,564	6,345	17,631	7,648	17,877	22,926
Purchase of securities		(11,505)	(12,882)	(19,945)	(10,259)	(11,451)	(12,022)
Sale of property, plant and equipment		421	1,541	1,161	48	305	164
Purchase of property, plant and equipment		(902)	(761)	(810)	(508)	(338)	(273)
Net (investment in)/divestment of business interests and intangible assets	32	(976)	53	(2,947)	(1,424)	(3,937)	(2,358)
Net cash flows from investing activities		(5,398)	(5,704)	(4,910)	(4,495)	2,456	8,437
Cash flows from financing activities							
Issue of subordinated liabilities		—	—	1,438	—	—	833
Proceeds of non-controlling interests issued		—	2,491	2,117	—	—	—
Redemption of equity preference shares		(1,744)	—	—	(1,744)	—	—
Non-controlling interests equity withdrawn and disposals		1	—	(1)	—	—	—
Redemption of subordinated liabilities		(10,556)	(2,279)	(4,181)	(10,535)	(1,894)	(4,121)
Dividends paid		(23)	(75)	(65)	(23)	(44)	(61)
Interest on subordinated liabilities		(1,210)	(1,313)	(1,308)	(1,157)	(1,338)	(1,236)
Net cash flows from financing activities		(13,532)	(1,176)	(2,000)	(13,459)	(3,276)	(4,585)
Effects of exchange rate changes on cash and cash equivalents		7,913	525	682	7,316	575	541
Net (decrease)/increase in cash and cash equivalents		(4,048)	(5,233)	(20,648)	(7,540)	5,243	(23,258)
Cash and cash equivalents at 1 January		102,075	107,308	127,956	106,613	101,370	124,628
Cash and cash equivalents at 31 December	35	98,027	102,075	107,308	99,073	106,613	101,370

The accompanying notes on pages 137 to 236, the accounting policies on pages 121 to 136 and the audited sections of the Financial review: Capital and risk management on pages 14 to 106 form an integral part of these financial statements.

1. Presentation of accounts

The accounts are prepared on a going concern basis (see the Report of the directors, page 107) 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.

RBSI Holdings was classified as a disposal group at 31 December 2016 and Citizens was classified as a disposal group at 31 December 2015. They are measured at fair value less costs to sell.

The Group adopted a number of revisions to IFRSs effective 1 January 2016:

'Accounting for Acquisitions of Interests in Joint Operations' issued in May 2014 amends IFRS 11 'Joint Arrangements'. An acquirer of an interest in a joint operation that is a business applies the relevant principles for business combinations in IFRS 3 and other standards and makes the relevant disclosures accordingly.

'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.

Annual Improvements to IFRS 2012 - 2014 cycle was issued in September 2014 making a number of minor amendments to IFRS.

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 December 2014 to clarify the application of the investment entity consolidation exception.

An amendment to IAS 1 'Presentation of Financial Statements' was issued in December 2014 to clarify the application of materiality to financial statements.

The implementation of these requirements has not had a material effect on the Group's accounts.

2. Basis of consolidation

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

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

3. Revenue recognition

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

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

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

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

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

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

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

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

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

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

4. Assets held for sale and discontinued operations

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

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

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

5. Employee benefits

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

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

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

The charge to profit or loss for pension costs (recorded in operating expenses) comprises:

- the current service cost
- interest, computed at the rate used to discount scheme liabilities, on the net defined benefit liability or asset
- past service cost resulting from a scheme amendment or curtailment
- gains or losses on settlement.

A curtailment occurs when the Group significantly reduces the number of employees covered by a plan. A plan amendment occurs when the Group introduces, or withdraws, a defined benefit plan or changes the benefits payable under an existing defined benefit plan. Past service cost may be either positive (when benefits are introduced or changed so that the present value of the defined benefit obligation increases) or negative (when benefits are withdrawn or changed so that the present value of the defined benefit obligation decreases). A settlement is a transaction that eliminates all further obligation for part or all of the benefits.

Actuarial gains and losses (i.e. gains or and losses on re-measuring the net defined benefit asset or liability) are recognised in other comprehensive income in full in the period in which they arise.

6. Intangible assets and goodwill

Intangible assets acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to profit or loss over the assets' estimated economic lives using methods that best reflect the pattern of economic benefits and is included in Depreciation and amortisation. These estimated useful economic lives are:

Computer software	3 to 12 years
Other acquired intangibles	5 to 10 years

Expenditure on internally generated goodwill and brands is written-off as incurred. Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have been established. These costs include payroll, the costs of materials and services, and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred as are all training costs and general overheads. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

Intangible assets include goodwill arising on the acquisition of subsidiaries and joint ventures. Goodwill on the acquisition of a subsidiary is the excess of the fair value of the consideration transferred, the fair value of any existing interest in the subsidiary and the amount of any non-controlling interest measured either at fair value or at its share of the subsidiary's net assets over the Group's interest in the net fair value of the subsidiary's identifiable assets, liabilities and contingent liabilities. Goodwill arises on the acquisition of a joint venture when the cost of investment exceeds the Group's share of the net fair value of the joint venture's identifiable assets and liabilities. Goodwill is measured at initial cost less any subsequent impairment losses. Goodwill arising on the acquisition of associates is included within their carrying amounts. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

7. Property, plant and equipment

Items of property, plant and equipment (except investment property - see Accounting policy 9) are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, these are accounted for separately.

Depreciation is charged to profit or loss on a straight-line basis so as to write-off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases) over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Freehold land is not depreciated.

The estimated useful lives of the Group's property, plant and equipment are:

Freehold buildings	50 years
Long leasehold property (leases with more than 50 years to run)	50 years
Short leaseholds	unexpired period of the lease
Property adaptation costs	10 to 15 years
Computer equipment	up to 5 years
Other equipment	4 to 15 years

The residual value and useful life of property, plant and equipment are reviewed at each balance sheet date and updated for any changes to previous estimates.

8. Impairment of intangible assets and property, plant and equipment

At each balance sheet date, the Group assesses whether there is any indication that its intangible assets, or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss if any. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

If an asset does not generate cash flows that are independent from those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. For the purposes of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units or groups of cash-generating units expected to benefit from the combination. The recoverable amount of an asset or cash-generating unit is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash-generating unit that have not been taken into account in estimating future cash flows. If the recoverable amount of an intangible or tangible asset is less than its carrying value, an impairment loss is recognised immediately in profit or loss and the carrying value of the asset reduced by the amount of the loss.

A reversal of an impairment loss on intangible assets (excluding goodwill) or property, plant and equipment is recognised as it arises provided the increased carrying value is not greater than it would have been had no impairment loss been recognised. Impairment losses on goodwill are not reversed.

9. Investment property

Investment property comprises freehold and leasehold properties that are held to earn rentals or for capital appreciation or both. Investment property is not depreciated but is stated at fair value. Fair value is based on current prices for similar properties in the same location and condition. Any gain or loss arising from a change in fair value is recognised in profit or loss. Rental income from investment property is recognised on a straight-line basis over the term of the lease in Other operating income. Lease incentives granted are recognised as an integral part of the total rental income.

10. Foreign currencies

The Group's consolidated financial statements are presented in sterling which is the functional currency of the company.

Group entities record transactions in foreign currencies in their functional currency, the currency of the primary economic environment in which they operate, at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the foreign exchange rates ruling at the balance sheet date. Foreign exchange differences arising on the settlement of foreign currency transactions and from the translation of monetary assets and liabilities are reported in income from trading activities except for differences arising on cash flow hedges and hedges of net investments in foreign operations (see Accounting policy 23).

Non-monetary items denominated in foreign currencies that are stated at fair value are translated into the relevant functional currency at the foreign exchange rates ruling at the dates the values are determined. Translation differences arising on non-monetary items measured at fair value are recognised in profit or loss except for differences arising on available-for-sale non-monetary financial assets, for example equity shares, which are recognised in other comprehensive income unless the asset is the hedged item in a fair value hedge.

Assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into sterling at foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of a foreign operation are recognised in other comprehensive income. The amount accumulated in equity is reclassified from equity to profit or loss on disposal of a foreign operation.

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 the settlement date; all other regular way transactions in financial assets are recognised on the trade date.

Held-to-maturity investments - a financial asset may be classified as a held-to-maturity investment only if it has fixed or determinable payments, a fixed maturity and the Group has the positive intention and ability to hold to maturity. Held-to-maturity investments are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see Accounting policy 3) less any impairment losses.

Held-for-trading - a financial asset is classified as held-for-trading if it is acquired principally for sale in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial assets are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Income from trading activities includes gains and losses on held-for-trading financial assets as they arise.

Designated as at fair value through profit or loss - financial assets may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both, that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

Financial assets that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Gains and losses are recognised in profit or loss as they arise.

Loans and receivables - non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables, except those that are classified as available-for-sale or as held-for-trading, or designated as at fair value through profit or loss. Loans and receivables are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see Accounting policy 3) less any impairment losses.

Available-for-sale financial assets - financial assets that are not classified as held-to-maturity; held-for-trading; designated as at fair value through profit or loss; or loans and receivables are classified as available-for-sale. Financial assets can be designated as available-for-sale on initial recognition. Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs.

They are subsequently measured at fair value. Unquoted equity investments whose fair value cannot be measured reliably are carried at cost and classified as available-for-sale financial assets. Impairment losses and exchange differences resulting from retranslating the amortised cost of foreign currency monetary available-for-sale financial assets are recognised in profit or loss together with interest calculated using the effective interest method (see Accounting policy 3) as are gains and losses attributable to the hedged risk on available-for-sale financial assets that are hedged items in fair value hedges (see Accounting policy 23). Other changes in the fair value of available-for-sale financial assets and any related tax are reported in other comprehensive income until disposal, when the cumulative gain or loss is reclassified from equity to profit or loss.

Reclassifications - held-for-trading and available-for-sale financial assets that meet the definition of loans and receivables (non-derivative financial assets with fixed or determinable payments that are not quoted in an active market) may be reclassified to loans and receivables if the Group has the intention and ability to hold the financial asset for the foreseeable future or until maturity. The Group typically regards the foreseeable future for this purpose as twelve months from the date of reclassification. Additionally, held-for-trading financial assets that do not meet the definition of loans and receivables may, in rare circumstances, be transferred to available-for-sale financial assets or to held-to-maturity investments. Reclassifications are made at fair value. This fair value becomes the asset's new cost or amortised cost as appropriate. Gains and losses recognised up to the date of reclassification are not reversed.

Fair value - the Group's approach to determining the fair value of financial instruments measured at fair value is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments. Further details are given in Note 9 on the accounts.

15. Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as held-to-maturity, as available-for-sale or as loans and receivables is impaired. A financial asset or group of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

Financial assets carried at amortised cost - if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables or as held-to-maturity investments has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition. For collateralised loans and receivables, estimated future cash flows include cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

Where, in the course of the orderly realisation of a loan, it is exchanged for equity shares or property, the exchange is accounted for as the sale of the loan and the acquisition of equity securities or investment property. Where the Group's interest in equity shares following the exchange is such that the Group controls an entity, that entity is consolidated.

Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant. In making collective impairment assessments, financial assets are grouped into portfolios on the basis of similar risk characteristics. Future cash flows from these portfolios are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics.

Historical loss experience is adjusted, on the basis of observable data, to reflect current conditions not affecting the period of historical experience. Impairment losses are recognised in profit or loss and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses. If, in a subsequent period, the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

Impaired loans and receivables are written off, i.e. the impairment provision is applied in writing down the loan's carrying value partially or in full, when the Group concludes that there is no longer any realistic prospect of recovery of part or all of the loan. For loans that are individually assessed for impairment, the timing of write off is determined on a case-by-case basis. Such loans are reviewed regularly and write off will be prompted by bankruptcy, insolvency, renegotiation and similar events.

The typical time frames from initial impairment to write off for the Group's collectively-assessed portfolios are:

- Retail mortgages: write off usually occurs within five years, or when an account is closed if earlier.
- Credit cards: the irrecoverable amount is written off after 12 months; three years later any remaining amounts outstanding are written off.
- Overdrafts and other unsecured loans: write off occurs within six years.
- Business and commercial loans: write offs of commercial loans are determined in the light of individual circumstances; the period does not exceed five years. Business loans are generally written off within five years.

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

Financial assets carried at fair value - when a decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in other comprehensive income and there is objective evidence that it is impaired, the cumulative loss is reclassified from equity to profit or loss. The loss is measured as the difference between the amortised cost (including any hedge accounting adjustments) of the financial asset and its current fair value. Impairment losses on available-for-sale equity instruments are not reversed through profit or loss, but those on available-for-sale debt instruments are reversed, if there is an increase in fair value that is objectively related to a subsequent event.

16. Financial liabilities

Financial liabilities are recognised initially at fair value and classified into held-for-trading; designated as at fair value through profit or loss; or amortised cost. Issues of financial liabilities measured at amortised cost are recognised on settlement date; all other regular way transactions in financial liabilities are recognised on trade date.

Held-for-trading - a financial liability is classified as held-for-trading if it is incurred principally for repurchase in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial liabilities are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Gains and losses are recognised in profit or loss as they arise.

Designated as at fair value through profit or loss - financial liabilities may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

Financial liabilities that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Income from trading activities includes gains and losses on held-for-trading financial liabilities as they arise.

Financial liabilities designated as at fair value through profit or loss principally comprise structured liabilities issued by the Group: designation significantly reduces the measurement inconsistency between these liabilities and the related derivatives carried at fair value.

Amortised cost - all other financial liabilities are measured at amortised cost using the effective interest method (see Accounting policy 3).

Fair value - the Group's approach to determining the fair value of financial instruments measured at fair value is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 9 on the accounts.

17. Financial guarantee contracts

Under a financial guarantee contract, the Group, in return for a fee, undertakes to meet a customer's obligations under the terms of a debt instrument if the customer fails to do so. A financial guarantee is recognised as a liability; initially at fair value and, if not designated as at fair value through profit or loss, subsequently at the higher of its initial value less cumulative amortisation and any provision under the contract measured in accordance with Accounting policy 12. Amortisation is calculated so as to recognise fees receivable in profit or loss over the period of the guarantee.

18. Loan commitments

Provision is made for loan commitments, other than those classified as held-for-trading, if it is probable that the facility will be drawn and the resulting loan will be recognised at an amount less than the cash advanced. Syndicated loan commitments in excess of the level of lending under the commitment approved for retention by the Group are classified as held-for-trading and measured at fair value.

19. Derecognition

A financial asset is derecognised when the contractual right to receive cash flows from the asset has expired or when it has been transferred and the transfer qualifies for derecognition. A transfer requires that the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Group assesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. The asset remains on the balance sheet if substantially all the risks and rewards have been retained. It is derecognised if substantially all the risks and rewards have been transferred. If substantially all the risks and rewards have been neither retained nor transferred, the Group assesses whether or not it has retained control of the asset. If the Group has retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement; if the Group has not retained control of the asset, it is derecognised.

A financial liability is removed from the balance sheet when the obligation is discharged, or is cancelled, or expires. On the redemption or settlement of debt securities (including subordinated liabilities) issued by the Group, the Group derecognises the debt instrument and records a gain or loss being the difference between the debt's carrying amount and the cost of redemption or settlement. The same treatment applies where the debt is exchanged for a new debt issue that has terms substantially different from those of the existing debt. The assessment of whether the terms of the new debt instrument are substantially different takes into account qualitative and quantitative characteristics including a comparison of the present value of the cash flows under the new terms with the present value of the remaining cash flows of the original debt issue discounted at the effective interest rate of the original debt issue.

20. Sale and repurchase transactions

Securities subject to a sale and repurchase agreement under which substantially all the risks and rewards of ownership are retained by the Group continue to be shown on the balance sheet and the sale proceeds recorded as a financial liability. Securities acquired in a reverse sale and repurchase transaction under which the Group is not exposed to substantially all the risks and rewards of ownership are not recognised on the balance sheet and the consideration paid is recorded as a financial asset.

Securities borrowing and lending transactions are usually secured by cash or securities advanced by the borrower. Borrowed securities are not recognised on the balance sheet or lent securities derecognised.

Cash collateral given or received is treated as a loan or deposit; collateral in the form of securities is not recognised. However, where securities borrowed are transferred to third parties, a liability for the obligation to return the securities to the stock lending counterparty is recorded.

21. Netting

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when, and only when, the Group currently has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. The Group is party to a number of arrangements, including master netting agreements, that give it the right to offset financial assets and financial liabilities, but where it does not intend to settle the amounts net or simultaneously, the assets and liabilities concerned are presented gross.

22. Capital instruments

The Group classifies a financial instrument that it issues as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms and as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities. The components of a compound financial instrument issued by the Group are classified and accounted for separately as financial assets, financial liabilities or equity as appropriate.

Incremental costs and related tax that are directly attributable to an equity transaction are deducted from equity.

The consideration for any ordinary shares of the company purchased by the Group (treasury shares) is deducted from equity. On the cancellation of treasury shares their nominal value is removed from equity and any excess of consideration over nominal value is treated in accordance with the capital maintenance provisions of the Companies Act. On the sale or reissue of treasury shares the consideration received and related tax are credited to equity, net of any directly attributable incremental costs.

23. Derivatives and hedging

Derivative financial instruments are initially recognised, and subsequently measured, at fair value. The Group's approach to determining the fair value of financial instruments is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 9 on the accounts.

A derivative embedded in a contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract; unless the entire contract is measured at fair value with changes in fair value recognised in profit or loss.

Gains and losses arising from changes in the fair value of derivatives that are not the hedging instrument in a qualifying hedge are recognised as they arise in profit or loss. Gains and losses are recorded in Income from trading activities except for gains and losses on those derivatives that are managed together with financial instruments designated at fair value; these gains and losses are included in Other operating income. The Group enters into three types of hedge relationship: hedges of changes in the fair value of a recognised asset or liability or unrecognised firm commitment (fair value hedges); hedges of the variability in cash flows from a recognised asset or liability or a highly probable forecast transaction (cash flow hedges); and hedges of the net investment in a foreign operation.

Hedge relationships are formally designated and documented at inception. The documentation identifies the hedged item and the hedging instrument and details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in fair values or cash flows attributable to the hedged risk, consistent with the documented risk management strategy, hedge accounting is discontinued. Hedge accounting is also discontinued if the Group revokes the designation of a hedge relationship.

Fair value hedge - in a fair value hedge, the gain or loss on the hedging instrument is recognised in profit or loss. The gain or loss on the hedged item attributable to the hedged risk is recognised in profit or loss and, where the hedged item is measured at amortised cost, adjusts the carrying amount of the hedged item. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; or if the hedging instrument expires or is sold, terminated or exercised; or if hedge designation is revoked. If the hedged item is one for which the effective interest rate method is used, any cumulative adjustment is amortised to profit or loss over the life of the hedged item using a recalculated effective interest rate.

Cash flow hedge - in a cash flow hedge, the effective portion of the gain or loss on the hedging instrument is recognised in other comprehensive income and the ineffective portion in profit or loss. When the forecast transaction results in the recognition of a financial asset or financial liability, the cumulative gain or loss is reclassified from equity to profit or loss in the same periods in which the hedged forecast cash flows affect profit or loss.

Otherwise the cumulative gain or loss is removed from equity and recognised in profit or loss at the same time as the hedged transaction. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; if the hedging instrument expires or is sold, terminated or exercised; if the forecast transaction is no longer expected to occur; or if hedge designation is revoked. On the discontinuance of hedge accounting (except where a forecast transaction is no longer expected to occur), the cumulative unrealised gain or loss is reclassified from equity to profit or loss when the hedged cash flows occur or, if the forecast transaction results in the recognition of a financial asset or financial liability, when the hedged forecast cash flows affect profit or loss. Where a forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss is reclassified from equity to profit or loss immediately.

Hedge of net investment in a foreign operation - in the hedge of a net investment in a foreign operation, the portion of foreign exchange differences arising on the hedging instrument determined to be an effective hedge is recognised in other comprehensive income. Any ineffective portion is recognised in profit or loss. Non-derivative financial liabilities as well as derivatives may be the hedging instrument in a net investment hedge. On disposal or partial disposal of a foreign operation, the amount accumulated in equity is reclassified from equity to profit or loss.

24. Share-based compensation

The Group operates a number of share-based compensation schemes under which it awards RBSG shares and share options to its employees. Such awards are generally subject to vesting conditions: conditions that vary the amount of cash or shares to which an employee is entitled. Vesting conditions include service conditions (requiring the employee to complete a specified period of service) and performance conditions (requiring the employee to complete a specified period of service and specified performance targets to be met). Other conditions to which an award is subject are non-vesting conditions (such as a requirement to save throughout the vesting period).

The cost of employee services received in exchange for an award of shares or share options granted is measured by reference to the fair value of the shares or share options on the date the award is granted and takes into account non-vesting conditions and market performance conditions (conditions related to the market price of RBSG shares): an award is treated as vesting irrespective of whether any market performance condition or non-vesting condition is met. The fair value of options granted is estimated using valuation techniques which incorporate exercise price, term, risk-free interest rates, the current share price and its expected volatility. The cost is expensed on a straight-line basis over the vesting period (the period during which all the specified vesting conditions must be satisfied) with a corresponding increase in equity in an equity-settled award, or a corresponding liability in a cash-settled award. The cost is adjusted for vesting conditions (other than market performance conditions) so as to reflect the number of shares or share options that actually vest.

If an award is modified, the original cost continues to be recognised as if there had been no modification. Where modification increases the fair value of the award, this increase is recognised as an expense over the modified vesting period. A new award of shares or share options is treated as the modification of a cancelled award if, on the date the new award is granted, the Group identifies them as replacing the cancelled award. The cancellation of an award through failure to meet non-vesting conditions triggers an immediate expense for any unrecognised element of the cost of an award.

25. Cash and cash equivalents

In the cash flow statement, cash and cash equivalents comprises cash and deposits with banks with an original maturity of less than three months together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

26. Shares in Group entities

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

Critical accounting policies and key sources of estimation uncertainty

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law and IFRS require the directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's 'Conceptual Framework for Financial Reporting'. The judgements and assumptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results.

(i) Goodwill

The Group capitalises goodwill arising on the acquisition of businesses, as discussed in Accounting policy 6. The carrying value of goodwill as at 31 December 2016 was £5,249 million (2015 - £5,549 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 inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of cash-generating units; and the valuation of their separable assets. The sensitivity of the assessment to changes in assumptions is discussed in Note 16 on the accounts.

(ii) Provisions for liabilities

As set out in Note 21 on the accounts, at 31 December 2016 the Group recognised provisions for liabilities in respect of Payment Protection Insurance, £1,252 million (2015 - £996 million), other customer redress, £1,041 million (2015 - £759 million), residential mortgage backed securities, £6,752 million (2015 - £3,772 million) and litigation and other regulatory proceedings, £1,057 million (2015 - £498 million). Provisions are liabilities of uncertain timing or amount, and are recognised when there is a present obligation as a result of a past event, the outflow of economic benefit is probable and the outflow can be estimated reliably. Judgement is involved in determining whether an obligation exists, and in estimating the probability, timing and amount of any outflows. Where the Group can look to another party such as an insurer to pay some or all of the expenditure required to settle a provision, any reimbursement is recognised when, and only when, it is virtually certain that it will be received.

Payment Protection Insurance - the Group has established a provision for redress payable in respect of the mis-selling of Payment Protection Insurance policies. The provision is management's best estimate of the anticipated costs of redress and related administration expenses. The determination of appropriate assumptions to underpin the provision requires significant judgement by management. The principal assumptions underlying the provision together with sensitivities to changes in those assumptions are given in Note 21 on the accounts.

Provisions for litigation - the Group and members of the Group are party to legal proceedings in the United Kingdom, the United States and other jurisdictions, arising out of their normal business operations. The measurement and recognition of liabilities in respect of litigation involves a high degree of management judgement. Before the existence of a present obligation as the result of a past event can be confirmed, numerous facts may need to be established, involving extensive and time-consuming discovery, and novel or unsettled legal questions addressed. Once it is determined there is an obligation, assessing the probability of economic outflows and estimating the amount of any liability can be very difficult. In many proceedings, it is not possible to determine whether any loss is probable or to estimate the amount of any loss. Furthermore, for an individual matter, there can be a wide range of possible outcomes and often it is not practicable to quantify a range of such outcomes. The Group's outstanding litigation is periodically assessed in consultation with external professional advisers, where appropriate, to determine the likelihood of the Group incurring a liability. A detailed description of the Group's material legal proceedings and a discussion of the nature of the associated uncertainties are given in Note 29 on the accounts.

Tax contingencies - determining the Group's income tax charge and its provisions for income taxes necessarily involves a significant degree of estimation and judgement. The tax treatment of some transactions is uncertain and tax computations are yet to be agreed with the tax authorities in a number of jurisdictions. The Group recognises anticipated tax liabilities based on all available evidence and, where appropriate, in the light of external advice. Any difference between the final outcome and the amounts provided will affect current and deferred income tax assets and liabilities in the period when the matter is resolved.

(iii) Deferred tax

The Group makes provision for deferred tax on temporary differences where tax recognition occurs at a different time from accounting recognition. Deferred tax assets of £1,798 million were recognised as at 31 December 2016 (2015 - £2,622 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 2016 and concluded that it is recoverable based on future projections.

Deferred tax assets of £5,728 million (2015 - £4,364 million) have not been recognised in respect of tax losses and other temporary differences where the availability of future taxable profits is uncertain. Further details about the Group's deferred tax assets are given in Note 22 on the accounts.

(iv) Loan impairment provisions

The Group's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans classified as loans and receivables and carried at amortised cost in accordance with Accounting policy 15.

A loan is impaired when there is objective evidence that events since the loan was granted have affected expected cash flows from the loan. Such objective evidence, indicative that a borrower's financial condition has deteriorated, can include for loans that are individually assessed: the non-payment of interest or principal; debt renegotiation; probable bankruptcy or liquidation; significant reduction in the value of any security; breach of limits or covenants; and deteriorating trading performance and, for collectively assessed portfolios: the borrowers' payment status and observable data about relevant macroeconomic measures.

The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate.

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

Individual component - all impaired loans that exceed specific thresholds are individually assessed for impairment. Individually assessed loans principally comprise the Group's portfolio of commercial loans to medium and large businesses. Impairment losses are recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held. These estimates take into account the customer's debt capacity and financial flexibility; the level and quality of its earnings; the amount and sources of cash flows; the industry in which the counterparty operates; and the realisable value of any security held. Estimating the quantum and timing of future recoveries involves significant judgement. The size of receipts will depend on the future performance of the borrower and the value of security, both of which will be affected by future economic conditions; additionally, collateral may not be readily marketable. The actual amount of future cash flows and the date they are received may differ from these estimates and consequently actual losses incurred may differ from those recognised in these financial statements.

Collective component - this is made up of two elements: loan impairment provisions for impaired loans that are below individual assessment thresholds (collectively assessed provisions) and for loan losses that have been incurred but have not been separately identified at the balance sheet date (latent loss provisions). Collectively assessed provisions are established on a portfolio basis using a present value methodology taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates and the related average life. These portfolios include mortgages, credit card receivables and other personal lending. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends. Latent loss provisions are held against estimated impairment losses in the performing portfolio that have yet to be identified as at the balance sheet date. To assess the latent loss within its portfolios, the Group has developed methodologies to estimate the time that an asset can remain impaired within a performing portfolio before it is identified and reported as such.

(v) Fair value - financial instruments

In accordance with Accounting policies 14, 16 and 23, financial instruments classified as held-for-trading or designated as at fair value through profit or loss and financial assets classified as available-for-sale are recognised in the financial statements at fair value. All derivatives are measured at fair value.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. It also uses the assumptions that market participants would use when pricing the asset or liability. In determining fair value the Group maximises the use of relevant observable inputs and minimises the use of unobservable inputs.

Where the Group manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, it measures the fair value of a group of financial assets and financial liabilities on the basis of the price that it would receive to sell a net long position (i.e. an asset) for a particular risk exposure or to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction at the measurement date under current market conditions.

Credit valuation adjustments are made when valuing derivative financial assets to incorporate counterparty credit risk. Adjustments are also made when valuing financial liabilities measured at fair value to reflect the Group's own credit standing.

Where the market for a financial instrument is not active, fair value is established using a valuation technique. These valuation techniques involve a degree of estimation, the extent of which depends on the instrument's complexity and the availability of market-based data. Further details about the Group's valuation methodologies and the sensitivity to reasonably possible alternative assumptions of the fair value of financial instruments valued using techniques where at least one significant input is unobservable are given in Note 9 on the accounts.

Accounting developments

International Financial Reporting Standards

A number of IFRSs and amendments to IFRS were in issue at 31 December 2016 that would affect RBS Group from 1 January 2017 or later.

Effective for 2017

In January 2016, the IASB amended IAS 7 'Cash Flow Statements' to require disclosure of the movements in financing liabilities. The amendment is effective from 1 January 2017.

In January 2016, the IASB amended IAS 12 'Income taxes' to clarify the recognition of deferred tax assets in respect of unrealised losses. The amendment is effective from 1 January 2017.

Neither of these amendments is expected to have a material effect on the Group's financial statements.

Effective after 2017 - IFRS 9

In July 2014, the IASB published IFRS 9 'Financial Instruments' with an effective date of 1 January 2018. IFRS 9 replaces the current financial instruments standard IAS 39, setting out new accounting requirements in a number of areas. The Group is continuing its assessment of the standard's effect on its financial statements.

The principle features of IFRS 9 are as follows:

Recognition and derecognition

The sections in IAS 39 setting out the criteria for the recognition and derecognition of financial instruments have been included unamended in IFRS 9.

Classification and measurement

Financial assets - There are three classifications for financial assets in IFRS 9.

- **Amortised cost** - Financial assets with terms that give rise to interest and principal cash flows only and which are held in a business model whose objective is to hold financial assets to collect their cash flow are measured at amortised cost.
- **Fair value through other comprehensive income** - Financial assets with terms that give rise to interest and principal cash flows only and which are held in a business model whose objective is achieved by holding financial assets to collect their cash flow and selling them are measured at fair value through other comprehensive income.
- **Fair value through profit and loss** - Other financial assets are measured at fair value through profit and loss.

At initial recognition, any financial asset may be irrevocably designated as measured at fair value through profit or loss if such designation eliminates a measurement or recognition inconsistency.

The Group continues to evaluate the overall effect, but expects that the measurement basis of the majority of the Group's financial assets will be unchanged on application of IFRS 9.

Financial liabilities - IFRS 9's requirements on the classification and measurement of financial liabilities are largely unchanged from those in IAS 39. However, there is a change to the treatment of changes in the fair value attributable to own credit risk of financial liabilities designated as at fair value through profit or loss which are recognised in other comprehensive income and not in profit or loss as required by IAS 39.

Hedge accounting

IFRS 9's hedge accounting requirements are designed to align the accounting more closely to the risk management framework; permit a greater variety of hedging instruments; and remove or simplify some of the rule-based requirements in IAS 39. The elements of hedge accounting: fair value, cash flow and net investment hedges are retained. There is an option in IFRS 9 for an accounting policy choice to continue with the IAS 39 hedge accounting framework; the Group currently anticipates applying this option.

Credit impairment

IFRS 9's credit impairment requirements apply to financial assets measured at amortised cost, to those measured at fair value through other comprehensive income, to lease receivables and to certain loan commitments and financial guarantee contracts. On initial recognition a loss allowance is established at an amount equal to 12-month expected credit losses (ECL) that is the portion of life-time expected losses resulting from default events that are possible within the next 12 months. Where a significant increase in credit risk since initial recognition is identified, the loss allowance increases so as to recognise all expected default events over the expected life of the asset. The Group expects that financial assets where there is objective evidence of impairment under IAS 39 will be credit impaired under IFRS 9, and carry loss allowances based on all expected default events.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted: determined by evaluating at the balance sheet date for each customer or loan portfolio a range of possible outcomes using reasonable and supportable information about past events, current conditions, forecasts of future events and economic conditions. The estimation of ECL also takes into account the discount of future cash flows. Recognition and measurement of credit impairments under IFRS 9 are more forward-looking than under IAS 39.

An RBS Group-wide programme has been established to implement the necessary changes in the modelling of credit loss parameters, and the underlying credit management and financial processes; this programme is led jointly by Risk and Finance. The inclusion of loss allowances on all financial assets will tend to result in an increase in overall credit impairment provisions when compared with the current basis of measurement under IAS 39.

Transition

The classification and measurement and impairment requirements will be applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. Hedge accounting will be applied prospectively from that date.

Accounting policies

The table below sets out the key descriptions used for credit impairment under IFRS 9 and their equivalent usage under IAS 39 and existing regulatory reporting.

Attribute	IFRS 9	IAS 39	Regulatory
Default / credit impairment	To determine the risk of a default occurring, management intends to apply a default definition that is consistent with the Basel/Regulatory definition of default. Assets that are defaulted will be shown as credit impaired. RBS intends to use 90 days past due as a consistent measure for default across all product classes. Also, where RBS considers that the customers unlikely to pay in credit obligations.	Default aligned to loss events, by classing all financial assets for which an impairment event has taken place as nonperforming. Nonperforming assets are defined as those that have a 100% probability of default and an internal asset quality grade of AQ10. (see page 52 for definition). Impaired financial assets are those for which there is objective evidence that the amount or timing of future cash flows have been adversely impacted since initial recognition.	A default shall be considered to have occurred with regard to a particular financial asset when either or both of the following have taken place: - RBS considers that the customer is unlikely to pay its credit obligations without recourse by the institution to actions such as realising security; - the customer is past due more than 90 days. For retail exposures, the definition of default may be applied at the level of an individual credit facility rather than in relation to the total obligations of a borrower.
Probability of default (PD)	PD is the likelihood of default assessed on the prevailing economic conditions at the reporting date (point in time), adjusted to take into account estimates of future economic conditions that are likely to impact the risk of default; it will not equate to a long run average.	Regulatory PDs adjusted to point in time metrics are used in the latent provision calculation.	The likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon for wholesale. PD models reflect losses that would arise through-the-cycle; this represents a long run average view of default levels. For Retail, PD models, the prevailing economic conditions at the reporting date (point in time) are used.

Attribute	IFRS 9	IAS 39	Regulatory
Significant increase in credit risk	A framework is being established that incorporates both quantitative and qualitative measures and is aligned to RBS's current risk management framework. Decisions in relation to credit deterioration will be management decisions, subject to approval by governing bodies such as RBS Provisions Committee. The staging assessment requires a definition of when a significant increase in credit risk has occurred; this moves the loss calculation for financial assets from a 12 month horizon to a lifetime horizon. Management propose to establish an approach that is primarily informed by the increase in lifetime probability of default, with additional qualitative measures to account for assets where PD does not move, but a high risk factor is determined, these include the Risk of Credit Loss framework and binary triggers (examples includes the use of payday lending, forbearance and 30 days past due). In most cases, management expect an asset that has demonstrated a doubling of its lifetime probability of default would be considered to have a significant increase in credit risk. IFRS 9 includes an option that permits assets that are 'low risk' to be excluded from this assessment; RBS does not intend to apply this option.	Not applicable	Not applicable
Forward-looking and multiple scenarios	The evaluation of future cash flows, the risk of default and impairment loss should take into account expectations of economic changes that are reasonable. More than one outcome should be considered to ensure that the resulting estimation of impairment is not biased towards a particular expectation of economic growth. Management have developed the default modelling capability for IFRS 9 to simulate multiple economic forecasts as part of the model outcomes for PD, LGD and exposure.	Financial asset carrying values based upon the expectation of future cash flows.	Follows financial accounting.
Loss given default (LGD)	LGD is a current assessment of the amount that will be recovered in the event of default, taking account of future conditions. It may occasionally equate to the regulatory view.	Regulatory LGD values are generally used for calculating collective and latent provisions.	An estimate of the amount that will not be recovered in the event of default, plus the cost of debt collection activities and the delay in cash recovery. LGD is a downturn based metric, representing a prudent view of recovery in adverse economic conditions.

Accounting policies

Attribute	IFRS 9	IAS 39	Regulatory
Exposure at default (EAD)	Expected balance sheet exposure at default. It differs from the regulatory method as follows: - it includes the effect of amortisation; - it caps exposure at the contractual limit.	Based on the current drawn balance plus future committed drawdowns	Models are used to 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. EAD cannot be lower than the reported balance sheet, but can be reduced by a legally enforceable netting agreement.
Date of initial recognition (DOIR)	The reference date used to assess a significant increase in credit risk is as follows. <i>Term lending</i> : the date the facility became available to the customer. <i>Wholesale revolving products</i> : the date of the last substantive credit review (typically annual) or, if later, the date facility became available to the customer. <i>Retail Cards</i> : the account opening date or, if later, the date the card was subject to a regular 3-year review or the date of any subsequent limit increases. <i>Current Accounts/ Overdrafts</i> : the account opening date or, if later, the date of initial granting of overdraft facility or of limit increases.	Not applicable for impairment but defined as the date when the entity becomes a party to the contractual provisions of the instrument.	Generally follows financial accounting.
Modification	A modification occurs when the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in derecognition. A modification requires immediate recognition in the income statement of any impact on the carrying value and EIR. Examples of modification events include forbearance and distressed restructuring. The financial impact is recognised in the income statement as an impairment release/(loss).	Modification is not separately defined but accounting impact arises as an EIR adjustment on changes that are not derecognition or impairment events.	Not applicable

Accounting policies

The Following table summarises the treatment of asset classification under IAS 39 and IFRS 9.

Assets	IFRS 9			IAS 39		
	AC ⁽¹⁾	FVTPL ⁽²⁾	FVOCI ⁽³⁾	AC ⁽¹⁾	FVTPL ⁽²⁾	FVOCI ⁽³⁾
Cash and balances at central banks						
Non held-for-trading	•			•		
Loans and advances to banks						
Held for trading		•			•	
Non held for trading	•			•		
Loans and advances to customers						
Held-for-trading		•			•	
Non held-for-trading	•	•	•	•	•	
Debt securities						
Held-for-trading		•			•	
Non held-for-trading: Held-to-maturity	•			•		
Available-for-sale		•	•			•
Other	•	•		•	•	
Equity shares						
Held-for-trading		•			•	
Non held-for-trading		•	•		•	•
Settlement balances						
Non held-for-trading	•			•		
Derivatives						
Held-for-trading		•			•	

Notes:

- (1) Amortised cost
- (2) Fair value through profit and loss
- (3) Fair value other comprehensive income

Effective after 2017 - other standards

IFRS 15 'Revenue from Contracts with Customers' was issued in May 2014. It will replace IAS 11 'Construction Contracts', IAS 18 'Revenue' and several Interpretations. Contracts are bundled or unbundled into distinct performance obligations with revenue recognised as the obligations are met. It is effective from 1 January 2018.

IFRS 2 'Share-based payment' was amended in June 2016 to clarify the accounting for net settlement of tax in respect of share-based payments and the calculation of the cost of modified awards and those with vesting conditions that are not market conditions. The effective date is 1 January 2018.

IFRIC Interpretation 22 'Foreign Currency Transaction and Advance Consideration' was issued in December 2016 clarifying the date of a foreign exchange transaction to be used on initial recognition of a related asset or other item. The effective date is 1 January 2018.

IAS 40 'Investment Property' was amended in December 2016 to clarify that transfers into or out of the investment property classification may only occur on a change of use or the property ceasing to meet the definition of an investment property. The effective date is 1 January 2018

IFRS 16 'Leases' was issued in January 2016 to replace IAS 17 'Leases'. There are no substantial changes to the accounting for leases by lessors. For lessees: accounting for finance leases will remain substantially the same; operating leases will be brought on balance sheet through the recognition of assets representing the contractual rights of use and liabilities will be recognised for the contractual payments. The effective date is 1 January 2019.

The Group is assessing the effect of adopting these standards on its financial statements.

Notes on the accounts

1 Net interest income

	2016 £m	2015 £m	2014 £m
Loans and advances to customers	10,505	10,969	11,952
Loans and advances to banks	246	373	356
Debt securities	243	221	304
Interest receivable (1)	10,994	11,563	12,612
Customer accounts: demand deposits	470	580	555
Customer accounts: savings deposits	428	438	720
Customer accounts: other time deposits	160	262	341
Balances with banks	100	65	85
Debt securities in issue	323	569	788
Subordinated liabilities	1,228	1,261	1,292
Internal funding of trading businesses	(3)	106	87
Interest payable (1)	2,706	3,281	3,868
Net interest income	8,288	8,282	8,744

2 Non-interest income

	2016 £m	2015 £m	2014 £m
Fees and commissions receivable			
Payment services	832	895	960
Credit and debit card fees	644	738	821
Lending (credit facilities)	1,032	1,066	1,232
Brokerage	153	260	317
Investment management	197	250	335
Trade finance	190	231	264
Other	196	189	339
	3,244	3,629	4,268
Fees and commissions payable	(800)	(804)	(839)
Income from trading activities			
Foreign exchange	1,023	730	1,291
Interest rate	(376)	8	(225)
Credit	98	(78)	3
Changes in fair value of own debt and derivative liabilities attributable to own credit			
- debt securities in issue	87	247	44
- derivative liabilities	59	2	(77)
Equities and other	(28)	3	114
	863	912	1,150
(Loss)/gain on redemption of own debt	(90)	(263)	6
Other operating income			
Operating lease and other rental income	286	276	379
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	40	83	(86)
- subordinated liabilities	(10)	(3)	(9)
Other changes in the fair value of financial assets and liabilities designated as at fair value through profit or loss and related derivatives	(30)	246	54
Changes in the fair value of investment properties	(15)	13	(25)
Profit on sale of securities	120	40	387
Profit on sale of property, plant and equipment	15	84	135
Profit/(loss) on sale of subsidiaries and associates	259	(158)	(30)
Loss on disposal or settlement of loans and receivables	(182)	(551)	(236)
Share of profits of associated entities	7	27	30
Other income (3)	128	126	476
	618	183	1,075

Notes:

(1) Negative interest on loans and advance is classed as interest payable.

(2) Measured as the change in fair value from movements in the year in the credit risk premium payable by the Group.

(3) Includes income from activities other than banking.

Notes on the accounts

3 Operating expenses

	2016 £m	2015 £m	2014 £m
Wages, salaries and other staff costs	4,228	4,698	4,650
Social security costs	382	338	372
Share-based compensation	32	36	43
Pension costs			
- defined benefit schemes (see Note 4)	253	510	451
- gains/(loss) on curtailments or settlements (see Note 4)	2	(65)	—
- defined contribution schemes	92	69	81
Staff costs	4,989	5,586	5,597
Premises and equipment	1,361	1,802	2,044
Other administrative expenses (1)	8,049	6,127	4,324
Property, plant and equipment depreciation and write down (see Note 17)	565	936	655
Intangible assets amortisation (see Note 16)	203	229	262
Depreciation and amortisation	768	1,165	917
Write down of goodwill and other intangible assets (see Note 16)	159	1,331	523
	15,326	16,011	13,405

Restructuring and divestment costs

Included in operating expenses are the following restructuring and divestment costs.

	Staff £m	Premises and depreciation £m	Other (2) £m	Total £m
Restructuring				
2016	466	145	1,132	1,743
2015	598	733	944	2,275
2014	259	269	268	796
Divestment				
2016	152	11	193	356
2015	214	9	405	628
2014	120	3	233	356

Notes:

(1) Includes litigation and conduct costs and UK bank levy. Further details are provided in Note 21.

(2) Includes other administrative expenses, write down of goodwill and other intangible assets.

Notes on the accounts

3 Operating expenses continued

The average number of persons employed, rounded to the nearest hundred, in continuing operations during the year, excluding temporary staff, was 80,300 (2015 - 85,800; 2014 - 89,200); on the same basis there were 1,600 people employed in discontinued operations (2015 - 11,700; 2014 - 19,800). The number of persons employed by the Group at 31 December, excluding temporary staff, was as follows:

	2016	2015	2014
UK Personal & Business Banking	20,300	24,600	24,500
Ulster Bank Rol	3,000	2,500	2,500
Personal & Business Banking	23,300	27,100	27,000
Commercial Banking	5,600	5,700	6,000
Private Banking	1,700	1,900	2,200
Commercial & Private Banking	7,300	7,600	8,200
NatWest Markets	1,100	1,200	1,700
Capital Resolution	300	1,000	1,900
Williams & Glyn	4,800	5,300	4,700
Central & Other	38,400	43,200	42,900
Total	75,200	85,400	86,400
UK	55,900	62,600	62,000
USA	700	1,100	2,000
Europe	5,000	6,000	7,300
Rest of the World	13,600	15,700	15,100
Total	75,200	85,400	86,400

The number of people employed in discontinued operations at 31 December was 1,600 (2015 - 1,600; 2014 - 18,900).

Share-based payments

As described in the Remuneration report in the RBS Group Annual Report and Accounts 2016, 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	2017 to 2021
Deferred performance awards	All	Awards of ordinary shares	Continuing employment or leavers in certain circumstances	2017 to 2019
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	2017 to 2021

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 Employee Share Plan.

The fair value of options granted in 2016 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 five 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 (three trading days for Sharesave) preceding grant date.

Notes on the accounts

3 Operating expenses continued

Sharesave

	2016		2015		2014	
	Average exercise price £	Shares under option (million)	Average exercise price £	Shares under option (million)	Average exercise price £	Shares under option (million)
At 1 January	2.87	56	2.85	51	2.90	62
Granted	1.68	17	2.91	12	3.43	12
Exercised	2.37	—	2.38	(2)	2.34	(6)
Cancelled	3.02	(17)	2.98	(5)	3.61	(17)
At 31 December	2.46	56	2.87	56	2.85	51

Options are exercisable within six months of vesting; 8.1 million options were exercisable at 31 December 2016 (2015 - 1.0 million; 2014 - 1.9 million). The weighted average share price at the date of exercise of options was £1.78 (2015 - £3.54; 2014 - £3.65). At 31 December 2016, exercise prices ranged from £1.68 to £4.34 (2015 - £2.33 and £18.93; 2014 - £2.33 to £39.27) and the remaining average contractual life was 2.9 years (2015 - 2.9 years; 2014 - 3.7 years). The fair value of options granted in 2016 was £18 million (2015 - £12 million; 2014 - £18 million).

Deferred performance awards

	2016		2015		2014	
	Value at grant £m	Shares awarded (million)	Value at grant £m	Shares awarded (million)	Value at grant £m	Shares awarded (million)
At 1 January	276	80	272	85	180	55
Granted	170	75	186	50	311	95
Forfeited	(19)	(7)	(34)	(11)	(28)	(7)
Vested	(131)	(46)	(148)	(44)	(170)	(51)
Disposals	—	—	—	—	(21)	(7)
At 31 December	296	102	276	80	272	85

The awards granted in 2016 vest in three equal tranches on the first, second and third anniversary of the award.

Long-term incentives

	2016			2015			2014		
	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	153	44	5	214	69	7	320	94	13
Granted	37	16	—	39	11	—	72	22	—
Vested/exercised	(39)	(12)	—	(51)	(18)	(2)	(61)	(14)	(5)
Lapsed	(32)	(10)	(1)	(49)	(18)	—	(85)	(22)	(1)
Disposal	—	—	—	—	—	—	(32)	(11)	—
At 31 December	119	38	4	153	44	5	214	69	7

The market value of awards vested/exercised in 2016 was £40 million (2015 - £55 million; 2014 - £44 million). There are vested options over 4 million shares exercisable up to 2019 (2015 - 5 million; 2014 - 7 million).

4 Pensions

The Group sponsors a number of pension schemes in the UK and overseas, including the Main Section of The Royal Bank of Scotland Group Pension Fund (the "Main scheme") which 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 (the Trustee), a wholly owned subsidiary of National Westminster Bank Plc. The Trustee is the legal owner of the Main scheme assets which are held separately from the assets of the Group. The Board of the Trustee 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.

Various changes have been made to the Group's defined benefit pension schemes to manage pension costs and risks. The Group announced in October 2016 that, following an extensive consultation process that, it would be increasing employee contributions in its UK defined benefit pension schemes by 2% of salary.

The Group's defined benefit schemes generally provide a pension of one-sixtieth of final pensionable salary for each year of service prior to retirement up to a maximum of 40 years. Employees making additional contributions can secure additional benefits.

Since October 2006, new UK entrants may join The Royal Bank of Scotland Retirement Savings Plan, a defined contribution pension scheme.

The Group also provides post-retirement benefits other than pensions, principally through subscriptions to private healthcare schemes in the UK and unfunded post-retirement benefit plans. Provision for the costs of these benefits is charged to the income statement over the average remaining future service lives of eligible employees. The amounts are not material.

Interim valuations of the Group's schemes under IAS 19 'Employee Benefits' were prepared at 31 December with the support of independent actuaries, using the following assumptions:

	Main scheme	
	2016	2015
	%	%
Principal IAS 19 actuarial assumptions		
Discount rate	2.7	3.9
Expected return on plan assets	2.7	3.9
Rate of increase in salaries	1.8	1.8
Rate of increase in pensions in payment	3.0	2.8
Rate of increase in deferred pensions	3.2	3.0
Inflation assumption (RPI)	3.2	3.0

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 94% of the Group's defined benefit obligations) is constructed by reference to yields on 'AA' corporate bonds from which a single discount rate is derived based on a cash flow profile similar in structure and duration to the pension obligations. The weighted average duration of the Main scheme's defined benefit obligation at 31 December 2016 is 20.9 years (2015 – 19.1 years). Significant judgement is required when setting the criteria for bonds to be included in the population from which the yield curve is derived.

The criteria include issue size, quality of pricing and the exclusion of outliers. Judgement is also required in determining the shape of the yield curve at long durations: a constant credit spread relative to gilts is assumed.

	Main scheme	
	2016 %	2015 %
Major classes of plan assets as a percentage of total plan assets		
Quoted assets		
Quoted equities		
- Consumer industry	4.6	5.3
- Manufacturing industry	1.8	3.2
- Energy and utilities	2.7	2.6
- Financial institutions	8.3	5.4
- Technology and telecommunications	2.3	3.4
- Other	0.8	0.9
Private equity	3.4	3.4
Index-linked bonds	31.4	28.2
Government fixed interest bonds	5.9	9.0
Corporate fixed interest bonds	17.9	18.0
Unquoted assets		
Corporate and other bonds	1.8	3.3
Hedge funds	0.2	0.2
Real estate	5.2	6.4
Derivatives	10.2	6.4
Cash and other assets	3.4	4.1
Equity exposure of equity futures	(1.8)	(1.4)
Cash exposure of equity futures	1.9	1.6
	100.0	100.0

The assets of the Main scheme, which represent 90% of plan assets at 31 December 2016 (2015 - 88%), are invested in a diversified portfolio of quoted and private equity, government and corporate fixed-interest and index-linked bonds, and other assets including real estate and hedge funds.

The Main scheme employs derivative instruments to achieve a desired asset class exposure or to match assets more closely to liabilities. The value of assets shown reflects the assets owned by the scheme, with any derivative holdings valued on a mark-to-market basis.

Notes on the accounts

4 Pensions continued

The Main scheme's holdings of derivative instruments are summarised in the table below:

	2016			2015		
	Notional amounts £m	Fair value		Notional amounts £m	Fair value	
		Assets £m	Liabilities £m		Assets £m	Liabilities £m
Inflation rate swaps	11,649	299	549	9,576	76	647
Interest rate swaps	41,463	9,440	5,442	32,622	5,722	3,710
Currency forwards	15,314	191	136	10,247	25	247
Equity and bond call options	2,157	799	1	6,277	744	1
Equity and bond put options	1,860	—	2	6,109	2	12
Other	3,711	1,719	1,816	2,311	1,506	1,479

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.

Swaps are used to manage interest rate and inflation risk of the liabilities, as well as being used to manage other risks within the Main scheme. They have been executed at prevailing market rates and within standard market bid/offer spreads with a number of counterparty banks, including The Royal Bank of Scotland plc.

At 31 December 2016, the gross notional value of the swaps was £55,874 million (2015 - £44,387 million) and had a net positive fair value of £3,629 million (2015 - £1,444 million). Collateral is required on all swap transactions. The counterparty banks had delivered a net amount of £3,991 million of collateral at 31 December 2016 (2015 - £2,153 million).

The schemes can have exposure to the Group within their investment programmes. At 31 December 2016 the Main scheme's exposure to the Group was £2,087 million (2015: £1,146 million) which includes indirect exposure to ordinary shares of the Group through index tracking investments, swaps contracts (before allowing for collateral posted against the mark value of the swaps) and cash deposits held with National Westminster Bank Plc.

IAS 19 post-retirement mortality assumptions (Main scheme)

	2016	2015
Longevity at age 60 for current pensioners (years)		
Males	27.4	27.8
Females	29.1	29.8
Longevity at age 60 for future pensioners currently aged 40 (years)		
Males	29.0	29.1
Females	31.2	31.4

Notes on the accounts

4 Pensions continued

	Fair value of plan assets £m	Present value of defined benefit obligations £m	Asset ceiling/ minimum funding (1) £m	Net pension deficit £m
Changes in value of net pension liability				
At 1 January 2015	34,341	36,596	1,854	4,109
Currency translation and other adjustments	(31)	(63)	—	(32)
Income statement				
Net interest expense	1,206	1,295	64	153
Current service cost		328		328
Past service cost		40		40
Gains on settlements		(65)		(65)
	1,206	1,598	64	456
Statement of comprehensive income				
Return on plan assets above recognised interest income	(457)	—		457
Experience gains and losses		(258)		(258)
Effect of changes in actuarial financial assumptions		(1,386)		(1,386)
Effect of changes in actuarial demographic assumptions		48		48
Asset ceiling/minimum funding adjustments			1,212	1,212
	(457)	(1,596)	1,212	73
Contributions by employer	1,059	—		(1,059)
Contributions by plan participants and other scheme members	6	6		—
Benefits paid	(1,129)	(1,129)		—
Transfer to disposal groups	(299)	(297)		2
At 1 January 2016	34,696	35,115	3,130	3,549
Currency translation and other adjustments	537	602	—	65
Income statement				
Net interest expense	1,451	1,322	122	(7)
Current service cost		258		258
Past service cost		8		8
Loss on curtailments or settlements		2		2
	1,451	1,590	122	261
Statement of comprehensive income				
Return on plan assets above recognised interest income	9,254			(9,254)
Experience gains and losses		(793)		(793)
Effect of changes in actuarial financial assumptions		9,557		9,557
Effect of changes in actuarial demographic assumptions		(543)		(543)
Asset ceiling/minimum funding adjustments			2,074	2,074
	9,254	8,221	2,074	1,041
Contributions by employer	4,783	—	—	(4,783)
Contributions by plan participants and other scheme members	12	12		—
Liabilities extinguished upon settlement	(43)	(129)		(86)
Benefits paid	(1,465)	(1,465)		—
Transfer to disposal groups	(787)	(769)	(11)	7
At 31 December 2016	48,438	43,177	5,315	54

Note:

(1) In recognising the net surplus or deficit of a pension scheme, the funded status of each scheme is adjusted to reflect any minimum funding requirement imposed on the sponsor and any ceiling on the amount that the sponsor has a right to recover from a scheme.

Notes on the accounts

4 Pensions continued

	Main scheme	
	2016	2015
	£m	£m
Analysis of net pension deficit		
Fund assets at fair value	43,824	30,703
Present value of fund liabilities	38,851	30,966
Funded status	4,973	263
Asset ceiling/minimum funding	(4,973)	2,981
Retirement benefit liability	—	3,244
Minimum funding requirement	—	3,657
Asset ceiling	—	(413)
	—	3,244

	2016	2015
	£m	£m
Net pension deficit comprises		
Net assets of schemes in surplus (included in Prepayments, accrued income and other assets, Note 18)	(267)	(215)
Net liabilities of schemes in deficit	321	3,764
	54	3,549

The income statement charge comprises:

	2016	2015	2014
	£m	£m	£m
Continuing operations	255	445	451
Discontinued operations	6	11	12
	261	456	463

The defined benefit obligation is attributable to the different classes of scheme members in the following proportions (Main scheme):

	2016	2015
	%	%
Active	18.1	17.5
Deferred	45.9	41.9
Pensioner	36.0	40.6
	100.0	100.0

The table below sets out the sensitivities of the present value of defined benefit obligations at 31 December to a separate change in the principal actuarial assumptions.

	Main scheme (decrease)/increase in obligation at 31 December	
	2016	2015
	£m	£m
0.25% increase in the discount rate	(1,978)	(1,392)
0.25% increase in inflation	1,552	1,106
0.25% additional rate of increase in pensions in payment	1,339	945
Longevity increase of one year	1,522	853

Notes on the accounts

4 Pensions continued

Pension liabilities are calculated on the central assumptions and under the relevant sensitivity scenarios. The sensitivity to pension liabilities is the difference between these calculations.

The sensitivity analysis presented above may not be representative of the actual change in the defined benefit obligation as it is unlikely that the changes in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

	Group				
	2016 £m	2015 £m	2014 £m	2013 £m	2012 £m
History of defined benefit schemes					
Fair value of plan assets	48,438	34,696	34,341	28,471	26,359
Present value of plan obligations	43,177	35,115	36,596	31,445	30,069
Net surplus/(deficit)	5,261	(419)	(2,255)	(2,974)	(3,710)
Experience (losses)/gains on plan liabilities	(793)	258	18	177	(202)
Experience gains/(losses) on plan assets	9,254	(457)	5,171	1,097	476
Actual return on plan assets	10,705	749	6,485	2,270	1,662
Actual return on plan assets - %	30.9%	2.2%	22.8%	8.6%	7.0%

Triennial funding valuation

In January 2016, the Group accelerated the settlement of the future contributions agreed with the Trustee as part of the 31 March 2013 triennial valuation of the Main scheme. This amounted to £4.2 billion. At the same time it entered into a Memorandum of Understanding with the Trustee that included advancing the date of the 31 March 2016 triennial funding valuation to 31 December 2015. Consequently, the next triennial valuation does not need to be agreed until 31 March 2020.

In June 2016, the triennial funding valuation of the Main scheme as at 31 December 2015 was agreed. Using the actuarial assumptions set out in the table below (which are different to the assumptions used to calculate the IAS 19 defined benefit obligation) the pension liabilities calculated at 31 December 2015 totalled £37 billion and the deficit was £5.8 billion, subsequently reduced by the £4.2 billion cash payment in March 2016. Investment returns over the next 10 year period are forecast to absorb the £1.6 billion balance of the deficit. The average cost of the future service of current members has increased from 27% to 35% of basic salary before contributions from those members; it includes the expenses of running the scheme.

The Trustee of the Main scheme is responsible for setting the actuarial assumptions used in the triennial funding valuation having taken advice from the Scheme Actuary. These represent the Trustee's prudent estimate of the future experience of the Main scheme taking into account the covenant provided by the Group and the investment strategy of the scheme. They are agreed with the Group and documented in the Statement of Funding Principles.

The key assumption methodology used in the 31 December 2015 valuation is set out below. As at that date the funding level disclosed on the assumptions below was 84%. This is before any allowance for the £4.2 billion contribution made in March 2016.

Principal actuarial assumptions for 2015 and 2013 triennial valuations

Discount rate	Fixed interest swap yield curve plus 1.5% per annum at all durations	
Inflation assumption	Retail price index (RPI) swap yield curve	
Rate of increase in pensions in payment	(RPI floor 0%, cap 5%): Limited price indexation (LPI) (0.5) swap yield curve	
Post retirement mortality assumptions:		
Longevity at age 60 for current pensioners (years)		
Male	2015 28.4	2013 28.8
Female	30.2	30.8
Longevity at age 60 for future pensioners currently aged 40 (years)		
Male	29.9	30.7
Female	32.4	32.9

Notes on the accounts

5 Auditor's remuneration

On 24 March 2016 Deloitte LLP (Deloitte) resigned as the Group's auditors and on 4 May 2016 the shareholder approved the appointment of Ernst & Young LLP (EY) as the Group's auditor at the Annual General Meeting for the audit of the 2016 annual accounts. Amounts paid to the Group's auditors for statutory audit and other services are set out below:

	Group	
	2016	2015
	£m	£m
Deloitte⁽¹⁾		
Fees payable for the audit of the Group's annual accounts	—	6.8
Fees payable to the auditor and its associates for other services to the Group		
- the audit of the Bank's subsidiaries pursuant to legislation	—	9.2
Total audit and audit-related assurance service fees	—	16.0

Note:

(1) Includes fees for the period Deloitte were principal Group auditor (2016: 1 January 2016 until effective resignation on 24 March 2016; 2015: 1 January 2015 - 31 December 2015)

	Group	
	2016	2015
	£m	£m
EY⁽¹⁾		
Fees payable for the audit of the Group's annual accounts	7.0	—
Fees payable to the auditor and its associates for other services to the Group		
- the audit of the Bank's subsidiaries pursuant to legislation	9.5	—
Total audit and audit-related assurance service fees	16.5	—

Note:

(1) Includes fees for the period EY were principal Group auditor (2016: 1 January 2016 to 31 December 2016)

Fees payable to the auditor for non-audit services are disclosed in the consolidated financial statements of The Royal Bank of Scotland Group plc.

Notes on the accounts

6 Tax

	Group		
	2016 £m	2015 £m	2014 £m
Current tax			
Charge for the year	(1,037)	(94)	(249)
Over provision in respect of prior years	176	235	75
	(861)	141	(174)
Deferred tax			
Credit/(charge) for the year	192	(93)	(354)
Reduction in the carrying value of deferred tax assets	(317)	—	(1,472)
(Under)/over provision in respect of prior year	(162)	4	(7)
Tax (charge)/credit for the year	(1,148)	52	(2,007)

The actual tax (charge)/credit differs from the expected tax (charge)/ credit computed by applying the standard rate of UK corporation tax of 20% (2015 – 20.25%; 2014 – 21.50%) as follows:

	2016 £m	2015 £m	2014 £m
Expected tax credit/(charge)	746	655	(501)
Losses and temporary differences in year where no deferred tax asset recognised	(679)	(968)	(14)
Foreign profits taxed at other rates	327	462	69
UK tax rate change impact (1)	6	94	—
Non-deductible goodwill impairment	—	(124)	(28)
Items not allowed for tax			
- losses on disposal and write-downs	(44)	(15)	(19)
- UK bank levy	(41)	(50)	(54)
- regulatory and legal actions	(817)	(226)	(182)
- other disallowable items	(141)	(215)	(148)
Non-taxable items	105	120	79
Taxable foreign exchange movements	(115)	(22)	(23)
Losses brought forward and utilised	8	102	218
(Reduction)/increase in carrying value of deferred tax asset in respect of:			
- UK losses	(317)	—	(850)
- US losses and temporary differences	—	—	(775)
- Ireland losses	—	—	153
Banking surcharge	(200)	—	—
Adjustments in respect of prior years (2)	14	239	68
Actual tax (charge)/credit	(1,148)	52	(2,007)

Notes:

(1) In recent years, the UK government has steadily reduced the rate of UK corporation tax, with the latest enacted rates standing at 20% with effect from 1 April 2015, 19% from 1 April 2017 and 17% from 1 April 2020. The Finance (No 2) Act 2015 restricts the rate at which tax losses are given credit in future periods to the main rate of UK corporation tax, excluding the Banking Surcharge 8% rate introduced by this Act. Deferred tax assets and liabilities at 31 December 2016 take into account the reduced rates in respect of tax losses and non-banking temporary differences and where appropriate, the banking surcharge inclusive rate in respect of other banking temporary differences.

(2) Prior year tax adjustments include releases of tax provisions that reflect the reduction of exposures in countries where RBS is ceasing operations in line with the strategy to become a smaller, simpler UK focused bank. The prior year tax adjustments also reflect adjustments to reflect submitted tax computations in the UK and overseas.

Notes on the accounts

7 Loss dealt with in the accounts of the Bank

As permitted by section 408(3) of the Companies Act 2006, no income statement for the Bank has been presented as a primary financial statement. Of the loss attributable to ordinary shareholders, £3,474 million (2015 - £1,075 million loss; 2014 - £2,119 million loss) has been dealt with in the accounts of the Bank.

8 Financial instruments - classification

The following tables show the Group's financial assets and liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown within other assets and other liabilities.

	Group								
	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	Finance leases £m	Other assets £m	Total £m
Assets									
Cash and balances at central banks	—	—		—	73,813	—			73,813
Loans and advances to banks									
- amounts due from fellow subsidiaries	288	—		—	749	—			1,037
- reverse repos	11,120	—		—	1,740	—			12,860
- other (1)	6,732	—		—	9,866	—			16,598
Loans and advances to customers									
- amounts due from holding company and fellow subsidiaries	—	—		—	1,116	—			1,116
- reverse repos	26,587	—		—	2,297	—			28,884
- other	17,500	82		—	293,914	—	3,459		314,955
Debt securities (2)	24,501	—		38,414	3,968	4,769			71,652
Equity shares	128	88		229	—	—			445
Settlement balances	—			—	5,557	—			5,557
Derivatives									
- amounts due from holding company and fellow subsidiaries	1,306	—	—						1,306
- other	242,073		4,365						246,438
Assets of disposal groups	—							8,366	8,366
Other assets	—	—		—	—	—		14,787	14,787
At 31 December 2016	330,235	170	4,365	38,643	393,020	4,769	3,459	23,153	797,814
Cash and balances at central banks	—	—		—	78,999	—			78,999
Loans and advances to banks									
- amounts due from fellow subsidiaries	886	—		—	671	—			1,557
- reverse repos	9,889	—		—	1,209	—			11,098
- other (1)	11,202	—		—	5,985	—			17,187
Loans and advances to customers									
- amounts due from holding company and fellow subsidiaries	—	—		—	1,258	—			1,258
- reverse repos	28,712	—		—	—	—			28,712
- other	17,516	63		—	283,709	—	3,699		304,987
Debt securities (2)	35,759	—		36,992	2,365	4,911			80,027
Equity shares	601	71		397	—	—			1,069
Settlement balances	—			—	4,108	—			4,108
Derivatives									
- amounts due from holding company and fellow subsidiaries	1,275	—	—						1,275
- other	258,258		3,550						261,808
Assets of disposal groups	—							3,486	3,486
Other assets	—	—		—	—	—		16,620	16,620
At 31 December 2015	364,098	134	3,550	37,389	378,304	4,911	3,699	20,106	812,191

For the notes to this table refer to page 151.

Notes on the accounts

8 Financial instruments - classification continued

	Group					
	Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Amortised cost £m	Other liabilities £m	Total £m
Liabilities						
Deposits by banks						
- amounts due to fellow subsidiaries	507	—		1,610		2,117
- repos	4,125	—		1,114		5,239
- other (3)	20,651	—		12,546		33,197
Customer accounts						
- amounts due to holding company	—	—		18,528		18,528
- repos	23,186	—		3,910		27,096
- other (4)	12,688	1,458		316,295		330,441
Debt securities in issue (5)	1,614	4,487		14,261		20,362
Settlement balances	—	—		3,641		3,641
Short positions	22,076	—				22,076
Derivatives						
- amounts due to holding company and fellow subsidiaries	1,228	—	—			1,228
- other	232,487	—	3,862			236,349
Subordinated liabilities						
- amounts due to holding company	—	—		11,212		11,212
- other	—	383		7,920		8,303
Liabilities of disposal groups					23,391	23,391
Other liabilities	—	—		2,028	16,787	18,815
At 31 December 2016	318,562	6,328	3,862	393,065	40,178	761,995
Deposits by banks						
- amounts due to fellow subsidiaries	190	—		3,809		3,999
- repos	9,657	—		609		10,266
- other (3)	20,285	—		7,544		27,829
Customer accounts						
- amounts due to holding company	—	—		5,021		5,021
- repos	25,570	—		1,542		27,112
- other (4)	11,723	2,661		327,557		341,941
Debt securities in issue (5)	3,881	5,873		16,050		25,804
Settlement balances	—	—		3,383		3,383
Short positions	20,808	—				20,808
Derivatives						
- amounts due to holding company and fellow subsidiaries	1,283	—	—			1,283
- other	251,693	—	2,572			254,265
Subordinated liabilities						
- amounts due to holding company	—	—		18,502		18,502
- other	—	327		8,201		8,528
Liabilities of disposal groups					2,980	2,980
Other liabilities	—	—		1,886	16,677	18,563
At 31 December 2015	345,090	8,861	2,572	394,104	19,657	770,284

For the notes to this table refer to page 151.

Notes on the accounts

8 Financial instruments - classification continued

The above includes amounts due from/to:

	Group			
	2016		2015	
	Holding company £m	Fellow subsidiaries £m	Holding company £m	Fellow subsidiaries £m
Assets				
Loans and advances to customers	972	144	895	363
Derivatives	260	1,046	65	1,210
Liabilities				
Derivatives	373	855	218	1,065

Notes:

- (1) Includes items in the course of collection from other banks of £781 million (2015 - £830 million).
- (2) Debt securities balances with Group companies are shown on pages 91 to 92.
- (3) Includes items in the course of transmission to other banks of £295 million (2015 - £338 million).
- (4) The carrying amount of other customer accounts designated as at fair value through profit or loss is £155 million (2015 - £297 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 both during the period and cumulatively. Measured as the change in fair value from movements in the period in the credit risk premium payable.
- (5) Comprises bonds and medium term notes of £17,154 million (2015 - £24,860 million) and certificates of deposit and other commercial paper of £3,208 million (2015 - £944 million).

Amounts relating to continuing operations included in operating (loss)/profit before tax:

	Group		
	2016 £m	2015 £m	2014 £m
Gains on financial assets/liabilities designated as at fair value through profit or loss	7	285	43
Losses on disposal or settlement of loans and receivables	(182)	(551)	(236)

Notes on the accounts

8 Financial instruments - classification continued

The following tables show the Bank's financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown within other assets and other liabilities.

	Bank								
	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	Finance leases £m	Other assets £m	Total £m
Assets									
Cash and balances at central banks	—	—		—	70,615	—			70,615
Loans and advances to banks									
- amounts due from subsidiaries	906	—		—	17,246	—			18,152
- reverse repos	7,107	—		—	1,740	—			8,847
- other (1)	6,734	—		—	5,285	—			12,019
Loans and advances to customers									
- amounts due from holding company and subsidiaries	2,062	—		—	25,060	—			27,122
- reverse repos	19,111	—		—	2,297	—			21,408
- other	17,042	82		—	94,492	—	45		111,661
Debt securities (2)	20,503	—		36,655	5,742	4,769			67,669
Equity shares	121	—		177	—	—			298
Investment in Group undertakings	—	—		—	—	—		35,169	35,169
Settlement balances	—	—		—	4,707	—			4,707
Derivatives									
- amounts due from holding company and subsidiaries	6,144		—						6,144
- other	242,642		2,690						245,332
Assets of disposal groups	—	—		—	—	—		591	591
Other assets	—	—		—	—	—		3,879	3,879
At 31 December 2016	322,372	82	2,690	36,832	227,184	4,769	45	39,639	633,613
Cash and balances at central banks	—	—		—	76,904	—			76,904
Loans and advances to banks									
- amounts due from subsidiaries	3,838	—		—	20,253	—			24,091
- reverse repos	7,516	—		—	1,208	—			8,724
- other (1)	10,975	—		—	1,560	—			12,535
Loans and advances to customers									
- amounts due from holding company and subsidiaries	2,954	—		—	25,329	—			28,283
- reverse repos	18,187	—		—	—	—			18,187
- other	17,341	63		—	97,734	—	44		115,182
Debt securities (2)	30,811	—		35,220	5,660	4,911			76,602
Equity shares	599	—		332	—	—			931
Investment in Group undertakings	—	—		—	—	—		34,482	34,482
Settlement balances	—	—		—	3,053	—			3,053
Derivatives									
- amounts due from holding company and subsidiaries	4,726		—						4,726
- other	258,370		2,505						260,875
Other assets	—	—		—	—	—		4,607	4,607
At 31 December 2015	355,317	63	2,505	35,552	231,701	4,911	44	39,089	669,182

For the notes to this table refer to page 154.

Notes on the accounts

8 Financial instruments - classification continued

	Bank					
	Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Amortised cost £m	Other liabilities £m	Total £m
Liabilities						
Deposits by banks						
- amounts due to subsidiaries	1,328	—		105,849		107,177
- repos	2,381	—		1,114		3,495
- other (3)	20,627	—		7,989		28,616
Customer accounts						
- amounts due to holding company and subsidiaries	7,997	—		23,667		31,664
- repos	11,874	—		3,910		15,784
- other (4)	12,678	94		81,998		94,770
Debt securities in issue (5)	1,614	4,487		12,780		18,881
Settlement balances	—	—		2,774		2,774
Short positions	17,590	—		—		17,590
Derivatives						
- amounts due to holding company and subsidiaries	5,036		—	—		5,036
- other	232,961		2,901	—		235,862
Subordinated liabilities						
- amounts due to holding company	—	—	—	11,212		11,212
- other	—	383	—	6,275		6,658
Other liabilities	—	—		1,276	6,942	8,218
At 31 December 2016	314,086	4,964	2,901	258,844	6,942	587,737
Deposits by banks						
- amounts due to subsidiaries	1,924	—		114,419		116,343
- repos	6,180	—		610		6,790
- other (3)	20,253	—		3,834		24,087
Customer accounts						
- amounts due to holding company and subsidiaries	4,686	—		12,181		16,867
- repos	18,591	—		1,542		20,133
- other (4)	11,703	284		89,787		101,774
Debt securities in issue (5)	3,881	5,202		14,278		23,361
Settlement balances	—	—		2,363		2,363
Short positions	17,593	—		—		17,593
Derivatives						
- amounts due to holding company and subsidiaries	3,528		—			3,528
- other	252,000		1,844			253,844
Subordinated liabilities						
- amounts due to holding company	—	—	—	18,485		18,485
- other	—	327	—	6,722		7,049
Other liabilities	—	—		1,205	4,583	5,788
At 31 December 2015	340,339	5,813	1,844	265,426	4,583	618,005

For the notes to this table refer to page 154.

Notes on the accounts

8 Financial instruments - classification continued

The above includes amounts due from/to:

	Bank					
	2016			2015		
	Holding company £m	Fellow subsidiaries £m	Subsidiaries £m	Holding company £m	Fellow subsidiaries £m	Subsidiaries £m
Assets						
Loans and advances to banks	—	656	17,496	—	2,409	21,682
Loans and advances to customers	972	399	25,751	895	4	27,384
Derivatives	260	1,046	4,838	65	1,210	3,451
Liabilities						
Deposits by banks	—	2,108	105,069	—	11,496	104,847
Customer accounts	18,528	—	13,136	5,021	—	11,846
Derivatives	373	855	3,808	218	1,065	2,245

Notes:

- (1) Includes items in the course of collection from other banks of £271 million (2015 - £216 million).
- (2) Debt securities balances with Group companies are shown on pages 91 to 92.
- (3) Includes items in the course of transmission to other banks of £165 million (2015 - £192 million).
- (4) The carrying amount of other customer accounts designated as at fair value through profit or loss is £17 million (2015 - £29 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 both during the period and cumulatively. Measured as the change in fair value from movements in the period in the credit risk premium payable.
- (5) Comprises bonds and medium term notes of £15,673 million (2015 - £22,418 million) and certificates of deposit and other commercial paper of £3,208 million (2015 - £943 million).

The tables below present information on financial assets and liabilities that are offset on the balance sheet under IFRS or subject to enforceable master netting agreements only, together with financial collateral received or given.

	Group								
	Offsetable instruments			Offsetable potential not recognised by IFRS				Instruments outside netting arrangements	
	Gross £m	IFRS offset £m	Balance sheet £m	Effect of master netting and similar agreements £m	Cash collateral £m	Other financial collateral £m	Net amount after the effect of netting arrangements and related collateral £m		Balance sheet total £m
2016									
Assets									
Derivatives	294,275	(51,080)	243,195	(197,778)	(28,700)	(8,435)	8,282	4,549	247,744
Reverse repos	69,762	(31,728)	38,034	(1,052)	—	(36,895)	87	3,710	41,744
Loans to customers	600	(600)	—	—	—	—	—	316,071	316,071
Settlement balances	1,711	(1,529)	182	—	—	—	182	5,375	5,557
	<u>366,348</u>	<u>(84,937)</u>	<u>281,411</u>	<u>(198,830)</u>	<u>(28,700)</u>	<u>(45,330)</u>	<u>8,551</u>	<u>329,705</u>	<u>611,116</u>
Liabilities									
Derivatives	285,121	(50,574)	234,547	(197,778)	(20,412)	(11,048)	5,309	3,030	237,577
Repos	61,742	(31,728)	30,014	(1,052)	—	(28,960)	2	2,321	32,335
Customer accounts	1,106	(1,106)	—	—	—	—	—	348,969	348,969
Settlement balances	1,677	(1,529)	148	—	—	—	148	3,493	3,641
	<u>349,646</u>	<u>(84,937)</u>	<u>264,709</u>	<u>(198,830)</u>	<u>(20,412)</u>	<u>(40,008)</u>	<u>5,459</u>	<u>357,813</u>	<u>622,522</u>
2015									
Assets									
Derivatives	381,673	(123,662)	258,011	(215,183)	(27,614)	(7,535)	7,679	5,072	263,083
Reverse repos	74,171	(34,361)	39,810	(2,500)	—	(37,185)	125	—	39,810
Loans to customers	2,955	(2,955)	—	—	—	—	—	306,245	306,245
Settlement balances	1,271	(1,225)	46	(26)	—	—	20	4,062	4,108
	<u>460,070</u>	<u>(162,203)</u>	<u>297,867</u>	<u>(217,709)</u>	<u>(27,614)</u>	<u>(44,720)</u>	<u>7,824</u>	<u>315,379</u>	<u>613,246</u>
Liabilities									
Derivatives	369,416	(118,366)	251,050	(215,183)	(25,729)	(8,213)	1,925	4,498	255,548
Repos	71,739	(34,361)	37,378	(2,500)	—	(34,878)	—	—	37,378
Customer accounts	8,251	(8,251)	—	—	—	—	—	346,962	346,962
Settlement balances	1,872	(1,225)	647	(26)	—	—	621	2,736	3,383
	<u>451,278</u>	<u>(162,203)</u>	<u>289,075</u>	<u>(217,709)</u>	<u>(25,729)</u>	<u>(43,091)</u>	<u>2,546</u>	<u>354,196</u>	<u>643,271</u>

Notes on the accounts

8 Financial instruments - classification continued

	Offsetable instruments			Bank					
				Offsetable potential not recognised by IFRS					
	Gross £m	IFRS offset £m	Balance sheet £m	Effect of master netting and similar agreements £m	Cash collateral £m	Other financial collateral £m	Net amount after the effect of netting arrangements and related collateral £m	Instruments outside netting arrangements £m	Balance sheet total £m
2016									
Assets									
Derivatives	299,268	(51,080)	248,188	(199,906)	(28,666)	(8,338)	11,278	3,288	251,476
Reverse repos	43,797	(17,253)	26,544	(439)	—	(26,103)	2	3,711	30,255
Loans to customers	600	(600)	—	—	—	—	—	138,783	138,783
Settlement balances	206	(24)	182	—	—	—	182	4,525	4,707
	343,871	(68,957)	274,914	(200,345)	(28,666)	(34,441)	11,462	150,307	425,221
Liabilities									
Derivatives	288,842	(50,574)	238,268	(199,906)	(20,404)	(11,048)	6,910	2,630	240,898
Repos	34,210	(17,253)	16,957	(439)	—	(16,518)	—	2,322	19,279
Customer accounts	1,106	(1,106)	—	—	—	—	—	126,434	126,434
Settlement balances	28	(24)	4	—	—	—	4	2,770	2,774
	324,186	(68,957)	255,229	(200,345)	(20,404)	(27,566)	6,914	134,156	389,385
2015									
Assets									
Derivatives	385,285	(123,662)	261,623	(216,601)	(27,595)	(7,464)	9,963	3,978	265,601
Reverse repos	47,285	(20,374)	26,911	(2,051)	—	(24,860)	—	—	26,911
Loans to customers	2,955	(2,955)	—	—	—	—	—	143,465	143,465
Settlement balances	188	(168)	20	—	—	—	20	3,033	3,053
	435,713	(147,159)	288,554	(218,652)	(27,595)	(32,324)	9,983	150,476	439,030
Liabilities									
Derivatives	371,569	(118,366)	253,203	(216,601)	(25,729)	(8,212)	2,661	4,169	257,372
Repos	47,297	(20,374)	26,923	(2,051)	—	(24,872)	—	—	26,923
Customer accounts	8,251	(8,251)	—	—	—	—	—	118,641	118,641
Settlement balances	193	(168)	25	—	—	—	25	2,338	2,363
	427,310	(147,159)	280,151	(218,652)	(25,729)	(33,084)	2,686	125,148	405,299

Reclassification of financial instrument

In 2008 and 2009, financial assets were reclassified from held-for-trading (HFT) into loans and receivables (LAR) and from HFT into available-for-sale (AFS). The tables below show the carrying value, fair value and the effect on profit or loss of these reclassifications. There have been no further reclassifications.

	Group					Reduction in profit or loss as a result of reclassification £m
	Amount recognised in income statement			Amount that would have been recognised had reclassification not occurred £m		
	Carrying value £m	Fair value £m	Income £m		Impairment losses £m	
2016						
Reclassified from HFT to LAR	1,165	1,078	244	—	274	30
Reclassified from HFT to AFS ⁽¹⁾	32	32	9	—	16	7
	1,197	1,110	253	—	290	37
2015						
Reclassified from HFT to LAR	1,002	877	(19)	(15)	4	38
Reclassified from HFT to AFS ⁽¹⁾	21	21	—	—	2	2
	1,023	898	(19)	(15)	6	40

The table below shows the carrying value and fair value of reclassifications undertaken by the Bank.

	Bank			
	2016		2015	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Reclassified from HFT to LAR	1,165	1,078	1,002	877
Reclassified from HFT to AFS ⁽¹⁾	32	32	21	21
	1,197	1,110	1,023	898

Note:

(1) A gain of £6 million (2015 - nil) was taken to AFS reserves.

9 Financial instruments - valuation

Valuation of financial instruments carried at fair value

Control environment

Common valuation policies, procedures, frameworks and models apply across the RBS Group. Therefore, for the most part, discussions on these aspects below reflect those in the RBS Group as relevant for businesses in the Group.

The Group's control environment for the determination of the fair value of financial instruments includes formalised protocols for the review and validation of fair values independent of the businesses entering into the transactions. There are specific controls to ensure consistent pricing policies and procedures, incorporating disciplined price verification. The Group ensures that appropriate attention is given to bespoke transactions, structured products, illiquid products and other instruments which are difficult to price.

Independent price verification (IPV)

IPV is a key element of the control environment. Valuations are first performed by the business which entered into the transaction. Such valuations may be directly from available prices, or may be derived using a model and variable model inputs. These valuations are reviewed, and if necessary amended, by a team independent of those trading the financial instruments, in the light of available pricing evidence.

IPV differences are classified according to the quality of independent market observables into IPV quality bands linked to the fair value hierarchy principles, as laid out in IFRS 13 'Fair Value Measurement'. These differences are classified into fair value levels 1, 2 and 3 (with the valuation uncertainty risk increasing as the levels rise from 1 to 3) and then further classified into high, medium, low and indicative depending on the quality of the independent data available to validate the prices. Valuations are revised if they are outside agreed thresholds.

Governance framework

IPV takes place at least each month end date, for exposures in the regulatory trading book and at least quarterly for exposures in the banking book. The IPV control includes formalised reporting and escalation of any valuation differences in breach of established thresholds. The Pricing Unit determines IPV policy, monitors adherence to that policy and performs additional independent reviews of highly subjective valuation issues.

The Modelled Product Review Committee sets the policy for model documentation, testing and review, and prioritises models with significant exposure being reviewed by the RBS Group Pricing Model Risk team. The NatWest Markets and Capital Resolution Valuation Committee is made up of valuation specialists and senior business representatives from various functions and oversee pricing, reserving and valuations issues. This committee meets monthly to review and ratify any methodology changes. The Executive Valuation Committee meets quarterly to address key material and subjective valuation issues, to review items escalated by the NatWest Markets and Capital Resolution Valuation Committee and to discuss other relevant matters including prudential valuation.

Valuation hierarchy

Initial classification of a financial instrument is carried out by the Product Control team following the principles in IFRS 13. They base their judgment on information gathered during the IPV process for instruments which include the sourcing of independent prices and model inputs. The quality and completeness of the information gathered in the IPV process gives an indication as to the liquidity and valuation uncertainty of an instrument.

These initial classifications are reviewed and challenged by the Pricing Unit and are also subject to senior management review. Particular attention is paid to instruments crossing from one level to another, new instrument classes or products, instruments that are generating significant profit and loss and instruments where valuation uncertainty is high.

Valuation techniques

The Group derives fair value of its instruments differently depending on whether the instrument is a non-modelled or a modelled product.

Non-modelled products

Non-modelled products are valued directly from a price input typically on a position by position basis and include cash, equities and most debt securities.

Modelled products

Modelled products valued using a pricing model range in complexity from comparatively vanilla products such as interest rate swaps and options (e.g. interest rate caps and floors) through to more complex derivatives. The valuation of modelled products requires an appropriate model and inputs into this model. Sometimes models are also used to derive inputs (e.g. to construct volatility surfaces). The Group uses a number of modelling methodologies.

Inputs to valuation models

Values between and beyond available data points are obtained by interpolation and extrapolation. When utilising valuation techniques, the fair value can be significantly affected by the choice of valuation model and by underlying assumptions concerning factors such as the amounts and timing of cash flows, discount rates and credit risk. The principal inputs to these valuation techniques are as follows:

- Bond prices - quoted prices are generally available for government bonds, certain corporate securities and some mortgage-related products.
- Credit spreads - where available, these are derived from prices of credit default swaps or other credit based instruments, such as debt securities. For others, credit spreads are obtained from pricing services. For counterparty credit spreads, adjustments are made to market prices (or parameters) when the creditworthiness of the counterparty differs from that of the assumed counterparty in the market price (or parameters).
- Interest rates - these are principally benchmark interest rates such as the London Interbank Offered Rate (LIBOR), Overnight Index Swaps (OIS) rate and other quoted interest rates in the swap, bond and futures markets.

9 Financial instruments - valuation continued

- Foreign currency exchange rates - there are observable prices both for spot and forward contracts and futures in the world's major currencies.
- Equity and equity index prices - quoted prices are generally readily available for equity shares listed on the world's major stock exchanges and for major indices on such shares.
- Commodity prices - many commodities are actively traded in spot and forward contracts and futures on exchanges in London, New York and other commercial centres.
- Price volatilities and correlations - volatility is a measure of the tendency of a price to change with time. Correlation measures the degree which two or more prices or other variables are observed to move together.
- Prepayment rates - the fair value of a financial instrument that can be prepaid by the issuer or borrower differs from that of an instrument that cannot be prepaid. In valuing prepayable instruments that are not quoted in active markets, the Group considers the value of the prepayment option.
- Recovery rates/loss given default - these are used as an input to valuation models and reserves for asset-backed securities and other credit products as an indicator of severity of losses on default. Recovery rates are primarily sourced from market data providers or inferred from observable credit spreads.

Consensus pricing

The Group uses consensus prices for the IPV of some instruments. The consensus service encompasses the equity, interest rate, currency, commodity, credit, property, fund and bond markets, providing comprehensive matrices of vanilla prices and a wide selection of exotic products. NatWest Markets and Capital Resolution contribute to consensus pricing services where there is a significant interest either from a positional point of view or to test models for future business use. Data sourced from consensus pricing services are used for a combination of control processes including direct price testing, evidence of observability and model testing. In practice this means that the Group submits prices for all material positions for which a service is available. Data from consensus services are subject to the same level of quality review as other inputs used for IPV process.

In order to determine a reliable fair value, where appropriate, management applies valuation adjustments to the pricing information gathered from the above sources. The sources of independent data are reviewed for quality and are applied in the IPV processes using a formalised input quality hierarchy. These adjustments reflect the Group's assessment of factors that market participants would consider in setting a price.

Furthermore, on an ongoing basis, the Group assesses the appropriateness of any model used. To the extent that the price determined by internal models does not represent the fair value of the instrument, for instance in highly stressed market conditions, the Group makes adjustments to the model valuation to calibrate to other available pricing sources.

Where unobservable inputs are used, the Group may determine a range of possible valuations derived from differing stress scenarios to determine the sensitivity associated with the valuation. When establishing the fair value of a financial instrument using a valuation technique, the Group considers adjustments to the modelled price which market participants would make when pricing that instrument. Such adjustments include the credit quality of the counterparty and adjustments to compensate for model limitations.

Valuation reserves

When valuing financial instruments in the trading book, adjustments are made to mid-market valuations to cover bid-offer spread, liquidity and credit risk. A breakdown of valuation adjustments is provided in Capital and risk management: Balance sheet analysis - derivatives on page 100.

Credit valuation adjustments (CVA)

CVA represents an estimate of the adjustment to fair value that a market participant would make to incorporate the counterparty credit risk inherent in derivative exposures. CVA is actively managed by a credit and market risk hedging process, and therefore movements in CVA are partially offset by trading revenue on the hedges.

The CVA is calculated on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the credit risk.

Where a positive exposure exists to a counterparty that is considered to be close to default, the CVA is calculated by applying expected losses to the current level of exposure. Otherwise, expected losses are applied to estimated potential future positive exposures which are modelled to reflect the volatility of the market factors which drive the exposures and the correlation between those factors.

Expected losses are determined from market implied probabilities of default and internally assessed recovery levels. The probability of default is calculated with reference to observable credit spreads and observable recovery levels. For counterparties where observable data do not exist, the probability of default is determined from the credit spreads and recovery levels of similarly rated entities.

9 Financial instruments - valuation continued

Bid-offer, liquidity and other reserves

Fair value positions are adjusted to bid (long positions) or offer (short positions) levels, by marking individual cash positions directly to bid or offer or by taking bid-offer reserves calculated on a portfolio basis for derivatives exposures. The bid-offer approach is based on current market spreads and standard market bucketing of risk.

Bid-offer adjustments for each risk factor (including delta (the degree to which the price of an instrument changes in response to a change in the price of the underlying), vega (the degree to which the price of an instrument changes in response to the volatility in the price of the underlying), correlation (the degree to which prices of different instruments move together)) are determined by aggregating similar risk exposures arising on different products. Additional basis bid-offer reserves are taken where these are charged in the market.

Bid-offer spreads vary by maturity and risk type to reflect different spreads in the market. For positions where there is no observable quote, the bid-offer spreads are widened in comparison to proxies to reflect reduced liquidity or observability. Bid-offer methodologies may also incorporate liquidity triggers whereby wider spreads are applied to risks above pre-defined thresholds.

As permitted by IFRS 13, netting is applied on a portfolio basis to reflect the value at which the Group believes it could exit the portfolio, rather than the sum of exit costs for each of the portfolio's individual trades. This is applied where the asset and liability positions are managed as a portfolio for risk and reporting purposes.

Vanilla risk on exotic products is typically reserved as part of the overall portfolio based calculation e.g. delta and vega risk on exotic products are included within the delta and vega bid-offer calculations.

Product related risks such as correlation risk, attract specific bid-offer reserves. Additional reserves are provided for exotic products to ensure overall reserves match market close-out costs. These market close-out costs inherently incorporate risk decay and cross-effects (taking into account how changes in one risk factor may affect other inputs rather than treating all risk factors independently) that are unlikely to be adequately reflected in a static hedge based on vanilla instruments. Where there is limited bid-offer information for a product, the pricing approach and risk management strategy are taken into account when assessing the reserve.

The discount rates applied to derivative cash flows in determining fair value reflect any underlying collateral agreements. Collateralised derivatives are generally discounted at the relevant OIS-related rates at an individual trade level. 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).

Funding valuation adjustment (FVA)

FVA represents an estimate of the adjustment to fair value that a market participant would make to incorporate funding costs and benefits that arise in relation to uncollateralised derivative exposures.

Funding levels are applied to estimated potential future exposures, the modelling of which is consistent with the approach used in the calculation of CVA. The counterparty contingent nature of the exposures is reflected in the calculation.

Amounts deferred on initial recognition

On initial recognition of financial assets and liabilities valued using valuation techniques incorporating information other than observable market data, any difference between the transaction price and that derived from the valuation technique is deferred. Such amounts are recognised in profit or loss over the life of the transaction; when market data becomes observable; or when the transaction matures or is closed out as appropriate. At 31 December 2016, net gains of £71 million (2015 - £80 million) were carried forward. During the year, net gains of £27 million (2015 - £16 million) were deferred, £47 million (2015 - £21 million) were recognised in the income statement and £11 million (2015 - nil) were reclassified from other categories of Day 1 reserves.

Own credit

The Group takes into account the effect of its own credit standing when valuing financial liabilities recorded at fair value in accordance with IFRS. Own credit spread adjustments are made when valuing issued debt held at fair value, including issued structured notes, and derivatives. An own credit adjustment is applied to positions where it is believed that counterparties would consider the Group's creditworthiness when pricing trades.

For issued debt this adjustment is based on debt issuance spreads above average inter-bank rates (at a range of tenors). Secondary senior debt issuance spreads are used in the calculation of the own credit adjustment applied to senior debt.

The fair value of the Group's derivative financial liabilities is also adjusted to reflect the Group's own credit risk through debit valuation adjustments (DVA). Expected gains are applied to estimated potential future negative exposures, the modelling of which is consistent with the approach used in the calculation of CVA. Expected gains are determined from market implied probabilities of default and recovery levels. FVA is considered the primary adjustment applied to derivative liabilities. The extent to which DVA and FVA overlap is eliminated from DVA.

The own credit adjustment does not alter cash flows, is not used for performance management, is disregarded for regulatory capital reporting processes and will reverse over time provided the liability is not repaid at a premium or a discount.

The reserve movement between periods will not equate to the reported profit or loss for own credit. The balance sheet reserves are stated by conversion of underlying currency balances at spot rates for each period whereas the income statement includes realised own credit gains and losses together with intra-period foreign exchange sell-offs.

Notes on the accounts

9 Financial instruments - valuation continued

The own credit adjustments (OCA) recorded on held-for-trading (HFT) and designated as at fair value through profit or loss (DFV) debt securities in issue, subordinated liabilities and derivative liabilities are set out below. The cumulative adjustments below represent reductions/(increases) to the balance sheet liability amounts.

	Debt securities in issue (2)			Subordinated liabilities		Derivatives	Total
	HFT	DFV	Total	DFV	Total		
Cumulative own credit adjustment (1)	£m	£m	£m	£m	£m	£m	£m
2016	(34)	(6)	(40)	45	5	74	79
2015	(118)	(29)	(147)	47	(100)	10	(90)

Carrying values of underlying liabilities	£bn	£bn	£bn	£bn	£bn
2016	1.6	4.5	6.1	0.4	6.5
2015	3.9	5.9	9.8	0.3	10.1

Notes:

- (1) Includes wholesale and retail note issuances.
- (2) 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.
- (3) The cumulative adjustment for debt securities in issue is opposite to that for subordinated liabilities. Debt securities in issue were issued relatively recently at wider than current spreads, whilst many of the subordinated liabilities were issued before the financial crisis at significantly tighter spreads.

Key points

- The cumulative OCA increase during the year was mainly due to the widening of spreads on Group issuance. The OCA on senior debt is determined by reference to secondary debt issuance spreads, which widened to 62 basis points at 31 December 2016 (31 December 2015 – 54 basis points) at the five year level.
- Group subordinated debt spreads widened to 281 basis points at 31 December 2016 (31 December 2015 – 267 basis points) at the five year level.
- Group five year CDS credit spreads widened to 125 basis points at 31 December 2016 (31 December 2015 – 58 basis points).

Notes on the accounts

9 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.

	2016						2015					
	Level 1 £bn	Level 2 £bn	Level 3 £bn	Total £bn	Level 3 sensitivity (5)		Level 1 £bn	Level 2 £bn	Level 3 £bn	Total £bn	Level 3 sensitivity (5)	
					Favourable £m	Unfavourable (£m)					Favourable £m	Unfavourable (£m)
Assets												
Loans and advances	—	61.7	0.6	62.3	50	(50)	—	67.9	0.3	68.2	50	(40)
Debt securities	53.8	8.3	0.8	62.9	70	(20)	60.3	11.6	0.9	72.8	30	(20)
- of which AFS	35.1	3.2	0.1	38.4	20	(10)	32.3	4.4	0.3	37.0	10	(10)
Equity shares	0.1	0.1	0.2	0.4	20	(30)	0.6	—	0.5	1.1	50	(30)
- of which AFS	—	—	0.2	0.2	10	(20)	—	—	0.4	0.4	40	(20)
Derivatives	—	245.0	2.8	247.8	210	(210)	—	261.1	2.0	263.1	380	(390)
	53.9	315.1	4.4	373.4	350	(310)	60.9	340.6	3.7	405.2	510	(480)
Proportion	14.4%	84.4%	1.2%	100%			15.0%	84.1%	0.9%	100%		
Liabilities												
Deposits	—	62.3	0.3	62.6	—	(10)	—	69.7	0.4	70.1	—	(10)
Debt securities in issue	—	5.5	0.6	6.1	40	(40)	—	9.3	0.5	9.8	30	—
Short positions	19.7	2.4	—	22.1	—	—	18.6	2.2	—	20.8	—	—
Derivatives	—	235.6	2.0	237.6	120	(120)	—	253.8	1.7	255.5	260	(270)
Subordinated liabilities	—	0.4	—	0.4	—	—	—	0.3	—	0.3	—	—
	19.7	306.2	2.9	328.8	160	(170)	18.6	335.3	2.6	356.5	290	(280)
Proportion	6.0%	93.1%	0.9%	100%			5.2%	94.1%	0.7%	100%		

Notes:

(1) Level 1: valued using unadjusted quoted prices in active markets, for identical financial instruments. Examples include G10 government securities, listed equity shares, certain exchange-traded derivatives and certain US agency securities.

Level 2: valued using techniques based significantly on observable market data. Instruments in this category are valued using:

(a) quoted prices for similar instruments or identical instruments in markets which are not considered to be active; or

(b) valuation techniques where all the inputs that have a significant effect on the valuations are directly or indirectly based on observable market data.

Level 2 instruments included non-G10 government securities, most government agency securities, investment-grade corporate bonds, certain mortgage products, including CLOs, most bank loans, repos and reverse repos, less liquid listed equities, state and municipal obligations, most notes issued, and certain money market securities and loan commitments and most OTC derivatives.

Level 3: instruments in this category have been valued using a valuation technique where at least one input which could have a significant effect on the instrument's valuation, is not based on observable market data. Level 3 instruments primarily include cash instruments which trade infrequently, certain syndicated and commercial mortgage loans, certain emerging markets instruments, unlisted equity shares, certain residual interests in securitisations, CDOs, other mortgage-backed products and less liquid debt securities, certain structured debt securities in issue, and OTC derivatives where valuation depends upon unobservable inputs such as certain credit and exotic derivatives. No gain or loss is recognised on the initial recognition of a financial instrument valued using a technique incorporating significant unobservable data.

(2) Transfers between levels are deemed to have occurred at the beginning of the quarter in which the instruments were transferred. There were no significant transfers between level 1 and level 2.

(3) For an analysis of debt securities (by issuer, measurement, classification and analysis of asset backed securities) and derivatives (by type of contract) refer to Capital and risk management: Balance sheet analysis – Debt securities and Derivatives respectively.

(4) The determination of an instrument's level cannot be made at a global product level as a single product type can be in more than one level. For example, a single name corporate credit default swap could be in Level 2 or Level 3 depending on whether the reference counterparty's obligations are liquid or illiquid.

(5) Sensitivity represents the favourable and unfavourable effect on the income statement or the statement of comprehensive income due to reasonably possible changes to valuations using reasonably possible alternative inputs in RBS's valuation techniques or models. Level 3 sensitivities are calculated on a trade or low level portfolio basis and hence these aggregated figures do not reflect the correlation between some of the sensitivities. In particular, for some portfolios, the sensitivities may be negatively correlated where a downward movement in one asset would produce an upward movement in another, but due to the additive presentation above, this correlation cannot be shown.

Notes on the accounts

9 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.

Financial instruments	Level 3 (£bn)		Valuation technique	Unobservable inputs	Range	
	Assets	Liabilities			Low	High
Loans and advances	0.6					
			Price-based	Price	0%	156%
Debt securities	0.8					
			Price-based	Price	0.01%	371.26%
Equity shares	0.2					
			Valuation	Discount factor	9%	13%
			Price-based	Price	80%	120%
Customer accounts		0.3				
			DCF based on recoveries	Credit spreads	0	25 bps
				Interest rate delta	0.823%	1.863%
Debt securities in issue		0.6				
			Price-based	Price	46.92%	151.98%
Derivatives	2.8	2.0				
Credit	0.2	0.2	DCF based on recoveries	Credit spreads	87 bps	925 bps
			Option pricing model	Correlation	-27%	-82%
				Volatility	40%	78%
Interest and foreign exchange contracts	2.6	1.7	Option pricing model	Correlation	-45%	99%
				Volatility	30%	78%
				Prepayment rate	5%	15%
Equity		0.1	Option pricing model	Volatility	-40%	99%

Notes:

- (1) The table above excludes unobservable inputs where the impact on valuation is not significant. Movements in the underlying input may have a favourable or unfavourable impact on the valuation depending on the particular terms of the contract and the exposure. For example, an increase in the credit spread of a bond would be favourable for the issuer but unfavourable for the note holder. Whilst the Group indicates where it considers that there are significant relationships between the inputs, their inter-relationships will be affected by macro economic factors including interest rates, foreign exchange rates or equity index levels.
- (2) Credit spreads and discount margins: credit spreads and margins express the return required over a benchmark rate or index to compensate for the credit risk associated with a cash instrument. A higher credit spread would indicate that the underlying instrument has more credit risk associated with it. Consequently, investors require a higher yield to compensate for the higher risk. The discount rate comprises credit spread or margin plus the benchmark rate; it is used to value future cash flows.
- (3) Price and yield: there may be a range of prices used to value an instrument that may be a direct comparison of one instrument or portfolio with another or, movements in a more liquid instrument may be used to indicate the movement in the value of a less liquid instrument. The comparison may also be indirect in that adjustments are made to the price to reflect differences between the pricing source and the instrument being valued, for example different maturity, credit quality, seniority or expected pay-outs. Similarly to price, an instrument's yield may be compared with other instruments' yields either directly or indirectly.
- (4) Recovery rate: reflects market expectations about the return of principal for a debt instrument or other obligations after a credit event or on liquidation. Recovery rates tend to move conversely to credit spreads.
- (5) Valuation: for private equity investments, risk may be measured by beta, estimated by looking at past prices of similar stocks and from valuation statements where valuations are usually derived from earnings measures such as EBITDA or net asset value.
- (6) Correlation: measures the degree by which two prices or other variables are observed to move together. If they move in the same direction there is positive correlation; if they move in opposite directions there is negative correlation. Correlations typically include relationships between: default probabilities of assets in a basket (a group of separate assets), exchange rates, interest rates and other financial variables.
- (7) Volatility: a measure of the tendency of a price to change with time.
- (8) Interest rate delta: these ranges represent the low/high marks on the relevant discounting curve.
- (9) The Group does not have any material liabilities measured at fair value that are issued with an inseparable third party credit enhancement.

9 Financial instruments - valuation continued

The Level 3 sensitivities on the previous page are calculated at a trade or low level portfolio basis. They are not calculated on an overall portfolio basis and therefore do not reflect the likely potential uncertainty on the portfolio as a whole. The figures are aggregated and do not reflect the correlated nature of some of the sensitivities. In particular, for some of the portfolios the sensitivities may be negatively correlated where a downwards movement in one asset would produce an upwards movement in another, but due to the additive presentation of the above figures this correlation cannot be displayed. The actual potential downside sensitivity of the total portfolio may be less than the non-correlated sum of the additive figures as shown in the above table.

Areas of judgement

Whilst the business has simplified, the diverse range of products historically traded by the Group results in a wide range of instruments that are classified into Level 3 of the hierarchy. Whilst the majority of these instruments naturally fall into a particular level, for some products an element of judgment is required. The majority of RBS's financial instruments carried at fair value are classified as Level 2: inputs are observable either directly (i.e. as a price) or indirectly (i.e. derived from prices).

Active and inactive markets

A key input in the decision making process for the allocation of assets to a particular level is market activity. In general, the degree of valuation uncertainty depends on the degree of liquidity of an input.

Where markets are liquid, little judgment is required. However, when the information regarding the liquidity in a particular market is not clear, a judgment may need to be made. This can be more difficult as assessing the liquidity of a market is not always straightforward. For an equity traded on an exchange, daily volumes of trading can be seen, but for an over-the-counter (OTC) derivative assessing the liquidity of the market with no central exchange is more difficult.

A key related matter is where a market moves from liquid to illiquid or vice versa. Where this change is considered to be temporary, the classification is not changed. For example, if there is little market trading in a product on a reporting date but at the previous reporting date and during the intervening period the market has been considered to be liquid, the instrument will continue to be classified in the same level in the hierarchy. This is to provide consistency so that transfers between levels are driven by genuine changes in market liquidity and do not reflect short term or seasonal effects. Material movements between levels are reviewed quarterly.

The breadth and depth of the IPV data allows for a rules based quality assessment to be made of market activity, liquidity and pricing uncertainty, which assists with the process of allocation to an appropriate level. Where suitable independent pricing information is not readily available, the quality assessment will result in the instrument being assessed as Level 3.

Modelled products

For modelled products the market convention is to quote these trades through the model inputs or parameters as opposed to a cash price equivalent. A mark-to-market is derived from the use of the independent market inputs calculated using the Group's model.

The decision to classify a modelled instrument as Level 2 or 3 will be dependent upon the product/model combination, the currency, the maturity, the observability and quality of input parameters and other factors. All these must be assessed to classify the asset.

If an input fails the observability or quality tests then the instrument is considered to be in Level 3 unless the input can be shown to have an insignificant effect on the overall valuation of the product.

The majority of derivative instruments for example vanilla interest rate swaps, foreign exchange swaps and liquid single name credit derivatives are classified as Level 2 as they are vanilla products valued using observable inputs. The valuation uncertainty on these is considered to be low and both input and output testing may be available.

Non-modelled products

Non-modelled products are generally quoted on a price basis and can therefore be considered for each of the three levels. This is determined by the market activity, liquidity and valuation uncertainty of the instruments which is in turn measured from the availability of independent data used by the IPV process to allocate positions to IPV quality levels.

The availability and quality of independent pricing information are considered during the classification process. An assessment is made regarding the quality of the independent information. For example, where consensus prices are used for non-modelled products, a key assessment of the quality of a price is the depth of the number of prices used to provide the consensus price. If the depth of contributors falls below a set hurdle rate, the instrument is considered to be Level 3. This hurdle rate is that used in the IPV process to determine the IPV quality rating. However, where an instrument is generally considered to be illiquid, but regular quotes from market participants exist, these instruments may be classified as Level 2 depending on frequency of quotes, other available pricing and whether the quotes are used as part of the IPV process or not.

For some instruments with a wide number of available price sources, there may be differing quality of available information and there may be a wide range of prices from different sources. In these situations the highest quality source is used to determine the classification of the asset. For example, a tradable quote would be considered a better source than a consensus price.

Notes on the accounts

9 Financial instruments - valuation continued

Level 3 portfolios and sensitively methodologies

Reasonably plausible alternative assumptions of unobservable inputs are determined based on specified target level of certainty of 90%. The assessments recognise different favourable and unfavourable valuation movements where appropriate. Each unobservable input within a product is considered separately and sensitivity is reported on an additive basis.

Alternative assumptions are determined with reference to all available evidence including consideration of the following: quality of independent pricing information taking into account consistency between different sources, variation over time, perceived tradability or otherwise of available quotes; consensus service dispersion ranges; volume of trading activity and market

bias (e.g. one-way inventory); day 1 profit or loss arising on new trades; number and nature of market participants; market conditions; modelling consistency in the market; size and nature of risk; length of holding of position; and market intelligence.

Other considerations

Whilst certain inputs used to calculate CVA, FVA and own credit adjustments are not based on observable market data, the uncertainty of the inputs is not considered to have a significant effect on the net valuation of the related derivative portfolios and issued debt. The classification of the derivative portfolios and issued debt is not determined by the observability of these inputs, and any related sensitivity does not form part of the Level 3 sensitivities presented.

Movement in Level 3

	2016				2015			
	FVTPL assets (2)	AFS assets	Total assets	Total liabilities	FVTPL assets (2)	AFS assets	Total assets	Total liabilities
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January	3,008	682	3,690	2,622	4,584	512	5,096	4,537
Amount recorded in the income statement (1)	(135)	(9)	(144)	(13)	(961)	—	(961)	(1,163)
Amount recorded in the statement of comprehensive income	—	76	76	—	—	194	194	—
Level 3 transfers in	2,036	27	2,063	1,400	1,628	150	1,778	1,439
Level 3 transfers out	(928)	(113)	(1,041)	(995)	(655)	(34)	(689)	(682)
Issuances	3	—	3	35	1	—	1	36
Purchases	1,300	42	1,342	521	557	7	564	40
Settlements	(678)	—	(678)	(596)	(868)	(117)	(985)	(1,573)
Sales	(604)	(370)	(974)	(87)	(1,288)	(31)	(1,319)	(15)
Foreign exchange and other adjustments	48	7	55	56	10	1	11	3
At 31 December	4,050	342	4,392	2,943	3,008	682	3,690	2,622
Amounts recorded in the income statement in respect of balances held at year end								
- unrealised	162	—	162	49	(156)	3	(153)	(470)
- realised	319	(4)	315	(35)	(43)	12	(31)	(4)

Notes:

(1) Net losses on HFT instruments of £167 million (2015 - £22 million) were recorded in income from trading activities in continuing operations. Net gains on other instruments of £10 million (2015 - £180 million) were recorded in other operating income and interest income as appropriate in continuing operations. There were no losses in 2016 and 2015 in discontinued operations.

(2) Fair value through profit or loss comprises held-for-trading predominantly and designated at fair value through profit of loss.

Notes on the accounts

9 Financial instruments - valuation continued

Fair value of financial instruments not carried at fair value

The following table shows the carrying value and fair value of financial instruments carried at amortised cost on the balance sheet.

2016	Group						Bank					
	Items where fair value approximates carrying value	Carrying value	Fair value	Fair value hierarchy level			Items where fair value approximates carrying value	Carrying value	Fair value	Fair value hierarchy level		
				Level 1	Level 2	Level 3				Level 1	Level 2	Level 3
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Financial assets												
Cash and balances at central banks	73.8						70.6					
Loans and advances to banks	0.8	11.5	11.5	—	3.2	8.3	0.3	24.0	24.9	—	6.3	18.6
Loans and advances to customers		300.8	299.3	—	0.9	298.4		121.8	119.5	—	14.7	104.8
Debt securities		8.7	8.8	5.0	0.3	3.5		10.5	10.7	5.0	1.4	4.3
Settlement balances	5.6						4.7					
Financial liabilities												
Deposits by banks	4.4	10.9	11.1	—	7.1	4.0	3.8	111.1	111.8	—	24.1	87.7
Customer accounts	285.7	53.0	53.1	—	10.9	42.2	77.9	31.7	32.0	—	5.4	26.6
Debt securities in issue		14.3	14.7	—	10.2	4.5		12.8	13.5	—	10.2	3.3
Settlement balances	3.6						2.8					
Notes in circulation (1)	2.0						1.3					
Subordinated liabilities		19.1	19.7	—	17.0	2.7		17.5	18.3	—	15.7	2.6

2015	Group						Bank					
	Items where fair value approximates carrying value	Carrying value	Fair value	Fair value hierarchy level			Items where fair value approximates carrying value	Carrying value	Fair value	Fair value hierarchy level		
				Level 1	Level 2	Level 3				Level 1	Level 2	Level 3
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Financial assets												
Cash and balances at central banks	79.0						76.9					
Loans and advances to banks	0.8	7.0	7.0	—	3.5	3.5	0.2	22.8	23.0	—	7.4	15.6
Loans and advances to customers		288.7	281.9	—	1.3	280.6		123.1	119.6	—	19.9	99.7
Debt securities		7.3	7.2	5.0	1.0	1.2		10.6	10.5	5.0	2.9	2.6
Settlement balances	4.1						3.1					
Financial liabilities												
Deposits by banks	4.7	7.3	7.3	—	4.0	3.3	47.6	71.2	71.4	—	23.1	48.3
Customer accounts	253.9	80.2	80.2	—	31.1	49.1	65.2	38.3	38.6	—	13.2	25.4
Debt securities in issue		16.0	16.7	—	14.4	2.3		14.3	15.2	—	14.1	1.1
Settlement balances	3.4						2.4					
Notes in circulation (1)	1.9						1.2					
Subordinated liabilities		26.7	27.7	—	16.4	11.3		25.2	26.4	—	15.2	11.2

Note:

(1) Included in Accruals and other liabilities.

9 Financial instruments - valuation continued

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Quoted market values are used where available; otherwise, fair values have been estimated based on discounted expected future cash flows and other valuation techniques. These techniques involve uncertainties and require assumptions and judgments covering prepayments, credit risk and discount rates. Furthermore there is a wide range of potential valuation techniques. Changes in these assumptions would significantly affect estimated fair values. The fair values reported would not necessarily be realised in an immediate sale or settlement.

The assumptions and methodologies underlying the calculation of fair values of financial instruments at the balance sheet date are as follows:

Short-term financial instruments

For certain short-term financial instruments: cash and balances at central banks, items in the course of collection from other banks, settlement balances, items in the course of transmission to other banks, customer demand deposits and notes in circulation, carrying value is a reasonable approximation of fair value.

Loans and advances to banks and customers

In estimating the fair value of loans and advances to banks and customers measured at amortised cost, RBS's loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans. Two principal methods are used to estimate fair value:

- (a) Contractual cash flows are discounted using a market discount rate that incorporates the current spread for the borrower or where this is not observable, the spread for borrowers of a similar credit standing. This method is used for portfolios where counterparties have external ratings: institutional and corporate lending in CIB.
- (b) Expected cash flows (unadjusted for credit losses) are discounted at the current offer rate for the same or similar products. This approach is adopted for lending portfolios in UK PBB, Ulster Bank RoI, Commercial Banking (SME loans) and Private Banking in order to reflect the homogeneous nature of these portfolios.

For certain portfolios where there are very few or no recent transactions, such as Ulster Bank RoI'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

10 Financial instruments - maturity analysis

Remaining maturity

The following table shows the residual maturity of financial instruments, based on contractual date of maturity.

	Group					
	2016			2015		
	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	73,813	—	73,813	78,999	—	78,999
Loans and advances to banks	30,405	90	30,495	29,649	193	29,842
Loans and advances to customers	113,087	231,868	344,955	112,136	222,821	334,957
Debt securities	18,664	52,988	71,652	27,318	52,709	80,027
Equity shares	—	445	445	—	1,069	1,069
Settlement balances	5,557	—	5,557	4,108	—	4,108
Derivatives	61,898	185,846	247,744	41,625	221,458	263,083
Liabilities						
Deposits by banks	34,004	6,549	40,553	41,558	536	42,094
Customer accounts	371,811	4,254	376,065	368,386	5,688	374,074
Debt securities in issue	5,853	14,509	20,362	7,913	17,891	25,804
Settlement balances and short positions	5,004	20,713	25,717	6,186	18,005	24,191
Derivatives	60,931	176,646	237,577	42,856	212,692	255,548
Subordinated liabilities	1,072	18,443	19,515	322	26,708	27,030

	Bank					
	2016			2015		
	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	70,615	—	70,615	76,904	—	76,904
Loans and advances to banks	34,045	4,973	39,018	35,011	10,339	45,350
Loans and advances to customers	77,645	82,546	160,191	76,278	85,374	161,652
Debt securities	18,521	49,148	67,669	24,806	51,796	76,602
Equity shares	—	298	298	—	931	931
Settlement balances	4,707	—	4,707	3,053	—	3,053
Derivatives	61,975	189,501	251,476	41,950	223,651	265,601
Liabilities						
Deposits by banks	119,183	20,105	139,288	128,250	18,970	147,220
Customer accounts	136,554	5,664	142,218	131,342	7,432	138,774
Debt securities in issue	5,853	13,028	18,881	7,908	15,453	23,361
Settlement balances and short positions	3,608	16,756	20,364	4,476	15,480	19,956
Derivatives	61,549	179,349	240,898	43,015	214,357	257,372
Subordinated liabilities	1,055	16,815	17,870	307	25,227	25,534

Notes on the accounts

10 Financial instruments – maturity analysis continued

On balance sheet liabilities

The tables below show the timing of cash outflows to settle financial liabilities, prepared on the following basis:

Financial liabilities are included at the earliest date on which the counterparty can require repayment regardless of whether or not such early repayment results in a penalty. If repayment is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the liability is included at the earliest possible date that the conditions could be fulfilled without considering the probability of the conditions being met. For example, if a structured note automatically prepays when an equity index exceeds a certain level, the cash outflow will be included in the less than three months' period whatever the level of the index at the year end. The settlement date of debt securities issued by certain securitisation vehicles consolidated by the Group depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date.

Liabilities with a contractual maturity of greater than 20 years - the principal amounts of financial liabilities that are repayable after 20 years or where the counterparty has no right to repayment of the principal, are excluded from the table along with interest payments after 20 years.

Held-for-trading liabilities - held-for-trading liabilities of £318.6 billion (2015 - £345.1 billion) for the Group and £314.1 billion (2015 - £340.3 billion) for the Bank, have been excluded from the tables.

	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
2016						
Deposits by banks	8,800	33	1,285	5,050	78	79
Customers accounts	318,780	19,233	2,158	147	8	30
Debt securities in issue	1,768	3,883	5,333	5,037	2,455	798
Derivatives held for hedging	210	395	1,234	515	782	854
Subordinated liabilities	1,076	942	4,086	2,900	11,124	5,112
Settlement balances and other liabilities	5,669	—	—	—	—	—
	336,303	24,486	14,096	13,649	14,447	6,873

Guarantees and commitments - notional amount

Guarantees (1, 2)	3,560	—	—	—	—	—
Commitments (3)	134,259	—	—	—	—	—
	137,819	—	—	—	—	—

2015

Deposits by banks	10,758	781	1	1	232	194
Customers accounts	328,245	6,360	1,744	322	8	22
Debt securities in issue	3,568	3,112	5,126	6,153	4,435	332
Derivatives held for hedging	142	271	597	408	632	701
Subordinated liabilities	478	1,089	5,353	7,587	11,956	6,011
Settlement balances and other liabilities	5,269	—	—	—	—	—
	348,460	11,613	12,821	14,471	17,263	7,260

Guarantees and commitments - notional amount

Guarantees (1,2)	5,894	—	—	—	—	—
Commitments (3)	131,906	—	—	—	—	—
	137,800	—	—	—	—	—

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 £248 million (2015 - £680 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

10 Financial instruments - maturity analysis *continued*

	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
2016						
Deposits by banks	92,629	3,154	6,214	10,902	3,510	79
Customers accounts	88,953	16,125	2,298	905	1,245	392
Debt securities in issue	1,748	3,823	5,190	4,914	2,211	203
Derivatives held for hedging	170	325	970	394	557	593
Subordinated liabilities	1,048	878	3,933	2,462	10,861	4,559
Settlement balances and other liabilities	4,050	—	—	—	—	—
	188,598	24,305	18,605	19,577	18,384	5,826
Guarantees and commitments - notional amount						
Guarantees (1, 2)	2,322	—	—	—	—	—
Commitments (3)	80,747	—	—	—	—	—
	83,069	—	—	—	—	—
2015						
Deposits by banks	97,019	3,794	6,212	5,842	5,034	2,819
Customers accounts	94,519	3,319	1,502	1,606	2,040	1,275
Debt securities in issue	3,532	3,013	4,611	5,978	3,192	231
Derivatives held for hedging	111	212	458	298	428	483
Subordinated liabilities	453	1,032	5,226	7,453	11,418	5,547
Settlement balances and other liabilities	3,568	—	—	—	—	—
	199,202	11,370	18,009	21,177	22,112	10,355
Guarantees and commitments - notional amount						
Guarantees (1,2)	4,534	—	—	—	—	—
Commitments (3)	83,737	—	—	—	—	—
	88,271	—	—	—	—	—

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 £248 million (2015 - £680 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.

Notes on the accounts

11 Financial assets - impairments

The following tables show the movement in the provision for impairment losses on loans and advances.

	Group				
	Individually assessed £m	Collectively assessed £m	Latent £m	2016 £m	2015 £m
At 1 January	2,609	3,861	582	7,052	17,404
Transfers to disposal groups	(8)	—	(3)	(11)	(20)
Currency translation and other adjustments	238	222	33	493	(576)
Amounts written-off	(2,063)	(1,602)	—	(3,665)	(8,950)
Recoveries of amounts previously written-off	71	42	—	113	172
Charge/(releases) to income statement					
- continuing operations	523	218	(217)	524	(835)
- discontinued operations	1	—	1	2	1
Unwind of discount (recognised in interest income)	(30)	(82)	—	(112)	(144)
At 31 December ⁽¹⁾	1,341	2,659	396	4,396	7,052

	Bank				
	Individually assessed £m	Collectively assessed £m	Latent £m	2016 £m	2015 £m
At 1 January	872	567	133	1,572	3,464
Currency translation and other adjustments	115	3	1	119	(52)
Disposals	—	—	—	—	(48)
Amounts written-off	(532)	(157)	—	(689)	(1,726)
Recoveries of amounts previously written-off	36	13	—	49	(234)
Charges/(releases) to the income statement - continuing operations	540	19	(17)	542	(253)
Unwind of discount (recognised in interest income)	(20)	(15)	—	(35)	(47)
At 31 December ⁽¹⁾	1,011	430	117	1,558	1,572

Notes:

(1) Includes nil relating to loans and advances to banks (2015 - £1 million).

(2) The table above excludes impairments relating to securities.

	Group		
	2016 £m	2015 £m	2014 £m
Impairment charges/(releases) to the income statement			
Loans and advances to customers	524	(831)	(1,308)
Loans and advances to banks	—	(4)	(10)
	524	(835)	(1,318)
Debt securities	5	(3)	(11)
Total	529	(838)	(1,329)

Loans and advances to customers impairment charge in relation to discontinued operation, £2 million (2015 - £1 million charge: 2014 - £202 million release).

Notes on the accounts

11 Financial assets - impairments continued

	Group		
	2016 £m	2015 £m	2014 £m
Gross income not recognised but which would have been recognised under the original terms of the impaired loans			
Domestic	243	310	402
Foreign	122	124	141
	365	434	543
Interest on impaired loans included in net interest income			
Domestic	75	98	145
Foreign	38	46	101
	113	144	246

There was no gross income in discontinued operations that was not recognised but which would have been recognised under the original terms of the impaired loan (2015 - £1 million; 2014 - £2 million)

There was no interest on impaired loans included in net interest income in discontinued operations (2015 - nil; 2014 - £1 million)

The following tables analyse impaired financial assets.

	Group					
	2016			2015		
	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m
Loans and receivables						
Loans and advances to banks (1)	—	—	—	1	1	—
Loans and advances to customers (2)	8,779	4,000	4,779	10,748	6,469	4,279
	8,779	4,000	4,779	10,749	6,470	4,279

	Group	
	Carrying value 2016 £m	Carrying value 2015 £m
Available-for-sale securities		
Debt securities	33	9
Equity shares	21	31
Loans and receivables		
Debt securities	1	2
Total	55	42

	Bank					
	2016			2015		
	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m
Loans and receivables						
Loans and advances to banks (1)	—	—	—	1	1	—
Loans and advances to customers (3)	3,498	1,441	2,057	2,807	1,437	1,370
	3,498	1,441	2,057	2,808	1,438	1,370

Notes:

(1) Impairment provisions individually assessed.

(2) Impairment provisions individually assessed on balances of £3,559 million (2015 - £4,408 million).

(3) Impairment provisions individually assessed on balances of £2,879 million (2015 - £1,999 million).

11 Financial assets - impairments continued

	Bank	
	Carrying value 2016 £m	Carrying value 2015 £m
Available-for-sale securities		
Debt securities	33	9
Equity shares	11	21
Loans and receivables		
Debt securities	1	2
Total	45	32

Financial and non-financial assets recognised on the balance sheet, obtained during the year by taking possession of collateral or calling on other credit enhancements, were £30 million (2015 - £34 million) for the Group and £9 million (2015 - £11 million) for the bank.

In general, the Group seeks to dispose of property and other assets not readily convertible into cash, obtained by taking possession of collateral, as rapidly as the market for the individual asset permits.

12 Derivatives

Companies in the Group transact derivatives as principal either as a trading activity or to manage balance sheet foreign exchange, interest rate and credit risk.

The Group enters into fair value hedges, cash flow hedges and hedges of net investments in foreign operations. The majority of the Group's interest rate hedges relate to the management of the Group's non-trading interest rate risk. The Group manages this risk within approved limits. Residual risk positions are hedged with derivatives principally interest rate swaps. Suitable larger financial instruments are fair value hedged; the remaining exposure, where possible, is hedged by derivatives documented as cash flow hedges and qualifying for hedge accounting. The majority of the Group's fair value hedges involve interest rate swaps hedging the interest rate risk in recognised financial assets and financial liabilities. Cash flow hedges relate to exposures to the variability in future interest payments and receipts on forecast transactions and on recognised financial assets and financial liabilities. The Group hedges its net investments in foreign operations with currency borrowings and forward foreign exchange contracts.

For cash flow hedge relationships of interest rate risk, the hedged items are actual and forecast variable interest rate cash flows arising from financial assets and financial liabilities with interest rates linked to LIBOR, EURIBOR or the Bank of England Official Bank Rate. The financial assets are customer loans and the financial liabilities are customer deposits and LIBOR linked medium-term notes and other issued securities. At 31 December 2016, variable rate financial assets of £81 billion (2015 - £77 billion) for the Group and £47 billion (2015 - £43 billion) for the Bank, and variable rate financial liabilities of £55 billion (2015 - £29 billion) for the Group and £31 billion (2015 - £21 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 2016, fixed rate financial assets of £28 billion (2015 - £25 billion) for the Group and £26 billion (2015 - £22 billion) for the Bank, and fixed rate financial liabilities of £14 billion (2015 - £16 billion) for the Group and £13 billion (2015 - £16 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.

Notes on the accounts

12 Derivatives continued

The following table shows the notional amounts and fair values of the Group's derivatives.

	Group					
	2016			2015		
	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m
Exchange rate contracts						
Spot, forwards and futures	2,282	35,875	34,044	1,965	22,908	22,407
Currency swaps	833	22,214	25,296	762	18,372	21,813
Options purchased	670	17,486	—	484	13,706	—
Options written	682	—	18,109	495	—	13,943
Interest rate contracts						
Interest rate swaps	11,532	139,596	127,890	12,541	174,884	162,784
Options purchased	1,414	31,457	—	1,373	31,309	—
Options written	1,371	—	31,324	1,334	—	32,526
Futures and forwards	3,667	63	36	4,543	390	317
Credit derivatives	42	682	557	66	909	844
Equity and commodity contracts	24	371	321	18	605	914
	247,744	237,577		263,083	255,548	

	Group			
	2016		2015	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Amounts above include:				
Due from/to holding company	255	373	65	218
Due from/to fellow subsidiaries	1,051	855	1,210	1,065

Included in the table above are derivatives held for hedging purposes as follows:

	Group			
	2016		2015	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedging				
Interest rate contracts	1,199	2,440	1,261	1,647
Cash flow hedging				
Interest rate contracts	3,079	1,419	2,231	917
Exchange rate contracts	21	—	11	—
Net investment hedging				
Exchange rate contracts	66	3	47	8

Hedge ineffectiveness recognised in other operating income in continuing operations comprised:

	2016 £m	2015 £m	2014 £m
Fair value hedging			
Gains on the hedged items attributable to the hedged risk	886	142	653
Losses on the hedging instruments	(864)	(80)	(690)
Fair value hedging ineffectiveness	22	62	(37)
Cash flow hedging ineffectiveness	(29)	(23)	(33)
	(7)	39	(70)

Note:

(1) Hedge ineffectiveness recognised in other operating income in discontinued operations was nil in 2016 (2015 - nil; 2014 - loss - 1 million).

Notes on the accounts

12 Derivatives continued

	Bank					
	2016			2015		
	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m
Exchange rate contracts						
Spot, forwards and futures	2,290	35,991	34,192	1,973	23,015	22,492
Currency swaps	839	22,353	25,759	768	18,880	21,835
Options purchased	670	17,473	—	484	13,669	—
Options written	682	—	18,123	495	—	13,933
Interest rate contracts						
Interest rate swaps	11,598	143,125	130,487	12,624	176,812	164,456
Options purchased	1,414	31,429	—	1,375	31,282	—
Options written	1,372	—	31,331	1,335	—	32,536
Futures and forwards	3,662	63	36	4,540	390	317
Credit derivatives	44	682	557	66	909	844
Equity and commodity contracts	24	360	413	20	644	959
		251,476	240,898		265,601	257,372

Notes on the accounts

12 Derivatives continued

	Bank			
	2016		2015	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Amounts above include:				
Due from/to holding company	256	373	65	218
Due from/to fellow subsidiaries	1,050	855	1,210	1,065
Due from/to subsidiaries	4,838	3,808	3,451	2,245

Included in the table above are derivatives held for hedging purposes as follows:

	Bank			
	2016		-	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Fair value hedging				
Exchange rate contracts	6	—	13	1
Interest rate contracts	1,084	1,868	1,197	1,198
Cash flow hedging				
Interest rate contracts	1,562	1,031	1,278	644
Exchange rate contracts	21	—	11	—
Net investment hedging				
Exchange rate contracts	17	2	6	1

In both the Group and the Bank substantially all of the forecast receivable hedged cash flows occur within 5 years (2015 - 10 years) and substantially all forecast payable cash flows occur within 10 years (2015 – 20 years); the income statement is impacted over the same periods.

Notes on the accounts

13 Debt securities

	Group							
	Central and local government			Banks	Other financial institutions	Corporate	Total	Of which ABS (1)
	UK	US	Other					
2016	£m	£m	£m	£m	£m	£m	£m	£m
Held-for-trading	2,615	4,133	14,087	818	2,299	549	24,501	886
Available-for-sale	10,581	6,953	15,137	1,748	3,990	5	38,414	2,263
Loans and receivables	—	—	—	—	3,774	194	3,968	3,814
Held-to-maturity	4,769	—	—	—	—	—	4,769	—
	17,965	11,086	29,224	2,566	10,063	748	71,652	6,963
Available-for-sale								
Gross unrealised gains	768	56	503	8	93	2	1,430	75
Gross unrealised losses	(16)	(123)	(13)	(1)	(43)	(2)	(198)	(32)

2015

Held-for-trading	4,107	4,627	22,222	576	3,591	636	35,759	707
Available-for-sale	9,110	10,265	11,293	1,639	4,670	15	36,992	2,252
Loans and receivables	—	—	—	—	2,221	144	2,365	2,222
Held-to-maturity	4,911	—	—	—	—	—	4,911	—
	18,128	14,892	33,515	2,215	10,482	795	80,027	5,181
Available-for-sale								
Gross unrealised gains	383	104	267	3	105	7	869	88
Gross unrealised losses	(7)	(62)	(9)	(1)	(33)	(3)	(115)	(16)

Note:

(1) Includes covered bonds. 2015 included asset-backed securities issued by US federal agencies and government sponsored entities and covered bonds.

Gross gains of £89 million (2015 - £30 million) and gross losses of £19 million (2015 - nil) were realised on the sale of available-for-sale securities in continuing operations.

Gross gains of nil (2015 - £11 million) were realised on the sale of available-for-sale securities in discontinued operations.

	Bank								
	Central and local government			Other financial institutions			Corporate	Total	Of which
	UK	US	Other	Banks	institutions	Corporate	Total	ABS (1)	
	£m	£m	£m	£m	£m	£m	£m	£m	
2016									
Held-for-trading	2,615	673	14,087	721	1,858	548	20,502	878	
Available-for-sale	10,581	6,953	13,445	1,393	4,284	—	36,656	2,179	
Loans and receivables	—	—	—	—	5,548	194	5,742	5,588	
Held-to-maturity	4,769	—	—	—	—	—	4,769	—	
	17,965	7,626	27,532	2,114	11,690	742	67,669	8,645	
Available-for-sale									
Gross unrealised gains	768	56	499	7	88	—	1,418	74	
Gross unrealised losses	(16)	(123)	(12)	(1)	(38)	—	(190)	(32)	
2015									
Held-for-trading	4,107	598	22,221	513	2,768	604	30,811	706	
Available-for-sale	9,110	10,265	9,770	1,367	4,708	—	35,220	2,252	
Loans and receivables	—	—	—	—	5,516	144	5,660	5,289	
Held-to-maturity	4,911	—	—	—	—	—	4,911	—	
	18,128	10,863	31,991	1,880	12,992	748	76,602	8,247	
Available-for-sale									
Gross unrealised gains	383	104	266	3	101	—	857	88	
Gross unrealised losses	(7)	(62)	(9)	(1)	(28)	—	(107)	(16)	

Note:

(1) Includes covered bonds. 2015 included asset-backed securities issued by US federal agencies and government sponsored entities and covered bonds.

Notes on the accounts

14 Equity shares

	Group					
	2016			2015		
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Held-for-trading	106	22	128	598	3	601
Designated as at fair value through profit or loss	3	85	88	—	71	71
Available-for-sale	13	216	229	10	387	397
	122	323	445	608	461	1,069

Available-for-sale

Gross unrealised gains	7	47	54	5	262	267
Gross unrealised losses	—	(1)	(1)	—	(6)	(6)

	Bank					
	2016			2015		
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Held-for-trading	106	15	121	597	2	599
Available-for-sale	7	170	177	6	326	332
	113	185	298	603	328	931

Available-for-sale

Gross unrealised gains	4	42	46	3	248	251
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Gross gains of £59 million (2015 - £11 million) and gross losses of £9 million (2015 - £1 million) were realised on the sale of available-for-sale equity shares in continuing operations. There were no gains or losses in discontinued operations.

Dividend income from available-for-sale equity shares in continuing operations was £9 million (2015 - £20 million) and in discontinued operations was nil (2015 - £15 million).

Unquoted equity investments whose fair value cannot be reliably measured are carried at cost and classified as available-for-sale financial assets.

Notes on the accounts

15 Investments in Group undertakings

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

	Bank	
	2016	2015
	£m	£m
At 1 January	34,482	39,857
Currency translation and other adjustments	73	83
Additional investments	1,304	857
Disposals	(152)	(270)
Write back/(impairment) of investments	53	(6,045)
Transfer to disposal groups	(591)	—
At 31 December	35,169	34,482

On 1 January 2017, the company exchanged its shareholdings in National Westminster Bank Plc and Adam & Company Group PLC for additional shares in its wholly-owned subsidiary NatWest Holdings Limited. The control over National Westminster Bank Plc and Adam & Company Group PLC is retained through NatWest Holdings Limited.

The impairment charge for 2015 principally relates to the Bank's investment in RBSG International Holdings Limited, the former direct parent of Citizens Financial Group Inc.

The principal subsidiary undertakings of the Bank are shown below. Their capital consists of ordinary and preference shares, which are unlisted with the exception of certain preference shares issued by NatWest. All of the subsidiary undertakings are owned either by the Bank, or directly or indirectly through intermediate holding companies. 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
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.

Full information on all related undertakings is included in Note 42.

Notes on the accounts

16 Intangible assets

2016	Group		
	Goodwill £m	Other (1) £m	Total £m
Cost			
At 1 January	9,826	2,210	12,036
Transfers to disposal groups	(300)	(5)	(305)
Currency translation and other adjustments	146	43	189
Additions	—	480	480
Disposals and write-off of fully amortised assets	—	(645)	(645)
At 31 December	9,672	2,083	11,755
Accumulated amortisation and impairment			
At 1 January	4,277	1,233	5,510
Transfers to disposal groups	—	(1)	(1)
Currency translation and other adjustments	146	37	183
Disposals and write-off of fully amortised assets	—	(465)	(465)
Charge for the year			
- continuing operations	—	203	203
- discontinued operations	—	1	1
Write down of goodwill and other intangible assets			
- continuing operations	—	159	159
At 31 December	4,423	1,167	5,590
Net book value at 31 December	5,249	916	6,165

2015	Group		
	Goodwill £m	Other (1) £m	Total £m
Cost			
At 1 January	10,061	2,994	13,055
Transfers from fellow subsidiaries	—	5	5
Transfers to disposal groups	(220)	(156)	(376)
Currency translation and other adjustments	(15)	(9)	(24)
Additions	—	613	613
Disposals and write-off of fully amortised assets	—	(1,237)	(1,237)
At 31 December	9,826	2,210	12,036
At 1 January	3,806	1,484	5,290
Transfers to disposal groups	—	(149)	(149)
Currency translation and other adjustments	(27)	(15)	(42)
Disposals and write-off of fully amortised assets	—	(1,149)	(1,149)
Charge for the year			
- continuing operations	—	229	229
Write down of goodwill and other intangible assets			
- continuing operations	498	833	1,331
At 31 December	4,277	1,233	5,510
Net book value at 31 December	5,549	977	6,526

Note:

(1) Principally internally generated software.

Notes on the accounts

16 Intangible assets continued

		Bank	
	Goodwill	Internally generated software	Total
	£m	£m	£m
2016			
Cost			
At 1 January	100	710	810
Currency translation and other adjustments	—	10	10
Transfers (to)/from fellow subsidiaries	—	3	3
Additions	—	470	470
Disposals and write-off of fully amortised assets	—	(433)	(433)
At 31 December	100	760	860
Accumulated amortisation and impairment			
At 1 January	15	251	266
Currency translation and other adjustments	—	10	10
Transfers (to)/from fellow subsidiaries	—	26	26
Disposals and write-off of fully amortised assets	—	(258)	(258)
Charge for the year	—	154	154
Write down of goodwill and other intangible assets	—	141	141
At 31 December	15	324	339
Net book value at 31 December	85	436	521
2015			
Cost			
At 1 January	100	1,292	1,392
Currency translation and other adjustments	—	(4)	(4)
Transfers (to)/from fellow subsidiaries	—	29	29
Additions	—	612	612
Disposals and write-off of fully amortised assets	—	(1,219)	(1,219)
At 31 December	100	710	810
Accumulated amortisation and impairment			
At 1 January	15	460	475
Currency translation and other adjustments	—	(3)	(3)
Transfers (to)/from fellow subsidiaries	—	42	42
Disposals and write-off of fully amortised assets	—	(1,131)	(1,131)
Charge for the year	—	158	158
Write down of goodwill and other intangible assets	—	725	725
At 31 December	15	251	266
Net book value at 31 December	85	459	544

Notes on the accounts

16 Intangible assets continued

The Group's goodwill acquired in business combinations is reviewed annually at 31 December for impairment.

Impairment testing involves the comparison of the carrying value of each cash-generating unit (CGU) 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. 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 is presented in the tables on the following page.

The recoverable amounts for all CGUs at 31 December 2016 were based on value in use, using management's latest five-year forecasts. The long-term growth rates have been based on expected nominal growth of the CGUs. The risk discount rates are based on those observed to be applied to businesses regarded as peers of the CGUs.

The annual review at 31 December 2016 indicated no impairment to goodwill.

As a result of the changes to the reportable segments in 2015 goodwill of £0.3 billion was allocated to RBSI Holdings (included in disposal groups at 31 December 2016), £0.2 billion of which was previously reported in Commercial Banking and £0.1 billion of which was previously reported in Private Banking. Goodwill of £0.2 billion was allocated from Private Banking to International Private Banking which was included within disposal groups at 31 December 2015, see Note 18. The 2015 annual review indicated that the remaining £0.5 billion goodwill relating to Private Banking was impaired. Other CGUs' goodwill was not impaired.

The analysis of goodwill by reportable segment is shown in Note 36.

The carrying value of goodwill and the amount by which it is exceeded by the recoverable amount are set out below by reportable segment, along with the key assumptions applied in calculating the recoverable amount and sensitivities to changes in those assumptions.

	Goodwill £bn	Assumptions		Recoverable amount exceeded carrying value £bn	Consequential impact of 1% adverse movement in		Consequential impact of 5% adverse movement in forecast pre-tax earnings £bn
		Terminal growth rate %	Pre-tax discount rate %		Discount rate £bn	Terminal growth rate £bn	
At 31 December 2016							
UK Personal & Business Banking	3.4	2.5	12.8	14.6	(2.3)	(1.5)	(1.4)
Commercial Banking	1.9	2.5	12.9	2.1	(1.2)	(0.8)	(0.8)
RBS International (1)	0.3	2.5	10.9	0.2	(0.3)	(0.2)	(0.1)
31 December 2015							
UK Personal & Business Banking	3.3	4.5	12.0	10.7	(2.6)	(1.5)	(1.7)
Commercial Banking	1.9	4.5	12.1	6.4	(1.9)	(0.9)	(1.2)
RBS International	0.3	4.5	10.2	1.2	(0.5)	(0.3)	(0.2)

Note:

(1) RBSIH is classified as a disposal group at 31 December 2016.

Other intangible assets are reviewed for indicators of impairment. In 2016, £159 million (2015 - £833 million) of previously capitalised software was impaired by the Group. Previously capitalised software impaired by the Bank was £141 million (2015 - £725 million).

Notes on the accounts

17 Property, plant and equipment

	Group						
	Investment properties £m	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Operating lease assets £m	Total £m
2016							
Cost or valuation							
At 1 January	906	2,524	177	1,248	2,268	1,556	8,679
Transfers to disposal groups	—	(22)	(3)	—	(90)	—	(115)
Currency translation and other adjustments	138	91	3	71	109	25	437
Reclassifications	—	46	—	(46)	—	—	—
Additions	103	208	5	79	279	228	902
Change in fair value of investment properties							
- continuing operations	(15)	—	—	—	—	—	(15)
Disposals and write-off of fully depreciated assets	(52)	(136)	(34)	(107)	(200)	(496)	(1,025)
At 31 December	1,080	2,711	148	1,245	2,366	1,313	8,863
Accumulated impairment, depreciation and amortisation							
At 1 January	—	1,069	88	750	1,643	676	4,226
Transfers to disposal groups	—	(4)	(2)	—	(71)	—	(77)
Currency translation and other adjustments	—	71	1	50	95	9	226
Reclassifications	—	9	—	(9)	—	—	—
Write down of property, plant and equipment	—	71	—	—	7	—	78
Disposals and write-off of fully depreciated assets	—	(119)	(22)	(76)	(152)	(250)	(619)
Charge for the year							
- continuing operations	—	74	4	82	174	153	487
- discontinued operations	—	—	—	—	6	—	6
At 31 December	—	1,171	69	797	1,702	588	4,327
Net book value at 31 December	1,080	1,540	79	448	664	725	4,536
2015							
Cost or valuation							
At 1 January	1,933	2,824	213	1,320	2,936	1,551	10,777
Transfers to disposal groups	—	(7)	—	(41)	(25)	—	(73)
Currency translation and other adjustments	(101)	13	(2)	(4)	1	15	(78)
Additions	12	139	8	125	349	202	835
Change in fair value of investment properties							
- continuing operations	13	—	—	—	—	—	13
Disposals and write-off of fully depreciated assets	(951)	(445)	(42)	(152)	(993)	(212)	(2,795)
At 31 December	906	2,524	177	1,248	2,268	1,556	8,679
Accumulated impairment, depreciation and amortisation							
At 1 January	—	986	121	785	2,100	662	4,654
Transfers to disposal groups	—	(3)	—	(24)	(23)	—	(50)
Currency translation and other adjustments	—	7	11	—	(3)	5	20
Write down of property, plant and equipment	—	279	—	—	93	—	372
Disposals and write-off of fully depreciated assets	—	(262)	(38)	(103)	(795)	(144)	(1,342)
Charge for the year							
- continuing operations	—	61	(6)	92	264	153	564
- discontinued operations	—	1	—	—	7	—	8
At 31 December	—	1,069	88	750	1,643	676	4,226
Net book value at 31 December	906	1,455	89	498	625	880	4,453

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 - 93% (2015 - 95%); otherwise investment property fair value measurements are categorised as level 3 - 7% (2015 - 5%).

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 £470 million (2015 - £700 million) was valued by independent valuers.

Rental income from investment properties was £79 million (2015 - £79 million). Direct operating expenses of investment properties were £16 million (2015 - £14 million).

Notes on the accounts

17 Property, plant and equipment continued

	Bank					Total £m
	Investment Properties £m	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	
2016						
Cost or valuation						
At 1 January	—	1,160	76	633	1,735	3,604
Transfers (to)/from fellow subsidiaries	(52)	(197)	—	5	(6)	(250)
Currency translation and other adjustments	—	5	2	9	14	30
Reclassifications	—	46	—	(46)	—	—
Additions	52	189	2	60	205	508
Disposals and write-off of fully depreciated assets	—	(96)	(29)	(51)	(144)	(320)
At 31 December	—	1,107	51	610	1,804	3,572
Accumulated impairment, depreciation and amortisation						
At 1 January	—	375	46	337	1,234	1,992
Transfers (to)/from fellow subsidiaries	—	(9)	—	—	(5)	(14)
Currency translation and other adjustments	—	5	1	9	14	29
Reclassifications	—	9	—	(9)	—	—
Write down of property, plant and equipment	—	69	—	—	7	76
Disposals and write-off of fully depreciated assets	—	(92)	(19)	(39)	(119)	(269)
Charge for the year	—	44	1	37	153	235
At 31 December	—	401	29	335	1,284	2,049
Net book value at 31 December	—	706	22	275	520	1,523

2015

Cost or valuation						
At 1 January	—	1,314	76	628	2,483	4,501
Currency translation and other adjustments	—	(1)	(1)	(1)	(4)	(7)
Additions	—	49	1	66	228	344
Disposals and write-off of fully depreciated assets	—	(202)	—	(60)	(972)	(1,234)
At 31 December	—	1,160	76	633	1,735	3,604
Accumulated impairment, depreciation and amortisation						
At 1 January	—	409	44	335	1,737	2,525
Currency translation and other adjustments	—	—	11	—	(3)	8
Write down of property, plant and equipment	—	—	—	—	81	81
Disposals and write-off of fully depreciated assets	—	(85)	—	(43)	(803)	(931)
Charge for the year	—	51	(9)	45	222	309
At 31 December	—	375	46	337	1,234	1,992
Net book value at 31 December	—	785	30	296	501	1,612

18 Prepayments, accrued income and other assets

	Group		Bank	
	2016 £m	2015 £m	2016 £m	2015 £m
Prepayments	343	392	238	277
Accrued income	367	268	170	107
Tax recoverable	40	150	23	143
Pension schemes in net surplus (see Note 4)	267	215	264	186
Interests in associates	390	306	68	61
Other assets	881	1,688	800	775
	2,288	3,019	1,563	1,549

Notes on the accounts

19 Discontinued operations and assets and liabilities of disposal groups

As part of implementing the legislation following the recommendations of the Independent Commission on Banking, on 1 January 2017 The Royal Bank of Scotland International (Holdings) Limited (RBSI Holdings) was sold to The Royal Bank of Scotland Group plc, the immediate parent of the Group. Accordingly, RBSI Holdings has been classified as a disposal group at 31 December 2016 and presented as a discontinued operation, with comparative income statement and related notes re-presented.

The Group sold the final tranche of its interest in Citizens Financial Group, Inc. (Citizens) in October 2015. Consequently, Citizens was classified as a disposal group at 31 December 2014 and presented as a discontinued operation until October 2015. From 3 August 2015, until the final tranche was sold in October 2015, Citizens was an associated undertaking.

The gain on disposal in 2015 comprised £249 million on the derecognition of assets and liabilities, and £1,001 million in respect of reserves reclassified in accordance with IFRS.

(a) Profit/(loss) from discontinued operations, net of tax

	2016 £m	2015 £m	2014 £m
Citizens			
Interest income	—	1,433	2,204
Interest expense	—	(144)	(191)
Net interest income	—	1,289	2,013
Other income	—	615	1,043
Total income	—	1,904	3,056
Operating expenses	—	(1,181)	(2,123)
Profit before impairment losses	—	723	933
Impairment losses	—	(103)	(197)
Operating profit before tax	—	620	736
Tax charge	—	(212)	(228)
Profit after tax	—	408	508
Provision for gain(loss) on disposal of subsidiary	—	10	(3,994)
Gain on disposal of subsidiary	—	1,159	—
Provision for loss on disposal of interest in associate	—	(130)	—
Gain on disposal of interest in associate	—	91	—
Profit/(loss) from Citizens discontinued operations, net of tax	—	1,538	(3,486)
RBSI Holdings			
Total income	275	212	214
Operating expenses	(130)	(130)	(147)
Profit before impairment losses	145	82	67
Impairment losses	(2)	(1)	8
Operating profit before tax	143	81	75
Tax charge	(26)	(23)	(26)
Profit from RBSI Holdings discontinued operations, net of tax	117	58	49

(b) Cash flows attributable to discontinued operations

Included within the Groups cash flows are the following amounts attributable to discontinued operations.

	2016 £m	2015 £m	2014 £m
Net cash flows from operating activities	(32)	(58)	4,015
Net cash flows from investing activities	(12)	(7)	(4,196)
Net cash flows from financing activities	—	10	596
Net (decrease)/increase in cash and cash equivalents	(16)	(60)	145

Notes on the accounts

19 Discontinued operations and assets and liabilities of disposal groups continued

(c) Assets and liabilities of disposal groups

	2016 £m	2015 £m
Assets		
Cash and balances at central banks	62	535
Loans and advances to banks	31	709
Loans and advances to customers	7,891	1,639
Debt securities and equity shares	—	443
Derivatives	15	30
Intangible assets	304	—
Property, plant and equipment	38	19
Other assets	25	111
Assets of disposal groups	8,366	3,486
Liabilities		
Deposits by banks	1	32
Customer accounts	23,272	2,805
Derivatives	9	28
Settlement balances	—	7
Other liabilities	109	108
Liabilities of disposal groups	23,391	2,980

At 31 December 2016 disposal groups primarily comprise the net assets of RBSI Holdings, which in January 2017 was sold to The Royal Bank of Scotland Group plc at its book value; costs to sell were immaterial. At 31 December 2015 the net assets of disposal groups primarily comprised International Private Banking measured at the agreed sale price to Union Bancaire Privée less costs to sell (fair value hierarchy level 3) (£3,344 million assets; £2,724 million liabilities).

20 Short positions

	Group		Bank	
	2016 £m	2015 £m	2016 £m	2015 £m
Debt securities				
- Government	20,978	19,840	16,586	16,769
- Other issuers	1,095	966	1,001	822
Equity shares	3	2	3	2
	22,076	20,808	17,590	17,593

Note:

(1) All short positions are classified as held-for-trading.

Notes on the accounts

21 Provisions for liabilities and charges

	Group					Total £m
	Payment protection insurance (1) £m	Other customer redress (2) £m	Residential mortgage backed securities (3) £m	Litigation and other regulatory(4) £m	Property and other (5,6) £m	
Provisions for liabilities and charges						
At 1 January 2016	996	759	3,772	498	1,195	7,220
Transfer to disposal groups	(1)	(10)	—	—	(6)	(17)
Transfer from accruals and other liabilities	—	37	17	17	36	107
Transfer	50	(26)	105	(53)	(76)	—
Currency translation and other movements	—	8	686	73	83	850
Charge to income statement						
- continuing operations	600	627	3,391	740	1,471	6,829
- discontinued operations	1	1	—	—	6	8
Releases to income statement						
- continuing operations	—	(26)	(91)	(73)	(319)	(509)
- discontinued operations	—	(3)	—	—	(2)	(5)
Provisions utilised	(394)	(326)	(1,128)	(145)	(650)	(2,643)
At 31 December 2016	1,252	1,041	6,752	1,057	1,738	11,840

	Bank					Total £m
	Payment protection insurance (1) £m	Other customer redress (2) £m	Residential mortgage backed securities (3) £m	Litigation and other regulatory(4) £m	Property and other (5) £m	
Provisions for liabilities and charges						
At 1 January 2016	393	179	—	399	876	1,847
Transfer from accruals and other liabilities	—	35	—	5	27	67
Transfer	16	(8)	—	52	(60)	—
Currency translation and other movements	—	—	—	59	53	112
Charge to income statement	237	151	1,786	649	1,287	4,110
Releases to income statement	—	(16)	—	(131)	(235)	(382)
Provisions utilised	(149)	(70)	—	(125)	(526)	(870)
At 31 December 2016	497	271	1,786	908	1,422	4,884

Notes:

(1) To reflect the developments detailed in Note 30, the Group increased its provision for PPI by £601 million in 2016 (2015 - £600 million), bringing the cumulative charge to £4.9 billion, of which £3.3 billion (67%) in redress, and £0.4 billion administrative expenses had been paid by 31 December 2016. Of the £4.9 billion cumulative charge, £4.5 billion relates to redress and £0.4 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 FCA policy statements and the expected rate of responses from proactive customer contact. The average redress assumption is based on recent experience and FCA calculation rules.

Notes on the accounts

21 Provisions for liabilities and charges *continued*

The table below shows the sensitivity of the provision to changes in the principal assumptions (all other assumptions remaining the same).

Assumption	Actual to date	Current assumptions	Sensitivity	
			Change in assumption %	Consequential change in provision £m
Single premium book past business review take up rate	57%	58%	+/-5	+/-55
Uphold rate ⁽¹⁾	91%	91%	+/-5	+/-50
Average redress	£1,693	£1,669	+/-5	+/-46

Note:

Uphold rates exclude claims where no PPI policy was held.

Interest that will be payable on successful complaints has been included in the provision as has the estimated cost to the Group of administering the redress process. There are uncertainties as to the eventual cost of redress which will depend on actual complaint volumes, take up and uphold rates and average redress costs. Assumptions related to these are inherently uncertain and the ultimate financial impact may be different from the amount provided. We continue to monitor the position closely and refresh the underlying assumptions.

Background information in relation to PPI claims is given in Note 30.

(2) The group has provided for other customer redress, primarily in relation to investment advice in retail and private banking, (2016 - nil: 2015 - £49 million), packaged accounts, (2016 - nil: 2015 - £157 million) and interest rate hedging products, (2016 - nil: 2015 - £81 million).

The group has a provision of £64 million for its liability in respect of the sale of Interest Rate Hedging Products (IRHP), having an incurred costs of £1.5 billion. The Review is now materially complete (99.4%) with only a small number of claims for additional losses (Consequential Loss) remaining. Background information in relation to Interest Rate Hedging Products is given in note 30.

The group established a provision of £400 million in November 2016 in respect of the FCA review of the groups treatment of SME customers, relating to the automatic refund of complex fees for SME customers that were in GRG between 2008 and 2013, additional redress costs arising from a new complaints process, and the associated operational costs. Background information in relation to the FCA review of SME customers is given in note 30.

(3) In the US, the Group is subject to civil litigation and various civil and criminal investigations relating to its issuance and underwriting of RMBS. As announced on 26 January, an additional charge of £3.1 billion was taken in the fourth quarter of 2016 in connection with these matters. Detailed descriptions of RBS's legal proceedings and discussion of the associated uncertainties are given in Note 30.

(4) The Group is party to certain legal proceedings and regulatory investigations and continues to co-operate with a number of regulators. All such matters are periodically reassessed with the assistance of external professional advisers, where appropriate, to determine the likelihood of the Group incurring a liability and to evaluate the extent to which a reliable estimate of any liability can be made. Details of these investigations and a discussion of the nature of the associated uncertainties are given in Note 30.

(5) The Group has recognised a £750 million provision in 2016 as a consequence of the announcement that HM Treasury is seeking a revised package of remedies that would conclude its remaining State Aid commitments.

(6) The majority of property provisions relate to vacant leasehold property and comprise the present value of the shortfall between rentals payable and rentals receivable from sub-letting. Other provisions include restructuring provisions of £430 million principally termination benefits.

22 Accruals and other liabilities

	Group		Bank	
	2016 £m	2015 £m	2016 £m	2015 £m
Notes in circulation	2,028	1,886	1,276	1,199
Current tax	346	186	250	166
Accruals	1,266	1,876	668	1,192
Deferred income	437	379	268	226
Other liabilities	2,052	2,523	807	1,046
	6,129	6,850	3,269	3,829

Notes on the accounts

23 Deferred tax

	Group		Bank	
	2016 £m	2015 £m	2016 £m	2015 £m
Deferred tax liability	525	729	—	—
Deferred tax asset	(1,798)	(2,622)	(272)	(902)
Net deferred tax asset	(1,273)	(1,893)	(272)	(902)

Net deferred tax asset comprised:

	Group										
	Pension £m	Accelerated capital allowances £m	Provisions £m	Deferred gains £m	Fair value of financial instruments £m	Available- for-sale financial assets £m	Cash flow hedging £m	Share schemes £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2015	(715)	540	(241)	39	(52)	48	280	(30)	(1,479)	(35)	(1,645)
Acquisitions and disposals of subsidiaries	7	(19)	—	(3)	—	(4)	—	—	—	(1)	(20)
Charge/(credit) to income statement - continuing operations	160	(289)	(89)	14	48	(44)	98	2	135	54	89
(Credit)/charge to other comprehensive income	(314)	—	—	—	—	66	(135)	5	—	—	(378)
Currency translations and other adjustments	5	9	3	—	—	23	—	—	13	8	61
At 1 January 2016	(857)	241	(327)	50	(4)	89	243	(23)	(1,331)	26	(1,893)
Acquisitions and disposals of subsidiaries	(6)	(62)	—	3	—	5	—	—	—	1	(59)
(Credit)/charge to income statement - continuing operations	(39)	147	(8)	(4)	26	(24)	(142)	13	317	1	287
- discontinued operations	—	1	—	—	—	—	—	—	—	—	1
Charge/(credit) to other comprehensive income	240	—	—	—	—	(8)	158	—	—	—	390
Currency translations and other adjustments	(4)	32	—	—	—	—	—	—	(36)	9	1
At 31 December 2016	(666)	359	(335)	49	22	62	259	(10)	(1,050)	37	(1,273)

	Bank									
	Pension £m	Accelerated capital allowances £m	Provisions £m	Deferred gains £m	Available- for-sale financial assets £m	Cash flow hedging £m	Share schemes £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2015	(3)	(229)	(195)	22	—	208	(29)	(489)	(18)	(733)
Credit/(charge) to income statement	1	(180)	(64)	9	—	13	2	27	18	(174)
Charge/(credit) to other comprehensive income	20	—	—	—	58	(77)	4	—	—	5
Currency translations and other adjustments	—	—	—	—	—	—	—	—	—	—
At 1 January 2016	18	(409)	(259)	31	58	144	(23)	(462)	—	(902)
Charge/(credit) to income statement	11	300	(2)	(6)	—	(5)	13	280	31	622
Charge/(credit) to other comprehensive income	21	—	—	—	2	(15)	—	—	—	8
Currency translations and other adjustments	—	—	—	(1)	—	—	—	—	1	—
At 31 December 2016	50	(109)	(261)	24	60	124	(10)	(182)	32	(272)

Notes on the accounts

23 Deferred tax continued

Deferred tax assets in respect of unused tax losses are recognised if the losses can be used to offset probable future taxable profits after taking into account the expected reversal of other temporary differences. Recognised deferred tax assets in respect of tax losses are analysed below.

	2016 £m	2015 £m
UK tax losses carried forward		
- The Royal Bank of Scotland plc	182	462
- National Westminster Bank Plc	605	628
- Ulster Bank Limited	14	31
	801	1,121
Overseas tax losses carried forward		
- Ulster Bank Ireland DAC	249	210
	1,050	1,331

UK tax losses

Under UK tax rules, tax losses can be carried forward indefinitely. In periods from 1 April 2015, the Finance Act 2015 limits the offset of losses carried forward by UK banks to 50% of profits. In periods from 1 April 2016, the Finance Act 2016 further limits the offset of losses carried forward by UK banks to 25% of profits. The main rate of UK Corporation Tax will reduce from 20% to 19% from 1 April 2017 and to 17% from 1 April 2020. Under the Finance (No 2) Act 2015, tax losses carried forward at 31 December 2016 are given credit in future periods at the main rate of UK corporation tax, excluding the Banking Surcharge rate (8%) introduced by the Act. Deferred tax assets and liabilities at 31 December 2016 take into account the reduced rates in respect of tax losses and non-banking temporary differences and where appropriate, the banking surcharge inclusive rate in respect of other banking temporary differences.

The Royal Bank of Scotland plc – The Royal Bank of Scotland plc reported taxable profits in 2011 and 2014, and tax losses in 2012, 2013 and 2015. The tax 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 accelerated recovery strategy recorded in the final quarter of the period. In 2014, core profitability remained strong and a taxable profit arose. In 2015 a further tax loss arises as a result of restructuring costs incurred as part of RBS's strategic plan. In 2016, a taxable profit arises. A reduction in the carrying value of deferred tax assets of £701 million was recorded in 2013, an additional reduction of £850 million was recorded in 2014, with a further reduction of £300 million being recorded in 2016. In addition, deferred tax of £150 million was not recognised in respect of excess 2013 UK taxable losses. RBS expects that the balance of recognised deferred tax asset at 31 December 2016 of £182 million in respect of tax losses amounting to £947 million will be recovered by the end of 2021.

National Westminster Bank Plc – the deferred tax asset in respect of tax losses at 31 December 2016 relates to residual unrelieved trading losses that arose between 2009 and 2014. 59% of the losses that arose were relieved against taxable profits arising in other UK Group companies. Taxable profits arose in 2015 and 2016. Based on its strategic plan, RBS expects that the recognised deferred tax asset of £605 million in respect of tax losses amounting to £3,361 million will be recovered by the end of 2022.

Overseas tax losses

Ulster Bank Ireland DAC – a deferred tax asset of £249 million has been recognised in respect of losses of £1,992 million (2015 - £1,678 million; 2014 - £1,776 million) of total tax losses of £7,989 million (2015 - £7,083 million; 2014 - £8,599 million) carried forward at 31 December 2016. Please note that the increase in the total tax losses and associated deferred tax asset is due to the €:£ exchange rate. These losses arose principally as a result of significant impairment charges between 2008 and 2013 reflecting challenging economic conditions in the Republic of Ireland. Impairment charges have reduced and Ulster Bank Ireland DAC returned to profitability during 2014, 2015 & 2016. Based on RBS's strategic plan, the losses on which a deferred tax asset has been recognised will be utilised against future taxable profits by the end of 2023.

Unrecognised deferred tax

Deferred tax assets of £5,728 million (2015 - £4,364 million, 2014 - £3,778 million) have not been recognised in respect of tax losses and other temporary differences carried forward of £24,373 million (2015 - £19,499 million, 2014 - £18,760 million) in jurisdictions where doubt exists over the availability of future taxable profits. Of these losses and other temporary differences, £7,888 million will expire after five years. The balance of tax losses and other temporary differences carried forward has no expiry date.

Deferred tax liabilities of £258 million (2015 - £256 million; 2014 - £186 million) have not been recognised in respect of retained earnings of overseas subsidiaries and held-over gains on the incorporation of overseas branches. Retained earnings of overseas subsidiaries are expected to be reinvested indefinitely or remitted to the UK free from further taxation. No taxation is expected to arise in the foreseeable future in respect of held-over gains. Changes to UK tax legislation largely exempts from UK tax, overseas dividends received on or after 1 July 2009.

Notes on the accounts

24 Subordinated liabilities

Certain preference shares issues are classified as liabilities; these securities remain subject to the capital maintenance rules of the Companies Act 2006.

The following tables analyse the remaining contracted maturity of subordinated liabilities by the final redemption date and by the next call date.

	Group		Bank	
	2016 £m	2015 £m	2016 £m	2015 £m
Dated loan capital	11,429	15,870	11,045	15,470
Undated loan capital	4,538	8,179	3,631	7,401
Preference shares	3,548	2,981	3,194	2,663
	19,515	27,030	17,870	25,534

2016 - final redemption	Group						Total £m
	2017 £m	2018 £m	2019-2021 £m	2022-2026 £m	Thereafter £m	Perpetual £m	
Sterling	21	—	369	—	—	2,166	2,556
US dollar	105	—	103	5,521	1,269	4,373	11,371
Euro	912	1,817	—	1,730	—	215	4,674
Other	34	—	—	872	—	8	914
	1,072	1,817	472	8,123	1,269	6,762	19,515

2016 - call date	Group						Total £m
	Currently £m	2017 £m	2018 £m	2019-2021 £m	2022-2026 £m	Thereafter £m	
Sterling	1,610	68	113	407	140	21	2,556
US dollar	2,711	2,293	—	103	3,904	1,751	11,371
Euro	162	1,394	1,817	870	378	—	4,674
Other	8	906	—	—	—	—	914
	4,491	4,661	1,930	1,380	4,422	1,772	19,515

2015 - final redemption	Group						Total £m
	2016 £m	2017 £m	2018-2020 £m	2021-2025 £m	Thereafter £m	Perpetual £m	
Sterling	34	—	4,999	369	—	4,661	10,063
US dollar	91	—	339	4,632	1,062	4,952	11,076
Euro	167	648	1,621	2,245	—	184	4,865
Other	30	—	18	737	—	241	1,026
	322	648	6,977	7,983	1,062	10,038	27,030

2015 - call date	Group						Total £m
	Currently £m	2016 £m	2017 £m	2018-2020 £m	2021-2025 £m	Thereafter £m	
Sterling	2,560	5,073	51	1,655	483	45	10,063
US dollar	2,011	1,055	2,919	339	3,289	1,463	11,076
Euro	—	1,063	1,063	2,372	320	—	4,865
Other	26	263	737	—	—	—	1,026
	4,597	7,454	4,770	4,366	4,092	1,508	27,030

Notes on the accounts

24 Subordinated liabilities continued

	Bank						Total £m
	2017 £m	2018 £m	2019-2021 £m	2022-2026 £m	Thereafter £m	Perpetual £m	
2016 - final redemption							
Sterling	11	—	—	—	—	1,910	1,921
US dollar	99	—	101	5,521	1,271	3,593	10,585
Euro	911	1,817	—	1,730	—	—	4,458
Other	34	—	—	872	—	—	906
	1,055	1,817	101	8,123	1,271	5,503	17,870

	Bank						Total £m
	Currently £m	2017 £m	2018 £m	2019-2021 £m	2022-2026 £m	Thereafter £m	
2016 - call date							
Sterling	1,610	59	113	38	51	20	1,921
US dollar	1,925	2,293	—	101	3,904	1,753	10,585
Euro	—	1,393	1,817	870	378	—	4,458
Other	—	906	—	—	—	—	906
	3,535	4,651	1,930	1,009	4,333	1,773	17,870

	Bank						Total £m
	2016 £m	2017 £m	2018-2020 £m	2021-2025 £m	Thereafter £m	Perpetual £m	
2015 - final redemption							
Sterling	24	—	4,999	—	—	4,406	9,429
US dollar	87	—	339	4,632	1,062	4,305	10,425
Euro	166	648	1,621	2,245	—	—	4,680
Other	30	—	—	737	—	233	1,000
	307	648	6,959	7,614	1,062	8,944	25,534

	Bank						Total £m
	Currently £m	2016 £m	2017 £m	2018-2020 £m	2021-2025 £m	Thereafter £m	
2015 - call date							
Sterling	2560	5,063	51	1,655	25	45	9,429
US dollar	1,838	577	2,919	339	3,289	1,463	10,425
Euro	—	925	1,063	2,372	320	—	4,680
Other	—	263	737	—	—	—	1,000
	4,398	6,828	4,770	4,366	3,634	1,508	25,534

Notes on the accounts

24 Subordinated liabilities continued

Issuances and redemptions during the year (value at date of transaction) are set out below.

	Capital treatment	2016 £m	2015 £m
Redemptions			
<i>The Royal Bank of Scotland plc</i>			
£54 million 5.13% undated notes	Ineligible	55	—
£5000 million floating rate dated notes	Tier 2	5,000	—
CAD474 million 5.37% undated notes	Ineligible	283	—
€1 billion 4.63% dated notes	Ineligible	866	—
US\$350 million 4.70% dated notes	Ineligible	282	—
US\$350 million undated floating rate notes	Ineligible	282	—
£940 million floating rate perpetual notes	Tier 2	940	—
£1,500 million floating rate perpetual notes	Tier 2	1,500	—
US\$1,600 million floating rate perpetual notes	Tier 2	1,289	—
€23 million floating rate dated notes	Ineligible	—	17
US\$675 million 5.05% dated notes	Ineligible	—	445
AU\$18 million floating rate dated notes	Ineligible	—	9
AU\$36 million floating rate dated notes	Ineligible	—	18
US\$238 million floating rate dated notes	Ineligible	—	154
€750 million 4.88% dated notes	Tier 2	—	546
£250 million 9.63% dated notes	Tier 2	—	250
CHF400 million 2.38% dated notes	Tier 2	—	259
CHF100 million 2.38% dated notes	Tier 2	—	65
CHF200 million 2.38% dated notes	Tier 2	—	129
<i>RBS Bank (Polska) S.A.</i>			
PLN102 billion dated notes	Tier 2	21	—
<i>National Westminster Bank Plc</i>			
£87 million 7.63% undated notes	Tier 2	—	87
£300 million 7.88% dated notes	Tier 2	—	300
		10,518	2,279

Note:

(1) There were no issuances in 2016 or 2015.

Dated loan capital

	Capital treatment	2016 £m	2015 £m
<i>The Royal Bank of Scotland plc</i>			
€100 million floating rate notes 2017	Tier 2	86	73
€750 million 4.35% notes 2017	Tier 2	670	597
€2,000 million 6.93% notes 2018	Tier 2	1,903	1,695
US\$125.6 million floating rate notes 2020	Tier 2	102	85
€1,000 million 4.63% notes 2021 (redeemed September 2016)	Ineligible	—	767
€300 million floating rate notes 2022	Tier 2	241	207
€144.4 million floating rate notes 2023	Tier 2	142	120
AU\$883 million 13.13% notes 2022 (callable once March 2017)	Tier 2	538	461
CAD420 million 10.50% notes 2022 (callable once March 2017)	Tier 2	261	212
CHF124 million 9.38% notes 2022 (callable once March 2017)	Tier 2	107	92
€564 million 10.50% notes 2022 (callable once March 2017)	Tier 2	523	450
US\$2,132 million 9.50% notes 2022 (callable once March 2017)	Tier 2	1,775	1,475
<i>Due to the holding company</i>			
US\$350 million 4.70% notes 2018 (redeemed December 2016) (1)	Tier 2	—	260
£5,000 million floating notes 2019 (redeemed June 2016) (1)	Tier 2	—	5,000
US\$2,250 million 6.22% notes 2022 (1)	Tier 2	1,778	1,490
US\$389 million 6.10% notes 2023 (1)	Tier 2	326	276
US\$2,000 million 6.00% notes 2023 (1)	Tier 2	1,700	1,439
€1,000 million 3.63% notes 2024 (callable once March 2019) (1)	Tier 2	893	771
		11,045	15,470

Notes:

(1) On-lent from The Royal Bank of Scotland Group plc on a subordinated basis.

(2) In the event of certain changes in tax laws, dated loan capital issues may be redeemed in whole, but not in part, at the option of the issuer, at the principal amount thereof plus accrued interest, subject to prior regulatory approval.

(3) Except as stated above, claims in respect of the Group's dated loan capital are subordinated to the claims of other creditors. None of the Group's dated loan capital is secured.

(4) Interest on all floating rate subordinated notes is calculated by reference to market rates.

Notes on the accounts

24 Subordinated liabilities continued

Undated loan capital

	Capital treatment	2016 £m	2015 £m
<i>The Royal Bank of Scotland plc</i>			
£31 million 4.96% notes	Ineligible	31	31
£51 million 6.25% notes (callable every five years from December 2017)	Ineligible	52	51
£54 million 5.13% notes (redeemed March 2016)	Ineligible	—	57
£35 million 5.50% notes (callable every five years from December 2019)	Ineligible	38	38
£21 million 6.20% notes (callable every five years from March 2022)	Ineligible	27	26
£103 million 9.50% notes (callable every five years from August 2018) (1)	Ineligible	117	121
£16 million 5.63% notes (callable every five years from September 2026) (1)	Ineligible	25	24
£19 million 5.63% notes (callable every five years from June 2032)	Ineligible	21	21
CAD474 million 5.37% fixed rate notes (redeemed August 2016)	Ineligible	—	235
<i>Due to the holding company</i>			
US\$350 million floating rate primary capital notes (redeemed December 2016) (2)	Tier 2	—	236
US\$1200 million 7.65% perpetual regulatory securities (callable September 2031) (2,3)	Tier 1	988	821
£1,500 million floating rate perpetual notes (redeemed December 2016) (2)	Tier 2	—	1,500
\$600 million floating rate perpetual notes (callable June 2018) (2)	Tier 2	487	405
\$1,600 million floating rate perpetual notes (redeemed December 2016) (2)	Tier 2	—	1,079
£940 million floating rate perpetual notes (redeemed December 2016) (2)	Tier 2	—	950
US\$150 million 8.00% perpetual notes (callable from October 2093) (2)	Tier 2	124	103
US\$136 million 7.75% perpetual notes (callable from May 2023) (2)	Tier 2	111	93
£200 million floating rate perpetual notes (callable) (2)	Tier 2	200	200
£885 million floating rate perpetual notes (callable) (2)	Tier 2	886	886
£100 million floating rate perpetual notes (callable) (2)	Tier 2	100	100
£420 million floating rate perpetual notes (callable) (2)	Tier 2	424	424
		3,631	7,401

Notes:

- (1) Guaranteed by the company.
(2) On-lent from The Royal Bank of Scotland Group plc on a subordinated basis.
(3) The company can satisfy interest payment obligations by issuing sufficient ordinary shares to appointed Trustees to enable them, on selling these shares, to settle the interest payment.
(4) Except as stated above, claims in respect of the Group's undated loan capital are subordinated to the claims of other creditors. None of the Group's undated loan capital is secured.
(5) In the event of certain changes in tax laws, undated loan capital issues may be redeemed in whole, but not in part, at the option of the Group, at the principal amount thereof plus accrued interest, subject to prior regulatory approval.
(6) Interest on all floating rate subordinated notes is calculated by reference to market rates.

Preference shares (1)

	Capital treatment	2016 £m	2015 £m
<i>The Royal Bank of Scotland plc</i>			
Non-cumulative preference shares of US\$0.01			
US\$200 million 7.65% Series F (callable anytime)	Ineligible	162	135
US\$300 million 7.25% Series H (callable anytime)	Ineligible	243	202
US\$750 million 6.80% Series L (callable anytime)	Ineligible	609	506
US\$650 million 6.43% Series N (callable January 2034)	Ineligible	660	556
US\$850 million 5.75% Series R (callable quarterly)	Ineligible	690	573
US\$1,000 million 9.12% Series 1 (callable anytime)	Ineligible	830	691
		3,194	2,663

Note:

- (1) Issued to the holding company on terms which, in general, mirror the original issues by the holding company.

Notes on the accounts

25 Share capital and reserves

	Allotted, called up and fully paid	
	2016 £m	2015 £m
Ordinary shares of £1	6,609	6,609

	Allotted, called up and fully paid	
	2016	2015
Number of shares - millions		
Ordinary shares of £1	6,609	6,609
Non-cumulative preference shares of US\$0.01	56	59
Non-cumulative preference shares of €0.01	—	1

Ordinary shares

No ordinary shares were issued during 2016 or 2015.

The Bank did not pay an ordinary dividend in 2016 or 2015.

Preference shares

In 2016, the Bank redeemed in whole the non cumulative preference shares Series O and P of US\$0.01 and Series 3 of €0.01.

Reserves

At 31 December 2016, the merger reserve comprises the premium on shares issued to acquire NatWest less goodwill amortisation charged under previous GAAP. No share premium was recorded in the Bank financial statements through the operation of the merger relief provisions of the Companies Act 1985.

UK law prescribes that only reserves of the Bank are taken into account for the purpose of making distributions and the permissible applications of the share premium account.

The Group optimises capital efficiency by maintaining reserves in subsidiaries, including regulated entities. Certain preference shares and subordinated debt are also included within regulatory capital. The remittance of reserves to the parent or the redemption of shares or subordinated capital by regulated entities may be subject to maintaining the capital resources required by the relevant regulator.

Notes on the accounts

26 Leases

Year in which receipt will occur	Finance lease contracts and hire purchase agreements				Operating lease assets:	
	Gross amounts £m	Present value adjustments £m	Other movements £m	Future drawdowns £m	Present value £m	future minimum lease rentals £m
2016						
Within 1 year	3,174	(230)	(54)	(27)	2,863	139
After 1 year but within 5 years	5,002	(518)	(113)	(68)	4,303	296
After 5 years	2,715	(951)	(26)	—	1,738	25
Total	10,891	(1,699)	(193)	(95)	8,904	460
2015						
Within 1 year	3,111	(236)	(31)	—	2,844	166
After 1 year but within 5 years	4,801	(420)	(83)	—	4,298	294
After 5 years	2,784	(1,120)	(24)	—	1,640	72
Total	10,696	(1,776)	(138)	—	8,782	532

	Group	
	2016 £m	2015 £m
Nature of operating lease assets on the balance sheet		
Transportation	391	556
Cars and light commercial vehicles	56	56
Other	278	268
	725	880

Amounts recognised as income and expense

Finance leases - contingent rental rebate	(76)	(81)
Operating leases - minimum rentals payable	239	239

Finance lease contracts and hire purchase agreements

Accumulated allowance for uncollectable minimum receivables	54	65
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There was no income or expense recognised in discontinued operations (2015 - £75 million; 2014 - £124 million) in relation to operating leases - minimum rentals payable.

Residual value exposures

The table below gives details of the unguaranteed residual values included in the carrying value of finance leases receivables (refer to page 152) and operating lease assets (refer to page 181).

	Year in which residual value will be recovered				Total £m
	Within 1 year £m	After 1 year but within 2 years £m	After 2 years but within 5 years £m	After 5 years £m	
2016					
Operating leases					
- transportation	24	60	128	21	233
- cars and light commercial vehicles	5	5	12	—	22
- other	30	19	32	6	87
Finance lease contracts	43	27	46	26	142
Hire purchase agreements	24	25	2	—	51
	126	136	220	53	535
2015					
Operating leases					
- transportation	126	57	52	108	343
- cars and light commercial vehicles	8	3	10	—	21
- other	24	29	35	2	90
Finance lease contracts	30	22	58	24	134
Hire purchase agreements	1	—	3	—	4
	189	111	158	134	592

Acting as a lessor, the Group provides asset finance to its customers. It purchases plant, equipment and intellectual property, renting them to customers under lease arrangements that, depending on their terms, qualify as either operating or finance leases.

27 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	Group							
	2016				2015			
	Debt securities in issue				Debt securities in issue			
	Assets	Held by third parties	Held by the Group (1)	Total	Assets	Held by third parties	Held by the Group (1)	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Mortgages								
- UK	1,475	—	1,774	1,774	3,954	961	3,067	4,028
- Irish	7,054	1,180	6,621	7,801	7,395	1,472	6,836	8,308
- US	301	301	—	301	—	—	—	—
Other loans (2)	—	—	—	—	46	9	—	9
	8,830	1,481	8,395	9,876	11,395	2,442	9,903	12,345
Cash deposits	965				1,201			
	9,795				12,596			

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 2016, assets held by the conduits totalled £0.1 billion (2015 - £0.6 billion). At 31 December 2016 and 31 December 2015 the conduits were funded entirely by the Group.

Covered bond programme

Certain loans and advances to customers have been assigned to bankruptcy remote limited liability partnership to provide security for issues of debt securities by the Group. The Group retains all of the risks and rewards of these loans. The partnerships are consolidated, the loans retained on the Group's balance sheet and the related covered bonds included within debt securities in issue. At 31 December 2016, £8,621 million of mortgages provided security for debt securities in issue of £3,935 million (2015: mortgages - £11,207 million, bonds - £5,585 million).

Notes on the accounts

27 Structured entities continued

Unconsolidated structured entities

The Group's interests in unconsolidated structured entities are analysed below.

	Asset backed securitisation vehicles £m	Investment funds and other £m	Total £m
2016			
Held for trading			
Loans and advances to customers	579	40	619
Debt securities	618	28	646
Equity shares	—	93	93
Derivatives assets	317	77	394
Derivatives liabilities	(506)	(101)	(607)
Total	1,008	137	1,145
Other than held-for-trading			
Loans and advances to customers	1,339	871	2,210
Debt securities	4,702	146	4,848
Total	6,041	1,017	7,058
Liquidity facilities/loan commitments	1,397	757	2,154
Guarantees	55	6	61
Maximum exposure	8,501	1,917	10,418
2015			
	£m	£m	£m
Held for trading			
Loans and advances to customers	131	—	131
Debt securities	455	73	528
Equity shares	—	111	111
Derivatives assets	548	13	561
Derivatives liabilities	(150)	(23)	(173)
Total	984	174	1,158
Other than held-for-trading			
Loans and advances to customers	2,663	2	2,665
Debt securities	3,153	123	3,276
Total	5,816	125	5,941
Liquidity facilities/loan commitments	1,362	—	1,362
Guarantees	—	—	—
Maximum exposure	8,162	299	8,461

Notes:

- (1) Net income arising from interests in unconsolidated structured entities includes interest receivable, trading income as a result of changes in fair value, foreign exchange gains/losses and other income less impairments.
- (2) A sponsored entity is a structured entity, established by the Group where the Group provides liquidity and/or credit enhancements or provides ongoing services to the entity. The Group can act as sponsor for its own or for customers' transactions.
- (3) In 2016, no assets were transferred into sponsored structured entities (2015 - nil) which are not consolidated by the Group and to which the Group held no interest at 31 December 2016. Income arising from sponsored entities where no interest was held at year end was gains of £21 million (2015 - losses £68 million).

Notes on the accounts

28 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.

Assets subject to securities repurchase agreements or security lending transactions

	Group		Bank	
	2016	2015	2016	2015
	£m	£m	£m	£m
Debt securities	18,107	20,224	15,206	16,484
Equity shares	—	9	—	2

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	
	2016(1)	2015
	£m	£m
UK mortgages - securisation (2)	221	702
UK mortgages - covered bond programme	997	2,020
	1,218	2,722

Notes:

(1) The associated liabilities are £1,217 million

(2) Creditors have recourse is to these assets only, the fair value of transferred assets and fair value of associated liabilities was not materially different.

Assets pledged as collateral

The Group pledges collateral with its counterparties in respect of derivative liabilities and bank and other borrowings.

	Group		Bank	
	2016	2015	2016	2015
	£m	£m	£m	£m
Assets pledged against liabilities				
Loans and advances to banks	7,352	11,477	6,985	10,843
Loans and advances to customers	29,657	17,595	28,118	17,170
Securities	20,152	14,414	19,937	14,414
	57,161	43,486	55,040	42,427
Liabilities secured by assets				
Deposits by banks	5,514	293	5,001	—
Customer accounts	—	—	—	—
Derivatives	26,437	31,093	26,402	30,865
	31,951	31,386	31,403	30,865

Notes on the accounts

29 Capital resources

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

	2016			2015		
	RBS plc £m	NatWest £m	UBI DAC £m	RBS plc £m	NatWest £m	UBI DAC £m
Shareholders' equity (excluding non-controlling interests)						
Shareholders' equity	45,876	15,297	5,556	51,177	11,282	5,753
Preference shares - equity	—	—	—	(1,421)	—	—
	45,876	15,297	5,556	49,756	11,282	5,753
Regulatory adjustments and deductions						
Own credit	(152)	—	(3)	17	—	—
Defined benefit pension fund adjustment	(198)	(15)	61	(138)	—	142
Cash flow hedging reserve	(261)	—	—	(286)	1	—
Deferred tax assets	(47)	(599)	(250)	(252)	(622)	(210)
Prudential valuation adjustments	(524)	(1)	—	(349)	(1)	—
Qualifying deductions exceeding AT1 Capital	—	(199)	—	—	—	—
Goodwill and other intangible assets	(521)	(477)	—	(544)	(498)	—
Expected losses less impairments	(642)	(534)	(165)	(395)	(703)	(22)
Instruments of financial sector entities where the institution has a significant investment	(20,433)	(3,019)	—	(15,680)	(2,413)	—
Significant investments in excess of secondary capital	—	(80)	—	—	(424)	—
Other regulatory adjustments	235	20	25	287	532	27
	(22,543)	(4,904)	(332)	(17,340)	(4,128)	(63)
CET1 capital	23,333	10,393	5,224	32,416	7,154	5,690
Additional Tier 1 (AT1) capital						
Qualifying instruments and related share premium subject to phase out	2,993	175	—	3,493	204	—
Tier 2 deductions						
Instruments of financial sector entities where the institution has a significant investment	(1,034)	(374)	—	(1,175)	(187)	—
Qualifying deductions exceeding AT1 capital	—	199	—	—	—	—
	(1,034)	(175)	—	(1,175)	(187)	—
Tier 1 capital	25,292	10,393	5,224	34,734	7,171	5,690
Qualifying Tier 2 capital						
Qualifying instruments and related share premium	12,161	4,735	555	19,039	5,058	492
Tier 2 deductions						
Instruments of financial sector entities where the institution has a significant investment	(3,302)	(112)	—	(2,432)	(92)	—
Other regulatory adjustments	—	—	(33)	—	—	(7)
	(3,302)	(112)	(33)	(2,432)	(92)	(7)
Tier 2 capital	8,859	4,623	522	16,607	4,966	485
Total regulatory capital	34,151	15,016	5,746	51,341	12,137	6,175

In the management of capital resources, the Group is governed by the RBS Group's policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the RBS Group has regard to the supervisory requirements of the PRA. The PRA uses capital ratios as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks); by international agreement, the Pillar 1 capital ratios, excluding capital buffers, should be not less than 8% with a Common Equity Tier 1 component of not less than 4.5%. The Group has complied with the PRA's capital requirements throughout the year.

A number of subsidiaries and sub-groups within the Group, principally banking entities, are subject to various individual regulatory capital requirements in the UK and overseas. Furthermore, the payment of dividends by subsidiaries and the ability of members of the RBS Group to lend money to other members of the RBS Group may be subject to restrictions such as local regulatory or legal requirements, the availability of reserves and financial and operating performance.

Notes on the accounts

30 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 2016. 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	
	2016	2015	2016	2015
	£m	£m	£m	£m
Contingent liabilities and commitments				
Guarantees and assets pledged as collateral security	3,808	5,894	2,570	4,534
Other contingent liabilities	4,141	6,789	2,904	5,363
Standby facilities, credit lines and other commitments	138,579	137,364	84,608	88,640
	146,528	150,047	90,082	98,537

Note:

(1) In the normal course of business, the Bank guarantees specified third party liabilities of certain subsidiaries; it also gives undertakings that individual subsidiaries will fulfil their obligations to third parties under contractual or other arrangements.

Banking commitments and contingent obligations, which have been entered into on behalf of customers and for which there are corresponding obligations from customers, are not included in assets and liabilities. The Group's maximum exposure to credit loss, in the event of its obligation crystallising and all counterclaims, collateral or security proving valueless, is represented by the contractual nominal amount of these instruments included in the table above. These commitments and contingent obligations are subject to the Group's normal credit approval processes.

Guarantees - the Group gives guarantees on behalf of customers. A financial guarantee represents an irrevocable undertaking that the Group will meet a customer's specified obligations to a third party if the customer fails to do so. The maximum amount that the Group could be required to pay under a guarantee is its principal amount as in the table above. The Group expects most guarantees it provides to expire unused.

Other contingent liabilities - these include standby letters of credit, supporting customer debt issues and contingent liabilities relating to customer trading activities such as those arising from performance and customs bonds, warranties and indemnities.

Standby facilities and credit lines - under a loan commitment the Group agrees to make funds available to a customer in the future. Loan commitments, which are usually for a specified term may be unconditionally cancellable or may persist, provided all conditions in the loan facility are satisfied or waived. Commitments to lend include commercial standby facilities and credit lines, liquidity facilities to commercial paper conduits and unutilised overdraft facilities.

Other commitments - these include documentary credits, which are commercial letters of credit providing for payment by the Group to a named beneficiary against presentation of specified documents, forward asset purchases, forward deposits placed and undrawn note issuance and revolving underwriting facilities, and other short-term trade related transactions.

Capital Support Deed

The Bank, together with other members of the RBS Group, is party to a Capital Support Deed (CSD). Under the terms of the CSD, the Bank may be required, if compatible with its legal obligations, to make distributions on, or repurchase or redeem, its ordinary shares. The amount of this obligation is limited to the Bank's capital resources in excess of the capital and financial resources needed to meet its regulatory requirements. The Bank may also be obliged to make onward distribution to its ordinary shareholders of dividends or other capital distributions received from subsidiaries that are party to the CSD. The CSD also provides that, in certain circumstances, funding received by the Bank from other parties to the CSD becomes immediately repayable, such repayment being limited to the Bank's available resources.

Notes on the accounts

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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	
	2016	2015	2016	2015
	£m	£m	£m	£m
Operating leases				
Minimum rentals payable under non-cancellable leases (1)				
- within 1 year	246	232	126	141
- after 1 year but within 5 years	786	759	454	501
- after 5 years	1,775	2,006	1,205	1,407
	2,807	2,997	1,785	2,049
Capital expenditure on property, plant and equipment	21	59	19	29
Contracts to purchase goods or services (2)	598	1,442	467	1,414
	3,426	4,498	2,271	3,492

Notes:

(1) Predominantly property leases.

(2) Of which due within 1 year: Group - £231 million (2015 - £302 million) and Bank - £201 million (2015 - £282 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 £196 million (2015 - £272 million; 2014 - £373 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 £325 million in 2015, no further levy is expected in relation to this matter. The interest element levied on the industry in 2016/17 scheme year was £337 million (£353 million in the 2015/16 scheme year).

The Group has accrued £38 million for its share of estimated FSCS levies.

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Litigation, investigations and reviews

RBS plc and certain members of the RBS Group are party to legal proceedings and the subject of investigation and other regulatory and governmental action ("Matters") in the United Kingdom (UK), the United States (US), the European Union (EU) and other jurisdictions.

The RBS Group recognises a provision for a liability in relation to these Matters when it is probable that an outflow of economic benefits will be required to settle an obligation resulting from past events, and a reliable estimate can be made of the amount of the obligation. While the outcome of these Matters is inherently uncertain, the directors believe that, based on the information available to them, appropriate provisions have been made in respect of the Matters as at 31 December 2016 (see Note 21).

In many proceedings and investigations, it is not possible to determine whether any loss is probable or to estimate reliably the amount of any loss, either as a direct consequence of the relevant proceedings and investigations or as a result of adverse impacts or restrictions on the RBS Group's reputation, businesses and operations. Numerous legal and factual issues may need to be resolved, including through potentially lengthy discovery and document production exercises and determination of important factual matters, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a liability can reasonably be estimated for any claim. The RBS Group cannot predict if, how, or when such claims will be resolved or what the eventual settlement, damages, fine, penalty or other relief, if any, may be, particularly for claims that are at an early stage in their development or where claimants seek substantial or indeterminate damages.

In respect of certain matters described below, we have established a provision and in certain of those matters, we have indicated that we have established a provision. The RBS Group generally does not disclose information about the establishment or existence of a provision for a particular matter where disclosure of the information can be expected to prejudice seriously the RBS Group's position in the matter.

There are situations where the RBS Group may pursue an approach that in some instances leads to a settlement agreement. This may occur in order to avoid the expense, management distraction or reputational implications of continuing to contest liability, or in order to take account of the risks inherent in defending claims or investigations even for those matters for which the RBS Group believes it has credible defences and should prevail on the merits.

The uncertainties inherent in all such matters affect the amount and timing of any potential outflows for both matters with respect to which provisions have been established and other contingent liabilities.

The future outflow of resources in respect of any matter may ultimately prove to be substantially greater than or less than the aggregate provision that the RBS Group has recognised. Where (and as far as) liability cannot be reasonably estimated, no provision has been recognised.

Other than those discussed below, no member of the Group is or has been involved in governmental, legal or regulatory proceedings (including those which are pending or threatened) that are expected to be material, individually or in aggregate. The RBS Group expects that in future periods additional provisions, settlement amounts, and customer redress payments will be necessary, in amounts that are expected to be substantial in some instances.

For a discussion of certain risks associated with the Group's litigation, investigations and reviews, see "Risk Factors" on pages 239 to 278.

Litigation

UK 2008 rights issue shareholder litigation

Between March and July 2013, claims were issued in the High Court of Justice of England and Wales by sets of current and former shareholders, against RBS Group (and in one of those claims, also against certain former individual officers and directors) alleging that untrue and misleading statements and/or improper omissions, in breach of the Financial Services and Markets Act 2000, were made in connection with the rights issue announced by the RBS Group on 22 April 2008. In July 2013 these and other similar threatened claims were consolidated by the Court via a Group Litigation Order. The RBS Group's defence to the claims was filed on 13 December 2013. Since then, further High Court claims have been issued against the RBS Group under the Group Litigation Order which is now closed to further claimants. Prior to the partial settlement described below, the aggregate value of the shares subscribed for at 200 pence per share by all of the then claimant shareholders was approximately £4 billion.

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In December 2016 the RBS Group concluded full and final settlements with four of the five shareholder groups representing 78% of the claims by value. The maximum settlement figure of £800 million is covered by existing RBS Group provisions and that total figure assumes that agreement is reached with all groups, is split proportionally between each, and is subject to validation of claims.

Should the remaining group's claim not be settled, the RBS Group will continue to defend it. Damages have not yet been quantified. The court timetable provides that a trial of the preliminary issue of whether the rights issue prospectus contained untrue and misleading statements and/or improper omissions will commence in May 2017. In the event that the court makes such a finding, further trial(s) will be required to consider whether any such statements and/or omissions caused loss and, if so, the quantum of that loss.

Residential mortgage-backed securities (RMBS) litigation in the US

RBS Group companies have been named as defendants in their various roles as issuer, depositor and/or underwriter in a number of claims in the US that relate to the securitisation and securities underwriting businesses. These cases include actions by individual purchasers of securities and a purported class action suit. Together, the pending individual and class action cases (including those claims specifically described in this note) involve the issuance of approximately US\$36.5 billion of RMBS 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 10 lawsuits brought by or on behalf of purchasers of RMBS, including the purported class action identified below.

In the event of an adverse judgment in any of these cases, the amount of the RBS Group's liability will depend on numerous factors that are relevant to the calculation of damages, which may include the recognised loss of principal value in the securities at the time of judgment (write-downs); the value of the remaining unpaid principal balance of the securities at the time the case began, at the time of judgment (if the plaintiff still owns the securities at the time of judgment), or at the time when the plaintiff disposed of the securities (if plaintiff sold the securities); and a calculation of pre and post judgment interest that the plaintiff could be awarded, which could be a material amount.

In September 2011, the US Federal Housing Finance Agency (FHFA) as conservator for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) filed RMBS-related lawsuits against the RBS Group and a number of other financial institutions, all of which, except for the two cases described below, have since settled for amounts that were publicly disclosed.

The primary FHFA lawsuit against the RBS Group remains pending in the United States District Court for the District of Connecticut, and it relates to approximately US\$32 billion of RMBS for which RBS Group entities acted as sponsor/depositor and/or lead underwriter or co-lead underwriter. Of the US\$32 billion, approximately US\$7.6 billion was outstanding at 31 December 2016 with cumulative write downs to date on the securities of approximately US\$1.1 billion (being the recognised loss of principal value suffered by security holders). In September 2013, the Court denied the defendants' motion to dismiss FHFA's amended complaint in this case. The matter continues in the discovery phase.

The other remaining FHFA lawsuit that involves the RBS Group relates to RMBS issued by Nomura Holding America Inc. (Nomura) and subsidiaries, and is the subject of an appeal. On 11 May 2015, following a trial, the United States District Court for the Southern District of New York issued a written decision in favour of FHFA on its claims against Nomura and RBS Securities Inc., finding, as relevant to the RBS Group, that the offering documents for four Nomura-issued RMBS for which RBS Securities Inc. served as an underwriter, relating to US\$1.4 billion in original principal balance, contained materially misleading statements about the mortgage loans that backed the securitisations, in violation of the Securities Act and Virginia securities law.

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RBS Securities Inc. estimates that its net exposure under the Court's judgment is approximately US\$383 million, which consists of the difference between the amount of the judgment against RBS Securities Inc. (US\$636 million) and the estimated market value of the four RMBS that FHFA would return to RBS Securities Inc. pursuant to the judgment, plus the costs and attorney's fees that will be due to FHFA if the judgment is upheld.

The Court has stayed the judgment pending the result of the appeal that the defendants are taking to the United States Court of Appeals for the Second Circuit, though post-judgment interest on the judgment amount will accrue while the appeal is pending. RBS Securities Inc. intends to pursue a contractual claim for indemnification against Nomura with respect to any losses it suffers as a result of this matter.

Other remaining RMBS lawsuits against RBS Group companies include cases filed by the Federal Home Loan Banks of Boston and Seattle and the Federal Deposit Insurance Corporation.

RBS Group companies are also defendants in a purported RMBS class action entitled *New Jersey Carpenters Health Fund v. Novastar Mortgage Inc. et al.*, which remains pending in the United States District Court for the Southern District of New York. The RBS Group has reached an agreement in principle to settle this matter, subject to documentation and court approval. The amount of the settlement is covered by an existing provision.

As at 31 December 2016, the total aggregate of provisions in relation to certain of the RMBS litigation matters (described immediately above) and RMBS and other securitised products investigations (set out under "Investigations and reviews" on page 207), including an additional provision of £3.4 billion (\$4.2 billion) in 2016, is £6.8 billion (\$8.3 billion). The duration and outcome of these investigations and litigation matters remain uncertain, including in respect of whether settlements for all or any of such matters may be reached.

Further substantial provisions and costs may be recognised and, depending on the final outcome, other adverse consequences may occur.

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 Group have been named as defendants in a number of class actions and individual claims filed in the US with respect to the setting of LIBOR and certain other benchmark interest rates. The complaints are substantially similar and allege that certain members of the Group and other panel banks individually and collectively violated various federal laws, including the US commodities and antitrust laws, and state statutory and common law, as well as contracts, by manipulating LIBOR and prices of LIBOR-based derivatives in various markets through various means.

Most of the USD LIBOR-related actions in which RBS Group companies are defendants, including all purported class actions relating to USD LIBOR, were transferred to a coordinated proceeding in the United States District Court for the Southern District of New York.

In the coordinated proceeding, consolidated class action complaints were filed on behalf of (1) exchange-based purchaser plaintiffs, (2) over-the-counter purchaser plaintiffs, and (3) corporate debt purchaser plaintiffs. Over 35 other USD LIBOR-related actions naming the RBS Group as a defendant, including purported class actions on behalf of lenders and mortgage borrowers, were also made part of the coordinated proceeding.

In a series of orders issued in 2013 and 2014, the district court overseeing the coordinated USD proceeding dismissed class plaintiffs' antitrust claims and claims under RICO (Racketeer Influenced and Corrupt Organizations Act), but declined to dismiss (a) certain Commodity Exchange Act claims on behalf of persons who transacted in Eurodollar futures contracts and options on futures contracts on the Chicago Mercantile Exchange (on the theory that defendants' alleged persistent suppression of USD LIBOR caused loss to plaintiffs), and (b) certain contract and unjust enrichment claims on behalf of over-the-counter purchaser plaintiffs who transacted directly with a defendant. On 23 May 2016, the district court's dismissal of plaintiffs' antitrust claims was vacated by the United States Court of Appeals for the Second Circuit, which held that plaintiffs have adequately pled antitrust injury and an antitrust conspiracy, but remanded to the lower court for further consideration on the question of whether plaintiffs possess the requisite antitrust standing to proceed with antitrust claims.

In a decision issued on 20 December 2016, the district court held that it lacks personal jurisdiction over the RBS Group with respect to certain claims asserted in the coordinated proceeding. Following that decision, the RBS Group is dismissed from each of the USD LIBOR-related class actions in the coordinated proceeding, subject to appeal, although certain non-class cases on behalf of particular plaintiffs remain pending.

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Certain members of the Group have also been named as defendants in class actions relating to (i) JPY LIBOR and Euroyen TIBOR (one case relating to Euroyen TIBOR futures contracts and one relating to other derivatives allegedly linked to JPY LIBOR and Euroyen TIBOR), (ii) Euribor, (iii) Swiss Franc LIBOR (iv) Pound sterling LIBOR, and (v) the Singapore Interbank Offered Rate and Singapore Swap Offer Rate, and (vi) the Australian Bank Bill Swap Reference Rate, all of which are pending before other judges in the United States District Court for the Southern District of New York. Each of these matters is subject to motions to dismiss that will be made or are currently pending, with the exceptions that on 28 March 2014, the Court in the action relating to Euroyen TIBOR futures contracts dismissed the plaintiffs' antitrust claims, but declined to dismiss their claims under the Commodity Exchange Act for price manipulation and on 21 February 2017, the court in the action relating to Euribor dismissed all claims alleged against the RBS Group for lack of personal jurisdiction.

Details of LIBOR investigations involving the RBS Group are set out under "Investigations and reviews" on page 208.

ISDAFIX antitrust litigation

Beginning in September 2014, The Royal Bank of Scotland plc (RBS plc) and a number of other financial institutions were named as defendants in several purported class action complaints (subsequently consolidated into one complaint) in the United States District Court for the Southern District of New York alleging manipulation of USD ISDAFIX rates. In 2015, RBS plc reached an agreement to settle this matter for US\$50 million, and that settlement received preliminary approval from the Court on 11 May 2016. The settlement amount has been paid into escrow pending the final court approval of the settlement.

FX antitrust litigation

In 2015, Group companies settled a consolidated antitrust class action (the "consolidated action"), pending in the United States District Court for the Southern District of New York, asserting claims on behalf of persons who entered into (a) over-the-counter foreign exchange (FX) spot transactions, forwards, swaps, futures, options or other FX transactions the trading or settlement of which is related in any way to FX rates, or (b) exchange-traded FX instruments. Following the Court's preliminary approval of the settlement on 15 December 2015, the RBS Group paid the total settlement amount (US\$255 million) into escrow pending final court approval of the settlement.

On 8 June 2016, the Court denied a motion by the settling defendants to enjoin a second FX-related antitrust class action pending in the same court from proceeding, holding that the alleged class of "consumers and end-user businesses" in that action is not included within the classes at issue in the consolidated action. The RBS Group has made a motion to dismiss the claims in this "consumer" action, and that motion remains pending.

A third FX-related class action, asserting Employee Retirement Income Security Act claims on behalf of employee benefit plans that engaged in FX transactions, including claims based on alleged non-collusive FX-related conduct, was dismissed on 20 September 2016 on the ground that the plaintiffs failed to plead that the defendants had ERISA-based fiduciary duties to the plaintiffs. Plaintiffs have commenced an appeal of this dismissal.

On 26 September 2016, a class action complaint was filed in the United States District Court for the Southern District of New York asserting claims on behalf of "indirect purchasers" of FX instruments. The complaint defines "indirect purchasers" as persons who were indirectly affected by FX instruments that others entered into directly with defendant banks or on exchanges. It is alleged that certain RBS Group companies and other defendant banks caused damages to the "indirect purchasers" by conspiring to restrain trade in the FX spot market. The complaint seeks damages and other relief under federal, California, and New York antitrust laws. The RBS Group and the other defendants have made a motion to dismiss this matter.

In September 2015, certain members of the Group, as well as a number of other financial institutions, were named as defendants in two purported class actions filed in Ontario and Quebec on behalf of persons in Canada who entered into foreign exchange transactions or who invested in funds that entered into foreign exchange transactions. The plaintiffs allege that the defendants violated the Canadian Competition Act by conspiring to manipulate the prices of currency trades. In January 2017, the RBS Group reached an agreement in principle to settle these matters for approximately CAD 13 million, subject to settlement documentation and court approval.

Certain other foreign exchange transaction related claims have been or may be threatened against the RBS Group in other jurisdictions. The RBS Group cannot predict whether any of these claims will be pursued, but expects that several may.

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US Treasury securities antitrust litigation

Beginning in July 2015, numerous class action antitrust complaints were filed in US federal courts against a number of primary dealers of US Treasury securities, including RBS Securities Inc. The complaints allege that the defendants rigged the US Treasury securities auction bidding process to deflate prices at which they bought such securities and colluded to increase the prices at which they sold such securities to plaintiffs. The complaints assert claims under the US antitrust laws and the Commodity Exchange Act on behalf of persons who transacted in US Treasury securities or derivatives based on such instruments, including futures and options.

On 8 December 2015, all pending matters were transferred to the United States District Court for the Southern District of New York for coordinated or consolidated pre-trial proceedings. The RBS Group anticipates making a motion to dismiss these claims.

Interest rate swaps antitrust litigation

Beginning in November 2015, RBS plc and other members of the Group, as well as a number of other interest rate swap dealers, were named as defendants in a number of class action antitrust complaints filed in the United States District Court for the Southern District of New York and the United States District Court for the Northern District of Illinois. The complaints, filed on behalf of persons who entered into interest rate swaps with the defendants, allege that the defendants violated the US antitrust laws by restraining competition in the market for interest rate swaps through various means and thereby caused inflated bid-ask spreads for interest rate swaps, to the alleged detriment of the plaintiff class. In addition, two complaints containing similar allegations of collusion were filed in United States District Court for the Southern District of New York on behalf of TeraExchange and Javelin, who allege that they would have successfully established exchange-like trading of interest rate swaps if the defendant dealers had not unlawfully conspired to prevent that from happening through boycotts and other means, in violation of the U.S. antitrust laws. On 2 June 2016, all of these matters were transferred to the United States District Court for the Southern District of New York for coordinated or consolidated pretrial proceedings.

The RBS Group has made a motion to dismiss the operative complaints in these matters.

Thornburg adversary proceeding

RBS Securities Inc. and certain other RBS Group companies, as well as several other financial institutions, are defendants in an adversary proceeding filed in the US bankruptcy court in Maryland by the trustee for TMST, Inc. (formerly known as Thornburg Mortgage, Inc.). The trustee seeks recovery of transfers made under certain restructuring agreements as, among other things, avoidable fraudulent and preferential conveyances and transfers. On 25 September 2014, the Court largely denied the defendants' motion to dismiss this matter and, as a result, discovery is ongoing.

Interest rate hedging products litigation

The RBS Group is dealing with a large number of active litigation claims in relation to the sale of interest rate hedging products (IRHPs). In general claimants allege that the relevant interest rate hedging products were mis-sold to them, with some also alleging the RBS Group made misrepresentations in relation to LIBOR. Claims have been brought by customers who were considered under the UK Financial Conduct Authority (FCA) redress programme, as well as customers who were outside of the scope of that programme, which was closed to new entrants on 31 March 2015. The RBS Group encouraged those customers that were eligible to seek redress under the FCA redress programme to participate in that programme. The RBS Group remains exposed to potential claims from customers who were either ineligible to be considered for redress or who are dissatisfied with their redress offers.

Property Alliance Group (PAG) v The Royal Bank of Scotland plc was the leading case before the English High Court involving both IRHP mis-selling and LIBOR misconduct allegations. The amount claimed was approximately £33 million and the trial ended in October 2016. On 21 December 2016 the Court dismissed all of PAG's claims. The decision (subject to any appeal by PAG) may have significance to other similar LIBOR-related cases currently pending in the English courts, some of which involve substantial amounts. The case of Wall v RBS plc, which concerns similar allegations to those in PAG, is currently scheduled to go to trial October 2017. The sum claimed is between £400 million and £700 million.

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In addition to claims alleging that IRHPs were mis-sold, the RBS Group has received a number of claims involving allegations that it breached a legal duty of care in its conduct of the FCA redress programme. These claims have been brought by customers who are dissatisfied with redress offers made to them through the FCA redress programme. The claims followed a preliminary decision against another UK bank. The RBS Group has since been successful in opposing an application by a customer to amend its pleadings to include similar claims against the RBS Group, on the basis that the bank does not owe a legal duty of care to customers in carrying out the FCA review. The customer has been granted leave to appeal by the Court of Appeal, and the appeal is scheduled for May 2017.

Tax dispute

HMRC issued a tax assessment in 2012 against the RBS Group for approximately £86 million regarding a value-added-tax ("VAT") matter in relation to the trading of European Union Allowances ("EUAs") by an RBS Group joint venture subsidiary in 2009. The RBS Group has commenced legal proceedings before the First-tier Tribunal (Tax), a specialist tax tribunal, challenging the assessment (the "Tax Dispute"). Separately, the RBS Group is a named defendant in proceedings before the High Court brought in 2015 by ten companies (all in liquidation) (the "Liquidated Companies") and their respective liquidators (together, "the Claimants"). The Liquidated Companies previously traded in EUAs in 2009 and are alleged to be defaulting traders within (or otherwise connected to) the EUA supply chains forming the subject of the Tax Dispute. The Claimants are claiming approximately £72.5 million by alleging that the RBS Group dishonestly assisted the directors of the Liquidated Companies in the breach of their statutory duties and/or knowingly participated in the carrying on of the business of the Liquidated Companies with intent to defraud creditors. The RBS Group strongly denies these allegations.

Weiss v. National Westminster Bank Plc (NatWest)

NatWest is defending a lawsuit filed by a number of US nationals (or their estates, survivors, or heirs) who were victims of terrorist attacks in Israel. The plaintiffs allege that NatWest is liable for damages arising from those attacks pursuant to the US Anti-terrorism Act because NatWest previously maintained bank accounts and transferred funds for the Palestine Relief & Development Fund, an organisation which plaintiffs allege solicited funds for Hamas, the alleged perpetrator of the attacks. 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. On 31 March 2016, the trial court denied a motion by NatWest to dismiss the case in which NatWest had argued that the court lacked personal jurisdiction over NatWest. NatWest has since asserted other grounds for summary judgment that the trial court has not previously ruled upon.

Investigations and reviews

The RBS Group's businesses and financial condition can be affected by the actions of various governmental and regulatory authorities in the UK, the US, the EU and elsewhere. The RBS Group has engaged, and will continue to engage, in discussions with relevant governmental and regulatory authorities, including in the UK, the US, the EU and elsewhere, on an ongoing and regular basis, and in response to informal and formal inquiries or investigations, regarding operational, systems and control evaluations and issues including those related to compliance with applicable laws and regulations, including consumer protection, business conduct, competition/anti-trust, anti-bribery, anti-money laundering and sanctions regimes. The NatWest Markets (formerly CIB) segment in particular has been providing information regarding a variety of matters, including, for example, the setting of benchmark rates and related derivatives trading, conduct in the foreign exchange market, and various issues relating to the issuance, underwriting, and sales and trading of fixed-income securities, including structured products and government securities. Any matters discussed or identified during such discussions and inquiries may result in, among other things, further inquiry or investigation, other action being taken by governmental and regulatory authorities, increased costs being incurred by the RBS Group, remediation of systems and controls, public or private censure, restriction of the RBS Group's business activities and/or fines. Any of the events or circumstances mentioned in this paragraph or below could have a material adverse effect on the RBS Group, its business, authorisations and licences, reputation, results of operations or the price of securities issued by it.

The RBS Group is co-operating fully with the investigations and reviews described below.

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RMBS and other securitised products investigations

In the US, the RBS Group is involved in reviews, investigations and proceedings (both formal and informal) by federal and state governmental law enforcement and other agencies and self-regulatory organisations, including the US Department of Justice (DOJ) and various other members of the Residential Mortgage-Backed Securities Working Group (RMBS Working Group) of the Financial Fraud Enforcement Task Force (including several state attorneys general, including those mentioned below), relating to, among other things, issuance, underwriting and trading in RMBS and other mortgage-backed securities, collateralised debt obligations (CDOs), collateralised loan obligations (CLOs) and synthetic products.

In connection with these inquiries, Group companies have received requests for information and subpoenas seeking information about, among other things, the structuring of CDOs, financing to loan originators, purchase of whole loans, sponsorship and underwriting of securitisations, due diligence, representations and warranties, communications with ratings agencies, disclosure to investors, document deficiencies, trading activities and practices and repurchase requests.

These ongoing matters include, among others, active civil and criminal investigations by the DOJ, relating primarily to due diligence on and disclosure related to loans purchased for, or otherwise included in, securitisations and related disclosures.

In June 2016, RBS Securities Inc. (RBSSI), a U.S. broker-dealer, reached an agreement in principle to resolve investigations by the office of the Attorney General of Connecticut on behalf of the Connecticut Department of Banking, concerning RBSSI's underwriting and issuance of RMBS and the potential consequences to RBSSI of RBS plc's May 2015 FX-related guilty plea. The agreement became final on 3 October 2016 through the publication by the Department of Banking of two agreed consent orders without RBSSI admitting or denying the Department of Banking's allegations. As required by the RMBS consent order, in addition to making certain undertakings, RBSSI has paid US\$120 million to the State of Connecticut to resolve the investigation.

The amount was covered by a provision that had previously been established. Pursuant to the FX consent order, RBSSI agreed, among other things, to certify to the Department of Banking its compliance with various obligations undertaken in connection with RBS plc's FX-related guilty plea and FX-related resolutions with the Commodity Futures Trading Commission and Board of Governors of the Federal Reserve System.

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.

As at 31 December 2016, the total aggregate of provisions in relation to certain of the RMBS investigations (described immediately above) and RMBS and other securitised products litigation matters (set out under "Litigation" on page 202), including an additional provision of £3.4 billion (\$4.2 billion) in 2016, is £6.8 (\$8.3 billion) billion. The Group continues to cooperate with the DOJ in its civil and criminal investigations of RMBS matters. The duration and outcome of these investigations and RMBS litigation matters remain uncertain, including in respect of whether settlements for all or any of such matters may be reached. Further substantial provisions and costs may be recognised and, depending on the final outcome, other adverse consequences as described above may occur.

RBSSI has also been responding to an ongoing criminal investigation by the United States Attorney for the District of Connecticut relating to alleged misrepresentations in the trading of various forms of asset-backed securities, including RMBS, commercial mortgage-backed securities, CDOs, and CLOs. In March and December 2015, two former RBSSI traders entered guilty pleas in the United States District Court for the District of Connecticut, each to one count of conspiracy to commit securities fraud while employed at RBSSI. RBSSI is in advanced discussions to resolve the matter.

30 Memorandum items continued

US mortgages - loan repurchase matters

RBS's NatWest Markets business in North America was a purchaser of non-agency residential mortgages in the secondary market, and an issuer and underwriter of non-agency RMBS.

In issuing RMBS, NatWest Markets in some circumstances made representations and warranties regarding the characteristics of the underlying loans. As a result, NatWest Markets may be, or may have been, contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of such representations and warranties. Depending on the extent to which such loan repurchase related claims are pursued against and not rebutted by NatWest Markets on timeliness or other grounds, the aggregate potential impact on the RBS Group, if any, may be material.

LIBOR and other trading rates

In February 2013, the RBS Group announced settlements with the Financial Services Authority (FSA) in the UK, the United States Commodity Futures Trading Commission (CFTC) and the DOJ in relation to investigations into submissions, communications and procedures around the setting of LIBOR.

The RBS Group agreed to pay penalties of £87.5 million, US\$325 million and US\$150 million to these authorities respectively to resolve the investigations and also agreed to certain undertakings in its settlement with the CFTC. As part of the agreement with the DOJ, RBS plc entered into a Deferred Prosecution Agreement (DPA) in relation to one count of wire fraud relating to Swiss Franc LIBOR and one count for an antitrust violation relating to Yen LIBOR. The DPA expired in April 2015 and is of no further effect.

In April 2013, RBS Securities Japan Limited entered a plea of guilty to one count of wire fraud relating to Yen LIBOR and in January 2014, the US District Court for the District of Connecticut entered a final judgment in relation to the conviction of RBS Securities Japan Limited pursuant to the plea agreement.

In February 2014, the RBS Group paid settlement penalties of approximately €260 million and €131 million to resolve investigations by the European Commission (EC) into Yen LIBOR competition infringements and EURIBOR competition infringements respectively. This matter is now concluded.

In July 2014, the RBS Group 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. The RBS Group made various undertakings and agreed to make a voluntary contribution of A\$1.6 million to fund independent financial literacy projects in Australia.

In October 2014, the EC announced its findings that (1) the RBS Group and one other financial institution had participated in a bilateral cartel aimed at influencing the Swiss Franc LIBOR benchmark interest rate between March 2008 and July 2009; and (2) the RBS Group and three other financial institutions had participated in a related cartel on bid-ask spreads of Swiss Franc interest rate derivatives in the European Economic Area (EEA). The RBS Group received full immunity from fines.

In December 2016 the Swiss ComCo announced the closure of four separate investigations into the RBS Group and certain other banks relating to interest rate derivatives and LIBOR. The RBS Group received full immunity for fines relating to the Swiss franc LIBOR benchmark investigation. The RBS Group has agreed to pay a total of CHF17.06m in fines to settle the other investigations.

The RBS Group is co-operating with investigations and 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.

On 3 February 2017, it was announced that the RBS Group and the CFTC entered into a civil settlement resolving the CFTC's investigation of ISDAFIX and related trading activities. As part of the settlement, the RBS Group has paid a penalty of US\$85 million and agreed to certain undertakings.

Foreign exchange related investigations

In November 2014, RBS plc reached a settlement with the FCA and the CFTC in relation to investigations into failings in the RBS Group's FX businesses within its NatWest Markets segment. RBS plc agreed to pay penalties of £217 million to the FCA and US\$290 million to the CFTC to resolve the investigations. The fines were paid on 19 November 2014.

On 20 May 2015, RBS plc announced that it had reached settlements with the DOJ and the Board of Governors of the Federal Reserve System (Federal Reserve) in relation to investigations into its FX business within its NatWest Markets segment. RBS plc paid a penalty of US\$274 million to the Federal Reserve and agreed to pay a penalty of US\$395 million to the DOJ to resolve the investigations.

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As part of its plea agreement with the DOJ, RBS plc pled guilty in the United States District Court for the District of Connecticut to a one-count information charging an antitrust conspiracy. RBS plc admitted that it knowingly, through one of its euro/US dollar currency traders, joined and participated in a conspiracy to eliminate competition in the purchase and sale of the euro/US dollar currency pair exchanged in the FX spot market.

The charged conspiracy occurred between as early as December 2007 to at least April 2010. On 5 January 2017, the United States District Court for the District of Connecticut imposed a sentence on RBS plc consisting of the US\$395 million criminal fine previously agreed with the DOJ and a term of probation, which among other things, prohibits RBS plc from committing another crime in violation of US law or engaging in the FX trading practices that form the basis for the charged crime and requires RBS plc to implement a compliance program designed to prevent and detect the unlawful conduct at issue and to strengthen its compliance and internal controls as required by other regulators (including the FCA and the CFTC).

A violation of the terms of probation could lead to the imposition of additional penalties. Subsequent to the sentencing, RBS plc paid the criminal fine, which had been covered by an existing provision.

RBS plc and RBS Securities Inc. have also entered into a cease and desist order with the Federal Reserve relating to FX and other designated market activities (the FX Order). In the FX Order, which is publicly available and will remain in effect until terminated by the Federal Reserve, RBS plc and RBS Securities Inc. agreed to take certain remedial actions with respect to FX activities and certain other designated market activities, including the creation of an enhanced written internal controls and compliance program, an improved compliance risk management program, and an enhanced internal audit program. RBS plc and RBS Securities Inc. are obligated to implement and comply with these programs as approved by the Federal Reserve, and are also required to conduct, on an annual basis, a review of applicable compliance policies and procedures and a risk-focused sampling of key controls.

The RBS Group is co-operating with investigations and responding to inquiries from other governmental and regulatory (including competition) authorities on similar issues relating to failings in its FX business within its NatWest Markets segment. The timing and amount of financial penalties with respect to any further settlements and related litigation risks and collateral consequences remain uncertain and may well be material.

On 21 July 2014, the Serious Fraud Office in the UK (SFO) announced that it was launching a criminal investigation into allegations of fraudulent conduct in the foreign exchange market, apparently involving multiple financial institutions. On 15 March 2016, the SFO announced that it was closing its investigation, having concluded that, based on the information and material obtained, there was insufficient evidence for a realistic prospect of conviction.

Interest rate hedging products (IRHP) redress programme

Since 2013, the RBS Group and other banks have been undertaking a redress exercise and past business review in relation to the sale of interest rate hedging products to some small and medium sized businesses classified as retail clients or private customers under FSA rules. This exercise was scrutinised by an independent reviewer, KPMG (appointed as a Skilled Person under section 166 of the Financial Services and Markets Act), and overseen by the FCA. The RBS Group has reached agreement with KPMG in relation to redress determinations for all in scope customers, as well as the majority of the consequential loss claims received.

The RBS Group provisions in relation to the above redress exercises total £1.5 billion to date for these matters, of which £1.4 billion had been utilised at 31 December 2016.

Judicial Review of Skilled Person's role in IRHP review

The RBS Group has been named as an interested party in a number of claims for judicial review of KPMG's decisions as Skilled Person in the RBS Group's previously disclosed IRHP redress programme. This follows a similar claim from a customer of another UK bank, also against KPMG.

All of these claims were stayed pending the outcome of the other bank's case. The trial in that case was heard on 25 January 2016. The court decided in favour of KPMG, finding that (1) KPMG is not a body amenable to judicial review in respect of its role as Skilled Person in this matter; and (2) that there was no unfairness by the other bank in the procedure adopted. The claimant has sought permission to appeal the decision.

The majority of the claims that name the RBS Group as an interested party have been discontinued but there are still several cases which remain stayed pending the outcome of any appeal in the other bank's case. If permission to appeal is granted and the appeal court finds that a section 166-appointed Skilled Person is susceptible to judicial review, these remaining claims against the RBS Group may then proceed to full hearing to assess the fairness of KPMG's role in the redress programme in those particular cases. If deemed unfair, this could have a consequential impact on the reasonableness of the methodology applied to reviewed and settled IRHP files generally.

Notes on the accounts

30 Memorandum items continued

As there remains some uncertainty, it is not practicable reliably to estimate the impact of this matter, if any, on the RBS Group which may be material.

Investment advice review

In February 2013, the FSA announced the results of a mystery shopping review it undertook into the investment advice offered by banks and building societies to retail clients. As a result of that review the FSA announced that firms involved were cooperative and agreed to take immediate action. The RBS Group was one of the firms involved.

The action required included a review of the training provided to advisers, considering whether changes are necessary to both advice processes and controls for new business, and undertaking a past business review to identify any historic poor advice (and where breaches of regulatory requirements are identified, to put this right for customers).

Subsequent to the FSA announcing the results of its mystery shopping review, the FCA 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 UK Personal & Business Banking (UK PBB) segment of the RBS Group, which includes RBS plc and NatWest, during the period from March 2012 until December 2012.

This review was conducted under section 166 of the Financial Services and Markets Act, under which a Skilled Person was appointed to carry out the exercise. Redress has been paid to certain customers in this sample group. Following discussions with the FCA after issue of the draft section 166 report, the RBS Group agreed with the FCA that it would carry out a wider review/remediation exercise relating to certain investment, insurance and pension sales from 1 January 2011 to present. The RBS Group started writing to the relevant customers during 2016 and redress payments have also commenced. The project is due to finish in Q4 2017. In addition, the RBS Group agreed with the FCA that it would carry out a remediation exercise, for a specific customer segment who were sold a particular structured product, in response to concerns raised by the FCA with regard to (a) the target market for the product and (b) how the product may have been described to customers by certain advisers. Redress has been paid to certain customers who took out the structured product.

The Group provisions in relation to investment advice total £138 million to date for these matters, of which £51 million had been utilised at 31 December 2016.

Packaged accounts

As a result of an uplift in packaged current account complaints, the RBS Group proactively put in place dedicated resources in 2013 to investigate and resolve complaints on an individual basis. The RBS Group has made gross provisions totalling £409 million to date for this matter.

FCA review of the RBS Group's treatment of SMEs

In November 2013, a report by Lawrence Tomlinson, entrepreneur in residence at the UK Government's Department for Business Innovation and Skills, was published ("Tomlinson Report"). The Tomlinson Report was critical of the RBS Group's treatment of SMEs.

The Tomlinson Report was passed to the PRA and FCA. Shortly thereafter, the FCA announced that an independent Skilled Person would be appointed under section 166 of the Financial Services and Markets Act to review the allegations in the Tomlinson Report. On 17 January 2014, a Skilled Person was appointed. The Skilled Person's review was focused on the RBS Group's UK small and medium sized business customers with credit exposures of up to £20 million whose relationship was managed within the RBS Group's Global Restructuring Group or within similar units within the RBS Group's Corporate Banking Division that were focused on customers in financial difficulties. In the period 2008 to 2013 the RBS Group was one of the leading providers of credit to the UK SME sector.

Separately, in November 2013, the RBS Group instructed the law firm Clifford Chance to conduct an independent review of the principal allegation made in the Tomlinson Report: the RBS Group was alleged to be culpable of systematic and institutional behaviour in artificially distressing otherwise viable businesses and, through that, putting businesses into insolvency. Clifford Chance published its report on 17 April 2014 and, while it made certain recommendations to enhance customer experience and transparency of pricing, it concluded that there was no evidence to support the principal allegation.

30 Memorandum items continued

A separate independent review of the principal allegation, led by Mason Hayes & Curran, Solicitors, was conducted in the Republic of Ireland. The report was published in December 2014 and found no evidence to support the principal allegation.

The Skilled Person review focused on the allegations made in the Tomlinson Report and certain observations made by Sir Andrew Large in his 2013 Independent Lending Review, and was broader in scope than the reviews undertaken by Clifford Chance and Mason, Hayes & Curran which are referred to above. The Skilled Person delivered the draft findings from its review to the FCA in March 2016. The RBS Group was then given the opportunity to consider and respond to those draft findings before the Skilled Person delivered its final report to the FCA during September 2016.

On 8 November 2016, the FCA published an update on its review. In response, the RBS Group announced steps that will impact SME customers in the UK and the Republic of Ireland that were in GRG between 2008 and 2013. These steps are (i) an automatic refund of certain complex fees; and (ii) a new complaints process, overseen by an Independent Third Party. These steps have been developed with the involvement of the FCA which agreed that they are appropriate for the RBS Group to take.

The RBS Group estimates the costs associated with the new complaints review process and the automatic refund of complex fees to be approximately £400 million, which has been recognised as a provision in 2016. This includes operational costs together with the cost of refunded complex fees and the additional estimated redress costs arising from the new complaints process.

The FCA has announced that its review will continue. The RBS Group continues to cooperate fully with the review.

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. The EC's case is ongoing.

On 8 June 2015, a regulation on interchange fees for card payments entered into force. The regulation requires the capping of both cross-border and domestic MIF rates for debit and credit consumer cards. The regulation also sets out other reforms including to the Honour All Cards Rule which require merchants to accept all cards with the same level of MIF but not cards with different MIF levels.

On 6 May 2015, the Competition & Markets Authority (CMA), announced that it had closed the investigations into domestic interchange fees on the grounds of administrative priorities.

Whilst there are no recent developments on the above to report, there remains uncertainty around the outcomes of the ongoing EC investigation, and the impact of the regulation, and they may have a material adverse effect on the structure and operation of four party card payment schemes in general and, therefore, on the RBS Group's business in this sector.

Payment Protection Insurance (PPI)

Since 2011, the RBS Group has been implementing a policy statement agreed with the FCA for the handling of complaints about the mis-selling of PPI. The RBS Group is also monitoring developments following the UK Supreme Court's decision in the case of *Plevin v Paragon Personal Finance Ltd* in November 2014.

That decision was that the sale of a single premium PPI policy could create an 'unfair relationship' under s.140A of the Consumer Credit Act 1974 (the 'Consumer Credit Act') because the premium contained a particularly high level of undisclosed commission.

The Financial Ombudsman Service (FOS) has confirmed on its website that unfair relationship provisions in the Consumer Credit Act and the *Plevin* judgment are 'potentially relevant considerations' in some of the PPI complaints referred to FOS.

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On 26 November 2015, the FCA issued Consultation Paper 15/39, in which it set out proposed rules and guidance for how firms should handle PPI complaints fairly in light of the Plevin decision and how the FOS should consider relevant PPI complaints. The Consultation Paper also contained proposals for the introduction in 2018 on a date to be confirmed of a deadline for submission of PPI complaints. The RBS Group submitted its response to the Consultation Paper on 26 February 2016.

The proposals in the Consultation Paper included an FCA-led communications campaign to raise awareness of the deadline and to prompt those who intend to complain to act ahead of the deadline.

Following feedback received on its Consultation Paper, on 2 August 2016, the FCA issued a further Consultation Paper (CP 16/20) on certain aspects of the proposed rules and guidance. As a result of this second Consultation Paper, it was expected that the complaint deadline would be end of June 2019 rather than 2018 as proposed in the initial Consultation Paper. The BBA and the RBS Group submitted responses to the Consultation Paper on 11 October 2016.

Following feedback received on its second Consultation Paper (CP16/20), on 9 December 2016, the FCA issued a statement explaining that it is carefully considering the issues raised and will make a further announcement before 31 March 2017. In light of this statement, the RBS Group expects that the implementation of the complaint deadline will be pushed back from end of June 2019 to 1 October or 31 December 2019. The introduction of new Plevin rules and guidance will also be delayed.

If the proposals contained in these Consultation Papers are agreed and implemented, the RBS Group would expect higher claims volumes, persisting longer than previously modelled, and additional compensation payments in relation to PPI claims made as a result of the Plevin judgment. If the end of June 2019 deadline is implemented by the FCA, complaints made after that time would lose the right to be assessed by firms or by the Financial Ombudsman Service, bringing an end to new PPI cases on 1 October or 31 December 2019.

The RBS Group has made provisions totalling £4.9 billion to date for PPI claims, including an additional provision of £601 million in 2016, in response to the anticipated further delay in guidance. Of the £4.9 billion cumulative provision, £3.3 billion in redress and £0.4 billion administrative expenses had been utilised by 31 December 2016.

[UK retail banking](#)

In November 2014, the CMA announced its decision to proceed with a market investigation reference (MIR) into retail banking, which would cover PCA and SME banking. On 9 August 2016, the CMA published its final report. The CMA concluded that there are a number of competition concerns in the provision of PCAs, business current accounts and SME lending, particularly around low levels of customers searching and switching, resulting in banks not being put under enough competitive pressure, and new products and new banks not attracting customers quickly enough. The final report sets out remedies to address these concerns. These include remedies making it easier for customers to compare products, ensure customers benefit from technological advantages around open banking, improve the current account switching service and provide PCA overdraft customers with greater control over their charges along with additional measures targeted at SME customers.

On 2 February 2017 the CMA published the Retail Banking Market Investigation Order 2017 which is the primary legal framework setting out the obligations for the implementation of the majority of remedies, including an implementation deadline for each. Other remedies are to be delivered via undertakings signed by Bacs and recommendations to be taken forward by other regulators (including the FCA).

At this stage there remains uncertainty around the financial impact of the remedies once implemented and it is not practicable to estimate the potential impact on the RBS Group, which may be material.

[FCA Wholesale Sector Competition Review](#)

In February 2015, the FCA launched a market study into investment and corporate banking. On 18 October 2016 by publication by the FCA published its final report. It found that whilst many clients feel well served by primary capital market services there were some areas where improvements could be made to encourage competition, particularly for smaller clients. It set out a package of remedies, including prohibiting the use of restrictive contractual clauses and ending league table misrepresentation by asking league table providers to review their recognition criteria.

In November 2015, the FCA also announced that a market study would be undertaken into asset management. On 18 November 2016, the FCA published the interim report which indicated that price competition is weak and expressed concerns around the lack of transparency on the objectives, and appropriate benchmarks, for reporting fund performance. The FCA has proposed a number of remedies. The deadline for responses to the interim report was 20 February 2017 and the FCA expects to publish the final report in Q2 2017.

30 Memorandum items continued

FCA Mortgages Market Study

In December 2016, the FCA launched a market study into the provision of mortgages. The FCA has announced that it intends to publish an interim report in summer 2017 with the final report expected in Quarter 1 2018.

At this very early stage, as there is considerable uncertainty around the outcome of this market study, it is not practicable reliably to estimate the aggregate impact, if any, on the RBS Group which may be material.

Governance and risk management consent order

In July 2011, the RBS Group agreed with the Board of Governors of the Federal Reserve System, the New York State Banking Department, the Connecticut Department of Banking, and the Illinois Department of Financial and Professional Regulation to enter into a consent Cease and Desist Order (Governance Order) (which is publicly available) to address deficiencies related to governance, risk management and compliance systems and controls in the US branches of RBS plc and RBS N.V. branches (the US Branches).

In the Governance Order, the RBS Group agreed to create the following written plans or programmes:

Key points

- a plan to strengthen board and senior management oversight of the corporate governance, management, risk management, and operations of the RBS Group's US operations on an enterprise-wide and business line basis;
- an enterprise-wide risk management programme for the RBS Group's US operations;
- a plan to oversee compliance by the RBS Group's US operations with all applicable US laws, rules, regulations, and supervisory guidance;
- a Bank Secrecy Act/anti-money laundering compliance programme for the US Branches on a consolidated basis;
- a plan to improve the US Branches' compliance with all applicable provisions of the Bank Secrecy Act and its rules and regulations as well as the requirements of Regulation K of the Federal Reserve;
- a customer due diligence programme designed to ensure reasonably the identification and timely, accurate, and complete reporting by the US Branches of all known or suspected violations of law or suspicious transactions to law enforcement and supervisory authorities, as required by applicable suspicious activity reporting laws and regulations; and
- a plan designed to enhance the US Branches' compliance with Office of Foreign Assets Control (OFAC) requirements.

The Governance Order identified specific items to be addressed, considered, and included in each proposed plan or programme. The RBS Group also agreed in the Governance Order to adopt and implement the plans and programmes after approval by the regulators, to comply fully with the plans and programmes thereafter, and to submit to the regulators periodic written progress reports regarding compliance with the Governance Order.

The RBS Group has created, submitted, and adopted plans and/or programmes to address each of the areas identified above. In connection with the RBS Group's efforts to implement these plans and programmes, it has, among other things, made investments in technology, hired and trained additional personnel, and revised compliance, risk management, and other policies and procedures for the RBS Group's US operations. The RBS Group continues to test the effectiveness of the remediation efforts it has undertaken to ensure they are sustainable and meet regulators' expectations.

Furthermore, the RBS Group continues to work closely with the regulators in its efforts to fulfil its obligations under the Governance Order, which will remain in effect until terminated by the regulators.

The RBS Group may be subject to formal and informal supervisory actions and may be required by its US banking supervisors to take further actions and implement additional remedial measures with respect to these and additional matters. The RBS Group's activities in the US may be subject to significant limitations and/or conditions.

US dollar processing consent order

In December 2013 the RBS Group and RBS plc agreed a settlement with the Federal Reserve, the New York State Department of Financial Services (DFS), and the Office of Foreign Assets Control (OFAC) with respect to RBS plc's historical compliance with US economic sanction regulations outside the US. As part of the settlement, the RBS Group and RBS plc entered into a consent Cease and Desist Order with the Federal Reserve (US Dollar Processing Order), which remains in effect until terminated by the Federal Reserve. The US Dollar Processing Order (which is publicly available) indicated, among other things, that the RBS Group and RBS plc lacked adequate risk management and legal review policies and procedures to ensure that activities conducted outside the US comply with applicable OFAC regulations.

30 Memorandum items continued

The RBS Group agreed to create an OFAC compliance programme to ensure compliance with OFAC regulations by the RBS Group's global business lines outside the US, and to adopt, implement, and comply with the programme. Prior to and in connection with the US Dollar Processing Order, the RBS Group has made investments in technology, hired and trained personnel, and revised compliance, risk management, and other policies and procedures.

Under the US Dollar Processing Order (as part of the OFAC compliance programme) the RBS Group was required to appoint an independent consultant to conduct an annual review of OFAC compliance policies and procedures and their implementation and an appropriate risk-focused sampling of US dollar payments. The RBS Group appointed the independent consultant and their reports were submitted to the authorities on 14 June 2015. The independent consultant review examined a significant number of sanctions alerts and no reportable issues were identified.

Pursuant to the US Dollar Processing Order, the authorities requested a second annual review to be conducted by an independent consultant. The second review was conducted by the independent consultant and reports were submitted to the authorities on 30 September 2016. In line with the first review, and following examination of a significant number of sanctions alerts, the independent consultant did not identify any reportable issues. In addition, pursuant to requirements of the US Dollar Processing Order, the RBS Group has provided the required written submissions, including quarterly updates, in a timely manner, and the RBS Group continues to participate in a constructive dialogue with the authorities.

US/Swiss tax programme

In August 2013, the DOJ announced a programme for Swiss banks (the Programme) which provides Swiss banks with an opportunity to obtain resolution, through non-prosecution agreements or non-target letters, of the DOJ's investigations of the role that Swiss banks played in concealing the assets of US tax payers in offshore accounts (US related accounts). In December 2013, Coutts & Co Ltd., a member of the Group incorporated in Switzerland, notified the DOJ that it intended to participate in the Programme.

As required by the Programme, Coutts & Co Ltd. subsequently conducted a review of its US related accounts and presented the results of the review to the DOJ. On 23 December 2015, Coutts & Co Ltd. entered into a non-prosecution agreement (the NPA) in which Coutts & Co Ltd. paid a US\$78.5 million penalty and acknowledged responsibility for certain conduct set forth in a statement of facts accompanying the agreement. Under the NPA, which has a term of four years, Coutts & Co Ltd. is required, among other things, to provide certain information, cooperate with DOJ's investigations, and commit no U.S. federal offences. If Coutts & Co Ltd. abides by the NPA, the DOJ will not prosecute it for certain tax-related and monetary transaction offenses in connection with US related accounts.

Enforcement proceedings and investigations in relation to Coutts & Co Ltd

The Swiss Financial Market Supervisory Authority (FINMA) has been taking enforcement proceedings against Coutts & Co Ltd, a member of the RBS Group incorporated in Switzerland, with regard to certain client accounts held with Coutts & Co Ltd relating to allegations in connection with the Malaysian sovereign wealth fund 1MDB. On 2 February 2017, FINMA announced that Coutts & Co Ltd had breached money laundering regulations by failing to carry out adequate background checks into business relationships and transactions associated with 1MDB. FINMA accordingly required Coutts & Co Ltd to disgorge profits of CHF 6.5 million.

Coutts & Co Ltd is also cooperating with investigations and enquiries from authorities in other jurisdictions in relation to the same subject matter. In this context, the Monetary Authority of Singapore (MAS)'s supervisory examination of Coutts & Co Ltd's Singapore branch revealed breaches of anti-money laundering requirements. MAS imposed on Coutts & Co Ltd financial penalties amounting to SGD 2.4 million in December 2016. The outcomes of other proceedings, investigations and enquiries are uncertain but may include financial consequences and/or regulatory sanctions.

Review of suitability of advice provided by Coutts & Co

In 2013 the FCA conducted a thematic review of the advice processes across the UK wealth management industry. As a result of this review, Coutts & Co undertook a past business review into the suitability of investment advice provided to its clients. This review has concluded, as Coutts & Co has contacted affected clients and offered redress in appropriate cases. The majority of these redress payments have now been paid, having been met by the RBS Group's existing provision.

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Regulator requests concerning Mossack Fonseca

In common with other banks, the RBS Group received a letter from the FCA in April 2016 requesting information about any relationship the RBS Group has with the Panama-based law firm Mossack Fonseca or any individuals named in recent media coverage in connection with the same. The RBS Group responded to the FCA setting out details of the limited services provided to Mossack Fonseca and its clients.

Review and investigation of treatment of tracker mortgage customers in Ulster Bank Ireland DAC (formerly Ulster Bank Ireland Limited)

On 22 December 2015, the Central Bank of Ireland (CBI) announced that it had written to a number of lenders requiring them to put in place a robust plan and framework to review the treatment of customers who have been sold mortgages with a tracker interest rate or with a tracker interest rate entitlement. The CBI stated that the intended purpose of the review was to identify any cases where customers' contractual rights under the terms of their mortgage agreements were not fully honoured, or where lenders did not fully comply with various regulatory requirements and standards regarding disclosure and transparency for customers. The CBI has required Ulster Bank Ireland DAC (UBI DAC), a member of the RBS Group, incorporated in the Republic of Ireland, to participate in this review and UBI DAC is co-operating with the CBI in this regard. The RBS Group has made a lifetime provision totalling EUR 211 million for this matter.

Separately, on 15 April 2016, the CBI notified UBI DAC that it was also commencing an investigation under its Administrative Sanctions Procedure into suspected breaches of the Consumer Protection Code 2006 during the period 4 August 2006 to 30 June 2008 in relation to certain customers who switched from tracker mortgages to fixed rate mortgages.

Notes on the accounts

31 Net cash flow from operating activities

	Group			Bank		
	2016 £m	2015 £m	2014 £m	2016 £m	2015 £m	2014 £m
Operating (loss)/profit before tax - continuing operations	(3,732)	(3,234)	2,328	(2,936)	(1,451)	(959)
Profit/(loss) before tax - discontinued operations	143	1,831	(3,183)	—	—	—
(Increase)/decrease in prepayments and accrued income	(52)	411	4	(32)	325	(110)
Interest on subordinated liabilities	1,228	1,267	1,302	1,175	1,285	1,234
Decrease in accruals and deferred income	(543)	(829)	(222)	(477)	(550)	(157)
Impairment losses/(recoveries)	531	(734)	(1,140)	558	(260)	(46)
Loans and advances written-off net of recoveries	(3,552)	(8,778)	(5,052)	(640)	(1,492)	(2,567)
Unwind of discount on impairment losses	(112)	(144)	(247)	(35)	(47)	(87)
(Profit)/loss on sale of property, plant and equipment	(15)	(88)	(138)	3	(24)	1
(Profit)/loss on sale of subsidiaries and associates	(38)	(1,092)	30	(198)	30	213
Profit on sale of securities	(120)	(40)	(387)	(89)	(40)	(317)
Charge for defined benefit pension schemes	259	521	463	165	20	13
Pension scheme curtailments or settlements loss/(gain)	2	(65)	—	2	(8)	—
Cash contribution to defined benefit pension schemes	(4,783)	(1,059)	(1,063)	(200)	(32)	(28)
Other provisions charged net of releases	6,323	4,470	2,478	3,728	1,326	1,453
Other provisions utilised	(2,643)	(2,159)	(3,254)	(870)	(1,097)	(1,606)
Depreciation and amortisation	775	1,173	1,105	465	548	511
Loss/(gain) on redemption of own debt	90	263	(6)	90	—	—
Loss on reclassification to disposal groups	—	273	3,994	—	—	—
Write down of goodwill and other intangible assets	159	1,331	533	141	725	393
Write down of investment in subsidiaries	—	—	—	(53)	6,045	4,353
Elimination of foreign exchange differences	(6,416)	(1,476)	(881)	(7,496)	(170)	123
Other non-cash items	260	(1,276)	1,135	135	(445)	73
Net cash (outflow)/inflow from trading activities	(12,236)	(9,434)	(2,201)	(6,564)	4,688	2,490
Decrease in loans and advances to banks and customers	(13,036)	57,211	13,385	7,411	65,905	14,376
Decrease/(increase) in securities	16,375	13,330	8,199	14,716	8,624	(3,244)
Decrease/(increase) in other assets	815	(1,813)	423	(16)	330	1,160
Decrease/(increase) in derivative assets	15,353	91,499	(65,586)	14,125	94,224	(66,945)
Changes in operating assets	19,507	160,227	(43,579)	36,236	169,083	(54,653)
Increase/(decrease) in deposits by banks and customers	23,211	(38,175)	(7,609)	(4,488)	(58,740)	(25,750)
Decrease in debt securities in issue	(5,494)	(16,455)	(16,119)	(4,532)	(13,382)	(14,795)
(Decrease)/increase in other liabilities	(111)	3,158	(4,606)	(169)	810	(946)
(Decrease)/increase in derivative liabilities	(17,990)	(95,235)	64,795	(16,474)	(97,375)	66,241
Increase/(decrease) in settlement balances and short positions	68	(2,733)	(4,799)	(1,246)	596	(373)
Changes in operating liabilities	(316)	(149,440)	31,662	(26,909)	(168,091)	24,377
Income taxes received/(paid)	14	(231)	(302)	335	(192)	135
Net cash inflow/(outflow) from operating activities	6,969	1,122	(14,420)	3,098	5,488	(27,651)

Notes on the accounts

32 Analysis of the net investment in business interests and intangible assets

	Group			Bank		
	2016 £m	2015 £m	2014 £m	2016 £m	2015 £m	2014 £m
Acquisitions and disposals						
Fair value given for businesses acquired	(87)	(59)	(54)	—	—	—
Value recognised for business transferred from fellow subsidiary	—	—	—	—	(2)	—
Additional and new investments in Group undertakings	—	—	—	(1,304)	(856)	(1,637)
Net outflow of cash in respect of acquisitions	(87)	(59)	(54)	(1,304)	(858)	(1,637)
Other assets sold	(506)	(2,301)	(2,250)	—	(2,630)	(46)
Repayment of investments	—	—	—	—	193	—
Disposal of investments	—	—	—	152	—	—
Non-cash consideration	(5)	—	—	—	—	—
Profit/(loss) on disposal	38	1,092	(30)	198	(30)	(213)
Net cash and cash equivalents disposed	55	1,923	8	—	—	—
Net (outflow)/inflow of cash in respect of disposals	(418)	714	(2,272)	350	(2,467)	(259)
Dividends received from associates	9	11	10	—	—	—
Cash expenditure on intangible assets	(480)	(613)	(631)	(470)	(612)	(462)
Net (outflow)/inflow	(976)	53	(2,947)	(1,424)	(3,937)	(2,358)

Note:

(1) Includes cash proceeds of £1,628 million in 2015 relating to the disposal of the controlling interest in Citizens.

33 Interest received and paid

	Group			Bank		
	2016 £m	2015 £m	2014 £m	2016 £m	2015 £m	2014 £m
Interest received	11,280	11,589	13,039	5,165	5,579	6,997
Interest paid	(2,865)	(3,699)	(4,332)	(3,018)	(3,800)	(4,140)
	8,415	7,890	8,707	2,147	1,779	2,857

34 Analysis of changes in financing during the year

	Group					
	Share capital, share premium and merger reserve			Subordinated liabilities		
	2016 £m	2015 £m	2014 £m	2016 £m	2015 £m	2014 £m
At 1 January	44,281	44,250	43,699	27,030	30,469	33,134
Issue of subordinated liabilities	—	—	—	—	—	1,438
Redemption of subordinated liabilities	—	—	—	(10,556)	(2,279)	(4,181)
Net cash outflow from financing	—	—	—	(10,556)	(2,279)	(2,743)
Redemption of preference shares	—	—	517	—	—	—
Currency translation and other adjustments	16	31	34	3,041	(1,160)	78
At 31 December	44,297	44,281	44,250	19,515	27,030	30,469

	Bank					
	Share capital, share premium and merger reserve			Subordinated liabilities		
	2016 £m	2015 £m	2014 £m	2016 £m	2015 £m	2014 £m
At 1 January	33,400	33,369	32,818	25,534	27,480	30,566
Issue of subordinated liabilities	—	—	—	—	—	833
Redemption of subordinated liabilities	—	—	—	(10,535)	(1,894)	(4,121)
Net cash outflow from financing	—	—	—	(10,535)	(1,894)	(3,288)
Redemption of preference shares	—	—	517	—	—	—
Currency translation and other adjustments	16	31	34	2,871	(52)	202
At 31 December	33,416	33,400	33,369	17,870	25,534	27,480

Notes on the accounts

35 Analysis of cash and cash equivalents

	Group (1)			Bank (2)		
	2016 £m	2015 £m	2014 £m	2016 £m	2015 £m	2014 £m
At 1 January						
- cash	92,981	90,191	97,340	92,821	82,975	96,056
- cash equivalents	9,094	17,117	30,616	13,792	18,395	28,572
	102,075	107,308	127,956	106,613	101,370	124,628
Net cash (outflow)/inflow	(4,048)	(5,233)	(20,648)	(7,540)	5,243	(23,258)
At 31 December	98,027	102,075	107,308	99,073	106,613	101,370
Comprising:						
Cash and balances at central banks	73,813	78,999	73,983	70,615	76,904	70,952
Treasury bills and debt securities	358	1,445	1,821	315	1,179	739
Loans and advances to banks	23,856	21,631	31,504	28,143	28,530	29,679
Cash and cash equivalents	98,027	102,075	107,308	99,073	106,613	101,370

Notes:

(1) Includes cash collateral posted with bank counterparties in respect of derivative liabilities of £6,653 million (2015 - £11,046 million, 2014 - £11,258 million).

(2) Includes cash collateral posted with bank counterparties in respect of derivative liabilities of £6,653 million (2015 - £10,843 million, 2014 - £10,845 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.

	2016	2015	2014
Bank of England	£0.5bn	£0.5bn	£0.6bn
US Federal Reserve	—	—	\$1.3bn
De Nederlandsche Bank	—	€0.2bn	€0.1bn

36 Segmental analysis

(a) Reportable segments

The Group continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. On 5 December 2016 the Corporate & Institutional Banking (CIB) business was re-branded as NatWest Markets (NWM) in readiness for our future ring-fenced structure; this included the renaming of the reportable operating segment as NatWest Markets. NatWest Markets will continue to offer financing, rates and currencies products to its customers. Reported operating segments are as follows:

Organisational structure

The Group continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. Reportable operating segments are as follows:

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

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

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

Capital Resolution was established to execute the sale or wind down of most of the global footprint, from 38 countries to 13, and trade finance and cash management outside the UK and Ireland. Additionally non-strategic markets, portfolio and banking assets identified are being sold or wound down.

Williams & Glyn (W&G) refers to the business formerly intended to be divested as a separate legal entity and comprises the RBS England and Wales branch-based businesses, along with certain small and medium enterprises and corporate activities across the UK. During the period presented W&G has not operated as a separate legal entity. The perimeter of the segment currently reported does not include certain portfolios that were ultimately intended to be divested such as the Scottish branch based activity of NatWest and NatWest Business Direct.

Central items & other includes corporate functions, such as RBS treasury, finance, risk management, compliance, legal, communications and human resources. Central functions manages RBS Group capital resources and RBS Group-wide regulatory projects and provides services to the reportable segments. Balances in relation to RBSI Holdings, Citizens and the international private banking business that are included in disposal groups are included in Central items in the relevant periods.

RBS International

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

Citizens Financial Group

The Group sold the final tranche of its interest in Citizens Financial Group, Inc. during the second half of 2015. Consequently, Citizens was classified as a disposal group at 31 December 2014 and presented as a discontinued operation until October 2015. From 3 August 2015 until the final tranche was sold in October 2015, Citizens was an associated undertaking.

Notes on the accounts

36 Segmental analysis continued

2016	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses £m	Depreciation and amortisation £m	Impairment releases/(losses) £m	Operating profit/(loss) £m
UK Personal & Business Banking	4,341	957	5,298	(3,498)	—	(83)	1,717
Ulster Bank Rol	409	167	576	(624)	—	112	64
Personal & Business Banking	4,750	1,124	5,874	(4,122)	—	29	1,781
Commercial Banking	2,479	1,251	3,730	(1,869)	(135)	(213)	1,513
Private Banking	407	208	615	(452)	—	3	166
Commercial & Private Banking	2,886	1,459	4,345	(2,321)	(135)	(210)	1,679
NatWest Markets	78	1,470	1,548	(1,614)	—	—	(66)
Capital Resolution	256	(656)	(400)	(4,035)	(12)	(294)	(4,741)
Williams & Glyn	658	179	837	(450)	—	(42)	345
Central items & other	(340)	259	(81)	(2,016)	(621)	(12)	(2,730)
Total	8,288	3,835	12,123	(14,558)	(768)	(529)	(3,732)

2015

UK Personal & Business Banking	4,263	998	5,261	(3,640)	—	7	1,628
Ulster Bank Rol	365	185	550	(383)	—	141	308
Personal & Business Banking	4,628	1,183	5,811	(4,023)	—	148	1,936
Commercial Banking	2,213	1,257	3,470	(1,413)	(141)	(69)	1,847
Private Banking	410	208	618	(1,018)	—	(13)	(413)
Commercial & Private Banking	2,623	1,465	4,088	(2,431)	(141)	(82)	1,434
NatWest Markets	82	1,440	1,522	(2,031)	—	5	(504)
Capital Resolution	440	(94)	346	(4,524)	(29)	781	(3,426)
Williams & Glyn	658	175	833	(387)	—	(15)	431
Central items & other	(149)	(512)	(661)	(1,450)	(995)	1	(3,105)
Total	8,282	3,657	11,939	(14,846)	(1,165)	838	(3,234)

UK Personal & Business Banking	4,277	1,172	5,449	(3,632)	—	(154)	1,663
Ulster Bank Rol	467	137	604	(368)	—	306	542
Personal & Business Banking	4,744	1,309	6,053	(4,000)	—	152	2,205
Commercial Banking	2,130	1,331	3,461	(1,466)	(141)	(85)	1,769
Private Banking	454	235	689	(506)	—	5	188
Commercial & Private Banking	2,584	1,566	4,150	(1,972)	(141)	(80)	1,957
NatWest Markets	117	1,942	2,059	(2,259)	—	7	(193)
Capital Resolution	908	1,089	1,997	(1,796)	(28)	1,293	1,466
Williams & Glyn	664	188	852	(326)	—	(55)	471
Central items & other	(273)	(434)	(707)	(2,135)	(748)	12	(3,578)
Total	8,744	5,660	14,404	(12,488)	(917)	1,329	2,328

	2016			2015			2014		
	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	6,239	52	6,291	6,195	50	6,245	6,351	39	6,390
Ulster Bank Rol	660	2	662	640	15	655	672	50	722
Personal & Business Banking	6,899	54	6,953	6,835	65	6,900	7,023	89	7,112
Commercial Banking	3,648	228	3,876	3,482	42	3,524	3,554	51	3,605
Private Banking	567	173	740	577	191	768	624	240	864
Commercial & Private Banking	4,215	401	4,616	4,059	233	4,292	4,178	291	4,469
NatWest Markets	1,854	397	2,251	1,872	1,199	3,071	2,541	1,212	3,753
Capital Resolution	(344)	786	442	746	1,455	2,201	2,597	2,611	5,208
Williams & Glyn	912	—	912	920	—	920	954	—	954
Central items & other	2,093	(1,638)	455	1,592	(2,952)	(1,360)	1,818	(4,203)	(2,385)
Total	15,629	—	15,629	16,024	—	16,024	19,111	—	19,111

Notes on the accounts

36 Segmental analysis continued

	2016			2015			2014		
	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	5,270	28	5,298	5,199	62	5,261	5,351	98	5,449
Ulster Bank Rol	584	(8)	576	569	(19)	550	559	45	604
Personal & Business Banking	5,854	20	5,874	5,768	43	5,811	5,910	143	6,053
Commercial Banking	3,967	(237)	3,730	3,835	(365)	3,470	3,806	(345)	3,461
Private Banking	513	102	615	508	110	618	542	147	689
Commercial & Private Banking	4,480	(135)	4,345	4,343	(255)	4,088	4,348	(198)	4,150
NatWest Markets	1,697	(149)	1,548	1,557	(35)	1,522	2,178	(119)	2,059
Capital Resolution	(479)	79	(400)	446	(100)	346	2,036	(39)	1,997
Williams & Glyn	852	(15)	837	852	(19)	833	872	(20)	852
Central items & other	(281)	200	(81)	(1,027)	366	(661)	(940)	233	(707)
Total	12,123	—	12,123	11,939	—	11,939	14,404	—	14,404

	2016			2015			2014		
	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	139,408	148,743	—	127,067	140,585	—	119,763	136,823	—
Ulster Bank Rol	24,112	19,300	—	21,264	15,837	—	22,479	17,962	—
Personal & Business Banking	163,520	168,043	—	148,331	156,422	—	142,242	154,785	—
Commercial Banking	107,090	107,434	288	96,983	94,849	214	90,677	89,772	218
Private Banking	12,628	26,673	—	11,596	23,256	—	12,241	22,660	21
Commercial & Private Banking	119,718	134,107	288	108,579	118,105	214	102,918	112,432	239
NatWest Markets	231,527	223,424	—	213,790	194,238	10	281,910	261,472	—
Capital Resolution	126,216	117,552	6	187,833	186,458	3	314,449	277,858	135
Williams & Glyn	20,599	24,230	—	20,117	24,171	—	19,563	22,065	—
Central items & other	136,234	94,639	1,088	133,541	90,890	1,221	184,300	169,082	1,041
Total	797,814	761,995	1,382	812,191	770,284	1,448	1,045,382	997,694	1,415

Segmental analysis of assets and liabilities included in disposal groups:

	2016		2015		2014	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Commercial Banking	—	—	—	—	2	—
NatWest Markets	—	—	—	—	18	14
Capital Resolution	—	—	130	251	46	2
Central items & other	8,366	23,391	3,356	2,729	80,967	71,268
Total	8,366	23,391	3,486	2,980	81,033	71,284

Segmental analysis of goodwill is as follows:

	UK Personal & Business Banking £m	Commercial Banking £m	Private Banking £m	RBSI £m	Total £m
At 1 January 2015	3,342	1,907	706	300	6,255
Transfer to disposal groups	—	—	(220)	—	(220)
Currency translation and other adjustments	—	—	12	—	12
Write down of goodwill - continuing operations	—	—	(498)	—	(498)
At 1 January 2016	3,342	1,907	—	300	5,549
Transfer to disposal groups	—	—	—	(300)	(300)
At 31 December 2016	3,342	1,907	—	—	5,249

Notes on the accounts

36 Segmental analysis *continued*

(b) Geographical segments

The geographical analysis in the tables below has been compiled on the basis of location of office where the transactions are recorded.

	UK £m	USA £m	Europe £m	Rest of the World £m	Total £m
2016					
Total revenue	14,349	270	794	216	15,629
Net interest income	7,826	83	360	19	8,288
Net fees and commissions	2,203	9	170	62	2,444
Income from trading activities	618	159	68	18	863
Other operating income	426	(35)	46	91	528
Total income	11,073	216	644	190	12,123
Operating (loss)/profit before tax	(2,023)	(1,652)	(80)	23	(3,732)
Total assets	718,795	44,512	30,321	4,186	797,814
Of which assets held for sale	7,999	—	367	—	8,366
Total liabilities	689,015	44,612	24,784	3,584	761,995
Of which liabilities held for sale	21,329	—	2,062	—	23,391
Net assets attributable to equity shareholders and non-controlling interests	29,780	(100)	5,537	602	35,819
Contingent liabilities and commitments	142,150	639	3,738	1	146,528
Cost to acquire property, plant and equipment and intangible assets	1,314	3	54	11	1,382
2015					
Total revenue	14,244	346	1,182	252	16,024
Net interest income	7,411	144	581	146	8,282
Net fees and commissions	2,282	138	334	71	2,825
Income from trading activities	781	44	111	(24)	912
Other operating income	59	(68)	(34)	(37)	(80)
Total income	10,533	258	992	156	11,939
Operating (loss)/profit before tax	(726)	(2,622)	431	(317)	(3,234)
Total assets	677,248	77,955	38,258	18,730	812,191
Of which assets held for sale	—	15	1,251	2,220	3,486
Total liabilities	644,067	76,618	31,268	18,331	770,284
Of which liabilities held for sale	—	16	418	2,546	2,980
Net assets attributable to equity shareholders and non-controlling interests	33,181	1,337	6,990	399	41,907
Contingent liabilities and commitments	128,478	9,729	11,148	692	150,047
Cost to acquire property, plant and equipment and intangible assets	1,330	70	21	27	1,448
2014					
Total revenue	15,483	1,236	1,848	544	19,111
Net interest income	7,475	217	783	269	8,744
Net fees and commissions	2,503	285	493	148	3,429
Income from trading activities	314	547	261	28	1,150
Other operating income	955	71	75	(20)	1,081
Total income	11,247	1,120	1,612	425	14,404
Operating loss before tax	373	382	1,619	(46)	2,328
Total assets	783,430	183,174	45,961	32,817	1,045,382
Of which assets held for sale	48	80,985	—	—	81,033
Total liabilities	757,650	167,421	40,454	32,169	997,694
Of which liabilities held for sale	2	71,282	—	—	71,284
Net assets attributable to equity shareholders and non-controlling interests	25,780	15,753	5,507	648	47,688
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

Notes on the accounts

37 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.

	2016 £000	2015 £000
Directors' remuneration		
Non-executive directors emoluments	1,466	1,466
Chairman and executive directors emoluments	5,801	5,781
	7,267	7,247
Amounts receivable under long-term incentive plans and share option plans	993	324
	8,260	7,571

No directors accrued benefits under defined benefit schemes or money purchase schemes during 2016 and 2015.

The executive directors may participate in the company's long-term incentive plans, executive share option and sharesave schemes and details of their interests in the company's shares arising from their participation are given in the Directors' remuneration report in the Report and Accounts of the RBS Group. Details of the remuneration received by each director is also given in the Directors' remuneration report in the 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:

	2016 £000	2015 £000
Short-term benefits	20,350	19,395
Post-employment benefits	471	435
Share-based payments	2,606	3,472
	23,427	23,302

Key management comprises members of the RBS Group Executive Committee.

38 Transactions with directors and key management

(a) At 31 December 2016, amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions, as defined in UK legislation, in the Group, were £207,284 in respect of loans to four persons who were directors of the Bank at any time during the financial period.

(b) For the purposes of IAS 24 'Related Party Disclosures', key management comprise directors of the Bank and members of the RBS Group Executive Committee. The captions in the Group's primary financial statements include the following amounts attributable, in aggregate, to key management:

	2016 £000	2015 £000
Loans and advances to customers	3,276	2,741
Customer accounts	17,045	12,332

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.

39 Related parties

UK Government

On 1 December 2008, the UK Government through HM Treasury became the ultimate controlling party of The Royal Bank of Scotland Group plc. The UK Government's shareholding is managed by UK Financial Investments Limited, a company wholly owned by the UK Government. As a result, the UK Government and UK Government controlled bodies became related parties of the Group. During 2015, all of the B shares held by the UK Government were converted into ordinary shares of £1 each.

The Group enters into transactions with many of these bodies on an arm's length basis. Transactions include the payment of: taxes principally UK corporation tax (see Note 6) and value added tax; national insurance contributions; local authority rates; and regulatory fees and levies (including the bank levy and FSCS levies (see Note 30)); together with banking transactions such as loans and deposits undertaken in the normal course of banker-customer relationships.

Bank of England facilities

The Group may participate in a number of schemes operated by the Bank of England in the normal course of business.

Members of the Group that are UK authorised institutions are required to maintain non-interest bearing (cash ratio) deposits with the Bank of England amounting to 0.18% of their average eligible liabilities in excess of £600 million. They also have access to Bank of England reserve accounts: sterling current accounts that earn interest at the Bank of England Rate.

The table below discloses items included in income and operating expenses on transactions between the Group and fellow subsidiaries of the RBS Group.

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.

	2016 £m	2015 £m	2014 £m
Interest receivable	50	93	92
Interest payable	(997)	(1,024)	(1,037)
Fees and commissions receivable	1	7	7
Fees and commissions payable	(3)	(2)	(3)
Continuing operations	(949)	(926)	(941)
Discontinued operations	(1)	(26)	(28)

40 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 2015, 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 71.3% of the issued ordinary share capital of the holding company and is therefore the Group's ultimate controlling party.

41 Post balance sheet events

There have been no other significant events between 31 December 2016 and the date of approval of these accounts which would require a change to or additional disclosure in the accounts.

Notes on the accounts

42 Related undertakings

Group legal entities and activities at 31 December 2016

In accordance with the Companies Act 2006, the Bank's related undertakings and the accounting treatment for each are listed below. All undertakings are wholly-owned by the Bank or subsidiaries of the Bank and are consolidated by reason of contractual control (Section 1162(2) CA 2006), unless otherwise indicated. Group interest refers to ordinary shares of equal values and voting rights unless further analysis is provided in the notes. Activities are classified in accordance with Annex I to the Capital Requirements Directive ("CRD IV") and the definitions in Article 4 of the Capital Requirements Regulation. All other requirements of the Capital Requirements (country-by-country) Reporting Regulations 2013 will be published on the RBS Group's website.

The following table details active related undertakings incorporated in the United Kingdom which are 100% owned by the Group and fully consolidated for accounting purposes.

Entity name	Activity(ies)	Address
Adam & Company Group PLC	BF	25 St. Andrew Square, Edinburgh, EH2 1AF, Scotland
Adam & Company Investment Management Ltd	BF	25 St. Andrew Square, Edinburgh, EH2 1AF, Scotland
Adam & Company PLC	CI	25 St. Andrew Square, Edinburgh, EH2 1AF, Scotland
Caledonian Sleepers Rail Leasing Ltd	BF	1 Princes Street, London, EC2R 8PB, England
Care Homes 1 Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
Care Homes 2 Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
Care Homes 3 Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
Care Homes Holdings Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
Churchill Management Ltd	BF	1 Princes Street, London, EC2R 8PB, England
Coutts & Company	BF	440 Strand, London, WC2R 0QS, England
Coutts Finance Company	BF	440 Strand, London, WC2R 0QS, England
Desertlands Entertainment Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Distant Planet Productions Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Dixon Motors Developments Ltd	BF	1 Princes Street, London, EC2R 8PB, England
Esme Loans Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
Euro Sales Finance Plc	BF	Smith House, P.O.Box 343, Elmwood Avenue, Feltham, TW13 7WH, England
Farming and Agricultural Finance Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
G L Trains Ltd	BF	1 Princes Street, London, EC2R 8PB, England
Gatehouse Way Developments Ltd	BF	1 Princes Street, London, EC2R 8PB, England
Heartlands (Central) Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Helena Productions Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
KUC (Public Houses) Ltd	BF	1 Princes Street, London, EC2R 8PB, England
KUC Holdings Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
KUC Properties Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Land Options (West) Ltd	INV	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Leckhampton Finance Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard & Ulster Ltd	BF	11-16 Donegall Square East, Belfast, BT1 5HD, Northern Ireland
Lombard Business Finance Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
Lombard Business Leasing Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
Lombard Charterhire Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
Lombard Corporate Finance (3) Ltd	BF	1 Princes Street, London, EC2R 8PB, England
Lombard Corporate Finance (6) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (7) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (10) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (11) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (13) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (14) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (15) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (December 1) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (December 3) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Corporate Finance (June 2) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Lombard Discount Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
Lombard Finance Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
Lombard Initial Leasing Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
Lombard Leasing Contracts Ltd	BF	1 Princes Street, London, EC2R 8PB, England
Lombard Lessors Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
Lombard Maritime Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
Lombard North Central Leasing Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England

For notes to this table refer to page 236.

Notes on the accounts

Entity name	Activity(1)	Address
Lombard North Central PLC	BF	280 Bishopsgate, London, EC2M 4RB, England
Lombard Property Facilities Ltd	BF	1 Princes Street, London, EC2R 8PB, England
Lombard Technology Services Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
Lombard Vehicle Management (1) Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
Lombard Vehicle Management (2) Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
Lombard Vehicle Management (3) Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
Lombard Vehicle Management Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
Lombard Venture Finance Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
Nanny McPhee Productions Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
National Westminster Bank Plc	CI	135 Bishopsgate, London, EC2M 3UR, England
National Westminster Home Loans Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
National Westminster Properties No. 1 Ltd	SC	135 Bishopsgate, London, EC2M 3UR, England
NatWest Capital Finance Ltd	BF	1 Princes Street, London, EC2R 8PB, England
NatWest Corporate Investments	BF	135 Bishopsgate, London, EC2M 3UR, England
NatWest Finance Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
NatWest Holdings Ltd	INV	135 Bishopsgate, London, EC2M 3UR, England
NatWest Machinery Leasing Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
NatWest Property Investments Ltd	INV	135 Bishopsgate, London, EC2M 3UR, England
NatWest Specialised Property Investments Ltd	BF	1 Princes Street, London, EC2R 8PB, England
NatWest Ventures Investments Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
Nevis Derivatives No. 1 LLP	BF	35 Great St Helen's, London, EC3A 6AP, England
Nevis Derivatives No. 2 LLP	BF	35 Great St Helen's, London, EC3A 6AP, England
Nevis Derivatives No. 3 LLP	BF	35 Great St Helen's, London, EC3A 6AP, England
Northern Isles Ferries Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
P of A Productions Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Patalex Productions Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Patalex II Productions Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Patalex III Productions Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Patalex IV Productions Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Patalex V Productions Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Pittville Leasing Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Premier Audit Company Ltd	BF	Smith House, P.O.Box 343, Elmwood Avenue, Feltham, TW13 7WH, England
Price Productions Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Priority Sites Investments Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
Priority Sites Ltd	INV	135 Bishopsgate, London, EC2M 3UR, England
Property Venture Partners Ltd	INV	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Property Ventures (B&M) Ltd	INV	1 Princes Street, London, EC2R 8PB, England
R.B. Capital Leasing Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
R.B. Equipment Leasing Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
R.B. Leasing (April) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
R.B. Leasing (December) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
R.B. Leasing (March) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
R.B. Leasing (September) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
R.B. Leasing Company Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
R.B. Quadrangle Leasing Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
R.B.S. Special Investments Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
RB Investments 2 Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
RB Investments 3 Ltd	OTH	135 Bishopsgate, London, EC2M 3UR, England
RBDC Administrator Ltd	SC	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RBDC Investments Ltd	INV	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RBEF Ltd	INV	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RBS Argonaut Ltd	OTH	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RBS Asset Finance Europe Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBS Asset Management (ACD) Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
RBS Asset Management Holdings	BF	135 Bishopsgate, London, EC2M 3UR, England
RBS Asset Management Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
RBS Investment Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RBS Invoice Finance (Holdings) Ltd	BF	Smith House, Elmwood Avenue, Feltham, TW13 7QD, England
RBS Invoice Finance Ltd	BF	Smith House, Elmwood Avenue, Feltham, TW13 7QD, England
RBS Mezzanine Ltd	BF	24/25 St. Andrew Square, Edinburgh, EH2 1AF, Scotland
RBS Property Developments Ltd	INV	36 St. Andrew Square, Edinburgh, EH2 2YB, Scotland

For notes to this table refer to page 236.

Notes on the accounts

Entity name	Activity ⁽¹⁾	Address
RBS Property Ventures Investments Ltd	BF	24/25 St. Andrew Square, Edinburgh, EH2 1AF, Scotland
RBS Residential Venture No.1 Ltd	INV	135 Bishopsgate, London, EC2M 3UR, England
RBS Secured Funding LLP	BF	35 Great St. Helen's, London, EC3A 6AP, England
RBS SME Investments Ltd	BF	1 Princes Street, London, EC2R 8PB, England
RBS Special Opportunities General Partner (England) Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
RBS Special Opportunities General Partner (Scotland) II Ltd	BF	24/25 St. Andrew Square, Edinburgh, EH2 1AF, Scotland
RBS Special Opportunities General Partner (Scotland) Ltd	BF	24/25 St. Andrew Square, Edinburgh, EH2 1AF, Scotland
RBS Specialised Property Investments Ltd	INV	135 Bishopsgate, London, EC2M 3UR, England
RBSG International Holdings Ltd	BF	24/25 St. Andrew Square, Edinburgh, EH2 1AF, Scotland
RBSM Capital Ltd	BF	24/25 St. Andrew Square, Edinburgh, EH2 1AF, Scotland
RBSSAF (2) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (4) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (6) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (7) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (8) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (10) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (11) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (12) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (25) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
RBSSAF (26) Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Riossi Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
RoboScot DevCap Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RoboScot Equity Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RoboScot Ventures Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Royal Bank Development Capital Ltd	BF	1 Princes Street, London, EC2R 8PB, England
Royal Bank Investments Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Royal Bank Invoice Finance Ltd	BF	Smith House, PO Box 50, Elmwood Avenue, Feltham, TW13 7QD, England
Royal Bank Leasing Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Royal Bank of Scotland (Industrial Leasing) Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Royal Bank Project Investments Ltd	INV	135 Bishopsgate, London, EC2M 3UR, England
Royal Bank Ventures Investments Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Royal Bank Ventures Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Royal Scot Leasing Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
RoyScot Financial Services Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
RoyScot Ltd	BF	280 Bishopsgate, London, EC2M 4RB, England
RoyScot Trust plc	BF	280 Bishopsgate, London, EC2M 4RB, England
Sandford Leasing Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
SIG 1 Holdings Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
SIG Number 2 Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Springwell Street Developments (No 1) Ltd	INV	280 Bishopsgate, London, EC2M 4RB, England
Style Financial Services Ltd	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
The One Account Ltd	BF	135 Bishopsgate, London, EC2M 3UR, England
The Royal Bank of Scotland Invoice Discounting Ltd	BF	Smith House, PO Box 50, Elmwood Avenue, Feltham, TW13 7QD, England
Theobald Film Productions LLP	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Total Capital Finance Ltd	BF	1 Princes Street, London, EC2R 8PB, England
Ulster Bank Commercial Services (NI) Ltd	BF	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland
Ulster Bank Ltd	CI	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland
Ulster Bank Pension Trustees Ltd	TR	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland
Voyager Leasing Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
W. & G. Industrial Leasing Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
W. & G. Lease Finance Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Walton Lake Developments Ltd	INV	1 Princes Street, London, EC2R 8PB, England
West Register (Hotels Number 1) Ltd	INV	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
West Register (Hotels Number 2) Ltd	INV	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
West Register (Hotels Number 3) Ltd	INV	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
West Register (Land) Ltd	INV	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
West Register (Northern Ireland) Property Ltd	INV	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland
West Register (Project Developments) Ltd	INV	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
West Register (Property Investments) Ltd	INV	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
West Register (Realisations) Ltd	INV	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
West Register (Residential Property Investments) Ltd	INV	135 Bishopsgate, London, EC2M 3UR, England

For notes to this table refer to page 236.

Notes on the accounts

Entity name	Activity(1)	Address
West Register Hotels (Holdings) Ltd	INV	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland
Williams & Glyn's Leasing Company Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
Winchcombe Finance Ltd	BF	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England
WR (NI) Property Investments Ltd	INV	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland
WR (NI) Property Realisations Ltd	INV	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland

The following table details active related undertakings incorporated outside the United Kingdom which are 100% owned by the Group and fully consolidated for accounting purposes.

Country	Entity name	Activity(1)	Address
Bahamas	CTB Ltd	BF	Trident Corporate Services (Bahamas) Ltd, Suite 200B, 2nd Floor, Centre of Commerce, One Bay Street, PO Box N-3944, Nassau, JE4 8ND
Bermuda	R.B. Leasing BDA One Ltd	BF	22 Victoria Street, 14 Bermidiana Road, Hamilton, HM12
Brazil	RBS Assessoria Ltda	SC	Rua Iguatemi, 151, conj. 161, CEP 01451-011, Cidade de Sao Paulo
Cayman Islands	Coutts & Co (Cayman) Ltd	BF	23/25 Broad Street, St Helier, JE4 8ND
Cayman Islands	Coutts General Partner (Cayman) V Ltd	BF	Coutts House, 1446, West Bay Road, PO Box 707, Georgetown, Grand Cayman, KY1-1107
Cayman Islands	Equator Investments (Cayman) Ltd	BF	Maples Corporate Services Limited, PO Box 39, George Town, Ugland House, Grand Cayman KY1-1104
Cayman Islands	Redlion Investments Ltd	OTH	Coutts House, 1446, West Bay Road, PO Box 707, Georgetown, Grand Cayman, KY1-1107
Cayman Islands	Redshield Holdings Ltd	BF	Estera Trust (Cayman)Limited, Clifton House, 75 Fort Street, PO Box 1350, Grand Cayman, KY1-1108, Cayman Islands
Cayman Islands	Royhaven Secretaries Ltd	BF	Coutts House, 1446, West Bay Road, PO Box 707, Georgetown, Grand Cayman, KY1-1107
Denmark	Airside Properties ASP Denmark AS	BF	c/o Visma Services, Lyskaer 3 CD, Herlev, 104 40 Denmark
Denmark	Airside Properties Denmark AS	BF	c/o Visma Services, Lyskaer 3 CD, Herlev, 104 40 Denmark
Denmark	Kastrup Commuter K/S	BF	c/o Visma Services, Lyskaer 3 CD, Herlev, 104 40 Denmark
Denmark	Kastrup Hangar 5 K/S	BF	c/o Visma Services, Lyskaer 3 CD, Herlev, 104 40 Denmark
Denmark	Kastrup V & L Building K/S	BF	c/o Visma Services, Lyskaer 3 CD, Herlev, 104 40 Denmark
Finland	Artur Kiinteistöt Oy	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Fab Ekenäs Formanshagen 4	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Forssa Liikekiinteistöt Oy	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Kiinteistö Oy Pennalan Johtotie 2	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Espoon Entresse II	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Espoon Niittysillantie 5	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Helsingin Mechelininkatu 1	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Helsingin Osmontie 34	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Helsingin Panuntie 11	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Helsingin Panuntie 6	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Iisalmen Kihlaviirta	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Jämsän Keskushovi	BF	Södra esplanaden 12 c/o Nordisk Renting Oy, 00130 Helsingfors, Finland
Finland	Koy Kokkolan Kaarlenportti Fab	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Kouvolan Oikeus ja Poliisitalo	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Lohjan Huonekalutalo	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Millennium	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Nummelan Portti	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Nuolialan päiväkot	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Päiväläisentie 1-6	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Peltolantie 27	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Raison Kihlakulma	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Ravattulan Kauppakeskus	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors

For notes to this table refer to page 236.

Notes on the accounts

Country	Entity name	Activity(1)	Address
Finland	Koy Tapiolan Louhi	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Koy Vapaalan Service-Center	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
Finland	Nordisk Renting Oy	BF	C/O Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130 Finland, Helsingfors
France	RDS Metropolis SAS	BF	Boulevard Hausmann, Paris, 75008
Germany	RBS (Deutschland) GmbH	CI	Junghofstrasse 22, Frankfurt am Main, D-60311
Germany	RBS Deutschland Holdings GmbH	BF	Junghofstrasse 22, Frankfurt am Main, D-60311
Germany	RBS Structured Financial Services GmbH	BF	Junghofstrasse 22, Frankfurt am Main, D-60311
Gibraltar	RBS (Gibraltar) Ltd	CI	1 Corral Road
Guernsey	Lothbury Insurance Company Ltd	BF	PO Box 384, The Albany, South Esplanade, St Peter Port, GY1 4NF
Guernsey	Morar ICC Insurance Ltd	BF	PO Box 384, The Albany, South Esplanade, St Peter Port, GY1 4NF
Guernsey	RBS Employment (Guernsey) Ltd	SC	1 Le Marchant Street, St. Peter Port, GY1 1LF
Hong Kong	RBS Securities Japan Ltd	BF	Level 54, Hopewell Centre, 183 Queen's Road East
India	RBS Services India Private Ltd	SC	DLF Cyber Green, Tower C, DLF Cyber City, Haryana, 122 002
Republic of Ireland	Easycash (Ireland) Ltd	BF	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	First Active Holdings Ltd	BF	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	First Active Insurances Services Ltd	BF	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	First Active Investments No. 4 Ltd	BF	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	First Active Treasury Ltd	BF	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	Hume Street Nominees Ltd	BF	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	Lombard Ireland Group Holdings Unlimited Company	BF	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	Lombard Ireland Ltd	BF	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	Norgay Property Ltd	BF	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	RBS Asset Management (Dublin) Ltd	BF	Guild House, Guild Street, IFSC, Dublin, 1
Republic of Ireland	The RBS Group Ireland Retirement Savings Trustee Ltd	TR	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	Ulster Bank (Ireland) Holdings Unlimited Company	INV	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	Ulster Bank Commercial Services Ltd	BF	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	Ulster Bank Dublin Trust Company Unlimited Company	TR	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	Ulster Bank Holdings (ROI) Ltd	BF	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	Ulster Bank Ireland Designated Activity Company	CI	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	Ulster Bank Pension Trustees (RI) Ltd	TR	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	Ulster Bank Wealth Unlimited Company	BF	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	Walter Property Ltd	BF	Ulster Bank Group Centre, George's Quay, Dublin 2
Republic of Ireland	West Register (Republic of Ireland) Property Ltd	INV	Ulster Bank Group Centre, George's Quay, Dublin 2
Isle Of Man	Coutts & Co (Manx) Ltd	BF	23/25 Broad Street, St Helier, JE4 8ND
Isle Of Man	Isle of Man Bank Ltd	BF	2 Athol Street, Douglas, IM99 1AN
Isle Of Man	Lombard Manx Leasing Ltd	BF	Royal Bank House, 2 Victoria Street, Douglas, IM1 2LN
Isle Of Man	Lombard Manx Ltd	BF	Royal Bank House, 2 Victoria Street, Douglas, IM1 2LN
Isle Of Man	The Royal Bank of Scotland Employment (Isle of Man) Ltd	BF	Sixty Circular Road, Douglas, IM1 1AE
Italy	Fondo Sallustio	BF	Via Vittorio Alfoeri 1 - 31015 Conegliano (TV)
Jersey	C.J. Fiduciaries Ltd	BF	23-25 Broad Street, Jersey, St Helier
Jersey	Lombard Finance (CI) Ltd	BF	Royal Bank House, 71 Bath Street, St Helier, JE4 8PJ
Jersey	RBS International Employees' Pension Trustees Ltd	BF	Coutts & Co Trustees (Jersey) Limited, 23/25 Broad Street, St Helier, JE4 8ND
Jersey	RoyScot Jersey Ltd	BF	Royal Bank House, 71 Bath Street, St Helier, JE4 8PJ
Jersey	The Royal Bank of Scotland International (Holdings) Ltd	BF	Royal Bank House, 71 Bath Street, St Helier, JE4 8PJ
Jersey	The Royal Bank of Scotland International Ltd	CI	Royal Bank House, 71 Bath Street, St Helier, JE4 8PJ

For notes for this table refer to page 236.

Notes on the accounts

Country	Entity name	Activity(1)	Address
Netherlands	National Westminster International Holdings B.V.	BF	24/25 St Andrew Square, Edinburgh, EH2 1AF Scotland
Netherlands	NatWest Securities B.V.	BF	Gustav Mahlerlaan 350, Amsterdam, 1082 ME
Netherlands	RBS Investments Netherlands B.V.	BF	Gustav Mahlerlaan 350, Amsterdam, 1082 ME
Netherlands	RBS Netherlands Holdings B.V.	BF	Gustav Mahlerlaan 350, Amsterdam, 1082 ME
Norway	BD Lagerhus AS	BF	C/O Nordisk Renting AS, 9 Estaje, Klingenberggata 7, NO-0161 Norway, Oslo
Norway	Eiendomsselskapet Apteno Larvik AS	BF	C/O Nordisk Renting AS, 9 Estaje, Klingenberggata 7, NO-0161 Norway, Oslo
Norway	Hatros 1 AS	BF	C/O Nordisk Renting AS, 9 Estaje, Klingenberggata 7, NO-0161 Norway, Oslo
Norway	Nordisk Renting AS	BF	C/O Nordisk Renting AS, 9 Estaje, Klingenberggata 7, NO-0161 Norway, Oslo
Norway	Ringdalveien 20 AS	BF	C/O Nordisk Renting AS, 9 Estaje, Klingenberggata 7, NO-0161 Norway, Oslo
Poland	RBS Bank (Polska) S.A.	CI	Wisniowy Business Park, ul 1-go Sierpnia 8a, Warsaw 02-134
Poland	RBS Polish Financial Advisory Services sp. z o.o.	BF	Wisniowy Business Park, ul 1-go Sierpnia 8a, Warsaw 02-134
Sweden	Airside Properties AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Arkivborgen KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Backsmedjan KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Bil Fastigheter i Sverige AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Bilfastighet i Täby AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Braheberget KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Brödmagasinet KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Dalklockan 6 KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Eurohill 4 KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighet Kallebäck 2:4 i Göteborg AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighets AB Flöjten i Norrköping	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighets AB Hammarbyvagnen	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighets AB Kabisten 1	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighets AB Stockmakaren	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighets AB Xalam	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighets Aktiebolaget Sambiblioteket	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Fastighetsbolaget Holma i Höör AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Forskningshöjden KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Förvaltningsbolaget Dalkyrkan KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Förvaltningsbolaget Predio 3 KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Gredelinen KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Grinnhagen KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Horrsta 4:38 KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	IR Fastighets AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	IR IndustriRenting AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Kallebäck Institutfastigheter AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	KB Eurohill	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	KB IR Gamlestaden	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	KB Lagermannen	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	KB Likriktaren	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Läkten 1 KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	LerumsKrysset KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Limstagården KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Mjälgen KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Nordisk Renting AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm

Notes on the accounts

Country	Entity name	Activity(1)	Address
Sweden	Nordisk Renting Kapital AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Nordisk Specialinvest AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Nordiska Strategifastigheter Holding AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Pyrrhula 6,7 AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	SFK Kommunfastigheter AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Sjöklockan KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Skinnarängen KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Solbanken KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Strand European Holdings AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Svenskt Fastighetskapital AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Svenskt Fastighetskapital Holding AB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Tingsbrogården KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Tygverkstaden 1 KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Vansbro Fjärrvärme KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Vansbroviken KB	BF	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Switzerland	Coutts & Co Ltd	BF	Lerchenstrasse 18, Zurich, 8022 Switzerland
Switzerland	Coutts & Co Trustees (Suisse) S.A.	BF	Rue du Rhône 14, c/o Regus Rue du Rhône Sàrl, 1204 Genève
Switzerland	RBS Services (Switzerland) Ltd	SC	Lerchenstrasse 18, Zurich, CH 8022
United Arab Emirates	RBS Operations FZ LLC	SC	Dubai Outsource Zone, Building 5, Level 3, P.O. Box 2567, Dubai
United States	Candlelight Acquisition LLC	BF	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	Communications Capital Group I, LLC	BF	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	Communications Capital Group II, LLC	BF	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	Financial Asset Securities Corp.	BF	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	Greenwich Capital Derivatives, Inc.	BF	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	Lease Plan North America LLC	BF	1209 Orange Street, Wilmington, New Castle, Delaware, 2903
United States	NatWest Group Holdings Corp	BF	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	Random Properties Acquisition Corp. I	INV	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	Random Properties Acquisition Corp. II	INV	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	Random Properties Acquisition Corp. III	INV	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	Random Properties Acquisition Corp. IV	INV	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	RBS Acceptance Inc.	CI	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	RBS Americas Property Corp.	SC	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	RBS Commercial Funding Inc.	BF	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	RBS Equity Corp	BF	340 Madison Avenue, New York, New York, 10173 United States
United States	RBS Financial Products Inc.	BF	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	RBS Holdings USA Inc.	BF	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	RBS Investments USA Corp.	BF	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	RBS Securities Inc.	BF	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
United States	RBS Smart Products Inc	BF	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808
Virgin Islands, British	Action Corporate Services Ltd	BF	PO Box 986, Mill Wall, Wickhams Cay, Tortola, JE4 8ND
Virgin Islands, British	Minster Corporate Services Ltd	BF	PO Box 986, Mill Wall, Wickhams Cay, Tortola, JE4 8ND

For notes for this table refer to page 236.

Notes on the accounts

The following table details active related undertakings incorporated in the United Kingdom where the Group ownership is less than 100%.

Entity name	Activity(1)	Accounting treatment(2)	Group interest %	Address	Notes
Arran Cards Funding plc	BF	FC	0	35 Great St Helens, London, EC3A 6AP England	
Arran Residential Mortgages Funding 2010-1 plc	BF	FC	0	35 Great St Helens, London, EC3A 6AP England	
Arran Residential Mortgages Funding 2011-1 plc	BF	FC	0	35 Great St Helen's, London, EC3A 6AP England	
Arran Residential Mortgages Funding 2011-2 plc	BF	FC	0	35 Great St Helens, London, EC3A 6AP England	
Aspire Oil Services Ltd	BF	EAA	28	Union Plaza 6th Floor, 1 Union Wynd, Aberdeen, AB10 1DQ Scotland	
Attlee Personal Loans Plc	BF	FC	0	35 Great St Helens, London, EC3A 6AP England	
Attraction Inns Ltd	BF	IA	30	4 Gillespie Road, Edinburgh, EH13 0LL Scotland	
Ballymore (London Arena) Ltd	BF	IA	45	St John's House, 5 South Parade, Summertown, Oxford, Oxfordshire, OX2 7JL England	(3)
Bevan Loan Interest Purchaser Plc	BF	FC	0	35 Great St Helens, London, EC3A 6AP England	
Business Growth Fund plc	BF	EAA	27	13-15 York Buildings, London, WC2N 6JU England	
CFN Packaging Group Ltd	BF	IA	25	27-29 Lumley Avenue, Skegness, PE25 2AT England	
Cloud Electronics Holdings Ltd	BF	IA	20	140 Staniforth Road, Darnall, Sheffield, South Yorkshire, S9 3HF England	
Coneworx Ltd	BF	IA	40	4 Biggar Road Industrial Estate, Cleland, Motherwell, ML1 5PB Scotland	
DF Ventures Ltd	BF	IA	20	7 Whiteladies Road, Clifton, Bristol, BS8 1NN Wales	
Ferrostatics Holdings Ltd	BF	IA	35	c/o John Hardman & Co, Blackfriars House, Parsonage, Manchester, M3 2JA England	
Funding For Equity Release Securitisation Transaction (No.4) Ltd	BF	FC	0	Wilmington Trust SP Services (London) Ltd, Third Floor, 1 Kings Arms Yard, London, EC2R 7AF England	
Funding For Equity Release Securitisation Transaction (No.5) Ltd	BF	FC	0	Wilmington Trust SP Services (London) Ltd, Third Floor, 1 Kings Arms Yard, London, EC2R 7AF England	
Greenock Funding No 5 Plc	BF	FC	0	35 Great St Helens, London, EC3A 6AP England	
GWNW City Developments Ltd	BF	EAJV	50	Gate House, Turnpike Road, High Wycombe, Buckinghamshire, HP12 3NR England	
Hamsard 3120 Ltd	BF	IA	40	Sycamore Road, Eastwood Trading Estate, Rotherham, South Yorkshire, S65 1EN England	(4)
Higher Broughton (GP) Ltd	BF	EAA	41	Floor 3, 1 St. Ann Street, Manchester, M2 7LR, England	
Higher Broughton Partnership LP	BF	EAA	41	Cornwall Buildings, 45-51 Newhall Street, Birmingham, West Midlands, B3 3QR England	
Isobel AssetCo Ltd	BF	FC	75	40 Berkeley Square, London, W1J 5AL England	
Isobel EquityCo Ltd	BF	FC	75	40 Berkeley Square, London, W1J 5AL England	
Isobel Finance HoldCo No2 Ltd	BF	FC	0	35 Great St Helens, London, EC3A 6AP England	
Isobel Finance No2 Plc	BF	FC	0	35 Great St Helens, London, EC3A 6AP England	
Isobel HoldCo Ltd	BF	FC	75	40 Berkeley Square, London, W1J 5AL England	
Isobel Intermediate HoldCo Ltd	BF	FC	75	40 Berkeley Square, London, W1J 5AL England	
Isobel Loan Capital Ltd	BF	FC	75	40 Berkeley Square, London, W1J 5AL England	
Isobel Mezzanine Borrower Ltd	BF	FC	75	40 Berkeley Square, London, W1J 5AL England	
Jaguar Cars Finance Ltd	BF	FC	50	280 Bishopsgate, London, EC2M 4RB England	
JCB Finance (Leasing) Ltd	BF	FC	75	The Mill, High Street, Rocester, ST14 5JW England	
JCB Finance Ltd	BF	FC	75	The Mill, High Street, Rocester, ST14 5JW England	
Land Options (East) Ltd	BF	EAJV	50	24/25 St Andrew Square, Edinburgh, EH2 1AF Scotland	
Landpower Leasing Ltd	BF	FC	75	The Mill, High Street, Rocester, ST14 5JW England	
London Rail Leasing Ltd	BF	EAJV	50	99 Queen Victoria Street, London, EC4V 4EH, England	
Lyalvale Property Ltd	INV	IA	31	Lyalvale Express Ltd, Express Estate, Fisherwick, Nr Whittington, Lichfield, WS13 8XA England	
Pollokshields Developments Ltd	INV	IA	49	Abercorn House, 79 Renfrew Road, Paisley, Renfrewshire, PA3 4DA Scotland	
Prestige Walker Ltd	OTH	IA	30	Terminal House, Station Approach, Shepperton, Middlesex, TW17 8AS England	
Race 500 Ltd	BF	IA	21	Unit 7, Newbridge Trading Estate, Newbridge Close, Whitby Road, Bristol, BS4 4AX Wales	
RBS Covered Bonds (LM) Ltd	BF	IA	20	35 Great St Helens, London, EC3A 6AP England	
RBS Covered Bonds LLP	BF	FC	73	1 Princes Street, London, EC2R 8BP England	
RBS Secured Funding (LM) Ltd	BF	FC	20	C/O SFM Corporate Services Ltd, 35 Great St. Helens, London, EC3A 6AP England	
RBS Sempra Commodities LLP	BF	FC	51	24/25 St Andrew Square, Edinburgh, EH2 1AF Scotland	
RBS Sempra Products Ltd	BF	FC	51	20-22 Bedford Row, London, WC1R 4JS, England	
Tay Valley Lighting (Leeds) Ltd	BF	EAJV	50	The Quadrangle, The Promenade, Cheltenham, GL50 1PX England	
Tay Valley Lighting (Newcastle and North Tyneside) Ltd	BF	EAJV	50	The Quadrangle, The Promenade, Cheltenham, GL50 1PX England	
Tay Valley Lighting (Stoke on Trent) Ltd	BF	EAJV	50	The Quadrangle, The Promenade, Cheltenham, GL50 1PX England	
The Appeal Group Ltd	OTH	IA	25	6 Vale Road, Bedminster, Bristol, BS3 5SD Wales	
The Scottish Agricultural Securities Corporation P.L.C.	BF	IA	33	30 St Vincent Place, Glasgow, G1 2EU Scotland	
Uniconn Ltd	OTH	IA	30	Howe Moss Drive, Kirkhill Industrial Estate, Dyce, Aberdeen, AB21 0GL Scotland	
Vocalink Holdings Ltd	BF	EAA	21	Drake House, Three Rivers Court, Homestead, Rickmansworth, Hertfordshire, WD3 1FX England	
Wealdland Ltd	OTH	EAA	29	10 Norwich Street, London, EC4A 1BD England	

For notes for this table refer to page 236.

Notes on the accounts

The following table details active related undertakings incorporated outside the United Kingdom where the Group ownership is less than 100%.

Country	Entity name	Activity (1)	Accounting treatment (2)	Group interest %	Address	Notes
Cayman Islands	Lunar Funding VIII Ltd	BF	FC	0	Boundary Hall, Cricket Square, 171 Elgin Avenue, Grand Cayman, KY1-1104	
China	Hua Ying Securities Company Ltd	BF	EAJV	33	Units 01-11, 15th Floor, 19 Gao Lang Dong Road, Wuxi New District	
China	Suzhou Trust Co. Ltd	BF	EAJV	20	Suzhou Industrial Park, Investment Building, No. 308, Suyu Road, Suzhou, 215021, China	
Cyprus	Pharos Estates Ltd	OTH	EAA	49	24 Demostheni Severi, 1st Floor, Nicosia, 1080	
France	Cinquième Lease G.I.E.	BF	EAJV	33	94, Boulevard Haussman, Paris, 75008	
France	Quatrième Lease G.I.E.	BF	EAJV	33	94, Boulevard Haussman, Paris, 75008 France	
Germany	Argos Vermögensver-waltung GmbH	OTH	IA	40	Junghofstr. 22, Frankfurt, 60311	
Germany	BLIXA Elfte Vermögensver-waltung GmbH	BF	IA	40	Junghofstrasse 22, Frankfurt am Main, D-60311	
Guernsey (Channel Islands)	MSE Holding Ltd	INV	IA	37	C/O Gentoo Fund Services Ltd, Mill Court, La Charrotiere, St Peter Port GY1 3GG	(4)
Republic of Ireland	Celtic Residential Irish Mortgage Securitisation No 09 plc	BF	FC	0	Riverside One, Sir John Rogersons Quay, Dublin 1	
Republic of Ireland	Celtic Residential Irish Mortgage Securitisation No 10 plc	BF	FC	0	5 Harbourmaster Place, Dublin 1	
Republic of Ireland	Celtic Residential Irish Mortgage Securitisation No 11 plc	BF	FC	0	5 Harbourmaster Place, Dublin 1	
Republic of Ireland	Celtic Residential Irish Mortgage Securitisation No 12 DAC	BF	FC	0	5 Harbourmaster Place, Dublin 1	
Republic of Ireland	Celtic Residential Irish Mortgage Securitisation No 14 DAC	BF	FC	0	5 Harbourmaster Place, Dublin 1	
Republic of Ireland	Celtic Residential Irish Mortgage Securitisation No 15 DAC	BF	FC	0	5 Harbourmaster Place, Dublin 1	
Republic of Ireland	Celtic Residential Irish mortgage Securitisation No 16 DAC	BF	FC	0	5 Harbourmaster Place, Dublin 1	
Ireland	Cesium Structured Funding Ltd	BF	FC	0	5 Harbourmaster Place, Dublin 1	
Ireland	CHESS III Ltd	BF	FC	0	77 Sir John Rogerson's Quay, Dublin 2	
Republic of Ireland	Qulpic Ltd	BF	FC	67	70 Sir John Rogerson's Quay, Dublin 2	
Republic of Ireland	The Drive4Growth Company Ltd	OTH	IA	20	C/O Denis Crowley & Co, Chartered Accountants, Unit 6 Riverside Grove, Riverstick, Co. Cork Ireland	
Republic of Ireland	Zrko Ltd	BF	FC	67	70 Sir John Rogerson's Quay, Dublin 2	
Jersey	Arran Cards Loan Note Issuer No. 1 Ltd	BF	FC	0	47 Esplanade, St Helier, Jersey, JE1 0BD	
Jersey	Chess II Ltd	BF	FC	0	13 Castle Street, St Helier, Jersey, JE4 5UT	
Jersey	Foundation Commercial Property Ltd	BF	EAJV	50	Royal Bank House, 71 Bath Street, St Helier JE4 8PJ	
Jersey	Spring Allies Jersey Ltd	BF	IA	49	Whiteley Chambers, Don Street, St Helier, JE4 9WG	
Netherlands	Exfin Capital B.V.	BF	FC	0	Amsteldijk 166, Amsterdam, 1082 MD	
Netherlands	STAR NO.1 B.V.	OTH	FC	0	Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands	
Netherlands	STICHTING STAR NO. 1	OTH	FC	0	Hoogoorddreef 15, 1101 BA Amsterdam, Netherlands	
Netherlands	Tulip Asset Purchase Company B.V.	BF	FC	0	Claude Debussylaan 24, Amsterdam, 1082 MD	
Poland	Wiśniowy Management sp. z o.o.	SC	EAA	25	Ilzecka 26 Street, Warsaw, 02-135	
Sweden	Bong Fastigheter KB	BF	FC	51	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm	
Sweden	Förvaltningsbolaget Klöverbacken Skola KB	BF	FC	51	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm	
Sweden	Optimus KB	BF	FC	51	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm	
Sweden	Stora Kvamen KB	BF	FC	51	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm	
United States	Amtrust Acquisition LLC	BF	IA	24	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808	(4)
United States	Churchill Loan Asset Securitisation Programme, LLC	BF	FC	0	2711 Centerville Road Suite 400, Wilmington, Delaware, 19808	
United States	Riverview Mortgage Loan Trust 2007-3	BF	FC	0	Rodney Square Market 1100 N Market Street, Wilmington, Delaware 19808	
United States	Sempra Energy Trading LLC	BF	FC	51	160 Greentree Drive, Suite 101, Dover	
United States	Thames Asset Global Securitization No.1 Inc.	BF	FC	0	114 West 47th Street, New York, 10036	

For notes for this table refer to page 236.

Notes on the accounts

The following table details an active related undertakings which is 100% owned by the Group but is not consolidated for accounting purposes(6).

Country	Entity Name	Activity(1)	Address	Notes
United States	West Granite Homes Inc.	OTH	Bellevue Parkway, Suite 210, Wilmington, Delaware, 19809	(7)

The following tables detail related undertakings that are not active.

Actively being dissolved

Country	Entity name	Accounting treatment (2)	Group interest %	Address	Notes
Cayman Islands	NatWest (Deansgate) Investments Ltd	FC	100	Intertrust Corporate Services (Cayman) Limited, 190 Elgin Avenue, George Town, Grand Cayman, KY1-9005	
Curaçao	RBSG Holdings N.V.	FC	100	Kaya Flambayan 9, Curacao, Netherlands Antilles	
Germany	West Register Prime Holding GmbH i. L.	INV	100	Emil-Riedl-Weg 6, Pullach i. Isartal, D-82049	
Gibraltar	Sotomar Ltd	FC	100	1 Corral Road	
Gibraltar	Gosport Ltd	FC	100	1 Corral Road	
Guernsey (Channel Islands)	RoyScot Guernsey Ltd	FC	100	PO Box 597, Royal Bank Place, 1 Glatigny Esplanade, St Peter Port, GY1 6NF	
Republic of Ireland	First Active Investments No. 3 Ltd	FC	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
Republic of Ireland	First Active Nominees Ltd	FC	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
Republic of Ireland	Meritvale Ltd	FC	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
Republic of Ireland	National Westminster Services (Ireland) Ltd	FC	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
Republic of Ireland	NatWest Holdings (Ireland)	FC	100	24/26 City Quay, Dublin 2	
Republic of Ireland	The Royal Bank of Scotland Finance (Ireland)	FC	100	24/26 City Quay, Dublin 2	
Republic of Ireland	UB SIG (ROI) Ltd	FC	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
Republic of Ireland	Ulster Bank Group Treasury Ltd	FC	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
Republic of Ireland	Ulster Bank Investment Funds Ltd	FC	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
Republic of Ireland	Ulster International Finance	FC	100	Ulster Bank Group Centre, George's Quay, Dublin 2	
Isle of Man	Isle of Man Bank (Nominees) Ltd	FC	100	2 Athol Street, Douglas, IM99 1AN	
Jersey (Channel Islands)	Mulcaster Street Nominees Ltd	FC	100	Royal Bank House, 71 Bath Street, St Helier, JE4 8PJ Jersey	
Norway	Airside Properties ASP Norway AS	FC	100	C/O Visma Services, Lyskaer 3 CD, Herlev, Denmark	
Norway	Airside Properties Norway AS	FC	100	C/O Visma Services, Lyskaer 3 CD, Herlev, Denmark	
United Kingdom	Beveltop Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England	
United Kingdom	BL Residential General Partner Ltd	EAJV	100	York House, 45 Seymour Street, London, W1H 7LX, England	
United Kingdom	Burridge Holdings Ltd	IA	40	Squires Farm Industrial Estate, Easons Green, Framfield, East Sussex, TN22 5RB England	
United Kingdom	Cala Campus Ltd	EAJV	50	Ledingham Chalmers, Johnstone House, 52-54 Rose Street, Aberdeen, AB10 1HA Scotland	
United Kingdom	Cornhill Holdings Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England	
United Kingdom	District Bank Ltd	FC	100	1 Princes Street, London, EC2R 8PB England	
United Kingdom	Ecosse Regeneration Ltd	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF Scotland	
United Kingdom	GATX Asset Residual Management Ltd	EAA	50	No 1 Dorset Street, Southampton, SO15 2DP England	
United Kingdom	GRG Real Estate Asset Management (Northern Ireland) Ltd	FC	100	11-16 Donegall Square East, Belfast, Belfast, BT1 5UB, Northern Island	
United Kingdom	Honroe (UK) Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England	
United Kingdom	Libra No 1 Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England	
United Kingdom	Lombard GATX Holdings Ltd	EAJV	50	1 Dorset Street, Southampton, SO15 2DP England	
United Kingdom	NatWest (HMHP) Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England	
United Kingdom	NatWest Corporate Services (Ireland)	FC	100	No. 1 Dorset Street, Southampton, Hampshire, SO15 2DP, England	
United Kingdom	Northants Developments Ltd	FC	100	1 Princes Street, London, EC2R 8PB England	
United Kingdom	Primemodern Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR, England	
United Kingdom	RBS Hotel Development Company Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England	
United Kingdom	RBS Hotel Investments Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England	
United Kingdom	RBS Property Ventures Investments Ltd	BF	100	24/25 St. Andrew Square, Edinburgh, EH2 1AF, Scotland	
United Kingdom	RBS Residential Venture No.2 Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England	
United Kingdom	RoyScot Vehicle Contracts Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England	
United Kingdom	STAR 1 Special Partner Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England	
United Kingdom	The Financial Trading Company Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England	
United Kingdom	The Mortgage Corporation	FC	100	Group Secretariat, RBS Group plc., 1 Princes Street, London, EC2R 8PB, England	

For notes for this table refer to page 236.

Notes on the accounts

Country	Entity name	Accounting treatment (2)	Group interest %	Address
United Kingdom	Thrapston Triangle Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	UB SIG (NI) Ltd	FC	100	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland
United Kingdom	Van Finance Ltd	FC	100	280 Bishopsgate, London, EC2M 4RB England
United Kingdom	West Register (Bankside) Ltd	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF Scotland

Dormant

Country	Entity name	Accounting treatment (2)	Group interest %	Address
Denmark	Nordisk Renting A/S	FC	100	c/o Adv Jan-Erik Svensson, HC Andersens Boulevard 12, Copenhagen V, 1553 Denmark
Republic of Ireland	First Active Ltd	FC	100	Ulster Bank Group Centre, George's Quay, Dublin 2
Jersey	Arran Cards Loan Note Issuer No.2 Ltd	FC	100	47 Esplanade, St Helier Jersey, Channel Islands, JE1 0BD Jersey
Jersey	National Westminster Bank Nominees (Jersey) Ltd	FC	100	16 Library Place, St. Helier, Jersey, JE4 8ND
Jersey	RBS Cards Securitisation Funding Ltd	FC	100	Royal Bank House, 71 Bath Street, St Helier, JE4 8PJ Jersey
Sweden	Nordisk Renting Facilities Management AB	FC	100	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Nordisk Renting HB	FC	100	C/O Nordisk Renting AB, Box 14044, SE-104 40, Stockholm
Sweden	Svenskt Energikapital AB	FC	100	C/O Nordisk Renting AB, Box 14044, SE-104 40 Sweden, Stockholm
United Kingdom	Adam & Company (Nominees) Ltd	FC	100	25 St. Andrew Square, Edinburgh, EH2 1AF Scotland
United Kingdom	British Overseas Bank Nominees Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR, England
United Kingdom	Buchanan Holdings Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	CNW Group Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England
United Kingdom	Coutts Group	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	CTL Nominees Ltd	FC	100	22 King Street, London, SW1Y 6QY England
United Kingdom	Dixon Motorcycle Holdings Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	Dixon Vehicle Sales Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	Dormaco (No.12) Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	Dunfly Trustee Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	Emperor Holdings Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	FIT Nominee Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England
United Kingdom	FIT Nominee 2 Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England
United Kingdom	Freehold Managers (Nominees) Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England
United Kingdom	Glyns Nominees Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England
United Kingdom	Greenwich NatWest Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England
United Kingdom	JCB Credit Ltd	FC	75	The Mill, High Street, Rocester, ST14 5JW England
United Kingdom	JCB Finance Pension Ltd	FC	88	11-16 Donegall Square East, Belfast, BT1 5UB Northern Ireland
United Kingdom	Latam Directors Ltd	NC	100	Quartermile Two, 2 Lister Square, Edinburgh, Midlothian, EH3 9GL Scotland
United Kingdom	Lombard Bank	FC	100	Lee House, Baird Road, Enfield, Middlesex, EN1 1SJ England
United Kingdom	Lombard North Central Wheelease Ltd	FC	100	280 Bishopsgate, London, EC2M 4RB England
United Kingdom	Marigold Nominees Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	N.C. Head Office Nominees Ltd	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF Scotland
United Kingdom	National Westminster Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	NatWest Aerospace Trust Company Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England
United Kingdom	NatWest FIS Nominees Ltd	FC	100	Premier Place, 2 1/2 Devonshire Square, London, EC2M 4BA England
United Kingdom	NatWest Invoice Finance Ltd	FC	100	Smith House, Elmwood Avenue, Feltham, TW13 7QD England
United Kingdom	NatWest Nominees Ltd	FC	100	Premier Place, 2 1/2 Devonshire Square, London, EC2M 4BA England
United Kingdom	NatWest PEP Nominees Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	NatWest Security Trustee Company Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England
United Kingdom	Project & Export Finance (Nominees) Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	R.B.S. Property (Greenock) Ltd	FC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF Scotland
United Kingdom	RB Investments 5 Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England
United Kingdom	RBS CIF Trustee Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	RBS Investment Executive Ltd	NC	100	24/25 St Andrew Square, Edinburgh, EH2 1AF Scotland
United Kingdom	RBS Pension Trustee Ltd	NC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	RBS Retirement Savings Trustee Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	RBS Secretarial Services Ltd	FC	100	24/25 St Andrew Square, Edinburgh, Midlothian, EH2 1AF Scotland
United Kingdom	RBS Shelf Nominees Ltd	FC	100	24/25 St Andrew Square, Edinburgh, Midlothian, EH2 1AF Scotland
United Kingdom	RBS Trustees Ltd	FC	100	24/25 St Andrew Square, Edinburgh, Midlothian, EH2 1AF Scotland
United Kingdom	RBSG Collective Investments Nominees Ltd	FC	100	24/25 St Andrew Square, Edinburgh, Midlothian, EH2 1AF Scotland

For notes for this table refer to page 236.

Notes on the accounts

Country	Entity name	Accounting treatment (2)	Group interest %	Address
United Kingdom	RoboScot (64) Ltd	FC	100	24/25 St Andrew Square, Edinburgh, Midlothian, EH2 1AF Scotland
United Kingdom	Rover Finance Holdings Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR, England
United Kingdom	Rover Finance Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR, England
United Kingdom	Royal Bank Business Asset Finance Ltd	FC	100	280 Bishopsgate, London, EC2M 4RB England
United Kingdom	Royal Bank Insurance Consultants Ltd	FC	100	24/25 St Andrew Square, Edinburgh, Midlothian, EH2 1AF Scotland
United Kingdom	RoyScot Auto Credit Ltd	FC	100	280 Bishopsgate, London, EC2M 4RB England
United Kingdom	RoyScot Industrial Leasing Ltd	FC	100	280 Bishopsgate, London, EC2M 4RB England
United Kingdom	RoyScot Leasing Ltd	FC	100	280 Bishopsgate, London, EC2M 4RB England
United Kingdom	RoyScot Motor Finance Ltd	FC	100	280 Bishopsgate, London, EC2M 4RB England
United Kingdom	Sixty Seven Nominees Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	Strand Nominees Ltd	FC	100	440 Strand, London, WC2R 0QS England
United Kingdom	Syndicate Nominees Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	The National Bank Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	The Royal Bank of Scotland (1727) Ltd	FC	100	24/25 St Andrew Square, Edinburgh, Midlothian, EH2 1AF Scotland
United Kingdom	Topco (No1) Ltd	IA	45	Macdonalds Hotels, Whiteside House, Whiteside Industrial Estate, Bathgate, West Lothian, EH48 2RX Scotland
United Kingdom	W.G.T.C.Nominees Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR, England
United Kingdom	Westminster Bank Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	Williams & Glyn Holdings Ltd	FC	100	135 Bishopsgate, London, EC2M 3UR England
United Kingdom	Williams & Glyn's Bank Ltd	FC	100	1 Princes Street, London, EC2R 8PB England
United Kingdom	Williams & Glyn's Trust Company Ltd	FC	100	1 Princes Street, London, EC2R 8PB England

In Administration

Country	Entity name	Activity (1)	Accounting treatment (2)	Group interest %	Address
United Kingdom	Adam & Company Second General Partner Ltd	BF	IA	50	FRP Advisory LLP, Apex 3 95 Haymarket Terrace, Edinburgh, EH12 5HD Scotland

Notes:

- (1) Activity:
 Banking and Financial institution - **BF**
 Credit institution - **CI**
 Investment (shares or property) holding company - **INV**
 Service company - **SC**
 Trustee - **TR**
 Other - **OTH**
- (2) Accounting treatment:
 Equity accounting - Associate - **EEA**
 Equity accounting - Joint Venture - **EAJV**
 Fully consolidated - **FC**
 Investment Accounting - **IA**
 Not consolidated - **NC**
- (3) The Group is interested in 25% of the voting rights
 (4) The Group is interested in none of the voting rights
 (5) Related undertaking consolidated because the Group controls the company by virtue of contractual agreements
 (6) Related undertaking not consolidated as it is not controlled by the Group.
 (7) Related undertaking owned for the benefit of Group pension schemes.

Group overseas branches

The company's related undertakings have branches in the following countries.

Subsidiary	Geographic location of branches
Coutts & Co Ltd	Hong Kong, Singapore
Easycash (Ireland) Ltd	United Kingdom
National Westminster Bank Plc	Jersey
RBS Securities Japan Ltd	Japan
The Royal Bank of Scotland International Ltd	Gibraltar, Guernsey, Isle of Man, Luxembourg
The Royal Bank of Scotland plc	Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hong Kong, Republic of Ireland, Italy, Japan, Jersey, Republic of Korea, Luxembourg, Malaysia, Netherlands, Norway, Poland, Singapore, Spain, Sweden, Switzerland, Turkey, United Arab Emirates, United States
Ulster Bank Ireland DAC	United Kingdom

Additional information

Financial summary

The Group's financial statements are prepared in accordance with IFRS. Selected data under IFRS for each of the last five years are presented below.

Summary consolidated income statement	2016 £m	2015 £m	2014 £m	2013 £m	2012 £m
Net interest income	8,288	8,282	8,744	8,545	8,541
Non-interest income	3,835	3,657	5,660	8,024	6,577
Total income	12,123	11,939	14,404	16,569	15,118
Operating expenses	(15,326)	(16,011)	(13,405)	(15,839)	(14,474)
(Loss)/profit before impairment losses	(3,203)	(4,072)	999	730	644
Impairment (losses)/releases	(529)	838	1,329	(8,119)	(4,908)
Operating (loss)/profit before tax	(3,732)	(3,234)	2,328	(7,389)	(4,264)
Tax (charge)/credit	(1,148)	52	(2,007)	(283)	(26)
(Loss)/profit from continuing operations	(4,880)	(3,182)	321	(7,672)	(4,290)
Profit/(loss) from discontinued operations, net of tax (5)	117	1,596	(3,437)	408	430
Loss for the year	(4,763)	(1,586)	(3,116)	(7,264)	(3,860)

Attributable to:

Non-controlling interests	4	320	57	(13)	19
Preference shareholders	23	44	61	58	58
Ordinary shareholders	(4,790)	(1,950)	(3,234)	(7,309)	(3,937)
	(4,763)	(1,586)	(3,116)	(7,264)	(3,860)

Summary consolidated balance sheet	2016 £m	2015 £m	2014 £m	2013 £m	2012 £m
Loans and advances	375,450	364,799	421,530	505,583	576,904
Debt securities and equity shares	72,097	81,096	89,477	108,974	150,457
Derivatives and settlement balances	253,301	267,191	359,292	295,037	450,818
Other assets	96,966	99,105	175,083	110,284	106,073
Total assets	797,814	812,191	1,045,382	1,019,878	1,284,252
Owners' equity	35,757	41,853	45,303	48,702	59,249
Non-controlling interests	62	54	2,385	79	137
Subordinated liabilities	19,515	27,030	30,469	33,134	33,851
Deposits	416,618	416,168	458,849	537,467	621,457
Derivatives, settlement balances and short positions	263,294	279,739	378,309	319,382	469,458
Other liabilities	62,568	47,347	130,067	81,114	100,100
Total liabilities and equity	797,814	812,191	1,045,382	1,019,878	1,284,252

Additional information

Financial summary continued

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
2016						
Operating leases	64	182	425	361	684	1,091
Contractual obligations to purchase goods or services	64	168	266	93	7	—
	128	350	691	454	691	1,091

2015

Operating leases	60	172	421	338	692	1,314
Contractual obligations to purchase goods or services	81	221	570	570	—	—
	141	393	991	908	692	1,314

	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
2016						
Operating leases	33	93	237	217	474	731
Contractual obligations to purchase goods or services	54	146	215	45	7	—
	87	239	452	262	481	731

2015

Operating leases	36	105	265	236	505	902
Contractual obligations to purchase goods or services	70	212	566	566	—	—
	106	317	831	802	505	902

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
2016						
United States	7,677	6,004	8,117	21,798	5,099	16,699
Japan	8,291	5,438	375	14,104	1	14,103
Germany	8,868	4,836	2,138	15,842	4,207	11,635
France	4,275	7,045	1,996	13,316	2,392	10,924
Netherlands	2,809	450	6,675	9,934	1,061	8,873

2015

United States	10,971	3,528	8,895	23,394	287	23,107
Japan	7,172	2,442	211	9,825	—	9,825
Germany	9,574	4,211	1,565	15,350	3,272	12,078
France	6,221	10,794	2,626	19,641	1,778	17,863
Netherlands	3,820	984	7,097	11,901	786	11,115

2014

United States	393	2,500	18,231	21,124	7,029	14,095
Japan	3,093	3,623	2,125	8,841	66	8,775
Germany	12,837	5,045	2,437	20,319	2,166	18,153
France	7,222	11,654	4,234	23,110	2,226	20,884
Netherlands	5,050	1,037	6,891	12,978	1,391	11,587

Additional information

Risk factors

Set out below are certain risk factors that could adversely affect the Group's future results, its financial condition and prospects and cause them to be materially different from what is expected. The Group is currently the principal operating subsidiary of The Royal Bank of Scotland Group plc (RBSG and, together with its subsidiaries, the RBS Group). Accordingly, in addition to the risks to which the Group and its business are or will be exposed, a number of the risk factors described below which relate to RBSG and the RBS Group will also be applicable to the Bank and the Group and the occurrence of any such risks could have a material adverse effect on the Group's business, reputation, results of operations, financial condition, cash flows or future prospects. The factors discussed below and elsewhere in this report should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties facing the Group.

Implementation of the ring-fencing regime in the UK which began in 2015 and must be completed before 1 January 2019 will result in material structural changes to the RBS Group and the Group including with respect to the perimeter of the Group's activities and the assets that it holds. These changes will have a material adverse effect on the Group.

The requirement to "ring-fence" retail banking operations was introduced under the UK Financial Services (Banking Reform) Act 2013 (the Banking Reform Act 2013) and adopted through secondary legislation (the UK ring-fencing regime). These reforms form part of a broader range of structural reforms of the banking industry seeking to improve the resilience and resolvability of banks and which range from structural reforms (including ring-fencing) to the implementation of a new recovery and resolution framework (which in the UK) will incorporate elements of the ring-fencing regime). See "RBSG and its subsidiaries (including the Bank) are subject to a new and evolving framework on recovery and resolution, the impact of which remains uncertain, and which may result in additional compliance challenges and costs."

On 30 September 2016, the RBS Group announced plans for its future ring-fencing compliant structure. By the end of 2018, the RBS Group intends to place the majority of its UK and Western European banking business in ring-fenced banking entities organised as a sub-group (RFB) under an intermediate holding company named NatWest Holdings Limited which will be a direct subsidiary of RBS plc and will ultimately assume ownership of National Westminster Bank Plc, Adam & Company PLC (to be renamed The Royal Bank of Scotland plc) and Ulster Bank Ireland DAC (Ulster Bank).

As a result, National Westminster Bank Plc will no longer be a direct subsidiary of the Bank. The NatWest Markets (NWM) franchise (formerly known as the Corporate and Institutional Banking business) and the RBS International business will be outside the ring-fence in other banking subsidiaries of RBSG, including the Bank. As part of this restructuring in mid-2018, the majority of existing personal, private, business and commercial customers of the Bank will be transferred to the RFB, specifically to National Westminster Bank Plc and to Adam & Company PLC, which (on the same day) will be renamed The Royal Bank of Scotland plc. At the same time, the Bank (which will sit outside the RFB) will be renamed NatWest Markets Plc to bring its legal name in line with the rebranding of the NWM franchise (formerly known as the Corporate and Investment Banking business) which was initiated in December 2016, and will continue to operate the NWM franchise as a direct subsidiary of RBSG.

As a result of the changes described above, the establishment of the RFB sub-group will have a material impact on how the RBS Group and the Group conduct their business and requires a significant legal and organisational restructuring of the RBS Group and the Group and the transfer of large numbers of assets, liabilities and customers between legal entities (within the RBS Group) and the realignment of employees which started in early 2017. As the Bank is currently the principal operating subsidiary of RBSG and holds a significant share of the RBS Group's assets and businesses, such changes, in conjunction with the concurrent restructuring of the NWM franchise, will result in a significant reduction of the perimeter of the Group's activities as well as the assets held by the Group as such businesses and assets will be divested or transferred to other entities within the RBS Group, which may adversely impact its security holders. The RBS Group's final ring-fenced legal structure and the actions taken to achieve it, remain subject to, amongst other factors, additional regulatory, board and other approvals as well as employee representative information and consultation procedures. In particular, transfers of assets and liabilities through a ring-fencing transfer scheme are now subject to review by an Independent Skilled Person designated by the PRA in advance of commencing the formal court process in late 2017 prior to such transfers and migrations taking place in 2018, which may result in amendments being required to be made to the RBS Group's current plan in delays in the implementation of the UK ring-fencing regime, additional costs and/or changes to the RBS Group's and/or the Group's business.

Additional information

Risk factors continued

The implementation of these changes involves a number of risks related to both the revised RBS Group and Group structures and also the process of transition to such new structures. Those risks include the following:

- The Group is unable to predict how some customers may react to the required changes, including if certain of its customers would be required as result to deal with both the Bank and its subsidiaries outside of the ring-fence and entities within the RFB to obtain the full range of products and services or to take any affirmative steps in connection with the reorganisation.
- The RFB will need to operate independently from the other RBS Group entities outside of the RFB (including the Bank) and as a result, material changes may need to be made to the RBS Group's and the Group's existing corporate governance structure to ensure the RFB's independence. This new structure may result in divergences between the various governance bodies within the RBS Group and create operational challenges. In addition, the RBS Group and the Group may experience difficulties in attracting qualified candidates to occupy these new positions and the new governance structure may result in an associated increase in overhead and compliance costs. In addition, remuneration policies will be required to be designed at Bank level.
- As a result of the ring-fence, subject to certain exceptions, the Bank and its subsidiaries will no longer be able to undertake retail or protected activities, including the accepting of European Economic Area retail deposits which must be carried out exclusively within the RFB. This will require the transfer of certain of the current Group's activities to the RFBs, leading to a loss of revenue and assets, associated risks, and limitations on the Group's ability to grow. The RBS Group is still considering whether a number of current activities will be conducted within or outside of the RFB, which may impact the operations of the Bank and its subsidiaries. Such changes will limit the scope of the current Group's activities and may have a material adverse effect on the Group's business, financial condition and results of operations.
- The Group currently receives certain services from, and provides other services to, entities within the RBS Group and has access to the infrastructure of the RBS Group which the Group currently requires in order to operate its business. In order to comply with the requirements of the UK ring-fencing regime, entities outside the RFB (including the Bank) will need to revise their operations infrastructure so as to comply with the shared services, independence and resolvability requirements set out in the UK ring-fencing rules, including in areas such as information technology (IT) infrastructure, human resources and critical service providers which may involve associated execution risks and may result in increased costs. Arrangements currently in place between the RFB and other RBS Group entities outside the RFB, including the Bank and its subsidiaries, will need to be reviewed in light of these requirements and the requirement that all such transactions take place on an arm's-length basis, which may result in increased operational costs for the Group if it has to rely on third party providers for the provision of such services.
- The implementation of the UK ring-fencing regime will significantly impact the management of the RBS Group's treasury operations, including internal and external funding arrangements. The changes required may adversely impact the assessment made by credit rating agencies, creditors and other stakeholders of the credit strength of some of the RFB or other RBS Group entities (including the Bank) on a standalone basis and the ability of the other RBS Group entities (including the Bank) to meet funding and capital prudential requirements will be dependent on obtaining an adequate credit ratings. There can be no guarantee that such a credit rating will be obtained by the Bank. The Group currently receives capital and funding support from the RBS Group, including RBS Group entities which will ultimately be inside the RFB. Restrictions or changes imposed on the ability of the RBS Group to provide intra-group funding, capital or other support directly or indirectly to the Bank or its subsidiaries, may result in funding or capital pressures and liquidity stress for the Bank or its subsidiaries.

Additional information

Risk factors continued

- Reliance on intragroup exemptions in relation to the calculation of risk-weighted assets and large exposures may not be possible between the Group and other RBS Group entities and may result in risk-weighted assets inflation. Intragroup distributions (including payments of dividends) between RFB and other RBS Group entities (including the Bank), will also be prohibited (with the exception of distributions to the RBS Group parent company).
- From 2026 it will not be possible for the RFB and the other RBS Group entities (including the Bank) that are not RFB entities or wholly owned subsidiaries of the RFB to participate in the same defined benefit pension plan. As a result, it will be necessary to restructure the RBS Group's defined benefit pension plans (including The Royal Bank of Scotland Group Pension Fund, the RBS Group's main defined benefit pension scheme (the Main Scheme) in which the Bank currently participates), such that either the RFB or other RBS Group entities (including the Bank) that are not wholly owned subsidiaries of the RFB leave the current scheme. The costs of separation may be material and may trigger certain legal and regulatory obligations, including possibly increased contributions or may require certain RBS Group entities (including the Bank) to set up their own schemes. Such restructuring may also result in additional or increased cash contributions in the event the pension trustees determine that the employer covenant has been weakened as a result of such separation.
- The restructuring and planned transfers may also result in accounting consequences for the Bank. Although a number of transfers will be made at book value between fully owned RBS Group entities and will therefore not have an accounting impact, certain transfers will be made at fair value which may result in a profit or loss being recognised by the RBS Group or other Group entities, including the Bank. In addition, transfers of assets that have related hedging arrangements may result in adverse operational, financial or accounting consequences if the transfer is not consistent with the unaffected continuation of such hedging arrangements.
- In addition, the proposed transfers may have tax costs, or may impact the tax attributes of each RBS Group entity (including the Bank) and the ability to transfer tax losses between RBS Group entities.

The steps required to implement the UK ring-fencing regime within the RBS Group (including with respect to the Group) to comply with the relevant rules and regulations are extraordinarily complex and require an extended period of time to plan, execute and implement and entail significant costs and operational, legal and execution risks, which risks may be exacerbated by the RBS Group's and the Group's other ongoing restructuring efforts. External or internal factors, including new and developing legal requirements relating to the regulatory framework for the banking industry and the evolving regulatory and economic landscape resulting from the UK's planned exit from the EU, as well as further political developments or changes to the Group's current strategy or means of compliance with its EU State Aid Commitments, may require the RBS Group to further restructure its operations (including its operations in Western Europe) and may in turn require further changes to be made to the RBS Group's ring-fencing plans (including the planned structure of the RBS Group post implementation). See also "Changes to the prudential regulatory framework for banks and investment banks within the EU may require additional structural changes to the RBS Group's operations which may affect current restructuring plans and have a material adverse effect on the Group".

There is no certainty that the RBS Group will be able to complete the legal restructuring and migration of customers by the 1 January 2019 deadline or in accordance with future rules and the consequences of non-compliance are currently uncertain. Conducting the RBS Group's operations in accordance with the new rules may result in additional costs (transitional and recurring) following implementation and impact the RBS Group's and/or the Group's profitability. As a result, the implementation of the UK ring-fencing regime could have a material adverse effect on the Group's reputation, results of operations, financial condition and prospects.

The RBS Group and the Group are subject to a number of legal, regulatory and governmental actions and investigations. Unfavourable outcomes in such actions and investigations could have a material adverse effect on the Group's operations, operating results, reputation, financial position and future prospects.

The Group's operations remain diverse and complex and it operates in legal and regulatory environments that expose it to potentially significant legal and regulatory actions, including litigation claims and proceedings and civil and criminal regulatory and governmental investigations, and other regulatory risk. The Group has settled a number of legal and regulatory actions over the past several years but continues to be, and may in the future be, involved in a number of legal and regulatory actions in the US, the UK, Europe and other jurisdictions.

Additional information

Risk factors continued

The legal and regulatory actions specifically referred to below are, in the Group's view, the most significant legal and regulatory actions to which the Group is currently exposed. However, the Group is also subject to a number of additional claims, proceedings and investigations, the adverse resolution of which may also have a material adverse impact on the Group and which include ongoing reviews, investigations and proceedings (both formal and informal) by governmental law enforcement and other agencies and litigation proceedings (including class action litigation), relating to, among other matters, the offering of securities, including residential mortgage-backed securities (RMBS), conduct in the foreign exchange market, the setting of benchmark rates such as LIBOR and related derivatives trading, the issuance, underwriting, and sales and trading of fixed-income securities (including structured products and government securities), product mis-selling, customer mistreatment, anti-money laundering, sanctions, and various other compliance issues.

See pages 201 to 215 for details for these matters. The Group continues to cooperate with governmental and regulatory authorities in relation to ongoing regulatory actions. Legal and regulatory actions are subject to many uncertainties, and their outcomes, including the timing, amount of fines or settlements or the form of any settlements, which may be material, are often difficult to predict, particularly in the early stages of a case or investigation. It is expected that the Group will continue to have a material exposure to legal and regulatory actions relating to legacy issues in the medium term.

In the US, ongoing matters include various civil claims relating to legacy RMBS activities, the most material of which are those of the Federal Housing Finance Agency (FHFA), and investigations by the civil and criminal divisions of the U.S. Department of Justice (DOJ) and various other members of the RMBS Working Group of the Financial Fraud Enforcement Task Force (including several state attorneys general). On 26 January 2017, the Group announced that it was taking a further £3.1bn (\$3.8bn) provision in relation to these litigation and investigation matters including in relation to the Group's issuance and underwriting of RBMS as well as other RMBS litigation matters.

The duration and outcome of the DOJ's civil and criminal investigations remain uncertain. No settlement may be reached with the DoJ and further substantial additional provisions and costs may be recognised. Any finding of criminal liability by US authorities (including as a result of guilty pleas) could have material collateral consequences for the Group's operations.

These may include consequences resulting from the need to reapply for various important licences or obtain waivers to conduct certain existing activities of the Group, particularly but not solely in the US, which may take a significant period of the time and the results of which are uncertain. Failure to obtain such licenses or waivers could adversely impact the Group's business, in particular the NatWest Markets business in the US, including if it results in the Group being precluded from carrying out certain activities. A further provision of £3.1 billion (\$3.8 billion) was recorded by the Group in Q4 2016 in relation to the Group's various RMBS investigations and litigation matters, taking the total of such provisions to £6.8 billion (\$8.9 billion) at 31 December 2016.

The Group is also facing litigation in the UK in connection with its 2008 shareholder rights issue. In December 2016, the Group concluded full and final settlements with four of the five shareholder groups representing 78% of the claims by value. As announced in December, although the Group has determined a settlement figure of up to £800 million for the resolution of these matters (including the settlement referred to above), which amount is covered by existing provisions. This figure assumes that agreement is also reached with the remaining claimant group, is split proportionally and is subject to validation of claims. Following the settlements described above, a number of claims remain outstanding with the final shareholder group and the Group may not manage to reach a settlement agreement with the remaining claimants, and as a result remains exposed to continuing litigation. Trial is scheduled to commence in March 2017.

In addition, the Group is undertaking various remediation programmes in response to past conduct issues. As announced on 8 November 2016, the Group is also taking steps, including automatic refunds of certain complex fees and a new complaints process, overseen by an independent third party for small and medium entity (SME) customers in the UK and the Republic of Ireland that were in its Global Restructuring Group (GRG) between 2008 and 2013. This new complaints review process and the automatic refund of complex fees was developed with the involvement of the Financial Conduct Authority (FCA). The FCA's review into these activities is continuing and fines or additional redress commitments may be accepted by or imposed upon the Group, notwithstanding the steps the Group has already taken. The Group booked a provision of £400 million in Q4 2016, based on its estimates of the costs associated with the new complaints review process and the automatic refund of complex fees for SME customers in GRG.

Additional information

Risk factors continued

In 2016, the Group booked additional provisions of £600 million with respect to payment protection insurance (PPI), resulting in total provisions made for such matters of £4.9 billion, of which £3.6 billion had been utilised by 31 December 2016 and additional future provisions and costs are possible until such time as the FCA's consultation on the deadline for PPI is concluded. Settlements, resolutions and outcomes in relation to ongoing legal or regulatory actions may result in material financial fines or penalties, non-monetary penalties, restrictions upon or revocation of regulatory permissions and licences and other collateral consequences and may prejudice both contractual and legal rights otherwise available to the Group. The costs of resolving these legal and regulatory actions could individually or in aggregate prove to be substantial and monetary penalties and other outcomes could be materially in excess of provisions, if any, made by the Group. New provisions or increases in existing provisions relating to existing or future legal or regulatory actions may be substantial and may have a material adverse effect on the Group's financial condition and results of operations as well as its reputation. The outcome of on-going claims against the Group may give rise to additional legal claims being asserted against the Group. Adverse outcomes or resolution of current or future legal or regulatory actions could result in restrictions or limitations on the Group's operations, adversely impact the implementation of Group's current transformation programme as well as its capital position and its ability to meet regulatory capital adequacy requirements. The remediation programmes or commitments which the Group has agreed to in connection with past settlements or investigations, could require significant financial costs and personnel investment for the Group and may result in changes in its operations or product offerings, and failure to comply with undertakings made by the Group to its regulators may result in additional measures or penalties being taken against the Group.

The RBS Group (including the Group) have been, and will remain, in a period of major restructuring through to 2019, which carries significant execution and operational risks including the risk of not meeting stated management targets and the RBS Group or the Group may not be a viable, competitive, customer-focussed and profitable banking group as a result.

Since early 2015, the RBS Group has been implementing a major restructuring and transformation programme, articulated around a strategy focussed on the growth of its strategic operations in Personal & Business Banking (PBB) and Commercial & Private Banking (CPB) and the further restructuring of the NWM business to focus mainly on UK and Western European corporate and financial institutions.

As part of this programme, the RBS Group also continues to run-down certain operations, businesses and portfolios in order to reduce risk-weighted assets as well as the scope and complexity of its activities, including through the run-down of the higher risk and capital intensive assets in Capital Resolution. Throughout 2016, the RBS Group stepped up the run-down of the higher risk and capital intensive assets in RBS Capital Resolution, reducing risk-weighted assets by £14.5 billion.

Part of the focus of this transformation programme is to downsize and simplify the RBS Group and the Group, reduce underlying costs, strengthen its overall capital position, improve customer experience and employee engagement, update operational and technological capabilities, strengthen governance and control frameworks and better position the RBS Group and the Group for the implementation of the UK ring-fencing regime by 1 January 2019. Together, these initiatives are referred to as the RBS Group's "transformation programme".

As part of its transformation programme, a number of financial, capital, operational and diversity targets, expectations and trends have been set by management for the RBS Group and the Group, both for the short term and throughout the restructuring period. These include (but are not limited to) expectations relating to the RBS Group's and the Group's return to profitability and the timing thereof, one-off costs incurred in connection with material litigation and conduct matters and the timing thereof, expected growth rates in income, customer loans and advances and volumes and underlying drivers and trends, cost:income ratio targets, expectations with respect to reductions in operating costs and charges as well as impairment charges, disposal losses relating to Capital Resolution, CET1 ratio targets and expectations regarding funding plans and requirements, expectations with respect to reductions in risk-weighted assets and the timing thereof, expectations with respect to employees engagement and diversity targets.

The successful implementation of the RBS Group's transformation programme and the RBS Group's ability to meet associated targets and expectations, are subject to various internal and external factors and risks, including those described in this risk factor, the other risk factors included in this section and the disclosure included in the rest of this document. These include but are not limited to, market, regulatory, economic and political uncertainties, developments relating to litigation and regulatory matters, operational risks, risks relating to the RBS Group's and the Group's business models and strategies and delays or difficulties in implementing its transformation programme, including the restructuring of the NWM franchise, the implementation of the UK ring-fencing regime and compliance with the RBS Group's State Aid obligations. A number of factors may impact the RBS Group's ability to maintain its CET1 ratio target at or over 13% throughout the restructuring period, including conduct related costs, pension or legacy charges, accounting impairments or limited organic capital generation through profits.

Additional information

Risk factors continued

In addition, the run-down of risk-weighted assets may be accompanied by the recognition of disposal losses which may be higher than anticipated, including due to a degraded economic environment. Further regulatory changes may also result in risk-weighted assets inflation in the medium term. For a further discussion of the risks associated with meeting the RBS Group's capital targets, see "The Group's business performance and financial position could be adversely affected if its or the RBS Group's capital is not managed effectively or if it or the RBS Group are unable to meet their capital targets." The RBS Group's and the Group's ability to meet cost:income ratio targets and the planned reductions in their annual underlying costs (excluding restructuring and conduct-related charges and remediation costs) may also be impacted and the focus on meeting cost reduction targets may result in limited investment in other areas which could affect the RBS Group's or the Group's long-term product offering or competitive position.

Due to the changed nature of the RBS Group's and the Group's business model, the RBS Group's and the Group's expectations with respect to its return to profitability and the timing thereof may not be achieved in the timescale envisaged or at any time. An adverse macroeconomic environment, including sustained low interest rates, political and regulatory uncertainty, increased market competition and/or heightened litigation costs may also pose significant headwinds to the profitability of the RBS Group and the Group. In addition there can be no certainty that the new business model defined for the NWM franchise will result in a sustainable or profitable business.

More generally, the targets, expectations and trends which accompany the RBS Group's transformation programme are based on management plans, projections and models and are subject to a number of key assumptions and judgments any of which may prove to be inaccurate. Among others, the targets, expectations and trends set as part of the RBS Group's transformation programme assume that the RBS Group and the Group will be successful: implementing their business models and strategies, executing the RBS Group transformation programme and reducing the complexity of their business and infrastructure at the same time that they will be implementing significant structural changes to comply with the regulatory environment and that they will implement and maintain a robust control environment and effective culture, including with respect to risk management.

The RBS Group may not be able to successfully implement any part of its transformation programme or reach any of its related targets or expectations in the time frames contemplated or at all. The RBS Group's transformation programme comprises a large number of concurrent actions and initiatives, any of which could fail to be implemented due to operational or execution issues. Implementation of the RBS Group's transformation programme is expected to result in significant costs, which could be materially higher than currently contemplated, including due to material uncertainties and factors outside of the RBS Group's control.

In addition, as the Bank is currently the principal operating subsidiary of RBSG and holds the majority the RBS Group's assets and businesses, certain aspects of this transformation programme directly and materially impact the Group's business and product offering, in particular as a result of the restructuring of the NWM franchise which sits within the Group as well as the divestment of certain of the Group's assets and portfolios.

Implementing the RBS Group's current transformation programme, including the restructuring of the NWM franchise, requires further material changes to be implemented within the RBS Group over the medium term concurrent with the implementation of significant structural changes to comply with the UK ring-fencing regime and resulting from the RBS Group's seeking to comply with its State Aid obligations. This restructuring period will be disruptive, will increase operational and people risks for the RBS Group and the Group and will continue to divert management resources from the conduct of the RBS Group's and the Group's operations and development of their business. The scale of changes being concurrently implemented has and will continue to require the implementation and application of robust governance and controls frameworks and there is no guarantee that the RBS Group or the Group will be successful in doing so.

Due to changes in the micro and macro-economic and political and regulatory environment in which the RBS Group and the Group operate, in particular as a result of the consequences of the EU Referendum, the RBS Group may also be required to reconsider certain aspects of its current restructuring programme, or the timeframe for its implementation. In particular, there may be a need to further restructure the RBS Group's Western European operations (including certain operations of the Group), including for example, as a result of potential changes in the prudential regulatory framework for banks and investment banks within the EU or if the RBS Group or the Group are no longer able to rely on the EU passporting framework for financial services. Any such additional restructuring will be likely to increase operational and people risks for the RBS Group and the Group.

Additional information

Risk factors continued

On completion of the implementation of its transformation programme, the further restructuring of the NWM franchise and the UK ring-fencing regime in 2019, previously anticipated levels of revenue and profitability may not be achieved in the timescale envisaged or at any time, due to the changed nature of the RBS Group's business model and revised scope of the Group's business. An adverse macroeconomic environment, including sustained low interest rates, political and regulatory uncertainty, market competition for margins and/or heightened litigation costs may also pose significant headwinds to the profitability of the RBS Group and/or the Group.

As a result, there can be no certainty that the implementation of the RBS Group's transformation programme will prove to be a successful strategy, that the RBS Group will meet its targets and expectations during the restructuring period or that the restructured RBS Group will be a viable, competitive, customer-focussed or profitable bank.

The Group is subject to political risks, including economic, regulatory and political uncertainty arising from the outcome of the recent referendum on the UK's membership of the European Union (EU Referendum) which could adversely impact the Group's business, results of operations, financial condition and prospects.

In a referendum held on 23 June 2016, a majority voted for the UK to leave the European Union (EU). There is now prevailing uncertainty relating to the timing of the UK's exit from the EU, as well as the negotiation and form of the UK's relationships with the EU, with other multilateral organisations and with individual countries at the time of exit and beyond. Once the exit process is triggered by the UK government, Article 50 of the Treaty on the EU stipulates that a maximum two year period of negotiation will begin to determine the new terms of the UK's exit from the EU and set the framework for the UK's new relationship with the EU, after which period its EU membership and all associated treaties will cease to apply, unless some form of transitional arrangement encompassing those associated treaties is agreed or there is unanimous agreement amongst EU member states and the European Commission to extend the negotiation period.

The direct and indirect effects of the UK's decision to leave the EU are expected to affect many aspects of the RBS Group's and the Group's business, including as described elsewhere in these risk factors, and may be material. During the period in which the UK is negotiating its exit from the EU, the RBS Group and the Group may face an increasingly uncertain operating environment.

The longer term effects of the EU Referendum on the RBS Group's and the Group's operating environment are difficult to predict, and subject to wider global macro-economic trends and events, but are likely to significantly impact the Group and its customers and counterparties who are themselves dependent on trading with the EU or personnel from the EU and may result in periodic financial volatility and slower economic growth, in the UK in particular, but also in Republic of Ireland (ROI), Europe and potentially the global economy. These longer term effects may endure until the bilateral and multilateral trading and economic relationships between the UK, the EU, members of the World Trade Organisation and other key trading partners are agreed, implemented and settled.

There is related uncertainty as to the respective legal and regulatory arrangements under which the RBS Group and the Group will operate when the UK is no longer a member of the EU. In addition, the Group and its counterparties may no longer be able to rely on the EU passporting framework for financial services and could be required to apply for authorisation in multiple EU jurisdictions, the costs, timing and viability of which is uncertain. This uncertainty and any actions taken as a result of this uncertainty, as well as new or amended rules, could have a significant impact on the RBS Group's and the Group's operations or legal entity structure, including attendant restructuring costs, capital requirements and tax implications and as result adversely impact the Group's profitability, business model and product offering.

See also "Changes to the prudential regulatory framework for banks and investment banks within the EU may require additional structural changes to the RBS Group's operations which may affect current restructuring plans and have a material adverse effect on the Group."

The outcome of the EU Referendum has created constitutional and political uncertainty as to how the Scottish parliamentary process may impact the negotiations relating to the UK's exit from the EU. As RBSG and the Bank are both headquartered and incorporated in Scotland, any changes to Scotland's relationship with the UK or the EU may further impact the environment in which the RBS Group and its subsidiaries operate and could adversely impact the Group's operations including as it may require changes to be made to the RBS Group's structure, independently or in conjunction with other mandatory or strategic structural and organisational changes and as a result could adversely impact the Group.

Additional information

Risk factors continued

Changes to the prudential regulatory framework for banks and investment banks within the EU may require additional structural changes to the RBS Group's operations which may affect current restructuring plans and have a material adverse effect on the Group.

The exit from the European Union by the UK following the EU Referendum may result in one or more structural and reorganisation changes being implemented within the RBS Group, in addition to those currently planned for. Current proposed changes to the European prudential regulatory framework for banks and investment banks may result in additional prudential or structural requirements being imposed on financial institutions based outside the EU wishing to provide financial services within the EU which may apply to the RBS Group once the UK has formally exited the EU. One of the proposals would impose a requirement for any third country banks with two or more institutions within the EU to establish a single intermediate parent undertaking in the European Union. These are currently draft proposals which, if adopted, are not expected to come into force until after the implementation deadline for the UK ring fencing regime (1 January 2019). The RBS Group is currently assessing how these proposals, if adopted, may impact the RBS Group and its current restructuring plans to implement the UK ring-fencing regime. If implemented, the impact of these proposals could be material given the expectation that both the RFB and the non-ring fenced group would continue to carry out operations in the EU. If adopted, these proposals would require further additional restructuring of the RBS Group's operations and legal structure, in addition to the changes already planned to be implemented for the purposes of compliance with the UK ring-fencing regime and any other changes required to be implemented as a result of other regulatory, political or strategic developments and could result in material additional capital requirements and have adverse tax implications. Planning and implementation of any additional restructuring of the RBS Group's activities may also divert management and personnel resources from the effective conduct of the RBS Group's operations, result in further material restructuring costs, jeopardise the delivery and implementation of a number of other significant change projects resulting from mandatory regulatory developments or as part of its transformation programme, impact the Group's product offering or business model or adversely impact the RBS Group's and the Group's ability to deliver its strategy and meet its targets and guidance, each of which could have a material adverse impact on the RBS Group's and the Group's results of operations, financial condition and prospects.

The RBS Group is in the process of seeking to satisfy its commitments arising as a result of the receipt of State Aid in December 2008. The process to amend the RBS Group's State Aid obligations in respect of Williams & Glyn may not ultimately amend such obligations or the revised obligations may be more onerous than those currently being discussed. The diversion of RBS Group resources required to meeting the RBS Group's obligations in respect of Williams & Glyn, associated costs or delays in meeting, or a failure to meet, the deadline for compliance, could have a material adverse effect on the Group's operations, operating results, financial position and reputation.

State Aid approval was received from the European Commission in connection with the financial assistance provided to the RBS Group by the UK Government in 2008. In connection with the receipt of such financial assistance, and as a condition for State Aid approval, the RBS Group entered into a state aid commitment deed with HM Treasury (as amended from time to time, the State Aid Commitment Deed) which set out conditions upon which such State Aid approval was granted including the requirement for the RBS Group to divest its RBS branches in England and Wales, NatWest branches in Scotland, Direct SME banking and certain mid-corporate customers (Williams & Glyn) by the end of 2017. In light of its obligations under the State Aid Commitment Deed, the RBS Group actively sought to fully divest Williams & Glyn and engaged in discussions with a number of interested parties concerning a transaction related to substantially all of the Williams & Glyn business. However, as none of these proposals could deliver full divestment by 31 December 2017, the RBS Group announced on 28 April 2016 that there was a significant risk that the previously planned separation and divestment of Williams & Glyn would not be achieved by the 31 December 2017 deadline. On 5 August 2016, the RBS Group announced that the Board had determined that it would not be prudent to continue with the plan for separating and divesting Williams & Glyn and announced that various alternative divestment structures were being actively explored.

The RBS Group subsequently announced on 17 February 2017 that the Commissioner responsible for EU competition policy planned to propose to the European Commission to open proceedings to develop an alternative plan for the RBS Group to meet its remaining State Aid obligations in regards to Williams & Glyn. If adopted, it is intended that this alternative plan would replace the existing requirement to achieve separation and divestment of Williams & Glyn by 31 December 2017 and the current conditions set out in the State Aid Commitment Deed would be amended accordingly.

Additional information

Risk factors continued

Under the current form of the alternative plan, the RBS Group will deliver a package of measures to promote competition in the market for banking services to small and medium enterprises (SMEs) in the UK. This package will include: (i) an SME banking capability fund, administered by an independent body, which eligible challenger banks could access to increase their SME business banking capabilities; (ii) funding for eligible challenger banks to help them incentivise UK SME customers to switch their accounts from the RBS Group to eligible challenger banks by paying in the form of “dowries”; (iii) the RBS Group granting business customers of eligible challenger banks access to its branch network for cash and cheque handling, to support the incentivised switching programme; and (iv) the funding of an independent financial services innovation fund to invest in and help support the growth of existing businesses providing or developing innovative financial services or products for UK SMEs. In connection with this package of alternative measures, the RBS Group has taken a £750 million provision in 2016. However, actual costs associated with the implementation of such measures may be materially higher as a result of unforeseen complexities and factors outside of the RBS Group's control.

Discussions will continue between the RBS Group, HM Treasury and the European Commission to further develop the design of this package of alternative measures and the duration of them. The timing of the approval for this or any package of alternative measures is uncertain and there is no guarantee that the European Commission will ultimately agree to this or any package of alternative measures in replacement of the original terms of the State Aid Commitment Deed in relation to Williams & Glyn. In addition, the final scope and content of the package of alternative measures will be subject to further market testing by HM Treasury and a consultation exercise by the European Commission, either of which may result in amendments to the scope of and costs associated with this package as a result of which the final terms of a package of alternative measures may be more onerous than the scope of the plan set out above.

Implementation of the package, or if required as a result of the above process a more onerous package, and any associated business restructuring could divert resources from the RBS Group's operations and jeopardise the delivery and implementation of other significant plans and initiatives. The incentivised transfer of SME customers to third parties places reliance on those third parties to achieve satisfactory customer outcomes which could give rise to reputational damage if these are not forthcoming.

Execution of the alternative measures package plan entails significant costs, including the funding commitments and financial incentives envisaged to be provided under the plan. In addition, the final terms of the agreement entered into among the RBS Group, HM Treasury and the European Commission may include sanctions or additional financial incentives designed to ensure that the RBS Group delivers its commitments. The RBS Group will also need to assess the timing and manner in which to reintegrate the remaining Williams & Glyn business into the RBS Group which is expected to result in additional restructuring charges and may adversely impact the RBS Group's existing restructuring plans, including in respect of the implementation of the UK ring-fencing regime.

As a direct consequence of the incentivised switching component of the package of alternative measures described above, the RBS Group will lose existing customers and deposits and associated revenues and margins. Furthermore, the SME banking capability fund and financial services innovation fund envisaged by the alternative plan is intended to benefit challenger banks and negatively impact the RBS Group's competitive position. To support this incentivised switching initiative, the RBS Group will also have to agree to grant business customers of eligible challenger banks access to its branch network for cash and cheque handling, which may result in reputational and financial exposure for the RBS Group and impact customer service quality for RBS's own customers with consequent competitive, financial and reputational implications.

If the RBS Group fails to come to an agreement with HM Treasury and the European Commission in respect of the proposed package of alternative measures, and a determination is made that the RBS Group remains required to divest Williams & Glyn, there is no guarantee that the RBS Group will be able to identify or recommence discussions with interested buyers for Williams & Glyn at that time or that it will be able to agree a divestment on commercially beneficial terms and there is no certainty that any such discussions would lead to a viable transaction. In addition, the RBS Group would be required to conduct further restructuring in order to divest the Williams & Glyn business, at the same time that it is implementing significant restructuring changes in connection with the implementation of the UK ring-fencing regime and other restructuring changes which may be required as a result of the UK terminating its membership of the European Union, which entails material execution risks and costs, as well as diverting RBS Group and management resources. In addition, if no alternative to the RBS Group's current State Aid Commitment Deed obligations becomes effective, the RBS Group would be unable to meet the principal obligation in the State Aid Commitment Deed to divest Williams & Glyn by 31 December 2017, which could entail material sanctions (including the appointment of a divestiture trustee, with the mandate to complete the divestment at no minimum price).

Additional information

Risk factors continued

A failure to comply with the terms of the revised State Aid Commitment Deed, once agreed, could result in the imposition of additional measures or limitations on the RBS Group's operations, additional supervision by the RBS Group's regulators, and loss of investor confidence, any of which could have a material adverse impact on the RBS Group. Delays in execution may also impact the RBS Group's ability to carry out its transformation programme, including the implementation of cost saving initiatives and implement mandatory regulatory requirements, including the UK ring-fencing regime. Such risks will increase in line with any additional delays.

Operational risks are inherent in the Group's businesses and these risks are heightened as a result of key strategic and regulatory initiatives being implemented by the RBS Group and the Group and against the backdrop of legal and regulatory changes.

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events, including legal risks. The Group has complex and diverse operations and operational risk and losses can result from a number of internal or external factors, including:

- internal and external fraud and theft from the Group,
- compromise of the confidentiality, integrity, or availability of the Group's data, systems and services;
- failure to identify or maintain the Group's key data within the limits of the Group's agreed risk appetite;
- failure of the Group's technology services due to loss of data, systems or data centre failure or failure by third parties to restore services;
- failure to appropriately or accurately manage the Group's operations, transactions or security;
- incorrect specification of models used by the Group, implementing or using such models incorrectly;
- failure to effectively execute or deliver the RBS Group's transformation programme;
- failure to attract, retain or engage staff;
- insufficient resources to deliver change and business-as-usual activity;
- decreasing employee engagement or failure by the Group to embed new ways of working and values; or
- incomplete, inaccurate or untimely statutory, regulatory or management reporting.

Operational risks for the Group are and will continue to be heightened as a result of the number of initiatives being concurrently implemented by the Group, including the implementation of the RBS Group's transformation programme, including its cost-reduction programme, the implementation of the UK ring-fencing regime and compliance with its State Aid obligations. Individually, these initiatives carry significant execution and delivery risk and such risks are heightened as their implementation is generally highly correlated and dependent on the successful implementation of interdependent initiatives.

These initiatives are being delivered against the backdrop of ongoing cost challenges and increasing legal and regulatory uncertainty and will put significant pressure on the Group's ability to maintain effective internal controls and governance frameworks. Although the Group has implemented risk controls and loss mitigation actions and significant resources and planning have been devoted to mitigate operational risk, it is not possible to be certain that such actions have been or will be effective in controlling each of the operational risks faced by the Group. Ineffective management of operational risks could have a material adverse effect on the Group's business, financial condition and results of operations.

The Group is exposed to cyberattacks and a failure to prevent or defend against such attacks could have a material adverse effect on the Group's operations, results of operations or reputation.

The RBS Group and the Group are subject to cybersecurity attacks which have regularly targeted financial institutions and corporates as well as governments and other institutions and have materially increased in frequency, sophistication and severity in recent years. The Group relies on the effectiveness of its internal policies and associated procedures, IT infrastructure and capabilities to protect the confidentiality, integrity and availability of information held on its computer systems, networks and mobile devices, and on the computer systems, networks and mobile devices of third parties on whom the Group relies.

Additional information

Risk factors continued

The Group takes measures to protect itself from attacks designed to prevent the delivery of critical business processes to its customers. Despite these preventative measures, the RBS Group's and the Group's computer systems, software, networks and mobile devices, and those of third parties on whom the Group relies, are vulnerable to cyberattacks, sabotage, unauthorised access, computer viruses, worms or other malicious code, and other events that have a security impact. Financial institutions, such as the Group, with complex legacy infrastructure may be even more susceptible to attack due to the increased number of potential entry points and weaknesses. Failure to protect the Group's operations from cyberattacks or to continuously review and update current processes in response to new threats could result in the loss of customer data or other sensitive information as well as instances of denial of service for the RBS Group's customers. Although the RBS Group experienced attempted distributed denial of service (DDoS) attacks in 2016, none of these attacks was successful. During 2015, the RBS Group experienced a number of DDoS attacks, one of which had a temporary impact on some of NatWest's web services, as well as a smaller number of malware attacks.

The Bank of England, the FCA and HM Treasury in the UK and regulators, in the US and in Europe have identified cybersecurity as a systemic risk to the financial sector and highlighted the need for financial institutions to improve resilience to cyberattacks and the RBS Group expects greater regulatory engagement, supervision and enforcement on cybersecurity in the future. The RBS Group and the Group continue to participate in initiatives led by the Bank of England and other regulators designed to test how major firms respond to significant cyberattacks. The outputs of this exercise and other regulatory and industry-led initiatives are being incorporated into the on-going IT priorities and improvement measures of the RBS Group and the Group.

However, the Group expects that it and the RBS Group will be the target of continued attacks in the future and there can be no certainty that the Group will be able to detect or prevent all threats.

Any failure in the Group's cybersecurity policies, procedures or capabilities, or cyber-related crime, could lead to the RBS Group and/or the Group suffering reputational damage and a loss of customers, regulatory investigations or sanctions being imposed and could have a material adverse effect on the RBS Group's and/or the Group's results of operations, financial condition or prospects.

The Group's business performance and financial position could be adversely affected if its or the RBS Group's capital is not managed effectively or if it or the RBS Group are unable to meet their capital targets.

Effective management of the RBS Group's and the Group's capital is critical to their ability to operate their businesses, comply with regulatory obligations (including those resulting from the implementation of the UK ring-fencing regime) and pursue the RBS Group's strategy of returning to stand-alone strength, resume dividend payments on RBSG ordinary shares and maintain discretionary payments.

The RBS Group and the Group (on a standalone basis) are required by regulators in the UK, the EU and other jurisdictions in which they undertake regulated activities to maintain adequate capital resources. Adequate capital also gives the RBS Group and the Group financial flexibility in the face of continuing turbulence and uncertainty in the global economy and specifically in its core UK and European markets.

The RBS Group currently targets a CET1 ratio at or above 13% throughout the period until completion of the implementation of its restructuring. On a fully loaded basis, the RBS Group's and the Group's CET1 ratio were 13.4% and 13.1%, respectively at 31 December 2016, compared with 15.5% and 16.0%, respectively, at 31 December 2015.

The RBS Group's target capital ratio for the RBS Group and the RBS Group entities, including the Group, is based on its expected regulatory requirements and internal modelling, including stress scenarios. However, the ability of the RBS Group or the Group to achieve such targets depends on a number of factors, including the implementation of the RBS Group's transformation programme and any of the factors described below. A shortage of capital, which could in turn affect the Group's capital ratio, could arise from:

- a depletion of the RBS Group's or the Group's capital resources through increased costs or liabilities (including pension, conduct and litigation costs), reduced profits or increased losses (which would in turn impact retained earnings), sustained periods of low or lower interest rates, reduced asset values resulting in write-downs or impairments or accounting charges;

Additional information

Risk factors continued

- an increase in the amount of capital that is required to meet the Group's regulatory requirements, including as a result of changes to the actual level of risk faced by the RBS Group or the Group, factors influencing the RBS Group's regulator's determination of the firm-specific Pillar 2B buffer applicable to the RBS Group (the PRA buffer), changes in the minimum levels of capital or liquidity required by legislation or by the regulatory authorities or the calibration of capital or leverage buffers applicable to the RBS Group or the Group, including countercyclical buffers, increases in risk-weighted assets or in the risk weighting of existing asset classes or an increase in the RBS Group's view of any management buffer it needs, taking account of, for example, the capital levels or capital targets of the RBS Group's peer banks and criteria set by the credit rating agencies.

In addition, the RBS Group's capital requirements, determined either as a result of regulatory requirements, including in light of the implementation of the UK ring-fencing regime and the establishment of the RFB or management targets, may impact the level of capital required to be held by the Group and as part of its capital management strategy, the RBS Group may decide to impose higher capital levels to be held by the Bank or the Group.

The RBS Group's and the Group's current capital strategy is based on the expected accumulation of additional capital through the accrual of profits over time and/or through the planned reduction of its risk-weighted assets through disposals or natural attrition, the execution of which is subject to operational and market risks. Further losses or a failure to meet profitability targets or reduce risk-weighted assets in accordance with or within the timeline contemplated by the RBS Group's capital plan, a depletion of its or the Group's capital resources, earnings and capital volatility resulting from the implementation of IFRS 9 as of 1 January 2018, or an increase in the amount of capital they need to hold (including as a result of the reasons described above), would adversely impact the RBS Group's and/or the Group's ability to meet capital targets or requirements and achieve their capital strategy during the restructuring period.

If the RBS Group or the Group are determined to have a shortage of capital as a result of any of the circumstances described above, the RBS Group may suffer a loss of confidence in the market with the result that access to liquidity and funding may become constrained or more expensive or, may be subject to regulatory interventions and sanctions. The RBS Group's regulators may also request that the RBS Group carry out certain capital management actions or, in an extreme scenario, this may also trigger the implementation of the RBS Group's recovery plans. Such actions may, in turn, affect the RBS Group's and/or the Group's product offering, capacity to continue their business operations, pay future dividends and make other distributions (including discretionary coupons on capital instruments) or adversely impact the RBS Group's or the Group's ability to pursue strategic opportunities, affecting the underlying profitability of the RBS Group and/or the Group and future growth potential.

If, in response to such shortage, certain regulatory capital instruments are converted into equity or the RBS Group raises additional capital through the issuance of share capital or regulatory capital instruments, existing RBSG shareholders may experience a dilution of their holdings. The success of such issuances will also be dependent on favourable market conditions and the RBS Group may not be able to raise the amount of capital required or on satisfactory terms. Separately, the RBS Group may address a shortage of capital by taking action to reduce leverage and/or risk-weighted assets, by modifying the RBS Group's legal entity structure or by asset or business disposals. Such actions may affect the underlying profitability of the RBS Group and/or the Group.

Failure by the RBS Group or the Group to comply with regulatory capital and leverage requirements may result in intervention by their regulators and loss of investor confidence, and may have a material adverse effect on their results of operations, financial condition and reputation and may result in distribution restrictions and adversely impact existing RBSG shareholders.

The RBS Group and, where applicable RBS Group entities, including the Group and the Bank on a standalone basis, are subject to extensive regulatory supervision in relation to the levels and quality of capital they are required to hold, including as a result of the transposition of the Basel Committee on Banking Supervision's regulatory capital framework (Basel III) in Europe by a Directive and Regulation (collectively known as CRD IV).

Additional information

Risk factors continued

In addition, the RBS Group is currently identified as a global systemically important bank (G-SIB) by the Financial Stability Board (FSB) and is therefore subject to more intensive oversight and supervision by its regulators as well as additional capital requirements, although the RBS Group belongs to the last “bucket” of the FSB G-SIB list and is therefore subject to the lowest level of additional loss-absorbing capital requirements.

As the RBS Group reduces its global footprint and its balance sheet, the FSB may, at its discretion, determine that the RBS Group is no longer a G-SIB.

Each business is subject to performance metrics which factor in underlying regulatory capital requirements, set under Individual Capital Guidance for the RBS Group and the Bank, to ensure that business capital targets and generation are aligned to the RBS Group's overall risk appetite.

Under CRD IV, the RBS Group is required, on a consolidated basis, to hold at all times a minimum amount of regulatory capital calculated as a percentage of risk-weighted assets (Pillar 1 requirement). CRD IV also introduced a number of new capital buffers that are in addition to the Pillar 1 and Pillar 2A requirements (as described below) that must be met with CET1 capital.

The combination of the capital conservation buffer (which, subject to transitional provisions, will be set at 2.5% from 2019), the countercyclical capital buffer (of up to 2.5% which is currently set at 0% by the FPC for UK banks) and the higher of (depending on the institution) the systemic risk buffer, the global systemically important institutions buffer (G-SIB Buffer) and the other systemically important institutions buffer, is referred to as the “combined buffer requirement”.

These rules entered into force on 1 May 2014 for the countercyclical capital buffer and on 1 January 2016 for the capital conservation buffer and the G-SIB Buffer. The G-SIB Buffer is currently set at 1.0% for the RBS Group (from 1 January 2017) and is being phased in over the period to 1 January 2019. The systemic risk buffer will be applicable from 1 January 2019.

The Bank of England's Financial Policy Committee (the FPC) was responsible for setting the framework for the systemic risk buffer and the PRA adopted in December 2016 a final statement of policy implementing the FPC's framework. In early 2019, the PRA is expected to determine which institutions the systemic risk buffer should apply to, and if so, how large the buffer should be up to a maximum of 3% of a firm's risk-weighted assets. The systemic risk buffer will apply to ring-fenced entities only and not all entities within a banking group. The systemic risk buffer is part of the UK framework for identifying and setting higher capital buffers for domestic systemically important banks (D-SIBs), which are groups that, upon distress or failure, could have an important impact on their domestic financial systems.

The Group expects that it may be subject to the systemic risk buffer. This follows on the 2012 framework recommendations by the FSB that national authorities should identify D-SIBs and take measures to reduce the probability and impact of the distress or failure of D-SIBs. In addition, national supervisory authorities may add extra capital requirements (the Pillar 2A requirements) to cover risks that they believe are not covered or insufficiently covered by Pillar 1 requirements.

The RBS Group's current Pillar 2A requirement set by the PRA is set at an equivalent of 3.8% of risk-weighted assets. The PRA has also introduced the PRA buffer which is a forward-looking requirement set annually and based on various factors including firm-specific stress test results and credible recovery and resolution planning and is to be met with CET1 capital (in addition to any CET1 capital used to meet any Pillar 1 or Pillar 2A requirements).

Where appropriate, the PRA may require an increase in an institution's PRA buffer to reflect additional capital required to be held to mitigate the risk of additional losses that could be incurred as a result of risk management and governance weaknesses, including with respect to the effectiveness of the internal stress testing framework and control environment. UK banks are required to meet the higher of the combined buffer requirement or PRA buffer requirement.

Additional information

Risk factors continued

In addition to capital requirements and buffers, the regulatory framework adopted under CRD IV, as transposed in the UK, sets out minimum leverage ratio requirements for financial institutions, namely: (i) a minimum leverage requirement of 3% which applies to major UK banks, (ii) an additional leverage ratio to be met by G-SIBs and ring-fenced institutions to be calibrated at 35% of the relevant firm's capital G-SIB Buffer or systemic risk buffer and which is being phased in from 2016 (currently set at 0.175% from 1 January 2017) and (iii) a countercyclical leverage ratio buffer for all firms subject to the minimum leverage ratio requirements which is calibrated at 35% of a firm's countercyclical capital buffer. Further changes may be made to the current leverage ratio framework as a result of future regulatory reforms, including FSB proposals and proposed amendments to the CRD IV proposed by the European Commission in November 2016.

Most of the capital requirements which apply or will apply to the RBS Group or the Group (directly or indirectly as a result of RBS Group internal capital management) will need to be met in whole or in part with CET1 capital. CET1 capital broadly comprises retained earnings and equity instruments, including ordinary shares.

As a result, the RBS Group's ability to meet applicable CET1 capital requirements is dependent on organic generation of CET1 through sustained profitability and/or the RBS Group's ability to issue ordinary shares, and there is no guarantee that the RBS Group may be able to generate CET1 capital through either of these alternatives.

The amount of regulatory capital required to meet the RBS Group's regulatory capital requirements (and any additional management buffer), is determined by reference to the amount of risk-weighted assets held by the RBS Group. The models and methodologies used to calculate applicable risk-weightings are a combination of individual models, subject to regulatory permissions, and more standardised approaches. The rules are applicable to the calculation of the RBS Group's risk-weighted assets are subject to regulatory changes which may impact the levels of regulatory capital required to be met by the RBS Group. The Basel Committee and other agencies remain focussed on changes that will increase, or recalibrate, measures of risk-weighted assets as the key measure of the different categories of risk in the denominator of the risk-based capital ratio. While they are at different stages of maturity, a number of initiatives across risk types and business lines are in progress that are expected to impact the calculation of risk-weighted assets.

The Basel Committee is currently consulting on new rules relating to the risk weighting of real estate exposures and other changes to risk-weighting calculations, including proposals to introduce floors for the calculation of risk-weighted assets, which could directly affect the calculation of capital ratios. However, given recent delays, the timing and outcome of this consultation is increasingly uncertain. In the UK, the PRA is also considering ways of reducing the sensitivity of UK mortgage risk weights to economic conditions. The Basel Committee is also consulting on a revised standardised measurement approach for operational risk. Certain EU officials have raised concerns in relation to the new proposed rules and there is therefore uncertainty as to the way in which the FSB's proposals would be implemented in the EU. The new approach for operational risk would replace the three existing standardised approaches for calculating operational risk, as well as the internal model-based approach. The proposed new methodology combines a financial statement-based measure of operational risk, with an individual firm's past operational losses.

While the quantum of impact of these reforms remains uncertain owing to lack of clarity of the proposed changes and the timing of their introduction, the implementation of such initiatives may result in higher levels of risk-weighted assets and therefore higher levels of capital, and in particular CET1 capital, required to be held by the RBS Group and the Group, under Pillar 1 requirements, particularly as a result of the Group operating businesses with high risk-weighted assets intensity. Such requirements would be separate from any further capital overlays required to be held as part of the PRA's determination of the RBS Group's Pillar 2A or PRA buffer requirements with respect to such exposures.

Although the above provides an overview of the capital and leverage requirements currently applicable to the RBS Group and the Group, such requirements are subject to ongoing amendments and revisions, including as a result of final rules and recommendations adopted by the FSB or by European or UK regulators. In particular, on 23 November 2016, the European Commission published a comprehensive package of reforms including proposed amendments to CRD IV and the EU Bank and Recovery and Resolution Directive (the BRRD). Although such proposals are currently being considered and discussed among the European Commission, the European Parliament and the European Council and their final form and the timetable for their implementation are not known, such amendments may result in increased or more stringent requirements applying to the RBS Group or its subsidiaries (including the Group). This uncertainty is compounded by the UK's decision to leave the EU following the outcome of the EU Referendum which may result in further changes to the prudential and regulatory framework applicable to the RBS Group and the Group.

Additional information

Risk factors continued

If the RBS Group is unable to raise the requisite amount of regulatory capital (including loss absorbing capital), or if the RBS Group or the Group otherwise fail to meet regulatory capital and leverage requirements, they may be exposed to increased regulatory supervision or sanctions, loss of investor or customer confidence, restrictions on distributions or they may be required to reduce further the amount of their risk-weighted assets or total assets and engage in the disposal of core and other non-core businesses, including businesses within the Group, which may not occur on a timely basis or achieve prices which would otherwise be attractive to the RBS Group or the Group. This may also result in write-down or the conversion into equity of certain regulatory capital instruments issued by the RBS Group or the issue of additional equity by the RBS Group, each of which could result in the dilution of RBS Group's existing shareholders. A breach of the RBS Group's or the Group's applicable capital or leverage requirements may also trigger the application of the RBS Group's recovery plan to remediate a deficient capital position.

Any of these developments, including the failure by the RBS Group to meet its regulatory capital and leverage requirements, may have a material adverse impact on the Group's capital position, operations, reputation or prospects.

Failure by the RBS Group to comply with its capital requirements or to maintain sufficient distributable reserves may result in the application of restrictions on its ability to make discretionary distributions, including the payment of dividends to its ordinary shareholders and coupons on certain capital instruments.

In accordance with the provisions of CRD IV, a minimum level of capital adequacy is required to be met by the RBS Group in order for it to be entitled to make certain discretionary payments.

Pursuant to Article 141 (Restrictions on distribution) of the CRD IV Directive, as transposed in the UK, 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 instruments (dividends), variable remuneration and coupon payments on additional tier 1 instruments).

The resulting restrictions are 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" which gives rise to a maximum distributable amount (MDA) (if any) that the financial institution can distribute through discretionary payments. The EBA has clarified that the CET1 capital to be taken into account for the MDA calculation should be limited to the amount not used to meet the Pillar 1 and Pillar 2 own funds requirements of the institution. In the event of a breach of the combined buffer requirement, the RBS Group will be required to calculate its MDA, and as a consequence it may be necessary for the RBS Group to reduce or cease discretionary payments to the extent of the breach.

The ability of the RBS Group to meet the combined buffer requirement will be subject to the RBS Group holding sufficient CET1 capital in excess of its minimum Pillar 1 and Pillar 2 capital requirements. In addition, the interaction of such restrictions on distributions with the capital requirements and buffers applicable to the RBS Group remains uncertain in many respects while the relevant authorities in the EU and the UK consult on and develop their proposals and guidance on the application of the rules.

In particular, the proposals published by the European Commission in November 2016 contain certain proposed amendments to Article 141, including to introduce a "stacking order" in the calculation of the maximum distributable amount and establish certain priorities in the payments which could be made in the event the restrictions apply (with payments relating to additional tier 1 instruments being required to be made before payments on CET1 instruments (dividends) or other discretionary payments). The treatment of MDA breaches under the European Commission proposals differ from the proposed consequences set out in the final PRA rules and may result in uncertainty in the application of these rules.

In addition to these rules, in order to make distributions (including dividend payments) in the first place, RBSG is required to have sufficient distributable reserves available. Furthermore, coupon payments due on the additional tier 1 instruments issued by RBSG must be cancelled in the event that RBSG has insufficient "distributable items" as defined under CRD IV. Both distributable reserves and distributable items are largely impacted by the RBS Group's ability to generate and accumulate profits or conversely by material losses (including losses resulting from conduct related-costs, restructuring costs or impairments).

Additional information

Risk factors continued

RBSG's distributable reserves and distributable items are sensitive to the accounting impact of factors including the redemption of preference shares, restructuring costs and impairment charges and the carrying value of its investments in subsidiaries which are carried at the lower of cost and their prevailing recoverable amount. Recoverable amounts depend on discounted future cash flows which can be affected by restructurings, including the restructuring required to implement the UK ring-fencing regime, or unforeseen events. The distributable reserves of RBSG also depend on the receipt of income from subsidiaries, principally as dividends.

The ability of subsidiaries to pay dividends is subject to their performance and applicable local laws and other restrictions, including their respective regulatory requirements and distributable reserves. Any of these factors, including restructuring costs, impairment charges and a reduction in the carrying value of RBSG subsidiaries or a shortage of dividends from them could limit the RBSG's ability to maintain sufficient distributable reserves to be able to pay coupons on certain capital instruments and dividends to its ordinary shareholders. In Q3 2016, the RBS Group reviewed the value of the investments in subsidiaries held in the parent company, RBSG, and in light of the deterioration in the economic outlook, impaired the carrying value of the investments by £6.0 billion to £44.7 billion.

This had the effect of reducing distributable reserves of RBSG by £6.0 billion to £7.2 billion and the RBS Group may be required to recognise further impairments in the future if the outlook for its subsidiaries were to worsen. Whilst this level of distributable profits does not impact upon RBSG's ability to pay coupons on existing securities, the RBS Group intends to implement a capital reorganisation in 2017 (subject to shareholder and court approval) in order to increase RBSG's distributable reserves, providing greater flexibility for potential future distributions and preference share redemptions (if any).

Failure by the RBS Group to meet the combined buffer requirement or retain sufficient distributable reserves or distributable items as a result of reduced profitability or losses, or changes in regulation or taxes adversely impacting distributable reserves or distributable items, may therefore result in limitations on the RBS Group's ability to make discretionary distributions which may negatively impact the RBS Group's shareholders, holders of additional tier 1 instruments, staff receiving variable compensation (such as bonuses) and other stakeholders and impact its market valuation and investors' and analysts' perception of its financial soundness.

The RBS Group is subject to stress tests mandated by its regulators in the UK and in Europe which may result in additional capital requirements or management actions which, in turn, may impact the RBS Group's and/or the Group's financial condition, results of operations and investor confidence or result in restrictions on distributions.

The RBS Group is subject to annual stress tests by its regulator in the UK and also subject to stress tests by the European regulators with respect to RBSG, RBS NV and Ulster Bank. Stress tests provide an estimate of the amount of capital banks might deplete in a hypothetical stress scenario. In addition, if the stress tests reveal that a bank's existing regulatory capital buffers are not sufficient to absorb the impact of the stress, it is possible that it will need to take action to strengthen its capital position. There is a strong expectation that the PRA would require a bank to take action if, at any point during the stress, a bank were projected to breach any of its minimum CET1 capital or leverage ratio requirements. However, if a bank is projected to fail to meet its systemic buffers, it will still be expected to strengthen its capital position over time but the supervisory response is expected to be less intensive than if it were projected to breach its minimum capital requirements.

The PRA will also use the annual stress test results to inform its determination of whether individual banks' current capital positions are adequate or need strengthening. For some banks, their individual stress-test results might imply that the capital conservation buffer and countercyclical rates set for all banks is not consistent with the impact of the stress on them. In that case, the PRA can increase regulatory capital buffers for individual banks by adjusting their PRA buffers.

Additional information

Risk factors continued

Under the 2016 Bank of England stress tests, which were based on the balance sheet of the RBS Group for the year ended 31 December 2015, the RBS Group did not meet its CET1 capital or tier 1 leverage hurdle rates before additional tier 1 conversion. After additional tier 1 conversion, it did not meet its CET1 systemic reference point or tier 1 leverage ratio hurdle rate. In light of the stress test results, the RBS Group agreed a revised capital plan with the PRA to improve its stress resilience in light of the various challenges and uncertainties facing both the RBS Group and the wider economy highlighted by the concurrent stress testing process. As part of this revised capital plan, the RBS Group intends to execute an array of capital management actions to supplement organic capital generation from its core franchises and further improve its stress resilience, including: further decreasing the cost base of the RBS Group; further reductions in risk-weighted assets across the RBS Group; further run-down and sale of other non-core loan portfolios in relation to the personal and commercial franchises; and the management of undrawn facilities in 2017. Additional management actions may be required by the PRA until the RBS Group's balance sheet is sufficiently resilient to meet the regulator's stressed scenarios. In addition, such actions may have an adverse impact on the Group as they may result in the divestment of assets, portfolios or businesses currently within the Group and the resulting loss in revenue could adversely impact the Group's financial condition, results of operations and future prospects.

Consistent with the approach set out in 2015, the 2017 Bank of England stress test will, for the first time, test the resilience of the system, and individual banks within it, against two stress scenarios.

In addition to the annual cyclical scenario, there will be an additional 'exploratory' scenario that will be tested for the first time in 2017. This will allow the Bank of England to assess the resilience of the system, and the individual banks within it, to a wider range of potential threats, including weak global supply growth, persistently low interest rates, and a continuation of declines in both world trade relative to GDP and cross-border banking activity. If the RBS Group were to fail under either of these scenarios, it may be required to take further action to strengthen its capital position, including further actions which may adversely impact the Group. In addition, the introduction of IFRS 9, effective for annual periods beginning on or after 1 January 2018, is expected to result in capital volatility for the RBS Group, which in turn could have an impact on the RBS Group's ability to meet its required CET1 ratio in a stress test scenario.

Failure by the RBS Group to meet the thresholds set as part of the stress tests carried out by its regulators in the UK and elsewhere may result in the RBS Group's regulators requiring the RBS Group to generate additional capital, increased supervision and/or regulatory sanctions, restrictions on capital distributions and loss of investor confidence, which may impact the RBS Group's and/or the Group's financial condition, results of operations and prospects.

As a result of extensive reforms being implemented relating to the resolution of financial institutions within the UK, the EU and globally, material additional requirements will arise to ensure that financial institutions maintain sufficient loss-absorbing capacity. Such changes to the funding and regulatory capital framework may require the RBS Group to meet higher capital levels than anticipated within the RBS Group's strategic plans and affect the RBS Group's and the Group's funding costs.

In addition to the prudential requirements applicable under CRD IV, the BRRD introduces, among other things, a requirement for banks to maintain at all times a sufficient aggregate amount of own funds and "eligible liabilities" (that is, liabilities that can absorb loss and assist in recapitalising a firm in accordance with a predetermined resolution strategy), known as the minimum requirements for own funds and eligible liabilities (MREL), designed to ensure that the resolution of a financial institution may be carried out, without public funds being exposed to the risk of loss and in a way which ensures the continuity of critical economic functions, maintains financial stability and protects depositors.

In November 2015, the FSB published a final term sheet setting out its total loss-absorbing capacity (TLAC) standards for G-SIBs. The EBA was mandated to assess the implementation of MREL in the EU and the consistency of MREL with the final TLAC standards and published an interim report setting out the conclusions of its review in July 2016 and its final report in December 2016. On the basis of the EBA's work and its own assessment of CRD IV and the BRRD, the European Commission published in November 2016 a comprehensive set of proposals, seeking to make certain amendments to the existing MREL framework. In particular, the proposals make a number of amendments to the MREL requirements under the BRRD, in part in order to transpose the FSB's final TLAC term sheet.

Additional information

Risk factors continued

The UK government is required to transpose the BRRD's provisions relating to MREL into law through further secondary legislation. In November 2016, the Bank of England published its final rules setting out its approach to setting MREL for UK banks. These final rules (which were adopted on the basis of the current MREL framework in force in the EU) do not take into account the European Commission's most recent proposals with respect to MREL and differ in a number of respects. In addition, rules relating to a number of specific issues under the framework remain to be implemented, following the publication of further rules by the FSB, in particular rules on internal MREL requirements, cross holdings and disclosure requirements are outstanding.

The Bank of England is responsible for setting the MREL requirements for each UK bank, building society and certain investment firms in consultation with the PRA and the FCA, and such requirement will be set depending on the resolution strategy of the financial institution. In its final rules, the Bank of England has set out a staggered compliance timeline for UK banks, including with respect to those requirements applicable to G-SIBs (including the RBS Group). Under the revised timeline, G-SIBs will be expected to (i) meet the minimum requirements set out in the FSB's TLAC term sheet from 1 January 2019 (i.e. the higher of 16% of risk-weighted assets or 6% of leverage exposures), and (ii) meet the full MREL requirements to be phased in from 1 January 2020, with the full requirements applicable from 2 January 2022 (i.e. for G-SIBs two times Pillar 1 plus Pillar 2A or the higher of two times the applicable leverage ratio requirement or 6.75% of leverage exposures). MREL requirements are expected to be set on consolidated, sub-consolidated and individual bases and are in addition to regulatory capital requirements (so that there can be no double counting of instruments qualifying for capital requirements).

In terms of applying MREL requirements to individual banking group entities (such as the Bank), the Bank of England will set individual MREs for all institutions within a banking group and may also set individual MREs for entities that are important from a resolution perspective on an entity-specific basis. As a result, the holding entity of the other RBS Group companies outside the RFB and the Bank on a solo basis may be required to meet specific MREL requirements set by the regulator. Such requirements will be required to be met with internal MREL resources which are subordinated to the operating liabilities of the entity issuing them and must be capable of being written down or converted to equity. The Bank of England has indicated that it expects to align the scope of MREL with the scope of capital requirements, unless there are compelling reasons to deviate from this and that it will, on an entity-by-entity basis, consider whether individual entities within a group could feasibly enter insolvency upon the resolution of the group as a whole. Where this is the case those entities may be set an individual MREL equal to their regulatory minimum capital requirements although the Bank of England may adjust the internal MREL set for an individual entity having regard to the consolidated MREL set for the resolution group.

For institutions, including the RBS Group, for which bail-in is the required resolution strategy and which are structured to permit single point of entry resolution due to their size and systemic importance, the Bank of England has indicated that in order to qualify as MREL, eligible liabilities must be issued by the resolution entity (i.e. the holding company for the RBS Group) and be structurally subordinated to operating and excluded liabilities (which include insured deposits, short-term debt, derivatives, structured notes and tax liabilities). The final PRA rules set out a number of liabilities which cannot qualify as MREL and are therefore "excluded liabilities".

As a result, senior unsecured issuances by RBSG will need to be subordinated to the excluded liabilities described above. The proceeds from such issuances will be transferred downstream to material operating subsidiaries in the form of capital or another form of subordinated claim. In this way, MREL resources will be "structurally subordinated" to senior liabilities of operating companies, allowing losses from operating companies to be transferred to the holding company and – if necessary – for resolution to occur at the holding company level, without placing the operating companies into a resolution process.

The TLAC standard includes an exemption from this requirement if the total amount of excluded liabilities on RBSG's balance sheet does not exceed 5% of its external TLAC (i.e. the eligible liabilities RBSG has issued to investors which meet the TLAC requirements) and the Bank of England has adopted this criterion in its final rules. If the RBS Group were to fail to comply with this "clean balance sheet" requirement, it could disqualify otherwise eligible liabilities from counting towards MREL and result in the RBS Group breaching its MREL requirements. The RBS Group's resolution authority can impose an MREL requirement over and above the regulatory minima and potentially higher than the RBS Group's peers, if it has concerns regarding the resolvability of the RBS Group. As a result, the RBS Group may be required to issue additional loss-absorbing instruments in the form of CET1 capital or subordinated or senior unsecured debt instruments and may result in an increased risk of a breach of the RBS Group's combined buffer requirement triggering the restrictions relating to the MDA described above.

Compliance with these and other future changes to capital adequacy and loss-absorbency requirements in the EU and the UK by the relevant deadline will require the RBS Group to restructure its balance sheet and issue additional capital compliant with the rules, which may be costly whilst certain existing tier 1 and tier 2 securities and other senior instruments issued by the RBS Group will cease to count towards the RBS Group's loss-absorbing capital for the purposes of meeting MREL/TLAC requirements.

Additional information

Risk factors continued

There remain some areas of uncertainty as to how these rules will be implemented within the UK, the EU and globally and the final requirements to which the RBS Group will be subject, and the RBS Group may therefore need to revise its capital plan accordingly. The European Commission's recent proposals also include a proposal seeking to harmonise the priority ranking of unsecured debt instruments under national insolvency proceedings to facilitate the implementation of MREL across Europe. This rule is currently subject to consideration and negotiation by the European institutions but, to the extent it were to apply to the RBS Group, it could impact the ranking of current or future senior unsecured creditors of the RBS Group.

The Group's borrowing costs and its liquidity depend significantly on its and the RBS Group's credit ratings and, to a lesser extent, on the rating of the UK Government.

The credit ratings of RBSG, the Bank and other RBS Group companies directly affect the cost of funding and capital instruments issued by the RBS Group, as well as secondary market liquidity in those instruments.

A number of UK and other European financial institutions, including RBSG, the Bank and other RBS Group companies, have been downgraded multiple times in recent years in connection with rating methodology changes and credit rating agencies' revised outlook relating to regulatory developments, macroeconomic trends and a financial institution's capital position and financial prospects.

The senior unsecured long-term and short-term credit ratings of RBSG are below investment grade by Moody's, and investment grade by S&P and Fitch. The senior unsecured long-term and short-term credit ratings of the Bank are investment grade by Moody's, S&P and Fitch. The outlook for RBSG and the Bank by Moody's is currently positive and is stable for S&P and Fitch.

Rating agencies regularly review the RBSG and RBS Group entity credit ratings, including those of the Bank and other RBS Group companies, and their ratings of long-term debt are based on a number of factors, including the RBS Group's financial strength as well as factors not within the RBS Group's control, including political developments and conditions affecting the financial services industry generally. In particular, the rating agencies may further review the RBSG, Bank and other RBS Group entity ratings, including those of the Bank, as a result of the implementation of the UK ring-fencing regime and related reorganisation, pension and litigation/regulatory investigation risk, including potential fines relating to investigations relating to legacy conduct issues, and other macroeconomic and political developments, including in light of the outcome of the negotiations relating to the shape and timing of the UK's exit from the EU. A challenging macroeconomic environment, reduced profitability and greater market uncertainty could negatively impact the RBS Group's and/or the Group's performance and potentially lead to credit ratings downgrades which could adversely impact the Group's funding or borrowing costs. The RBS Group's ability to access capital markets on acceptable terms and hence its ability to raise the amount of capital and funding required to meet its regulatory requirements and targets, including those relating to loss-absorbing instruments to be issued by the RBS Group, could be affected.

Any further reductions in the long-term or short-term credit ratings of RBSG, the Bank or of certain other RBS Group entities, including further downgrades below investment grade, could adversely affect the RBS Group's issuance capacity in the financial markets, increase the RBS Group's or the Group's funding and borrowing costs, require the RBS Group (including the Bank) to replace funding lost due to the downgrade, which may include the loss of customer deposits and may limit the RBS Group's access to capital and money markets and trigger additional collateral or other requirements in derivatives contracts and other secured funding arrangements or the need to amend such arrangements, limit the range of counterparties willing to enter into transactions with RBSG and its subsidiaries (including the Bank) and adversely affect the competitive position of the RBS Group or the Group, all of which could have a material adverse impact on the RBS Group's and the Group's earnings, cash flow and financial condition.

Additional information

Risk factors continued

As discussed above, the success of the implementation of the UK ring-fencing regime and the restructuring of the NWM franchise, is in part dependent upon the relevant banking entities, including the Bank, obtaining a sustainable credit rating. A failure to obtain such a rating, or any subsequent downgrades to current or future ratings may threaten the ability of the NWM franchise or other entities outside of the RFB, in particular with respect to their ability to meet prudential capital requirements.

The major credit rating agencies downgraded and changed their outlook to negative on the UK's sovereign credit rating following the result of the EU Referendum in June 2016. Any further downgrade in the UK Government's credit ratings could adversely affect the credit ratings of RBS Group companies (including the Bank) and may result in the effects noted above. Further political developments, including in relation to the UK's exit from the EU or the outcome of any further Scottish referendum could negatively impact the credit ratings of the UK Government and result in a downgrade of the credit ratings of RBSG, the Bank and RBS Group entities.

The ability of the RBS Group and the Group to meet their obligations including their funding commitments depends on their ability to access sources of liquidity and funding.

Liquidity risk is the risk that a bank will be unable to meet its obligations, including funding commitments, as they fall due. This risk is inherent in banking operations and can be heightened by a number of factors, including an over-reliance on a particular source of wholesale funding (including, for example, short-term and overnight funding), changes in credit ratings or market-wide phenomena such as market dislocation and major disasters.

Credit markets worldwide, including interbank markets, have experienced severe reductions in liquidity and term funding during prolonged periods in recent years. In 2016, although the RBS Group's and the Group's overall liquidity position remained strong, credit markets experienced elevated volatility and certain European banks, in particular in the peripheral countries of Spain, Portugal, Greece and Italy, remained reliant on the ECB as one of their principal sources of liquidity.

The RBS Group relies on retail and wholesale deposits to meet a considerable portion of its funding. The level of deposits may fluctuate due to factors outside the Group's control, such as a loss of confidence (including in other RBS Group entities), increasing competitive pressures for retail customer deposits or the repatriation of deposits by foreign wholesale depositors, which could result in a significant outflow of deposits within a short period of time.

An inability to grow, or any material decrease in, the Group's deposits could, particularly if accompanied by one of the other factors described above, have a material adverse impact on the Group's ability to satisfy its liquidity needs. Increases in the cost of retail deposit funding may impact the Group's margins and profitability.

The implementation of the UK ring-fencing regime may also impact the Group's funding strategy which is managed centrally by the RBS Group insofar as the Group also depends on intragroup funding arrangements entered into with other RBS Group entities. As a result of the implementation of the UK ring-fencing regime, such arrangements may no longer be permitted if they are provided to the Group by an entity within the RFB and as a result the cost of funding may increase for certain Group entities, including the Bank, which will be required to manage their own funding and liquidity strategy.

The RBS Group is using the Bank of England's term funding scheme which was introduced in August 2016, in order to reduce the funding costs for the RBS Group. Such funding has a short maturity profile and hence the Group will diversify its sources of funding.

The market view of bank credit risk has changed radically as a result of the financial crisis and banks perceived by the market to be riskier have had to issue debt at significantly higher costs. Although conditions have improved, there have been recent periods where corporate and financial institution counterparties have reduced their credit exposures to banks and other financial institutions, limiting the availability of these sources of funding. The ability of the Bank of England to resolve the RBS Group in an orderly manner may also increase investors' perception of risk and hence affect the availability and cost of funding for the RBS Group. Any uncertainty relating to the credit risk of financial institutions may lead to reductions in levels of interbank lending or may restrict the RBS Group's access to traditional sources of funding or increase the costs or collateral requirements for accessing such funding.

The RBS Group and the Group have, at times, been required to rely on shorter-term and overnight funding with a consequent reduction in overall liquidity, and to increase recourse to liquidity schemes provided by central banks. Such schemes require assets to be pledged as collateral. Changes in asset values or eligibility criteria can reduce available assets and consequently available liquidity, particularly during periods of stress when access to the schemes may be needed most.

In addition, the RBS Group and the Group are subject to certain regulatory requirements with respect to liquidity coverage, including a liquidity coverage ratio set by the PRA in the UK. This requirement is currently being phased in and is set at 90% from 1 January 2017 to increase 100% in January 2018 (as required by the CRR).

Additional information

Risk factors continued

The PRA may also impose additional liquidity requirements on the RBS Group to reflect risks not captured in the leverage coverage ratio by way of Pillar 2 add-ons, which may increase from time to time and require the RBS Group to obtain additional funding or diversify its sources of funding. Current proposals by the FSB and the European Commission also seek to introduce certain liquidity requirements for financial institutions, including the introduction of a net stable funding ratio (NSFR). Under the European Commission November 2016 proposals, the NSFR would be calculated as the ratio of an institution's available stable funding relative to the required stable funding it needs over a one-year horizon.

The NSFR would be expressed as a percentage and set at a minimum level of 100%, which indicates that an institution holds sufficient stable funding to meet its funding needs during a one-year period under both normal and stressed conditions. If an institution's NSFR were to fall below the 100% level, the institution would be required to take the measures laid down in the CRD IV Regulation for a timely restoration to the minimum level. Competent authorities would assess the reasons for non-compliance with the NSFR requirement before deciding on any potential supervisory measures. These proposals are currently being considered and negotiated among the European Commission, the European Parliament and the European Council and, in light of the UK's decision to leave the EU, there is considerable uncertainty as to the extent to which such rules will apply to the RBS Group.

If the RBS Group is unable to raise funds through deposits and/or in the capital markets, the liquidity position of the RBS Group or the Group could be adversely affected and they might be unable to meet deposit withdrawals on demand or at their contractual maturity, to repay borrowings as they mature, to meet obligations under committed financing facilities, to comply with regulatory funding requirements or to fund new loans, investments and businesses. The RBS Group or the Group may need to liquidate unencumbered assets to meet their liabilities, including disposals of assets not previously identified for disposal to reduce their funding commitments. In a time of reduced liquidity, the RBS Group or the Group may be unable to sell some of their assets, or may need to sell assets at depressed prices, which in either case could have a material adverse effect on the RBS Group's and/or the Group's financial condition and results of operations.

The Group's businesses and performance can be negatively affected by the performance of the UK economy as well as actual or perceived economic and financial market conditions in the UK and globally and other global risks and the Group will be increasingly impacted by developments in the UK as its operations become increasingly concentrated in the UK.

Actual or perceived difficult global economic conditions create challenging economic and market conditions and a difficult operating environment for the Group's businesses and its customers and counterparties. As part of its revised strategy, the RBS Group has been refocusing its business in the UK, the ROI and Western Europe and, accordingly is more exposed to the economic conditions of the British economy as well as the Eurozone.

In particular, the longer term effects of the EU Referendum are difficult to predict, and subject to wider global macro-economic trends, but may include periods of financial market volatility and slower economic growth, in the UK in particular, but also in the ROI, Europe and the global economy, at least in the short to medium term.

The outlook for the global economy over the medium-term remains uncertain due to a number of factors including: political instability, continued slowdown of global growth, an extended period of low inflation and low interest rates and delays in normalising monetary policy. Such conditions could be worsened by a number of factors including political uncertainty or macro-economic deterioration in the Eurozone or the US, increased instability in the global financial system and concerns relating to further financial shocks or contagion, a further weakening of the pound sterling, new or extended economic sanctions, volatility in commodity prices or concerns regarding sovereign debt. In particular, concerns relating to emerging markets, including lower economic growth or recession, concerns relating to the Chinese economy and financial markets, reduced global trade in emerging market economies to which the Group is exposed (including those economies to which the Group remains exposed pending the exit of certain of its businesses and which include China and India), or increased financing needs as existing debt matures, may give rise to further instability and financial market volatility. Any of the above developments could impact the Group directly by resulting in credit losses and indirectly by further impacting global economic growth and financial markets.

Additional information

Risk factors continued

Developments relating to current economic conditions, 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. Any such developments may also adversely impact the financial position of the RBS Group's pension schemes, which may result in the RBS Group being required to make additional contributions. See "The Group is subject to pension risks and may be required to make additional contributions to cover pension funding deficits as a result of degraded economic conditions or as a result of the restructuring of their pension schemes in relation to the implementation of the UK ring-fencing regime."

In addition, the Group is exposed to risks arising out of geopolitical events or political developments, such as trade barriers, exchange controls, sanctions and other measures taken by sovereign governments that can hinder economic or financial activity levels. Furthermore, unfavourable political, military or diplomatic events, armed conflict, pandemics and terrorist acts and threats, and the responses to them by governments, could also adversely affect economic activity and have an adverse effect upon the Group's business, financial condition and results of operations.

Changes in interest rates or foreign exchange rates have significantly affected and will continue to affect the Group's business and results of operations.

Some of the most significant market risks that the Group faces are interest rate and foreign exchange risks. Monetary policy has been highly accommodative in recent years, including as a result of certain policies implemented by the Bank of England and HM Treasury such as the 'Funding for Lending' scheme, which have helped to support demand at a time of very pronounced fiscal tightening and balance sheet repair. In the UK, the Bank of England lowered interest rates to 0.25% in August 2016 and there remains considerable uncertainty as to whether or when the Bank of England and other central banks will increase interest rates. While the ECB has been conducting a quantitative easing programme since January 2015 designed to improve confidence in the Eurozone and encourage more private bank lending, there remains considerable uncertainty as to whether such measures have been or will be sufficient or successful and the extension of this programme during 2017 may put additional pressure on margins. Further decreases in interest rates by the Bank of England or other central banks, continued sustained low or negative interest rates or any divergences in monetary policy approach between the Bank of England and other major central banks, could put further pressure on the Group's interest margins and adversely affect the Group's profitability and prospects. A continued period of low interest rates and yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs, the effect of which may be heightened during periods of liquidity stress.

Conversely while increases in interest rates may support the Group's income, sharp increases in interest rates could lead to generally weaker than expected growth, or even contracting GDP, reduced business confidence, higher levels of unemployment or underemployment, adverse changes to levels of inflation, potentially higher interest rates and falling property prices in the markets in which the Group operates. In turn, this could cause stress in the loan portfolio of the Group, particularly in relation to non-investment grade lending or real estate loans and consequently to an increase in delinquency rates and default rates among customers, leading to the possibility of the Group incurring higher impairment charges.

Similar risks result from the exceptionally low level of inflation in developed economies, which in Europe particularly could deteriorate into sustained deflation if policy measures prove ineffective. Reduced monetary stimulus and the actions and commercial soundness of other financial institutions have the potential to impact market liquidity.

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 Bank's non-UK subsidiaries and may affect the Group's reported consolidated financial condition or its income from foreign exchange dealing. Such changes may result from the decisions of the Bank of England, ECB or of the US Federal Reserve or from political events and lead to sharp and sudden variations in foreign exchange rates, such as those seen in the GBP/USD exchange rates during the second half of 2016 following the EU Referendum.

Additional information

Risk factors continued

The Group's earnings and financial condition have been, and its future earnings and financial condition may continue to be, materially affected by depressed asset valuations resulting from poor market conditions.

The Group's businesses and performance are also affected by financial market conditions.

The performance and volatility of financial markets affect bond and equity prices and have caused, and may in the future cause, changes in the value of the Group's investment and trading portfolios. Financial markets have recently experienced and may in the near term experience significant volatility, including as a result of concerns about the outcome of the EU Referendum, political and financial developments in the US and in Europe, including as a result of general elections, geopolitical developments and developments relating to trade agreements, volatility and instability in the Chinese and global stock markets, expectations relating to or actions taken by central banks with respect to monetary policy and weakening fundamentals of the Chinese economy, resulting in further short-term changes in the valuation of certain of the Group's assets. Uncertainty about potential fines for past misconduct and concerns about the longer-term viability of business models have also weighed heavily on the valuations of some financial institutions in Europe and in the UK, including the RBS Group.

Any further deterioration in economic and financial market conditions or weak economic growth could require the Group to recognise further significant write-downs and realise increased impairment charges, all of which may have a material adverse effect on its financial condition, results of operations and capital ratios. As part of its transformation programme, the RBS Group is executing the run-down or disposal of a number of businesses, assets and portfolios. In addition, the RBS Group's interest in the remainder of the businesses and portfolios within the exiting business may be difficult to sell due to unfavourable market conditions for such assets or businesses.

Moreover, market volatility and illiquidity (and the assumptions, judgements and estimates in relation to such matters that may change over time and may ultimately not turn out to be accurate) make it difficult to value certain of the Group's exposures.

Valuations in future periods reflecting, among other things, the then-prevailing market conditions and changes in the credit ratings of certain of the Group's assets may result in significant changes in the fair values of the Group's exposures, such as credit market exposures, and the value ultimately realised by the Group may be materially different from the current or estimated fair value. As part of its ongoing derivatives operations, the Group also faces significant basis, volatility and correlation risks, the occurrence of which are also impacted by the factors noted above.

In addition, for accounting purposes, the Group carries some of its issued debt, such as debt securities, at the current market price on its balance sheet. Factors affecting the current market price for such debt, such as the credit spreads of the Group, may result in a change to the fair value of such debt, which is recognised in the income statement as a profit or loss.

The financial performance of the Group has been, and may continue to be, materially affected by customer and counterparty credit quality and deterioration in credit quality could arise due to prevailing economic and market conditions and legal and regulatory developments.

The Group has exposure to many different industries, customers and counterparties, and risks arising from actual or perceived changes in credit quality and the recoverability of monies due from borrowers and other counterparties are inherent in a wide range of the Group's businesses.

In particular, the Group has significant exposure to certain individual customers and other counterparties in weaker business sectors and geographic markets and also has concentrated country exposure in the UK, the US and across the rest of Europe principally Germany, the Netherlands, Ireland and France.

Additional information

Risk factors continued

At 31 December 2016, the current exposure in the UK was £337.4 billion, in the US was £22.3 billion and in Western Europe (excluding the UK) was £75.6 billion); and within certain business sectors, namely personal, financial institutions, property, shipping and the oil and gas sector (at 31 December 2016, personal lending amounted to £166.2 billion, lending to financial institutions was £46.2 billion, property lending was £42.3 billion, lending to the oil and gas sector was £2.9 billion and shipping was £4.6 billion).

Provisions held on loans in default have decreased in recent years due to asset sales and the portfolio run-down in Ulster Bank ROI and Capital Resolution. If the risk profile of these loans were to increase, including as a result of a degradation of economic or market conditions, this could result in an increase in the cost of risk and the Group may be required to make additional provisions, which in turn would reduce earnings and impact the Group's profitability. The Group's lending strategy or processes may also fail to identify or anticipate weaknesses or risks in a particular sector, market or borrower category, which may result in an increase in default rates, which may, in turn, impact the Group's profitability. Any adverse impact on the credit quality of the Group's customers and other counterparties, coupled with a decline in collateral values, could lead to a reduction in recoverability and value of the Group's assets and higher levels of impairment allowances, which could have an adverse effect on the Group's operations, financial position or prospects.

The credit quality of the Group's borrowers and its other counterparties is impacted by prevailing economic and market conditions and by the legal and regulatory landscape in their respective markets.

Credit quality has improved in certain of the Group's core markets, in particular the UK and Ireland, as these economies have improved. However, a further deterioration in economic and market conditions or changes to legal or regulatory landscapes could worsen borrower and counterparty credit quality and also impact the Group's ability to enforce contractual security rights. In particular, the UK's decision to leave the EU may adversely impact credit quality in the UK.

In addition, as the Group implements its new strategy and withdraws from many geographic markets and continues to materially scale down its international activities, the Group's relative exposure to the UK and certain sectors and asset classes in the UK will increase significantly as its business becomes more concentrated in the UK. The level of UK household indebtedness remains high and the ability of some households to service their debts could be challenged by a period of higher unemployment. Highly indebted households are particularly vulnerable to shocks, such as falls in incomes or increases in interest rates, which threaten their ability to service their debts.

In particular, in the UK the Group is at risk from volatility in property prices in both the residential and commercial sectors. With UK home loans representing the most significant portion of the Group's total loans and advances to the retail sector, the Group has a large exposure to adverse developments in the UK residential property sector. In the UK commercial real estate market, activity slowed during the second half of 2016 following the EU Referendum. There is a risk of further adjustment given the reliance of the UK commercial real estate market in recent years on inflows of foreign capital and, in some segments, stretched property valuations. As a result, a fall in house prices, particularly in London and the South East of the UK, would be likely to lead to higher impairment and negative capital impact as loss given default rate increases. In addition, reduced affordability of residential and commercial property in the UK, for example, as a result of higher interest rates or increased unemployment, could also lead to higher impairments on loans held by the Group being recognised.

In addition, the Group's credit risk is exacerbated when the collateral it holds cannot be realised as a result of market conditions or regulatory intervention or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due to them, which is most likely to occur during periods of illiquidity and depressed asset valuations, such as those experienced in recent years. This has particularly been the case with respect to large parts of the Group's commercial real estate portfolio. Any such deterioration in the Group's recoveries on defaulting loans could have an adverse effect on the Group's results of operations and financial condition.

Additional information

Risk factors continued

Concerns about, or a default by, one financial institution could lead to significant liquidity problems and losses or defaults by other financial institutions, as the commercial and financial soundness of many financial institutions may be closely related as a result of credit, trading, clearing and other relationships.

Even the perceived lack of creditworthiness of, or questions about, a counterparty may lead to market-wide liquidity problems and losses for, or defaults by, the RBS Group and/or the Group. This systemic risk may also adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with which the Group interacts on a daily basis.

The effectiveness of recent prudential reforms designed to contain systemic risk in the EU and the UK is yet to be tested. Counterparty risk within the financial system or failures of the Group's financial counterparties could have a material adverse effect on the Group's access to liquidity or could result in losses which could have a material adverse effect on the Group's financial condition, results of operations and prospects.

The trends and risks affecting borrower and counterparty credit quality have caused, and in the future may cause, the Group to experience further and accelerated impairment charges, increased repurchase demands, higher costs, additional write-downs and losses for the Group and an inability to engage in routine funding transactions.

The Group's operations are highly dependent on its and the RBS Group's IT systems, including as a result of the lack of or untimely investments. A failure of the RBS Group's or the Group's IT systems could adversely affect its operations, competitive position and investor and customer confidence and expose the RBS Group to regulatory sanctions.

The Group's operations are dependent on the ability to process a very large number of transactions efficiently and accurately while complying with applicable laws and regulations where it does business. The proper functioning of the Group's payment systems, financial and sanctions controls, risk management, credit analysis and reporting, accounting, customer service and other IT systems, as well as the communication networks between its branches and main data processing centres, are critical to the Group's operations.

The vulnerabilities of the Group's IT systems are due to their complexity, attributable in part to overlapping multiple dated systems that result from the RBS Group's historical acquisitions and insufficient investment prior to 2013 to keep the IT applications and infrastructure up-to-date. A complex IT estate containing end-of-life hardware and software creates challenges in recovering from system breakdowns. IT failures adversely affect the RBS Group's and the Group's relationship with their customers and reputation and have led, and may in the future, lead to regulatory investigations and redress.

The RBS Group experienced a limited number of IT failures in 2016 affecting customers, although improvements introduced since 2012 allowed the RBS Group to contain the impact of such failures. The Group's regulators in the UK are actively surveying progress made by banks in the UK to modernise, manage and secure their IT infrastructures, in order to prevent future failures affecting customers. Any critical system failure, any prolonged loss of service availability or any material breach of data security could cause serious damage to the Group's ability to service its customers, could result in significant compensation costs or fines resulting from regulatory investigations and could breach regulations under which the Group operates.

In particular, failures or breaches resulting in the loss or publication of confidential customer data could cause long-term damage to the RBS Group's and/or the Group's reputation, business and brands, which could undermine their ability to attract and keep customers.

The RBS Group is currently implementing a number of complex initiatives, including its transformation programme, the UK ring-fencing regime and the restructuring of the NWM franchise all which put additional strains on the RBS Group's and Group's existing IT systems. A failure to safely and timely implement one or several of these initiatives could lead to disruptions of the RBS Group's or the Group's IT infrastructure and in turn cause long-term damage to the Group's reputation, brands, results of operations and financial position.

Additional information

Risk factors continued

The RBS Group has made, and will continue to make, considerable investments in its (including the Group's) IT systems to further simplify and upgrade the systems and capabilities to make them more cost-effective and improve controls and procedures, strengthen cyber security defences, enhance the digital services provided to bank customers and improve the RBS Group's and the Group's competitive position and address system failures which adversely affect their relationship with their customers and reputation and may lead to regulatory investigations and redress.

However, the RBS Group's current focus on cost-saving measures as part of its transformation programme may impact the resources available to implement further improvements to the RBS Group's and/or the Group's IT infrastructure or limit the resources available for investments in technological developments and innovations. Should such investment and rationalisation initiatives fail to achieve the expected results, or prove to be insufficient, it could have a material adverse impact on the Group's operations, its ability to retain or grow its customer business or its competitive position and could negatively impact the Group's financial position.

The Group's businesses are subject to substantial regulation and oversight. Significant regulatory developments and increased scrutiny by the Group's key regulators has had and is likely to continue to increase compliance and conduct risks and could have a material adverse effect on how the Group conducts its business and on its results of operations and financial condition.

The Group is subject to extensive laws, regulations, corporate governance requirements, administrative actions and policies in each jurisdiction in which it operates. Many of these have been introduced or amended recently and are subject to further material changes. Among others, the implementation and strengthening of the prudential and resolution framework applicable to financial institutions in the UK, the EU and the US, and future amendments to such rules, are considerably affecting the regulatory landscape in which the Group operates and will operate in the future, including as a result of the adoption of rules relating to the UK ring-fencing regime, prohibitions on proprietary trading, CRD IV and the BRRD and certain other measures. Increased regulatory focus in certain areas, including conduct, consumer protection regimes, anti-money laundering, payment systems, and antiterrorism laws and regulations, have resulted in the Group facing greater regulation and scrutiny in the UK, the US and other countries in which it operates.

Recent regulatory changes, proposed or future developments and heightened levels of public and regulatory scrutiny in the UK, Europe and the US have resulted in increased capital, funding and liquidity requirements, changes in the competitive landscape, changes in other regulatory requirements and increased operating costs, and have impacted, and will continue to impact, product offerings and business models.

Such changes may also result in an increased number of regulatory investigations and proceedings and have increased the risks relating to the RBS Group's ability to comply with the applicable body of rules and regulations in the manner and within the time frames required.

Such risks are currently exacerbated by the outcome of the EU Referendum and the UK's decision to leave the EU and the unprecedented degree of uncertainty as to the respective legal and regulatory frameworks in which the RBS Group and the Group will operate when the UK is no longer a member of the EU. For example, current proposed changes to the European prudential regulatory framework for banks and investment banks may result in additional prudential or structural requirements being imposed on financial institutions based outside the EU wishing to provide financial services within the EU (which may apply to the Group once the UK has formally exited the EU). See also "Changes to the prudential regulatory framework for banks and investment banks within the EU may require additional structural changes to the RBS Group's operations which may affect current restructuring plans and have a material adverse effect on the Group". In addition, the Group and its counterparties may no longer be able to rely on the European passporting framework for financial services and could be required to apply for authorisation in multiple European jurisdictions, the costs, timing and viability of which is uncertain.

Any of these developments (including failures to comply with new rules and regulations) could have a significant impact on how the RBS Group and the Group conduct their business, their authorisations and licences, the products and services they offer, their reputation and the value of their assets, the Group's operations or legal entity structure, including attendant restructuring costs and consequently have a material adverse effect on their business, funding costs, results of operations, financial condition and future prospects.

Additional information

Risk factors continued

Areas in which, and examples of where, governmental policies, regulatory and accounting changes and increased public and regulatory scrutiny could have an adverse impact (some of which could be material) on the Group include, but are not limited to, those set out above as well as the following:

- amendments to the framework or requirements relating to the quality and quantity of regulatory capital to be held by the RBS Group or the Group as well as liquidity and leverage requirements, either on a solo, consolidated or subgroup level (and taking into account the RBS Group's new legal structure following the implementation of the UK ring-fencing regime), including amendments to the rules relating to the calculation of risk-weighted assets and reliance on internal models and credit ratings as well as rules affecting the eligibility of deferred tax assets;
- the design and implementation of national or supranational mandated recovery, resolution or insolvency regimes or the implementation of additional or conflicting loss-absorption requirements, including those mandated under MREL or by the FSB's recommendations on TLAC;
- new or amended regulations or taxes that reduce profits attributable to shareholders which may diminish, or restrict, the accumulation of the distributable reserves or distributable items necessary to make distributions or coupon payments or limit the circumstances in which such distributions may be made or the extent thereof;
- the monetary, fiscal, interest rate and other policies of central banks and other governmental or regulatory bodies;
- further investigations, proceedings or fines either against the RBS Group or the Group in isolation or together with other large financial institutions with respect to market conduct wrongdoing;
- the imposition of government-imposed requirements and/or related fines and sanctions with respect to lending to the UK SME market and larger commercial and corporate entities;
- increased regulatory scrutiny with respect to mortgage lending, including through the implementation of the UK mortgage market review and other initiatives led by the Bank of England or European regulators
- additional rules and regulatory initiatives and review relating to customer protection, including the FCA's Treating Customers Fairly regime and increased focus by regulators on how institutions conduct business, particularly with regard to the delivery of fair outcomes for customers and orderly/transparent markets;
- the imposition of additional restrictions on the Group's ability to compensate its senior management and other employees and increased responsibility and liability rules applicable to senior and key employees;
- regulations relating to, and enforcement of, anti-bribery, anti-money laundering, anti-terrorism or other similar sanctions regimes;
- rules relating to foreign ownership, expropriation, nationalisation and confiscation of assets;
- changes to financial reporting standards (including accounting standards or guidance) and guidance or the timing of their implementation;
- changes to risk aggregation and reporting standards;
- changes to corporate governance requirements, senior manager responsibility, corporate structures and conduct of business rules;
- competition reviews and investigations relating to the retail banking sector in the UK, including with respect to SME banking and PCAs;
- financial market infrastructure reforms establishing new rules applying to investment services, short selling, market abuse, derivatives markets and investment funds, including the European Market Infrastructure Regulation and the Markets in Financial Instruments Directive and Regulation in the EU and the Dodd Frank Wall Street Reform Consumer Protection Act of 2010 in the US;
- increased attention to competition and innovation in UK payment systems following the establishment of the new Payments Systems Regulator and developments relating to the UK initiative on Open Banking and the European directive on payment services;
- new or increased regulations relating to customer data and privacy protection, including the EU General Data Protection Regulation;
- restrictions on proprietary trading and similar activities within a commercial bank and/or a group;
- the introduction of, and changes to, taxes, levies or fees applicable to the Group's operations, such as the imposition of a financial transaction tax, changes in tax rates, increases in the bank corporation tax surcharge in the UK, restrictions on the tax deductibility of interest payments or further restrictions imposed on the treatment of carry-forward tax losses that reduce the value of deferred tax assets and require increased payments of tax;
- investigations into facilitation of tax evasion or avoidance or the creation of new civil or criminal offences relating thereto;
- the regulation or endorsement of credit ratings used in the EU (whether issued by agencies in European member states or in other countries, such as the US); and
- other requirements or policies affecting the Group's profitability or product offering, including through the imposition of increased compliance obligations or obligations which may lead to restrictions on business growth, product offerings, or pricing.

Additional information

Risk factors continued

Changes in laws, rules or regulations, or in their interpretation or enforcement, or the implementation of new laws, rules or regulations, including contradictory laws, rules or regulations by key regulators in different jurisdictions, or failure by the Group to comply with such laws, rules and regulations, may have a material adverse effect on the 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 and the Group's ability to engage in effective business, capital and risk management planning.

The Group is subject to pension risks and may be required to make additional contributions to cover pension funding deficits as a result of degraded economic conditions or as a result of the restructuring of their pension schemes in relation to the implementation of the UK ring-fencing regime.

The Group maintains a number of defined benefit pension schemes for certain former and current employees. Pension risk includes the risk that the assets of the RBS Group's various defined benefit pension schemes, including those in which the Group participates do not fully match the timing and amount of the schemes' liabilities, as a result of which the RBS Group and/or the Group are required or choose to make additional contributions to address deficits that may emerge. Risk arises from the schemes because the value of the asset portfolios may be less than expected and because there may be greater than expected increases in the estimated value of the schemes' liabilities and additional future contributions to the schemes may be required.

The value of pension scheme liabilities varies with changes to long-term interest rates (including prolonged periods of low interest rates as is currently the case), inflation, monetary policy, pensionable salaries and the longevity of scheme members, as well as changes in applicable legislation. In particular, as life expectancies increase, so too will the pension scheme liabilities; the impact on the pension scheme liabilities due to a one year increase in longevity would have been expected to be £1.5 billion as at 31 December 2016.

Given economic and financial market difficulties and volatility, the low interest rate environment and the risk that such conditions may occur again over the near and medium term, some of the RBS Group's pension schemes have experienced increased pension deficits.

The last triennial valuation of the Main Scheme, which covers certain of the Group's current or former employees and to which the Group contributes, had an effective date of 31 December 2015. This valuation was concluded with the acceleration of the nominal value of all committed contributions in respect of past service (£4.2 billion), which was paid in Q1 2016.

The next triennial period valuation will take place in Q4 2018 and the Main Scheme pension trustee has agreed that it would not seek a new valuation prior to that date, except where a material change arises. The 2018 triennial valuation is expected to result in a significant increase in the regular annual contributions in respect of the ongoing accrual of benefits. Notwithstanding the 2016 accelerated payment and any additional contributions that may be required beforehand as a result of a material change, the RBS Group expects to have to agree additional contributions, to which the Group may be required to contribute over and above the existing committed past service contributions, as a result of the next triennial valuation. Under current legislation, such agreement would need to be reached no later than Q1 2020.

The cost of such additional contributions could be material and any additional contributions that are committed to the Main Scheme following new actuarial valuations would trigger the recognition of a significant additional liability on the balance sheet of the Group and/or an increase in any pension surplus derecognised, which in turn could have a material adverse effect on the Group's results or operations, financial position and prospects.

In addition, the UK ring-fencing regime will require significant changes to the structure of the RBS Group's existing defined benefit pension schemes as RFB entities may not be liable for debts to pension schemes that might arise as a result of the failure of an entity that is not an RFB or wholly owned subsidiary thereof after 1 January 2026. The restructuring of the RBS Group and its defined benefit pension plans to implement the UK ring-fencing regime could affect assessments of the RBS Group's pension scheme deficits, or result in the pension scheme trustees considering that the employer covenant has been weakened, and result in additional contributions being required.

The RBS Group is developing a strategy to meet these requirements, which has been discussed with the PRA and is likely to require the agreement of the pension scheme trustee. Discussions with the pension scheme trustee are ongoing and will be influenced by the RBS Group's overall ring-fence strategy and its pension funding and investment strategies.

If agreement is not reached with the pension trustee, alternative options less favourable to the RBS Group or the Group may need to be developed to meet the requirements of the pension regulations.

Additional information

Risk factors continued

The costs associated with the restructuring of the Group's existing defined benefit pension schemes could be material and could result in higher levels of additional contributions than those described above and currently agreed with the pension trustee, which could have a material adverse effect on the Group's results of operations, financial position and prospects.

Pension risk and changes to the RBS Group's funding of its pension schemes may have a significant impact on the RBS Group's and/or the Group's capital position.

The RBS Group's capital position is influenced by pension risk in several respects: Pillar 1 capital is impacted by the requirement that net pension assets are to be deducted from capital and that actuarial gains/losses impact reserves and, by extension, CET1 capital; Pillar 2A requirements result in the RBS Group being required to carry a capital add-on to absorb stress on the pension fund and finally the risk of additional contributions to the RBS Group's pension fund is taken into account in the RBS Group's capital framework plan. Changes to the RBS Group's capital position or capital requirements relating to pension risks, are then reflected in the capital which the Group is required to hold, in line with the RBS Group's capital strategy which requires Group entities, including the Group, to maintain adequate capital at all times. In addition, an increase in the pension risk to which the Group is exposed may result in increased regulatory capital requirements applicable to the Group.

The RBS Group believes that the accelerated payment to the RBS Group's Main Scheme pension fund made in Q1 2016 improved the RBS Group's and the Group's capital planning and resilience through the period to 2019 and provided the Main Scheme pension trustee with more flexibility over its investment strategy. This payment has resulted in a reduction in prevailing Pillar2A add-on. However, subsequent contributions required in connection with the 2018 triennial valuation may adversely impact the RBS Group's and the Group's capital position.

The RBS Group's expectations as to the impact on its capital position of this payment in the near and medium term and of the accounting impact under its revised accounting policy are based on a number of assumptions and estimates, including with respect to the beneficial impact on its Pillar 2A requirements and confirmation of such impact by the PRA and the timing thereof, any of which may prove to be inaccurate (including with respect to the calculation of the CET1 ratio impact on future periods), including as a result of factors outside of the RBS Group's control (which include the PRA's approval).

As a result, if any of these assumptions proves inaccurate, the RBS Group's capital position may significantly deteriorate and fall below the minimum capital requirements applicable to the RBS Group or RBS Group entities (including the Bank) and in turn result in increased regulatory supervision or sanctions, restrictions on discretionary distributions or loss of investor confidence, which could individually or in aggregate have a material adverse effect on the RBS Group's and/or the Group's results of operations, financial prospects or reputation.

The impact of the Group's pension obligations on its results and operations are also dependent on the regulatory environment in which it operates. There is a risk that changes in prudential regulation, pension regulation and accounting standards, or a lack of coordination between such sets of rules, may make it more challenging for the RBS Group to manage its pension obligations resulting in an adverse impact on the RBS Group's CET1 capital.

The Group relies on valuation, capital and stress test models to conduct its business, assess its risk exposure and anticipate capital and funding requirements. Failure of these models to provide accurate results or accurately reflect changes in the micro-and macroeconomic environment in which the Group operates or findings of deficiencies by the Group's regulators resulting in increased regulatory capital requirements could have a material adverse effect on the Group's business, capital and results.

Given the complexity of the Group's business, strategy and capital requirements, the Group relies on analytical models to manage its business, assess the value of its assets and its risk exposure and anticipate capital and funding requirements, including with stress testing. The Group's valuation, capital and stress test models and the parameters and assumptions on which they are based, need to be periodically reviewed and updated to ensure their accuracy.

Failure of these models to accurately reflect changes in the environment in which the Group operates or to be updated in line with changes in the RBS Group's or the Group's business model or operations, or the failure to properly input any such changes could have an adverse impact on the modelled results or could fail to accurately capture the Group's risk exposure or the risk profile of the Group's financial instruments or result in the RBS Group being required to hold additional capital as a function of the PRA buffer. The Group also uses valuation models that rely on market data inputs. If incorrect market data is input into a valuation model, it may result in incorrect valuations or valuations different to those which were predicted and used by the Group in its forecasts or decision making. Internal stress test models may also rely on different, less severe, assumptions or take into account different data points than those defined by the Group's regulators.

Additional information

Risk factors continued

Some of the analytical models used by the Group are predictive in nature. In addition, a number of the internal models used by the Group are designed, managed and analysed by the RBS Group and may inappropriately capture the risks and exposures relating to the Group's portfolios. Some of the Group's internal models are subject to periodic review by its regulators and, if found deficient, the Group may be required to make changes to such models or may be precluded from using any such models, which would result in an additional capital requirement that could have a material impact on the Group's capital position.

The Group could face adverse consequences as a result of decisions which may lead to actions by management based on models that are poorly developed, implemented or used, or as a result of the modelled outcome being misunderstood or such information being used for purposes for which it was not designed. Risks arising from the use of models could have a material adverse effect on the Group's business, financial condition and/or results of operations, minimum capital requirements and reputation.

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Its results in future periods may be affected by changes to applicable accounting rules and standards.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, results reported in future periods may reflect amounts which differ from those estimates.

Estimates, judgements and assumptions take into account historical experience and other factors, including market practice and expectations of future events that are believed to be reasonable under the circumstances.

The accounting policies deemed critical to the Group's results and financial position, based upon materiality and significant judgements and estimates, include goodwill, provisions for liabilities, deferred tax, loan impairment provisions, fair value of financial instruments, which are discussed in detail in "Critical accounting policies and key sources of estimation uncertainty" on page 129. IFRS Standards and Interpretations that have been issued by the International Accounting Standards Board (the IASB) but which have not yet been adopted by the Group are discussed in "Accounting developments" on page 131.

Changes in accounting standards or guidance by internal accounting bodies or in the timing of their implementation, whether mandatory or as a result of recommended disclosure relating to the future implementation of such standards could result in the Group having to recognise additional liabilities on its balance sheet, or in further write-downs or impairments and could also significantly impact the financial results, condition and prospects of the Group.

In July 2014, the IASB published a new accounting standard for financial instruments (IFRS 9) effective for annual periods beginning on or after 1 January 2018. It introduces a new framework for the recognition and measurement of credit impairment, based on expected credit losses, rather than the incurred loss model currently applied under IAS 39. The inclusion of loss allowances with respect to all financial assets that are not recorded at fair value will tend to result in an increase in overall impairment balances when compared with the existing basis of measurement under IAS 39. As a result of ongoing regulatory consultation, there is currently uncertainty as to the impact of the implementation of this standard on the RBS Group's CET1 capital (and therefore CET1 ratio), although it is expected that this will result in increased earnings and capital volatility for the RBS Group.

The valuation of financial instruments, including derivatives, measured at fair value can be subjective, in particular where models are used which include unobservable inputs. Generally, to establish the fair value of these instruments, the Group relies on quoted market prices or, where the market for a financial instrument is not sufficiently active, internal valuation models that utilise observable market data. In certain circumstances, the data for individual financial instruments or classes of financial instruments utilised by such valuation models may not be available or may become unavailable due to prevailing market conditions.

In such circumstances, the Group's internal valuation models require the Group to make assumptions, judgements and estimates to establish fair value, which are complex and often relate to matters that are inherently uncertain. Resulting changes in the fair values of the financial instruments has had and could continue to have a material adverse effect on the Group's earnings, financial condition and capital position.

The RBS Group's and the Group's operations entail inherent reputational risk.

Reputational risk, meaning the risk of brand damage and/or financial loss due to a failure to meet stakeholders' expectations of the conduct, performance and business profile of the RBS Group and the Group, are inherent in their business. Stakeholders include customers, investors, rating agencies, employees, suppliers, governments, politicians, regulators, special interest groups, consumer groups, media and the general public.

Additional information

Risk factors continued

Brand damage can be detrimental to the business of the Group in a number of ways, including its ability to build or sustain business relationships with customers, low staff morale, regulatory censure or reduced access to, or an increase in the cost of, funding. In particular, negative public opinion resulting from the actual or perceived manner in which the RBS Group or any member of the RBS Group conduct their business activities and operations, including as a result of speculative or inaccurate media coverage, financial performance, ongoing investigations and proceedings and the settlement of any such investigations and proceedings, IT failures or cyber-attacks resulting in the loss or publication of confidential customer data or other sensitive information, the level of direct and indirect government support, or the actual or perceived strength or practices in the banking and financial industry may adversely affect the RBS Group's and the Group's ability to keep and attract customers and, in particular, corporate and retail depositors.

Modern technologies, in particular online social networks and other broadcast tools which facilitate communication with large audiences in short time frames and with minimal costs, may also significantly enhance and accelerate the impact of damaging information and allegations.

Reputational risks may also be increased as a result of the restructuring of the RBS Group to implement its transformation programme and the UK ring-fencing regime, which could, in turn, have an adverse effect on the Group.

Although the RBS Group has implemented a Reputational Risk Policy across customer-facing businesses (including those of the Group) to improve the identification, assessment and management of customers, transactions, products and issues which represent a reputational risk, the RBS 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 Group is exposed to conduct risk which may adversely impact the Group or its employees and may result in conduct having a detrimental impact on the Group's customers or counterparties.

In recent years, the RBS Group, including the Group, have sought to refocus their culture on serving the needs of their customers and continue to redesign many of their systems and processes to promote this focus and strategy. However, the RBS Group and the Group are exposed to various forms of conduct risk in their operations.

These include business and strategic planning that does not consider customers' needs, ineffective management and monitoring of products and their distribution, a culture that is not customer-centric, outsourcing of customer service and product delivery via third parties that do not have appropriate levels of control, oversight and culture, the possibility of alleged mis-selling of financial products or the mishandling of complaints related to the sale of such product, or poor governance of incentives and rewards. Some of these risks have materialised in the past and ineffective management and oversight of conduct issues may result in customers being poorly or unfairly treated and may in the future lead to further remediation and regulatory intervention/enforcement.

The RBS Group and the Group are also exposed to risk from employee misconduct including non-compliance with policies and regulatory rules, negligence or fraud, any of which could result in regulatory sanctions and serious reputational or financial harm to the RBS Group and/or the Group. In recent years, a number of multinational financial institutions, including the RBS Group and the Group, have suffered material losses due to the actions of employees, including, for example, in connection with the foreign exchange and LIBOR investigations and the RBS Group and the Group may not succeed in protecting themselves from such conduct in the future. It is not always possible to deter employee misconduct and the precautions the RBS Group and the Group take to prevent and detect this activity may not always be effective.

The RBS Group and the Group have implemented a number of policies and allocated new resources in order to help mitigate against these risks. The RBS Group and the Group have also prioritised initiatives to reinforce good conduct in their engagement with the markets in which they operate, together with the development of preventative and detective controls in order to positively influence behaviour.

The RBS Group's transformation programme is also intended to improve the control environment of the RBS Group and the Group. Nonetheless, no assurance can be given that the RBS Group's strategy and the control framework of the RBS Group or the Group will be effective and that conduct issues will not have an adverse effect on the RBS Group's and/or the Group's results of operations, financial condition or prospects.

Additional information

Risk factors continued

The Group may be adversely impacted if its or the RBS Group's risk management is not effective and there may be significant challenges in maintaining the effectiveness of the Group's risk management framework as a result of the number of strategic and restructuring initiatives being carried out by the RBS Group simultaneously.

The management of risk is an integral part of all of the Group's activities. Risk management includes the definition and monitoring of the Group's risk appetite and reporting of the Group's exposure to uncertainty and the consequent adverse effect on profitability or financial condition arising from different sources of uncertainty and risks as described throughout these risk factors.

Ineffective risk management may arise from a wide variety of events and behaviours, including lack of transparency or incomplete risk reporting, unidentified conflicts or misaligned incentives, lack of accountability control and governance, lack of consistency in risk monitoring and management or insufficient challenges or assurance processes.

Failure to manage risks effectively could adversely impact the RBS Group's and/or the Group's reputation or their relationship with their customers, shareholders or other stakeholders, which in turn could have a significant effect on the RBS Group's and/or the Group's business prospects, financial condition and/or results of operations.

Risk management is also strongly related to the use and effectiveness of internal stress tests and models. See "The Group relies on valuation, capital and stress test models to conduct its business, assess its risk exposure and anticipate capital and funding requirements. Failure of these models to provide accurate results or accurately reflect changes in the micro-and macroeconomic environment in which the Group operates or findings of deficiencies by the Group's regulators resulting in increased regulatory capital requirements could have a material adverse effect on the Group's business, capital and results."

A failure by the RBS Group to embed a strong risk culture across the organisation could adversely affect the ability of the RBS Group and the Group to achieve their strategic objectives.

In response to weaknesses identified in previous years, the RBS Group is currently seeking to embed a strong risk culture within the organisation based on a robust risk appetite and governance framework. A key component of this approach is the three lines of defence model designed to identify, manage and mitigate risk across all levels of the organisation.

This framework has been implemented and improvements continue and will continue to be made to clarify and improve the three lines of defence and internal risk responsibilities and resources, including in response to feedback from regulators. Notwithstanding the RBS Group's efforts, changing an organisation's risk culture requires significant time, investment and leadership, and such efforts may not insulate the RBS Group or the Group from future instances of misconduct. A failure by any of these three lines to carry out their responsibilities or to effectively embed this culture could have a material adverse effect on the RBS Group and/or the Group through an inability to achieve their strategic objectives for their customers, employees and wider stakeholders.

The Group's business and results of operations may be adversely affected by increasing competitive pressures and technology disruption in the markets in which it operates.

The markets for UK financial services, and the other markets within which the Group operates, are very competitive, and management expects such competition to continue or intensify in response to customer behaviour, technological changes (including the growth of digital banking), competitor behaviour, new entrants to the market (including non-traditional financial services providers such as large retail or technology conglomerates), new lending models (such as peer-to-peer lending), industry trends resulting in increased disaggregation or unbundling of financial services or conversely the re-intermediation of traditional banking services, and the impact of regulatory actions and other factors.

Additional information

Risk factors continued

In particular, developments in the financial sector resulting from new banking, lending and payment solutions offered by rapidly evolving incumbents, challengers and new entrants, in particular with respect to payment services and products, and the introduction of disruptive technology may impede the Group's ability to grow or retain its market share and impact its revenues and profitability, particularly in its key UK retail banking segment. These trends may be catalysed by regulatory and competition policy implemented by the UK government, particularly as a result of the Open Banking initiative and remedies imposed by the Competition and Markets Authority (CMA) designed to support the objectives of this initiative.

Increasingly many of the products and services offered by the Group are, and will become, technology intensive and the Group's ability to develop such services has become increasingly important to retaining and growing the Group's customer business in the UK.

There can be no certainty that the Group's investment in its IT capability intended to address the material increase in customer use of online and mobile technology for banking will be successful or that it will allow the Group to continue to grow such services in the future. Certain of the Group's current or future competitors may have more efficient operations, including better IT systems allowing them to implement innovative technologies for delivering services to their customers. Furthermore, the Group's competitors may be better able to attract and retain customers and key employees and may have access to lower cost funding and/or be able to attract deposits on more favourable terms than the Group. Although the Group invests in new technologies and participates in industry and research led initiatives aimed at developing new technologies, such investments may be insufficient, especially against a backdrop of cost savings targets for the Group, or the Group may fail to identify future opportunities or derive benefits from disruptive technologies. If the Group is unable to offer competitive, attractive and innovative products that are also profitable, it will lose market share, incur losses on some or all of its activities and lose opportunities for growth.

In addition, recent and future disposals and restructurings relating to the implementation of non-customer facing elements of the RBS Group's transformation programme and the UK ring-fencing regime, or required by the Group's regulators, as well as constraints imposed on the Group's ability to compensate its employees at the same level as its competitors, may also have an impact on its ability to compete effectively. Intensified competition from incumbents, challengers and new entrants in the Group's core markets could lead to greater pressure on the Group to maintain returns and may lead to unsustainable growth decisions. The impact of any such developments in the UK will become more significant as the Group's business becomes increasingly concentrated in the UK retail sector. These and other changes in the Group's competitive environment could have a material adverse effect on the Group's business, margins, profitability, financial condition and prospects.

The Group operates in markets that are subject to intense scrutiny by the competition authorities and its business and results of operations could be materially affected by competition rulings and other government measures.

The competitive landscape for banks and other financial institutions in the UK, the rest of Europe and the US is changing rapidly. Recent regulatory and legal changes have and may continue to result in new market participants and changed competitive dynamics in certain key areas, such as in retail and SME banking in the UK where the introduction of new entrants is being actively encouraged by the UK Government. The competitive landscape in the UK is also likely to be affected by the UK Government's implementation of the UK ring-fencing regime and other customer protection measures introduced by the Banking Reform Act 2013. The implementation of these reforms may result in the consolidation of newly separated businesses or assets of certain financial institutions with those of other parties to realise new synergies or protect their competitive position and is likely to increase competitive pressures on the Group.

The UK retail banking sector has been subjected to intense scrutiny by the UK competition authorities and by other bodies, including the FCA, in recent years, including with a number of reviews/inquiries being carried out, including market reviews conducted by the CMA and its predecessor the Office of Fair Trading regarding SME banking and Personal Current Accounts (PCAs), the Independent Commission on Banking and the Parliamentary Commission on Banking Standards. These reviews raised significant concerns about the effectiveness of competition in the banking sector.

Additional information

Risk factors continued

The CMA's Retail Banking Market Investigation report sets out measures primarily intended to make it easier for consumers and businesses to compare PCA and SME bank products, increase the transparency of price comparison between banks and amend PCA overdraft charging. The CMA is working with HM Treasury and other regulators to implement these remedies which are likely to impose additional compliance requirements on the Group and could, in aggregate, adversely impact the Group's competitive position, product offering and revenues.

Adverse findings resulting from current or future competition investigations may result in the imposition of reforms or remedies which may impact the competitive landscape in which the Group operates or result in restrictions on mergers and consolidations within the UK financial sector.

These and other changes to the competitive framework in which the Group operates could have a material adverse effect on the Group's business, margins, profitability, financial condition and prospects.

As a result of the commercial and regulatory environment in which it operates, the Group may be unable to attract or retain senior management (including members of the board) and other skilled personnel of the appropriate qualification and competence. The Group may also suffer if it does not maintain good employee relations.

The Group's future success depend on its ability to attract, retain and remunerate highly skilled and qualified personnel, including senior management (which includes directors and other key employees), in a highly competitive labour market. This cannot be guaranteed, particularly in light of heightened regulatory oversight of banks and the increasing scrutiny of, and (in some cases) restrictions placed upon, employee compensation arrangements, in particular those of banks in receipt of Government support (such as the RBS Group), which may place the Group at a competitive disadvantage. In addition, the market for skilled personnel is increasingly competitive, thereby raising the cost of hiring, training and retaining skilled personnel.

Certain of the Group's directors as well as members of its executive committee and certain other senior managers and employees are also subject to the new responsibility regime introduced under the Banking Reform Act 2013 which introduces clearer accountability rules for those within the new regime. The senior managers' regime and certification regime took effect on 7 March 2016, whilst the conduct rules will apply to the wider employee population from 7 March 2017 onwards, with the exception of some transitional provisions. The new regulatory regime may contribute to reduce the pool of candidates for key management and non-executive roles, including non-executive directors with the right skills, knowledge and experience, or increase the number of departures of existing employees, given concerns over the allocation of responsibilities introduced by the new rules.

In addition, in order to ensure the independence of the RFB, the Group will be required to recruit new independent directors and senior members of management to sit on the boards of directors and board committees of the RFB and other RBS Group entities, and there may be a limited pool of competent candidates from which such appointments can be made.

The RBS Group's evolving strategy has led to the departure of a large number of experienced and capable employees, including Group employees. The restructuring relating to the ongoing implementation of the RBS Group's transformation programme and related cost-reduction targets may cause experienced staff members to leave and prospective staff members not to join the RBS Group. The lack of continuity of senior management and the loss of important personnel coordinating certain or several aspects of the RBS Group's restructuring (including those which impact the Group) could have an adverse impact on the Group's business and future success.

The failure to attract or retain a sufficient number of appropriately skilled personnel to manage the complex restructuring required to implement the UK ring-fencing regime and the RBS Group's strategy could prevent the RBS Group from successfully implementing its strategy and meeting regulatory commitments. This could have a material adverse effect on the RBS Group's and/or the Group's business, financial condition and results of operations.

Additional information

Risk factors continued

In addition, many of the 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 Group and a breakdown of these relationships could adversely affect the Group's business, reputation and results.

HM Treasury (or UKFI on its behalf) may be able to exercise a significant degree of influence over the RBS Group, including the Group, and any further offer or sale of its interests may affect the price of securities issued by the RBS Group.

On 6 August 2015, the UK Government made its first sale of RBSG ordinary shares since its original investment in 2009 and sold approximately 5.4% of its stake in RBSG. Following this initial sale, the UK Government exercised its conversion rights under the B Shares on 14 October 2015 which resulted in HM Treasury holding 72.88% of the ordinary share capital of RBSG, and which entity owns all of the Bank's share capital. The UK Government, through HM Treasury, currently holds 71.3% of the issued ordinary share capital of the RBS Group. The UK Government has indicated its intention to continue to sell down its shareholding in the RBS Group.

In addition, UKFI manages HM Treasury's shareholder relationship with the RBS Group and, although HM Treasury has indicated that it intends to respect the commercial decisions of the RBS Group and that the RBS Group companies (including the Bank) will continue to have their own independent board of directors and management team determining their own strategy, its position as a majority shareholder (and UKFI's position as manager of this shareholding) means that HM Treasury or UKFI might be able to exercise a significant degree of influence over, among other things, the election of directors and appointment of senior management, the RBS Group's capital strategy, dividend policy, remuneration policy or the conduct of 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 conflicts between the interests of HM Treasury and the interests of other shareholders. The Board of RBSG has a duty to promote the success of the RBS Group for the benefit of its members as a whole.

The Group is committed to executing the run-down and sale of certain businesses, portfolios and assets forming part of the businesses and activities being exited by the RBS Group. Failure by the Group to do so on commercially favourable terms could have a material adverse effect on the Group's operations, operating results, financial position and reputation.

The Group's ability to dispose of the remaining businesses, portfolios and assets forming part of the businesses and activities being exited by the RBS Group and the price achieved for such disposals will be dependent on prevailing economic and market conditions, which remain volatile.

As a result, there is no assurance that the Group will be able to sell, exit or run down these businesses, portfolios or assets either on favourable economic terms to the Group or at all or that it may do so within the intended timetable. Material tax or other contingent liabilities could arise on the disposal or run-down of assets or businesses and there is no assurance that any conditions precedent agreed will be satisfied, or consents and approvals required will be obtained in a timely manner or at all.

The Group may be exposed to deteriorations in the businesses, portfolios or assets being sold between the announcement of the disposal and its completion, which period may span many months.

In addition, the Group may be exposed to certain risks, including risks arising out of ongoing liabilities and obligations, breaches of covenants, representations and warranties, indemnity claims, transitional services arrangements and redundancy or other transaction-related costs, and counterparty risk in respect of buyers of assets being sold.

The occurrence of any of the risks described above could have a material adverse effect on the Group's business, results of operations, financial condition and capital position and consequently may have the potential to impact the competitive position of part or all of the Group's business.

The value or effectiveness of any credit protection that the Group has purchased depends on the value of the underlying assets and the financial condition of the insurers and counterparties.

The Group has some remaining credit exposure arising from over-the-counter derivative contracts, mainly credit default swaps (CDSs), and other credit derivatives, each of which are carried at fair value.

The fair value of these CDSs, as well as the Group's exposure to the risk of default by the underlying counterparties, depends on the valuation and the perceived credit risk of the instrument against which protection has been bought.

Many market counterparties have been adversely affected by their exposure to residential mortgage-linked and corporate credit products, whether synthetic or otherwise, and their actual and perceived creditworthiness may deteriorate rapidly. If the financial condition of these counterparties or their actual or perceived creditworthiness deteriorates, the Group may record further credit valuation adjustments on the credit protection bought from these counterparties under the CDSs. The Group also recognises any fluctuations in the fair value of other credit derivatives.

Additional information

Risk factors continued

Any such adjustments or fair value changes may have a material adverse impact on the Group's financial condition and results of operations.

RBSG and its subsidiaries (including the Bank) are subject to a new and evolving framework on recovery and resolution, the impact of which remains uncertain, and which may result in additional compliance challenges and costs.

In the EU, the UK and the US, regulators have implemented or are in the process of implementing recovery and resolution regimes designed to prevent the failure of financial institutions and resolution tools to ensure the timely and orderly resolution of financial institutions. These initiatives have been complemented by a broader set of initiatives to improve the resilience of financial institutions and reduce systemic risk, including the UK ring-fencing regime, the introduction of certain prudential requirements and powers under CRD IV, and certain other measures introduced under the BRRD, including the requirements relating to loss absorbing capital.

The BRRD which was implemented in the UK from January 2015, provides a framework for the recovery and resolution of credit institutions and investment firms, their subsidiaries and certain holding companies in the EU, and the tools and powers introduced under the BRRD include preparatory and preventive measures, early supervisory intervention powers and resolution tools.

Implementation of certain provisions of the BRRD remains subject to secondary rulemaking as well as a review by the European Parliament and the European Commission of certain topics mandated by the BRRD. In November 2016, as a result of this review, the European Commission published a package of proposals seeking to introduce certain amendments to CRD IV and the BRRD as well as a new proposal seeking to harmonize creditor hierarchy.

These proposals are now subject to further discussions and negotiations among the European institutions and it is not possible to anticipate their final content. Further amendments to the BRRD or the implementing rules in the EU may also be necessary to ensure continued consistency with the FSB recommendations on resolution regimes and resolution planning for G-SIBs, including with respect to TLAC requirements.

In light of these potential developments as well as the impact of the UK's decision to leave the EU following the result of the EU Referendum, there remains uncertainty as to the rules which may apply to the RBS Group going forward. In addition, banks headquartered in countries which are members of the Eurozone are now subject to the European banking union framework. In November 2014, the ECB assumed direct supervisory responsibility for RBS NV and Ulster Bank under the Single Supervisory Mechanism (SSM). As a result of the above, there remains uncertainty as to how the relevant resolution regimes in force in the UK, the Eurozone and other jurisdictions, would interact in the event of a resolution of the RBS Group.

The BRRD requires national resolution funds to raise "ex ante" contributions on banks and investment firms in proportion to their liabilities and risk profiles and allow them to raise additional "ex post" funding contributions in the event the ex-ante contributions do not cover the losses, costs or other expenses incurred by use of the resolution fund. Although receipts from the UK bank levy are currently being used to meet the ex-ante and ex post funding requirements, the RBS Group may be required to make additional contributions in the future. In addition, RBS Group entities in countries subject to the European banking union are required to pay supervisory fees towards the funding of the SSM as well as contributions to the single resolution fund.

The new recovery and resolution regime implementing the BRRD in the UK replaces the previous regime and has imposed and is expected to impose in the near-to medium-term future, additional compliance and reporting obligations on the RBS Group, including the Group, which may result in increased costs, including as a result of the RBS Group's mandatory participation in resolution funds, and heightened compliance risks and the RBS Group may not be in a position to comply with all such requirements within the prescribed deadlines or at all.

Additional information

Risk factors continued

In addition, the PRA has adopted a new framework requiring financial institutions to ensure the continuity of critical shared services (provided by entities within the group or external providers) to facilitate recovery action, orderly resolution and post-resolution restructuring, which will apply from 1 January 2019.

The application of such rules to the RBS Group may require the RBS Group to restructure certain of its activities or reorganise the legal structure of its operations, may limit the RBS Group's ability to outsource certain functions and/or may result in increased costs resulting from the requirement to ensure the financial and operational resilience and independent governance of such critical services. Any such developments could have a material adverse impact on the Group.

In addition, compliance by the RBS Group with this new recovery and resolution framework has required and is expected to continue to require significant work and engagement with the RBS Group's regulators, including in order for the RBS Group to submit to the PRA credible recovery and resolution plans, the outcome of which may impact the operations or structure of the RBS Group or the Group. Such rules will need to be implemented consistently with the UK ring-fencing regime.

[The RBS Group may become subject to the application of stabilisation or resolution powers in certain significant stress situations, which may result in various actions being taken in relation to the RBS Group and any securities of the RBS Group, including the Group, including the write-off, write-down or conversion of the securities issued by the RBS Group or the Group.](#)

The Banking Act 2009, as amended to implement the BRRD (Banking Act) confers substantial powers on relevant UK authorities designed to enable them to take a range of actions in relation to UK banks or investment firms and certain of their affiliates in the event a bank or investment firm in the same group is considered to be failing or likely to fail. Under the Banking Act, wide powers are granted to the relevant resolution authorities, as appropriate as part of a special resolution regime (the SRR). These powers enable the relevant UK resolution authority to implement resolution measures with respect to a UK bank or investment firm and certain of its affiliates (including, for example, RBSG) (each a relevant entity) in circumstances in which the relevant UK resolution authority is satisfied that the resolution conditions are met.

Under the applicable regulatory framework and pursuant to guidance issued by the Bank of England, governmental capital support, if any is provided, would only be used as a last resort measure where a serious threat to financial stability cannot be avoided by other measures (such as the stabilisation options described below, including the UK bail-in power) and subject to the limitations set out in the Banking Act.

Several stabilisation options and tools are available to the relevant UK resolution authority under the SRR, where a resolution has been triggered. In addition, the UK resolution authority may commence special administration or liquidation procedures specifically applicable to banks.

Where stabilisation options are used which rely on the use of public funds, the option can only be used once there has been a contribution to loss absorption and recapitalisation of at least 8% of the total liabilities of the institution under resolution. The Bank of England has indicated that among these options, the UK bail-in tool (as described further below) would apply in the event a resolution of the RBS Group were triggered.

Further, the Banking Act grants broad powers to the UK resolution authority, the application of which may adversely affect contractual arrangements and which include the ability to (i) modify or cancel contractual arrangements to which an entity in resolution is party, in certain circumstances; (ii) suspend or override the enforcement provisions or termination rights that might be invoked by counterparties facing an entity in resolution, as a result of the exercise of the resolution powers; and (iii) disapply or modify laws in the UK (with possible retrospective effect) to enable the powers under the Banking Act to be used effectively.

The stabilisation options are intended to be applied prior to the point at which any insolvency proceedings with respect to the relevant entity would otherwise have been initiated. Accordingly, the stabilisation options may be exercised if the relevant UK resolution authority: (i) is satisfied that a UK bank or investment firm is failing, or is likely to fail; (ii) determines that it is not reasonably likely that (ignoring the stabilisation powers) action will be taken by or in respect of a UK bank or investment firm that will result in condition (i) above ceasing to be met; (iii) considers the exercise of the stabilisation powers to be necessary, having regard to certain public interest considerations (such as the stability of the UK financial system, public confidence in the UK banking system and the protection of depositors, being some of the special resolution objectives) and (iv) considers that the special resolution objectives would not be met to the same extent by the winding-up of the UK bank or investment firm.

Additional information

Risk factors continued

In the event that the relevant UK resolution authority seeks to exercise its powers in relation to a UK banking group company (such as RBSG), the relevant UK resolution authority has to be satisfied that (A) the conditions set out in (i) to (iv) above are met in respect of a UK bank or investment firm in the same banking group (or, in respect of an EEA or third country credit institution or investment firm in the same banking group, the relevant EEA or third country resolution authority is satisfied that the conditions for resolution applicable in its jurisdiction are met) and (B) certain criteria are met, such as the exercise of the powers in relation to such UK banking group company being necessary having regard to public interest considerations. The use of different stabilisation powers is also subject to further "specific conditions" that vary according to the relevant stabilisation power being used.

Although the SRR sets out the pre-conditions for determining whether an institution is failing or likely to fail, it is uncertain how the Bank of England would assess such conditions in any particular pre-insolvency scenario affecting RBSG and/or other members of the RBS Group (including the Bank) and in deciding whether to exercise a resolution power. Further regulatory developments, including proposals by the FSB on cross-border recognition of resolution actions, could also influence the conditions for the exercise of the stabilisation powers.

There has been no application of the SRR powers in the UK to a large financial institution, such as RBSG, to date, which could provide an indication of the relevant UK resolution authority's approach to the exercise of the resolution powers, and even if such examples existed, they may not be indicative of how such powers would be applied to RBSG. Therefore, holders of shares and other securities issued by RBS Group entities may not be able to anticipate a potential exercise of any such powers.

The UK bail-in tool is one of the powers available to the UK resolution authority under the SRR and was introduced under the Banking Reform Act 2013. The UK government amended the provisions of the Banking Act to ensure the consistency of these provisions with the bail-in provisions under the BRRD, which amendments came into effect on 1 January 2015. The UK bail-in tool includes both a power to write-down or convert capital instruments and triggered at the point of non-viability of a financial institution and a bail-in tool applicable to eligible liabilities (including senior unsecured debt securities issued by the RBS Group) and available in resolution.

The capital instruments write-down and conversion power may be exercised independently of, or in combination with, the exercise of a resolution tool, and it allows resolution authorities to cancel all or a portion of the principal amount of capital instruments and/or convert such capital instruments into common equity tier 1 instruments when an institution is no longer viable. The point of non-viability for such purposes is the point at which the Bank of England or the PRA determines that the institution meets the conditions for entry into the Special Resolution Regime as defined under the Banking Act or will no longer be viable unless the relevant capital instruments are written down or extraordinary public support is provided, and without such support the appropriate authority determines that the institution would no longer be viable.

Where the conditions for resolution exist and it is determined that a stabilisation power may be exercised, the Bank of England may use the bail-in tool (in combination with other resolution tools under the Banking Act) to, among other things, cancel or reduce all or a portion of the principal amount of, or interest on, certain unsecured liabilities of a failing financial institution and/or convert certain debt claims into another security, including ordinary shares of the surviving entity.

In addition, the Bank of England may use the bail-in tool to, among other things, replace or substitute the issuer as obligor in respect of debt instruments, modify the terms of debt instruments (including altering the maturity (if any) and/or the amount of interest payable and/or imposing a temporary suspension on payments) and discontinue the listing and admission to trading of financial instruments. The exercise of the bail-in tool will be determined by the Bank of England which will have discretion to determine whether the institution has reached a point of non-viability or whether the conditions for resolution are met, by application of the relevant provisions of the Banking Act, and involves decisions being taken by the PRA and the Bank of England, in consultation with the FCA and HM Treasury. As a result, it will be difficult to predict when, if at all, the exercise of the bail-in power may occur.

Additional information

Risk factors continued

The potential impact of these powers and their prospective use may include increased volatility in the market price of shares and other securities issued by the RBS Group entities, as well as increased difficulties for RBSG or other RBS Group entities in issuing securities in the capital markets and increased costs of raising such funds.

If these powers were to be exercised (or there is an increased risk of exercise) in respect of the RBS Group or any entity within the RBS Group (including the Bank) such exercise could result in a material adverse effect on the rights or interests of RBSG shareholders which would likely be extinguished or very heavily diluted. Holders of debt securities (which may include holders of RBSG senior unsecured debt), would see the conversion of part (or all) of their claims into equity or written down in part or written off entirely. In accordance with the rules of the Special Resolution Regime, the losses imposed on holders of equity and debt instruments through the exercise of bail-in powers would be subject to the "no creditor worse off" safeguard, which requires losses not to exceed those which would be realised in insolvency.

Although the above represents the risks associated with the UK bail-in power currently in force in the UK and applicable to the RBS Group, changes to the scope of, or conditions for the exercise of the UK bail-in power may be introduced as a result of further political or regulatory developments. In addition, further political, legal or strategic developments may lead to structural changes to the RBS Group, including at the holding company level. Notwithstanding any such changes, the RBS Group expects that its securities would remain subject to the exercise of a form of bail-in power, either pursuant to the provisions of the Banking Act, the BRRD or otherwise.

In the UK and in other jurisdictions, the RBS Group and the Group are responsible for contributing to compensation schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers.

In the UK, the Financial Services Compensation Scheme (FSCS) was established under the Financial Services and Markets Act 2000 and is the UK's statutory fund of last resort for customers of authorised financial services firms. The FSCS pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising levies on the industry, including the RBS Group and the Group. In relation to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits.

In the event that the FSCS needs to raise additional and unexpected funding, is required to raise funds more frequently or significantly increases the levies to be paid by authorised firms, the associated costs to the RBS Group or the Group may have an adverse impact on the RBS Group's and/or the Group's results of operations and financial condition. For example, the deposit protection limit increased by £10,000 to £85,000 effective from 30 January 2017, which will result in an increase to the RBS Group's FSCS levies.

To the extent that other jurisdictions where the RBS Group operates have introduced or plan to introduce similar compensation, contributory or reimbursement schemes, the RBS Group may make further provisions and may incur additional costs and liabilities, which may have an adverse impact on the RBS Group's and/or the Group's financial condition and results of operations.

The Group's results could be adversely affected in the event of goodwill impairment.

The Group capitalises goodwill, which is calculated as the excess of the cost of an acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Acquired goodwill is recognised initially at cost and subsequently at cost less any accumulated impairment losses. As required by IFRS Standards, the Group tests goodwill for impairment annually, or more frequently when events or circumstances indicate that it might be impaired. An impairment test involves comparing the recoverable amount (the higher of the value in use and fair value less cost to sell) of an individual cash generating unit with its carrying value.

At 31 December 2016, the Group carried goodwill of £5.2 billion on its balance sheet. The value in use and fair value of the Group's cash-generating units are affected by market conditions and the performance of the economies in which the Group operates.

Where the Group is required to recognise a goodwill impairment, it is recorded in the Group's income statement, but it has no effect on the Group's regulatory capital position. Further impairments of the Group's goodwill could have an adverse effect on the Group's results and financial condition.

Additional information

Risk factors continued

Recent and anticipated changes in the tax legislation in the UK are likely to result in increased tax payments by the Group and may impact the recoverability of certain deferred tax assets recognised by the Group.

In accordance with IFRS Standards, the Group has recognised deferred tax assets on losses available to relieve future profits from tax only to the extent it is probable that they will be recovered. The deferred tax assets are quantified on the basis of current tax legislation and accounting standards and are subject to change in respect of the future rates of tax or the rules for computing taxable profits and offsetting allowable losses.

In the UK, legislation has been introduced over the past few years which seeks to impose restrictions on the use of certain brought forward tax losses of banking companies. This has impacted and will continue to impact the extent to which the RBS Group is able to recognise deferred tax assets. Failure to generate sufficient future taxable profits or further changes in tax legislation (including rates of tax) or accounting standards may reduce the recoverable amount of the recognised deferred tax assets.

Further changes to the treatment of deferred tax assets may impact the Group's capital, for example by reducing further the Group's ability to recognise deferred tax assets. The implementation of the rules relating to the UK ring-fencing regime and the resulting restructuring of the RBS Group may further restrict the Group's ability to recognise tax deferred tax assets in respect of brought forward losses.

Abbreviations and acronyms

ABS	Asset-backed securities	ILAAP	Internal Liquidity Adequacy Assessment Process
AFS	Available-for-sale		
ALCo	Asset and Liability Management Committee	IPV	Independent price verification
AQ	Asset quality	IRC	Incremental risk charge
AT1	Additional Tier 1	IRHP	Interest rate hedging product
BCBS	Basel Committee on Banking Supervision	L-SREP	Liquidity Supervisory Review and Evaluation Process
BoE	Bank of England		
C&RA	Conduct & Regulatory Affairs	LAR	Loans and receivables
CDO	Collateralised debt obligation	LCR	Liquidity coverage ratio
CDS	Credit default swap	LIBOR	London Interbank Offered Rate
CEC	Control Environment Certification	LGD	Loss given default
CET1	Common equity tier 1	LTi	Long term incentive awards
CFG	Citizens Financial Group Inc.	LTV	Loan-to-value
CIB	Corporate & Institutional Banking	MDA	Maximum distributable amount
CLO	Collateralised loan obligation	MREL	Minimum requirement for own funds and eligible liabilities
CMBS	Commercial mortgage-backed securities		
CPB	Commercial & Private Banking	MRM	Model risk management
CRD	Capital Requirements Directive	NI	Northern Ireland
CRE	Commercial real estate	NSFR	Net stable funding ratio
CVA	Credit valuation adjustment	NTIRR	Non-traded interest rate risk
DFV	Designated as at fair value through profit or loss	NWM	NatWest Markets
		PBB	Personal & Business Banking
DVA	Debit valuation adjustment	PD	Probability of default
EAD	Exposure at default	PPI	Payment Protection Insurance
EBA	European Banking Authority	PRA	Prudential Regulation Authority
EC	European Commission	RBSG	The Royal Bank of Scotland Group plc
ECB	European Central Bank	RCR	RBS Capital Resolution
ECL	Expected credit losses	REIL	Risk elements in lending
EMEA	Europe, the Middle East and Africa	RFB	Ring-fenced Banking
ERF	Executive Risk Forum	RFS	RFS Holdings B.V.
EU	European Union	RMBS	Residential mortgage-backed securities
FCA	Financial Conduct Authority	RNIV	Risks not In VaR
FI	Financial institution	ROI	Republic of Ireland
FSA	Financial Services Authority	RoW	Rest of the World
FSB	Financial Stability Board	RWA	Risk-weighted asset
FSCS	Financial Services Compensation Scheme	SE	Structured entity
FVTPL	Fair value through profit or loss	SEC	US Securities and Exchange Commission
GDP	Gross domestic product	SME	Small and medium-sized enterprise
GSIB	Global systemically important bank	SVaR	Stressed value-at-risk
HFT	Held-for-trading	TLAC	Total loss absorbing capacity
HMT	HM Treasury	UBI DAC	Ulster Bank Ireland Designated Activity Company
HTM	Held-to-maturity		
IAS	International Accounting Standards	UK	United Kingdom
IASB	International Accounting Standards Board	UKFI	UK Financial Investments Limited
ICAAP	Internal Capital Adequacy Assessment Process	US/USA	United States of America
		VaR	Value-at-risk
IFRS	International Financial Reporting Standards		

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

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

Glossary of terms

Arrears - the aggregate of contractual payments due on a debt that have not been met by the borrower. A loan or other financial asset is said to be 'in arrears' when payments have not been made.

Asset-backed commercial paper (ABCP) - a form of asset-backed security generally issued by a commercial paper conduit.

Asset-backed securities (ABS) - securities that represent interests in specific portfolios of assets. They are issued by a structured entity following a securitisation. The underlying portfolios commonly comprise residential or commercial mortgages but can include any class of asset that yields predictable cash flows. Payments on the securities depend primarily on the cash flows generated by the assets in the underlying pool and other rights designed to assure timely payment, such as guarantees or other credit enhancements. Collateralised debt obligations, collateralised loan obligations, commercial mortgage backed securities and residential mortgage backed securities are all types of ABS.

Asset quality (AQ) band - probability of default banding for all counterparties on a scale of 1 to 10.

Assets under management - assets managed by the Group on behalf of clients.

Back-testing - statistical techniques that assess the performance of a model, and how that model would have performed had it been applied in the past.

Basel II - the capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the 'International Convergence of Capital Measurement and Capital Standards'.

Basel III - in December 2010, the Basel Committee on Banking Supervision issued final rules: 'Basel III: A global regulatory framework for more resilient banks and banking systems' and 'Basel III: International framework for liquidity risk measurement, standards and monitoring'.

Basis point - one hundredth of a per cent i.e. 0.01 per cent. 100 basis points is 1 per cent. Used when quoting movements in interest rates or yields on securities.

Buy-to-let mortgages - mortgages to customers for the purchase of residential property as a rental investment.

Capital requirements regulation (CRR) - refer to CRD IV.

Central counterparty (CCP) - an intermediary between a buyer and a seller (generally a clearing house).

Certificates of deposit (CDs) - bearer negotiable instruments acknowledging the receipt of a fixed term deposit at a specified interest rate.

Collateralised debt obligations (CDOs) - asset-backed securities for which the underlying asset portfolios are debt obligations: either bonds (collateralised bond obligations) or loans (collateralised loan obligations) or both. The credit exposure underlying synthetic CDOs derives from credit default swaps. The CDOs issued by an individual vehicle are usually divided in different tranches: senior tranches (rated AAA), mezzanine tranches (AA to BB), and equity tranches (unrated). Losses are borne first by the equity securities, next by the junior securities, and finally by the senior securities; junior tranches offer higher coupons (interest payments) to compensate for their increased risk.

Collateralised loan obligations (CLOs) - asset-backed securities for which the underlying asset portfolios are loans, often leveraged loans.

Collectively assessed loan impairment provisions - impairment loss provisions in respect of impaired loans, such as credit cards or personal loans, that are below individual assessment thresholds. Such provisions are established on a portfolio basis, taking account of the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends.

Commercial mortgage backed securities (CMBS) - asset-backed securities for which the underlying asset portfolios are loans secured on commercial real estate.

Commercial paper (CP) - unsecured obligations issued by a corporate or a bank directly or secured obligations (asset-backed CP), often issued through a commercial paper conduit, to fund working capital. Maturities typically range from two to 270 days. However, the depth and reliability of some CP markets means that issuers can repeatedly roll over CP issuance and effectively achieve longer term funding. CP is issued in a wide range of denominations and can be either discounted or interest-bearing.

Commercial paper conduit - a structured entity that issues commercial paper and uses the proceeds to purchase or fund a pool of assets. The commercial paper is secured on the assets and is redeemed either by further commercial paper issuance, repayment of assets or liquidity drawings.

Commercial real estate - freehold and leasehold properties used for business activities. Commercial real estate includes office buildings, industrial property, medical centres, hotels, retail stores, shopping centres, agricultural land and buildings, warehouses, garages etc.

Common Equity Tier 1 capital - the highest quality form of regulatory capital under Basel III comprising common shares issued and related share premium, retained earnings and other reserves excluding reserves which are restricted or not immediately available, less specified regulatory adjustments.

Contractual maturity - the date in the terms of a financial instrument on which the last payment or receipt under the contract is due for settlement.

Glossary of terms

Cost:income ratio - operating expenses as a percentage of total income.

Counterparty credit risk - the risk that a counterparty defaults before the maturity of a derivative or sale and repurchase contract. In contrast to non-counterparty credit risk, the exposure to counterparty credit risk varies by reference to a market factor (e.g. interest rate, exchange rate, asset price).

Coverage ratio - impairment provisions as a percentage of impaired loans.

Covered bonds - debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds.

CRD IV - the European Union has implemented the Basel III capital proposals through the CRR and the CRD, collectively known as CRD IV. CRD IV was implemented on 1 January 2014. The EBA's technical standards are still to be finalised through adoption by the European Commission and implemented within the UK.

Credit default swap (CDS) - a contract where the protection seller receives premium or interest-related payments in return for contracting to make payments to the protection buyer upon a defined credit event in relation to a reference financial asset or portfolio of financial assets. Credit events usually include bankruptcy, payment default and rating downgrades.

Credit derivative product company (CDPC) - a structured entity that sells credit protection under credit default swaps or certain approved forms of insurance policies. CDPCs are similar to monoline insurers. However, unlike monoline insurers, they are not regulated as insurers.

Credit derivatives - contractual agreements that provide protection against a credit event on one or more reference entities or financial assets. The nature of a credit event is established by the protection buyer and protection seller at the inception of a transaction, and such events include bankruptcy, insolvency or failure to meet payment obligations when due. The buyer of the credit derivative pays a periodic fee in return for a payment by the protection seller upon the occurrence of a credit event. Credit derivatives include credit default swaps, total return swaps and credit swap options.

Credit enhancements - techniques that improve the credit standing of financial obligations; generally those issued by a structured entity in a securitisation. External credit enhancements include financial guarantees and letters of credit from third party providers. Internal enhancements include excess spread - the difference between the interest rate received on the underlying portfolio and the coupon on the issued securities; and over-collateralisation - at inception, the value of the underlying portfolio is greater than the securities issued.

Credit grade - a rating that represents an assessment of the creditworthiness of a customer. It is a point on a scale representing the probability of default of a customer.

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

Credit risk mitigation - reducing the credit risk of an exposure by application of techniques such as netting, collateral, guarantees and credit derivatives.

Credit valuation adjustment (CVA) - the CVA is the difference between the risk-free value of a portfolio of trades and its market value, taking into account the counterparty's risk of default. It represents the market value of counterparty credit risk, or an estimate of the adjustment to fair value that a market participant would make to reflect the creditworthiness of its counterparty.

Currency swap - an arrangement in which two parties exchange specific principal amounts of different currencies at inception and subsequently interest payments on the principal amounts. Often, one party will pay a fixed rate of interest, while the other will pay a floating rate (though there are also fixed-fixed and floating-floating currency swaps). At the maturity of the swap, the principal amounts are usually re-exchanged.

Customer accounts - money deposited with the Group by counterparties other than banks and classified as liabilities. They include demand, savings and time deposits; securities sold under repurchase agreements; and other short term deposits. Deposits received from banks are classified as deposits by banks.

Debit valuation adjustment (DVA) - an adjustment made in valuing OTC derivative liabilities to reflect the entity's own credit risk.

Debt securities - transferable instruments creating or acknowledging indebtedness. They include debentures, bonds, certificates of deposit, notes and commercial paper. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue, such as the right to receive certain information. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured or unsecured.

Debt securities in issue - unsubordinated debt securities issued by the Group. They include commercial paper, certificates of deposit, bonds and medium-term notes.

Deferred tax asset - income taxes recoverable in future periods as a result of deductible temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in tax deductible amounts in future periods) and the carry-forward of tax losses and unused tax credits.

Deferred tax liability - income taxes payable in future periods as a result of taxable temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in taxable amounts in future periods).

Defined benefit obligation - the present value of expected future payments required to settle the obligations of a defined benefit plan resulting from employee service.

Glossary of terms

Defined benefit plan/scheme - pension or other post-retirement benefit plan other than a defined contribution plan.

Defined contribution plan/scheme - pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.

Deposits by banks - money deposited with the Group by banks and recorded as liabilities. They include money-market deposits, securities sold under repurchase agreements, federal funds purchased and other short term deposits. Deposits received from customers are recorded as customer accounts.

Derivative - a contract or agreement whose value changes with changes in an underlying variable such as interest rates, foreign exchange rates, share prices or indices and which requires no initial investment or an initial investment that is smaller than would be required for other types of contracts with a similar response to market factors. The principal types of derivatives are: swaps, forwards, futures and options.

Discontinued operation - a component of the Group that either has been disposed of or is classified as held for sale. A discontinued operation is either: a separate major line of business or geographical area of operations or part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or a subsidiary acquired exclusively with a view to resale.

Economic capital - an internal measure of the capital required by the Group to support the risks to which it is exposed.

Economic profit - the difference between the return on shareholders funds and the cost of that capital. Economic profit is usually expressed as a percentage.

Effective interest rate method - the effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees payable or receivable that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows.

Encumbrance - an interest in an asset held by another party. Encumbrance usually restricts the asset's transferability until the encumbrance is removed.

Equity risk - the risk of changes in the market price of the equities or equity instruments arising from positions, either long or short, in equities or equity-based financial instruments.

Eurozone - the 19 European Union countries that have adopted the euro: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

Expected credit loss (ECL, an IFRS 9 accounting measure) – generally is the weighted average of credit losses; for collectively assessed portfolios it is the product of the exposure, probability of default at the reporting date and the lifetime loss given default. At initial recognition of a financial asset, an allowance is made for the 12 month expected credit loss, using the probability of default in the first 12 months only. On a significant increase in credit risk, the expected credit loss is increased to the lifetime probability of default. ECL is applied to exposures to all financial assets and contractual facilities whose performance is not recognised at fair value in the income statement.

Expected loss (EL, a regulatory measure) – is the product of the regulatory credit exposure, the probability of default over the next 12 months, averaged through an economic cycle, and the downturn loss given default. It is applied to exposures whether performance is recognised in income or reserves. Credit exposures include all financial assets, customer facilities and are subject to regulatory overlays.

Exposure - a claim, contingent claim or position which carries a risk of financial loss.

Exposure at default (EAD) - an estimate of the extent to which the bank will be exposed under a specific facility, in the event of the default of a counterparty.

FICO score - a credit score calculated using proprietary software developed by the Fair Isaac Corporation in the US from a consumer's credit profile. The scores range between 300 and 850 and are used in credit decisions made by banks and other providers of credit.

Financial Conduct Authority (FCA) - the statutory body responsible for conduct of business regulation and supervision of UK authorised firms from 1 April 2013. The FCA also has responsibility for the prudential regulation of firms that do not fall within the PRA's scope.

Financial Services Compensation Scheme (FSCS) - the UK's statutory fund of last resort for customers of authorised financial services firms. It pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the financial services industry.

First/second lien - a lien is a charge such as a mortgage held by one party, over property owned by a second party, as security for payment of some debt, obligation, or duty owed by that second party. The holder of a first lien takes precedence over all other encumbrances on that property i.e. second and subsequent liens.

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

Forward contract - a contract to buy (or sell) a specified amount of a physical or financial commodity, at an agreed price, at an agreed future date.

Glossary of terms

Futures contract - a contract which provides for the future delivery (or acceptance of delivery) of some type of financial instrument or commodity under terms established at the outset. Futures differ from forward contracts in that they are standardised and traded on recognised exchanges and rarely result in actual delivery; most contracts are closed out prior to maturity by acquisition of an offsetting position.

G10 - the Group of Ten comprises the eleven industrial countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States) that have agreed to participate in the International Monetary Fund's (IMF's) General Arrangements to Borrow.

Government Sponsored Enterprises (GSEs) - a group of financial services corporations created by the US Congress. Their function is to improve the efficiency of capital markets and to overcome statutory and other market imperfections which otherwise prevent funds from moving easily from suppliers of funds to areas of high loan demand. They include the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association.

Gross yield - the interest rate earned on average interest-earning assets i.e. interest income divided by average interest-earning assets.

Haircut - a downward adjustment to collateral value to reflect its nature and any currency or maturity mismatches between the collateral and the exposure it secures.

Hedge funds - pooled investment vehicles that are not widely available to the public; their assets are managed by professional asset managers who participate in the performance of the fund.

Impaired loans - all loans for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans.

Impairment allowance - refer to Loan impairment provisions.

Impairment losses - (a) for impaired financial assets measured at amortised cost, impairment losses - the difference between carrying value and the present value of estimated future cash flows discounted at the asset's original effective interest rate - are recognised in profit or loss and the carrying amount of the financial asset reduced by establishing a provision (allowance) (b) for impaired available-for-sale financial assets, the cumulative loss that had been recognised directly in equity is removed from equity and recognised in profit or loss as an impairment loss.

Individual liquidity guidance (ILG) - guidance from the PRA on a firm's required quantity of liquidity resources and funding profile.

Individually assessed loan impairment provisions - impairment loss provisions for individually significant impaired loans assessed on a case-by-case basis, taking into account the financial condition of the counterparty and any guarantor and the realisable value of any collateral held.

Interest rate swap - a contract under which two counterparties agree to exchange periodic interest payments on a predetermined monetary principal, the notional amount.

Interest spread - the difference between the gross yield and the interest rate paid on average interest-bearing liabilities.

Internal Capital Adequacy Assessment Process (ICAAP) - the Group's own assessment, as part of Basel III requirements, of its risks, how it intends to mitigate those risks and how much current and future capital is necessary having considered other mitigating factors.

Internal funding of trading business - the internal funding of the trading book comprises net banking book financial liabilities that fund financial assets in the Group's trading portfolios. Interest payable on these financial liabilities is charged to the trading book.

Internal Liquidity Adequacy Assessment Process (ILAAP) an ongoing exercise as part of the PRA's regulatory framework to comply with best practice and regulatory standards for liquidity management.

International Accounting Standards Board (IASB) - the independent standard-setting body of the IFRS Foundation. Its members are responsible for the development and publication of International Financial Reporting Standards (IFRSs) and for approving Interpretations of IFRS as developed by the IFRS Interpretations Committee.

International Swaps and Derivatives Association (ISDA) master agreement - a standardised contract developed by ISDA for bilateral derivatives transactions. The contract grants legal rights of set-off for derivative transactions with the same counterparty.

Investment grade - generally represents a risk profile similar to a rating of BBB-/Baa3 or better, as defined by independent rating agencies.

Key management - members of the RBS Group Executive Committee.

L-SREP - An annual Liquidity Supervisory Review and Evaluation Process with the PRA, that involves a comprehensive review of the RBS ILAAP, liquidity policies and risk management framework.

Latent loss provisions - loan impairment provisions held against impairments in the performing loan portfolio that have been incurred as a result of events occurring before the balance sheet date but which have not been identified at the balance sheet date.

Level 1 - level 1 fair value measurements are derived from quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

Level 2 - level 2 fair value measurements use inputs, other than quoted prices included within level 1, that are observable for the asset or liability, either directly or indirectly.

Level 3 - level 3 fair value measurements use one or more unobservable inputs for the asset or liability.

Glossary of terms

Leverage ratio - a measure prescribed under Basel III. It is the ratio of Tier 1 capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives, and generally follow the accounting measure of exposure.

Liquidity and funding risk - the risk that the Group is unable to meet its financial liabilities when they fall due.

Liquidity coverage ratio (LCR) - the ratio of the stock of high quality liquid assets to expected net cash outflows over the following 30 days. High quality liquid assets should be unencumbered, liquid in markets during a time of stress and, ideally, central bank eligible.

Loan:deposit ratio - the ratio of loans and advances to customers net of provision for impairment losses and excluding reverse repurchase agreements to customer deposits excluding repurchase agreements.

Loan impairment provisions - loan impairment provisions are established to recognise incurred impairment losses on a portfolio of loans classified as loans and receivables and carried at amortised cost. It has three components: individually assessed loan impairment provisions, collectively assessed loan impairment provisions and latent loss provisions.

Loan-to-value ratio - the amount of a secured loan as a percentage of the appraised value of the security e.g. the outstanding amount of a mortgage loan as a percentage of the property's value.

London Interbank Offered Rate (LIBOR) - the benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.

Loss given default (LGD) - an estimate of the amount that will not be recovered by the Group in the event of default, plus the cost of debt collection activities and the delay in cash recovery.

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

Master netting agreement - an agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.

Maximum distributable amount (MDA) - a restriction on distributions which may be made by a bank which does not meet the combined buffer requirements as set out in the PRA Supervisory Statement SS6/14 'Implementing CRD IV: capital buffers'.

Medium term notes (MTNs) - debt securities usually with a maturity of five to ten years, but the term may be less than one year or as long as 50 years. They can be issued on a fixed or floating coupon basis or with an exotic coupon; with a fixed maturity date (non-callable) or with embedded call or put options or early repayment triggers. MTNs are generally issued as senior unsecured debt.

Minimum requirement for own funds and eligible liabilities (MREL) - Tier 1 and Tier 2 capital plus specific loss absorbing instruments, including senior notes, that may be used to cover certain gone concern requirements in the EU.

Monoline insurers (monolines) - entities that specialise in providing credit protection against the notional and interest cash flows due to the holders of debt instruments in the event of default. This protection is typically in the form of derivatives such as credit default swaps.

Model Risk Management - performs independent model validation for material models where necessary.

Mortgage-backed securities - asset-backed securities for which the underlying asset portfolios are loans secured on property. See Residential mortgage backed securities and Commercial mortgage backed securities.

Mortgage servicing rights - the rights of a mortgage servicer to collect mortgage payments and forward them, after deducting a fee, to the mortgage lender.

Net interest income - the difference between interest receivable on financial assets classified as loans and receivables or available-for-sale and interest payable on financial liabilities carried at amortised cost.

Net interest margin - net interest income as a percentage of average interest-earning assets.

Net stable funding ratio (NSFR) - the ratio of available stable funding to required stable funding over a one year time horizon, assuming a stressed scenario. Available stable funding includes items such as equity capital, preferred stock with a maturity of over one year and liabilities with an assessed maturity of over one year.

Non-performing loans - loans classified as Risk elements in lending and potential problem loans. They have a 100% probability of default and have been assigned an AQ10 internal credit grade.

Operational risk - the risk of loss resulting from inadequate or failed processes, people, systems or from external events.

Option - an option is a contract that gives the holder the right but not the obligation to buy (or sell) a specified amount of an underlying physical or financial commodity, at a specific price, at an agreed date or over an agreed period. Options can be exchange-traded or traded over-the-counter.

Over-the-counter (OTC) derivatives - derivatives with tailored terms and conditions negotiated bilaterally, in contrast to exchange traded derivatives that have standardised terms and conditions.

Own credit adjustment (OCA) - the effect of the Group's own credit standing on the fair value of financial liabilities.

Past due - a financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.

Glossary of terms

Pillar 1 - the part of CRD IV that sets out the process by which regulatory capital requirements should be calculated for credit, market and operational risk.

Pillar 2 - Pillar 2 is intended to ensure that firms have adequate capital to support all the relevant risks in their business and is divided into capital held against risks not captured or not fully captured by the Pillar 1 regulations (Pillar 2A) and risks to which a firm may become exposed over a forward-looking planning horizon (Pillar 2B). Capital held under Pillar 2A, in addition to the Pillar 1 requirements, is the minimum level of regulatory capital a bank should maintain at all times to cover adequately the risks to which it is or might be exposed, and to comply with the overall financial adequacy rules. Pillar 2B is a capital buffer which helps to ensure that a bank can continue to meet minimum requirements during a stressed period, and is determined by the PRA evaluating the risks to which the firm may become exposed (e.g. due to changes to the economic environment) during the supervisory review and evaluation process. All firms will be subject to a PRA buffer assessment and the PRA will set a PRA buffer only if it judges that the CRD IV buffers are inadequate for a particular firm given its vulnerability in a stress scenario, or where the PRA has identified risk management and governance failings, which the CRD IV buffers are not intended to address.

Pillar 3 - the part of CRD IV that sets out the information banks must disclose about their risks, the amount of capital required to absorb them, and their approach to risk management. The aim is to strengthen market discipline.

Potential future exposure - is a measure of counterparty risk/credit risk. It is calculated by evaluating existing trades done against the possible market prices in future during the lifetime of the transactions.

Potential problem loans (PPL) - loans for which an impairment event has taken place but no impairment loss is expected. This category is used for advances which are not past due 90 days or revolving credit facilities where identification as 90 days overdue is not feasible.

PRA Rule Book - contains provisions made by the PRA that apply to PRA authorised firms. Within 'Banking and Investment Rules', the Capital Requirements firms' section applies to the Group.

Private equity - equity investments in operating companies not quoted on a public exchange. Capital for private equity investment is raised from retail or institutional investors and used to fund investment strategies such as leveraged buyouts, venture capital, growth capital, distressed investments and mezzanine capital.

Probability of default (PD) - the likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon.

Prudential Regulation Authority (PRA) - the statutory body responsible for the prudential supervision of banks, building societies, insurers and a small number of significant investment firms in the UK. The PRA is a subsidiary of the Bank of England.

Regular way purchase or sale - a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.

Regulatory capital - the amount of capital that the Group holds, determined in accordance with rules established by the PRA for the consolidated Group and by local regulators for individual Group companies.

Repurchase agreement (Repo) - refer to Sale and repurchase agreements.

Residential mortgage - a loan to purchase a residential property where the property forms collateral for the loan. The borrower gives the lender a lien against the property and the lender can foreclose on the property if the borrower does not repay the loan per the agreed terms. Also known as a home loan.

Residential mortgage backed securities (RMBS) - asset-backed securities for which the underlying asset portfolios are residential mortgages. RBS Group RMBS classifications, including prime, non-conforming and sub-prime, reflect the characteristics of the underlying mortgage portfolios. RMBS are classified as prime RMBS where the loans have low default risk and are made to borrowers with good credit records and reliable payment histories and there is full documentation. Non-conforming RMBS include US Alt-A RMBS, together with RMBS in jurisdictions other than the US where the underlying mortgages are not classified as either prime or sub-prime. Classification of RMBS as subprime or Alt-A is based on Fair Isaac Corporation (FICO) scores, level of documentation and loan-to-value ratios of the underlying mortgage loans. US RMBS are classified as sub-prime if the mortgage portfolio comprises loans with FICO scores between 500 and 650 with full or limited documentation. Mortgages in Alt-A RMBS portfolios have FICO scores of 640 to 720, limited documentation and an original LTV of 70% to 100%. In other jurisdictions, RMBS are classified as sub-prime if the mortgage portfolio comprises loans with one or more high risk characteristics such as: unreliable or poor payment histories; high loan-to-value ratios; high debt-to-income ratio; the loan is not secured on the borrower's primary residence; or a history of delinquencies or late payments on the loan.

Retail loans - loans made to individuals rather than institutions. The loans may be for car purchases, home purchases, medical care, home repair, holidays and other consumer uses.

Return on equity - profit attributable to ordinary shareholders divided by average shareholders' equity as a percentage.

Reverse repurchase agreement (Reverse repo) - refer to Sale and repurchase agreements.

Risk appetite - an expression of the maximum level of risk that the Group is prepared to accept to deliver its business objectives.

Risk asset ratio (RAR) - total regulatory capital as a percentage of risk-weighted assets.

Glossary of terms

Risk elements in lending (REIL) - impaired loans and accruing loans which are contractually overdue 90 days or more as to principal or interest.

Risk-weighted assets (RWAs) - assets adjusted for their associated risks using weightings established in accordance with the CRD IV as implemented by the PRA. Certain assets are not weighted but deducted from capital.

Sale and repurchase agreements - in a sale and repurchase agreement one party, the seller, sells a financial asset to another party, the buyer, at the same time the seller agrees to reacquire and the buyer to resell the asset at a later date. From the seller's perspective such agreements are repurchase agreements (repos) and from the buyer's reverse repurchase agreements (reverse repos).

Securitisation - a process by which assets or cash flows are transformed into transferable securities. The underlying assets or cash flows are transferred by the originator or an intermediary, typically an investment bank, to a structured entity which issues securities to investors. Asset securitisations involve issuing debt securities (asset-backed securities) that are backed by the cash flows of income-generating assets (ranging from credit card receivables to residential mortgage loans).

Settlement balances - payables and receivables that result from purchases and sales of financial instruments recognised on trade date. Asset settlement balances are amounts owed to the Group in respect of sales and liability settlement balances are amounts owed by the Group in respect of purchases.

Sovereign exposures - exposures to governments, ministries, departments of governments and central banks.

Standardised approach - a method used to calculate credit risk capital requirements under Pillar 1. In this approach the risk weights used in the capital calculation are determined by regulators. For operational risk, capital requirements are determined by multiplying three years' historical gross income by a percentage determined by the regulator. The percentage ranges from 12 to 18%, depending on the type of underlying business being considered.

Standstill - is an agreement, usually for a specified period of time, not to enforce the lender's rights as a result of a customer breaching the terms and conditions of their facilities. This is a concession to the customer. A standstill is most commonly used in a complex restructuring of a company's debts, where a group of creditors agree to delay enforcement action to give the company time to gather information and formulate a strategy with a view to establishing a formal restructuring.

Stress testing - a technique used to evaluate the potential effects on an institution's financial condition of an exceptional but plausible event and/or movement in a set of financial variables.

Stressed value-at-risk (SVaR) - a VaR measure using historical data from a one year period of stressed market conditions. For the purposes of calculating regulatory SVaR, a time horizon of ten trading days is assumed at a confidence level of 99%. Refer also to Value-at-risk below.

Structured credit portfolio (SCP) - a portfolio of certain illiquid assets - principally CDO super senior positions, negative basis trades and monoline exposures.

Structured entity (SE) - an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose, they do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions.

Structured notes - securities that pay a return linked to the value or level of a specified asset or index. Structured notes can be linked to equities, interest rates, funds, commodities and foreign currency.

Subordinated liabilities - liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.

Super senior CDO - the most senior class of instrument issued by a CDO vehicle. They benefit from the subordination of all other instruments, including AAA rated securities, issued by the CDO vehicle.

Tier 1 capital - a component of regulatory capital, comprising Common Equity Tier 1 and Additional Tier 1. Additional Tier 1 capital includes eligible non-common equity capital securities and any related share premium. Under Basel II, Tier 1 capital comprises Core Tier 1 capital plus other Tier 1 securities in issue, less certain regulatory deductions.

Tier 2 capital - qualifying subordinated debt and other Tier 2 securities in issue, eligible collective impairment allowances less certain regulatory deductions.

Total loss absorbing capacity (TLAC) - a Financial Stability Board requirement for global systemically important banks to have a sufficient amount of specific types of liabilities which can be used to absorb losses and recapitalise a bank in resolution. The implementation of the TLAC requirements is being discussed within local regulators.

Unaudited - financial information that has not been subjected to the audit procedures undertaken by the Group's auditors to enable them to express an opinion on the Group's financial statements.

US Federal Agencies - are independent bodies established by the US Government for specific purposes such as the management of natural resources, financial oversight or national security. A number of agencies, including, the Government National Mortgage Association, issue or guarantee publicly traded debt securities.

Value-at-risk (VaR) - a technique that produces estimates of the potential loss in the market value of a portfolio over a specified time period at a given confidence level.

Wholesale funding - wholesale funding comprises Deposits by banks, Debt securities in issue and Subordinated liabilities.

Write-down - a reduction in the carrying value of an asset to record a decline in its fair value or value in use.

Forward-looking statements

Cautionary statement regarding forward-looking statements

Certain sections in this document contain 'forward-looking statements' as that term is defined in the United States Private Securities Litigation Reform Act of 1995, such as statements that include the words 'expect', 'estimate', 'project', 'anticipate', 'commit', 'believe', 'should', 'intend', 'plan', 'could', 'probability', 'risk', 'Value-at-Risk (VaR)', 'target', 'goal', 'objective', 'may', 'endeavour', 'outlook', 'optimistic', 'prospects' and similar expressions or variations on these expressions.

In particular, this document includes forward-looking statements relating, but not limited to: future profitability and performance, including financial performance targets such as return on tangible equity; cost savings and targets, including cost:income ratios; litigation and government and regulatory investigations, including the timing and financial and other impacts thereof; structural reform and the implementation of the UK ring-fencing regime; the implementation of RBSG's transformation programme, including the further restructuring of the NatWest Markets business; the satisfaction of RBSG's residual EU State Aid obligations; the continuation of RBSG's and the Group's balance sheet reduction programme, including the reduction of risk-weighted assets (RWAs) and the timing thereof; capital and strategic plans and targets; capital, liquidity and leverage ratios and requirements, including CET1 Ratio, RWA equivalents (RWAE), Pillar 2 and other regulatory buffer requirements, minimum requirement for own funds and eligible liabilities, and other funding plans; funding and credit risk profile; capitalisation; portfolios; net interest margin; customer loan and income growth; the level and extent of future impairments and write-downs, including with respect to goodwill; restructuring and remediation costs and charges; future pension contributions; and RBSG's and the Group's exposure to political risks, operational risk, conduct risk, cyber and IT risk and credit rating risk and to various types of market risks, including as interest rate risk, foreign exchange rate risk and commodity and equity price risk; customer experience including our Net Promoter Score (NPS); employee engagement and gender balance in leadership positions.

Limitations inherent to forward-looking statements

These statements are based on current plans, estimates, targets and projections, and are subject to significant inherent risks, uncertainties and other factors, both external and relating to the RBS Group and the Group's strategy or operations, which may result in the Group being unable to achieve the current targets, predictions, expectations and other anticipated outcomes expressed or implied by such forward-looking statements. In addition certain of these disclosures are dependent on choices relying on key model characteristics and assumptions and are subject to various limitations, including assumptions and estimates made by management. By their nature, certain of these disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated. Accordingly, undue reliance should not be placed on these statements. Forward-looking statements speak only as of the date we make them and we expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the RBSG's or the Group's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Important factors that could affect the actual outcome of the forward-looking statements

We caution you that a large number of important factors could adversely affect our results or our ability to implement our strategy, cause us to fail to meet our targets, predictions, expectations and other anticipated outcomes or affect the accuracy of forward-looking statements we describe in this document including in the risk factors set out in the Group's 2016 Annual Report and other uncertainties discussed in this document. These include the significant risks for RBSG and the Group presented by the outcomes of the legal, regulatory and governmental actions and investigations that RBSG and the Group are or may be subject to (including active civil and criminal investigations) and any resulting material adverse effect on RBSG and the Group of unfavourable outcomes and the timing thereof (including where resolved by settlement); economic, regulatory and political risks, including as may result from the uncertainty arising from the EU Referendum; RBSG's ability to satisfy its residual EU State Aid obligations and the timing thereof; RBSG's ability to successfully implement the significant and complex restructuring required to be undertaken in order to implement the UK ring fencing regime and related costs; RBSG's ability to successfully implement the various initiatives that are comprised in its transformation programme, particularly the proposed further restructuring of the NatWest Markets business, the balance sheet reduction programme and its significant cost-saving initiatives and whether RBSG and the Group will be a viable, competitive, customer focused and profitable bank especially after its restructuring and the implementation of the UK ring-fencing regime; the exposure of RBSG and the Group to cyber-attacks and their ability to defend against such attacks; RBSG's and the Group's ability to achieve their capital and leverage requirements or targets which will depend in part on RBSG and the Group's success in reducing the size of their business and future profitability as well as developments which may impact its CET1 capital including additional litigation or conduct costs, additional pension contributions, further impairments or accounting changes; ineffective management of capital or changes to regulatory requirements relating to capital adequacy and liquidity or failure to pass mandatory stress tests; RBSG's and the Group's ability to access sufficient sources of capital, liquidity and funding when required; changes in the credit ratings of RBSG, the Bank or the UK government; declining revenues resulting from lower customer retention and revenue generation in light of RBSG's and the Group's strategic refocus on the UK; as well as increasing competition from new incumbents and disruptive technologies.

Forward-looking statements

In addition, there are other risks and uncertainties that could adversely affect our results, ability to implement our strategy, cause us to fail to meet our targets or the accuracy of forward-looking statements in this document. These include operational risks that are inherent to the Group's business and will increase as a result of RBSG's and the Group's significant restructuring initiatives being concurrently implemented; the potential negative impact on RBSG's and the Group's business of global economic and financial market conditions and other global risks; the impact of a prolonged period of low interest rates or unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices; basis, volatility and correlation risks; the extent of future write-downs and impairment charges caused by depressed asset valuations; deteriorations in borrower and counterparty credit quality; heightened regulatory and governmental scrutiny and the increasingly regulated environment in which RBSG and the Group operate as well as divergences in regulatory requirements in the jurisdictions in which RBSG and the Group operate; the risks relating to RBSG's or the Group's IT systems or a failure to protect themselves and their customers against cyber threats, reputational risks; risks relating to increased pension liabilities and the impact of pension risk on RBSG's and the Group's capital positions; risks relating to the failure to embed and maintain a robust conduct and risk culture across the organisation or if their risk management framework is ineffective; the Group's ability to attract and retain qualified personnel; limitations on, or additional requirements imposed on, the Group's activities as a result of HM Treasury's investment in RBSG; the value and effectiveness of any credit protection purchased by the Group; risks relating to the reliance on valuation, capital and stress test models and any inaccuracies resulting therefrom or failure to accurately reflect changes in the micro and macroeconomic environment in which the Group operates, risks relating to changes in applicable accounting policies or rules which may impact the preparation of RBSG's and the Group's financial statements or adversely impact their capital positions; the impact of the recovery and resolution framework and other prudential rules to which RBSG and the Group are subject; the recoverability of deferred tax assets by the Group; and the success of RBSG and the Group in managing the risks involved in the foregoing.

The forward-looking statements contained in this document speak only as at the date hereof, and RBSG and the Group do not assume or undertake any obligation or responsibility to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The information, statements and opinions contained in this document do not constitute a public offer under any applicable legislation or an offer to sell or solicit of any offer to buy any securities or financial instruments or any advice or recommendation with respect to such securities or other financial instruments.

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