

Company Registered Number: R0000733

ULSTER BANK LIMITED
ANNUAL REPORT AND ACCOUNTS
31 December 2019

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Presentation of information

Ulster Bank Limited ('UBL' or 'the Bank') is a wholly-owned subsidiary of National Westminster Bank Plc ('NatWest Bank'). NatWest Bank is in turn a wholly-owned subsidiary of NatWest Holdings Limited ('NatWest Holdings'). The ultimate holding company is The Royal Bank of Scotland Group plc ('RBSG' or the 'ultimate holding company'). 'RBS Group' or 'the Group' refers to the ultimate holding company and its subsidiary and associated undertakings.

The Bank presents its financial statements in pounds sterling ('£' or 'sterling'). The abbreviation '£m' represents millions of pounds sterling and the abbreviation '£k' represents thousands of pounds sterling. The abbreviation '€' represents 'euros'.

The directors of the Bank present their strategic and directors' reports, together with audited financial statements of the Bank for the financial year ended 31 December 2019. The financial statements are prepared in accordance with International Financial Reporting Standards, as adopted by the European Union (EU).

Principal activities

The Bank, operating under the Ulster Bank brand, provides a comprehensive range of financial services through its Personal Banking and Commercial Banking divisions. Personal Banking serves individuals and mass affluent customers through the Bank's network of branches and direct channels, including mobile, internet and telephony. Commercial Banking provides services to small businesses, corporate and commercial customers.

Business review

In June 2019, RBS Group announced its intention, subject to legal and regulatory approval, to transfer the Ulster Bank Limited business into its immediate parent, NatWest Bank. This reorganisation would see the Ulster Bank brand in Northern Ireland become a trading name of NatWest Bank and simplify the RBS Group by aligning the legal entity structure with the existing management structure. It is not intended that the legal entity will be wound up following the transfer.

The proposed simplification would ensure continuity of service under the Ulster Bank brand, with customers continuing to receive the same products and services through the same channels. However, the transfer would enable the Bank's regional management team to dedicate their focus on serving local customers whilst realising the benefits of being part of a leading UK retail and commercial bank.

In October 2019, the Bank announced a multi-million pound investment in the refurbishment and upgrade of its Belfast Head Office location. The programme of work, to be completed in 2020, will provide staff with a highly modernised and collaborative working environment. The enhanced design and functionality will ensure better utilisation of building capacity, enabling the Bank to reduce its property footprint by relocating colleagues from its Danesfort premises to the city centre location.

The refurbishment of the Head Office location will complement the state of the art Entrepreneur Accelerator hub opened in 2018. Together with other hubs in the RBS Group, the hub represents the UK's largest fully-funded accelerator network and demonstrates the Bank's ongoing commitment to supporting Northern Ireland businesses. In 2019, the hub welcomed its latest intake of entrepreneurs who are provided with free office space, facilities and access to the Bank's comprehensive programme of mentoring, insight and coaching, specifically designed to meet the needs of entrepreneurs who want to grow and scale their business.

The Bank continued to invest in strengthening its digital proposition, in particular enhancing and optimising its mobile capabilities. A number of new features were introduced to the app, including the ability for customers to more easily view and manage their spending, with transactions summarised across eleven different spending categories. Ulster Bank Visa debit card customers can now temporarily freeze their debit card if it is misplaced, a feature introduced in 2018 for Ulster Bank MasterCard credit cards. Additionally, customers with Ulster Bank MasterCard credit cards can now implement a merchant restriction on their card to block any gambling-related transactions.

The Bank continued with its strong corporate social responsibility agenda and holds "CORE (NI)" status, an accreditation awarded by Business in the Community NI, recognising the Bank's commitment to integrating corporate responsibility into the way it does business. As part of the RBS Group, the Bank is a founding signatory to the UN Environment Programme and its 'Equator Principles', a voluntary set of standards for responsible banking.

The Bank's 'Do Good, Feel Good' initiative ran throughout June 2019, giving colleagues the opportunity to provide support and arrange fundraising activities for charities of their choice. Around £136,000 was raised for charities across Northern Ireland. During 2019, the 'Healthy U' programme was also launched in partnership with Vitality. The purpose of the initiative was to encourage staff to become more active through participating in both individual and team challenges. All participants had the opportunity to earn rewards, such as retail vouchers, whilst the top performing individuals and teams received community cash back contributions that they could award to a charity of their choice.

MoneySense, the Bank's financial education programme for primary and secondary level students, has enjoyed continued success with multiple workshops held across the country, presented by volunteer colleagues from the Bank.

Strategic report

The Bank has established a set of key performance indicators (KPIs) to track its performance towards its objectives.

	2019	2018
Net interest margin ⁽¹⁾	1.40%	1.35%
Cost: income ratio	84%	75%
CET1 ratio	17.0%	15.2%
Digitally active customers ⁽²⁾	63%	61%

Notes:

(1) Net interest margin is calculated on loans to customers and banks including amounts due from holding companies and fellow subsidiaries.

(2) A customer is considered digitally active if they have used online or mobile banking in the preceding 90 days.

The drivers of the changes in the financial ratios are discussed further in the financial performance section of this report.

Financial performance

The Bank's financial performance is presented in the income statement on page 18. The Bank reported a total profit before tax for the financial year of £20 million (2018 - £53 million).

Net interest income

Net interest income remained relatively stable as increased commercial lending income offset a reduction in mortgage volumes.

Non-interest income

An £8 million increase to £99 million was primarily due to an increase in the income on services provided to Ulster Bank Ireland DAC.

Operating expenses

Operating expenses increased by £28 million to £204 million.

During the year the Bank wrote to a cohort of commercial customers to advise that it was simplifying the interest rates charged on its lending products, replacing the LIBOR-Linked Rate (LLR) rate of interest with either the London Inter-Bank Offered Rate (LIBOR) or the Bank's base rate. This simplification was applied to LLR products entered into by certain commercial customers since 2008, to whom voluntary refunds were made. A charge of £10 million has been incurred in other administrative expenses in respect of these refunds and the associated project costs.

The remaining increase in operating expenses is due to an increase in the cost of services provided to the Bank by other RBS Group companies, notably investment in Technology, and a £6 million impairment in the Bank's Danesfort property associated with the city centre relocation.

Impairment

The impairment loss of £18 million represents a £12 million increase from £6 million in 2018. The 2019 charge was driven by a deterioration in the probability of default on the Commercial Banking portfolio and an increased charge relating to economic uncertainty. The 2018 charge primarily reflects a mortgage impairment charge.

Tax

The Bank incurred a tax charge in 2019 of £4 million (2018 - £5 million). The reduction reflects a decrease in taxable profits, offset by a £2 million impairment on the deferred tax asset on losses.

Return on assets

At the year end the total assets of the Bank were £11,236 million (2018 - £11,641 million). Return on total assets for 2019 was 0.2% (2018 - 0.5%).

Capital ratios

The Bank's capital position remained strong during 2019. Its CET1 ratio of 17.0% (2018 - 15.2%) remained significantly above the regulatory minimum.

Outlook

The formation of a new Northern Ireland Executive in January 2020 represented a positive milestone for the NI economy both in boosting business confidence, amid weakening private sector output, as well as enabling the release of critical public services and infrastructure investment. However, the Bank's business remains vulnerable to changes and uncertainty in the external economic and political environment.

Scenarios identified as having a potentially material negative impact on the Bank's business include: uncertainty surrounding the Brexit process, including the nature and timing of any free trade agreement negotiated between the UK and EU; the policy effects of the new NI Executive; a UK recession including significant falls in house prices; global financial market volatility linked to advanced economy interest rate decreases; a protracted period of low interest rates in the UK; vulnerabilities in emerging market economies resulting in contagion in the local market; and major geopolitical instability.

Prevailing uncertainty regarding the terms of the UK's withdrawal from the European Union

Following the EU Referendum in June 2016, and pursuant to the exit process triggered under Article 50 of the Treaty on European Union in March 2017 and the ratification of the withdrawal agreement by the UK Parliament and the European Parliament, the UK ceased to be a member of the EU and the European Economic Area ('EEA') on 31 January 2020 ('Brexit') and entered a transition period, currently due to expire on 31 December 2020. During this transition period, the UK retains the benefits of membership of the EU's internal market and the customs union but loses its representation in the EU's institutions and its role in EU decision-making.

The UK and EU are currently seeking to determine the terms of their future relationship by the end of the transition period, and the resulting economic, trading and legal relationships with both the EU and other counterparties currently remain unclear and subject to significant uncertainty. If the UK and EU do not agree a new comprehensive trade agreement by the end of the transition period and the transition period is not extended, then it is expected that the UK will fall back on the basic World Trade Organization terms, the outcome of which for the Bank would be similar in certain respects to a 'no-deal' Brexit, and which may result in, amongst other things, loss of access to the EU single market for goods and services, the imposition of import duties and controls on trade between the UK and the EU and related trade disruption.

The direct and indirect effects of the UK's exit from the EU and the EEA are expected to affect many aspects of the Bank's business and operating environment and may be material and/or cause a near-term impact on impairment. The longer term effects of Brexit on the Bank's operating environment depend significantly on the terms of the ongoing relationship between the UK and EU and are difficult to predict. They are subject to wider global macro-economic trends and events but may significantly impact the Bank and its customers and counterparties who are themselves dependent on trading with, or personnel from, the Republic of Ireland and the wider EU and may result in or be exacerbated by periodic financial volatility and slower economic growth in Northern Ireland and the wider UK, but also in the Republic of Ireland, the rest of Europe and potentially the global economy.

The consensus view on Brexit suggests a weaker Northern Ireland economy in the short to medium term. With the current high level of household debt, any increases in unemployment and interest rates present a threat to retail impairment rates. In wholesale portfolios any further softening of regional GDP growth would be expected to impact credit losses negatively. Significant uncertainty exists as to the respective legal and regulatory arrangements under which the Bank will operate once the transition period has ended. The legal and political 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 Bank's operations, including attendant restructuring costs, level of impairments, capital requirements, regulatory environment and tax implications and as a result may adversely impact the Bank's profitability, competitive position, viability, business model and product offering.

The RBS Group has obtained the requisite regulatory permissions (including third country licence branch approvals and access to TARGET2 clearing and settlement mechanisms) it currently considers are required for continuity of its, and the Bank's, business as a result of the UK's departure from the EU. These licences are required to maintain the ability to clear euro denominated payments and to serve non-UK EEA customers if there is a loss of access to the European Single Market. The regulatory permissions from the Dutch and German authorities are conditional in nature and will require on-going compliance with certain conditions, including maintaining minimum capital level and deposit balances as well as a defined local physical presence going forward; such conditions may be subject to change in the future. Maintaining these permissions and the Bank's access to the euro payment infrastructure will be fundamental to its business going forward and further changes to the Bank's business operations may be required.

Accounting policies

The reported results of the Bank are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its accounts. Details of the Bank's critical accounting policies and key sources of estimation uncertainty are included in the respective notes as further described on page 26.

Risk management

The Bank has established a framework for managing risk, which is continually evolving as the Bank's business activities change in response to market, credit, product, regulatory and other developments. The major risks associated with the Bank's businesses and the Bank's policies for managing each of these risks and its exposure thereto are detailed in Note 15 to the accounts. The principal risk associated with the Bank's business is credit risk.

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

Stakeholder engagement and s.172(1) statement

The Board objectives, approved in February 2019, identified the Board's key stakeholders as set out in this statement. During 2019 the Board undertook a variety of activities to engage with key stakeholders and bring their voice into the boardroom. Details are set out below, together with additional information on related engagement activities undertaken within RBS Group which impacted the Bank.

This section of the Strategic Report describes how the directors have had regard to the matters set out in section 172(1) (a) to (f), and forms the directors' statement required under section 414CZA, of The Companies Act 2006.

Board training and support on s.172 duties

Directors are supported in the discharge of their duties by the Company Secretary. All directors receive guidance on their statutory duties including section 172 and were briefed on the reporting requirements introduced by the Companies (Miscellaneous Reporting) Regulations 2018 in advance of the effective date. A new approach to Board and committee papers has been introduced with greater focus on ensuring relevant stakeholder interests are clearly articulated; and guidance on documenting decisions has been refreshed to ensure these are recorded in a consistent manner across RBS Group.

Customers

Customers are at the heart of everything the Bank does. During the year the Board received updates on key customer issues through customer service performance updates and regular business reviews. There was also a dedicated Board session on the Retail Banking environment. During a programme of visits in September 2019, the directors met a range of business and personal customers of NatWest Holdings Group (comprising NatWest Holdings and its subsidiaries, including the Bank). This provided an opportunity to gain insights into customer issues and challenges. The Chairman and Chief Executive Officer (CEO) have regular meetings with customers to enhance relationships and understand their views.

Colleagues

References to "colleagues" in this Report mean all members of the workforce (for example, contractors and agency workers).

Strategic report

Colleague voice

The Board promotes colleague voice in the boardroom through a variety of channels. During 2019 the Board engaged with colleagues during a number of Board and committee visits to businesses and functions and there was also a Meet the Board event for colleagues.

The Colleague Advisory Panel (CAP), established in 2018, met twice during 2019, providing a valuable mechanism for directors to engage directly with colleagues on topics of strategic interest affecting RBS Group and the workforce; and offering colleagues a greater understanding of the Board's role. A number of directors attended the CAP meetings during the year and discussion topics included purpose, future strategy, executive pay, inclusion and sustainability. Outputs were reported to the Board and have influenced the Board's consideration of these topics.

Engaging colleagues

Every year colleagues are asked to share their thoughts on what it's like to work for RBS Group via a colleague opinion survey. The results from the 2019 survey, which were considered by the Board in October 2019, showed a further improvement in colleague sentiment and demonstrate that the culture of RBS Group is changing for the better. Key measures of engagement, leadership and culture have increased further, and RBS Group is above the global financial services norm in all comparable survey categories.

The colleague opinion survey results was one culture oversight tool available to the Board and the Board also listened to colleague views during the process of establishing RBS Group's Purpose.

A specific report detailing the sentiment of all the Bank's colleagues (regardless of business/functional alignment) was also prepared and discussed by the Northern Ireland Regional Board. The continued strengthening of RBS Group's culture was also echoed in this year's improved Banking Standards Board annual assessment of culture in the UK banking sector, which was also considered by the Board and provides further proof of progress across a range of measures.

Employee consultation

Having ongoing discussion and engagement with a number of employee representatives such as trade unions and work councils is vital and RBS Group regularly discusses developments and updates on the progress of strategic plans.

Speak Up

Where colleagues wish to report any concerns relating to wrong doing or misconduct, one of the ways they can do this is by raising their concerns via Speak Up, the Bank's whistleblowing service. The 2019 colleague opinion survey showed the highest ever score when asking colleagues if they feel safe to speak up, as well as understanding the process of how they do that. In 2019, 458 cases were raised across RBS Group, compared to 480 in 2018.

Developing colleagues

Culturally, becoming a learning organisation is a strategic priority. Focus has been on preparing colleagues for the future with broader development focused on key Critical People Capabilities.

In 2019 RBS Group created an Agile Capability Hub, providing learning content to support colleagues to confidently engage in new ways of working. This year, RBS Group was also the first UK retail bank to launch a Data Academy, to nurture and grow data expertise, innovation, and collaboration. More information can be found in the 2019 Annual Report and Accounts of RBSG and on [rbs.com](https://www.rbs.com).

Investing in colleagues

RBS Group has also transformed colleagues' experience by deploying new digital tools. Workday was implemented as a new digital HR platform in November 2019 and includes a mobile app, giving colleagues an experience on par with the digital experience customers enjoy. ServiceNow was extended to improve how RBS Group responds to colleagues' queries, and an expanded HR chat bot has helped over 50,000 colleagues to answer their basic queries. These enhancements are enabling RBS Group to respond to the evolving world of work and needs of its colleagues.

Health and wellbeing of colleagues

As a strong component of making RBS Group a great place to work, wellbeing initiatives have been successfully delivered against four pillars; Physical, Mental, Social and Financial Wellbeing. Further details can be found in the 2019 Annual Report and Accounts of RBSG and on [rbs.com](https://www.rbs.com).

Inclusion

RBS Group is proud to be building an inclusive bank which is a great place for all colleagues to work. RBS Group's inclusion guidelines apply to all colleagues globally and focus on five key priorities - LGBT Innovative, Gender Balanced, Disability Smart, Ethnically Diverse, all leading to Inclusive Culture. Detailed information can be found in the 2019 Annual Report and Accounts of RBSG and on [rbs.com](https://www.rbs.com).

RBS Group has been recognised for work on Equality, Diversity and Inclusion in 2019 by retaining position in the Times Top 50 Employers for Women; being recognised again as a Top 10 Employer for Working Families; being Exemplary Level in the Scottish Carer Positive Campaign; being a Top Global Stonewall employer; being a Top Ten Employer in the Investing in Ethnicity Maturity Matrix; and rated as Gold in the Business Disability Forum benchmark.

Employment of people with disabilities

The Bank's policy is that people with disabilities are given full and fair consideration for employment and subsequent training, career development and promotion based on merit. If colleagues develop a disability, it is the Bank's policy, wherever possible, to retain them in their existing jobs or to re-deploy them in suitable alternative duties, making appropriate adjustments.

Regulators

The Board recognises the importance of open and continuous dialogue with regulators. Representatives from the Financial Conduct Authority (FCA) attended the February 2019 Board meeting to present and discuss their annual Firm Evaluation letter. The Prudential Regulation Authority (PRA) conducted a Board effectiveness review in 2019, which included attendance at the October 2019 Board meeting and meetings with directors.

Strategic report

The Chairman and Executive Directors have regular meetings with both the FCA and PRA. In addition, individual directors engage regularly with regulators through Continuous Assessment and Proactive Engagement meetings.

Suppliers

The Board recognises the key role suppliers play in ensuring the Bank delivers a reliable service to customers. In October 2019 the Board held a suppliers' spotlight session, which included an overview of RBS Group's key suppliers and provided insights on the approach towards managing supplier relationships, including payment practices. The directors discussed the future approach to suppliers and the changing regulatory landscape in relation to outsourcing. Meetings with key suppliers in September 2019 provided a first hand opportunity for directors to hear directly from strategic partners and to discuss current challenges.

Community and environment

Community engagement

Our community programmes focus on delivering genuine benefits that make a difference to people's lives throughout Northern Ireland. The Bank invests in programmes that are most relevant for it as a financial institution – in particular promoting financial education. Colleagues across the Bank continue to widely support, both financially and through volunteering, many community and other worthy causes. Such giving is encouraged by the Bank through its use of payroll giving and its staff charity fund that supports worthy causes at local, national and international levels. Whilst our community programme and activities run throughout the year, every June there is a particular focus and colleagues come together to raise funds for local and national charities. "Give A Day" offers colleagues an extra three days of annual leave to give their time as volunteers and fundraisers to a charity or cause that matters to them.

Environment

The Bank is committed to managing the wider social, environmental and economic impacts of its operations which includes the way it deals with its customers and manages sustainability issues in its supply chain. Refer to [rbs.com](https://www.rbs.com) for RBS Group's Modern Slavery Statement and details of the Supplier Code of Conduct, both of which apply to the Bank. It is recognised by the Board that climate change must have greater prominence at both senior management and board levels across RBS Group, including the Bank. Further details on RBS Group's response to climate change can be found within the 2019 Annual Report and Accounts of RBSG.

How stakeholder interests have influenced decision-making

UBL recognises the importance of engaging with stakeholders to help inform strategy and Board decision-making. Relevant stakeholder interests, including those of employees, suppliers, customers and others are taken into account by the Board when it takes decisions. UBL defines principal decisions as those that are material, or of strategic importance, to UBL, and also those that are significant to any of its key stakeholder groups.

In making its decisions, the Board considers the outcomes of relevant stakeholder engagement as well as the need to maintain a reputation for high standards of business conduct, and to consider the long-term consequences of its decisions.

The appointment of a new CEO in 2019 provides one example of how stakeholder interests were considered in a principal decision made by the Board.

Appointment of Chief Executive Officer

In 2019 the Board approved the appointment of Alison Rose as CEO with effect from 1 November 2019. From the outset, the Board placed stakeholder interests at the core of its objectives in the search for Ross McEwan's successor.

The Nominations Committee, on behalf of the Board, agreed a role specification which required candidates to demonstrate broad and authoritative banking and strategic experience that would serve to deliver long-term sustainable growth to the business for the benefit of its shareholders and wider stakeholders. A rigorous search process was undertaken, involving the consideration of both internal and external candidates. Alison Rose was identified as the strongest candidate on the basis of the role specification criteria.

In reaching its decision, the interests of RBS Group customers were a key focus for the Board, particularly each candidate's ability to lead a business that would be recognised as truly customer centric. The Board also ensured that colleague interests were taken into account when agreeing the critical capabilities used to assess potential candidates. These required candidates to demonstrate the strong ethical and moral principles needed to lead the culture and values of RBS Group. The Board ensured that relevant regulators, another of its key stakeholder groups, were kept regularly apprised of progress during the search.

The Board will continue to ensure that its nominations process is based on the principles of fairness, respect and inclusion and that all nominations and appointments are made on the basis of individual competence, skills and expertise measured against identified objective criteria and taking into account a broad range of stakeholder interests.

Further details on how RBS Group engages with its stakeholders can be found in the 2019 Annual Report and Accounts of RBSG and on [rbs.com](https://www.rbs.com).

Approval of Strategic report

The Strategic report for the year ended 31 December 2019 set out on pages 1 to 5 was approved by the Board of directors on 13 February 2020.

By order of the Board:

Jan Cargill
Company Secretary
13 February 2020

Board of directors and secretary

Chairman

Howard Davies

Executive directors

Alison Rose

Katie Murray

Non-executive directors

Francesca Barnes

Graham Beale

Ian Cormack

Alison Davis

Patrick Flynn

Morten Friis

Robert Gillespie

Yasmin Jetha

Baroness Noakes

Mike Rogers

Mark Seligman

Lena Wilson

Baroness Noakes

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

Mike Rogers

[Remuneration](#)

Mark Seligman

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

Lena Wilson

Chief Governance Officer and Company Secretary

Jan Cargill (appointed 5 August 2019)

Chairman

Howard Davies

[Nominations \(Chairman\)](#)

Executive director

Alison Rose

[ExCo \(Chairman\)](#)

Katie Murray (appointed 1 January 2019)

[ExCo](#)

Independent non-executive directors

Francesca Barnes

Graham Beale

[Senior Independent Director](#)

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

Ian Cormack

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

Alison Davis

[Remuneration](#)

Patrick Flynn

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

Morten Friis

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

Robert Gillespie

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

Yasmin Jetha

[Remuneration](#)

Other Board changes in 2019

Aileen Taylor (company secretary) resigned on 5 August 2019

Ross McEwan (executive director) resigned on 31 October 2019

Auditors

Ernst & Young

Chartered Accountants and Statutory Auditor

Ernst & Young Building

Harcourt Centre

Harcourt Street

Dublin D02 YA40

Registered office and Head office

11-16 Donegall Square East

Belfast BT1 5UB

Northern Ireland

Ulster Bank Limited

Registered in Northern Ireland No. R0000733

Key:

Audit	member of the Audit Committee
ExCo	member of the Executive Committee
Nominations	member of the Nominations Committee
Remuneration	member of the Performance and Remuneration Committee
Risk	member of the Board Risk Committee

For additional detail on the activities of the Committees above, refer to the Report of the directors.

Report of the directors

The strategic report contains information on risk management, future developments in the business of the Bank, staff involvement and employment of people with disabilities.

Corporate Governance statement

The Companies (Miscellaneous Reporting) Regulations 2018 introduced new statutory reporting requirements for financial years beginning on or after 1 January 2019. As a result of these new requirements, the directors are required to provide a statement in the Report of the directors stating which corporate governance code, if any, the Bank followed during the year, how it applied the code and any part of the code it did not follow. For the financial year ended 31 December 2019, the Bank has chosen to report against the Wates Corporate Governance Principles for Large Private Companies, published by the Financial Reporting Council (FRC) in December 2018 and available on the FRC website (the Wates Principles). The disclosures below explain how the Bank has applied the Wates Principles in the context of its corporate governance arrangements.

1. Purpose and leadership

RBS Group's Purpose is established by the RBSG Board, promoted across RBS Group and cascaded to subsidiaries including the Bank. Further information on RBS Group's Purpose can be found in the 2019 Annual Report and Accounts of RBSG.

RBS Group's strategy is set and approved by the RBSG Board. The Board monitors and maintains the consistency of the Bank's activities within the strategic direction of RBS Group and, as appropriate, the strategies approved by NatWest Holdings for each of the businesses within the NatWest Holdings Group.

The RBSG Board is supported in monitoring culture across RBS Group by the RBS Group Sustainable Banking Committee and the RBS Group Board Risk Committee. RBS Group is on a journey towards a generative risk culture whereby "risk is simply part of the way people work and think". There is regular reporting to the Board on risk culture which allows the Board to have appropriate oversight of risk culture matters that are relevant for the Bank.

The Board also considered the overall alignment of purpose and strategy with culture and values.

Building a healthy culture that embodies Our Values is a core priority for RBS Group.

Our Values, which guide the way RBS Group identifies the right people to serve customers well, and how to manage, engage and reward colleagues, are at the heart of Our Code (the RBS Group-wide Code of Conduct).

2. Board composition

The Board has fifteen directors comprising the Chairman, two executive directors and twelve independent non-executive directors, one of whom is the Senior Independent Director.

The names of the current directors and secretary are shown on page 6.

The Board considers that the Chairman was independent on appointment and that all the non-executive directors are independent. Non-executive director independence and individual directors' continuing contribution to the Bank are considered at least annually.

The Board operates a Boardroom Inclusion Policy which reflects the most recent industry targets and is aligned to the RBS Inclusion Policy and Principles applying to the wider RBS Group. This policy provides a framework to ensure that the Board attracts, motivates and retains the best talent and avoids limiting potential caused by bias, prejudice or discrimination. The policy currently applies to the Boards of RBSG, NatWest Holdings, RBS plc, NatWest Bank and UBL. A copy of the Boardroom Inclusion Policy is available on [rbs.com](https://www.rbs.com).

The Boardroom Inclusion Policy contains a number of measurable objectives, targets and ambitions reflecting the ongoing commitment of the Board to inclusion progress. The Board aims to meet the highest industry standards and recommendations wherever possible. That includes, but is not limited to, aspiring to meet the targets set by the Hampton-Alexander Report: FTSE100 Women Leaders (33% female representation on the boards) and the Parker Report: Beyond 1 by '21 (at least one director from an ethnic minority background on the boards) by 2020/2021. The policy supports the RBS Group-wide ambition to aim for a 50/50 gender balance across all levels of the organisation by 2030.

The Board currently meets the Parker target and exceeds the Hampton-Alexander target with a female representation of 47%.

The role of the Chairman is to lead the Board and ensure its overall effectiveness. This is distinct and separate from that of the CEO who manages the business day-to-day.

All directors receive accurate, timely and clear information on relevant matters and have access to the advice and services of the Company Secretary. In addition, all directors are able, if necessary, to obtain independent professional advice at the Bank's expense.

The Senior Independent Director acts as a sounding board for the Chairman and as an intermediary for other directors when necessary.

An integral part of RBS Group's governance arrangements is the appointment of four Double Independent Non-Executive Directors (DINEDs) to the boards of NatWest Holdings, NatWest Bank, RBS plc, and UBL (the NWH Sub Group). The DINEDs are independent in two respects: (i) independent of management as non-executives; and (ii) independent of the rest of RBS Group by virtue of their NWH Sub Group only directorships.

The DINEDs play a critical role in RBS Group's ring-fencing governance structure, and are responsible for exercising appropriate oversight of the independence and effectiveness of the NWH Sub Group's governance arrangements, including the ability of each board to take decisions independently.

Report of the directors

The DINEDs also have an enhanced role in managing any conflicts which may arise between the interests of the Bank and other members of RBS Group.

All the Bank's directors who are not DINEDs are directors of RBSG. All DINEDs attend RBSG Board meetings in an observer capacity.

The Board is structured to ensure that the directors provide the Bank with the appropriate balance of skills, experience and knowledge as well as independence. Given the nature of the Bank's businesses, experience of banking and financial services is clearly of benefit. A number of directors have substantial experience in that area, including retail and commercial banking.

In addition, the directors have relevant experience in customer service; government and regulatory matters; mergers & acquisitions; corporate restructuring; stakeholder management; technology, digital and innovation; finance and accountancy; risk; and change management.

Board committees also comprise directors with a variety of skills and experience so that no undue reliance is placed on any one individual.

The independent non-executive directors combine broad business and commercial experience with independent and objective judgement and provide independent challenge to the executive directors and the leadership team. The balance between independent non-executive and executive directors enables the Board to provide clear and effective leadership across the Bank's business activities.

The Board monitors the commitment of the Chairman and directors and is satisfied that they are able to allocate sufficient time to enable them to discharge their duties and responsibilities effectively. Any additional external appointments require prior Board approval.

There is an induction programme for all new directors which is tailored to their specific experience and knowledge. In 2019, Katie Murray and Alison Rose undertook induction programmes following their appointments as Chief Financial Officer and Deputy CEO respectively. These programmes focused on building existing knowledge of the Bank, meetings with relevant internal and external stakeholders and personal development. Alison Rose's induction programme continues following her appointment as CEO.

The Board is supported in its succession planning activities, including the recruitment of non-executive directors, by the Nominations Committee, which is responsible for considering and making recommendations to the Board in respect of Board appointments.

The Nominations Committee reviews the structure, size and composition of the Board, and makes recommendations to the Board in relation to any necessary changes, having regard to the overall balance of skills, knowledge, experience and diversity on the Board, the length of service of the Board as a whole; and the requirement to keep membership regularly refreshed.

The Nominations Committee considers Board composition and succession planning at least annually. The RBSG Group Nominations and Governance Committee also approves all appointments to the Board, reflecting the Bank's position as a subsidiary within RBS Group.

A review of the effectiveness of the Board, including the Chairman, individual directors and Board committees, is conducted at least annually.

2019 Performance evaluation

The 2019 evaluation of the NWH Sub Group Boards was facilitated by the Chief Governance Officer and Company Secretary, Jan Cargill, during Q4 2019, alongside the evaluation of the RBSG Board. The conclusion of the 2019 Board evaluation was that the Board operated effectively throughout the year and fulfilled its remit as set out in its terms of reference. Directors engaged fully with the evaluation exercise and commented positively in relation to many aspects of the Board's operations.

Key findings and recommendations were closely aligned with the RBSG findings and included the following:

- Agenda focus had improved following introduction of the Board objectives, particularly in relation to stakeholder voice.
- Ring-fencing governance arrangements had embedded well. The DINED role was clearly understood and functioning effectively, and a recovery fire drill had provided a useful opportunity to test the conflicts of interest process.
- Directors had responded positively to the new reporting style for Board and committee papers, which had driven better quality presentations and shorter packs.
- Although the Board's size had reduced following the departure of Brendan Nelson, most directors still felt the Board was too large, although not necessarily unwieldy or unworkable.
- The balance of skills, knowledge and experience on the Board was considered appropriate, however there was scope for additional technology experience, to support future strategy.
- Focus was needed to continue promoting good working relationships between the Board and executive management.
- Enhancing the quality of management information would enable the Board to focus less on the details and spend more time on key strategic issues.
- There was clear appetite amongst Board members to have more visibility of top executive talent.

Actions

Following Board discussion of the evaluation report, a number of actions were agreed for 2020:

- Agree a focused set of Board objectives for 2020.
- Maintain focus on Board composition and succession planning, balancing the desire to reduce overall Board size with the requirement to ensure an appropriate balance of skills, knowledge and experience, and the need to improve diversity.
- Consider further ways to improve Board dynamics.
- Consider improvements to future management reporting to the Board.
- Develop a structured programme for the Board to meet key executive talent.

Report of the directors

Implementation of the 2019 Board evaluation actions will be overseen by the Nominations Committee during 2020.

The Chairman met each director individually to discuss their own performance and continuing professional development and establish whether each director continues to contribute effectively to the Bank's long-term sustainable success. The Chairman also shared peer feedback provided to the Company Secretary as part of the individual evaluation process.

Separately, the Senior Independent Director sought feedback on the Chairman's performance from the non-executive directors, executive directors and other key internal and external stakeholders and discussed it with the Chairman. Non-executive directors discuss professional development annually with the Chairman and they participate in scheduled Board training sessions and other external sessions, as appropriate.

Training topics during 2019 included financial crime, political and economic outlook, directors' duties (including the new statutory reporting requirements), suppliers' spotlight, climate risk, data teach-in, enterprise wide risk management (including the risk appetite framework), and inside information. Directors may also request individual in-depth briefings from time to time on areas of particular interest.

3. Director responsibilities

All directors receive guidance on their statutory duties under the Companies Act and are supported in the discharge of their duties by the Company Secretary, as further described on page 3.

Each director has a role profile which clearly articulates their responsibilities and accountabilities and any additional regulatory responsibilities and accountabilities are set out in their Statement of Responsibilities.

RBS Group also produces and maintains a document called "Our Governance" which sets out the governance, systems and controls applicable to RBSG and the NWH Sub Group. Our Governance is made available to all directors and is reviewed and approved by the Board at least annually.

The Directors' Conflicts of Interest policy sets out procedures to ensure that the Board's management of conflicts of interest and its powers for authorising certain conflicts are operating effectively. This includes the management of conflicts that may arise during Board decisions where the interests of the Bank conflict with the interests of other members of RBS Group. The Bank maintains a register of directors' interests and appointments, which is reviewed annually by the Board, and there is discussion of directors' conflicts in Board meetings, as required.

The Board is the main decision-making forum for the Bank. The Board is collectively responsible for the long-term success of the Bank and the delivery of sustainable value to its shareholders. The Board's role is to provide leadership of the Bank.

It monitors and maintains the consistency of the Bank's activities within the strategic direction of RBS Group; it reviews and approves risk appetite for strategic and material risks in accordance with the RBS Group Risk Appetite Framework and it monitors performance against risk appetite for the Bank. It approves the Bank's key financial objectives and keeps the capital and liquidity positions of the Bank under review. The Board's terms of reference include a formal schedule of matters specifically reserved for the Board's decision and are reviewed at least annually.

The Chairman, CEO and Company Secretary are responsible for the quality and integrity of information provided to directors. At each scheduled Board meeting the directors receive reports from the Chairman, Board Committee Chairmen, CEO, Chief Financial Officer, and other members of the executive management team, as appropriate. Other senior executives attended Board meetings throughout the year to present reports to the Board. This provides the Board with an opportunity to engage directly with management on key issues and supports succession planning.

The Board held eight scheduled meetings during the year. The Board's key areas of focus for 2019 included CEO appointment; capital distributions; risk appetite framework; a review of payments strategy; and Brexit planning and preparedness.

In order to provide effective oversight and leadership, the Board has established a number of Board committees with particular responsibilities. The Audit, Performance & Remuneration, and Nominations Committees of NWH Ltd operate as committees of each of NatWest Holdings, NatWest Bank, RBS plc and UBL, with meetings running concurrently. During 2019, the Executive Committee operated as a Committee of the Board.

The Audit Committee comprises at least three independent non-executive directors, two of whom are DINEDs. The Committee assists the Board in discharging its responsibilities for monitoring the integrity of the financial statements. It reviews the accounting policies, financial reporting and regulatory compliance practices of the Bank, its system and standards of internal controls, and monitors its processes for internal audit and external audit.

The Board Risk Committee comprises at least four independent non-executive directors, one of whom is the Chairman of the Audit Committee and two of whom are DINEDs. It provides oversight and advice to the Board in relation to current and potential future risk exposures and future risk profile, including determination of risk appetite; and the effectiveness of the risk management framework within the Bank and (in conjunction with the Audit Committee) internal controls required to manage risk. It reviews compliance with the RBS Group Policy Framework within the Bank and reviews the performance of the Bank relative to risk appetite.

Report of the directors

The Performance and Remuneration Committee (RemCo)

comprises at least four independent non-executive directors and assists the RBSG Group Performance and Remuneration Committee with the oversight and implementation of RBS Group's remuneration policy. It also considers and makes recommendations on remuneration arrangements for senior executives of the Bank.

The Nominations Committee comprises the Chairman, Senior Independent Director and at least three further independent non-executive directors. 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 Executive Committee comprises the Bank's most senior executives and supports the CEO in managing the Bank's businesses. It considers strategic, financial, capital, risk and operational issues.

4. Opportunity and risk

The role of the Board is to promote the long-term sustainable success of the Bank.

The Board reviews and approves risk appetite for strategic and material risks in accordance with the RBS Group risk appetite framework; monitors performance against risk appetite for the Bank; and considers any material risks and approves, as appropriate, recommended actions escalated by the Board Risk Committee (BRC).

The Bank's risk strategy is informed and shaped by an understanding of the risk landscape including a range of significant risks and uncertainties in the external economic, political and regulatory environments.

The Bank complies with RBS Group's risk appetite framework, which is approved annually by the Board, in line with risk appetite statements, frameworks and policies. Risk appetite is set in line with overall strategy.

RBS Group operates an integrated risk management framework, which is centred around the embedding of a strong risk culture. The framework ensures the tools and capability are in place to facilitate sound risk management and decision-making across the organisation.

During 2019, a number of enhancements to the risk management framework were developed. The increasing significance of climate risk was considered as part of these developments and will be fully integrated as part of the implementation of the enhanced framework in 2020.

The Bank also complies with the RBS Group Policy Framework, the purpose of which is to ensure that RBS Group establishes and maintains policies that adequately address the material inherent risks it faces in its business activities.

Further information on the Bank's risk management framework including risk culture, risk governance, risk appetite, risk controls and limits, and risk identification and measurement can be found in Note 15.

5. Remuneration

The RBS Group remuneration policy provides a consistent policy across all companies in RBS Group and ensures compliance with regulatory requirements. The remuneration policy is aligned with the business strategy, objectives, values and long-term interests of the Bank. The policy supports a culture where individuals are rewarded for delivering sustained performance in line with risk appetite and for demonstrating the right conduct and behaviours.

RemCo reviews remuneration for executives of the Bank and considers reports on the wider workforce including annual pay outcomes and diversity information. The RemCo helps to ensure that the remuneration policies, procedures and practices being applied are appropriate for the Bank.

Executive remuneration structures incentivise individuals to deliver sustainable performance based on strategic objectives for RBS Group and the relevant business area. Performance is assessed against a balanced scorecard of financial and non-financial measures and variable pay is subject to deferral as well as malus and clawback provisions to ensure rewards are justified in the long-term.

The approach to performance management provides clarity for employees about how their contribution links to RBS Group's ambition and all employees have goals set across a balanced scorecard of measures. RBS Group continues to ensure employees are paid fairly for the work they do and are supported by simple and transparent pay structures in line with industry best practices. This clarity and certainty on how pay is delivered is also helping to improve employees' financial wellbeing, which is a priority. Employees are provided with flexibility in terms of how they wish to receive pay to suit their circumstances. Pay is compared against the external market so that pay and benefits are competitive.

RBS Group is a fully accredited Living Wage Employer in the UK with rates of pay that continue to exceed the Living Wage Foundation Benchmarks.

RBS Group ensures colleagues have a common awareness of the financial and economic factors affecting its performance through quarterly "Results Explained" communications and Workplace Live events with the Group CEO and Chief Financial Officer.

Further information on the remuneration policy can be found in the Directors' Remuneration Report (DRR) of the 2019 Annual Report and Accounts of RBSG along with the steps being taken to build an inclusive and engaged workforce and employee share plans. The DRR also contains details of pay ratios for RBS Group. Gender and Ethnicity Pay Gap information can be found in the Strategic Report section of the 2019 RBSG Annual Report and Accounts.

Report of the directors

6. Stakeholder relationships and engagement

In developing its annual objectives, the Board identified a number of key stakeholders, and the Board's agenda and engagement plans were structured to enhance the Board's understanding of these key stakeholders' views and interests. This in turn has supported more informed Board discussions and decision-making. Of particular note is the developing role of the CAP, which was established in 2018 in response to the requirements of the 2018 UK Corporate Governance Code.

Engagement with Employees, Suppliers, Customers and Others

For further details on the Board's engagement with employees, customers, suppliers and others, and how these stakeholders' interests have influenced Board discussions and principal decisions, see pages 3 to 5 of the Strategic Report which includes a section 172(1) statement.

Internal control over financial reporting

The internal controls over financial reporting for the Bank are consistent with those at RBS Group level. The Group has designed and assessed the effectiveness of its internal control over financial reporting as of 31 December 2019 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'. Any deficiencies identified are reported to the Audit Committee along with management's remediation plans.

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

Directors' interests

Where directors of the Bank are also directors of RBSG, their interests in the shares of the ultimate holding company at 31 December 2019 are shown in the Corporate governance, Annual report on remuneration section of the 2019 Annual Report and Accounts of RBSG. None of the directors held an interest in the loan capital of the ultimate holding company or in the shares or loan capital of the Bank or its subsidiary, during the period from 1 January 2019 to 13 February 2020.

Directors' indemnities

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

Share capital

Details of the ordinary share capital at 31 December 2019 are shown in Note 13 to the accounts.

Dividends

The directors do not recommend the payment of a final dividend on ordinary shares (2018 - nil). There were no interim dividends approved or paid during 2019 (2018 - £42 million).

Post balance sheet events

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

Country-by-Country Reporting

The Bank is availing of the exemption under section 5(3) of The Capital Requirements (Country-by-Country Reporting) Regulations 2013 as the information required under the regulations is produced on a consolidated basis by the Bank's ultimate parent company, RBSG, and published on its website.

Going concern

The directors, having considered the Bank's business activities and financial position discussed in the business review (pages 1 to 2), its liquidity and funding profile and the risk factors set out in Note 15 and having made such enquiries as they considered appropriate, have a reasonable expectation that the Bank's business and legal entity will continue in operational existence for the foreseeable future. Accordingly, the financial statements of the Bank have been prepared on a going concern basis.

Political donations

During 2019, no political donations were made nor any political expenditure incurred (2018: nil).

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.

Auditors

Ernst & Young are the Bank's auditors and have indicated their willingness to continue in office. A resolution to re-appoint Ernst & Young as the Bank's auditors will be proposed at the forthcoming Annual General Meeting.

By order of the Board:

Jan Cargill
Company Secretary

13 February 2020

Ulster Bank Limited is registered in Northern Ireland No. R0000733

Statement of directors' responsibilities

This statement should be read in conjunction with the responsibilities of the auditor set out in their report on page 17.

The directors are responsible for the preparation of the Annual Report and Accounts. The directors are required by Article 4 of the IAS Regulation (European Commission Regulation No 1606/2002) to prepare Group accounts, and as permitted by the Companies Act 2006 have elected to prepare company accounts, for each financial year in accordance with International Financial Reporting Standards as adopted by the European Union. They are responsible for preparing accounts that present fairly the financial position, financial performance and cash flows of the 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 Bank 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 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 strategic report and report of the directors (incorporating the Financial review) includes a fair review of the development and performance of the business and the position of the Bank, together with a description of the principal risks and uncertainties that they face.

By order of the Board:

Howard Davies
Chairman

Alison Rose-Slade
Chief Executive Officer

Katie Murray
Chief Financial Officer

13 February 2020

Board of directors

Chairman

Howard Davies

Executive directors

Alison Rose
Katie Murray

Non-executive directors

Francesca Barnes
Graham Beale
Ian Cormack
Alison Davis
Patrick Flynn
Morten Friis
Robert Gillespie
Yasmin Jetha
Baroness Noakes
Mike Rogers
Mark Seligman
Lena Wilson

Independent auditor's report to the members of Ulster Bank Limited

Opinion

We have audited the financial statements of Ulster Bank Limited ('the Company') for the year ended 31 December 2019, which comprise the Income Statement, Statement of Comprehensive Income, Balance Sheet, Statement of Changes in Equity, Cash Flow Statement, summary of significant accounting policies and the related notes 1 to 23 (excluding those marked as 'unaudited'). 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.

In our opinion, the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2019 and of the Company's profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

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

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

Overview of our audit approach

Key audit matters	<ul style="list-style-type: none">• Impairment provision on loans and advances to customers• IT systems and controls
Materiality	<ul style="list-style-type: none">• Overall materiality of £9.7m which represents 2% of Equity

Key audit matters

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

Independent auditor's report to the members of Ulster Bank Limited

Risk	Our response to the risk
<p>Impairment provision on loans to customers</p> <p>At 31 December 2019 the Company reported total gross loans to customers of £3,644m (2018: £3,807m) and £95m (2018: £88m) subject to expected credit losses ('ECL').</p> <p>Key judgements and estimates in respect of the timing and measurement of ECL include:</p> <ul style="list-style-type: none"> • Allocation of assets to stage 1, 2, or 3 using criteria in accordance with the accounting standard; • Accounting interpretations, modelling assumptions and data used to build and run the models that calculate the ECL; • Inputs and assumptions used to estimate the impact of multiple economic scenarios; • Completeness and valuation of post model adjustments; and • Accuracy and completeness of the financial statement disclosures. <p>Refer to the Accounting policies and Notes 9 and 15 of the financial statements.</p>	<p>Tested the design and operating effectiveness of key controls across the processes relevant to the ECL, including the key judgements and estimates noted involving specialists where appropriate. This included the allocation of assets into stages including management's monitoring of stage effectiveness, model monitoring, model validation, data accuracy and completeness, credit monitoring, multiple economic scenarios, post model adjustments, individual provisions and production of journal entries and disclosures.</p> <p>In obtaining sufficient audit evidence we:</p> <ul style="list-style-type: none"> • Reviewed the key risk committee minutes where the inputs, assumptions and adjustments to the ECL were discussed and approved. • Performed an overall assessment of the ECL provision levels by stage to determine if they were reasonable considering the Company's portfolio, risk profile, credit risk management practices and the macroeconomic environment. Considered trends in the economy and industries to which the Company is exposed. • Challenged the criteria used to allocate an asset to stage 1, 2 or 3 in accordance with IFRS 9. Tested assets in stage 1, 2 and 3 to verify that they were allocated to the appropriate stage and performed sensitivity analysis to assess the impact of different criteria on the ECL. • Involved modelling specialists to test the assumptions, inputs and formulas used in a sample of ECL models. This included assessing the appropriateness of model design and formulas used, alternative modelling techniques and recalculating the Probability of Default, Loss Given Default and Exposure at Default for a sample of models. • Tested the data quality in the ECL calculation by reconciling to source systems. To test credit monitoring, assessed the risk ratings for a sample of performing loans. • With the support of our economic specialists, assessed the base case and alternative economic scenarios, including challenging probability weights. Assessed whether forecasted macroeconomic variables were appropriate, such as GDP, unemployment, interest rates and House Price Index. With the support of our modelling specialists challenged the correlation and impact of the macroeconomic factors to the ECL. • Assessed the completeness and appropriateness of post model adjustments and recalculated a sample. Based on current economic conditions and market circumstances, we considered the need for sector or systemic adjustments and assessed the appropriateness of the scenarios used in response to economic uncertainty. • With the support of our internal valuation specialists, recalculated a sample of individually assessed provisions including the alternative scenarios and challenging probability weights assigned. • Assessed the adequacy and appropriateness of disclosures for compliance with the accounting standards and the process and controls management had in place to create and approve the disclosures. <p>Our planned audit procedures were completed without material exception.</p>

Independent auditor's report to the members of Ulster Bank Limited

Risk	Our response to the risk
IT systems and controls	
<p>The IT environment is complex and pervasive to the operations of the Company due to the large volume of transactions processed in numerous locations daily and the reliance on automated and IT dependent manual controls. Appropriate IT controls are required to ensure that applications process data as expected and that changes are made in an appropriate manner. This risk is also impacted by the greater dependency on third-parties, increasing use of cloud platforms, decommissioning of legacy systems, and migration to new systems. Such controls contribute to mitigating the risk of potential fraud or errors as a result of changes to applications and data.</p> <p>Our audit approach relies upon IT applications and the related control environment including:</p> <ul style="list-style-type: none"> • User access management across application, database and operating systems; • Changes to the IT environment, including transformation that changes the IT landscape including the general ledger and human resource system migrations; • IT operational controls; • IT application or IT dependent controls; and • Evaluation of IT control environment at third party service providers. 	<p>Evaluated the design and operating effectiveness of IT controls over the applications, operating systems and databases that are relevant to financial reporting.</p> <p>In obtaining sufficient audit evidence we:</p> <ul style="list-style-type: none"> • Assessed automated controls within business processes and the reliability of relevant reports used as part of a manual control. This included assessing the integrity of system interfaces, the completeness and accuracy of data feeds, automated calculations and specific input controls. • Tested system migrations and related technology changes (including where relevant new systems) resulting from transformation programmes that were material to financial statement reporting. This included verifying the completeness of information transferred to new systems as well as testing the controls in place for both the migration and the new system. • Tested user access by assessing the controls in place for in-scope applications and verifying the addition and removal of users. • Identified an increasing number of systems outsourced to third party service providers. For these systems, tested IT general controls through evaluating the relevant Service Organisation Controls reports produced by third parties by assessing the timing of the reporting and the controls tested. Tested required complementary controls performed by management. • Where control deficiencies were identified, tested remediation activities performed by management and compensating controls in place and assessed where necessary to mitigate any residual risk. <p>Our planned audit procedures were completed without material exception.</p>

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the Company. Taken together, this enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Company and effectiveness of controls and changes in the business when assessing the level of work to be performed.

There have been no significant changes in scoping that applied in our prior year audit and all audit work was performed directly by, or under the instruction of, the audit engagement team.

Our application of materiality

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

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures. We determined materiality for the Company to be £9.7m (2018: £10m), which is 2% (2018: 2%) of Equity. We believe that Equity provides us with the most appropriate basis for materiality having considered the expectation of the users of the financial statements and the overall business environment.

Performance materiality

The application of materiality at the individual account or balance level is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality. On the basis of our risk assessments, together with our assessment of the Company's overall control environment, our judgement was that performance materiality was 75% (2018: 75%) of our planning materiality, namely £7.3m (2018: £7.4m). We have set performance materiality at this level having considered our prior year experience of the risk of misstatements, both corrected and uncorrected.

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

Independent auditor's report to the members of Ulster Bank Limited

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.5m (2018: £0.5m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. Our reporting threshold amount is designated at an amount below which misstatements would not be accumulated because we expect that the accumulation of such amounts clearly would not have a material effect on the financial statements.

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

Other information

Other information comprises the information included in the Annual Report other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

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

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

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

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

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

Matters on which we are required to report by exception

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

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

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

Responsibilities of directors

As explained more fully in the statement directors' responsibilities set out on page 12, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for the implementation of such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

Independent auditor's report to the members of Ulster Bank Limited

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

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

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Company and have a direct impact on the preparation of the financial statements and understood how the Company is complying with those frameworks by reviewing policy framework, holding discussions with the Company's general counsel and internal audit, amongst others.
- We assessed the susceptibility of the financial statements to material misstatement, including how fraud might occur by holding discussions with senior management, including the Chief Executive Officer, Chief Financial Officer, Group General Counsel, Head of Internal Audit and Audit Committee Chairman. We also reviewed the fraud-related policies and mandates of different governance forums assessing fraud.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved inquiring of key management, reviewing the key policies and reports on the aforementioned regulatory frameworks as well as reviewing the correspondence exchanged with the Regulators.

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

Other matters we are required to address

- We were appointed by the company on 21 April 2016 to audit the financial statements for the year ending 31 December 2016 and subsequent financial periods. The current period of total uninterrupted engagement including previous renewals and reappointments of the firm is 4 years, covering the years ending 31 December 2016 to 31 December 2019.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the company and we remain independent of the company in conducting the audit.
- The audit opinion is consistent with the additional report to the audit committee.

Use of our report

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

Martina Keane
for and on behalf of
Ernst & Young Chartered Accountants, Statutory Auditor
Office: Dublin

Date: 13 February 2020

Income statement for the year ended 31 December 2019

	Note	2019 £m	2018* £m
Interest receivable		193	195
Interest payable		(50)	(51)
Net interest income	1	143	144
Fees and commissions receivable		56	53
Fees and commissions payable		(9)	(9)
Other operating income		52	47
Non-interest income	2	99	91
Total income		242	235
Staff costs		(89)	(88)
Premises and equipment		(14)	(15)
Other administrative expenses		(92)	(70)
Depreciation, impairment and amortisation		(9)	(3)
Operating expenses	3	(204)	(176)
Profit before impairment losses		38	59
Impairment losses	9	(18)	(6)
Operating profit before tax		20	53
Tax charge	6	(4)	(5)
Profit for the year		16	48
Attributable to:			
Ordinary shareholders		12	44
Paid-in equity holders		4	4
		16	48

*Restated for the revision to IAS 12 'Income taxes'. Refer to accounting policy 1 for further details.

Statement of comprehensive income for the year ended 31 December 2019

	2019 £m	2018* £m
Profit for the year	16	48
Items that do not qualify for reclassification:		
Gain on remeasurement of retirement benefit scheme	-	3
Tax	-	(1)
Other comprehensive income after tax	-	2
Total comprehensive income for the year	16	50
Attributable to:		
Ordinary shareholders	12	46
Paid-in equity holders	4	4
	16	50

*Restated for the revision to IAS 12 'Income taxes'. Refer to accounting policy 1 for further details.

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

Balance sheet as at 31 December 2019

	Note	2019 £m	2018 £m
Assets			
Cash and balances at central banks	8	1,076	1,063
Derivatives	7	3	5
Loans to banks - amortised cost	8	14	58
Loans to customers - amortised cost	8	3,556	3,699
Amounts due from holding companies and fellow subsidiaries	8	6,513	6,750
Other assets	10	74	66
Total assets		11,236	11,641
Liabilities			
Bank deposits - amortised cost	8	6	5
Customer deposits - amortised cost	8	7,030	6,963
Customer deposits - designated at fair value through profit or loss	8	-	10
Amounts due to holding companies and fellow subsidiaries	8	2,795	3,299
Derivatives	7	6	9
Other liabilities	12	902	869
Total liabilities		10,739	11,155
Owners' equity		497	486
Total liabilities and equity		11,236	11,641

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

The accounts were approved by the Board of Directors on 13 February 2020 and signed on its behalf by:

Howard Davies
Chairman

Alison Rose-Slade
Chief Executive Officer

Katie Murray
Chief Financial Officer

Ulster Bank Limited is registered in Northern Ireland No. R0000733

Statement of changes in equity for the year ended 31 December 2019

	2019	2018
	£m	£m
Called-up share capital - at 1 January and 31 December	254	254
Paid-in equity - at 1 January and 31 December	60	60
Retained earnings - at 1 January	172	172
Implementation of IFRS 9 on 1 January 2018	-	(4)
Implementation of IFRS 16 on 1 January 2019 (Note 14)	(1)	-
Gain on remeasurement of retirement benefit scheme	-	3
Tax	-	(1)
Profit attributable to ordinary shareholders	12	44
Profit attributable to paid-in equity holders	4	4
Paid-in equity coupon payments	(4)	(4)
Dividends paid	-	(42)
At 31 December	183	172
Owners' equity at 31 December	497	486
Owners' equity is attributable to:		
Ordinary shareholders	437	426
Paid-in equity holders	60	60
	497	486

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

Cash flow statement for the year ended 31 December 2019

	Note	2019 £m	2018 £m
Cash flows from operating activities			
Operating profit before tax		20	53
Dividends received		-	(1)
Depreciation and impairment of property, plant and equipment		9	3
Interest on subordinated liabilities		-	1
Defined benefit pension schemes		-	3
Provisions: expenditure in excess of charges		21	8
Impairment losses on loans to banks and customers		18	6
Loans written-off		(13)	(39)
Elimination of foreign exchange differences		(1)	(2)
Other non-cash items		(2)	(4)
Net cash flows from trading activities		52	28
Decrease in loans to banks and customers		142	75
Decrease/(increase) in amounts due from holding companies and fellow subsidiaries		57	(247)
Increase in other assets		(8)	-
Increase in derivative assets and liabilities		(1)	(5)
Increase/(decrease) in bank and customer deposits		58	(865)
(Decrease)/increase in amounts due to holding companies and fellow subsidiaries		(499)	476
Increase in other liabilities		12	1
Changes in operating assets and liabilities		(239)	(565)
Income taxes paid		(11)	(14)
Net cash flows used in operating activities⁽¹⁾		(198)	(551)
Cash flows from investing activities			
Purchase of property, plant and equipment		(3)	(3)
Sale of property, plant and equipment		-	4
Dividends received		-	1
Net cash flows (used in)/from investing activities		(3)	2
Cash flows from financing activities			
Interest on subordinated liabilities		-	(1)
Paid-in equity coupon payments		(4)	(4)
Net cash flows used in financing activities		(4)	(5)
Effect of exchange rate changes on cash and cash equivalents		(5)	1
Net decrease in cash and cash equivalents		(210)	(553)
Cash and cash equivalents 1 January*	18	5,508	6,061
Cash and cash equivalents 31 December	18	5,298	5,508

*2018 data has been restated to include items in the course of collection (1 January 2018 - £41 million, 31 December 2018 - £38 million) as cash and cash equivalents.

Note:

(1) Includes interest received of £193 million (2018 – £194 million) and interest paid of £50 million (2018 – £50 million).

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

Accounting policies

1. Presentation of accounts

The accounts, set out on pages 18 to 79 including these accounting policies on pages 22 to 26 and the audited sections of Risk management on pages 46 to 76, are prepared on a going concern basis (see the Report of the directors, page 11) and in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB), and interpretations as issued by the International Financial Reporting Interpretations Committee of the IASB (IFRIC) and adopted by the EU (together IFRS). The significant accounting policies and related judgments are set out below.

The company is incorporated in the UK and registered in Northern Ireland. Its accounts are presented in accordance with the Companies Act 2006.

The accounts are presented in the functional currency, pounds sterling.

With the exception of certain financial instruments as described in accounting policies 11 and 16 the accounts are presented on a historical cost basis.

Adoption of IFRS 16

Refer to Accounting policy 8 and Note 14 for details of the adoption of IFRS 16.

Other amendments to IFRS

IAS 12 'Income taxes' was revised with effect from 1 January 2019. The income statement now includes any tax relief on the servicing cost of instruments classified as equity. Relief of £1 million was recognised in the statement of changes in equity for the year ended 31 December 2018; this has been restated.

IAS 19 'Employee Benefits' was amended by the IASB in February 2018 to clarify the need to update assumptions whenever there is a plan amendment, curtailment or settlement. This amendment has not affected the accounts.

Presentation of interest in suspense

In March 2019 IFRIC issued an agenda decision on the presentation of unrecognised interest when a credit-impaired financial asset (commonly referred to as a 'Stage 3' financial asset) is subsequently paid in full or is no longer credit-impaired. This concluded that the difference arising from the additional interest recovered must be recognised as a reversal of impairment rather than within interest revenue. This affects both recognition and the reversal of the expected credit loss (ECL) allowance.

Until 1 January 2019, interest in suspense recoveries were presented as a component of interest receivable within net interest income in the income statement. From 1 January 2019 interest in suspense recoveries are presented within impairment losses and amounted to £2 million for the year ended 31 December 2019. Income statement comparatives have not been restated on the grounds of materiality.

The Bank changed its accounting policy in line with the IFRIC decision. Hence, the gross carrying amount of the financial assets on the balance sheet within the scope of the provisions of the decision, as well as the associated ECL allowance on the balance sheet, have been adjusted by £2 million and the comparative period restated by £5 million with no effect on income statement or equity.

The coverage ratio for the current and comparative periods has been adjusted and restated accordingly.

2. Basis of consolidation

The accounts contain information about Ulster Bank Limited as an individual company and do not contain consolidated financial information as the parent of a group. The company is exempt under IFRS 10 'Consolidated Financial Statements' from the requirement to prepare consolidated accounts as the company and its subsidiary are included by full consolidation in the IFRS consolidated accounts of its ultimate parent, RBSG, a public company registered in Scotland.

3. Revenue recognition

Interest income or expense relates to financial instruments measured at amortised cost and debt instruments classified as fair value through Other comprehensive income (OCI) using the effective interest rate method. The effective part of any related accounting hedging instruments. Negative effective interest accruing to financial assets is presented in interest payable.

Other interest relating to financial instruments measured at fair value is recognised as part of the movement in fair value.

Fees in respect of services are recognised as the right to consideration accrues through the performance of each distinct service obligation 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.

4. Assets held for sale

A non-current asset is classified as held for sale if the Bank will recover its carrying amount principally through a sale transaction rather than through continuing use. A non-current asset classified as held for sale is measured at the lower of its carrying amount and fair value less costs to sell. If the asset is acquired as part of a business combination, it is initially measured at fair value less costs to sell. Non current assets classified as held for sale are shown under the heading of other assets on the balance sheet.

5. Employee benefits

Short-term employee benefits, such as salaries, paid absences, and other benefits are accounted for on an accruals basis over the period in which the employees provide the related services. Employees may receive variable compensation satisfied by cash, by debt instruments issued by the Group or by RBSG plc shares. The Group operates a number of share-based compensation schemes under which it awards RBSG plc shares and share options to its employees. Such awards are generally subject to vesting conditions.

Variable compensation that is settled in cash or debt instruments is charged to profit or loss on a straight-line basis over the vesting period, taking account of forfeiture and clawback criteria.

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

Accounting policies

For defined benefit schemes, the defined benefit obligation is measured on an actuarial basis. Actuarial gains and losses (i.e. gains and/or 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. The difference between scheme assets and scheme liabilities, the net defined benefit asset or liability, is recognised in the balance sheet subject to the asset ceiling test which requires the net defined benefit surplus to be limited to the present value of any economic benefits available to the Bank in the form of refunds from the plan or reduced contributions to it.

The charge to profit or loss for pension costs (mainly the service cost and the net interest on the net defined benefit asset or liability) is recognised in operating expenses.

6. Property, plant and equipment

Items of property, plant and equipment 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 Bank'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 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.

7. Impairment of right of use assets and property, plant and equipment

At each balance sheet date, the Bank assesses whether there is any indication that its right of use assets or property, plant and equipment are impaired. If any such indication exists, the Bank estimates the recoverable amount of the asset and the impairment loss, if any.

The recoverable amount of an asset that does not generate cash flows that are independent from those of other assets or groups of assets, is determined as a part of 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.

The recoverable amount of an asset or cash generating unit is the higher of its fair value less cost to sell or 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.

An impairment loss is recognised if the recoverable amount of an intangible or tangible asset is less than its carrying value. The carrying value of the asset is reduced by the amount of the loss and a charge recognised in profit or loss. A reversal of an impairment loss on property, plant and equipment can be recognised when an increase in service potential arises provided the increased carrying value is not greater than it would have been had no impairment loss been recognised.

8. Leases

The Bank has adopted IFRS 16 'Leases' with effect from 1 January 2019, replacing IAS 17 'Leases'. The Bank has applied IFRS 16 on a modified retrospective basis without restating prior years.

As lessor

Finance lease contracts are those which transfer substantially all the risks and rewards of ownership of an asset to a customer. All other contracts with customers to lease assets are classified as operating leases.

Loans to customers include finance lease receivables measured at the net investment in the lease, comprising the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Interest receivable includes finance lease income recognised at a constant periodic rate of return before tax on the net investment. 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 other operating 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.

As lessee

On entering a new lease contract, the Bank recognises a right of use asset and a liability to pay future rentals. The liability is measured at the present value of future lease payments discounted at the applicable incremental borrowing rate. The right of use asset is depreciated over the shorter of the term of the lease and the useful economic life, subject to review for impairment. Short term and low value leased assets are expensed on a systematic basis.

9. Provisions and contingent liabilities

The Bank 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.

Accounting policies

Provision is made for restructuring costs, including the costs of redundancy, when the Bank has a constructive obligation to restructure. An obligation exists when the Bank 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.

The Bank recognises any onerous cost of the present obligation under a contract as a provision. An onerous cost is the unavoidable cost of meeting the Bank's contractual obligations that exceed the expected economic benefits. When the Bank vacates a leasehold property, the right of use asset would be tested for impairment and a provision may be recognised for the ancillary occupancy costs, such as rates.

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.

10. 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. The tax consequences of servicing equity instruments are recognised in the income statement.

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 their recovery is probable.

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 Bank has a legally enforceable right to offset.

Accounting for taxes is judgemental and carries a degree of uncertainty because tax law is subject to interpretation, which might be questioned by the relevant tax authority. The Bank recognises the most likely current and deferred tax liability or asset, assessed for uncertainty using consistent judgements and estimates. Current and deferred tax assets are only recognised where their recovery is deemed probable, and current and deferred tax liabilities are recognised at the amount that represents the best estimate of the probable outcome having regard to their acceptance by the tax authorities.

11. Financial instruments

Financial instruments are classified either by product, by business model or by reference to the IFRS default classification.

Classification by product relies on specific designation criteria which are applicable to certain classes of financial assets or circumstances where accounting mismatches would otherwise arise. Classification by business model reflects how the Bank manages its financial assets to generate cash flows. A business model assessment determines if cash flows result from holding financial assets to collect the contractual cash flows; from selling those financial assets; or both.

The product classifications apply to financial assets that are either designated at fair value through profit or loss (DFV), or to equity investments designated as at fair value through other comprehensive income (FVOCI). Financial assets may also be irrevocably designated at fair value through profit or loss upon initial recognition if such designation eliminates, or significantly reduces, accounting mismatch. In all other instances, fair value through profit or loss (MFVTPL) is the default classification and measurement category for financial assets.

Regular way purchases of financial assets classified as amortised cost, are recognised on the settlement date; all other regular way transactions in financial assets are recognised on the trade date.

Business model assessment of assets is made at portfolio level, being the level at which they are managed to achieve a predefined business objective. This is expected to result in the most consistent classification of assets because it aligns with the stated objectives of the portfolio, its risk management, manager's remuneration and the ability to monitor sales of assets from a portfolio.

Most financial assets are within 'held to collect' business models, and have contractual cash flows that comprise solely payments of principal and interest and therefore are measured at amortised cost.

Certain financial assets are managed under a business model of both 'held to collect and sell' and have contractual cash flows comprising solely of payments of principal and interest, and are measured at fair value through other comprehensive income ('FVOCI'). Financial assets may also be irrevocably designated at fair value through profit or loss upon initial recognition if such designation eliminates, or significantly reduces, accounting mismatch.

Accounting policies

The contractual terms of a facility; any leverage features; prepayment and extension terms; and triggers that might reset the effective rate of interest; are considered in determining whether cash flows comprise solely payments of principal and interest.

All financial instruments are measured at fair value on initial recognition.

All liabilities not subsequently measured at fair value are measured at amortised cost.

12. Impairment: expected credit losses

At each balance sheet date each financial asset or portfolio of loans measured at amortised cost or at fair value through other comprehensive income, issued financial guarantee and loan commitment is assessed for impairment and presented as impairments in the income statement. Loss allowances are forward looking, based on 12 month expected credit losses where there has not been a significant increase in credit risk rating, otherwise allowances are based on lifetime expected losses.

Expected credit losses are a probability-weighted estimate of credit losses. The probability is determined by the risk of default which is applied to the cash flow estimates. In the absence of a change in credit rating, allowances are recognised when there is reduction in the net present value of expected cash flows.

On a significant increase in credit risk, allowances are recognised without a change in the expected cash flows, although typically expected cash flows do also change; and expected credit losses are adjusted from 12 month to lifetime expectations.

Judgement is exercised as follows:

- **Models** – in certain low default portfolios, Basel parameter estimates are also applied for IFRS 9.
- **Non-modelled portfolios** – use a standardised capital requirement under Basel II. Under IFRS 9, they have bespoke treatments for the identification of significant increase in credit risk. Benchmark PDs, EADs and LGDs are reviewed annually for appropriateness. The ECL calculation is based on expected future cash flows, which is typically applied at a portfolio level.
- **Multiple economic scenarios (MES)** – the central, or base, scenario is most critical to the ECL calculation, independent of the method used to generate a range of alternative outcomes and their probabilities.
- **Significant increase in credit risk** – IFRS 9 requires that at each reporting date, an entity shall assess whether the credit risk on an account has increased significantly since initial recognition. Part of this assessment requires a comparison to be made between the current lifetime PD (i.e. the current probability of default over the remaining lifetime) with the equivalent lifetime PD as determined at the date of initial recognition.

On restructuring a financial asset without causing derecognition of the original asset the revised cash flows are used in re-estimating the credit loss. Where restructuring causes derecognition of the original financial asset, the fair value of the replacement asset is used as the closing cash flow of the original asset.

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.

The costs of loss allowances on assets held at amortised cost, fair value through comprehensive income (excluding equity shares), and in respect of financial guarantees and loan commitments are presented as impairments in the income statement.

Impaired loans are written off and therefore derecognised from the balance sheet when the Bank 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 the 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 Bank'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.
- Commercial loans: write offs are determined in the light of individual circumstances; the period does not exceed five years.
- Business loans are generally written off within five years.

Provision is made for expected credit loss on 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.

13. Financial guarantee contracts

Under a financial guarantee contract, the Bank, 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 11. Amortisation is calculated so as to recognise fees receivable in profit or loss over the period of the guarantee.

Accounting policies

14. 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. Conversely, an asset is not derecognised by a contract under which the Bank retains substantially all the risks and rewards of ownership. If substantially all the risks and rewards have been neither retained nor transferred, the Bank does not derecognise an asset over which it has retained control but limits its recognition to the extent of its continuing involvement.

A financial liability is removed from the balance sheet when the obligation is discharged, or is cancelled, or expires. Cancellation includes the issuance of a substitute instrument on substantially different terms.

15. Netting

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when, and only when, the Bank 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 Bank 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.

16. Derivatives

Derivative financial instruments are initially recognised, and subsequently measured, at fair value. The Bank'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 8 to the accounts.

A derivative embedded in a financial liability 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.

17. 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.

Critical accounting policies and key sources of estimation uncertainty

The reported results of the Bank 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 Bank'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 Bank'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 Bank would affect its reported results.

Critical accounting policy	Note
Deferred tax	6
Fair value: financial instruments	8
Loan impairment provisions	9
Provisions for liabilities and charges	12

Accounting developments International Financial Reporting Standards

A number of IFRSs and amendments to IFRS were in issue at 31 December 2019 that would affect the Bank from 1 January 2020 or later.

- The amendments to IAS 1 'Presentation of Financial Statements' and IAS 8 'Accounting Policy, Changes in Accounting Estimates and Errors' on the definition of material were issued in October 2018 and are effective for annual periods beginning on or after 1 January 2020 with earlier application permitted. The amendments are aimed at improving the understanding of the existing requirements rather than to significantly impact current materiality judgements. They provide a new definition of material which shall be used to assess whether information, either individually or in combination with other information, is material in the context of the financial statements.
- The amendments to IFRS 3 'Business Combinations' which clarify the definition of a Business were issued in October 2018, are effective for annual reporting periods beginning on or after 1 January 2020 and apply prospectively with earlier application permitted. They clarify the minimum requirements for a business; remove the assessment of whether market participants are capable of replacing any missing elements; add guidance to help entities assess whether an acquired process is substantive; narrow the definitions of a business and of outputs; and introduce an optional fair value concentration test.

The Bank is assessing the effect of adopting these standards on its financial statements.

Notes to the accounts

1. Net interest income

	2019 £m	2018 £m
Loans to banks - amortised cost	3	2
Loans to customers - amortised cost	129	129
Amounts due from holding company and fellow subsidiaries	61	64
Interest receivable	193	195
Customer deposits: demand - amortised cost	(9)	(8)
Customer deposits: savings - amortised cost	(15)	(20)
Customer deposits: other time - amortised cost	(2)	(1)
Subordinated liabilities	-	(1)
Amounts due to holding company and fellow subsidiaries	(24)	(21)
Interest payable	(50)	(51)
Net interest income	143	144

Interest income on financial instruments measured at amortised cost and debt instruments classified as fair value through OCI is measured using the effective interest rate which allocates the interest income or interest expense over the expected life of the asset or liability at the rate that exactly discounts all estimated future cash flows to equal 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.

2. Non-interest income

	2019 £m	2018 £m
Net fees and commissions (Note 4)	47	44
Other operating income:		
Income on services provided to other RBS Group companies	53	44
Cost of economic hedging		
- Foreign exchange	1	2
- Interest rates	(1)	1
Dividend income	-	1
Other income	(1)	(1)
	52	47
Non-interest income	99	91

3. Operating expenses

	2019 £m	2018 £m
Wages, salaries and other staff costs	59	57
Temporary and contractor costs ⁽¹⁾	4	7
Social security costs	7	6
Pension costs		
- defined benefit schemes (Note 5)	10	14
- defined contribution schemes	2	2
Restructure costs	7	2
Staff costs	89	88
Premises and equipment	14	15
Depreciation, impairment and amortisation (Note 11)	9	3
Other administrative expenses	92	70
Administrative expenses	115	88
	204	176

Note:

(1) During the year the Bank reclassified temporary and contractor costs from other administrative expenses to staff costs. Comparatives have been restated.

Notes to the accounts

3. Operating expenses continued

The average number of persons employed by the Bank during the year, excluding temporary staff, was 1,776 (2018 - 1,820). The average number of temporary employees during 2019 was 145 (2018 - 140). The number of persons employed by the Bank at 31 December, excluding temporary staff, was as follows:

	2019 Number	2018 Number
Personal Banking	880	870
Commercial Banking	167	167
Other	692	761
	1,739	1,798

Effective 1 January 2019 Business Banking was transferred from Personal Banking to Commercial Banking. Refer to Note 4 for further details. Comparative employee numbers have been restated.

Other principally comprises staff members whose roles involve the provision of services exclusively to other companies in RBS Group including attributable central costs at an arm's length transfer pricing mark up. The staff costs of these employees are recharged to the companies they provide services to.

Amounts paid to the auditors for the statutory audit and other services are set out below:

	2019 £k	2018 £k
Fees payable for the audit of the Bank's annual accounts	346	341
Fees payable to the auditor for other assurance services	-	70
Total audit and audit related assurance service fees	346	411

Other than the amounts disclosed above, no remuneration was payable in respect of tax advisory services and other non-audit services. Auditors' remuneration is disclosed exclusive of VAT.

4. Segmental analysis

Effective from 1 January 2019 Business Banking was transferred from Personal & Business Banking (PBB) to Commercial Banking, as the nature of the business, including distribution channels, products and customers, was more closely aligned to the Commercial Banking business. Following the transfer, PBB was renamed Personal Banking. Comparatives have been restated.

Reportable operating segments

The Bank operates entirely in the UK and is managed by the following classes of business on which basis the segmental analysis is presented.

Personal Banking provides loans and deposits through a network of branches and direct channels to individuals and mass affluent customers.

Commercial Banking including Business Banking, provides services to commercial and corporate customers.

Other represents central functions comprising Treasury, Customer Debt Solutions, Finance, Risk, Legal and Human Resources which support the Personal Banking and Commercial Banking divisions and other RBS Group subsidiaries. The services provided to other RBS Group companies are invoiced through the Bank's transfer pricing process on an arm's length basis including an appropriate mark up on costs incurred.

	2019				2018*			
Class of Business	Personal Banking £m	Commercial Banking £m	Other £m	Total £m	Personal Banking £m	Commercial Banking £m	Other £m	Total £m
Net interest income	84	59	-	143	87	57	-	144
Net fees and commissions	23	24	-	47	21	23	-	44
Other operating income	(1)	(4)	57	52	3	(3)	47	47
Total income	106	79	57	242	111	77	47	235
Operating profit/(loss) before tax	55	46	(81)	20	72	66	(85)	53
Total assets	3,137	1,514	6,585	11,236	3,337	1,483	6,821	11,641
Total liabilities	(5,309)	(2,600)	(2,830)	(10,739)	(5,346)	(2,473)	(3,336)	(11,155)
Net assets/(liabilities)	(2,172)	(1,086)	3,755	497	(2,009)	(990)	3,485	486

*2018 data has been restated for the business re-segmentation completed in the first quarter of 2019.

Notes to the accounts

4. Segmental analysis continued

Class of business	2019			2018*		
	Personal Banking	Commercial Banking	Total	Personal Banking	Commercial Banking	Total
	£m	£m	£m	£m	£m	£m
Fees and commissions receivable						
- Payment services	11	19	30	12	16	28
- Credit and debit card fees	16	2	18	13	3	16
- Lending (Credit facilities)	1	4	5	1	4	5
- Brokerage	1	-	1	1	-	1
- Other	1	1	2	2	1	3
Total	30	26	56	29	24	53
Fees and commissions payable	(7)	(2)	(9)	(8)	(1)	(9)
Net fees and commissions	23	24	47	21	23	44

*2018 data has been restated for the business re-segmentation completed in the first quarter of 2019.

5. Pensions

Defined contribution scheme

The Bank contributes to its own defined contribution scheme and a small number of RBS Group Pension Schemes, the costs of which are accounted for as defined contributions, which new employees are offered the opportunity to join.

Defined benefit scheme

The Bank sponsors the Ulster Bank Pension Scheme (UBPS), which operates under Northern Ireland trust law and is managed and administered on behalf of its members in accordance with the terms of the trust deed, the scheme rules and Northern Ireland legislation.

A pension fund trustee is appointed to operate the fund and ensure benefits are paid in accordance with scheme rules and national law. The trustee is the legal owner of the scheme's assets, and has a duty to act in the best interests of all scheme members.

The scheme generally provides a pension of one-sixtieth of final pensionable salary for each year of service prior to retirement up to a maximum of 40 years and is contributory for current members.

It has been closed to new entrants for over ten years, although current members continue to build up additional pension benefits, currently subject to 2% maximum annual salary inflation, while they remain employed by the Bank.

The UBPS corporate trustee is Ulster Bank Pension Trustees Limited (UBPTL), a wholly owned subsidiary of the Bank. UBPTL is the legal owner of the scheme assets which are held separately from the assets of the Bank. The board of UBPTL comprises three trustee directors nominated by members selected from eligible active staff, deferred and pensioner members who apply and six appointed by the Bank.

Under Northern Ireland legislation a defined benefit pension scheme is required to meet the statutory funding objective of having sufficient and appropriate assets to cover its liabilities (the pensions that have been promised to members).

Investment strategy

The assets of the UBPS are invested in a diversified portfolio as shown in the table below.

The scheme employs derivative instruments to achieve a desired asset class exposure and to reduce the scheme's interest rate, inflation and currency risk. This means that the net funding position is considerably less sensitive to changes in market conditions than the value of the assets or liabilities in isolation.

Major classes of plan assets as a percentage of total plan assets of the scheme	2019			2018		
	Quoted %	Unquoted %	Total %	Quoted %	Unquoted %	Total %
Equities	2	3	5	3	3	6
Index linked bonds	32	-	32	31	-	31
Government bonds	4	-	4	3	-	3
Corporate and other bonds	19	4	23	22	4	26
Hedge funds	-	4	4	-	3	3
Real estate	-	3	3	-	4	4
Derivatives	-	12	12	-	6	6
Cash and other assets	-	17	17	-	21	21
	57	43	100	59	41	100

Notes to the accounts

5. Pensions continued

	Fair value of plan assets £m	Present value of defined benefit obligations £m	Asset ceiling/ minimum funding ⁽¹⁾ £m	Net pension surplus £m
Changes in value of net pension asset				
At 1 January 2018	1,191	(896)	(295)	-
Income statement	30	(37)	(7)	(14)
Statement of comprehensive income	(44)	48	(1)	3
Contributions by employer	11	-	-	11
Contributions by plan participants	1	(1)	-	-
Benefits paid	(48)	48	-	-
At 1 January 2019	1,141	(838)	(303)	-
Income statement	33	(34)	(9)	(10)
Net interest expense	33	(23)	-	10
Current service cost	-	(8)	-	(8)
Expenses	-	(2)	-	(2)
Past service cost	-	(1)	-	(1)
Interest on the asset ceiling	-	-	(9)	(9)
Statement of comprehensive income	77	(136)	59	-
Return on plan assets above recognised interest income	77	-	-	77
Experience gains and losses	-	(6)	-	(6)
Effect of changes in actuarial financial assumptions	-	(137)	-	(137)
Effect of changes in actuarial demographic assumptions	-	7	-	7
Asset ceiling/minimum funding adjustments	-	-	59	59
Contributions by employer ⁽²⁾	10	-	-	10
Contributions by plan participants	1	(1)	-	-
Benefits paid	(43)	43	-	-
At 31 December 2019	1,219	(966)	(253)	-

Notes:

(1) In recognising the net surplus or deficit of a pension scheme, the funded status of the 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 the scheme.

(2) The Bank expects to contribute £9 million to its defined benefit pension scheme in 2020.

	2019 £m	2018 £m
Amounts recognised on the balance sheet		
Fund assets at fair value	1,219	1,141
Present value of fund liabilities	(966)	(838)
Funded status	253	303
Asset ceiling/minimum funding	(253)	(303)
Retirement benefit asset	-	-
	2019 £m	2018 £m
Amounts recognised in the income statement		
Operating expenses	10	14

Funding and contributions by the Bank

In Northern Ireland, the trustees of defined benefit pension schemes are required to perform funding valuations every three years. The trustee and the Bank, with the support of the scheme actuary, agree the assumptions used to value the liabilities and a Schedule of Contributions required to eliminate any funding deficit. The funding assumptions incorporate a margin for prudence over and above the expected cost of providing the benefits promised to members, taking into account the sponsor's covenant and the investment strategy of the scheme. The latest funding valuation of the scheme was at 31 December 2015 and the next funding valuation is due at 31 December 2018, to be agreed by 31 March 2020.

The triennial funding valuation of the scheme as at 31 December 2015 determined the funding level to be 99%, pension liabilities to be £922 million and the deficit to be £9 million. The average cost of the future service of current members is 40% of basic salary before contributions from those members. During 2016 (and concluding in early February 2017), the terms of the 31 December 2015 funding valuation of the UBPS were agreed with the Trustee. This resulted in the cessation of deficit recovery contributions from the Bank. Contributions to cover the ongoing accrual of benefits by employees and the expenses of the pension scheme continue.

Notes to the accounts

5. Pensions continued

Assumptions

Placing a value on the Bank's defined benefit pension scheme's liabilities requires the Bank's management to make a number of assumptions, with the support of independent actuaries. The ultimate cost of the defined benefit obligations will depend upon actual future events and the assumptions made are unlikely to be exactly borne out in practice, meaning the final cost may be higher or lower than expected.

A year-end valuation of the Bank's scheme was prepared to 31 December 2019 by independent actuaries using the following assumptions:

	Principal IAS 19 actuarial assumptions		Principal assumptions of 2015 triennial valuation
	2019 %	2018 %	2015 %
Discount rate	2.05	2.90	Fixed interest swap yield curve plus 0.7% per annum at all durations
Inflation assumption (CPI)	1.90	2.15	RPI swap yield curve less 1% per annum
Rate of increase in salaries	1.75	1.75	CPI curve adjusted to reflect a 0% per annum floor and 2% per annum cap
Rate of increase in deferred pensions	2.95	3.10	RPI curve
Rate of increase in pensions in payment	0.00-2.25	0.00-2.30	Inflation curves adjusted to reflect the floor and cap
Proportion of pension converted to a cash lump sum at retirement	25.00	25.00	25.00
Longevity:	years	years	years
Current pensioners, aged 70 years			
Males	19.2	19.4	19.6
Females	20.5	20.7	21.1
Future pensioners, currently aged 63 years			
Males	25.6	25.8	26.4
Females	27.1	27.3	28.0

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

Discount rate

The IAS 19 valuation uses a single discount rate by reference to the yield on a basket of 'high quality' sterling corporate bonds. For the triennial valuation discounting is by reference to a yield curve.

The average duration of the Bank's defined benefit obligation at 31 December 2019 is 21 years (2018 - 21 years).

Significant judgement is required when setting the criteria for bonds to be included in IAS 19's basket of bonds that is used to determine the discount rate used in the valuations. 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.

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

	(Decrease)/increase in pension cost for the year		(Decrease)/increase in obligation at 31 December	
	2019 £m	2018 £m	2019 £m	2018 £m
0.25% increase in the discount rate	(0.6)	(0.7)	(49)	(42)
0.25% increase in inflation	0.2	0.6	25	17
Longevity increase of 1 year	0.3	0.2	28	20
0.25% additional rate of increase in pensions in payment	0.3	0.4	24	21
0.25% additional rate of increase in deferred pensions	0.0	0.1	11	10
0.25% additional rate of increase in salaries	0.3	0.3	6	3

Notes to the accounts

5. Pensions continued

The defined benefit obligation is attributable to the different classes of scheme members in the following proportions:

Membership category	2019 %	2018 %
Active	21.6	21.1
Deferred	33.8	43.1
Pensioners and dependents	44.6	35.8
	100.0	100.0

The experience history of the scheme is shown below:

History of defined benefit scheme	2019 £m	2018 £m	2017 £m	2016 £m	2015 £m
Fair value of plan assets	1,219	1,141	1,191	1,162	911
Present value of defined benefit obligations	(966)	(838)	(896)	(884)	(755)
Net surplus	253	303	295	278	156
Experience (losses)/gains on plan liabilities	(6)	(1)	(1)	42	8
Experience gains/(losses) on plan assets	77	(44)	9	200	(33)
Actual return on pension scheme assets	110	(14)	40	236	1
Actual return on pension scheme assets	9.6%	(1.2%)	3.4%	25.9%	0.1%

6. Taxation

	2019 £m	2018 £m
Current tax		
Charge for the year	(9)	(12)
Over provision in respect of prior periods	2	-
	(7)	(12)
Deferred tax		
Charge for the year	(1)	(2)
(Reduction)/increase in the carrying value of deferred tax assets in respect of losses	(2)	7
Over provision in respect of prior periods	6	2
	3	7
Tax charge for the year	(4)	(5)

The actual tax charge differs from the expected tax charge computed by applying the main UK corporation tax rate of 19% (2018 - 19%).

	2019 £m	2018 £m
Expected tax charge	(4)	(10)
Non-deductible items	(4)	(1)
Tax credit on paid-in equity	1	1
Surcharge on banking companies	(3)	(4)
(Reduction)/increase in the carrying value of deferred tax asset in respect of losses	(2)	7
Adjustments to tax charge in respect of prior periods	8	2
Actual tax charge for the financial year	(4)	(5)

Note:

In recent years, the UK government has steadily reduced the rate of UK corporation tax, with the latest enacted rates standing at 19% with effect from 1 April 2017 and 17% from 1 April 2020.

Notes to the accounts

6. Taxation continued

Deferred tax

Net deferred tax asset comprised:

	Pension £m	Accelerated capital allowances £m	Deferred gains £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2018	-	3	(7)	14	-	10
Implementation of IFRS 9 on 1 January 2018	-	-	-	-	1	1
Credit to income statement	1	-	-	5	1	7
Charge to other comprehensive income	(1)	-	-	-	-	(1)
At 1 January 2019	-	3	(7)	19	2	17
Charge to income statement	-	-	-	(2)	1	(1)
Adjustments in respect of prior years	-	-	7	(2)	(1)	4
At 31 December 2019	-	3	-	15	2	20

Critical accounting policy: Deferred tax

The deferred tax asset of £20 million as at 31 December 2019 (2018 - £17 million) principally comprises losses and temporary differences. These deferred tax assets are recognised to the extent that it is probable that there will be future taxable profits to recover them.

Judgement - The Bank has considered their carrying value as at 31 December 2019 and concluded that, based on management's estimates, sufficient taxable profits will be generated in future years to recover recognised deferred tax assets.

Estimate – These estimates are partly based on forecast performance beyond the horizon for management's detailed plans. They have regard to inherent uncertainties, such as Brexit and climate change. The Bank expects the deferred tax asset to be consumed by future taxable profits by the end of 2025.

UK tax losses

Under UK tax rules, tax losses can be carried forward indefinitely. As the recognised tax losses in the Bank arose prior to 1 April 2015, credit in future periods is given against 25% of profits at the main rate of UK corporation tax, excluding the Banking Surcharge 8% rate introduced by The Finance (No. 2) Act 2015. Deferred tax assets and liabilities at 31 December 2019 take into account the reduced rates in respect of tax losses and temporary differences and where appropriate, the banking surcharge inclusive rate in respect of other banking temporary differences.

Unrecognised deferred tax

Deferred tax assets of £12 million (2018 - £9 million) have not been recognised in respect of tax losses carried forward of £68 million (2018 - £52 million) where doubt exists over the availability of future taxable profits.

7. Derivatives

The Bank transacts derivatives as principal either as a trading activity or to manage balance sheet foreign exchange, interest rate and credit risk.

The following table shows the notional amount and fair value of the Bank's derivatives.

	2019			2018		
	Notional amount £m	Assets £m	Liabilities £m	Notional amount £m	Assets £m	Liabilities £m
Over-the-counter derivatives						
Foreign exchange contracts	75	1	1	17	1	-
Interest rate contracts	1,453	2	5	2,408	4	9
	1,528	3	6	2,425	5	9
Amounts above include						
Due from/to fellow subsidiaries	1,528	3	6	2,425	5	9

Notes to the accounts

8. Financial instruments – classification

The following tables analyse the Bank's financial assets and financial liabilities in accordance with the categories of financial instruments on an IFRS 9 basis at 31 December 2019. Assets and liabilities outside the scope of IFRS 9 are shown within other assets and other liabilities.

	MFVTPL £m	Held-for- trading £m	DFV £m	Amortised cost £m	Other assets/liabilities £m	Total £m
2019						
Assets						
Cash and balances at central banks	-	-	-	1,076	-	1,076
Derivatives	3	-	-	-	-	3
Loans to banks - amortised cost ⁽¹⁾	-	-	-	14	-	14
Loans to customers - amortised cost	-	-	-	3,556	-	3,556
Amounts due from holding companies and fellow subsidiaries	-	-	-	6,513	-	6,513
Other assets	-	-	-	-	74	74
	<u>3</u>	<u>-</u>	<u>-</u>	<u>11,159</u>	<u>74</u>	<u>11,236</u>
Liabilities						
Bank deposits - amortised cost ⁽²⁾	-	-	-	6	-	6
Customers deposits - amortised cost	-	-	-	7,030	-	7,030
Amounts due to holding companies and fellow subsidiaries	-	-	-	2,795	-	2,795
Derivatives	-	6	-	-	-	6
Other liabilities	-	-	-	842	60	902
	<u>-</u>	<u>6</u>	<u>-</u>	<u>10,673</u>	<u>60</u>	<u>10,739</u>
Equity						497
						<u>11,236</u>

	MFVTPL £m	Held-for- trading £m	DFV £m	Amortised cost £m	Other assets/liabilities £m	Total £m
2018						
Assets						
Cash and balances at central banks	-	-	-	1,063	-	1,063
Derivatives	5	-	-	-	-	5
Loans to banks - amortised cost ⁽¹⁾	-	-	-	58	-	58
Loans to customers - amortised cost	-	-	-	3,699	-	3,699
Amounts due from holding companies and fellow subsidiaries	-	-	-	6,750	-	6,750
Other assets	-	-	-	-	66	66
	<u>5</u>	<u>-</u>	<u>-</u>	<u>11,570</u>	<u>66</u>	<u>11,641</u>
Liabilities						
Bank deposits - amortised cost ⁽²⁾	-	-	-	5	-	5
Customers deposits - amortised cost	-	-	-	6,963	-	6,963
Customer deposits - DFV ⁽³⁾	-	-	10	-	-	10
Amounts due to holding companies and fellow subsidiaries	-	-	-	3,299	-	3,299
Derivatives	-	9	-	-	-	9
Other liabilities	-	-	-	821	48	869
	<u>-</u>	<u>9</u>	<u>10</u>	<u>11,088</u>	<u>48</u>	<u>11,155</u>
Equity						486
						<u>11,641</u>

Notes:

(1) Includes items in the course of collection from other banks of nil (2018 - £38 million).

(2) Includes items in the course of transmission to other banks of nil (2018 - £5 million).

(3) The carrying amount of customer deposits designated at fair value through profit or loss is equal to the principal amount. No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities.

(4) There are no financial instruments that are subject to IAS 32 (on balance sheet) netting arrangements or subject to enforceable master netting instruments or similar agreements that are not set off in accordance with IAS 32.

Notes to the accounts

8. Financial instruments - classification continued

Amounts due to/from holding companies and fellow subsidiaries comprise:

	2019 £m	2018 £m
Amounts due from holding companies and fellow subsidiaries		
Loans to banks - amortised cost	6,513	6,750
Amounts due to holding companies and fellow subsidiaries		
Bank deposits - amortised cost	2,681	3,190
Customers deposits - amortised cost	12	2
Subordinated liabilities	102	107
	2,795	3,299

Financial instruments – valuation

Critical accounting policy: Fair value - financial instruments

In accordance with Accounting policies 11 and 16, financial instruments at fair value through profit or loss and financial assets classified as fair value through other comprehensive income 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 Bank maximises the use of relevant observable inputs and minimises the use of unobservable inputs.

Where the Bank manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risk 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.

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.

Valuation of financial instruments carried at fair value

Fair Value Hierarchy

Financial Instruments carried at fair value have been classified under the IFRS fair value hierarchy as follows.

Level 1 – Instruments valued using unadjusted quoted prices in active and liquid markets, for identical financial instruments. Examples include government bonds, listed equity shares and certain exchange-traded derivatives.

Level 2 - Instruments valued using valuation techniques that have observable inputs. Examples include most government agency securities, investment-grade corporate bonds, certain mortgage products, including collateralised loan obligations (CLO), 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 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. Examples include cash instruments which trade infrequently, certain syndicated and commercial mortgage loans and derivatives with unobservable model inputs.

The following table shows the financial instruments carried at fair value by valuation method:

	2019				2018			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets								
Derivatives	-	3	-	3	-	1	4	5
Total	-	3	-	3	-	1	4	5
Liabilities								
Customer deposits - DFV	-	-	-	-	-	10	-	10
Derivatives	-	6	-	6	-	2	7	9
Total	-	6	-	6	-	12	7	19

8. Financial instruments – valuation continued

The Bank places reliance on the oversight of the Ring Fence Bank Valuation Committee on the Independent Price Verification (IPV) process and the Bank eliminates its market risk on its portfolios by entering into back to back positions with National Westminster Bank plc.

Valuation Techniques

The fair value of instruments are derived differently depending on whether the instrument is a non-modelled or a modelled product.

Non-modelled products are valued directly from a price input typically on a position by position basis. Examples include equities and most debt securities.

Products that are priced using models range in complexity from comparatively vanilla 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.

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:

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 third party benchmarking services. For counterparty credit spreads, adjustments are made to market prices (or parameters) when the creditworthiness of the counterparty differs from that of the assumed counterparty in the market price (or parameters).

Interest rates - these are principally benchmark interest rates such as the London Interbank Offered Rate (LIBOR), Overnight Index Swaps (OIS) rate and other quoted interest rates in the swap, bond and futures markets.

Foreign currency exchange rates - there generally 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.

Price volatilities and correlations - volatility is a measure of the tendency of a price to change with time. Correlation measures the degree to which two or more prices or other variables are observed to move together.

Valuation Control

The 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.

IPV is a key element of the control environment. Valuations are first performed by the business which owns 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.

Where measurement differences are identified through the IPV process these are grouped by fair value level and quality of data. If the size of the difference exceeds defined thresholds adjustment to independent levels are made.

IPV takes place at least each month, for all fair value positions. The IPV control includes formalised reporting and escalation of any valuation differences in breach of established thresholds.

Valuation committees are made up of valuation specialists and senior business representatives from various functions and oversee pricing, reserving and valuations issues. These committees meet monthly to review and ratify any methodology changes. The Ring Fenced Bank Valuation Committee meets monthly to address key material and subjective valuation issues, to review items escalated by valuation committees and to discuss other relevant matters including prudential valuation.

Initial classification of a financial instrument is carried out following the principles in IFRS 13. These initial classifications are 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.

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 assessment of factors that market participants would consider in setting a price.

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.

8. Financial instruments – valuation continued

Active and inactive markets continued

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 valuation is derived from the use of the independent market inputs calculated using NatWest'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. 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.

Notes to the accounts

8. Financial instruments – valuation continued

The following tables show the carrying values and the fair values of financial instruments on the balance sheet carried at amortised cost. The fair value of the cash and balances at central banks has been determined using procedures consistent with the requirements of level 2 valuation methodologies, as set out above. All other balances have been fair valued using procedures that fall within level 3 of the fair value methodologies.

	2019		2018	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Cash & balances at central banks	1,076	1,076	1,063	1,063
Loans to banks - amortised cost	14	14	58	58
Loans to customers - amortised cost	3,556	3,516	3,699	3,641
Amounts due from holding companies and fellow subsidiaries				
- Loans to banks - amortised cost	6,513	6,513	6,750	6,750
Financial liabilities				
Bank deposits - amortised cost	6	6	5	5
Customer deposits - amortised cost	7,030	7,030	6,963	6,963
Amounts due to holding companies and fellow subsidiaries				
- Bank deposits	2,681	2,681	3,190	3,190
- Customer deposits	12	12	2	2
- Subordinated liabilities	102	93	107	98
Other liabilities - notes in circulation	842	842	821	821

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 to banks and customers

In estimating the fair value of loans to banks and customers measured at amortised cost, the Bank's loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans.

The principal method used to estimate fair value in the Bank is to discount expected cash flows at the current offer rate for the same or similar products.

Bank and customer deposits

Fair values of deposits are estimated using discounted cash flow valuation techniques.

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.

Financial instruments – maturity analysis

Remaining maturity

The following table shows the residual maturity of financial instruments, based on contractual date of maturity.

	2019			2018		
	Less than 12 months £m	More than 12 months £m	Total £m	Less than 12 months £m	More than 12 months £m	Total £m
Assets						
Cash and balances at central banks	1,076	-	1,076	1,063	-	1,063
Derivatives	1	2	3	1	4	5
Loans to banks - amortised cost	14	-	14	58	-	58
Loans to customers - amortised cost	817	2,739	3,556	844	2,855	3,699
Amounts due from holding companies and fellow subsidiaries	4,777	1,736	6,513	4,833	1,917	6,750

Notes to the accounts

8. Financial instruments – maturity analysis continued

Remaining maturity continued

	2019			2018		
	Less than 12 months £m	More than 12 months £m	Total £m	Less than 12 months £m	More than 12 months £m	Total £m
Liabilities						
Bank deposits - amortised cost	6	-	6	5	-	5
Customer deposits - amortised cost	7,030	-	7,030	6,963	-	6,963
Customer deposits - DFV	-	-	-	10	-	10
Amounts due to holding companies and fellow subsidiaries	2,678	117	2,795	2,976	323	3,299
Derivatives	1	5	6	2	7	9

On balance sheet liabilities

The following table shows, by contractual maturity, the undiscounted cash flows payable from the balance sheet date, including future receipts/payments of interest. The balances in the tables below do not agree directly to the Bank balance sheet as the tables include all cash flows relating to principal and future coupon payments presented on an undiscounted basis.

	0–3 months £m	3–12 months £m	1–3 years £m	3–5 years £m	5–10 years £m	10–20 years £m	>20 years £m
2019							
Liabilities by contractual maturity							
Bank deposits - amortised cost	6	-	-	-	-	-	-
Customer deposits - amortised cost	6,923	108	-	-	-	-	-
Amounts due to holding companies and fellow subsidiaries	2,477	201	1	16	2	4	102
Other liabilities ⁽¹⁾	842	1	2	1	3	7	-
	10,248	310	3	17	5	11	102

Guarantees and commitments notional amount

Guarantees ⁽²⁾	21	-	-	-	-	-	-
Commitments ⁽³⁾	870	-	-	-	-	-	-
	891	-	-	-	-	-	-

2018

Liabilities by contractual maturity							
Bank deposits - amortised cost	5	-	-	-	-	-	-
Customer deposits - amortised cost	6,865	109	-	-	-	-	-
Customer deposits - DFV	10	-	-	-	-	-	-
Amounts due to holding companies and fellow subsidiaries	2,757	220	201	16	3	5	107
Other liabilities	821	-	-	-	-	-	-
	10,458	329	201	16	3	5	107

Guarantees and commitments notional amount

Guarantees ⁽²⁾	22	-	-	-	-	-	-
Commitments ⁽³⁾	909	-	-	-	-	-	-
	931	-	-	-	-	-	-

Notes:

(1) Other liabilities include notes in circulation.

(2) 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.

(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 to the accounts

9. Loan impairment provisions

Loan exposure and impairment metrics

The table below summarises loans and related credit impairment measures on an IFRS 9 basis.

	2019 £m	2018* £m
Loans - amortised cost		
Stage 1	2,887	3,053
Stage 2	650	571
Stage 3	107	183
Inter-Group ⁽¹⁾	6,513	6,750
	10,157	10,557
ECL provisions		
Stage 1	5	5
Stage 2	32	23
Stage 3	58	60
Inter-Group	1	1
	96	89
ECL provision coverage^(2,3)		
Stage 1 (%)	0.17	0.16
Stage 2 (%)	4.92	4.03
Stage 3 (%)	54.21	32.79
Inter-Group (%)	0.02	0.01
	0.95	0.84
Impairment losses		
ECL charge		
Third party	18	7
Inter-Group	-	(1)
	18	6
ECL loss rate- annualised (basis points)⁽³⁾	49.40	18.39
Amounts written-off	13	39

*2018 data has been restated for a change to presentation of unrecognised interest, refer to accounting policy 1 for further details.

Notes:

(1) Amounts due from holding companies and fellow subsidiaries (Inter-Group) are all considered as Stage 1.

(2) ECL provisions coverage is ECL provisions divided by loans - amortised cost.

(3) ECL provisions coverage and loss rates are calculated based on third party loans and related ECL provisions and charge respectively.

Credit risk enhancement and mitigation

For information on credit risk enhancement and mitigation held as security, refer to risk management – credit risk on page 69.

Critical accounting policy: Loan impairment provisions

The loan impairment provisions have been established in accordance with IFRS 9. Accounting policy 12 sets out how the expected loss approach is applied. At 31 December 2019, customer loan impairment provisions amounted to £96 million (2018 - £89 million). A loan is impaired when there is objective evidence that the cash flows will not occur in the manner expected when the loan was advanced.

Such evidence includes changes in the credit rating of a borrower, the failure to make payments in accordance with the loan agreement; significant reduction in the value of any security; breach of limits or covenants; 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.

The measurement of credit impairment under the IFRS expected loss model depends on management's assessment of any potential deterioration in the credit worthiness of the borrower, its modelling of expected performance and the application of economic forecasts. All three elements require judgements that are potentially significant to the estimate of impairment losses. Further information and sensitivity analyses are on page 65.

Notes to the accounts

9. Loan impairment provisions [continued](#)

IFRS 9 ECL model design principles

To meet IFRS 9 requirements for ECL estimation, probability of default (PD), loss given default (LGD) and exposure at default (EAD) used in the calculations must be:

- Unbiased - material regulatory conservatism has been removed to produce unbiased model estimates;
- Point-in-time - recognise current economic conditions;
- Forward-looking - incorporated into PD estimates and, where appropriate, EAD and LGD estimates; and
- For the life of the loan - all models produce a term structure to allow a lifetime calculation for assets in Stage 2 and Stage 3. IFRS 9 requires that at each reporting date, an entity shall assess whether the credit risk on an account has increased significantly since initial recognition. Part of this assessment requires a comparison to be made between the current lifetime PD (i.e. the current probability of default over the remaining lifetime) with the equivalent lifetime PD as determined at the date of initial recognition.

The general approach for the IFRS 9 LGD models has been to leverage the Basel LGD models with bespoke IFRS 9 adjustments to ensure unbiased estimates, i.e. use of effective interest rate as the discount rate and the removal of: downturn calibration, indirect costs, other conservatism and regulatory floors.

For Wholesale, while conversion ratios in the historical data show temporal variations, these cannot (unlike in the case of PD and some LGD models) be sufficiently explained by the CCI measure and are presumed to be driven to a larger extent by exposure management practices. Therefore point-in-time best estimates measures for EAD are derived by estimating the regulatory model specification on a rolling five year window.

[Approach for multiple economic scenarios \(MES\)](#)

The base scenario plays a greater part in the calculation of ECL than the approach to MES.

10. Other assets

	2019	2018
	£m	£m
Prepayments	3	4
Accrued income	2	1
Other assets	1	1
Deferred taxation (Note 6)	20	17
Property, plant and equipment (Note 11)	43	42
Asset held for sale	5	1
	74	66

Notes to the accounts

11. Property, plant and equipment

	Freehold land and buildings	Leases of 50 years or more unexpired	Leases of 50 years or less unexpired	Computer and other equipment	Right of use property ⁽¹⁾	Total
	£m	£m	£m	£m	£m	£m
2019						
Cost or valuation:						
At 1 January	37	18	9	48	-	112
Implementation of IFRS16	-	-	-	-	20	20
Transfer to assets held for sale	-	(14)	-	(1)	-	(15)
Reclassification	-	(4)	4	-	-	-
Additions	1	-	1	1	-	3
At 31 December	38	-	14	48	20	120
Accumulated depreciation, impairment and amortisation:						
At 1 January	14	5	6	45	-	70
Implementation of IFRS16	-	-	-	-	8	8
Transfer to assets held for sale	-	(9)	-	(1)	-	(10)
Reclassification	-	(2)	2	-	-	-
Charge for the year	1	6	-	1	1	9
At 31 December	15	-	8	45	9	77
Net book value at 31 December	23	-	6	3	11	43
2018						
Cost or valuation:						
At 1 January	37	19	9	53	-	118
Transfer to assets held for sale	(1)	(1)	-	-	-	(2)
Transfers from fellow subsidiaries	-	-	1	-	-	1
Additions	1	-	1	1	-	3
Disposals and write-off of fully depreciated assets	-	-	(2)	(6)	-	(8)
At 31 December	37	18	9	48	-	112
Accumulated depreciation, impairment and amortisation:						
At 1 January	14	4	7	48	-	73
Transfer to assets held for sale	(1)	-	-	-	-	(1)
Disposals and write-off of fully depreciated assets	-	-	(1)	(4)	-	(5)
Charge for the year	1	1	-	1	-	3
At 31 December	14	5	6	45	-	70
Net book value at 31 December	23	13	3	3	-	42

Note:

(1) For more details of right of use property refer to Note 14.

Notes to the accounts

12. Other liabilities

	2019 £m	2018 £m
Notes in circulation	842	821
Current tax	7	12
Accruals	8	8
Deferred income	1	2
Provisions for liabilities and charges	19	20
Other liabilities	11	6
Lease liabilities (Note 14)	14	-
	902	869

The following amounts are included within provisions for liabilities and charges:

	Property £m	Payment protection insurance £m	Global Restructuring Group (GRG) £m	Restructuring £m	Other £m	Total £m
Provision as at 1 January 2018	6	8	4	2	5	25
Implementation of IFRS 9 on 1 January 2018	-	-	-	-	2	2
Transfer from accruals	-	-	-	1	-	1
Charge to income statement	2	2	3	2	3	12
Utilised in the year	(2)	(6)	(2)	(3)	(3)	(16)
Release to income statement	(1)	-	-	(1)	(2)	(4)
Provision as at 31 December 2018	5	4	5	1	5	20
Implementation of IFRS 16 on 1 January 2019	(2)	-	-	-	-	(2)
Charge to income statement	2	1	2	7	9	21
Utilised in the year	(2)	(3)	(4)	(2)	(9)	(20)
Provision as at 31 December 2019	3	2	3	6	5	19

There are uncertainties as to the eventual cost of redress in relation to certain of the provisions contained in the table above. Assumptions relating to these are inherently uncertain and the ultimate financial impact may be different from the amount provided.

Property

The property provisions principally comprise provisions relating to property closures. The timing for such payments is uncertain.

Payment protection insurance (PPI)

An additional provision of £1 million was taken in 2019, reflecting greater than predicted complaints volumes in the lead up to the 29 August 2019 deadline for making new PPI complaints.

Global Restructuring Group (GRG)

The Bank holds a provision in respect of the FCA review of the 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 16.

Restructuring

The restructuring provisions principally comprise redundancy costs. The Bank expects the majority of these provisions to be utilised within the next 12 months.

Critical accounting policy: Provision for liabilities

Judgement is involved in determining whether an obligation exists, and in estimating the probability, timing and amount of any outflows. Where the Bank 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.

Estimates – 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. Any difference between the final outcome and the amounts provided will affect the reported results in the period when the matter is resolved.

Notes to the accounts

13. Share capital and other equity

	Allotted, called up and fully paid		Authorised	
	2019 £m	2018 £m	2019 £m	2018 £m
<i>Equity shares:</i>				
Ordinary shares of £1	254	254	2,000	2,000
<i>Equity preference shares:</i>				
Non-cumulative redeemable preference shares of €1 each	-	-	425	448
Total share capital	254	254	2,425	2,448

	Allotted, called up and fully paid		Authorised	
Number of shares	2019 millions	2018 millions	2019 millions	2018 millions
<i>Equity shares:</i>				
Ordinary shares of £1	254	254	2,000	2,000
<i>Equity preference shares:</i>				
Non-cumulative redeemable preference shares of €1 each	-	-	500	500
Total share capital	254	254	2,500	2,500

Paid-in equity - comprises equity instruments issued by the company other than those legally constituted as shares.

	2019 £m	2018 £m
Additional Tier 1 loan £60 million 7.4% perpetual loan repayable from July 2022	60	60

The coupons on this instrument are non-cumulative and payable at the company's discretion. In the event of winding up any amounts outstanding on the loan will be subordinated. While taking the legal form of debt this loan is classified as equity under IAS 32 'Financial Instruments: Presentation'.

Notes to the accounts

14. Leases

The Bank has adopted IFRS 16 Leases retrospectively from 1 January 2019 but has not restated comparatives as permitted under the transition provisions of the standard. The impact on the Bank's balance sheet and retained earnings is shown below:

	£m
Retained earnings at 1 January 2019	172
Other assets - Net right of use assets	11
- Recognition of lease liabilities (Note 12)	(14)
- Provision for onerous leases	2
Other liabilities	(12)
Net impact on retained earnings	(1)
Retained earnings at 1 January 2019	171

On adoption of IFRS 16, the Bank recognised right of use assets and lease liabilities in relation to leases which had been previously classified as operating leases under IAS 17 Leases subject to certain practical expedients as allowed by the standard.

The following practical expedients permitted by the standard were used:

- A single rate discount rate has been applied to a portfolio of leases with reasonably similar characteristics
- Not applying IFRS 16 to operating leases with a remaining lease term of less than 12 months or low volume leases (non-property leases)
- Exclusion of initial direct costs from the measurement of the right of use asset at the date of initial application
- Reliance on the assessment of whether the lease contract is onerous under IAS 37 Provisions, Contingent liabilities and Contingent assets at 31 December 2018 as an alternative to performing an impairment review of right of use assets created on 1 January 2019.
- The use of hindsight where contracts contain options to extend or terminate the lease in determining the lease term.

The lease liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of 1 January 2019. The weighted average lessee's incremental borrowing rate applied to the lease liabilities on 1 January 2019 was 2.3%.

	£m
Operating lease commitments as at 31 December 2018	99
Discounted using the incremental borrowing rate	(83)
Other	(2)
Lease liability recognised as at 1 January 2019 on adoption of IFRS 16	14

Lessees

	2019 £m
Amounts recognised in income statement	
Depreciation and impairment	1
Amounts recognised on balance sheet	
Right of use assets included in property, plant and equipment ⁽¹⁾	11
Lease liabilities	(14)

The total cash outflows in respect of leases for the year ended 31 December 2019 was £1 million.

Note:

(1) Includes right of use assets for plant and equipment of £20 million and depreciation of £9 million.

	2018 £m
Operating leases	
Minimum rentals payable under non-cancellable leases ⁽¹⁾	
-within 1 year	(2)
-after 1 year but within 5 years	(5)
-after 5 years	(92)

Note:

(1) Predominantly property leases

Notes to the accounts

15. Risk management

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Presentation of information

The risk management function of the Bank is fully integrated with the risk management function of the RBS Group. The disclosures in this section discuss the RBS Group risk management policies, procedures, frameworks and models as they apply to the Bank.

Risk management framework (unaudited)

Introduction

RBS Group operates an integrated risk management framework, which is centred around the embedding of a strong risk culture. The framework ensures the tools and capability are in place to facilitate risk management and decision-making across the organisation.

Risk appetite, supported by a robust set of principles, policies and practices, defines the levels of tolerance for a variety of risks and provides a structured approach to risk-taking within agreed boundaries.

All RBS Group colleagues share ownership of the way risk is managed, working together to make sure business activities and policies are consistent with risk appetite.

The methodology for setting, governing and embedding risk appetite is being further enhanced with the aim of revising current risk appetite processes and increasing alignment with strategic planning and external threat assessments.

During 2019, a number of enhancements to the RBS Group risk management framework were developed. The increasing significance of climate risk was considered as part of these developments and will be fully integrated as part of the implementation of the enhanced framework in 2020.

Risk culture

Risk culture is at the centre of both the risk management framework and risk management practice. The target culture across the Bank is one in which risk is part of the way employees work and think. The target risk culture behaviours are aligned to the Bank's core values. They are embedded in Our Standards and therefore form an effective basis for risk culture since these are used for performance management, recruitment and development. Further information on risk culture can be found in the 2019 Annual Report and Accounts of RBSG.

Training

A wide range of learning, both technical and behavioural, is offered across the risk disciplines. This training can be mandatory, role-specific or for personal development and enables colleagues to develop the capabilities and confidence to manage risk effectively.

Code of Conduct

A Code of Conduct is in place across all entities within RBS Group. It provides guidance on the behaviour expected of employees and describes the principles that must be followed. Further information on the Code of Conduct can be found in the 2019 Annual Report and Accounts of RBSG.

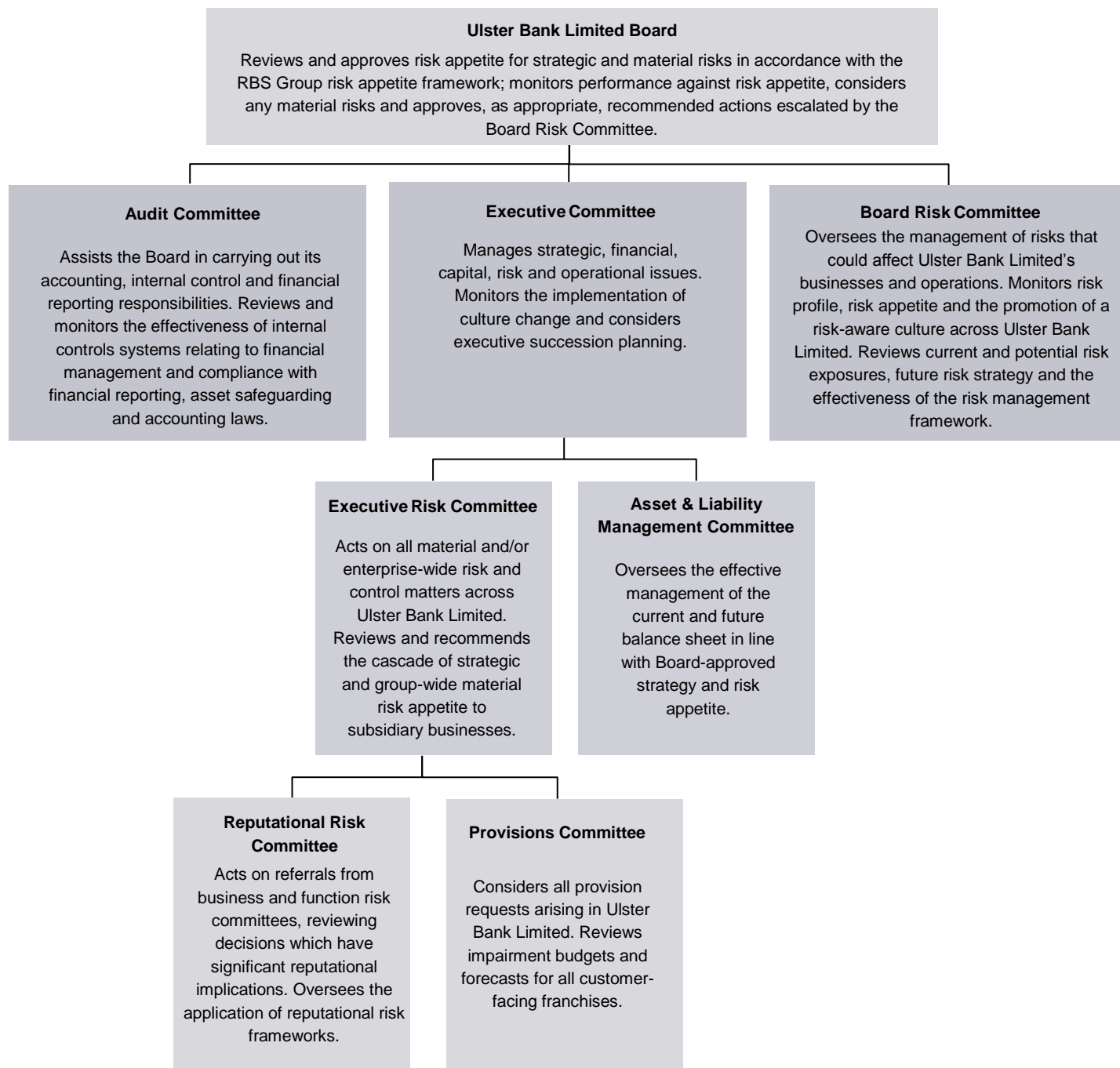
Notes to the accounts

15. Risk management - Risk management framework (unaudited) continued

Risk governance

Committee structure

The diagram illustrates the Bank's risk committee structure in 2019 and the main purposes of each committee.



Business and function risk committees

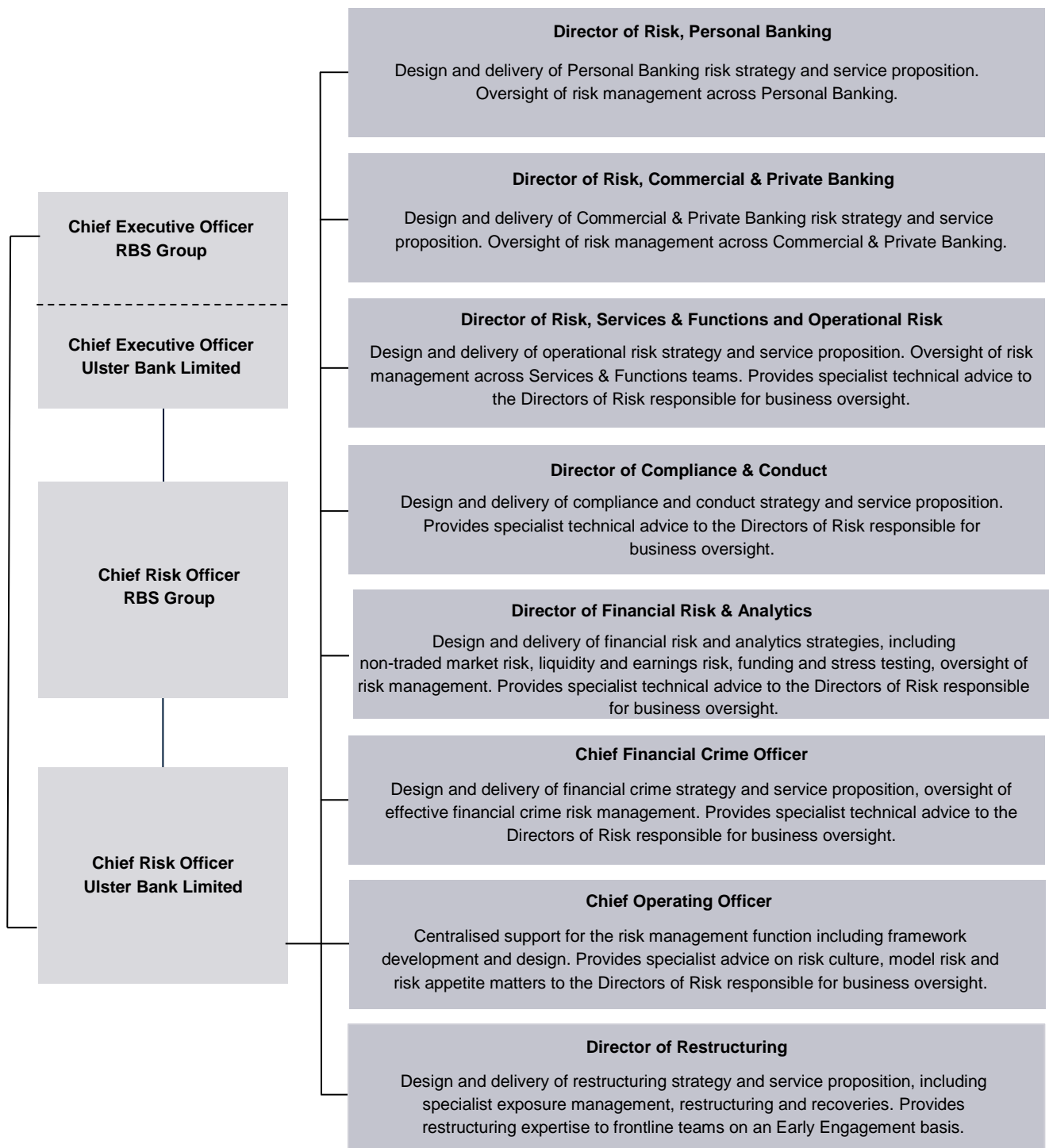
Risk committees review and monitor all risks, providing guidance, recommendations and decisions on risks affecting the businesses and functions.

Notes to the accounts

15. Risk management - Risk management framework (unaudited) continued

Risk management structure

The diagram illustrates the Bank's risk management structure in 2019 and key risk management responsibilities.



Notes:

(1) The Ulster Bank Limited Chief Risk Officer reports directly to the Ulster Bank Limited Chief Executive Officer (who is also the RBS Group Chief Executive Officer) and to the RBS Group Chief Risk Officer. There is a further secondary reporting line to the chair of the Ulster Bank Limited Board Risk Committee and a right of access to the committee, including the deputy chair. The members of the committee mirror those of the NatWest Holdings Board Risk Committee.

(2) The Risk function is independent of the franchises and support functions. Its structure is divided into three parts (Directors of Risk, Specialist Risk Directors and Chief Operating Officer) to facilitate effective management of the risks facing Ulster Bank Limited. Risk committees in the customer businesses and key functional risk committees oversee risk exposures arising from management and business activities and focus on ensuring that these are adequately monitored and controlled.

15. Risk management - Risk management framework

(unaudited) continued

Three lines of defence

The three lines of defence model is used across the RBS Group to articulate accountabilities and responsibilities for managing risk. The first line is accountable for managing its own risks within the appetite set by the Board. It incorporates most roles in RBS Group – including those in the customer-facing franchises, Technology and Services as well as support functions such as Human Resources, Legal and Finance. The second line – which is responsible for the design and maintenance of the risk management framework and proactive oversight as well as advising, monitoring, approving, challenging and reporting on the first line's risk-taking activities – is the Risk function. The third line of defence is Internal Audit, which provides assurance to the Audit Committee on the appropriateness of the design and operational effectiveness of governance, risk management and internal controls to monitor and mitigate material risks. All roles, except for that of CEO, sit within one of these three lines. Further information on the three lines of defence can be found in the 2019 Annual Report and Accounts of RBSG.

Risk appetite

Risk appetite defines the level and types of risk that are acceptable, 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.

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

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

The annual process of establishing risk appetite statements is completed alongside the business and financial planning process. This ensures plans and risk appetite are appropriately aligned. The Board sets risk appetite for the most material risks to help ensure the Bank is well placed to meet its priorities and long-term targets even under challenging economic environments. It is the basis on which the Bank remains safe and sound while implementing its strategic business objectives.

The Bank's risk profile is frequently reviewed and monitored and management focus is concentrated on all strategic risks, material risks and emerging risk issues. Risk profile relative to risk appetite is reported regularly to the Board and senior management. Further information on risk appetite can be found in the 2019 Annual Report and Accounts of RBSG.

Risk controls and limits

Risk controls and their associated limits are an integral part of the risk appetite approach and a key part of embedding risk appetite in day-to-day risk management decisions. A clear tolerance for material risk types is set in alignment with business activities.

Group policies directly support the qualitative aspects of risk appetite. They ensure that appropriate controls are set and monitored.

Risk identification and measurement

Risk identification and measurement within the risk management process comprise:

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

The financial and non-financial risks that the Bank faces each day are detailed in the Risk Directory. This provides a common risk language to ensure consistent terminology is used across RBS Group. The Risk Directory is subject to annual review. This ensures that it continues to provide a comprehensive and meaningful list of the inherent risks within the businesses.

Risk treatment and mitigation

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

When evaluating possible strategies, costs and benefits, residual risks (risks that are retained) and secondary risks (those that are due to risk mitigation actions) are considered. Monitoring and review processes are in place to evaluate results. Early identification, and effective management, of changes in legislation and regulation are critical to the successful mitigation of compliance and conduct risk. The effects of all changes are managed to ensure the timely achievement of compliance. Those changes assessed as having a high or medium-high impact are managed more closely. Significant and emerging risks that could affect future results and performance are reviewed and monitored. Action is taken to mitigate potential risks as and when required. Further in-depth analysis, including the stress testing of exposures relative to the risk, is also carried out.

Notes to the accounts

15. Risk management - Risk management framework

(unaudited) continued

Risk testing and monitoring

Targeted credit risk, compliance & conduct risk and financial crime risk activities are subject to testing and monitoring to confirm to both internal and external stakeholders – including the Board, senior management, the customer-facing businesses, Internal Audit and the Bank's regulators – that risk owned policies and procedures are being correctly implemented and operating adequately and effectively. Selected key controls are also reviewed. Thematic reviews and deep dives are also carried out where appropriate.

The adequacy and effectiveness of selected key controls owned and operated by the second line of defence are also tested (with a particular focus on credit risk controls). Selected controls within the scope of Section 404 of the US Sarbanes-Oxley Act 2002 as well as selected controls supporting risk data aggregation and reporting are also reviewed.

Anti-money laundering, sanctions, and anti-bribery and corruption processes and controls are also tested and monitored. This helps provide an independent understanding of the financial crime control environment, whether or not controls are adequate and effective and whether financial crime risk is appropriately identified, managed and mitigated.

The RBS Group Risk Testing & Monitoring Forum and methodology ensures a consistent approach to all aspects of the second-line review activities. The forum also monitors and validates the annual plan and ongoing programme of reviews.

Stress testing

Stress testing – capital management

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

Stress testing includes:

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

The process for stress testing consists of four broad stages:

Define scenarios	<ul style="list-style-type: none"> • Identify RBS Group-specific vulnerabilities and risks. • Define and calibrate scenarios to examine risks and vulnerabilities. • Formal governance process to agree scenarios.
Assess impact	<ul style="list-style-type: none"> • Translate scenarios into risk drivers. • Assess impact to current and projected P&L and balance sheet. • Impact assessment captures input from across RBS Group.

Calculate results and assess implications	<ul style="list-style-type: none"> • Aggregate impacts into overall results. • Results form part of risk management process. • Scenario results are used to inform RBS Group's business and capital plans.
Develop and agree management actions	<ul style="list-style-type: none"> • Scenario results are analysed by subject matter experts and appropriate management actions are then developed. • Scenario results and management actions are reviewed and agreed by senior management through executive committees including the Executive Risk Committee, the Board Risk Committee and the Board.

Stress testing is used widely across RBS Group. The diagram below summarises areas of focus:



Specific areas that involve capital management include:

- **Strategic financial and capital planning** - by assessing the impact of sensitivities and scenarios on the capital plan and capital ratios.
- **Risk appetite** - by gaining a better understanding of the drivers of, and the underlying risks associated with, risk appetite.
- **Risk identification** - by better understanding the risks that could potentially affect the Bank's financial strength and capital position.
- **Risk mitigation** - by identifying actions to mitigate risks, or those that could be taken, in the event of adverse changes to the business or economic environment. Key risk mitigating actions are documented in the RBS Group's recovery plan.

Reverse stress testing is also carried out in order to identify circumstances that may lead to specific, defined outcomes such as business failure. Reverse stress testing allows potential vulnerabilities in the business model to be examined more fully.

Notes to the accounts

15. Risk management - Risk management framework

(unaudited) [continued](#)

Stress testing continued

[Capital sufficiency - going concern forward-looking view](#)

Going concern capital requirements are examined on a forward-looking basis – including as part of the annual budgeting process – by assessing the resilience of capital adequacy and leverage ratios under hypothetical future states. These assessments include assumptions about regulatory and accounting factors (such as IFRS 9). They are linked to economic variables and impairments and seek to demonstrate that RBS Group and its operating subsidiaries maintain sufficient CET1 capital. A range of future states are tested. In particular, capital requirements are assessed:

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

The examination of capital requirements under normal economic and adverse market conditions enables RBS Group to determine whether its projected business performance meets internal and regulatory capital requirements.

The examination of capital requirements under adverse economic and market conditions is assessed through stress testing. The results of stress tests are not only used widely across RBS Group but also by the regulators to set specific capital buffers. RBS Group takes part in stress tests run by regulatory authorities to test industry-wide vulnerabilities under crystallising global and domestic systemic risks. In 2019, RBS Group took part in the Bank of England stress test exercise.

Stress and peak-to-trough movements are used to help assess the amount of CET1 capital RBS Group needs to hold in stress conditions in accordance with the capital risk appetite framework.

[Internal assessment of capital adequacy](#)

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

The ICAAP is used to form a view of capital adequacy separately to the minimum regulatory requirements. The ICAAP is used by the PRA to assess RBS Group's specific capital requirements through the Pillar 2 framework.

[Capital allocation](#)

RBS Group has mechanisms to allocate capital across its legal entities and businesses. These aim to optimise the use of capital resources taking into account applicable regulatory requirements; strategic and business objectives; and risk appetite. The framework for allocating capital is approved by the Group Asset & Liability Management Committee.

[Governance](#)

Capital management is subject to substantial review and governance. Formal approval of capital management policies is either by the Asset & Liability Management Committee or by the Board on the recommendation of the Board Risk Committee. The RBSG Board approves the capital plans, including those for key legal entities and businesses as well as the results of the stress tests relating to those capital plans.

[Stress testing - liquidity](#)

[Liquidity risk monitoring and contingency planning](#)

A suite of tools is used to monitor, limit and stress test the risks on the balance sheet. Limit frameworks are in place to control the level of liquidity risk, asset and liability mismatches and funding concentrations. Liquidity risks are reviewed at significant legal entity and business levels daily, with performance reported to the Group Asset & Liability Management Committee at least monthly. Liquidity Condition Indicators are monitored daily. This ensures any build-up of stress is detected early and the response escalated appropriately through recovery planning.

[Internal assessment of liquidity](#)

Under the liquidity risk management framework, RBS Group maintains the Individual Liquidity Adequacy Assessment Process. This includes assessment of net stressed liquidity outflows under a range of extreme but plausible stress scenarios detailed in the table below.

Type	Description
Idiosyncratic scenario	The market perceives RBS 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, potential counterparty failure and other market risks. RBS Group is affected under this scenario but no more severely than any other participants with equivalent exposure.
Combined scenario	This scenario models the combined impact of an idiosyncratic and market stress occurring at once, severely affecting funding markets and the liquidity of some assets.

RBS Group uses the most severe combination of these to set the internal stress testing scenario which underpins its internal liquidity risk appetite. This complements the regulatory liquidity coverage ratio requirement.

15. Risk management - Risk management framework

(unaudited) continued

Stress testing continued

Stress testing - recovery and resolution planning

The RBS Group recovery plan explains how RBS Group and its subsidiaries - as a consolidated group - would identify and respond to a financial stress event and restore its financial position so that it remains viable on an ongoing basis.

The recovery plan ensures risks that could delay the implementation of a recovery strategy are highlighted and preparations are made to minimise the impact of these risks. Preparations include:

- Developing a series of recovery indicators to provide early warning of potential stress events;
- Clarifying roles, responsibilities and escalation routes to minimise uncertainty or delay;
- Developing a recovery playbook to provide a concise description of the actions required during recovery; and
- Detailing a range of options to address different stress conditions; and
- Appointing dedicated option owners to reduce the risk of delay and capacity concerns.

The plan is intended to enable RBS Group to maintain critical services and products it provides to its customers, maintain its core business lines and operate within risk appetite while restoring RBS Group's financial condition. It is assessed for appropriateness on an ongoing basis and is updated annually. The plan is reviewed and approved by the Board prior to submission to the PRA each year.

Fire drill simulations of possible recovery events are used to test the effectiveness of the RBS Group and individual legal entity recovery plans. The fire drills are designed to replicate possible financial stress conditions and allow senior management to rehearse the responses and decisions that may be required in an actual stress. The results and lessons learnt from the fire drills are used to enhance RBS Group's approach to recovery planning.

Under the resolution assessment part of the PRA rulebook, RBS Group is required to carry out an assessment of its preparations for resolution, submit a report of the assessment to the PRA and publish a summary of this report. The initial report submission to the PRA is in Q4 2020. RBS Group has a programme of work in place to carry out these requirements.

Resolution would be implemented if RBS Group was assessed by the UK authorities to have failed and the appropriate regulator put it into resolution. The process of resolution is owned and implemented by the Bank of England (as the UK resolution authority). A multi-year programme is in place to further develop resolution capability in line with regulatory requirements.

Stress testing - market risk

Non-traded market risk

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

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

Non-traded exposures are capitalised through the ICAAP. It covers gap risk, basis risk, credit spread risk, pipeline risk, structural foreign exchange risk, prepayment risk and accounting volatility risk.

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

Capital, liquidity and funding risk

Definitions

Regulatory capital consists of reserves and instruments issued that are available, 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 as capital.

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

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

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

Liquidity and funding risks arise in a number of ways, including through the maturity transformation role that banks perform.

The risks are dependent on factors such as:

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

Notes to the accounts

15. Risk management - Capital, liquidity and funding risk continued

Sources of risk

Capital

The eligibility of instruments and financial resources as regulatory 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.
- **Additional Tier 1 (AT1) capital** - This is the second type of loss absorbing capital and must be capable of absorbing losses on a going concern basis. These instruments are either written down or converted into CET1 capital when the CET1 ratio falls below a pre-specified level.
- **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.

Liquidity

Liquidity risk within the Bank is managed as part of the Domestic Liquidity Sub-Group (UK DoLSub), which is regulated by the PRA and comprises Natwest Holdings Group's four licensed deposit taking UK banks: The Royal Bank of Scotland plc, Natwest Bank Plc, Coutts & Company and Ulster Bank Limited. Natwest Holdings Group maintains a prudent approach to the definition of liquidity resources. Natwest Holdings Group manages its liquidity to ensure it is always available when and where required, taking into account regulatory, legal and other constraints.

Liquidity resources of the UK DoLSub are divided into primary and secondary liquidity as follows:

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

Funding

NatWest Holdings Group maintains a diversified set of funding sources. The Bank's principal source of funding is customer deposits.

Managing capital requirements: regulated entities

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

Capital management (unaudited)

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

Capital planning is integrated into the Bank's wider annual budgeting process and is assessed and updated at least monthly. This is summarised below. Other elements of capital management, include risk appetite and stress testing.

Produce capital plans ↓	<ul style="list-style-type: none"> • Capital plans are produced for the Bank and its businesses over a five year planning horizon under expected and stress conditions. Stressed capital plans are produced to support internal stress testing in the ICAAP for regulatory purposes. • Shorter term forecasts are developed frequently in response to actual performance, changes in internal and external business environment and to manage risks and opportunities.
Assess capital adequacy ↓	<ul style="list-style-type: none"> • Capital plans are developed to maintain capital of sufficient quantity and quality to support the Bank's business and strategic plans over the planning horizon within approved risk appetite, as determined via stress testing, and minimum regulatory requirements. • Capital resources and capital requirements are assessed across a defined planning horizon. • Impact assessment captures input from across the Bank's businesses.
Inform capital actions	<ul style="list-style-type: none"> • Capital planning informs potential capital actions including buy backs, redemptions, dividends and new issuance via internal transactions. • Decisions on capital actions will be influenced by strategic and regulatory requirements, risk appetite, costs and prevailing market conditions.

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

Notes to the accounts

15. Risk management - Capital, liquidity and funding risk continued

Liquidity risk management (unaudited)

Natwest Holdings Group manages its liquidity risk taking into account regulatory, legal and other constraints to ensure sufficient liquidity is available where required to cover liquidity stresses. Liquidity risk within the Bank is managed as part of the UK DoLSUB.

The size of the liquidity portfolio held in the UK DoLSUB is determined by referencing Natwest Holdings Group's liquidity risk appetite. The Natwest Holdings 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.

Minimum requirements (unaudited)

Capital adequacy ratios

The Bank is subject to minimum capital requirements relative to RWAs. The table below summarises the minimum ratios of capital to RWAs that the Bank is expected to meet.

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

Note:

(1) The countercyclical capital buffer (CCyB) applied to designated assets is set by the Financial Policy Committee (FPC). The CCyB is currently 1.0% increasing to 2.0%, effective December 2020.

(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.

Leverage ratio

The Capital Requirements Regulation2 (CRR2) amendments to the Capital Requirements Regulation (CRR) will introduce a binding 3% Tier 1 minimum capital leverage ratio for individual regulated legal entities, including the Bank, from 28 June 2021.

Liquidity and funding ratios (unaudited)

The table below summarises the minimum requirements for key liquidity and funding metrics, under the relevant legislative framework. The Bank is a member of the UK DoLSUB which is presented below.

Type	From 1 January 2019	From 1 January 2020
Liquidity coverage ratio (LCR)	100%	100%

Note:

(1) The CRR2 amendments to the CRR will introduce a binding 3% Tier 1 minimum capital leverage ratio for individual regulated legal entities, including the Bank, from 28 June 2021.

NatWest Bank manages the majority of the UK DoLSUB portfolio, for which the RBS Group Treasurer is responsible.

Funding risk management (unaudited)

The Bank manages funding risk through a comprehensive framework which measures and monitors the funding risk on the balance sheet. The asset and liability types broadly match. Customer deposits provide more funding than customer loans utilise.

Notes to the accounts

15. Risk management - Capital, liquidity and funding risk *continued*

Measurement

Capital resources *(unaudited)*

Under 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 PRA transitional basis for the Bank are set out below.

	2019	2018
	£m	£m
Shareholders' equity (excluding non-controlling interests)		
Shareholders' equity	497	486
Preference shares - equity	(60)	(60)
	437	426
Regulatory adjustments and deductions		
Deferred tax assets	(15)	(17)
Other regulatory adjustments	(12)	(46)
	(27)	(63)
CET1 capital	410	363
Additional Tier 1 (AT1) capital		
Qualifying instruments and related share premium	60	60
Tier 1 capital	470	423
Qualifying Tier 2 capital		
Qualifying instruments and related share premium	102	107
Excess provisions over expected losses	9	3
Tier 2 capital	111	110
Total regulatory capital	581	533
RWAs		
Credit risk		
- non-counterparty	2,007	2,051
- counterparty	2	6
Market risk	-	1
Operational risk	396	330
Total RWAs	2,405	2,388
Risk asset ratios	%	%
CET1	17.0%	15.2%
Tier 1	19.5%	17.7%
Total	24.2%	22.3%

Notes to the accounts

15. Risk management - Capital, liquidity and funding risk *continued*

Contractual maturity

The table shows the residual maturity of third party financial instruments, based on contractual date of maturity of the Bank's activities, including third party and intercompany hedging derivatives. Trading activities comprising Mandatory fair value through profit or loss (MFVTPL) assets and held-for-trading liabilities (HFT) have been excluded from the maturity analysis due to their short-term nature and are shown in total in the table below.

Banking activities												
	Less than 1 month	1–3 months	3–6 months	6 months–1 year	Sub total	1–3 years	3–5 years	More than 5 years	Total excluding MFVTPL and HFT	MFVTPL and HFT	Impairment provisions	Total
2019	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	1,076	-	-	-	1,076	-	-	-	1,076	-	-	1,076
Derivatives	-	-	-	-	-	-	-	-	-	3	-	3
Loans to banks - amortised cost	5	-	9	-	14	-	-	-	14	-	-	14
Loans to customers - amortised cost	392	185	115	219	911	730	560	1,450	3,651	-	(95)	3,556
Total financial assets	1,473	185	124	219	2,001	730	560	1,450	4,741	3	(95)	4,649
2018												
Total financial assets	1,524	218	126	182	2,050	630	557	1,672	4,909	5	(89)	4,825
Bank deposits - amortised cost	6	-	-	-	6	-	-	-	6	-	-	6
Customer deposits - amortised cost	6,885	37	40	68	7,030	-	-	-	7,030	-	-	7,030
Derivatives	-	-	-	-	-	-	-	-	-	6	-	6
Total financial liabilities	6,891	37	40	68	7,036	-	-	-	7,036	6	-	7,042
2018												
Total financial liabilities	6,802	69	51	56	6,978	-	-	-	6,978	9	-	6,987

Notes to the accounts

15. Risk management continued

Credit risk

Definition

Credit risk is the risk that customers and counterparties fail to meet their contractual obligation to settle outstanding amounts.

Sources of risk (unaudited)

The principal sources of credit risk are lending and related financial guarantees and undrawn commitments. Through its payments activities the Bank is also exposed to settlement risk.

Risk governance (unaudited)

NatWest Holdings Group operates a Credit Risk function which provides oversight of frontline credit risk management activities.

Governance activities include:

- Defining credit risk appetite for the management of concentration risk and credit policy to establish the key causes of risk in the process of providing credit and the controls that must be in place to mitigate them.
- Approving and monitoring credit limits.
- Oversight of the first line of defence to ensure that credit risk remains within the appetite set by the Board and that controls are being operated adequately and effectively.

The CCO has overall responsibility for the credit risk function and chairs the Wholesale and Retail Credit Risk Committees. These committees review, recommend or approve risk appetite limits (depending on their materiality) within the appetite set by the Board.

The Provisions Committee has authority over provisions adequacy and approves proposals from business provisions committees in accordance with approval thresholds. The Provisions Committee is chaired either by the CCO or the Head of Provisions & Restructuring Credit.

Risk appetite (unaudited)

The Bank's approach to credit risk is governed by a comprehensive credit risk appetite framework. The framework is monitored and actions are taken to adapt lending criteria as appropriate. Credit risk appetite aligns to the strategic risk appetite set by the RBSG Board. The framework has been designed to reflect factors that influence the ability to operate within risk appetite. Tools such as stress testing and economic capital are used to measure credit risk volatility and develop links between the framework and risk appetite limits. The framework is supported by a suite of transaction acceptance standards that set out the risk parameters within which businesses should operate.

The Personal credit risk appetite framework sets limits that measure and control the quality and concentration of both existing and new business for each relevant business segment. The actual performance of each portfolio is tracked relative to these limits and management action is taken where necessary.

The limits apply to a range of credit risk-related measures including expected loss at both portfolio and product level, projected credit default rates across products and the loan-to-value (LTV) ratio of the Personal mortgage portfolios.

For the Wholesale credit risk appetite framework, the four formal frameworks used – and their basis for classification – are detailed in the following table.

Framework	Basis for classification	
	Measure	Other
Single name concentration	Exposure	Risk – based on loss given default for a given probability of default
Sector		Risk – based on economic capital and other qualitative factors
Country		Risk – based on sovereign default risk, political stability and macroeconomic factors
Product and asset class		Risk – based on heightened risk characteristics

Risk controls (unaudited)

Credit policy standards are in place for both the Wholesale and Personal portfolios. They are expressed as a set of mandatory controls.

Risk identification and measurement (unaudited)

Credit stewardship

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

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

Risk models (unaudited)

Credit risk models is the collective term used to describe all models, frameworks and methodologies used to calculate PD, EAD, LGD, maturity and the production of credit grades.

Credit risk models are designed to provide:

- An assessment of customer and transaction characteristics.
- A meaningful differentiation of credit risk.
- Accurate internal default, loss and exposure at default estimates that are used in the capital calculation or wider risk management purposes.

15. Risk management - Credit risk continued

Risk models continued

Asset quality (unaudited)

All credit grades map to an asset quality (AQ) scale, used for financial reporting. For Wholesale customers, a master grading scale is used for internal management reporting across portfolios. 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 or Stage 3 under IFRS 9 (where the PD is 100%).

Risk mitigation (unaudited)

Risk mitigation techniques, as set out in the appropriate credit policies, are used in the management of credit portfolios across the Bank. These techniques mitigate credit concentrations in relation to an individual customer, a borrower group or a collection of related borrowers. Where possible, customer credit balances are netted against obligations. Mitigation tools can include structuring a security interest in a physical or financial asset and the use of guarantees and similar instruments (for example, credit insurance) from related and third parties. Property is used to mitigate credit risk across a number of portfolios, in particular residential mortgage lending and commercial real estate (CRE).

The valuation methodologies for residential mortgage collateral and CRE are detailed below.

Residential mortgages – the Bank takes collateral in the form of residential property to mitigate the credit risk arising from mortgages. The Bank values residential property during the loan underwriting process by either appraising properties individually or valuing them collectively using statistically valid models. The Bank updates residential property values quarterly using the UK House Price Index published by the Land Registry. The current indexed value of the property is a component of the ECL provisioning calculation.

Commercial real estate valuations – the Bank has a panel of chartered surveying firms that cover the spectrum of geography and property sectors in which the Bank takes collateral. Suitable valuers for particular assets are contracted through a single service agreement to ensure consistency of quality and advice. Valuations are generally commissioned when an asset is taken as security; a material increase in a facility is requested; or a default event is anticipated or has occurred. In the UK, an independent third-party market indexation is applied to update external valuations once they are more than a year old and every three years a formal independent valuation is commissioned. The current indexed value of the property is a component of the ECL provisioning calculation.

Risk assessment and monitoring (unaudited)

Practices for credit stewardship – including credit assessment, approval and monitoring as well as the identification and management of problem debts – differ between the Personal and Wholesale portfolios.

Personal

Personal customers are served through a lending approach that entails making a large number of small-value loans. To ensure that these lending decisions are made consistently, the Bank analyses internal credit information as well as external data supplied from credit reference agencies (including historical debt servicing behaviour of customers with respect to both the Bank and other lenders). The Bank then sets its lending rules accordingly, developing different rules for different products.

The process is then largely automated, with each customer receiving an individual credit score that reflects both internal and external behaviours and this score is compared with the lending rules set. For relatively high-value, complex personal loans, including some residential mortgage lending, specialist credit managers make the final lending decisions. These decisions are made within specified delegated authority limits that are issued dependent on the experience of the individual. Underwriting standards and portfolio performance are monitored on an ongoing basis to ensure they remain adequate in the current market environment and are not weakened materially to sustain growth.

Wholesale

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. Customers are aggregated as a single risk when sufficiently interconnected.

A credit assessment is carried out before credit facilities are made available to customers. The assessment process is dependent on the complexity of the transaction. Credit approvals are subject to environmental, social and ethical risk policies which restrict exposure to certain highly carbon intensive industries as well as those with potentially heightened reputational impacts.

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

For all other transactions credit is only granted to customers following joint approval by an approver from the business and the credit risk function. The joint business and credit approvers act within a delegated approval authority under the Wholesale Credit Authorities Framework Policy.

The level of delegated authority held by approvers is dependent on their experience and expertise with only a small number of senior executives holding the highest approval authority.

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

15. Risk management - Credit risk continued

Risk assessment and monitoring (unaudited) continued

Transaction Acceptance Standards provide detailed transactional lending and risk acceptance metrics and structuring guidance. As such, these standards provide a mechanism to manage risk appetite at the customer/transaction level and are supplementary to the established credit risk appetite.

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

Problem debt management

Personal (unaudited)

Early problem identification

Pre-emptive triggers are in place to help identify customers that may be at risk of being in financial difficulty. These triggers are both internal, using the Bank's data, and external using information from credit reference agencies. Pro-active contact is then made with the customer to establish if they require help with managing their finances. By adopting this approach, the aim is to prevent a customer's financial position deteriorating which may then require intervention from the Collections and Recoveries teams.

Personal customers experiencing financial difficulty are managed by the Collections team. If the Collections team is unable to provide appropriate support after discussing suitable options with the customer, management of that customer moves to the Recoveries team. If at any point in the Collections and Recoveries process, the customer is identified as being potentially vulnerable, the customer will be separated from the regular process and supported by a specialist team to ensure the customer receives appropriate support for their circumstances.

Collections

When a customer exceeds an agreed limit or misses a regular monthly payment the customer is contacted by the Bank and requested to remedy the position. If the situation is not regularised then, where appropriate, the Collections team will become more fully involved and the customer will be supported by skilled debt management staff who endeavour to provide customers with bespoke solutions. Solutions include short-term account restructuring, refinance loans and forbearance which can include interest suspension and 'breathing space'. In the event that an affordable/sustainable agreement with a customer cannot be reached, the debt will transition to the Recoveries team. For provisioning purposes, under IFRS 9, exposure to customers managed by the Collections team is categorised as Stage 2 and subject to a lifetime loss assessment, unless it is 90 days past due, in which case it is categorised as Stage 3.

Recoveries

The Recoveries team will issue a notice of intention to default to the customer and, if appropriate, a formal demand, while also registering the account with credit reference agencies where appropriate.

Following this, the customer's debt may then be placed with a third-party debt collection agency, or alternatively a solicitor, in order to agree an affordable repayment plan with the customer. Exposures subject to formal debt recovery are defaulted and categorised as Stage 3 impaired.

Wholesale (unaudited)

Early problem identification

Each segment and sector has defined early warning indicators to identify customers experiencing financial difficulty, and to increase monitoring if needed.

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

Risk of Credit Loss framework

The Risk of Credit loss framework is used where the credit profile of a Wholesale customer has deteriorated. Experienced credit risk officers apply expert judgement to classify cases into categories that reflect progressively deteriorating credit risk. There are two classifications in the framework that apply to non-defaulted customers – Heightened Monitoring and Risk of Credit Loss. For the purposes of provisioning, all exposures subject to the framework are categorised as Stage 2 and subject to a lifetime loss assessment. The framework also applies to those customers that have met the Bank's default criteria (AQ10 exposures). Defaulted exposures are categorised as Stage 3 impaired for provisioning purposes.

Customers classified in the Heightened Monitoring category are those who are still performing but have certain characteristics – such as trading issues, covenant breaches, material PD downgrades and past due facilities – that may affect the ability to meet repayment obligations. Heightened Monitoring customers require pre-emptive actions to return or maintain their facilities within risk appetite prior to maturity.

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

Once classified as either Heightened Monitoring or Risk of Credit Loss, a number of mandatory actions are taken including 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.

Further information on the Risk of Credit Loss framework can be found in the 2019 Annual Report and Accounts of RBSG.

15. Risk management - Credit risk continued

Problem debt management continued

Restructuring

For the Wholesale problem debt portfolio, customer relationships are mainly managed by the Restructuring team. The purpose of Restructuring is to protect the Bank's capital. Restructuring does this by working with corporate and commercial customers in financial difficulty on their restructuring and repayment strategies. Restructuring will always aim to recover capital fairly and efficiently.

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

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

Forbearance

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

The aim of forbearance is to support and restore the customer to financial health while minimising risk. To ensure that forbearance is appropriate for the needs of the customer, minimum standards are applied when assessing, recording, monitoring and reporting forbearance. A loan/debt may be forborne more than once, generally where a temporary concession has been granted and circumstances warrant another temporary or permanent revision of the loan's terms.

In the Personal portfolio, loans are considered forborne until they meet the exit criteria set out by the European Banking Authority. These include being classified as performing for two years since the last forbearance event, making regular repayments and the loan/debt being less than 30 days past due. Exit criteria are not currently applied for Wholesale portfolios.

Types of forbearance

Personal

In the Personal portfolio, forbearance may involve payment concessions and loan rescheduling (including extensions in contractual maturity) and capitalisation of arrears. Forbearance is granted principally to customers with mortgages and less frequently to customers with unsecured loans. This includes instances where forbearance may be provided to customers with highly flexible mortgages.

Wholesale

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

Monitoring of forbearance

Personal

For Personal portfolios, forborne loans are separated and regularly monitored and reported while the forbearance strategy is implemented, until they exit forbearance.

Wholesale

In the Wholesale portfolio, customer PDs and facility LGDs are re-assessed prior to finalising any forbearance arrangement.

The ultimate outcome of a forbearance strategy is highly dependent on the cooperation of the borrower and a viable business or repayment outcome. Where forbearance is no longer appropriate, the Bank will consider other options such as the enforcement of security, insolvency proceedings or both, although these are options of last resort.

Provisioning for forbearance

Personal

The methodology used for provisioning in respect of Personal 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.

Granting forbearance will only change the arrears status of the loan in specific circumstances, which can include capitalisation of principal and interest in arrears, where the loan may be returned to the performing book if the customer has demonstrated an ability to meet regular payments and is likely to continue to do so. The loan would remain in forbearance for the defined probation period and be subject to performance criteria. These include making regular repayments and being less than 30 days past due.

Additionally, for some forbearance types a loan may be transferred to the performing book if a customer makes payments that reduce loan arrears below 90 days.

For ECL provisioning, all forborne but performing exposures are categorised as Stage 2 and are subject to a lifetime loss provisioning assessment. For non-performing forborne loans, the Stage 3 loss assessment process is the same as for non-forborne loans.

Wholesale

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

15. Risk management - Credit risk continued

Forbearance continued

Wholesale loans granted forbearance are individually assessed in most cases. Performing loans subject to forbearance treatment are categorised as Stage 2 and subject to a lifetime loss assessment.

Forbearance may result in the value of the outstanding debt exceeding the present value of the estimated future cash flows. This difference will lead to a customer being classified as non-performing.

In the case of non-performing forbore loans, an individual loan impairment provision assessment generally 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 from impaired to performing status follows assessment by relationship managers and credit. When no further losses are anticipated and the customer is expected to meet the loan's revised terms, any provision is written-off or released and the balance of the loan returned to performing status. This is not dependent on a specified time period and follows the credit risk manager's assessment.

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.

RBS Group's IFRS 9 provisioning models, which used existing Basel models as a starting point, incorporate term structures and forward-looking information.

Five key areas may materially influence the measurement of credit impairment under IFRS 9 – two of these relate to model build and three relate to their application:

- **Model build:**
 - The determination of economic indicators that have most influence on credit loss for each portfolio and the severity of impact (this leverages existing stress testing mechanisms).
 - The build of term structures to extend the determination of the risk of loss beyond 12 months that will influence the impact of lifetime loss for assets in Stage 2.
- **Model application:**
 - The assessment of the significant increase in credit risk and the formation of a framework capable of consistent application.
 - The determination of asset lifetimes that reflect behavioural characteristics while also representing management actions and processes (using historical data and experience).

- The determination of a base case (or central) economic scenario which has the most material impact (of all forward-looking scenarios) on the measurement of loss (RBS Group uses consensus forecasts to remove management bias).

Refer to Accounting policy 12 for further details.

Economic loss drivers

Introduction

The most material economic loss drivers for Personal portfolios include UK GDP, unemployment rate, house price index, and base rate. In addition to some of these loss drivers, world GDP is a primary loss driver for Wholesale portfolios.

Central base case economic scenario

The internal base case scenario is the primary forward-looking economic information driving the calculation of ECL. The same base case scenario is used for financial planning with the exception of the yield curve, as a result of the different timing of the exercises. The key elements of the current economic base case, which includes forecasts over a five year forecast horizon, are summarised below.

The central base case economic scenario projects modest growth in the UK economy, in line with the consensus outlook. Brexit related uncertainty results in subdued confidence in the near term, placing it in the lower quartile of advanced economies. Business investment is weak at the start of the forecast, improving only gradually. Consumer spending rises steadily as households benefit from falling inflation and rising wage growth, though it is a modest upturn. The central scenario assumes slower job growth than seen in recent years, meaning unemployment edges up from its current historic lows. House price growth slows, extending the current slowdown, before picking up to low single digit growth in later years. Monetary policy follows the market implied path for Bank of England base rate at the time the scenarios were set, therefore it is assumed there are two base rate cuts over the next five years, whereas the yield curve used for financial planning assumes one base rate cut.

Use of the central base case in Personal

In Personal the internal base case is directly used as the central scenario for the ECL calculations by feeding the forecasted economic loss drivers into the respective PD and LGD models.

Use of the central base case in Wholesale

As in Personal the primary input is the central base case scenario but a further adjustment is applied to the aggregate credit cycle conditions arising from the base case to explicitly enforce a gradual reversion to long run average conditions starting from the first projected year onwards.

The application of the mean reversion adjustment is based on two empirical observations. Firstly historic credit loss rates in Wholesale portfolios show pronounced mean reversion behaviour and secondly, the accuracy of economic forecasts tends to drop significantly for horizons beyond one or two years.

Notes to the accounts

15. Risk management - Credit risk continued

Economic loss drivers continued

Approach for multiple economic scenarios (MES)

The response of portfolio loss rates to changes in economic conditions is typically non-linear and asymmetric. Therefore in order to appropriately take account of the uncertainty in economic forecasts a range of economic scenarios is considered when calculating ECL.

- **Personal** – In addition to the central base case a further four bespoke scenarios are taken into account – a base case upside and downside – and an additional upside and downside. The overall MES ECL is calculated as a probability weighted average across all five scenarios (refer to the Probability weightings of scenarios section for further details).

The ECL impact on the Personal portfolio arising from the systematic application of MES over the single, central base case was relatively low and estimated at less than 1%, in line with 2018. Losses are expected to increase on a non-linear basis in the event of an economic downturn, and for Personal Banking, this effect was included within an overlay for UK economic uncertainty.

Key economic loss drivers

The tables and commentary below provide an update on the base case economics used at 31 December 2019, and also the MES used for Personal portfolios. The average over the five year horizon (2020 to 2024) for the central base case and two upside and downside scenarios used for ECL modelling, are set out below. It is compared with the five year average (2019 to 2023) of the 2018 scenarios. The extreme points table shows the best and worst readings for three key variables in the two upside and two downside scenarios, highlighting the most challenging points in the downside scenarios and the strongest points in the upside scenarios. The 2019 base case GDP growth and interest rate assumptions are pessimistic compared to 2018 as consensus outlook and market implied interest rate projections worsened over the year. Unemployment rate projections are less extreme in the 2019 downside scenarios as RBS Group aimed to align the Downside 2 scenario with Office for Budget Responsibility's analysis of a hard Brexit scenario.

UK	2019					2018				
	Upside 2 %	Upside 1 %	Base case %	Downside 1 %	Downside 2 %	Upside 2 %	Upside 1 %	Base case %	Downside 1 %	Downside 2 %
GDP - change	2.4	2.2	1.6	1.3	0.9	2.6	2.3	1.7	1.3	0.9
Unemployment	3.6	3.9	4.4	4.7	5.2	3.3	3.8	4.9	5.6	6.7
House Price Inflation– change	4.1	3.3	1.6	0.8	(1.0)	4.6	3.6	1.7	0.9	(0.9)
Bank of England base rate	1.0	0.7	0.3	-	-	1.6	1.2	1.1	0.4	-
World GDP – change	3.8	3.3	2.8	2.5	2.1	3.9	3.3	2.8	2.4	2.1
Probability weight	12.7	14.8	30.0	29.7	12.7	12.8	17.0	30.0	25.6	14.6

UK GDP - annual growth

	Upside 2 %	Upside 1 %	Base case %	Downside 1 %	Downside 2 %
2019	1.3	1.4	1.2	1.1	1.1
2020	3.5	3.2	1.1	(0.1)	(1.3)
2021	3.6	3.0	1.7	1.2	-
2022	2.2	1.9	1.7	2.0	1.9
2023	1.5	1.5	1.7	1.7	2.1
2024	1.4	1.5	1.6	1.6	1.9

UK unemployment rate

	Upside 2 %	Upside 1 %	Base case %	Downside 1 %	Downside 2 %
Q4 2019	4.0	4.0	4.1	4.1	4.1
Q4 2020	3.7	3.8	4.4	4.8	5.1
Q4 2021	3.5	3.8	4.4	4.8	5.5
Q4 2022	3.5	3.8	4.4	4.7	5.4
Q4 2023	3.6	3.9	4.4	4.6	5.3
Q4 2024	3.8	4.0	4.4	4.6	5.1

- **Wholesale** – the approach to MES is a Monte Carlo method that involves simulating a large number of alternative scenarios around the central scenario (adjusted for mean reversion) and averaging the losses and PD values for each individual scenario into unbiased expectations of losses (ECL) and PD.

The simulation of alternative scenarios does not occur on the level of the individual economic loss drivers but operates on the aggregate Credit Cycle Indices (CCI) that underpin the Wholesale credit models. The Monte Carlo MES approach increases Wholesale modelled ECL for Stage 1 and Stage 2 by approximately 7% above the single, central scenario outcomes. No additional non-linearity overlay was applied for Wholesale, similar to 2018.

For both Personal and Wholesale, the impact from MES is factored into account level PDs through scalars. These MES-adjusted PDs are used to assess whether a significant increase in credit risk has occurred.

Notes to the accounts

15. Risk management - Credit risk continued

Economic loss drivers continued

UK House Price Inflation - annual growth

	Upside 2 %	Upside 1 %	Base case %	Downside 1 %	Downside 2 %
2019	1.7	1.7	1.5	1.5	1.4
2020	5.7	4.5	1.0	(1.1)	(3.6)
2021	8.2	6.0	0.9	(2.7)	(7.7)
2022	4.2	3.1	1.5	0.8	(1.9)
2023	1.7	1.4	2.0	3.1	3.0
2024	0.9	1.4	2.6	3.9	5.2

	Best points				Worst points			
	H2 2019		H1 2019		H2 2019		H1 2019	
	Upside 2 %	Upside 1 %	Upside 2 %	Upside 1 %	Downside 2 %	Downside 1 %	Downside 2 %	Downside 1 %
UK								
GDP (year-on-year)	4.6	4.0	5.0	4.1	(0.2)	(1.8)	(0.1)	(1.9)
Unemployment	3.5	3.8	2.8	3.4	4.9	5.5	5.9	7.4
House Price Inflation (year-on-year)	8.9	6.7	9.1	7.0	(3.5)	(8.4)	(2.8)	(7.3)

Probability weightings of scenarios

The Bank's approach to IFRS 9 MES in Personal involves selecting a suitable set of discrete scenarios to characterise the distribution of risks in the economic outlook and assigning appropriate probability weights to those scenarios. This involves the following steps:

- **Scenario selection** – two upside and two downside scenarios from Moody's inventory of scenarios were chosen. The aim is to obtain downside scenarios that are not as severe as stress tests, so typically they have a severity of around one in ten and one in five of approximate likelihood, along with corresponding upsides.
- **Severity assessment** – having selected the most appropriate scenarios, their severity is then assessed based on the behaviour of UK GDP, by calculating a variety of measures such as average growth, deviation from baseline and peak to trough falls. These measures are compared against a set of 1,000 model runs following which, a percentile in the distribution is established which most closely corresponds to the scenario.
- **Probability assignment** – having established the relevant percentile points probability weights are assigned to ensure that the scenarios produce an unbiased result.

UK economic uncertainty

The Group's approach is designed to capture the historic variability and distribution of economic risks. The Group's approach to capturing these incremental or skewed forward-looking risks is to apply an overlay to ECL. The Bank's overlay for 2019 was £6 million (2018 – £5 million). To calculate the value of this overlay, information was used from prevailing downside sensitivity scenario analyses.

The underlying economics were broadly aligned to published International Monetary Fund and Office for Budget Responsibility hard Brexit scenarios and management judgement was applied on the likelihood of this alternative path for the economy emerging. The value of the overlay was increased once during the year, in the third quarter, when management judged uncertainty to be more pronounced at the juncture the decision was taken. The value of the overlay was subsequently reviewed in the fourth quarter, when management concluded that it was appropriate to leave it unchanged.

Credit risk modelling

ECLs are calculated using a combination of:

- Probability of default.
- Loss given default.
- Exposure at default.

In addition, lifetime PDs (as at reporting date and at date of initial recognition) are used in the assessment of the significant increase in credit risk criteria.

IFRS 9 ECL model design principles

To meet IFRS 9 requirements, PD, LGD and EAD used in ECL calculations must be:

- Unbiased – material regulatory conservatism has been removed to produce unbiased model estimates.
- Point-in-time – recognise current economic conditions.
- Forward-looking – incorporated into PD estimates and, where appropriate, EAD and LGD estimates.
- For the life of the loan – all PD, LGD and EAD models produce term structures to allow a lifetime calculation for assets in Stage 2 and Stage 3.

15. Risk management - Credit risk continued

Credit risk modelling continued

IFRS 9 requires that at each reporting date, an entity shall assess whether the credit risk on an account has increased significantly since initial recognition. Part of this assessment requires a comparison to be made between the current lifetime PD (i.e. the probability of default over the remaining lifetime at the reporting date) with the equivalent lifetime PD as determined at the date of initial recognition. For assets originated before IFRS 9 was introduced, comparable lifetime origination PDs did not exist. These have been retrospectively created using the relevant model inputs applicable at initial recognition.

PD estimates

Personal models

Personal PD models use the Exogenous, Maturity and Vintage (EMV) approach to model default rates. The EMV approach separates portfolio default risk trends into three components: vintage effects (quality of new business over time), maturity effects (changes in risk relating to time on book) and exogenous effects (changes in risk relating to changes in macro-economic conditions). The EMV methodology has been widely adopted across the industry because it enables forward-looking economic information to be systematically incorporated into PD estimates.

Wholesale models

Wholesale PD models use the existing CCI based point-in-time/through-the-cycle framework to convert one-year regulatory PDs into point-in-time estimates that reflect economic conditions observed at the reporting date across a comprehensive set of region/industry segments.

One year point-in-time PDs are then subsequently extended to life-time PDs using a conditional transition matrix approach. The conditional transition matrix approach allows for the incorporation of forward-looking economic information into the life-time PDs.

LGD estimates

The general approach for the IFRS 9 LGD models is to leverage corresponding Basel LGD models with bespoke adjustments to ensure estimates are unbiased and where relevant forward-looking.

Personal

Forward-looking information has only been incorporated for the secured portfolios, where changes in property prices can be readily accommodated. Analysis has shown minimal impact of economic conditions on LGDs for the other Personal portfolios.

Wholesale

Forward-looking economic information is incorporated into LGD estimates using the existing CCI framework. For low default portfolios, including sovereigns and banks, loss data is too scarce to substantiate estimates that vary with economic conditions. Consequently, for these portfolios, LGD estimates are assumed to be constant throughout the projection horizon.

EAD estimates

Personal

The IFRS 9 Personal modelling approach for EAD is dependent on product type.

- Revolving products use the existing Basel models as a basis, with appropriate adjustments incorporating a term structure based on time to default.
- Amortising products use an amortising schedule, where a formula is used to calculate the expected balance based on remaining terms and interest rates.
- There is no EAD model for Personal loans. Instead, debt flow (i.e. combined PD x EAD) is directly modelled.

Analysis has indicated that there is minimal impact on EAD arising from changes in the economy for all Retail portfolios except mortgages. Therefore, forward-looking information is only incorporated in the mortgage EAD model (through forecast changes in interest rates).

Wholesale

For Wholesale, EAD values are projected using product specific credit conversion factors (CCF), closely following the product segmentation and approach of the respective Basel model. However, the CCFs are estimated over multi-year time horizons to produce unbiased model estimates.

No explicit forward-looking information is incorporated on the basis that analysis has shown that temporal variations in CCFs are largely attributable to changes in exposure management practices rather than economic conditions.

Governance and post model adjustments

The IFRS 9 PD, EAD and LGD models are subject to RBS Group's model risk policy that stipulates periodic model monitoring, periodic re-validation and defines approval procedures and authorities according to model materiality. Post model adjustments (PMAs) are applied where necessary to incorporate the most recent data available and made on a temporary basis ahead of the underlying model parameter changes being implemented, and also where management judge that additional ECL is required on certain portfolio segments.

For Personal Banking, these PMAs netted to a total overlay of approximately £7 million at the year end. In Commercial Banking, PMAs totalled £2 million. These adjustments were over and above those covering economic uncertainty and non-linearity of losses discussed above and are also subject to oversight and governance by the Provisions Committee.

Significant increase in credit risk

Exposures that are considered significantly credit deteriorated since initial recognition are classified in Stage 2 and assessed for lifetime ECL measurement (exposures not considered deteriorated carry a 12 month ECL). The Bank has adopted a framework to identify deterioration based primarily on movements in probability of default supported by additional backstops. The principles applied are consistent across the Bank and align to credit risk management practices.

Notes to the accounts

15. Risk management - Credit risk continued

Significant increase in credit risk continued

The framework comprises the following elements:

- **IFRS 9 lifetime PD assessment (the primary driver)** – on modelled portfolios the assessment is based on the relative deterioration in forward-looking lifetime PD and is assessed monthly. To assess whether credit deterioration has occurred, the residual lifetime PD at balance sheet date (which PD is established at date of initial recognition (DOIR)) is compared to the current PD. If the current lifetime PD exceeds the residual origination PD by more than a threshold amount deterioration is assumed to have occurred and the exposure transferred to Stage 2 for a lifetime loss assessment. For Commercial, a doubling of PD would indicate a significant increase in credit risk subject to a minimum PD uplift of 0.1%. For Personal portfolios, the criteria varies by risk band, with lower risk exposures needing to deteriorate more than higher risk exposures, as outlined in the following table:

Personal risk bands	Risk bandings (based on residual lifetime PD calculated at DOIR)	PD deterioration threshold criteria
Risk band A	<0.762%	PD@DOIR + 1%
Risk band B	<4.306%	PD@DOIR + 3%
Risk band C	>=4.306%	1.7 x PD@DOIR

- **Qualitative high-risk backstops** – the PD assessment is complemented with the use of qualitative high-risk backstops to further inform whether significant deterioration in lifetime risk of default has occurred. The qualitative high-risk backstop assessment includes the use of the mandatory 30+ days past due backstop, as prescribed by IFRS 9 guidance, and other features such as forbearance support, Wholesale exposures managed within the Risk of Credit Loss framework, and for Personal, adverse credit bureau results.
- **Persistence (Personal and Business Banking customers only)** – the persistence rule ensures that accounts which have met the criteria for PD driven deterioration are still considered to be significantly deteriorated for three months thereafter. This additional rule enhances the timeliness of capture in Stage 2. It is a Personal methodology feature and is applied to PD driven deterioration only.

The criteria are based on a significant amount of empirical analysis and seek to meet three key objectives:

- **Criteria effectiveness** – the criteria should be effective in identifying significant credit deterioration and prospective default population.
- **Stage 2 stability** – the criteria should not introduce unnecessary volatility in the Stage 2 population.
- **Portfolio analysis** – the criteria should produce results which are intuitive when reported as part of the wider credit portfolio.

Asset lifetimes

The choice of initial recognition and asset duration is another critical judgement in determining the quantum of lifetime losses that apply.

- The date of initial recognition reflects the date that a transaction (or account) was first recognised on the balance sheet; the PD recorded at that time provides the baseline used for subsequent determination of significant increase in credit risk.
- For asset duration, the approach applied (in line with IFRS 9 requirements) is:
 - **Term lending** – the contractual maturity date, reduced for behavioural trends where appropriate (such as, expected pre-payment and amortisation).
 - **Revolving facilities** – for Personal portfolios (except credit cards), asset duration is based on behavioural life and this is normally greater than contractual life (which would typically be overnight). For Wholesale portfolios, asset duration is based on annual counterparty review schedules and will be set to the next review date.

In the case of credit cards, the most significant judgement is to reflect the operational practice of card reissuance and the associated credit assessment as enabling a formal re-origination trigger. As a consequence a capped lifetime approach of up to 36 months is used on credit card balances. If the approach was uncapped the ECL impact is estimated at £1.3 million.

The approach reflects the Bank's practice of a credit-based review of customers prior to credit card issuance and complies with IFRS 9. Benchmarking information indicates that peer UK banks use behavioural approaches in the main for credit card portfolios with average durations between three and ten years. Across Europe durations are shorter and are, in some cases, as low as one year.

Measurement uncertainty and ECL sensitivity analysis

The recognition and measurement of ECL is complex and involves the use of significant judgement and estimation. This includes the formulation and incorporation of multiple forward-looking economic conditions into ECL to meet the measurement objective of IFRS 9. The ECL provision is sensitive to the model inputs and economic assumptions underlying the estimate.

Notes to the accounts

15. Risk management - Credit risk continued

Credit risk- Banking activities

Introduction

This section details the credit risk profile of UBL's banking activities.

Refer to Accounting policy 12 and Note 9 for revisions to policies and critical judgements relating to impairment loss determination.

Presentation of interest in suspense recoveries

Refer to Accounting policy 1 for further details.

Financial instruments within the scope of the IFRS 9 ECL framework

Refer to Note 8 for balance sheet analysis of financial assets that are classified as amortised cost (AC) or fair value through other comprehensive income (FVOCI), the starting point for IFRS 9 ECL framework assessment.

Financial assets

	2019 £m	2018 £m
Balance sheet total gross AC/FVOCI	4,741	4,904
In scope of IFRS 9 ECL framework	4,636	4,781
% in scope	100%	100%
Loans - in scope	3,644	3,807
Stage 1	2,887	3,053
Stage 2	650	572
Stage 3	107	182
Other financial assets - in scope	992	974
Stage 1	992	974
Out of scope of IFRS 9 ECL framework	105	123

Those assets outside the IFRS 9 ECL framework were as follows:

- Settlement balances, items in the course of collection, cash balances and other non-credit risk assets. These were assessed as having no ECL unless there was evidence that they were credit impaired.
- Fair value adjustments on loans hedged by interest rate swaps, where the underlying loan was within the IFRS 9 ECL scope.
- Commercial cards which operate in a similar manner to charge cards, with balances repaid monthly via mandated direct debit with the underlying risk of loss captured within the customer's linked current account.

Contingent liabilities and commitments

In addition to contingent liabilities and commitments disclosed in Note 16 - reputationally - committed limits are also included in the scope of the IFRS 9 ECL framework. These are offset by out of scope balances primarily related to facilities that, if drawn would not be classified as AC or FVOCI, or undrawn limits relating to financial assets exclusions.

Asset quality (unaudited)

Internal asset quality ratings 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 map to both an asset quality scale, used for external financial reporting, and a master grading scale used for internal management reporting across portfolios. The table that follows details the relationship between internal asset quality (AQ) bands and external ratings published by Standard & Poor's (S&P), for illustrative purposes only.

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 to 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

Notes to the accounts

15. Risk management - Credit risk continued

Portfolio summary - sector analysis

The table below shows financial assets and off-balance sheet exposures gross of ECL and related ECL provisions, impairment and past due by sector and asset quality and geographical region based on the country of operation of the customer.

	Personal £m	Wholesale £m	Total £m
2019			
Loans by geography	2,114	1,530	3,644
- UK	2,114	1,472	3,586
- RoI	-	13	13
- Other Europe	-	8	8
- RoW	-	37	37
Loans by stage and asset quality	2,114	1,530	3,644
- AQ1	-	35	35
- AQ2	-	15	15
- AQ3	277	73	350
- AQ4	934	296	1,230
- AQ5	510	427	937
- AQ6	148	351	499
- AQ7	112	232	344
- AQ8	42	52	94
- AQ9	19	14	33
- AQ10	72	35	107
Loans by stage	2,114	1,530	3,644
- Stage 1	1,737	1,150	2,887
- Stage 2	305	345	650
- Stage 3	72	35	107
Loans - past due analysis	2,114	1,530	3,644
- Not past due	2,003	1,470	3,473
- Past due 1-29 days	30	22	52
- Past due 30-89 days	16	3	19
- Past due 90-180 days	8	-	8
- Past due > 180 days	57	35	92
Loans - Stage 2	305	345	650
- Not past due	266	335	601
- Past due 1-29 days	24	7	31
- Past due 30 - 89 days	15	3	18
Weighted average life *			
- ECL measurement years	7.0	7.0	7.0
Weighted average 12 month PDs*			
- IFRS 9 (%)	0.83	1.04	0.91
- Basel (%)	1.12	1.78	1.39
ECL provision by geography	48	47	95
- UK	48	46	94
- RoI	-	1	1
- RoW	-	-	-
ECL provision by stage	48	47	95
- Stage 1	2	3	5
- Stage 2	18	14	32
- Stage 3	28	30	58
ECL Provision coverage (%)	2.27	3.07	2.61
- Stage 1 (%)	0.12	0.26	0.17
- Stage 2 (%)	5.90	4.06	4.92
- Stage 3 (%)	38.89	85.71	54.21
ECL charge - Third party	8	10	18
ECL loss rate (%)	0.38	0.65	0.49
Amounts written-off	7	6	13
Other financial assets by asset quality	-	992	992
- AQ 1-AQ 4	-	992	992
Off balance sheet	389	487	876
- Loan commitments	389	423	812
- Financial guarantees	-	64	64
Off balance sheet by asset quality	389	487	876
- AQ 1 - AQ 4	139	202	341
- AQ 5 - AQ 8	245	278	523
- AQ 9	-	3	3
- AQ 10	5	4	9

Notes to the accounts

15. Risk management - Credit risk continued

Portfolio summary - sector analysis continued

	Personal £m	Wholesale £m	Total £m
2018*			
Loans by geography	2,312	1,495	3,807
- UK	2,312	1,443	3,755
- RoI	-	18	18
- Other Europe	-	10	10
- RoW	-	24	24
Loans by stage and asset quality	2,312	1,495	3,807
- AQ1	-	39	39
- AQ2	-	20	20
- AQ3	279	44	323
- AQ4	1,047	241	1,288
- AQ5	610	482	1,092
- AQ6	142	337	479
- AQ7	90	185	275
- AQ8	41	39	80
- AQ9	20	9	29
- AQ10	83	99	182
Loans by stage	2,312	1,495	3,807
- Stage 1	1,787	1,266	3,053
- Stage 2	442	130	572
- Stage 3	83	99	182
Loans - past due analysis	2,312	1,495	3,807
- Not past due	2,073	1,379	3,452
- Past due 1-29 days	33	43	76
- Past due 30-89 days	128	31	159
- Past due 90-180 days	9	1	10
- Past due > 180 days	69	41	110
Loans - Stage 2	442	130	572
- Not past due	288	110	398
- Past due 1-29 days	28	2	30
- Past due 30 - 89 days	126	18	144
Weighted average life *			
- ECL measurement (years)	7.0	4.0	6.0
Weighted average 12 month PDs*			
- IFRS 9 (%)	0.88	1.11	0.96
- Basel (%)	1.01	1.70	1.28
ECL provision by geography	47	41	88
- UK	47	38	85
- RoI	-	1	1
- RoW	-	2	2
ECL provision by stage	47	41	88
- Stage 1	2	3	5
- Stage 2	20	3	23
- Stage 3	25	35	60
ECL Provision coverage (%)	2.03	2.74	2.31
- Stage 1 (%)	0.11	0.24	0.16
- Stage 2 (%)	4.52	3.08	4.02
- Stage 3 (%)	30.12	35.35	32.97
ECL charge - Third party	9	(2)	7
ECL loss rate (%)	0.39	(0.13)	0.18
Amounts written-off	23	16	39
Other financial assets by asset quality	-	974	974
- AQ 1-AQ 4	-	974	974
Off balance sheet	370	500	870
- Loan commitments	370	433	803
- Financial guarantees	-	67	67
Off balance sheet by asset quality	370	500	870
- AQ 1 - AQ 4	185	217	402
- AQ 5 - AQ 8	181	273	454
- AQ 9	-	3	3
- AQ 10	4	7	11

*2018 data has been restated for a change to presentation of unrecognised interest, refer to accounting policy 1 for further details.

Notes to the accounts

15. Risk management - Credit risk continued

Credit risk enhancement and mitigation

The table below shows exposures of modelled portfolios within the scope of the ECL framework and related credit risk enhancement and mitigation (CREM).

	Gross exposure		Maximum credit risk		CREM by type			CREM coverage		Exposure post CREM	
	£m	ECL £m	Total £m	Stage 3 Financial £m	Financial ⁽¹⁾ £m	Property £m	Other ⁽²⁾ £m	Total £m	Stage 3 £m	Total £m	Stage 3 £m
2019											
Financial assets											
Cash and balances at central banks	992	-	992	-	-	-	-	-	-	992	-
Loans - amortised cost ⁽³⁾	3,644	94	3,550	47	1	2,152	151	2,304	21	1,246	26
Personal	2,114	48	2,066	43	-	1,571	-	1,571	21	495	22
Wholesale ⁽⁴⁾	1,530	46	1,484	4	1	581	151	733	-	751	4
Total financial assets	4,636	94	4,542	47	1	2,152	151	2,304	21	2,238	26
Contingent liabilities and commitments											
Personal ⁽⁵⁾	389	-	389	5	-	-	-	-	-	389	5
Wholesale	487	1	486	3	6	79	31	116	-	370	3
Total off-balance sheet	876	1	875	8	6	79	31	116	-	759	8
Total exposure	5,512	95	5,417	55	7	2,231	182	2,420	21	2,997	34
2018*											
Financial assets											
Cash and balances at central banks	974	-	974	-	-	-	-	-	-	974	-
Loans - amortised cost ⁽³⁾	3,807	88	3,719	123	8	2,525	180	2,713	73	1,006	50
Personal	2,312	47	2,265	58	-	1,961	-	1,961	14	304	44
Wholesale ⁽⁴⁾	1,495	41	1,454	65	8	564	180	752	59	702	6
Total financial assets	4,781	88	4,693	123	8	2,525	180	2,713	73	1,980	50
Contingent liabilities and commitments											
Personal ⁽⁵⁾	370	-	370	4	-	-	-	-	-	370	4
Wholesale	500	-	500	7	9	67	33	109	1	391	6
Total off-balance sheet	870	-	870	11	9	67	33	109	1	761	10
Total exposure	5,651	88	5,563	134	17	2,592	213	2,822	74	2,741	60

*2018 data has been restated for a change to presentation of unrecognised interest, refer to accounting policy 1 for further details.

Notes:

(1) Includes cash and securities collateral.

(2) Includes guarantees, charges over trade debtors as well as the amount by which credit risk exposure is reduced through netting arrangements, mainly cash management pooling, which give the Bank a legal right to set off the financial asset against a financial liability due to the same counterparty.

(3) The Bank holds collateral in respect of individual loans – amortised cost to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant and equipment, inventories and trade debtors; and guarantees of lending from parties other than the borrower. Collateral values are capped at the value of the loan.

(4) Stage 3 exposures post credit risk enhancement and mitigation in Wholesale mainly represent enterprise value and the impact of written down collateral values; an individual assessment to determine ECL will consider multiple scenarios and in some instances allocate a probability weighting to a collateral value in excess of the written down value.

(5) £5m (2018 – £4m) of Personal Stage 3 balances primarily relates to loan commitments, the draw down of which is effectively prohibited.

Notes to the accounts

15. Risk management - Credit risk continued

Personal portfolio

Disclosures in the Personal portfolio section include drawn exposure (gross of provisions). Loan-to-value (LTV) ratios are split by stage under IFRS 9.

	2019 £m	2018 £m
Personal lending		
Mortgages		
Of which:	1,848	2,055
Owner occupied	1,705	1,894
Buy-to-let	143	161
Interest-only – variable	275	303
Interest - only – fixed	35	33
Mixed ⁽¹⁾	47	55
Impairment provisions	30	26
Other personal lending	257	234
Impairment provisions	18	15
Total personal lending	2,105	2,289
Mortgage LTV ratios		
- Total portfolio	64%	65%
- Stage 1	61%	63%
- Stage 2	85%	86%
- Stage 3	83%	87%
- Buy to let	74%	75%
- Stage 1	72%	74%
- Stage 2	91%	88%
- Stage 3	74%	77%
Gross new mortgage lending		
Of which:	101	137
Owner occupied exposure	100	134
Weighted average LTV	68%	67%
Buy-to-let	1	3
Weighted average LTV	68%	64%
Interest only variable rate	-	-
Interest only fixed rate	-	-
Mixed ⁽¹⁾	-	-
Mortgage forbearance		
Forbearance flow	-	3
Forbearance stock	21	27
<i>Current</i>	6	8
<i>1-3 months in arrears</i>	1	2
<i>>3 months in arrears</i>	14	17

Notes:

(1) Includes accounts which have an interest only sub-account and a capital and interest sub-account to provide a more comprehensive view of interest only exposures.

Notes to the accounts

15. Risk management - Credit risk *continued*

Personal portfolios

Mortgage LTV distribution by stage

The table below shows gross mortgage lending and related ECL by LTV band.

	Mortgages						ECL Provisions				ECL provisions coverage ⁽¹⁾			
	Stage 1	Stage 2	Stage 3	Not within IFRS 9 ECL scope	Total	Of which: Gross new lending	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	%	%	%	%
2019														
≤50%	485	35	13	65	598	24	-	1	4	5	-	3.4%	28.6%	0.8%
>50% and ≤70%	464	45	11	22	542	23	-	2	4	6	-	4.7%	34.6%	1.1%
>70% and ≤80%	239	37	6	6	288	14	1	2	1	4	0.1%	5.0%	24.8%	1.2%
>80% and ≤90%	148	27	4	3	182	34	-	2	1	3	0.1%	5.7%	24.4%	1.5%
>90% and ≤100%	42	20	5	4	71	6	-	1	1	2	0.1%	7.0%	26.4%	3.8%
>100% and ≤110%	24	16	4	1	45	-	-	1	1	2	0.1%	6.2%	17.9%	3.7%
>110% and ≤130%	35	29	5	2	71	-	-	2	2	4	0.1%	6.7%	34.9%	5.3%
>130% and ≤150%	13	20	5	-	38	-	-	1	1	2	0.2%	6.7%	25.5%	7.1%
>150%	3	6	3	-	12	-	-	-	2	2	0.1%	6.5%	45.7%	15.2%
Total with LTVs	1,453	235	56	103	1,847	101	1	12	17	30	-	5.4%	29.6%	1.6%
Other	1	-	-	-	1	-	-	-	-	-	0.2%	-	0.1%	0.2%
Total	1,454	235	56	103	1,848	101	1	12	17	30	-	5.4%	29.6%	1.6%
2018*														
≤50%	507	39	11	75	632	32	1	1	2	4	0.0%	2.7%	29.8%	0.7%
>50% and ≤70%	483	51	10	26	570	27	-	2	3	5	0.0%	4.6%	29.3%	0.9%
>70% and ≤80%	295	42	4	7	348	19	-	2	1	3	0.1%	4.3%	20.3%	0.8%
>80% and ≤90%	180	35	5	5	225	48	-	2	1	3	0.1%	4.3%	24.1%	1.2%
>90% and ≤100%	47	24	5	4	80	7	-	2	1	3	0.1%	7.6%	20.1%	3.5%
>100% and ≤110%	31	17	3	1	52	-	-	1	1	2	0.1%	5.5%	20.1%	3.1%
>110% and ≤130%	41	30	6	2	79	-	-	2	1	3	0.1%	6.0%	17.3%	3.6%
>130% and ≤150%	16	22	5	-	43	-	-	1	1	2	0.1%	6.4%	18.5%	5.6%
>150%	3	9	3	-	15	-	-	-	1	1	0.1%	6.2%	23.1%	8.4%
Total with LTVs	1,603	269	52	120	2,044	133	1	13	12	26	-	4.9%	23.9%	1.3%
Other	3	3	3	2	11	4	-	1	2	3	0.3%	15.9%	85.8%	27.1%
Total	1,606	272	55	122	2,055	137	1	14	14	29	-	5.0%	27.1%	1.4%

*2018 data has been restated for a change to presentation of unrecognised interest, refer to accounting policy 1 for further details.

Note:

(1) ECL provisions coverage is ECL provisions divided by mortgages.

Notes to the accounts

15. Risk management - Credit risk continued

Flow statements

The flow statements that follow show the main ECL and related income statement movements. They also show the changes in ECL as well as the changes in related financial assets used in determining ECL. Due to differences in scope, exposures in this section may therefore differ from those reported in other tables in the credit risk section, principally in relation to exposures in Stage 1 and Stage 2. These differences do not have a material ECL impact. Other points to note:

- Financial assets include treasury liquidity portfolios, comprising balances at central banks and debt securities, as well as loans. Both modelled and non-modelled portfolios are included.
- Stage transfers (for example, exposures moving from Stage 1 to Stage 2) are a key feature of the ECL movements, with the net re-measurement cost of transitioning to a worse stage being a primary driver of income statement charges. Similarly, there is an ECL benefit for accounts improving stage.
- Changes in risk parameters shows the reassessment of the ECL within a given stage, including any ECL overlays and residual income statement gains or losses at the point of write-off or accounting write-down.
- Other (P&L only items) includes any subsequent changes in the value of written-down assets (for example, fortuitous recoveries) along with other direct write-off items such as direct recovery costs. Other (P&L only items) affects the income statement but does not affect balance sheet ECL movements.
- Amounts written-off represent the gross asset written-down against accounts with ECL, including the net asset write-down for debt sale activity.
- There were small ECL flows from Stage 3 to Stage 1. This does not however indicate that accounts returned from Stage 3 to Stage 1 directly. On a similar basis, there were flows from Stage 1 to Stage 3 including transfers due to unexpected default events.
- The impact of model changes during 2019 was not material at a RBS Group-wide level or on the portfolios disclosed below.
- Reporting enhancements since 31 December 2018 now mean all movements are captured monthly and aggregated. Previously, for example, the main Personal portfolios were prepared on a six month movement basis.

	Stage 1		Stage 2		Stage 3		Total	
	Financial assets £m	ECL £m	Financial assets £m	ECL £m	Financial assets £m	ECL £m	Financial assets £m	ECL £m
At 1 January 2019*	3,971	5	584	23	162	60	4,717	88
Currency translation and other adjustments	(4)	-	(1)	2	2	2	(3)	4
Transfers from Stage 1 to Stage 2	(521)	(2)	521	2	-	-	-	-
Transfers from Stage 2 to Stage 1	346	6	(346)	(6)	-	-	-	-
Transfers to Stage 3	(4)	-	(32)	(10)	36	10	-	-
Transfers from Stage 3	3	1	69	5	(72)	(6)	-	-
Net re-measurement of ECL on stage transfer	-	(6)	-	19	-	5	-	18
Changes in risk parameters (model inputs)	-	-	-	-	-	6	-	6
Other changes in net exposure	(923)	1	(136)	(3)	(18)	(1)	(1,077)	(3)
Other (P&L only items- primarily fortuitous recoveries)	-	-	-	-	-	(3)	-	(3)
Income statement (releases)/charges	-	(5)	-	16	-	7	-	18
Amounts written-off	-	-	-	-	(13)	(13)	(13)	(13)
Other movements	-	-	-	-	-	(2)	-	(2)
At 31 December 2019	2,868	5	659	32	97	58	3,624	95
Net carrying amount	2,863		627		39		3,529	
Memo: changes to ECL models								
At 1 January 2018	3,954	5	644	18	140	94	4,738	117
Movement in the period/effects of IIS	17	-	(60)	5	22	(34)	(21)	(29)
At 31 December 2018	3,971	5	584	23	162	60	4,717	88
Net carrying amount	3,966		561		102		4,629	

*1 January 2019 data has been restated for a change to presentation of unrecognised interest, refer to accounting policy 1 for further details.

2018 movements included transfers from Stage 1 to Stage 2 of £287 million (ECL – £1 million), transfers from Stage 2 to Stage 1 of £225 million (ECL – £4 million), transfers into Stage 3 of £80 million (ECL – £2 million) and transfers from Stage 3 of £16 million (ECL – £4 million). An additional ECL of £6 million was recognised as a result of these cumulative transfers. Also included were amounts written-off of £39 million.

Notes to the accounts

15. Risk management continued

Non-traded market risk

Definition

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

Sources of risk (unaudited)

The Bank's non-traded market risk exposure largely comprises interest rate risk.

Risk governance, appetite and controls

For general information on risk governance, appetite and controls, refer to pages 47 to 49. Further information specific to non-traded market risk can be found in the non-traded market risk section of the RBS Group ARA.

Risk monitoring and mitigation (unaudited)

Interest rate risk

Non-traded interest rate risk (NTIRR) arises from the provision to customers of a range of banking products with 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 can give rise to volatility in net interest income as interest rates vary. NTIRR comprises three primary risk types: gap risk, basis risk and option risk.

To manage exposures within its risk appetite the Bank aggregates interest rate positions and hedges its residual exposure, primarily using back-to-back trades with NatWest Bank.

Risk measurement

The market risk exposures arising as a result of the Bank's Personal and Commercial banking activities are measured using a combination of value-based metrics (VaR and sensitivities) and earnings-based metrics.

The Bank uses VaR as its value-based approach and sensitivity of net interest earnings as its earnings-based approach. Further detail on these measurement approaches can also be found in the non-traded market risk section of the RBS Group ARA.

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 further information on non-traded VaR metrics, refer to the non-traded market risk section of the RBS Group ARA.

	2019			2018	
	Average	Maximum	Minimum	Period-end	Period-end
	£m	£m	£m	£m	£m
Interest rate	0.2	0.2	0.1	0.2	0.2

Pension risk (unaudited)

Definition

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

Sources of pension risk

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

Risk governance

The Pension Committee is chaired by the RBS Group Chief Financial Officer. It receives its authority from the Group Executive Committee and formulates the Group's view of pension risk. The Pension Committee is a key component of the Group's approach to managing pension risk and it reviews and monitors risk management, asset strategy and financing issues on behalf of the Bank. It also considers investment strategy proposals from the trustee.

Risk appetite

The Group maintains an independent view of the risk inherent in its pension funds. The Bank has an annually reviewed pension risk appetite statement incorporating defined metrics against which risk is measured. The Group undertakes regular pension risk monitoring and reporting to the RBSG Board, the RBSG Board Risk Committee and the Pension Committee on the material pension schemes that the Group has an obligation to support.

Risk controls

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

Risk monitoring and measurement

Pension risk reports are submitted to the Executive Risk Forum and the RBSG Board Risk Committee four times a year in the Risk Management Quarterly Report. The Group also undertakes stress tests and scenario analysis on its material defined benefit pension schemes each year. These tests are also used to satisfy the requests of regulatory bodies such as the Bank of England.

Notes to the accounts

15. Risk management – Pension risk (unaudited) continued

Risk monitoring and measurement continued

The stress testing framework includes pension risk capital calculations for the purposes of the Internal Capital Adequacy Assessment Process as well as additional stress tests for a number of internal management purposes. The results of the stress tests and their consequential impact on the Group's balance sheet, income statement and capital position are incorporated into the overall RBS Group stress test results.

Compliance & conduct risk (unaudited)

Definition

Compliance risk is the risk that the behaviour of RBS Group towards customers fails to comply with laws, regulations, rules, standards and codes of conduct. Such a failure may lead to breaches of regulatory requirements, organisational standards or customer expectations and could result in legal or regulatory sanctions, material financial loss or reputational damage.

Conduct risk is the risk that the conduct of RBS Group and its subsidiaries 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.

Sources of risk

Compliance and conduct risks exist across all stages of RBS Group's relationships with its customers and arise from a variety of activities including product design, marketing and sales, complaint handling, staff training, and handling of confidential insider information.

Key developments in 2019

- Policies were simplified and enhanced to reflect regulatory changes and technical training delivered across the lines of defence.
- Ongoing investment in regulatory technology.
- Planning for LIBOR transition continued including an extended SONIA pilot and further industry engagement.
- Preparations continued for a number of Brexit outcomes.
- Enhanced operational capabilities to cope with unprecedented volumes of PPI mis-selling claims.

Risk governance

RBS Group defines appropriate standards of compliance and conduct and ensures adherence to those standards through its risk management framework. Relevant Conduct & Compliance matters are escalated through Executive Risk Committee and Board Risk Committee.

Risk appetite

Risk appetite for compliance and conduct risks is set at Board level. Risk appetite statements articulate the levels of risk that legal entities, businesses and functions work within when pursuing their strategic objectives and business plans.

Risk controls

A range of controls is operated to ensure business delivers good customer outcomes and is conducted in accordance with legal and regulatory requirements. A suite of policies addressing compliance and conduct risks set appropriate standards across RBS Group. Examples of these include the Complaints Management Policy, Client Assets & Money Policy, and Product Lifecycle Policy as well as policies relating to customers in vulnerable situations, cross-border activities and market abuse. Continuous monitoring and targeted assurance is carried out as appropriate.

Risk monitoring and measurement

Compliance and conduct risks are measured and managed through continuous assessment and reporting to RBS Group's senior risk committees and at Board level.

The compliance and conduct risk framework facilitates the consistent monitoring and measurement of compliance with laws and regulations and the delivery of consistently good customer outcomes. The first line of defence is responsible for effective risk identification, reporting and monitoring, with oversight, challenge and review by the second line. Compliance and conduct risk management is also integrated into the RBS Group's strategic planning cycle.

Risk mitigation

Activity to mitigate the most-material compliance and conduct risks is carried out across RBS Group with specific areas of focus in the customer-facing businesses and legal entities. Examples of mitigation include consideration of customer needs in business and product planning, targeted training, complaints management, as well as independent monitoring activity. Internal policies help support a strong customer focus across RBS Group. Independent assessments of compliance with applicable regulations are also carried out at a legal entity level.

Financial crime risk (unaudited)

Definition

Financial crime risk is the risk presented by criminal activity in the form of money laundering, terrorist financing, bribery and corruption, sanctions and tax evasion. It does not include fraud risk management.

Sources of risk

Financial crime risk may be presented if the Bank's employees, customers or third parties undertake or facilitate financial crime, or if the Bank's products or services are used to facilitate such crime. Financial crime risk is an inherent risk across all of the Bank's lines of business.

Key developments in 2019

- Enhanced financial crime risk assessment processes were implemented to enable improved identification and mitigation of financial crime risks.
- Improvements were made to transaction monitoring alert processes, including the use of risk-based artificial intelligence to facilitate focus on activity of higher concern.
- Financial crime policies were refreshed and updated to reflect changes to the regulatory environment and industry best practice.

15. Risk management – Financial crime risk (unaudited) continued

Risk governance

The Financial Crime Risk Executive Committee, which is chaired by the Group Chief Financial Crime Risk Officer, is the principal financial crime risk management forum. The committee reviews and, where appropriate, escalates material financial crime risks and issues across RBS Group to the Executive Risk Committee and the Board Risk Committee.

Risk appetite

There is no appetite to operate in an environment where systems and controls do not enable the identification, assessment, monitoring, management and mitigation of financial crime risk. The Bank's systems and controls must be comprehensive and proportionate to the nature, scale and complexity of its businesses. There is no tolerance to systematically or repeatedly breach relevant financial crime regulations and laws.

Risk controls

The Bank operates a framework of preventative and detective controls designed to ensure the Bank mitigates the risk that it could facilitate financial crime. These controls are supported by a suite of policies, procedures and detailed instructions to ensure they operate effectively.

Risk monitoring and measurement

Financial crime risks are identified and reported through continuous risk management and regular monthly reporting to the Bank's senior risk committees and the Board. Quantitative and qualitative data is reviewed and assessed to measure whether financial crime risk is within the Bank's risk appetite.

Risk mitigation

Through the financial crime framework, the Bank employs relevant policies, systems, processes and controls to mitigate financial crime risk. This would include the use of dedicated screening and monitoring controls to identify people, organisations, transactions and behaviours which might require further investigation or other actions. The Bank ensures that centralised expertise is available to detect and disrupt threats to the Bank and its customers. Intelligence is shared with law enforcement, regulators and government bodies to strengthen national and international defences against those who would misuse the financial system for criminal motives.

Climate-related financial risk (unaudited)

Definition

Climate-related financial risk is the threat arising from the impact climate change will have on the Bank's risk profile and its ability to achieve its strategic ambitions.

Financial risks from climate change arise through two primary channels: physical (extreme weather events, flooding and sea level rises) and transition (changes in policy, technology and sentiment in support of a low carbon economy).

The RBS Group Board is responsible for addressing and overseeing the financial risks from climate change within the Bank's overall business strategy and risk appetite. Climate risk will be considered and, where appropriate, embedded in the RBS Group risk management framework and subject to the governance set out by individual risk disciplines.

For further detail, please see the RBS Group Strategic Review.

Operational risk (unaudited)

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 appetite supports effective management of material operational risks. It expresses the level and types of operational risk the Bank is willing to accept to achieve its strategic objectives and business plans.

The RBS Group-wide operational risk appetite statement encompasses the full range of operational risks faced by its legal entities, businesses and functions. A subset of the most material risk appetite measures are defined as board risk measures, which are those that align to strategy and should the limit be breached, would impact on the ability to achieve business plans and threaten stakeholder confidence.

Risk and control assessments are used across all business areas and support functions to identify and assess material operational and conduct risks and key controls. All risks and controls are mapped to RBS Group's Risk Directory. Risk assessments are refreshed at least annually to ensure they remain relevant and capture any emerging risks and also ensure risks are reassessed.

The process is designed to confirm that risks are effectively managed in line with risk appetite. Controls are tested on a regular basis to ensure they operate effectively to reduce identified risks.

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

The Bank manages and monitors operational resilience through its risk and control assessments methodology. This is underpinned by setting and monitoring risk indicators and performance metrics for key business services. Progress continues on the response to regulator expectations on operational resilience, with involvement in a number of industry-wide operational resilience forums. This enables a more holistic view of RBS Group's operational resilience risk profile and the pace of ongoing innovation and change, internally and externally.

Notes to the accounts

15. Risk management continued

Model risk (unaudited)

A variety of models are used as part of risk management processes and activities. To mitigate the risk that models are specified, implemented or used incorrectly, independent validation and regular reviews are carried out. Oversight is provided by an RBS Group model risk governance committee in accordance with relevant policies and procedures. Further information on model risk can be found in the 2019 Annual Report and Accounts of RBSG.

16. 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 2019. Although the Bank 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 Bank's expectation of future losses.

	2019 £m	2018 £m
Contingent liabilities:		
Guarantees and assets pledged as collateral security	21	22
Other contingent liabilities	41	41
	<u>62</u>	<u>63</u>
Commitments:		
Documentary credits and other short-term trade related transactions	1	2
Commitments to lend	862	900
Other commitments	7	7
	<u>870</u>	<u>909</u>

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 Bank's maximum exposure to credit loss, in the event of non-performance by the other party and where all counterclaims, collateral or security proves valueless, is represented by the contractual nominal amount of these instruments included in the table. These commitments and contingent obligations are subject to the Bank's normal credit approval processes.

Contingent liabilities

Guarantees - the Bank gives guarantees on behalf of customers. A financial guarantee represents an irrevocable undertaking that the Bank will meet a customer's obligations to third parties if the customer fails to do so. The maximum amount that the Bank could be required to pay under a guarantee is its principal amount as disclosed in the table above. The Bank expects most guarantees it provides to expire unused.

Other contingent liabilities - these include standby letters of credit, supporting customer debt issues and contingent liabilities relating to customer trading activities such as those arising from performance and customs bonds, warranties and indemnities.

Commitments

Commitments to lend - under a loan commitment the Bank agrees to make funds available to a customer in the future.

Reputational risk (unaudited)

A reputational risk policy is in place to support the management of issues that could pose a threat to the Bank's public image. A number of measures - including some also used in the management of operational, conduct and financial risks - are used to assess risk levels against risk appetite. Where a material reputational risk is presented, this is escalated to the RBS Group Reputational Risk Committee. Further information on reputational risk can be found in the 2019 Annual Report and Accounts of RBSG.

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 Bank 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 certain other subsidiaries of NatWest Holdings Limited, 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 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 to the accounts

16. Memorandum items continued

Contractual obligations for future expenditure not provided for in the accounts

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

	2019	2018
	£m	£m
Capital expenditure on other property, plant and equipment	1	-
Contracts to purchase goods or services	2	2
	<u>3</u>	<u>2</u>

Litigation, investigations and reviews

The Bank is involved in litigation arising in the ordinary course of business. No material adverse effect on the net assets of the Bank is expected to arise from the ultimate resolution of these claims. Material investigations and reviews involving the Bank are described below.

FCA review of RBS Group's treatment of SMEs

In 2014, the FCA appointed an independent Skilled Person under section 166 of the Financial Services and Markets Act 2000 to review RBS Group's treatment of SME customers whose relationship was managed by RBS Group's Global Restructuring Group (GRG) in the period 1 January 2008 to 31 December 2013.

The Skilled Person delivered its final report to the FCA during September 2016, and the FCA published an update in November 2016. In response, RBS Group announced redress steps for SME customers in the UK and the Republic of Ireland that were in GRG between 2008 and 2013. These steps were (i) an automatic refund of certain complex fees; and (ii) a new complaints process, overseen by an independent third party. The complaints process has since closed to new complaints.

The Bank has made provisions totalling £12 million in respect of the above redress steps of which £9 million had been utilised by 31 December 2019.

In July 2018, the FCA confirmed that it had concluded its investigation and that it did not intend to take disciplinary or prohibitory action against any person in relation to these matters. On 13 June 2019, the FCA published a full report explaining how it had reached that conclusion.

17. Analysis of changes in financing during the year

	Share capital, share premium and paid-in equity		Subordinated liabilities ⁽¹⁾	
	2019	2018	2019	2018
	£m	£m	£m	£m
At 1 January	314	314	107	107
Currency translation and other adjustments	-	-	(5)	-
At 31 December	<u>314</u>	<u>314</u>	<u>102</u>	<u>107</u>

Notes:

(1) Included in Amounts due to holding companies and fellow subsidiaries (Note 8). This denotes €120 million undated loan notes held by NatWest Holdings (3months EURIBOR plus 0.80%); repayable at the option of the Bank, only with prior consent of the Prudential Regulatory Authority (PRA). Claims in respect of the Bank's loan capital are subordinate to the claims of other creditors. None of the loan capital is secured.

18. Analysis of cash and cash equivalents

	2019	2018*
	£m	£m
At 1 January		
Cash	1,063	1,032
Cash equivalents	4,445	5,029
	<u>5,508</u>	<u>6,061</u>
Net cash outflow	(205)	(554)
Effect of exchange rate changes on cash and cash equivalents	(5)	1
At 31 December	<u>5,298</u>	<u>5,508</u>
Comprising:		
Cash and balances at central banks	1,076	1,063
Loans to banks ⁽¹⁾	4,222	4,445
Cash and cash equivalents	<u>5,298</u>	<u>5,508</u>

*2018 data has been restated to include items in the course of collection (1 January 2018 - £41 million, 31 December 2018 - £38 million) as cash and cash equivalents.

Notes:

(1) Included in Amounts due from holding companies and fellow subsidiaries (Note 8).

Notes to the accounts

19. Directors' and key management remuneration

Up to 30 April 2018 the directors and other key management of the Bank were aligned to the directors and other key management of the ultimate holding company, RBSG. From 30 April 2018 the directors and other key management of the Bank were aligned to NatWest Holdings. In both periods the directors and other key management were remunerated for their services to the RBS Group as a whole and the Bank did not remunerate them nor could their remuneration be apportioned in respect of their services to the Bank.

The directors' emoluments in the table below represent the NatWest Holdings Group emoluments of the directors from April 2018 and the remuneration they received from the RBS Group prior to that. The remuneration of the RBS Group directors is disclosed in the 2019 Annual Report and Accounts of the RBS Group. Where directors of the Bank are also directors of RBSG, details of their share interests can be found in the 2019 Annual Report and Accounts of RBSG, in line with regulations applying to RBSG as a premium listed company.

	2019	2018
Directors' remuneration	£'000	£'000
Non-executive directors emoluments	2,276	2,209
Chairman and executive directors emoluments	6,471	4,802
	8,747	7,011
Amounts receivable under long-term incentive plans and share options plans	741	-
	9,488	7,011

The total emoluments and amounts receivable under long-term incentive plans and share option plans of the highest paid director were £2,082k (2018 - £2,467k).

No directors accrued benefits under defined benefit schemes or money purchase schemes during 2019 and 2018. The executive directors may participate in RBS Group's long-term incentive plans, executive share option and sharesave schemes.

Compensation of key management

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

	2019	2018
	£'000	£'000
Short term benefits	17,295	17,461
Post employment benefits	1,111	60
Share-based benefits	1,686	-
	20,092	17,521

Key management comprises directors of the Bank and members of the Executive Committee.

20. Transactions with directors and key management

(a) At 31 December 2019, amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions in the Group, as defined in UK legislation, were £740,303 in respect of loans to seven 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 comprises directors of the Bank and members of the Executive committee. Applying the captions in the Bank's primary financial statements the following amounts⁽¹⁾ are attributable, in aggregate, to key management in respect of transactions with Group entities:

	2019	2018
	£'000	£'000
Loans to customers	1,566	1,530
Customer deposits	29,887	28,728

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.

Note:

(1) Amounts are attributed to each person at their highest level of RBS Group key management.

Notes to the accounts

21. 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 Government 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 Bank enters into transactions with many of these bodies on an arm's length basis. Transactions include the payment of taxes principally UK corporation tax (Note 6) and value added tax; national insurance contributions; local authority rates; and regulatory fees and levies; together with banking transactions such as loans and deposits undertaken in the normal course of banker-customer relationships.

At the balance sheet date the carrying value of the Bank's shares in subsidiary undertakings was £100 (2018: £400,113).

The table below discloses items included in income and operating expenses on transactions between the Bank and fellow subsidiaries of the RBS Group.

	2019 £m	2018 £m
Interest receivable	61	64
Interest payable	(24)	(22)
Fees and commissions receivable	2	3
Fees and commissions payable	(1)	-
Other operating income	53	44
Other administrative expenses	(63)	(49)
	28	40

22. Ultimate holding company

The Bank's ultimate holding company is The Royal Bank of Scotland Group plc which is incorporated in Great Britain and registered in Scotland and its immediate holding company is National Westminster Bank Plc which is incorporated in Great Britain and registered in England.

As at 31 December 2019, The Royal Bank of Scotland Group plc heads the largest group in which the Bank 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.

Bank of England facilities

The Bank may participate in a number of schemes operated by the Bank of England in the normal course of business.

As a UK authorised institution the Bank is required to maintain a non-interest bearing (cash ratio) deposit with the Bank of England amounting to 0.296% of average eligible liabilities in excess of £600 million. The Bank also has access to Bank of England reserve accounts. These are sterling current accounts that earn interest at the Bank of England Rate.

Related undertakings

The following is the active related undertaking incorporated in the United Kingdom which is 100% owned by the Bank and fully consolidated into NatWest Bank for accounting purposes.

Entity name	Activity
Ulster Bank Pension Trustees Limited	Trustee

The registered office for the above undertaking is 11-16 Donegall Square East, Belfast, BT1 5UB.

Following placing and open offers by The Royal Bank of Scotland Group plc in December 2008 and April 2009, the UK Government, through HM Treasury, currently holds 62.1% of the issued ordinary share capital of the holding company and is therefore the Bank's ultimate controlling party.

23. Post balance sheet events

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