Annual Report and Accounts 2018

NatWest

Strategic report

Presentation of information

National Westminster Bank Plc ('NatWest' or the 'Bank') is a wholly-owned subsidiary of NatWest Holdings Limited ('NatWest Holdings', 'NWH' or 'the intermediate holding company. The ultimate holding company is The Royal Bank of Scotland Group plc (the 'ultimate holding company' or 'RBSG'). The 'Group' or 'NatWest Group' comprises NatWest and its subsidiary and associated undertakings. 'RBS Group' comprises the ultimate holding company and its subsidiary and associated undertakings.

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

RBS Group ring-fencing

The UK ring-fencing legislation requires the separation of essential banking services from investment banking services from 1 January 2019. RBS Group has placed the majority of the UK and Western European banking business in ring-fenced banking entities, including the Bank, under an intermediate holding company, NatWest Holdings. NatWest Markets Plc (NWM Plc) and RBS International (RBSI) are separate banks outside the ring-fence, both as subsidiaries of RBSG. Key activities in 2018 included:

NatWest Holdings

Certain parts of NWM Plc's (formerly RBS plc), Central items to be included in the ring-fenced bank, were transferred to the Group in 2018. This included certain property portfolios and treasury balances including the covered bond programme.

This was followed by the transfer of NatWest Holdings, the Bank's intermediate parent company, to RBSG on 2 July 2018 to create a separate ring-fenced bank (RFB). The second phase of ring-fencing related transfers, involving the transfer of certain markets products from NatWest to NWM Plc, was completed in the third quarter of 2018.

RBS Netherlands Holdings B.V. was sold by National Westminster International Holdings B.V. (a direct subsidiary of NatWest) to NWM Plc as part of the ring-fencing related transfers.

NatWest Group Holdings Corporation.

During 2018, NatWest Group Holdings Corporation (NWGH) which wholly owns NatWest Markets Securities Inc. (NWMSI) (formerly RBS Securities Inc.) was transferred to NatWest Markets Plc. NWGH was previously a direct subsidiary of NatWest.

Principal activities and operating segments

The Group serves customers across the UK and Western Europe with a range of retail and commercial banking products. A wide range of personal products are offered including current accounts, credit cards, personal loans and mortgages. Personal & Business Banking (PBB) serves individuals and mass affluent customers together with small businesses through the Group's network of branches and direct channels, including the internet, mobile and telephony. Commercial & Private Banking (CPB) provides services to private, corporate and commercial customers. NatWest is the main provider of shared service activities for the RBS Group. This includes the provision of Treasury services on behalf of the RFB and RBS Group.

The reportable operating segments are as follows:

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

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

Central items & other includes corporate functions, such as treasury, finance, risk management, compliance, legal, communications and human resources. Central functions manages RBS Group capital resources and RBS Group-wide regulatory projects and provides services to the reportable segments. Balances in relation to legacy litigation issues are included in Central items in the relevant periods.

Preparations for Brexit

As part of Brexit preparations, NatWest plans to migrate an estimated £2.1 billion of loans and receivables relating to part of the Commercial Banking Western European Large Corporate portfolio to NatWest Markets N.V., when the loan re-financing becomes due over the next five years.

Performance overview

Income resilient in a competitive market:

Across Personal & Business Banking and Commercial & Private Banking income increased by £474 million, 6%, compared with 2017. The Group's total income increased by £1,385 million, or 17% to £9,532 million.

Lower costs through continued transformation and increased digitisation offset by the transfer of shared service related activities:

As a result of the Ring-Fenced Transfer Scheme (RFTS) completed on 30 April 2018 NatWest has become the main provider of shared services activities for the RBS Group. Principally as a result of the transfer of these shared services activities, operating expenses increased by £1,274 million, 30%, to £5,594 million. Underlying costs continue to reduce through digitisation initiatives.

Legacy issues diminishing:

Entered in to a Memorandum of Understanding with the Trustees of the Main scheme of the RBS Group Pension Fund to address the historical funding weakness of the pension scheme, recognising a pre-tax £2.0 billion contribution against reserves.

Capital adequacy:

The PRA transitional CET1 ratio decreased by 610 basis points to 17.4% mainly due to increased RWAs resulting from the RFTS.

RWAs increased by £18.9 billion, mainly resulting from RFTS. These transfers into NatWest included treasury services, including a significant proportion of the RBS Group liquidity portfolio.

Board of directors and secretary

Approval of Strategic report

The Strategic report for the year ended 31 December 2018 set out on pages 1 to 57 was approved by the Board of directors on 14 February 2019.

By order of the Board.
Aileen Taylor
Company Secretary
14 February 2019

Chairman
Howard Davies

Executive directors
Ross McEwan
Katie Murray
Alison Rose-Slade

Non-executive directors

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

Chairman
Howard Davies
Nominations (Chairman)

Executive directors
Ross McEwan
Executive (Chairman)

Katie Murray (appointed 1 January 2019)
Executive

Alison Rose-Slade (appointed 3 December 2018)
Executive

Independent non-executive directors
Francesca Barnes (appointed 1 May 2018)

Graham Beale (appointed 1 May 2018)
Audit, Nominations, Risk

Ian Cormack (appointed 1 May 2018)
Audit, Remuneration, Risk

Alison Davis
Remuneration

Patrick Flynn (appointed 1 June 2018)
Audit (Chairman),Risk

Morten Friis
Audit, Risk

Robert Gillespie
Remuneration (Chairman), Nominations, Risk

Yasmin Jetha
Remuneration

Baroness Noakes
Risk (Chairman), Audit, Nominations

Mike Rogers
Remuneration

Mark Seligman
Audit, Nominations, Remuneration

Dr Lena Wilson

Chief Governance & Regulatory Officer and Board Counsel
Aileen Taylor (Company secretary)

Other Board changes in 2018
Ewen Stevenson (executive director) resigned on 30 September 2018
Sandy Crombie (non-executive director) resigned on 1 January 2018
Frank Dangeard (non-executive director) resigned on 30 April 2018
Penny Hughes (non-executive director) resigned on 30 May 2018
Brendan Nelson (non-executive director) resigned on 31 December 2018.

Auditors
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London, EC2M 4AA
Telephone: +44 (0)20 7085 5000

Other principal offices
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Belfast BT1 5UB Northern Ireland

Coutts & Company
440 Strand
London WC2R 0QS

Lombard North Central PLC
280 Bishopsgate
London EC2M 4RB

National Westminster Bank Plc
Registered in England No. 929027

Key:

Audit	member of the Audit Committee
Executive	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.

Top and emerging risks

The Group employs a continuous process for identifying and managing its principal and emerging risks. These are defined as scenarios that could have a significant negative impact on the Group's ability to operate or meet its strategic objectives

Type	Risk	Mitigation
Operational and IT resilience	RBS's information technology systems are critical to the services it provides, with any outages experienced in the banking sector widely publicised. Cyber attacks continue to evolve in frequency, sophistication and severity. There is a risk that a cyber attack damages the Group's ability to do business and/or compromises data security. The Group's information technology systems are complex, making recovery from failure challenging. There is a risk that the Group lacks sufficient capability or capacity to deliver, or adapt to, change. There is a risk that achieving cost reductions will lead to heightened operational risk, particularly against a backdrop of political and economic uncertainty. There is a risk that the actions of a third-party supplier could negatively affect the Group's reputation or profitability. A breach in data privacy, either within the Group or in a third-party organisation, may lead to negative impacts. There is a risk that the Group's data strategy is not adequate for the evolving landscape.	A major security programme has delivered control enhancements to mitigate the risk of cyber attack. The Group continues to invest in its defences. A major investment programme within the RBS Group has improved systems resilience. As the Group continues to simplify and modernise infrastructure and applications, system sustainability has improved. The Group monitors people risk closely and has plans in place to support retention of key roles, with wider programmes supporting engagement and training. The Group continues to implement change in line with its project plans while assessing the implementation risks and mitigating where possible. The Group continues to maintain a strong focus on its control environment at all stages of the customer journey, including its approach to data management. Relationships with third-party suppliers are subject to a number of controls and guidelines outlined in the appropriate policy within the RBS Group Policy Framework.
Economic and political risk	The Group remains vulnerable to changes and uncertainty in the economic and political environment. Scenarios that could have a potentially material negative effect on the Group include the impact of the UK's exit from the European Union; a UK recession (including significant falls in house prices); a protracted period of low interest rates and growth in the UK; vulnerabilities in emerging market economies resulting in contagion in the Group's core markets; a Eurozone crisis or major geopolitical instability. Accelerating climate change may lead to faster-than-anticipated climate-related impacts on the Group and the wider economy.	The Group uses a number of complementary approaches to inform strategic planning and risk mitigation relating to a range of economic and political risks. These include robust risk assessment and dynamic portfolio management in accordance with the risk appetite framework, the setting of prudent lending criteria and, for specific market risks, structural hedging. Stress testing and scenario planning is also used extensively across the Group. The Group is working to embed climate risk into the risk framework, and adapting its operation and business strategy to mitigate the risks of both climate change and the transition to a low-carbon economy.
Financial resilience	The Group's ongoing compliance with the UK's ring-fencing regime may entail significant costs, and may also impose significant operational, legal and execution risk in the Group's day-to-day activities. The Group's target markets are highly competitive, which poses challenges in terms of achieving some strategic objectives. Moreover, changes in technology, customer behaviour and business models in these markets have accelerated. There is a risk that, as new technologies develop, the Group's business model is disrupted or that its customer focus fails to keep pace with evolving customer needs. The changing demographic in core markets, as the average age of the population rises, may affect profitability.	The Group's planning and strategy takes into account the risks related to ring-fencing implementation, particularly as they relate to the funding plan. The Group continues to innovate – including the development of a number of digital initiatives designed to meet evolving customer needs – and monitor the competitive environment as well as associated regulatory, technological and strategic developments in order to make adjustments as appropriate.
Legal regulatory and conduct risk	The Group expects government and regulatory intervention in the financial services industry to remain high for the foreseeable future, and also subject to increasing regulation in new areas such as financial risks relating to climate change and artificial intelligence. The Group is subject to the requirements of the UK ring-fencing regime and is required to ensure operational continuity in resolution. The steps required to ensure such compliance entail significant costs, and also impose significant operational, legal and execution risk that could continue to affect its business model. Implementation of the Alternative Remedies Package (regarding the business previously described as Williams & Glyn) brings a range of risks for the Group including significant costs, loss of customers/deposits and associated execution risks. The impacts of past business conduct resulting in future litigation and conduct charges could be substantial. The Group is involved in a number of investigations, including: investigations into the treatment of small and medium-sized business customers in financial difficulty; anti-money laundering; and mis-selling (including mis-selling of payment protection insurance products). Settlements may result in additional financial penalties, non-monetary penalties or other consequences, which may be material. The transition from LIBOR and other IBOR rates to alternative risk-free rates may lead to heightened legal, business and conduct risks.	The Group considers and incorporates the implications of proposed or potential regulatory activities in its strategic and financial plans. The Group has invested significant resources to meet the terms of the Alternative Remedies Package and manage the associated risks. An enhanced compliance and conduct risk framework has been developed, setting minimum standards for the management of conduct risks across the RBS Group. Building a healthy culture is a core priority. RBS continues to focus on creating a solid platform for behavioural and cultural change. In addition, RBS continues to strengthen its control environment and the journey of improvement remains an ongoing area of focus. A programme to determine the scale and scope of the impacts relating to the transition to alternative risk-free rates is underway. Activity to manage the transition will take place within the Group's control framework and in line with expected standards of conduct.

Financial review

Summary consolidated income statement for the year ended 31 December 2018

	2018	2017	Variance	
	£m	£m	£m	%
Net interest income	5,814	5,481	333	6.1
Fees and commissions receivable	2,113	2,054	59	2.9
Fees and commissions payable	(462)	(499)	37	(7.4)
Other operating income	2,067	1,111	956	86.0
Non-interest income	3,718	2,666	1,052	39.5
Total income	9,532	8,147	1,385	17.0
Operating expenses	(5,594)	(4,320)	(1,274)	29.5
Profit before impairment losses	3,938	3,827	111	2.9
Impairment losses	(428)	(311)	(117)	37.6
Operating profit before tax	3,510	3,516	(6)	(0.2)
Tax charge	(771)	(812)	41	(5.0)
Profit from continuing operations	2,739	2,704	35	1.3
Loss from discontinued operations net of tax for the year	(3)	(635)	632	(99.5)
Profit for the year	2,736	2,069	667	32.2
Attributable to:				
Ordinary shareholders	2,619	2,065	554	26.8
Paid-in equity holders	111	—	111	nm
Non-controlling interests	6	4	2	50.0
	2,736	2,069	667	32.2

Key metrics and ratios			
Cost:income ratio (%)	58.7	53.0	5.7
CET 1 ratio (%)	17.4	23.5	(6.1)
Leverage ratio (%)	5.2	6.2	(1.0)
Risk weighted assets (£bn)	75.6	56.7	18.9

The Group reported a profit of £2,736 million compared with £2,069 million in 2017, primarily due to the non repeat of losses from discontinued operations of £635 million in 2017. An increase in total income of £1,385 million was primarily offset by increases in operating expenses of £1,274 million and impairment losses of £117 million.

ICB related transfers

The income statement movements in the year are materially impacted by transfers to set up the ring-fenced bank during the year. These include the transfer to the Group of treasury management from NWM and the Group becoming the main provider of shared services to the RBS Group in Q2 2018. Following the transfer of services, functions and certain segment related direct costs incurred are recovered through legal entity recharging and recorded in other operating income. For the period prior to the transfers, the Group was a receiver of shared services from NWM Plc and consequently had comparatively lower direct costs and received higher legal entity recharges which were booked in other administrative expenses.

Total income increased by £1,385 million, 17%, to £ 9,532 million compared with £8,147 million in 2017.

Net interest income increased by £333 million, 6%, to £5,814 million, compared with £5,481 million in 2017, reflecting increases in:

- UK PBB, £52 million to £3,773 million driven mainly by mortgage balance growth of £4.7 billion and deposit margin benefits offset by lower mortgage new business margins. Interest receivable increased by £102 million which was partially offset by a £50 million increase in interest payable as a result of higher savings balances and increased interest rates for customers following increases in the Bank of England base rate;
- Commercial Banking, £39 million to £1,605 million primarily driven by £168 million increase in interest receivable due to the transfer in of the Western Europe loan portfolio from NWM Plc, and corporate lending portfolio growth, offset by lower lending volumes due to active capital management. This was partially offset by a £130 million increase in interest payable partly due to the transfer in of the Western Europe loan portfolio and an increase in savings and time deposits as a result of increased balance and interest rate growth;
- Private Banking, £58 million to £444 million, due to increases in interest income from growth in mortgage and business term lending, as well as deposits.
- Central & other items, £184 million, primarily reflecting the transfer of treasury related money market and debt securities instruments. Treasury positions have also benefited from an increase in the Bank of England base rate by 25 basis points.

Non-interest income increased by £1,052 million, 40%, to £3,718 million, compared with £2,666 million in 2017.

- Fees and commissions receivable increased by £59 million to £2,113 million, mainly reflecting increase in fees related to mortgage balance growth and commission received on FX transactions, partly offset by reductions in facility arrangement and overdraft fees.
- Fees and commissions payable decreased by £37 million to £462 million, as a result of lower ATM charges due to a reduction in transaction volumes.
- Other operating income increased by £956 million to £2,067 million, compared with £1,111 million in 2017.
  - The majority of the increase, £590 million, represents income from legal entity cost recharging.
  - The cost of economic hedging increased by £87 million to £112 million.
  - The remainder of the increase, £277 million, primarily reflects £822 million of FX reserves recycling to income as part of the disposal of NWGH and RBS Netherlands Holdings B.V., offset by the net impact of the non-repeat in 2017 of income generated by the sale of RBS International, £444 million and Ulster Bank Ireland Holdings, £132 million, together with the sale of Vocalink, £63 million.

Operating expenses increased by £1,274 million, 30%, to £5,594 million, compared with £4,320 million in 2017.

- The increase in operating expenses primarily reflects the Group becoming the main service provider for the RBS Group, resulting in an overall increase of £2,972 million in direct costs. This was partially offset by a decrease of £1,698 million of costs recharged from other entities.

Financial review

Summary consolidated income statement continued

- Staff costs increased by £1,340 million to £2,184 million, compared with £844 million in 2017, primarily in relation to staff transfers from NWM Plc, partly offset by cost reduction initiatives. Premises and equipment costs increased by £484 million to £757 million, compared with £273 million in 2017, in line with the Group becoming the main shared service provider for the RBS Group which included the transfer of shared properties and intangibles. Related depreciation and amortisation costs increased by £239 million to £521 million.
- Other administrative expenses decreased by £789 million to £2,132 million, compared with £2,921 million in 2017. The reduction in legal entity recharges more than offset the increase in administrative costs following the RFTS transfers. The Bank, on behalf of the RBS Group, is the responsible member for the UK bank levy and recorded the charge of £179 million with £95 million being recovered from other RBS Group entities. An additional charge was made in respect of PPI provision, £125 million.

Impairment losses increased by £117 million, 38%, to £428 million, compared with £311 million in 2017. The net impairment loss of £428 million represents 20 basis points of gross customer loans. This increase of £117 million included a charge of £63 million reflecting the more uncertain economic and political outlook. There were also fewer provision releases and lower recoveries following debt sales in prior years. Underlying credit conditions remained benign during 2018.

Loss from discontinued operations was £3 million compared with £635 million in 2017 which represented the results of NWGH classified as a discontinued operation at 31 December 2017 and UBIH which was sold to NatWest Holdings on 1 January 2017.

Segmental performance

The following tables provide a segmental analysis of operating profit by main income statement captions(1)

2018	Net interest income £m	Net fees and commissions £m	Other non-interest income £m	Total income £m	Operating expenses £m	Impairment losses £m	Operating profit £m
UK Personal & Business Banking	3,773	793	185	4,751	(2,721)	(251)	1,779
Commercial Banking	1,605	655	241	2,501	(1,432)	(204)	865
Private Banking	444	213	27	684	(453)	8	239
Commercial & Private Banking	2,049	868	268	3,185	(1,885)	(196)	1,104
Central items & other	(8)	(10)	1,614	1,596	(988)	19	627
Total	5,814	1,651	2,067	9,532	(5,594)	(428)	3,510
2017							
UK Personal & Business Banking	3,721	802	(28)	4,495	(2,490)	(186)	1,819
Commercial Banking	1,566	603	228	2,397	(1,040)	(119)	1,238
Private Banking	386	159	25	570	(388)	(5)	177
Commercial & Private Banking	1,952	762	253	2,967	(1,428)	(124)	1,415
Central items & other	(192)	(9)	886	685	(402)	(1)	282
Total	5,481	1,555	1,111	8,147	(4,320)	(311)	3,516

Note:
(1) The segments presented are those which relate to the Group and not the RBS Group.

Personal & Business Banking (UK PBB)

Operating profit was £1,779 million, compared with £1,819 million in 2017.

Net interest income increased by £52 million to £3,773 million compared with £3,721 million in 2017, mainly driven by mortgage balance growth of £4.7 billion and deposit margin benefits offset by reduced mortgage new business margins due to competitive market conditions. Interest receivable increased by £103 million which was partially offset by £50 million increase in interest payable as a result of higher savings balances and increased interest rates.

Net fees and commissions decreased by £9 million to £793 million compared with £802 million in 2017, mainly reflecting reductions in card fees, £36 million and credit facilities fees, £22 million, partially offset by increased fees related payment services, £27 million and lower fees payable, £20 million due to a reduction in ATM transaction volumes. Other non-interest income increased by £213 million to £185 million, primarily reflecting a charge for the disposal of UBIH of £160 million in 2017, service charge income from other entities, £113 million, increased lifetime mortgages, £17 million, partially offset by decrease of £45 million in income from asset sales.

Operating expenses increased by £231 million to £2,721 million, reflecting an increase of £320 million in direct staff, premises and related costs due to RFTS transfers and the transfer to UK PBB of shared services activities from Services, partially offset by £101 million lower legal entity recharges. £113 million of costs were recovered through service charges in non interest income. An additional charge of £108 million was taken during 2018 in respect of a PPI provision.

Impairment losses increased by £65 million, 35%, to £251 million, compared with £186 million in 2017. The impairment charge for the year included a £26 million charge reflecting uncertainty over the UK economic outlook. There were also fewer provision releases and lower recoveries following debt sales in prior years. Underlying credit conditions remained benign during 2018. For more details on provision movements refer to the Credit risk section on page 36.

Loans to customers increased by £5.3 billion, to £128.9 billion, compared with £123.6 billion at 31 December 2017, with the increase driven by continued mortgage growth of £4.7 billion, to £115.2 billion. The impact of intense competition has been mitigated as a result of management actions taken to maintain customer retention levels. Customer deposits increased by £3.6 billion to £139.2 billion, compared with £135.6 billion at 31 December 2017, driven by growth in personal savings and business deposits, as a result of improved customer rates.

Financial review

Segment performance continued

Commercial & Private Banking (CPB)

Commercial Banking

Operating profit was £865 million, compared with £1,238 million in 2017. Net interest income increased by £39 million to £1,605 million, compared with £1,566 million in 2017, primarily as a result of £168 million increase in interest receivable due to the RTFS transfer of Western Europe customers from NatWest Markets Plc and growth in other corporate lending portfolios, offset by an increase in interest payable of £130 million due to the transfer in of the Western Europe loan portfolio and an increase in savings and time deposits as a result of increased balance and interest rate growth. Interest payable increased due to higher intragroup interest payable, £39 million, and interest from debt securities in issue, £38 million.

Net fees and commissions increased by £52 million to £655 million, compared with £603 million in 2017, primarily reflecting increases in credit facilities fees, £61 million, fees related to payment services, £14 million, partially offset by a decrease of £43 million in trade finance commissions. Other non-interest income increased by £13 million to £241 million, compared with £228 million in 2017, mainly due to the non-repeat of £65 million profit on sales of premises and operating lease income in 2017, partially offset by £21 million profit from sale of assets relating to the real estate finance portfolio in 2018 and £55 million of service charge income from other entities.

Operating expenses increased by £392 million to £1,432 million, principally reflecting an increase of £310 million in direct staff, premises and related costs due to RFTS and the transfer to Commercial shared services activities from Services, increase of £190 million of indirect costs, mainly due to Functions costs being allocated to segments in 2018, partially offset by £109 million lower legal entity recharges as costs are incurred now directly in NatWest. £55 million of costs were recovered through service charges in non interest income.

Impairment losses increased by £85 million to £204 million, of which £37 million charge reflecting uncertainty over the UK economic outlook. Underlying credit conditions remained benign during 2018[(1)].

Loans to customers increased by £5.8 billion to £61.1 billion, primarily due to the migration of Western Europe customer loans, £2.7 billion, as part of the RFTS and an increase in the corporate lending portfolios of £2.4 billion. Customer deposits increased by £1.1 billion to £67.4 million as a result of improved customer rates.

Private Banking

Operating profit was £239 million compared with £177 million in 2017.

Total income increased by £114 million, to £684 million compared with £570 million in 2017, driven by increases in net interest income, £58 million and an increase in non-interest income, £56 million, primarily due to higher net fees and commissions. Increases were mainly driven by loan and deposit volume growth together with margins improvements, due to the implementation of effective pricing strategies. Higher fees received from management advice followed increase of investment fund volumes during the year.

Operating expenses increased by £65 million to £453 million, primarily driven by inclusion of Services staff and associated other non-staff costs, £52 million, increase of £70 million of indirect costs, mainly due to Functions costs being allocated to segments in 2018, partially offset by decrease of £57 million in strategic and conduct costs as a result of non repeat of one off provisions booked in 2017.

Net impairment release of £8 million for 2018, compared with a charge of £5 million in 2017, following more detailed assessment of portfolios and associated models.

Loans to customers increased by £0.8 billion, primarily in relation to personal mortgages and corporate loans, as a result of competitive pricing initiatives. Customer deposits increased by £1.8 billion, reflecting increase in customers switching from investment funds into cash, particularly at year end in response to adverse market movements on investment funds.

Central items & other

Operating profit from Central items was £627 million compared with £282 million in 2017.

The increase of £184 million in net interest income reflects the transfer of Treasury related money market and debt securities instruments from NWM Plc to NatWest as part of ring-fencing preparations. NatWest is now the primary entity used for managing the RBS Group and Group liquidity portfolio. Treasury positions have also benefited from an increase of the Bank of England base rate by 25 basis points.

Other non-interest income increased by £728 million, primarily reflecting income of £421 million from legal entity cost recharging. Direct costs for services provided to other entities are recovered through legal entity service charges and recorded in other operating income. The remaining increase of £307 million mainly relates to income reflecting IFRS and market volatility in relation to Treasury hedging activities, £204 million, net impact of sales of subsidiaries, £103 million, and £822 million FX reserves recycling to income as part of the disposal of NWGH and NW Netherlands Holdings B.V., this was offset by £872 million due to the non-repeat of income on the sale of subsidiaries in 2017.

Operating expenses increased by £586 million to £988 million reflecting increased staff, premises and other associated costs in Services and Functions due to the RFTS and transfer of shared services activities from NWM Plc to NatWest. The increase of £2,242 million in direct costs was partially offset by £1,404 million lower legal entity recharges and an increase of £252 million in indirect costs being allocated to segments. £421 million of the total expenses were recovered through service charges in non interest income, £395 million related to strategic costs and £69 million in relation to pension plan settlement costs.

Note:
(1) For more details on provision movements refer to the Credit risk section on page 36.

Financial review

Summary consolidated balance sheet as at 31 December 2018

	2018	2017	Variance	
	£m	£m	£m	%
Assets				
Cash and balances at central banks	45,032	35,799	9,233	26
Derivatives	1,253	2,315	(1,062)	(46)
Loans to banks - amortised cost	6,406	1,919	4,487	234
Loans to customers - amortised cost	203,647	191,882	11,765	6
Amounts due from holding companies and fellow subsidiaries	5,206	77,930	(72,724)	(93)
Other financial assets	41,226	1,665	39,561	2,376
Other assets	7,168	29,333	(22,165)	(76)
Total assets	309,938	340,843	(30,905)	(9)
Liabilities				
Bank deposits	17,563	20,544	(2,981)	(15)
Customer deposits	237,770	226,423	11,347	5
Amounts due to holding companies and fellow subsidiaries	22,542	44,599	(22,057)	(49)
Derivatives	779	3,178	(2,399)	(75)
Other financial liabilities	6,497	575	5,922	1,030
Subordinated liabilities	1,275	1,240	35	3
Other liabilities	3,638	27,917	(24,279)	(87)
Total liabilities	290,064	324,476	(34,412)	(11)
Total equity	19,874	16,367	3,507	21
Total liabilities and equity	309,938	340,843	(30,905)	(9)

The balance sheet movements in the year are materially impacted by transfers to set up the ring-fenced bank. These are described where relevant below; further analysis of the impact is also presented on page 8.

Total assets decreased by £30.9 billion to £309.9 billion at 31 December 2018, compared with £340.8 billion at 31 December 2017.

Cash and balances at central banks increased by £9.2 billion to £45.0 billion, compared with £35.8 billion at 31 December 2017. The increase primarily reflects the transfer of Group treasury. The Group now manages the funding and liquidity requirements of the RBS Group and funds are placed directly with central banks. This increase was partially offset by a reduction in Term Funding Scheme borrowings of £5 billion during Q4 2018 reflecting the gradual repayments under the terms of the scheme. A pension liability of £2.0 billion was also paid during the year, following a commitment made in April 2018 to provide additional funding to the Main Pension Scheme.

Derivative assets decreased by £1.1 billion to £1.3 billion, compared with £2.3 billion at 31 December 2017, due to transfers of certain markets products to NWM Plc.

Loans to banks – amortised cost increased by £4.5 billion to £6.4 billion, compared with £1.9 billion at 31 December 2017, mainly representing increased reverse repos of £3.5 billion and other loans from banks, in relation to treasury funding activities transferred to the Group from NWM Plc.

Loans to customers – amortised cost increased by £11.8 billion to £203.6 billion, compared with £191.9 billion at 31 December 2017, reflecting increases in UK PBB, Commercial and Private Banking:

- UK PBB lending to customers increased by £5.3 billion to £128.9 billion, driven by mortgage lending growth of £4.7 billion to £115.2 billion. The impact of intense competition has been mitigated as a result of management actions to maintain customer retention levels.
- Commercial Banking lending to customers increased by £5.8 billion to £61.1 billion, mainly due to the migration of Western Europe customer loans, £2.7 billion and an increase in corporate lending portfolios of £2.4 billion
- The increase of £0.8 billion in Private Banking was primarily in relation to growth in personal mortgage lending as a result of competitive pricing initiatives.

Amounts due from holding companies and fellow subsidiaries decreased by £72.7 billion to £5.2 billion, compared with £77.9 billion at 31 December 2017, primarily due to the transfer of the Group treasury function to NatWest. Surplus funds previously placed with NWM Plc are now being placed directly with the Bank of England leading to the associated reduction of inter-company balances with NWM Plc.

Other financial assets increased by £39.6 billion to £41.2 billion, primarily reflecting the transfer of £41.9 million debt securities which form part of the treasury liquidity portfolio, together with the purchase of mortgage backed securities in April 2018, £0.6 billion, partially offset by decreases in other bonds as a result of optimising the liquidity portfolio.

Other assets decreased by £22.2 billion to £7.2 billion, primarily reflecting the decrease in assets of disposal groups of £24.5 billion to £0.1 billion, due to the transfer of NWGH to NWM Plc. This was partially offset by the increase of assets as a result of shared services assets being transferred.

Bank deposits decreased by £3.0 billion to £17.6 billion, compared with £20.5 billion at 31 December 2017, primarily due to the Term Funding Scheme repayment of £5 billion in November 2018, partially offset by increase in third party deposits.

Customer deposits increased by £11.3 billion to £237.8 billion, mainly reflecting an increase of £4.6 billion in repos and treasury time deposits as part of ring-fencing.

- UK PBB customer deposits increased by £3.6 billion, driven by growth across current account and saving products.
- Commercial Banking customer deposits increased by £1.1 billion as a result of improved customer rates.
- Private Banking customer deposits increased by £1.8 billion mainly as a result an increase in customers switching from investment funds in to cash of £0.5 billion and improved customer rates.

Financial review

Summary consolidated balance sheet continued

Amounts due to holding companies and fellow subsidiaries decreased by £22.1 billion to £22.5 billion, compared with £44.6 billion at 31 December 2017, due to the transfer of the treasury function.

Derivative liabilities decreased by £2.4 billion to £0.8 billion, compared with £3.2 billion at 31 December 2017, due to transfers of certain markets products to NWM Plc.

Other financial liabilities increased by £5.9 billion to £6.5 billion, compared with £0.6 billion at the 31 December 2017, reflecting the migration of the covered bond programme from NWM Plc as part of the treasury transfer.

Other liabilities decreased by £24.3 billion to £3.6 billion, compared with £27.9 billion at the 31 December 2017, mainly reflecting a decrease in disposal group liabilities of £23.8 billion to nil, reflecting the transfer of NWGH to NWM Plc.

Owners' equity increased by £3.5 billion to £19.9 billion, compared with £16.4 billion at 31 December 2017. The increase reflects:

- the attributable profit for the period, £2.7 billion;
- an equity debt issuance to NatWest Holdings limited, $3.3 billion (£2.4 billion), as part of capitalising NatWest in preparation for ring-fencing;
- a net decrease of £0.3 billion for changes to pension arrangements. NatWest agreed it would make a pension contribution to strengthen funding of the Main section of £1.5 billion (net of tax). This was offset by a £1.2 billion capital contribution, paid by NWM Plc to NatWest Holdings and then to the Bank;
- a reduction of £0.8 billion in FX reserves primarily as a result of equity recycling on the disposal of NWGH and RBS Netherlands Holdings B.V.; and a
- £0.3 billion reduction on adoption of IFRS 9.

Key balance sheet movements in the year

The following table summarises the impact of the balance sheet movements relating to ring-fencing transfers in the year.

	31 December 2017 £bn	Transfers: Business acquired (9) £bn	Transfers: Other transfers (10) £bn	Transfers: Disposal (11) £bn	Business movements and intercompany £bn	31 December 2018 £bn
Assets						
Cash and balances at central banks (1)	35.8	15.4	—	—	(6.2)	45.0
Derivatives (2)	2.3	2.1	(1.2)	—	(1.9)	1.3
Loans to banks - amortised cost	1.9	0.7	—	—	3.8	6.4
Loans to customers - amortised cost (3)	191.9	4.5	—	—	7.2	203.6
Amounts due from holding companies and fellow subsidiaries (4)	77.9	—	—	—	(72.7)	5.2
Other financial assets (5)	1.7	41.9	—	—	(2.4)	41.2
Other assets	29.3	—	1.9	(24.7)	0.7	7.2
Total assets	340.8	64.6	0.7	(24.7)	(71.5)	309.9
Liabilities						
Bank deposits	20.5	1.6	—	—	(4.5)	17.6
Customer deposits (6)	226.4	3.2	—	—	8.2	237.8
Amounts due to holding companies and fellow subsidiaries (4)	44.6	—	—	—	(22.1)	22.5
Derivatives (2)	3.2	1.8	(1.4)	—	(2.8)	0.8
Other financial liabilities (7)	0.6	5.1	—	—	0.8	6.5
Subordinated liabilities	1.2	—	—	—	0.1	1.3
Other liabilities	27.9	—	1.2	(23.8)	(1.8)	3.5
Equity (8)	16.4	—	—	(0.9)	4.4	19.9
Total liabilities and equity	340.8	11.7	(0.2)	(24.7)	(17.7)	309.9

Notes:
(1) Transfers include the migration of Treasury cash on deposit with central banks
(2) Transfers in are all in relation to derivatives with fellow subsidiaries. Transfers out related to customer derivatives moved to the non ring-fenced bank (NWM Plc).
(3) Transfers include the Western Europe loan portfolio (£3.0 billion) from NWM Plc, along with finance lease lending (£1.5 billion).
(4) Movement in the year includes the net impact of the Treasury funding activities transferred to the Group, in addition to the other transfers completed in preparation for ring- fencing and consideration for the transfers satisfied by reductions in the amounts due from transferring entities
(5) Transfers mainly relate to debt securities held as part of the Treasury liquidity portfolio.
(6) Transfers include Treasury repurchase agreements.
(7) Transfers relate to the covered bond debt securities in issue.
(8) Movements in the year include the issue of £2.4 billion AT1 capital notes which are held by NWH and a £1.2 billion capital contribution that was received from NWH. Refer to the Statement of changes in equity for details of the other movements in equity.
(9) Includes the RBS Group Treasury function that was transferred to the Group in the year. The net asset value transferred was £52.9 billion. The consideration was substantially satisfied by reductions in the amounts due from NWM Plc.
(10) Includes amounts relating to the transfer of derivatives to NWM Plc, and the shared services activity from NWM Plc to the Group. The shared services transfers mainly relate to property, plant and equipment and accruals and other liabilities.
(11) Comprises of assets and liabilities of disposal groups, principally in relation to NatWest Group Holdings Corp (NWGH). NWGH was a direct subsidiary of the Group, and wholly owns NatWest Markets Securities Inc. (NWSSI) (formerly RBSSI), which was transferred to NWM Plc in Q1 2018.

Capital and risk management

Presentation of information
Where indicated in the section headers, information in the Capital and risk management section (pages 9 to 57) is within the scope of the Independent auditor's report. Where a main section header, presented in bold, is marked as audited all sub sections are also audited. Unless otherwise indicated, disclosures in this section include disposal groups in relevant exposures and measures. Disposal groups comprise NatWest Holdings Group Corp in 2018 and Ulster Bank (Ireland) Holdings in 2017. Capital and risk management are generally conducted on an overall basis within RBS Group such that common policies, procedures, frameworks and models apply across the RBS Group. Therefore, for the most part, discussion on these qualitative aspects reflects those in the RBS Group as relevant for the businesses and operations in the Group.

Risk management framework
Introduction
The RBS Group operates an integrated risk management framework, centred around the embedding of a strong risk culture, which is designed to achieve compliance with prudential and conduct obligations. Each element of the risk management framework functions both individually and as part of a larger continuum. The framework ensures the tools and capability are in place to facilitate risk management and decision-making across the organisation.

The RBS Group's 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 environment. Identifying these risks and understanding how they affect the RBS Group informs risk appetite and risk management practice.

Risk appetite, which is supported by a robust set of principles, policies and practices, defines our levels of tolerance for a variety of risks.

It is a key element of the RBS Group's risk management framework and culture, providing a structured approach to risk-taking within agreed boundaries.

Effective governance, underpinned by the three lines of defence model, is essential to ensure the right decisions are being made by the right people at the right time. Governance includes regular and transparent risk reporting as well as discussion and decision-making at senior management committees, which informs management strategies across the organisation.

The RBS Group aims to have the right tools in place to support effective risk management. Having the appropriate capability, people and infrastructure is central. This is supported by a strong emphasis on systems, training and development to ensure threats are anticipated and managed appropriately within the boundaries determined by the agreed risk appetite.

Measurement, evaluation and transparency are also fundamental elements of the framework, providing robust analysis of the materiality and likelihood of specific threats as well as supporting understanding and communication of the financial and non-financial risks to which the RBS Group is exposed.

The RBS Group has a strong focus on defining the control environment to ensure the effective operation of policies and processes embedded in the customer-facing businesses, thus facilitating the management of the risks they take in the course of their day-to-day activities.

The RBS Group also has a strong focus on continually improving the way risk is managed, particularly in terms of how threats are anticipated or responded to, but also in terms of simplifying or enhancing existing controls, policies and practice.

Essential to this is the ability to scan both the medium- and long-term horizon for risks. Stress testing is used to quantify, evaluate and understand the potential impact that changes to risks may have on the financial strength of the RBS Group, including its capital position. In turn, the results of stress tests can be used to inform and shape strategy.

Risk management framework continued

Given the evolving landscape, including the structural reform required by the UK's ring-fencing requirements, in 2018 there was an emphasis on enhancing both the risk culture and risk appetite elements of the framework – as well as the interconnectivity between framework components.

All RBS Group employees share ownership of the way risk is managed. The businesses, the control and support functions, and Internal Audit work together to make sure business activities and policies are consistent with risk appetite; following the three lines of defence model. The RBS Group constantly monitors its risk profile against its defined risk appetite and limits, taking action when required to balance risk and return.

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

Risk culture

A strong risk culture is essential if the RBS Group is to achieve its ambition to build a truly customer-focused bank. The RBS Group's risk culture target is to make risk simply part of the way that employees work and think.

Such a culture must be built on strong risk practices and appropriate risk behaviours must be embedded throughout the organisation.

To achieve this, the RBS Group is focusing on leaders as role models and taking action to build clarity, continuing to develop capability and motivate employees to reach the required standards of risk culture behaviour. This includes: taking personal responsibility for understanding and proactively managing the risks associated with individual roles; respecting risk management and the part it plays in daily work; understanding clearly the risks associated with individual roles; aligning decision-making to RBS' risk appetite; considering risk in all actions and decisions; escalating risks and issues early; taking action to mitigate risks; learning from mistakes and near-misses; challenging others' attitudes, ideas and actions; and reporting and communicating risks transparently.

The RBS Group's target risk culture behaviours are embedded in Our Standards and are clearly aligned to the core values of "serving customers", "working together", "doing the right thing" and "thinking long term". These act as an effective basis for a strong risk culture because Our Standards are used for performance management, recruitment and development.

A risk culture measurement and reporting approach has been developed, enabling the RBS Group to benchmark both internally and externally. This allows the RBS Group to assess progress in embedding its target risk culture where risk is simply part of the way staff work and think.

Training

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

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

Code of Conduct

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

These principles cover conduct-related issues as well as wider business activities. They focus on desired outcomes, with practical guidelines to align the values with commercial strategy and actions. The embedding of these principles facilitates sound decision-making and a clear focus on good customer outcomes.

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

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

Each of the five questions is a prompt to think about how the situation fits with the RBS Group's values. It ensures that employees can think through decisions that do not have a clear answer, and guides their judgements.

If conduct falls short of RBS's required standards, the accountability review process is used to assess how this should be reflected in pay outcomes for those individuals concerned. RBS Group-wide remuneration policy ensures that the remuneration arrangements for all employees reflect the principles and standards prescribed by the PRA rulebook and the FCA handbook. Any employee falling short of the expected standards would also be subject to internal disciplinary policies and procedures. If appropriate, the relevant authority would be notified.

Risk management framework continued

Risk governance

Committee structure

The diagram illustrates the Group's risk committee structure in 2018 and the main purposes of each committee.

National Westminster Bank Plc Board

Reviews and approves the risk appetite framework and risk appetite targets for the Group's strategic risk objectives.

National Westminster Bank Plc Executive Committee

Manages and oversees all aspects of the Group's business and operations.

National Westminster Bank Plc Board Risk Committee

Provides oversight and advice on: current and potential future risk exposures, and future risk strategy, including determination of risk appetite and tolerance; and the effectiveness of the risk management framework.

National Westminster Bank Plc Executive Risk Committee

Acts on all material and/or enterprise-wide risk and control matters across the Group.

National Westminster Bank Plc Asset & Liability Management Committee

Oversees the effective management of the current and future balance sheet in line with Board-approved strategy and risk appetite.

ERC sub committees

Responsible for the establishment of risk policies – as well as oversight of compliance – for each relevant risk type. In addition, they are responsible for the approval of certain risk measures and recommendation of other measures to Group Board for approval. Includes Retail Credit Risk Committee, Wholesale Credit Risk Committee, Operational Risk Executive Committee, Financial Crime Risk Executive Committee, and Reputational Risk Committee.

Provisions Committee

Reviews and approves large credit impairment charges or releases.

IFRS 9 Metrics Oversight Committee

Responsible for approving the Significant Deterioration framework and data rules for missing variables.

Capital Management & Stress Testing Committee

Reviews and challenges the end-to-end capital management process. It is the focal point for prudential regulatory requests regarding asset quality reviews and stress testing.

Technical Asset & Liability Management Committee

Responsible for setting the limits, policies and controls relating to financial balance sheet risks, including funding and liquidity, intra-group exposures, non-traded market risk and structural foreign currency risks.

Franchise and function risk committees

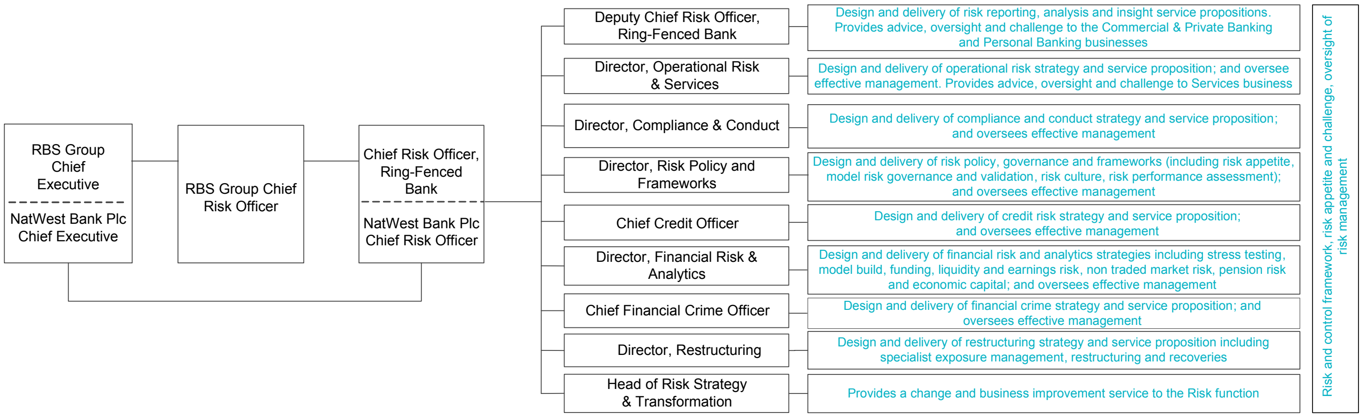
Risk committees review and monitor all risks, providing guidance, recommendations and decisions on risks affecting the franchises and functions.

Note:
(1) National Westminster Bank Plc is a wholly-owned subsidiary of NatWest Holdings Limited. The diagram above illustrates the risk governance structure of National Westminster Bank Plc. The IFRS 9 Metrics Oversight Committee has delegated authority from the Provisions Committee to approve the Significant Deterioration framework, the data rules for missing variables, materiality decisions relating to the expected credit loss calculation, adjustments relating to the expected credit loss calculation if necessary, and changes in expected credit loss provision calculation methodology.

Risk management framework continued

Risk management structure

The diagram illustrates the Group's risk management structure in 2018 and key risk management responsibilities.



Notes:
(1) NatWest Bank Plc is a wholly-owned subsidiary of NatWest Holdings Limited, which is the ring-fenced sub-Group of the RBS Group. The diagram above illustrates the risk management structure of NatWest Bank Plc.
(2) The NatWest Bank Plc CRO reports directly to i) the NatWest Bank Plc CEO, whose role is also undertaken by the same individual who undertakes the roles of NatWest Holdings CEO and RBS Group CEO; and ii) the NatWest Holdings CRO, albeit given both these CRO roles are undertaken by the same individual, in effect, the reporting line is to the RBS Group CRO. There is a further secondary reporting line to the chair of the NatWest Bank Plc BRC and a right of access to the Committee, including the deputy chair, but noting the constituent members of the Committee mirror those of the NatWest Holdings BRC.
(3) The Risk function is independent of the franchises and is structured by risk discipline to facilitate effective risk management. 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.

Three lines of defence

The Group uses the three lines of defence model to articulate accountabilities and responsibilities for managing risk across the organisation. The three lines of defence model is adopted across the industry to support the embedding of effective risk management and is expressed through a set of principles as outlined below. All roles, regardless of level, sit within one of these three lines.

First line of defence – Management and supervision

The first line of defence encompasses most roles within the Group, including those in customer franchises, Technology and Services as well as support functions such as Human Resources, Communications & Marketing and Finance. Responsibilities include:

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

Second line of defence – Oversight and control

The second line of defence is the Risk function as well as the policy and control elements of Human Resources, Legal and the Finance function. Responsibilities include:

- Leading the articulation, design and development of risk culture and appetite.
- Setting the standard for risk management across the Group.
- Overseeing and challenging the management of risks and controls.
- Analysing the aggregate risk profile and ensuring that risks are being managed within risk appetite.
- Providing expert advice to the first line on risk management, including the application of effective risk and control frameworks and the consideration of risk in decision-making.
- Providing senior executives with relevant management information and reports, and escalating concerns where appropriate.

Third line of defence – Internal Audit

Responsibilities include:

- Providing assurance to the NatWest Holdings Audit Committee on the appropriateness of the design and operational effectiveness of governance, risk management and internal controls to monitor and mitigate material risks.
- Engaging with management to provide perspectives, insights and challenge in order to influence the building of a sustainable bank.
- Providing independent assurance to the Financial Conduct Authority, Prudential Regulation Authority, Central Bank of Ireland and other key jurisdictional regulators on specific risks and controls.

Risk appetite

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

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

Risk appetite framework

The risk appetite framework 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.

To facilitate this, a detailed annual review of the framework is carried out. The review includes:

- Assessing the adequacy of the framework when compared to internal and external expectations.
- Ensuring the framework remains effective as a strong control environment for risk appetite.

Risk management framework continued

- Assessing the level of embedding of risk appetite across the organisation.

The RBS Group Board approves the risk appetite framework annually.

Establishing risk appetite

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

Risk appetite statements consist of qualitative statements of appetite supported by risk limits and triggers that operate as a defence against excessive risk-taking. They are established at the Group level for all strategic risks and material risks, and at franchise, and function level where appropriate.

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 Group is well placed to meet its priorities and long-term targets even under challenging economic environments. It is the basis on which the Group remains safe and sound while implementing its strategic business objectives.

The Group's risk profile is frequently reviewed and monitored to ensure it remains within appetite and that 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.

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.

The RBS Group policies directly support the qualitative aspects of risk appetite, helping to rebuild and maintain stakeholder confidence in RBS Group's risk control and governance. Its integrated approach is designed to ensure that appropriate controls, aligned to risk appetite, are set for each of the strategic and material risks it faces, with an effective assurance process put in place to monitor and report on performance.

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 trading and 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 RBS Group faces each day are detailed in the Risk Directory. This provides a common risk language to ensure consistent terminology is used across the 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 caused by the risk mitigation actions) are considered. Monitoring and review processes are in place to track results.

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

Significant and emerging risks that may affect future results and performance are reviewed and monitored. Action is taken to mitigate potential risks as and when required. In depth analysis is carried out, including the stress testing of exposures relative to the risk.

Risk assurance

Assurance is carried out on targeted credit risk, market risk, compliance and conduct risk and financial crime risk activities to provide assurance to both internal and external stakeholders including the Board, senior management, the customer-facing franchises, Internal Audit and the Group's regulators. Selected key controls are also reviewed.

Qualitative reviews are carried out to assess various risk aspects as appropriate, including: the quality of risk portfolios, the accuracy of the Basel model inputs and related probability of default/loss given default classifications, the quality of risk management practices, policy compliance and adherence to risk appetite. This can include testing the Group's credit portfolios and market risk exposures to assist in the early identification of emerging risks, as well as undertaking targeted reviews to examine specific issues.

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 and market risk controls). Selected controls supporting risk data aggregation and reporting are also reviewed.

Assurance is carried out on Anti-Money Laundering, Sanctions, and Anti-Bribery & Corruption processes and controls. This helps inform whether or not the financial crime control environment is adequate and effective and whether financial crime risk is appropriately identified, managed and mitigated.

The Risk Assurance Committee ensures a consistent and fair approach to all aspects of the second-line assurance review activities. The committee also monitors and validates the ongoing programme of reviews and tracks the remediation of the more material review actions.

Model risk

Model risk is the risk that a model is specified incorrectly (not achieving the objective for which it is designed), implemented incorrectly (an error in translating the model specification into the version actually used), or being used incorrectly (correctly specified but applied inappropriately).

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

Key developments in 2018

In April 2018, the PRA set out its expectations on the model risk management practices that should be adopted when using stress test models. RBS has a strong focus on model risk management and, as a result, practices were reviewed and, where appropriate, work to enhance them in line with regulatory expectations continues.

RBS further invested in model risk management during 2018, particularly given business demand and the growing complexity of requirements, such as new regulation and AI. This included the specification of additional IT systems to enhance capability in this area.

Risk management framework continued

Model Risk Governance

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

Model Risk Management

Model Risk Management performs independent model validation for material models. It works with individual businesses and functions to monitor adherence to model risk standards, ensuring that models are developed and implemented appropriately and that their operational environment is fit for purpose.

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

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

Based on the review and findings from Model Risk Management, the RBS Group's model or risk committees consider whether a model can be approved for use. Models used for regulatory reporting may additionally require regulatory approval before implementation.

Model Risk Management reassesses the appropriateness of approved risk models on a periodic basis. Each periodic review begins with an initial assessment. Based on the initial assessment, an internal model governance committee will decide to re-ratify a model or to carry out additional work. In the initial assessment, Model Risk Management assesses factors such as a change in the size or composition of the portfolio, market changes, the performance of – or any amendments to – the model and the status of any outstanding issues or scheduled activities carried over from previous reviews.

Model Risk Management also monitors the performance of RBS Group's portfolio of models to ensure they appropriately capture underlying business rationale.

Stress testing

Stress testing – capital management

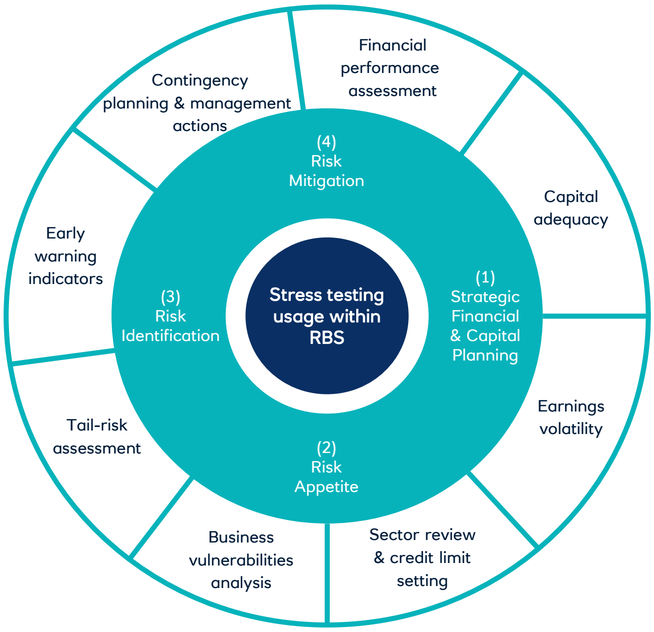
Stress testing is a key risk management tool and a fundamental component of the RBS group approach to capital management. It is used to quantify, evaluate and understand the potential impact of specified changes to risk factors on the financial strength of RBS group, including its capital position. Stress 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	• Identify the RBS-specific vulnerabilities and risks. • Define and calibrate scenarios to examine risks and vulnerabilities. • Formal governance process to agree scenarios.
Assess impact	• Translate scenarios into risk drivers. • Assess impact to positions, income and costs. • Impact assessment captures input from across the RBS Group.
Calculate results and assess implications	• Aggregate impacts into overall results. • Results form part of risk management process. • Scenario results are used to inform the RBS's business and capital plans.
Develop and agree management actions	• 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 Executive Risk Committee, Board Risk Committee and the Board.

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



Specific areas that involve capital management include:

- *Strategic financial and capital planning* – through assessing the impact of sensitivities and scenarios on the capital plan and capital ratios.

Capital and risk management

Risk management framework continued

- *Risk appetite* – through gaining a better understanding of the drivers of – and the underlying risks associated with – risk appetite.
- *Risk identification* – through a better understanding of the risks that could potentially impact the RBS Group's financial strength and capital position.
- *Risk mitigation* – through identifying actions that can be taken to mitigate risks, or could be taken, in the event of adverse changes to the business or economic environment. Risk mitigation is substantially supplemented through the RBS Group's recovery plan.

Reverse stress testing is also carried out. This examines circumstances that can lead to specific, defined outcomes such as business failure. Reverse stress testing allows the RBS Group to examine potential vulnerabilities in its business model more fully.

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. These assessments consider the resilience of capital adequacy and leverage ratios under a range of hypothetical future states. The assessments incorporate assumptions regarding a range of regulatory and accounting aspects such as IFRS 9, taking account of a number of factors including economic variables and impairments. These plans to seek to demonstrate that the Group and its operating subsidiaries maintain sufficient CET1 capital in these conditions. A range of future states are examined. In particular, assessments of capital requirements rely on forecasts of:

- Future business performance given expectations of economic and market conditions over the forecast period.
- Future business performance under adverse economic and market conditions over the forecast period. A range of scenarios of different severity may be examined.

The examination of capital requirements under normal economic and market conditions enables the RBS Group to demonstrate how its projected business performance allows it to meet all internal and regulatory capital requirements as they arise over the plan horizon. For example, the RBS Group will assess its ability to issue loss-absorbing debt instruments in sufficient quantity to meet regulatory timelines. The cost of issuance will be factored into business performance metrics.

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 the RBS Group but also by the regulators to set specific capital buffers. The RBS Group takes part in a number of stress tests run by regulatory authorities to test industry-wide vulnerabilities under crystallising global and domestic systemic risks. In 2018, the RBS Group took part in the Bank of England and European Banking Authority stress tests.

Under stress testing, IFRS 9 volatility can have a more material impact. This is because the peak-to-trough change in CET1 may be affected by the transitions from Stage 1 to Stage 2 in stress conditions. RBS uses stress and the peak-to-trough movements to help assess the amount of CET1 capital it 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 the RBS Group's 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 make an assessment of the RBS Group-specific capital requirements through the Pillar 2 framework.

Capital allocation
The RBS Group has mechanisms to allocate capital across its legal entities and businesses which aim to optimise the utilisation 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 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 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
In implementing the liquidity risk management framework, 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 Asset & Liability Management Committee at least monthly. Liquidity Condition Indicators are monitored daily which 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, the RBS Group undertakes the Individual Liquidity Adequacy Assessment Process. This includes assessment of net stressed liquidity outflows under a range of extreme but plausible stress scenarios, as outlined below.

Type	Description
Idiosyncratic scenario	The market perceives the 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. The 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.

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

Stress testing – recovery and resolution planning
The NatWest Holdings Recovery Plan covers NatWest Holdings Limited and all its subsidiaries. NatWest Holdings will contain five licensed banks within the ring-fenced group: National Westminster Bank Plc, The Royal Bank of Scotland plc (previously Adam & Company plc), Coutts and Co, Ulster Bank Ireland DAC and Ulster Bank Limited.

Risk management framework continued

The NatWest Holdings Recovery Plan is designed to provide the necessary tools and processes to enable NatWest Holdings, and its subsidiaries, to manage a response to a financial stress and restore its financial position to remain viable on an ongoing basis. It has been prepared alongside the RBS Group Recovery Plan and all elements are aligned to the RBS Group approach.

The Recovery Plan ensures that risks which could delay the implementation of a recovery strategy are highlighted and preparations are made to minimise the impact of these risks. Preparations the RBS Group has taken 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
- detailing a range of options to address different stress conditions
- appointing dedicated option owners to reduce the risk of delay and bandwidth concerns

The Recovery Plan is intended to enable NatWest Holdings and its subsidiaries to maintain critical services and products it provides to its customers (its critical economic functions), maintain its important business lines (core business lines) and operate within risk appetite whilst restoring the bank's financial condition.

The Recovery Plan is assessed for appropriateness on an ongoing basis and is updated annually, in line with regulatory requirements. It is reviewed and approved by the Board prior to submission to the PRA each year.

Individual Recovery Plans have been prepared for NatWest Holdings Limited, NatWest Markets Plc, RBS International Holdings Limited, Ulster Bank Ireland DAC and NatWest Markets N.V. These plans reflect the structure and operations of the post-ring-fenced group and detail the recovery options, recovery indicators and escalation routes for each entity to manage its own response to a financial stress.

If RBS was assessed by the UK authorities as failing or likely to fail the authorities have a wide range of powers to place RBS into resolution. The UK's Special Resolution Regime places an obligation on banks to ensure they are resolvable. Resolvability is a measure of how effectively a set of actions could be taken to manage the failure of RBS, through execution of a preferred resolution strategy which the Group is Single Point of Entry Bail-in of the Group Hold Co. The process of resolution is owned and implemented by the Bank of England (as UK Resolution Authority).

RBS has a multi-year programme of work scheduled through to 1 January 2022 to ensure impediments to resolvability are removed and the regulatory resolution strategy could be executed.

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. The return provides the regulator with an overview of the RBS Group's banking book interest rate exposure, providing 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 industry-wide Bank of England and European Banking Authority stress exercises. In addition, the RBS Group produces its own internal scenario analysis as part of the financial planning cycles.

Non-traded market risk exposures which are not captured under Pillar 1 are capitalised through the ICAAP. The process covers the following risk types: 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 the RBS Group Model Risk and the results are approved by the Capital Management & Stress Testing Committee.

Capital and risk management

Capital, liquidity and funding risk

Definitions

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 at 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; and
- Depositor and investor behaviour.

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 on either a going or gone concern basis, 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 a pre-specified CET1 ratio is reached.
- 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.

Minimum requirement for own funds and eligible liabilities (MREL)

In addition to capital, other specific loss absorbing instruments, including senior notes issued by NatWest Bank, may be used to cover certain gone concern capital requirements which, in the EU, is referred to as MREL. Gone concern refers to the situation in which resources must be available to enable an orderly resolution, in the event that the Bank of England (BoE) deems that the Group has failed, or is likely to fail.

Liquidity

Liquidity risk within NatWest Bank is managed as part of the UK Domestic Liquidity Sub-Group (UK DoLSub), which is regulated by the PRA and comprises NWH Group's four licensed deposit taking UK banks: National Westminster Bank Plc, The Royal Bank of Scotland plc, Coutts & Company, and Ulster Bank Limited. NatWest Markets Plc left the UK DoLSub during H2 2018.

NWH Group maintains a prudent approach to the definition of liquidity resources. NWH Group manages its liquidity to ensure it is always available when and where required, taking into account regulatory, legal and other constraints.

Liquidity resources 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 Bank maintains a diversified set of funding sources, including customer deposits, wholesale deposits and term debt issuance. NatWest Bank also retains access to central bank funding facilities.

For further details on capital constituents and the regulatory framework covering capital, liquidity and funding requirements, please refer to the RBS Pillar 3 Report 2018 on pages 6. For MREL refer to page 8

Managing capital requirements: regulated entities

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

For disclosure purposes, significant subsidiaries are determined with reference to RBS Group RWAs, using 5% as the threshold. The significant legal entity in the NatWest Group is National Westminster Bank Plc (NatWest).

Liquidity and funding disclosures are presented for the NatWest Group rather than for NatWest.

Key developments in 2018

Bank

17.4% CET1 ratio

- The CET1 ratio decreased by 610 basis points from 23.5% to 17.4%, mainly due to increased RWAs resulting from the Ring-Fencing Transfer Scheme (RFTS). These transfers into NWB plc included Treasury Services and a significant portion of the ring-fenced group liquidity portfolio.
- RWAs increased by £18.9 billion in the year, mainly resulting from the RFTS during H1 2018 of £10.7 billion. Further increases in credit risk RWAs were driven by increased asset size due to lending growth and various LGD model changes.
- In December 2018, NatWest Holdings Limited issued £4.8 billion MREL compliant debt and utilised a portion of these funds to invest in its subsidiaries' MREL eligible issuance.

5.2% leverage ratio

- The leverage ratio on a PRA transitional basis decreased to 5.2%, reflecting the RFTS assets partially offset by increased Tier 1 capital.

Capital, liquidity and funding risk continued

Group

Liquidity position:

- NatWest Bank's liquidity portfolio is managed as part of the UK DoLSub. The UK DoLSub's liquidity portfolio was £160 billion at 31 December 2018 (2017 - £180 billion), comprising primary liquidity of £90 billion (2017 - £118 billion) and secondary liquidity of £70 billion (2017 - £62 billion). The reduction in primary liquidity is mainly due to NWM plc leaving the UK DoLSub.

Capital management

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

Capital management is critical in supporting the bank entities' businesses and is also considered at Group level. It is enacted through an RBS Group-wide an end to end framework.

Capital planning is integrated into the Group's wider annual budgeting process and is assessed and updated at least monthly. This is summarised below. Other elements of capital management, including risk appetite and stress testing, are set out on pages 12 and 14.

Produce capital plans ↓	• Capital plans are produced for the Group, its key operating entities 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 ↓	• Capital plans are developed to maintain capital of sufficient quantity and quality to support the Group's business, it's subsidiaries 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 Group including from businesses.
Inform capital actions	• Capital planning informs potential capital actions including buy backs, redemptions, dividends and new issuance to external investors or via internal transactions. • Decisions on capital actions will be influenced by strategic and regulatory requirements, risk appetite, costs and prevailing market conditions. • As part of capital planning, RBS will monitor its portfolio of issued capital securities and assess the optimal blend and most cost effective means of financing.

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

Liquidity risk management

NWH 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.

The size of the liquidity portfolio held in the UK DoLSub is determined by referencing the NWH's liquidity risk appetite. The NWH 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.

NatWest Bank manages the majority of the UK DoLSub's liquidity portfolio under the responsibility of the RBS Group Treasurer.

Funding risk management

The Group 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.

Capital and risk management

Capital, liquidity and funding risk continued

Minimum requirements

Capital adequacy ratios

The bank entities are subject to minimum capital requirements relative to RWAs. The table below summarises the minimum ratios of capital to RWAs that the UK bank entities are expected to have to meet once CRR is fully implemented by 1 January 2019.

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)	0.9%	0.9%	0.9%
Total (2)	7.9%	9.4%	11.4%

Notes:
(1) The institution specific countercyclical capital buffer requirement is based on the weighted average of geographical exposures. The Financial Policy Committee (FPC) sets the UK countercyclical capital buffer, which is currently 1.0% (effective from November 2018). The rate had previously increased from 0.0% to 0.5% (effective June 2018). Foreign exposures may be subject to different countercyclical capital buffer rates dependent on the rate set in those jurisdictions.
(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

In November 2016, the European Commission published a proposal for the adoption of a legally binding 3% of Tier 1 capital minimum leverage ratio as part of the CRR 2 package of legislation. There remains considerable uncertainty regarding the timing of the implementation of CRR 2 proposals and at present there is no binding minimum ratios of capital to leverage exposure that applies to individual bank entities as regulated by the PRA in the UK.

Liquidity and funding ratios

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

Type	From 1 January 2018	From 1 January 2019
Liquidity coverage ratio (LCR)	100%	100%
Net stable funding ratio (NSFR)(1)	N/A	N/A

Note:

(1) In November 2016, the European Commission published its proposal for NSFR rules within the EU as part of its CRR2 package of regulatory reforms. CRR2 NSFR is expected to become the regulatory requirement in future within the EU and the UK. RBS has changed its policy on the NSFR to align with its interpretation of the CRR2 proposals with effect from 1 January 2018.

Capital, liquidity and funding risk continued

Measurement

Capital, RWAs and leverage

The table below sets out the key Capital and Leverage ratios.

	2018	2017
Capital (1)	£m	£m
CET1	13,138	13,301
Tier 1	15,389	13,301
Total	18,490	17,536
RWAs		
Credit risk	63,548	48,575
Counterparty credit risk	325	266
Market risk	50	136
Operational risk	11,660	7,724
Total RWAs	75,583	56,701
Capital adequacy ratios	%	%
CET1	17.4	23.5
Tier 1	20.4	23.5
Total	24.5	30.9
Leverage		
Tier 1 capital (£m)	15,389	13,301
Leverage exposure (£m)	295,483	213,474
Leverage ratio (%)	5.2	6.2

Note:
(1) CRR as implemented by the PRA in the UK, with effect from 1 January 2014.
From 1 January 2015, UK Banks have been required to meet at least 56% of its Pillar 2A capital requirement with CET1 capital and the balance with Additional Tier 1 and/or Tier 2 capital. The Pillar 2A capital requirement is the additional capital that the Bank must hold, in addition to meeting its Pillar 1 requirements in order to comply with the PRA's overall financial adequacy rule.

Liquidity key metrics

Liquidity within NatWest Bank is managed and regulated as part of the UK DoLSub. The table below sets out the key liquidity and related metrics for the UK DoLSub.

2018	UK DoLSub
Liquidity coverage ratio (%) (1)	153%
Stressed outflow coverage (%) (2)	147%
Net stable funding ratio (%) (3)	144%

Notes:
(1) On 1 October 2015 the LCR became the PRA's primary regulatory liquidity standard. It is a Pillar 1 metric to which the PRA apply Pillar 2 add-ons. The published LCR excludes Pillar 2 add-ons. RBS calculates the LCR using its own interpretations of the EU LCR Delegated Act, which may change over time and may not be fully comparable with those of other financial institutions.
(2) RBS's stressed outflow coverage (SOC) is an internal measure calculated by reference to liquid assets as a percentage of net stressed contractual and behavioural outflows over three months under the worst of three severe stress scenarios of a market-wide stress, an idiosyncratic stress and a combination of both as per ILAAP. This assessment is performed in accordance with PRA guidance.
(3) In November 2016, the European Commission published its proposal for NSFR rules within the EU as part of its CRR2 package of regulatory reforms. CRR2 NSFR is expected to become the regulatory requirement in future within the EU and the UK. RBS has changed its policy on the NSFR to align with its interpretation of the CRR2 proposals with effect from 1 January 2018.

Capital, liquidity and funding risk continued

Capital resources (audited)

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

	2018 £m	2017 £m
Shareholders' equity (excluding non-controlling interests)		
Shareholders' equity	18,276	15,355
Other equity instruments	(2,370)	—
	15,906	15,355
Regulatory adjustments and deductions		
Defined benefit pension fund adjustment	(11)	(11)
Deferred tax assets	(462)	(537)
Prudential valuation adjustments	(18)	(1)
Qualifying deductions exceeding AT1 capital	—	(41)
Goodwill and other intangible assets	(966)	(490)
Expected losses less impairments	(193)	(511)
Instruments of financial sector entities where the institution has a significant investment	(538)	(456)
Significant investments in excess of secondary capital	(574)	—
Other regulatory adjustments	(6)	(7)
	(2,768)	(2,054)
CET1 capital	13,138	13,301
Additional Tier 1 (AT1) capital		
Qualifying instruments and related share premium	2,370	—
Qualifying instruments and related share premium subject to phase out	117	140
	2,487	140
Tier 1 deductions		
Instruments of financial sector entities where the institution has a significant investment	(236)	(181)
Qualifying deductions exceeding AT1 capital	—	41
	(236)	(140)
Tier 1 capital	15,389	13,301
Qualifying Tier 2 capital		
Qualifying instruments and related share premium	3,376	4,412
Tier 2 deductions		
Instruments of financial sector entities where the institution has a significant investment	(275)	(177)
Tier 2 capital	3,101	4,235
Total regulatory capital	18,490	17,536

Note:
(1) CRR as implemented by the Prudential Regulation Authority in the UK, with effect from 1 January 2014. All regulatory adjustments and deductions to CET1 have been applied in full.

Leverage exposure

The leverage exposure is based on the CRR delegated act.

Leverage	2018 £m	2017 £m
Cash and balances at central banks	43,966	34,763
Derivatives	1,277	2,277
Loans	207,872	216,460
Other assets	48,509	6,217
Total assets	301,624	259,717
Derivatives		
- netting and variation margin	(1,872)	(1,696)
- potential future exposures	1,203	287
Securities financing transactions gross up	203	—
Undrawn commitments	21,047	10,466
Regulatory deductions and other adjustments	(2,997)	(2,188)
Exclusion of core UK-group exposure	(23,725)	(53,112)
Leverage exposure	295,483	213,474

Capital, liquidity and funding risk continued

Liquidity portfolio (audited)

The table below shows the liquidity portfolio by product, liquidity value and carrying value. Liquidity for NWB is managed and regulated as part of the UK DoLSub. NatWest Bank manages the majority of the UK DoLSub's portfolio under the control of the RBS Treasurer. Liquidity value is lower than carrying value as it is stated after discounts (or haircuts) applied to instruments by the Bank of England and other central banks.

	2018 UK DoLSub (1) £m	2018 Group £m	2017 UK DoLSub (1) £m	2017 Group £m
Cash and balances at central banks	59,745	41,130	91,377	34,614
Central and local government bonds				
AAA rated governments	4,386	4,386	2,760	2,760
AA- to AA+ rated governments and US agencies	25,845	25,845	24,084	24,084
	30,231	30,231	26,844	26,844
Primary liquidity	89,976	71,361	118,221	61,458
Secondary liquidity (2)	69,642	54,616	62,144	52,406
Total liquidity value	159,618	125,977	180,365	113,114
Total carrying value	186,340	147,260	203,733	135,602

Notes:
(1) As at end 2018, The UK DoLSub comprises the NatWest Holding Group's four licensed deposit-taking UK banks: National Westminster Bank Plc, The Royal Bank of Scotland plc, Coutts and Co and Ulster Bank Limited. NatWest Markets Plc left the UK DoLSub during H2 2018.
(2) Comprises assets eligible to discounting at the Bank of England and other central banks.

Funding sources (audited)

The table below shows the Group's carrying values of the principal funding sources based on contractual maturity. Balance sheet captions include balances held at all classifications under IFRS 9/IAS 39 but excludes derivative cash collateral.

By product	2018 Third party short-term less than 1 year £m	2018 Third-party Long-term more than 1 year £m	2018 Total £m	2018 Amounts due to holding companies and fellow subsidiaries (1) £m	2017 Third party short-term less than 1 year £m	2017 Third party Long-term more than 1 year £m	2017 Total £m	2017 Amounts due to holding companies and fellow subsidiaries (1) £m
Personal and corporate deposits								
Personal (2)	133,590	1,162	134,752	—	129,489	1,132	130,621	—
Corporate (3)	83,950	18	83,968	513	80,652	14	80,666	17
	217,540	1,180	218,720	513	210,141	1,146	211,287	17
Financial Institutions deposits								
Banks	3,022	14,023	17,045	13,564	3,529	17,015	20,544	33,303
Non-bank financial institutions (NBFI)	15,296	—	15,296	3,979	15,274	28	15,302	6,757
	18,318	14,023	32,341	17,543	18,803	17,043	35,846	40,060
Debt securities in issue								
Commercial papers (CP's) and certificates of deposits (CD's)	330	—	330	—	—	—	—	—
Medium-term notes	—	—	—	1,580	—	—	—	—
Covered bonds	—	5,369	5,369	—	—	—	—	—
Securitisations	—	597	597	—	—	396	396	—
	330	5,966	6,296	1,580	—	396	396	—
Subordinated liabilities	23	1,252	1,275	2,904	13	1,227	1,240	4,515
Repos - Financial institutions (4)	4,292	—	4,292	—	—	—	—	—
Total funding	240,503	22,421	262,924	22,540	228,957	19,812	248,769	44,592
Of which: available in resolution (5)	*15*	*1,252*	*1,267*	*4,451*	*5*	*1,227*	*1,232*	*4,409*

Notes:
(1) Amounts due to holding companies and fellow subsidiaries relate to non-financial instruments of £2 million (2017 - £7 million) have been excluded from the table.
(2) Includes £20 million (2017 - £130 million) of DFV deposits included in other financial liabilities on the balance sheet.
(3) Includes nil million (2017 - £36 million) of DFV deposits included in other financial liabilities on the balance sheet.
(4) Includes amortised cost repos of £4,292 million (2017 – nil).
(5) Eligible liabilities (as defined in the Banking Act 2009 as amended from time to time) that meet the eligibility criteria set out in the regulations, rules, policies, guidelines, or statements of the Bank of England including the Statement of Policy published by the Bank of England in June 2018.

Capital and risk management

Capital, liquidity and funding risk continued

Contractual maturity (audited)

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

	Banking activities										
2018	Less than 1 month £m	1-3 months £m	3-6 months £m	6 months - 1 year £m	Subtotal £m	1-3 years £m	3-5 years £m	More than 5 years £m	Total £m	Trading activities £m	Total £m
Central bank balances	45,032	—	—	—	45,032	—	—	—	45,032		45,032
Derivatives	27	—	—	109	136	230	102	121	589	664	1,253
Loans to banks	5,651	25	654	—	6,330	67	9	—	6,406		6,406
Loans to customers (1)	24,645	4,133	5,165	9,623	43,566	32,387	26,433	102,898	205,284		205,284
Personal	3,956	1,833	2,515	4,618	12,922	16,181	13,673	91,510	134,286		134,286
Corporate	19,589	2,251	2,602	4,884	29,326	15,709	12,104	11,206	68,345		68,345
NBFI	1,100	49	48	121	1,318	497	656	182	2,653		2,653
Other financial assets	1,006	1,362	737	2,258	5,363	8,792	8,498	18,293	40,946	280	41,226
Total financial assets	76,361	5,520	6,556	11,990	100,427	41,476	35,042	121,312	298,257	944	299,201
2017											
Total financial assets	63,073	3,989	5,312	9,179	81,553	29,229	23,046	98,869	232,697	2,322	235,019
2018											
Bank deposits	2,874	148	—	—	3,022	12,023	2,000	—	17,045		17,045
Bank repos	518	—	—	—	518	—	—	—	518		518
Customer repos	3,774	—	—	—	3,774	—	—	—	3,774		3,774
Customer deposits	225,261	3,839	1,739	1,977	232,816	1,162	—	18	233,996		233,996
Personal	128,435	2,536	1,014	1,583	133,568	1,162	—	—	134,730		134,730
Corporate	82,448	570	606	366	83,990	—	—	18	84,008		84,008
NBFI	14,378	733	119	28	15,258	—	—	—	15,258		15,258
Derivatives	—	64	62	—	126	266	106	279	777	2	779
Other financial liabilities	205	145	52	79	481	3,147	—	2,819	6,447	50	6,497
CP's and CD's	68	141	44	77	330	—	—	—	330	—	330
Covered bonds	—	—	—	—	—	3,147	—	2,222	5,369	—	5,369
Securitisations	—	—	—	—	—	—	—	597	597	—	597
Bank deposits	—	—	—	—	—	—	—	—	—	12	12
Customer deposits	6	4	8	2	20	—	—	—	20	38	58
Settlement balances	131	—	—	—	131	—	—	—	131	—	131
Subordinated liabilities	3	2	3	15	23	302	—	950	1,275		1,275
Other liabilities (2)	821	—	—	—	821	—	—	—	821		821
Total financial liabilities	233,456	4,198	1,856	2,071	241,581	16,900	2,106	4,066	264,653	52	264,705
2017											
Total financial liabilities	223,968	2,786	1,327	1,686	229,767	4,187	14,310	1,322	249,586	3,177	252,763

Notes:
(1) Loans to customers excludes £1,637 million (2017 - £1,439 million) of impairment provision.
(2) Includes notes in circulation.

Encumbrance (audited)

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

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

- Already encumbered and used to support funding currently in place through own-asset securitisations, covered bonds and securities repurchase agreements.
- Pre-positioned with central banks as part of funding schemes and those encumbered under such schemes.
- Not currently encumbered. In this category, the Group has in place an enablement programme which seeks to identify assets capable of being encumbered and to identify the actions to facilitate such encumbrance whilst not affecting customer relationships or servicing.

Capital, liquidity and funding risk continued

Balance sheet encumbrance - third party (audited)

2018	Encumbered as a result of transactions with counterparties other than central banks: Covered bonds and securitisations (1) £bn	SFT, Derivatives and similar (2) £bn	Total (3) £bn	Pre-positioned & encumbered assets held at central bank (4) £bn	Unencumbered assets not pre-positioned with central banks: Readily available (5) £bn	Other available (6) £bn	Cannot be used (7) £bn	Total £bn	Total third party £bn	Balances with holding companies and fellow subsidiaries £bn	Total £bn
Cash and balances at central banks	—	5.2	5.2	—	39.8	—	—	39.8	45.0	—	45.0
Derivatives	—	—	—	—	—	—	1.3	1.3	1.3	—	1.3
Loans to banks - amortised cost	0.2	0.7	0.9	—	1.9	—	3.6	5.5	6.4	—	6.4
Loans to customers - amortised cost											
- residential mortgages	7.1	—	7.1	92.0	16.0	8.3	—	24.3	123.4	—	123.4
- credit cards	—	—	—	—	2.7	0.2	—	2.9	2.9	—	2.9
- personal loans	—	—	—	—	3.9	2.1	1.4	7.4	7.4	—	7.4
- other	—	—	—	2.6	1.7	47.8	17.8	67.3	69.9	—	69.9
Other financial assets	—	10.6	10.6	—	28.6	—	2.0	30.6	41.2	—	41.2
Other assets	—	—	—	—	—	2.1	5.1	7.2	7.2	—	7.2
Total assets	7.3	16.5	23.8	94.6	94.6	60.5	31.2	186.3	304.7	5.2	309.9
2017											
Total assets	8.9	3.5	12.4	88.5	64.3	53.7	29.9	147.9	248.8	92.0	340.8

Notes:
(1) Covered bonds and securitisations include securitisations, conduits and covered bonds.
(2) Repos and other secured deposits, cash, coin and nostro balance held with the Bank of England as collateral against deposits and notes in circulation are included here rather than within those positioned at the central bank as they are part of normal banking operations. Securities financing transactions (SFT) include collateral given to secure derivative liabilities.
(3) Total assets encumbered as a result of transactions with counterparties other than central banks are those that have been pledged to provide security and are therefore not available to secure funding or to meet other collateral needs.
(4) Assets pre-positioned at the central banks include loans provided as security as part of funding schemes and those encumbered under such schemes.
(5) Readily available for encumbrance: including assets that have been enabled for use with central banks but not pre-positioned; cash and high quality debt securities that form part of NatWest's liquidity portfolio and unencumbered debt securities.
(6) Other assets that are capable of being encumbered are those assets on the balance sheet that are available for funding and collateral purposes but are not readily realisable in their current form. These assets include loans that could be prepositioned with central banks but have not been subject to internal and external documentation review and diligence work.
(7) Cannot be used includes:
(a) Derivatives, reverse repurchase agreements and trading related settlement balances.
(b) Non-financial assets such as intangibles, prepayments and deferred tax.
(c) Loans that cannot be pre-positioned with central banks based on criteria set by the central banks, including those relating to date of origination and level of documentation.
(d) Non-recourse invoice financing balances and certain shipping loans whose terms and structure prohibit their use as collateral
(8) In accordance with market practice, NatWest employs securities recognised on the balance sheet, and securities received under reverse repo transactions as collateral for repos.

Capital and risk management

Credit risk

Definition

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

The following disclosures in this section are audited:
- Forbearance.
- Impairment, provisioning and write-offs.
- Transition from IAS 39 to IFRS 9.
- Key elements of IFRS 9 impairment provisions
    - Economic loss drivers (excluding economic parameters).
    - IFRS 9 credit risk modelling.
    - Significant increase in credit risk.
    - Asset lifetimes.
- Measurement uncertainty and ECL sensitivity analysis.
- Banking activities (except PDs and additional Stage 2 and Stage 3 analysis).

Sources of risk

The principal sources of credit risk are lending and related undrawn commitments. Derivatives and securities financing and debt securities are also a source of credit risk, primarily related to Treasury activities for the Group. The Group is also exposed to settlement risk through foreign exchange and payments activities.

Risk governance

Credit risk management is led by the Chief Credit Officer (CCO). Credit risk management activities include:
- Defining credit risk appetite for the management of concentration risk and credit policy to establish the key risks in the process of providing credit and the controls that must be in place to mitigate them.
- Approving credit limits for customers.
- Oversight of the first line of defence to ensure that credit risk remains within the risk appetite set by the Board.

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

The Group's approach to lending is governed by comprehensive credit risk appetite frameworks. The frameworks are closely monitored and actions are taken to adapt lending criteria as appropriate. Credit risk appetite aligns to the strategic risk appetite set by the Board, which includes capital adequacy, earnings volatility, funding and liquidity, and stakeholder confidence. The credit risk appetite frameworks have been designed to reflect factors (for example, strategic and emerging risks) 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 credit risk appetite frameworks and risk appetite limits. The frameworks are supported by a suite of transaction acceptance standards that set out the risk parameters within which franchises should operate.

The Personal credit risk appetite framework sets limits that measure and control the quality of both existing and new business for each relevant franchise or 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 Wholesale, 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	Exposure	Risk – based on economic capital and other qualitative factors
Country	Exposure	Probability of default of a sovereign and average loss given default
Product and asset class	Exposure	Risk – based on heightened risk characteristics

Risk controls

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

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.

Risk models

The output of credit risk models is used in the credit approval process – as well as for ongoing assessment, monitoring and reporting – to inform risk appetite decisions. These models are divided into different categories. Where the calculation method is on an individual counterparty or account level, the models used will be probability of default (PD), loss given default (LGD), or exposure at default (EAD). The economic capital model is used for credit risk appetite setting.

Asset quality

All credit grades map to an asset quality scale, used for external financial reporting. For Wholesale customers, a master grading scale is used for internal management reporting across portfolios. Accordingly, measures of risk exposure may be aggregated and reported at differing levels of detail depending on stakeholder or business requirements. Performing loans are defined as AQ1-AQ9 (where the PD is less than 100%) and non-performing loans as AQ10 or Stage 3 under IFRS 9 (where the PD is 100%).

Risk mitigation

Risk mitigation techniques, as set out in the appropriate credit policies, are used in the management of credit portfolios across the Group. 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, the use of credit derivatives including credit default swaps, credit-linked debt instruments and securitisation structures, 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).

Credit risk continued

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

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

Region	Index used
UK	Halifax quarterly regional house price index
Northern Ireland	UK House Price Index (published by the Land Registry)

The current indexed value of the property is a component of the expected credit loss (ECL) provisioning calculation.

Commercial real estate valuations – The Group has a panel of chartered surveying firms that cover the spectrum of geography and property sectors in which the Group takes collateral. Suitable valuers for particular assets are contracted through a single service agreement to ensure consistency of quality and advice. Valuations are commissioned when an asset is taken as security; a material increase in a facility is requested; or 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.

Counterparty credit risk

In addition to the credit risk management practices set out in this section, the Group mitigates counterparty credit risk arising from both derivatives transactions and repurchase agreements through the use of market standard documentation, enabling netting (for credit risk management only and not for accounting purposes), and through collateralisation.

Amounts owed by the Group to a counterparty are netted against amounts the counterparty owes the Group, in accordance with relevant regulatory and internal policies. Netting is only applied if a netting agreement is in place.

Risk assessment and monitoring

Practices for credit stewardship – including credit assessment, approval and monitoring as well as the identification and management of problem debts – differ between the 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 Group 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 Group and other lenders). The Group 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. Consideration is given to identifying groups of individual customers with sufficient inter-connectedness to merit assessment as a single risk.

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.

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 to provide a recommended credit decision. 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.

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.

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

Problem debt management

Personal

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 Group's data and external 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.

Credit risk continued

Collections

When a customer exceeds an agreed limit or misses a regular monthly payment the customer is contacted by the Group 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.

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

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 framework focuses on Wholesale customers whose credit profiles have deteriorated since origination. Expert judgement is applied by experienced credit risk officers to classify cases into categories that reflect progressively deteriorating credit risk to the Group. There are two classifications which apply to non-defaulted customers within the framework – 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 Group's default criteria (AQ10 exposures). Defaulted exposures are categorised as Stage 3 impaired for provisioning purposes.

Heightened Monitoring customers are performing customers that have met certain characteristics, which have led to significant credit deterioration. Collectively, characteristics reflect circumstances that may affect the customer's ability to meet repayment obligations. Characteristics include trading issues, covenant breaches, material PD downgrades and past due facilities. Heightened Monitoring customers require pre-emptive actions (outside the customer's normal trading patterns) to return or maintain their facilities within the Group's current 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 Group 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 in accordance with policies. Actions include a review of the customer's credit grade, facility and security documentation and the valuation of security. Depending on the severity of the financial difficulty and the size of the exposure, the customer relationship strategy is reassessed by credit officers, by specialist credit risk or relationship management units in the relevant business or by Restructuring.

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

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

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

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

Restructuring

For the Wholesale problem debt portfolio, customer relationships are mainly managed by the Restructuring team (excluding customers managed by UK PBB). The purpose of Restructuring is to protect the Group's capital. Where practicable, Restructuring does this by working with corporate and commercial customers to support their turnaround and recovery strategies and enable them to return to mainstream banking. Restructuring will always aim to recover capital in a fair and efficient manner.

Specialists in Restructuring work with customers experiencing financial difficulties and showing signs of financial stress. 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 (audited)

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.

Capital and risk management

Credit risk continued

Types of forbearance

Personal

In the Personal portfolio, forbearance may involve payment concessions and loan rescheduling (including extensions in contractual maturity) and/or 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 Group 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.

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.

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 forborne 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 (audited)

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

The new IFRS 9 impairment provisions accounting standard was implemented with effect from 1 January 2018. Set out below is further detail regarding the impact of the transition from IAS 39 to IFRS 9 impairment provisioning, how key credit risk management activities link to IFRS 9 impairment provisioning and the key policy and modelling decisions that have been made in implementing IFRS 9 (refer also to Accounting policy 13 and Note 13 on the accounts).

Transition from IAS 39 to IFRS 9 (audited)

The Group implemented IFRS 9 with effect from 1 January 2018 with no restatement of comparatives other than the Day One impact on implementation reflected in opening equity.

Cash flows and cash losses are unchanged by the change in impairment framework from IAS 39 to IFRS 9. IFRS 9 has changed the basis of loss calculation to expected loss (forward-looking), as opposed to the incurred loss model under IAS 39, which focused only on losses that had already occurred. There are a number of changes as well as judgements involved in measuring ECL. New elements include:

- Move from incurred loss model to expected loss model, including all performing assets having 12-month ECL on origination.
- Determination of significant increase in credit risk – this moves a subset of assets from a 12-month ECL (Stage 1) to lifetime ECL (Stage 2) when credit risk has significantly increased since origination.
- Change in scope of impaired assets (Stage 3).
- Incorporation of forward-looking information, including multiple economic scenarios (MES). MES are assessed in order to identify non-linearity of losses in the portfolio.

The overall provisioning requirement under IFRS 9 increased by £364 million a 25% increase relative to IAS 39. The main driver of the increase was the requirement to hold a minimum of 12 months of ECL on performing assets, increasing to lifetime loss for assets that have exhibited a significant increase in credit risk.

Key differences in moving from IAS 39 to IFRS 9 on impairment loss (audited)	Total £m
31 December 2017 - IAS 39 impairment provision	1,441
Impact of IFRS 9 - third party	347
Impact of IFRS 9 - inter-Group	17
1 January 2018 - IFRS 9 ECL	1,805

Credit risk continued

Key elements of IFRS 9 impairment provisions (audited)

IFRS 9 introduced additional complexity into the determination of credit impairment provisioning requirements. However, the building blocks that deliver an ECL calculation already existed in the RBS Group. Existing Basel models were used as a starting point in the construction of IFRS 9 models, which also incorporate term extension 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 (the Group uses consensus forecasts to remove management bias).

Policy elections and simplifications relating to IFRS 9

In addition to the five key areas above, which are relevant from period to period, there was one further significant judgment that was made as a one-off exercise to support the Day One implementation: this was the application of the new IFRS 9 models to the determination of origination date metrics. Since it is not possible to determine the economic forecasts and alternative scenarios going backwards in time it is necessary to use a series of assumptions to enable this process. The Group assumed a flat economic forecast, for all dates historically. There were some other less significant judgments, elections and simplification assumptions that informed the ECL process; these were not seen as 'critical' in determining the appropriate level of impairment but represented choices taken by management across areas of estimation uncertainty. The main examples of these are:

- Models – for example in the case of some low default portfolios, Basel parameter estimates have been applied for IFRS 9.
- Non-modelled portfolios – certain portfolios have their Basel II capital requirement calculated under the standardised framework for regulatory purposes and do not have systematically modelled PDs, EADs and LGDs. Under IFRS 9, they have bespoke treatments for the identification of significant increase in credit risk and ECL provisions. With respect to the latter, benchmark PDs, EADs and LGDs are used with the benchmarks being reviewed annually for appropriateness. The main portfolio subject to this approach is Private Banking.
- Discounting of future losses – the ECL calculation is based on expected future cash-flows. These are discounted using the effective interest rate – for practical purposes, this is typically applied at a portfolio level rather than being established and operated at an individual asset level.
- Multiple economic scenarios (MES) – it is the selection of the central (or base) scenario that is most critical to the ECL calculation, independent of the method used to generate a range of alternative outcomes and their probabilities. Different approaches to model MES around the central scenario have all been found of low significance for the overall ECL impact.

Economic loss drivers

Introduction (audited)

The portfolio segmentation and selection of economic loss drivers for IFRS 9 follow closely the approach already used in stress testing. To enable robust modelling the forecasting models for each portfolio segment (defined by asset class and where relevant – industry sector and region) are based on a selected, small number of economic factors, (typically two to four) that best explain the temporal variations in portfolio loss rates. The process to select economic loss drivers involves empirical analysis and expert judgment.

The most material primary economic loss drivers for Personal portfolios include UK GDP, unemployment rate, House Price Index, and base rate for UK portfolios as relevant.

In addition to some of these loss drivers, for Wholesale portfolios, World GDP is a primary loss driver.

Central base case economic scenario (audited)

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 the Group's financial planning. The key elements of the current economic base case, which includes forecasts over a five year forecast horizon, are summarised below.

The central 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 only two further base rate increases over the next five years.

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 explicitly enforce a gradual reversion to long run average credit cycle conditions from the first projected year onwards.

This adjustment process leverages the existing Wholesale credit models framework that utilises Credit Cycle Indices (CCI) to measure the point-in-time default rate conditions in a comprehensive set of region/industry groupings. The CCI are constructed by summarising market data based Point-in-Time PDs for all publicly listed entities in the respective region/industry grouping on a monthly frequency. Positive CCI values indicate better than average conditions, i.e. low default rates and a CCI value of zero indicates default rate conditions at long run average levels. The CCI can be interpreted as an aggregation of the primary economic loss drivers most relevant for each portfolio segment into a single measure. The central base case scenario forecasts provided at the level of economic loss drivers are fed into the ECL calculations by first translating them into corresponding CCI forecasts for each portfolio segment and subsequently applying the aforementioned mean-reversion adjustment.

Initially at transition, mean reversion was applied from year five onwards. Since H1 2018, mean reversion is applied from the first year onwards. The earlier application of the mean reversion adjustment was introduced to account for 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.

Credit risk continued

Approach for MES (audited)

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 MES are considered when calculating ECL.

- Personal – the approach to MES is based on using a set of discrete scenarios. 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 below).

The ECL impact on the Personal portfolio arising from the application of MES over the single, central base case is relatively low, and following review by the Provisions Committee, overlays were agreed to ensure the expected effect of non-linearity of losses was appropriately recognised. As at 31 December 2018, the value of the overlays was £19 million for UK PBB.

- 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 CCI described earlier. Since the existing Wholesale credit models for PD and LGD were already built within the CCI framework the chosen Monte Carlo method provided a conceptually rigorous but still efficient approach to implement the MES requirement.

The Monte Carlo MES approach increases Wholesale ECL for Stage 1 and Stage 2 by approximately 5% above the single, central scenario outcomes. No additional MES overlay was applied for Wholesale.

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

Key economic loss drivers – average over the five year planning horizon (2019 to 2023 for 31 December 2018 and 2018 to 2022 for 1 January 2018) – in the most relevant planning cycle for the central base case and two upside and downside scenarios used for ECL modelling are set out below.

Economic parameters

	31 December 2018					1 January 2018				
	Upside 2	Upside 1	Base case	Downside 1	Downside 2	Upside 2	Upside 1	Base case	Downside 1	Downside 2
UK	%	%	%	%	%	%	%	%	%	%
GDP - change	2.6	2.3	1.7	1.5	1.1	2.2	1.9	1.7	1.5	1.3
Unemployment	3.3	3.8	5.0	5.6	6.9	5.0	5.2	5.3	5.4	5.5
House Price Inflation - change	4.3	3.3	1.7	1.1	(0.5)	4.2	3.4	3.1	2.9	2.7
Bank of England base rate	1.7	1.3	1.1	0.5	—	1.7	1.2	0.8	0.4	0.2
World GDP - change	3.6	3.2	2.7	2.5	2.3	2.9	2.7	2.6	2.5	2.4
Probability weight	12.8	17.0	30.0	25.6	14.6	5.0	15.0	60.0	15.0	5.0

Credit risk continued

Probability weightings of scenarios (audited)

The Group'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 has the following basic steps:

- Scenario selection – for 2018 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 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 GDP growth deviation from base and peak to trough falls in GDP. These measures are compared against a set of 1,000 model runs and it is established what percentile in the distribution most closely corresponds with each scenario.
- Probability assignment – having established the relevant percentile points, probability weights are assigned to ensure that the scenarios produce an unbiased result. If the severity assessment step shows the scenarios to be broadly symmetric, then this will result in a symmetric probability weighting (same probability weight above and below the base case, as was used in the first half of 2018). However if the downsides are not as extreme as the upsides, then more probability weight is allocated to the downsides to ensure the unbiasedness requirement is satisfied (as was the case in the second half of 2018). This adjustment is made purely to restore unbiasedness, not to address any relative skew in the distribution of risks in the economic outlook, which is dealt with through overlays and covered in the section on UK economic uncertainty.

UK economic uncertainty (audited)

The Group's 2018 results were prepared during the run up to the UK leaving the European Union, a period of elevated uncertainty over the UK economic outlook. The Group's approach to capturing that elevated uncertainty is to apply an overlay to ECL. Information is used from the earnings volatility scenario that is part of the 2018 planning process and credit risk appetite setting. Key elements include an alternative path the economy could take, being characterised as more severe than the Bank of England's "Disruptive Brexit" scenario (ACS) but less severe than the "Disorderly Brexit" scenario and then applying management judgement as to its likelihood. The overlay of £62 million booked in the third quarter of 2018 remained in place at the year end.

IFRS 9 credit risk modelling (audited)

IFRS 9 introduced lifetime ECL for the measurement of credit impairment. This required the development of new models or the enhancement of existing Basel models. IFRS 9 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 a significant increase in credit risk (SICR) criteria.

IFRS 9 ECL model design principles

To meet IFRS 9 requirements for ECL estimation, PD, LGD and 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.
- 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.

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. Due to data availability, two practical measures have been taken:

- Where model inputs were not available at the point of initial recognition the earliest available robust metrics were used. For instance, since Basel II was introduced in 2008, the earliest available and reliable production Basel PDs range from between December 2007 and April 2008 depending on the portfolio.
- Economic conditions at the date of initial recognition have been assumed to remain constant from that point forward.

PD estimates

Personal models

Personal PD models use an Exogenous, Maturity and Vintage (EMV) approach to model default rates by taking into account EMV effects. 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). This EMV methodology has been widely adopted across the industry because it enables forward-looking information to be modelled separately by isolating exogenous or macroeconomic effects. Forward-looking information is incorporated by fitting an appropriate macroeconomic model, such as the relevant stress testing model to the exogenous component and utilising forecasts of the relevant macro-economic factors.

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 current economic conditions across a comprehensive set of region/industry segments.

One year point-in-time PDs are then extrapolated to multi-year PDs using a conditional transition matrix approach. The conditional transition matrix approach allows the incorporation of forward-looking information, provided in the form of yearly CCI projections, by adjusting the credit state transition probabilities according to projected, forward-looking changes of credit conditions in each region/industry segment.

This results in forward-looking point-in-time PD term structures for each obligor from which the lifetime PD for a specific exposure can be calculated according to the exposure's residual contractual maturity.

LGD estimates

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

Personal

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

Wholesale

Current and forward-looking economic information is incorporated into the LGD estimates using the existing CCI framework. For low default portfolios (for example, sovereigns) loss data is too scarce to substantiate estimates that vary with systematic conditions.

Credit risk continued

Consequently, for these portfolios, LGD estimates are assumed to be constant throughout the projection horizon.

EAD estimates

Retail

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 estimated on the basis of credit conversion factor (CCF) models. The Group have observed historic, realised CCF values to vary over time but there is no clear relationship between the temporal changes in CCF and economic conditions. The Group attribute changes in CCFs to changes in exposure management practices.

Therefore the Group does not include forward-looking economic information into projected CCF/EAD. To ensure CCF values reflect most recent exposure management practices, the Group update CCF coefficients in the model frequently (typically annually) using the last five years of observed data.

Governance and post model adjustments

The IFRS 9 PD, EAD and LGD models are subject to the Group's model monitoring and governance frameworks, which include approving post model adjustments (PMAs) calculated to incorporate the most recent data available and made on a temporary basis ahead of the underlying model parameter changes being implemented. These PMAs totalled approximately £50 million at the year end primarily reflecting PD under-predictions of £48 million. In addition, as at 31 December 2018, judgemental ECL overlays on the UK PBB mortgage portfolio totalled £19 million, including £8 million in respect of the repayment risk not captured in the models that a proportion of customers on interest only mortgages will not be able to repay the capital element of their loan at end of term. The overlay for interest only mortgages was based on an analysis of recent experience on customer repayments pre and post end of term, and modelling that forward for maturities over the next ten years. These adjustments were over and above those covering economic uncertainty and non-linearity of losses discussed above and are also subject to over-sight and governance by the Provisions Committee.

Significant increase in credit risk (audited)

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). RBS 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 RBS and align to credit risk management practices.

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 Wholesale, 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 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 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 (audited)

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 SICR.
- 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 approximately £70 million.

The approach reflects the Group's practice of a credit-based review of customers prior to credit card issuance and complies with IFRS 9.

Credit risk continued

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 (audited)

The recognition and measurement of ECL is highly 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. Set out below is the impact of some of the material sensitivities considered for 2018 year end reporting. These ECL simulations are separate to the impact arising from MES as described earlier in this disclosure, which impacts are embedded in the reported ECL. Given the current benign environment for impairments the focus is on downsides to the existing ECL provision levels.

The focus of the simulations is on ECL provisioning requirements on performing exposures in Stage 1 and Stage 2. The simulations are run on a stand-alone basis and are independent of each other; the potential ECL uplifts reflect the simulated impact as at the year end balance sheet date.

As default is an observed event as at the balance sheet date, Stage 3 provisions are not subject to the same level of measurement uncertainty, and therefore have not been considered in this analysis. The following common scenarios have been applied across the key Personal and Wholesale portfolios.

- Economic uncertainty – simulating the impact arising from the Downside 2 scenario, which is one of the five discrete scenarios used in the methodology for Personal MES. In the simulation the Group have assumed that the economic macro variables associated with the Downside 2 scenario replace the existing base case economic assumptions, giving them a 100% probability weighting for Personal and using the Monte Carlo approach in Wholesale to simulate the impact of MES around the base case economic scenario.
- As reflected in the economic metrics in the following table, the Downside 2 scenario assumes a significant economic downturn in the UK in 2019 running in to 2020, with recovery in the later years. UK GDP turns negative in 2019 compared to the base case assumption of continued growth, unemployment increases and peaks at the end of 2020. House prices fall in both 2019 and 2020 before starting to recover, and interest rates are assumed to be lower for longer.

	Base case economic parameters					Downside 2 economic parameters				
	2019 Q4	2020 Q4	2021 Q4	2022 Q4	2023 Q4	2019 Q4	2020 Q4	2021 Q4	2022 Q4	2023 Q4
UK	%	%	%	%	%	%	%	%	%	%
GDP (year-on-year)	1.7	1.5	1.9	1.8	1.8	(1.2)	1.2	2.7	2.0	2.1
Unemployment rate	4.8	5.0	5.1	5.1	5.1	6.7	7.4	7.3	6.9	6.4
House Price Inflation (year-on-year)	1.1	0.7	1.5	2.3	3.4	(7.0)	(4.5)	1.0	4.1	6.3
Bank of England rate	1.0	1.0	1.3	1.3	1.3	—	—	—	—	—
World GDP (year-on-year)	2.7	2.4	2.9	2.7	2.5	(0.8)	3.1	4.4	3.2	2.8

This scenario has been applied to all modelled portfolios in the analysis below, with the simulation impacting both PDs and LGDs. For some portfolios this creates a significant impact on ECL, for others less so but on balance the impact is deemed reasonable. In this simulation, it is assumed the existing modelled relationship between key economic variables and loss drivers holds good.

- Portfolio risk – evaluation of the impact of a movement in one of the key metrics, PD, simulating a relative 25% upward shift in PDs.

These common scenarios were complemented with two specific portfolio simulations:

- Wholesale portfolios – simulating the impact of PDs moving upwards to the through-the-cycle (TTC) average from their current point-in-time (PIT) estimate. This simulation looks solely at PD movements, potential movements in LGD rates have not been considered. With the current benign economic conditions wholesale IFRS 9 PIT PDs are significantly lower than TTC PD. This scenario shows the increase to ECL by immediately switching to TTC PDs providing an indication of long run average expectations. IFRS 9 PDs have been used so there remains some differences to Basel TTC PDs where conservative assumptions are required, such as caps or floors, not permitted under the IFRS 9 best estimate approach.
- Mortgages – House Price Inflation (HPI) is a key economic driver and the Group have simulated a univariate scenario of a 5% decrease in HPI across the main mortgage portfolios. A univariate analysis using only HPI does not allow for the interdependence across the other key primary loss drivers to be reflected in any ECL estimate. The simulated impact is based on 100% probability weighting to demonstrate the sensitivity of HPI on the central base case. The Downside 2 scenario above has house prices falling by a more material amount, and also includes the impact of PD increases which are not captured under the HPI univariate simulation.

The Group's core criterion to identify a significant increase in credit risk is founded on PD deterioration, as discussed above. Under the simulations, PDs increase and result in exposures moving from Stage 1 to Stage 2 contributing to the ECL uplift.

Credit risk continued

Economic sensitivity analysis

	Actual position at 31 December 2018 Stage 1 and Stage 2 (1)			Common scenarios (3) Downside 2			25% PD increase			Discrete scenarios (3)		
	Exposure	of which in Stage 2	ECL provision (2)	Potential ECL uplift		Exposure in Stage 2	Potential ECL uplift		Exposure in Stage 2	HPI (4)/TTC PD (5) potential ECL uplift		Exposure in Stage 2
	£bn	%	£m	£m	%	%	£m	%	%	£m	%	%
UK PBB	128.6	8.0	457.5	133.5	29.2	10.3	135.5	29.6	9.3			
Of which: mortgages	*114.8*	*6.2*	*55.6*	—	—	—	—	—	—	*4.2*	*7.5*	*6.2*
Wholesale	137.6	4.5	141.0	45.8	32.5	9.7	32.8	23.3	5.7	62.2	44.1	8.6
Total	266.2	6.2	598.5	179.3	30.0	10.0	168.3	28.1	7.4			

Notes:
(1) Reflects drawn exposure and ECL for all modelled exposure in scope for IFRS 9; in addition to loans this includes bonds, and cash. The analysis excludes Personal exposures in the Private Banking segment.
(2) The ECL provision includes the ECL overlay taken in quarter 3 to recognise the elevated economic uncertainty in the UK in the period running up to the UK leaving the European Union.
(3) All simulations are run on a stand-alone basis and are independent of each other, with the potential ECL uplift reflecting the simulated impact at the year end balance sheet date at that time.
(4) HPI is applied to the most material mortgage portfolios only in UK PBB.
(5) TTC or long-run average PDs are applied to Wholesale portfolios only, excluding business banking exposures in PBB, the impact on which is included within the PBB portfolio for this analysis.

Key points

- In the Downside 2 scenario, the ECL requirement overall was simulated to increase by £179 million on Stage 1 and Stage 2 exposures from the current level of £599 million. The simulation estimates the balance sheet ECL requirement as at 31 December 2018 and assumes that the economic variables associated with the Downside 2 scenario had been the Group’s base case economic assumption.
- UK PBB segment, the simulated ECL uplift observed in the Downside 2 and 25% PD increase scenarios were similar. The impact on ECL at a product level under the Downside 2 scenario varied with mortgages observing a higher uplift percentage relative to unsecured products. Slightly more exposures moved to Stage 2 under the Downside 2 simulation.
- On the univariate HPI scenario, the impact of a 5% fall in house prices was relatively modest. The relationship between the required ECL and house price movements is expected to be non-linear should the level of house prices reduce by more material amounts, with the rate of loss accelerating when prices fall by more than 10%.
- Wholesale, the TTC PD scenario has the most significant impact on ECL highlighting that reverting to long run average PDs is more severe than a 25% increase in PDs or a switch to a downside scenario. Moving to TTC PDs requires an average PD uplift of over 40%.
- Downside 2 scenario results in more corporate exposure moving to Stage 2 than either the TTC PD or 25% PD increase scenarios. The impact is more concentrated on shorter dated exposure, reflecting the year 1 downturn, which has less of an impact on total ECL.

Credit risk – Banking activities
All the disclosures in this section are audited with the exception of Stage 2 analysis.

Introduction
This section covers the credit risk profile of the Group’s banking activities. Exposures and credit risk measures presented as of and for year ended 31 December 2018 and at 1 January 2018 are on an IFRS 9 basis. Exposures and credit risk measures as of and for the year ended 31 December 2017 are on an IAS 39 basis.

Refer to Accounting policy 13 and Note 13 on the accounts for revisions to policies and critical judgements relating to impairment loss determination.

Financial instruments within the scope of the IFRS 9 ECL framework (audited)
Refer to Note 10 on the accounts 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
Of the total third party £297.7 billion AC and FVOCI balance (gross of ECL), £295.9 billion or 99% was within the scope of the IFRS 9 ECL framework and comprised by stage: Stage 1 £276.2 billion; Stage 2 £16.7 billion and Stage 3 £3.0 billion. Total assets within IFRS 9 ECL scope comprised the following by balance sheet caption and stage:

- Loans: £211.2 billion of which Stage 1 £191.5 billion; Stage 2 £16.7 billion and Stage 3 £3.0 billion.
- Other financial assets: £84.7 billion of which Stage 1 £84.7 billion; Stage 2 nil and Stage 3 nil.

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 of £1.2 billion. These were assessed as having no ECL unless there was evidence that they were credit impaired.
- Group-originated securitisations, where ECL was captured on the underlying loans of £0.4 billion.
- 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 of £0.2 billion.

In scope assets also include £5.0 billion of inter-Group assets.

Contingent liabilities and commitments
In addition to contingent liabilities and commitments disclosed in Note 29 on the accounts – reputationally-committed limits are also included in the scope of the IFRS 9 ECL framework. These are offset by £1.8 billion 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.
Total contingent liabilities (including financial guarantees) and commitments within IFRS 9 ECL scope of £96.6 billion comprised Stage 1; £92.0 billion; Stage 2 £4.2 billion and Stage 3 £0.4 billion.

Credit risk – Banking activities continued

Portfolio summary – segment analysis (audited)

The table below summarises gross loans and ECL, by segment and stage, within the scope of the IFRS 9 ECL framework.

31 December 2018	UK PBB £m	Commercial Banking £m	Private Banking £m	Central items & other £m	Total £m	1 January 2018 £m
Loans - amortised cost						
Stage 1	118,429	54,463	13,089	5,497	191,478	178,078
Stage 2	10,317	5,876	506	33	16,732	14,288
Stage 3	1,385	1,419	185	16	3,005	2,605
Inter-Group	—	—	—	—	5,046	77,772
Total	130,131	61,758	13,780	5,546	216,261	272,743
ECL provisions (1)						
Stage 1	96	70	13	—	179	150
Stage 2	368	71	10	—	449	323
Stage 3	538	472	17	16	1,043	1,293
Inter-Group	—	—	—	—	1	17
	1,002	613	40	16	1,672	1,783
ECL provisions coverage (2,3)						
Stage 1 (%)	0.08	0.13	0.10	—	0.09	0.08
Stage 2 (%)	3.57	1.21	1.98	—	2.68	2.26
Stage 3 (%)	38.84	33.26	9.19	100.00	34.71	49.63
Inter-Group (%)	—	—	—	—	0.01	0.02
	0.77	0.99	0.29	0.29	0.77	0.91
ECL charge (4)						
Third party	251	204	(6)	(4)	445	
Inter-Group	—	—	—	—	(17)	
	251	204	(6)	(4)	428	
Impairment losses						
ECL loss rate - annualised (basis points)(4)	19.29	33.03	(4.35)	(7.21)	21.07	
Amounts written-off	401	204	7	—	612	

Notes:
(1) At 31 December 2018, ECL provisions in the above table are provisions on loan assets only. Other ECL provisions, not included above, relate to cash, debt securities and contingent liabilities, and amount to £7 million, of which FVOCI is £2 million.
(2) ECL provisions coverage is ECL provisions divided by loans - amortised cost.
(3) ECL provisions coverage and ECL loss rates are calculated on third party loans and related ECL provision and charge respectively.
(4) ECL charge balances in the above table include £2 million charge relating to other financial assets, of which £2 million charge relates to assets at FVOCI; and £17 million release relating to contingent liabilities.

The table below summarises gross loans (excluding reverse repos and intra-Group balances) and related credit metrics by segment on an IAS 39 basis.

2017 December	UK PBB £m	Commercial Banking £m	Private Banking £m	Central items & other £m	Total £m
Gross loans to banks	325	460	100	1,034	1,919
Gross loans to customers	124,549	55,831	12,747	201	193,328
Risk elements in lending (REIL)	1,225	1,157	83	18	2,483
Provisions	894	499	28	18	1,439
REIL as a % of gross loans to customers	1.0	2.1	0.7	9.0	1.3
Provisions as a % of REIL	73	43	34	100	58
Provisions as a % of gross loans to customers	0.7	0.9	0.2	9.0	0.7
Impairment losses	186	119	5	1	311

Key points

- UK PBB accounts for a higher proportion of total ECL provisions than the other businesses reflecting the size and mix of assets.
- On performing exposures (Stage 1 and Stage 2), materially higher ECL provision was held in credit deteriorated Stage 2 exposures than in Stage 1, in line with expectations. This was also reflected in provision coverage levels.
- Stage 3 cover is similar in both UK PBB and Commercial Banking, coverage by asset class is provided later in the report.
- The ECL charge for the year was £428 million inclusive of an inter-Group benefit of £17 million. This reflected the relatively stable external environment.

Credit risk – Banking activities continued

Portfolio summary – sector analysis

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

	Personal				Wholesale					Total
2018	Mortgages (1) £m	Credit cards £m	Other personal £m	Total £m	Property £m	Corporate £m	FI £m	Sovereign £m	Total £m	£m
Loans by geography	124,091	3,010	7,482	134,583	18,820	47,375	7,226	3,211	76,632	211,215
- UK	*123,591*	*3,010*	*7,249*	*133,850*	*18,335*	*42,129*	*2,379*	*2,200*	*65,043*	*198,893*
- RoI	*11*	—	*6*	*17*	*44*	*312*	*50*	—	*406*	*423*
- Other Europe	*100*	—	*67*	*167*	*292*	*2,834*	*3,227*	*848*	*7,201*	*7,368*
- RoW	*389*	—	*160*	*549*	*149*	*2,100*	*1,570*	*163*	*3,982*	*4,531*
Loans by stage and asset quality (2)	124,091	3,010	7,482	134,583	18,820	47,375	7,226	3,211	76,632	211,215
Stage 1	115,903	2,021	5,481	123,405	17,127	40,675	7,073	3,198	68,073	191,478
- AQ1-AQ4	*81,591*	*29*	*918*	*82,538*	*6,808*	*12,701*	*5,809*	*3,167*	*28,485*	*111,023*
- AQ5-AQ8	*34,285*	*1,988*	*4,518*	*40,791*	*10,313*	*27,957*	*1,264*	*31*	*39,565*	*80,356*
- AQ9	*27*	*4*	*45*	*76*	*6*	*17*	—	—	*23*	*99*
Stage 2	7,270	908	1,597	9,775	1,130	5,674	140	13	6,957	16,732
- AQ1-AQ4	*2,654*	*1*	*38*	*2,693*	*262*	*372*	*1*	*13*	*648*	*3,341*
- AQ5-AQ8	*4,047*	*865*	*1,414*	*6,326*	*830*	*5,069*	*138*	—	*6,037*	*12,363*
- AQ9	*569*	*42*	*145*	*756*	*38*	*233*	*1*	—	*272*	*1,028*
Stage 3	918	81	404	1,403	563	1,026	13	—	1,602	3,005
- AQ10	*918*	*81*	*404*	*1,403*	*563*	*1,026*	*13*	—	*1,602*	*3,005*
Loans - past due analysis (3,4)										
Total	124,091	3,010	7,482	134,583	18,820	47,375	7,226	3,211	76,632	211,215
- Not past due	*121,930*	*2,882*	*6,873*	*131,685*	*18,036*	*45,660*	*7,166*	*3,178*	*74,040*	*205,725*
- Past due 1-29 days	*1,008*	*47*	*140*	*1,195*	*192*	*1,154*	*46*	*33*	*1,425*	*2,620*
- Past due 30-89 days	*580*	*26*	*81*	*687*	*190*	*127*	*11*	—	*328*	*1,015*
- Past due 90-180 days	*209*	*20*	*49*	*278*	*36*	*64*	—	—	*100*	*378*
- Past due >180 days	*364*	*35*	*339*	*738*	*366*	*370*	*3*	—	*739*	*1,477*
Stage 2	7,270	908	1,597	9,775	1,130	5,674	140	13	6,957	16,732
- Not past due	*6,130*	*861*	*1,418*	*8,409*	*887*	*5,362*	*138*	*13*	*6,400*	*14,809*
- Past due 1-29 days	*672*	*29*	*105*	*806*	*62*	*208*	*1*	—	*271*	*1,077*
- Past due 30-89 days	*468*	*18*	*74*	*560*	*181*	*104*	*1*	—	*286*	*846*
Weighted average life *										
- ECL measurement (years)	4	2	3	3	3	3	2	4	3	3
Weighted average 12 months PDs *										
- IFRS 9 (%)	0.23	4.11	2.78	0.46	0.82	0.94	0.39	0.04	0.85	0.57
- Basel (%)	0.68	3.44	3.52	0.90	1.12	1.52	0.44	0.05	1.26	1.02
ECL provisions by geography	140	163	557	860	266	528	17	—	811	1,671
- UK	*140*	*163*	*557*	*860*	*245*	*446*	*15*	—	*706*	*1,566*
- RoI	—	—	—	—	*1*	*4*	—	—	*5*	*5*
- Other Europe	—	—	—	—	*18*	*26*	*1*	—	*45*	*45*
- RoW	—	—	—	—	*2*	*52*	*1*	—	*55*	*55*
ECL provisions by stage	140	163	557	860	266	528	17	—	811	1,671
- Stage 1	*9*	*27*	*48*	*84*	*23*	*67*	*5*	—	*95*	*179*
- Stage 2	*50*	*88*	*197*	*335*	*21*	*92*	*1*	—	*114*	*449*
- Stage 3	*81*	*48*	*312*	*441*	*222*	*369*	*11*	—	*602*	*1,043*
ECL provisions coverage (%)	0.11	5.42	7.44	0.64	1.41	1.11	0.24	—	1.06	0.79
- Stage 1 (%)	*0.01*	*1.34*	*0.88*	*0.07*	*0.13*	*0.16*	*0.07*	—	*0.14*	*0.09*
- Stage 2 (%)	*0.69*	*9.69*	*12.34*	*3.43*	*1.86*	*1.62*	*0.71*	—	*1.64*	*2.68*
- Stage 3 (%)	*8.82*	*59.26*	*77.23*	*31.43*	*39.43*	*35.96*	*84.62*	—	*37.58*	*34.71*
ECL charge - Third party	25	70	175	270	84	88	1	2	175	445
ECL loss rate (%)	0.02	2.33	2.33	0.20	0.45	0.19	0.01	0.06	0.23	0.21
Amounts written-off	23	61	260	345	86	178	4	—	268	612

* Not within audit scope.

For footnotes to this table refer to the following page.

Credit risk – Banking activities continued

Portfolio summary - sector analysis (audited)

2018	Personal Mortgages £m	Personal Credit cards £m	Personal Other personal £m	Personal Total £m	Wholesale Property £m	Wholesale Corporate £m	Wholesale FI £m	Wholesale Sovereign £m	Wholesale Total £m	Total £m
Other financial assets by asset quality (2)	—	—	—	—	—	11	5,082	79,610	84,703	84,703
- AQ1-AQ4	—	—	—	—	—	*10*	*4,533*	*79,610*	*84,153*	*84,153*
- AQ5-AQ8	—	—	—	—	—	*1*	*549*	—	*550*	*550*
Off-balance sheet	8,726	12,208	10,547	31,481	7,992	32,209	5,057	19,839	65,097	96,578
- Loan commitments	*8,726*	*12,208*	*10,547*	*31,481*	*7,687*	*30,279*	*4,923*	*19,839*	*62,728*	*94,209*
- Financial guarantees	—	—	—	—	*305*	*1,930*	*134*	—	*2,369*	*2,369*
Off-balance sheet by asset quality (2)	8,726	12,208	10,547	31,481	7,992	32,209	5,057	19,839	65,097	96,578
- AQ1-AQ4	*8,518*	*371*	*7,935*	*16,824*	*5,783*	*20,908*	*4,278*	*19,838*	*50,807*	*67,631*
- AQ5-AQ8	*203*	*11,618*	*2,604*	*14,425*	*2,146*	*11,164*	*779*	*1*	*14,090*	*28,515*
- AQ9	—	*3*	*8*	*11*	*4*	*27*	—	—	*31*	*42*
- AQ10	*5*	*216*	—	*221*	*59*	*110*	—	—	*169*	*390*

Notes:
(1) At 31 December 2018, mortgages include £0.7 billion secured lending in Private Banking, in line with ECL calculation methodology.
(2) AQ bandings are based on Basel PDs.
(3) 30 DPD – 30 days past due, the mandatory 30 days past due backstop as prescribed by the IFRS 9 guidance for significant increase in credit risk.
(4) Days past due – Personal products: at a high level, for amortising products, the number of days past due is derived from the arrears amount outstanding and the monthly repayment instalment. For credit cards, it is based on payments missed, and for current accounts the number of continual days in excess of borrowing limit. Wholesale products: the number of days past due for all products is the number of continual days in excess of borrowing limit.

Wholesale forbearance

The table below summarises Wholesale forbearance, Heightened Monitoring and Risk of Credit Loss by sector. Personal forbearance is disclosed on page 41.

2018	FI £m	Property £m	Other corporate £m	Total £m
Forbearance (flow)	13	144	1,216	1,373
Forbearance (stock)	13	236	1,600	1,849
Heightened Monitoring and Risk of Credit Loss	7	222	2,208	2,437
2017				
Forbearance (flow)	11	218	836	1,065
Forbearance (stock)	13	397	1,413	1,823
Heightened Monitoring and Risk of Credit Loss	35	374	2,092	2,501

Risk elements in lending

The table below summarises risk elements in lending by segment on an IAS 39 basis.

	UK PBB £m	Commercial Banking £m	Private Banking £m	Central items & other £m	Total £m
At 1 January 2017	1,488	892	94	3,597	6,071
Transfer from fellow subsidiaries	—	337	—	(61)	276
Currency translation and other adjustments	—	—	—	(2)	(2)
Additions	780	829	26	14	1,649
Transfers between REIL and potential problem loans	(98)	2	(5)	—	(101)
Transfers to performing book	(160)	(143)	—	(1)	(304)
Disposal of subsidiaries	—	—	—	(3,511)	(3,511)
Repayments and disposals	(385)	(590)	(28)	(15)	(1,018)
Amounts written-off	(400)	(170)	(4)	(3)	(577)
At 31 December 2017	1,225	1,157	83	18	2,483

Credit risk – Banking activities continued

Portfolio summary – sector analysis (audited)

Provisions

The table below summarises provisions by segment on an IAS 39 basis.

	UK PBB £m	Commercial Banking £m	Private Banking £m	Central items & other £m	Total £m
At 1 January 2017	1,072	412	28	1,251	2,763
Transfer from fellow subsidiaries	—	132	—	(32)	100
Disposal of subsidiaries	—	—	—	(1,200)	(1,200)
Amounts written-off	(400)	(170)	(4)	(3)	(577)
Recoveries of amounts previously written-off	62	10	—	1	73
Charge to the income statement from continuing operations	186	119	5	1	311
Unwind of discount - continuing operations	(26)	(4)	(1)	—	(31)
At 31 December 2017	894	499	28	18	1,439

Key points

- Geography – The vast majority of exposures were in the UK. Other exposures in Europe and the Rest of the World were mainly Wholesale. Mortgages accounted for a large proportion of the total exposure.
- Asset quality – Measured against the Group's asset quality scale, as at 31 December 2018, 54% of total lending exposure was rated in the AQ1-AQ4 bands. This equated to an indicative investment rating of BBB- or above. 63% of Personal lending exposure and 38% of Wholesale lending exposure was in the AQ1-AQ4 category respectively.
- Loans by stage – 91% of exposures were in Stage 1, with 8% in Stage 2 significantly credit deteriorated. Stage 3 assets, which align to AQ10, represented 1% of total exposures. In the Personal portfolio, in line with expectations, there were a higher proportion of unsecured lending assets in Stage 2 than in the mortgage portfolio. In the Wholesale portfolio, the proportion of assets in Stage 2, was slightly higher than in Personal overall.
- Drivers of movements to stage 2 – In Personal, the primary driver of exposures into Stage 2 credit deteriorated was PD deterioration, including persistence, contributing approximately 60%. High-risk back-stops, for example, forbearance and adverse credit bureau, provided additional valuable discrimination particularly in mortgages. Similarly in Wholesale, the primary driver of movements into Stage 2 was PD deterioration, approximately 55%, with risk of credit loss being the other major trigger.
- Loans – Past due analysis and Loans – Stage 2 – the vast majority of assets overall were not past due, with the Stage 2 classification driven primarily by changes in lifetime PD. (For further detail, refer to the Significant increase in credit risk section above). In other personal, the relatively high rate of exposures past due by more than 90 days reflected the fact that impaired assets can be held on balance sheet with commensurate ECL provision for up to six years after default.
- Weighted average 12 months PDs – In Wholesale, Basel PDs, which are based on a through-the-cycle approach, tend to be higher than point-in-time best estimate IFRS 9 PDs, reflecting the current state in the economic cycle, and also an element of conservatism in the regulatory capital framework. In Personal, the Basel PDs, which are point-in-time estimates, tend to be higher also reflecting conservatism, higher in mortgages than other products, and an element of default rate under-prediction in the IFRS 9 PD models. This has been mitigated by ECL overlays of approximately £48 million at the year end, pending model calibrations being implemented. The IFRS 9 PD for credit cards was higher than the Basel equivalent and reflected the relative sensitivity of the IFRS 9 model to forward-looking economic drivers.
- ECL provision by geography – In line with exposures by geography, the vast majority of ECL related to exposures in the UK.
- ECL provision by stage and coverage – The weight of ECL by value was in Stage 3 impaired, more so in Wholesale than Personal. Provision coverage was progressively higher by stage reflecting the lifetime nature of losses in both Stage 2 and Stage 3. In the Personal portfolio, provision coverage was materially lower on mortgages relative to credit cards and other personal reflecting the secured nature of the facilities. For Wholesale exposures, security and enterprise value mitigated against losses in Stage 3.
- The ECL charge for the year was £428 million inclusive of an inter-Group benefit of £17 million. This reflected the relatively stable external environment.
- Other financial assets by asset quality – Consisting almost entirely of cash and balances at central banks and debt securities, these assets were mainly within the AQ1-AQ4 category.
- Off-balance sheet exposures by asset quality – For Personal exposures, undrawn exposures are reflective of available credit lines on credit cards and current accounts. Additionally, in mortgages there is undrawn exposure, where a formal offer has been made to a customer but has not yet been drawn down. The asset quality distribution in mortgages is heavily weighted to the highest quality bands AQ1-AQ4 as it is in other personal in line with expectations, with credit card concentrated in the risk bands AQ5-AQ8. In Wholesale, the majority of undrawn exposure was in the AQ1-AQ4 bands and the majority of the remaining undrawn exposure within the AQ5-AQ8 bands.
- Forbearance – Completed forbearance flow in 2018 for Wholesale was £1.4 billion compared to £1.1 billion in 2017. Services, which is a diverse sector, saw an increase in forbearance of £304 million, from £201 million to £505 million and was the main driver of the increase. Of the forbearance that completed during the year, £0.7 billion related to payment concessions (2017 – £0.7billion) and £0.6 billion related to non-payment concessions (2017 – £0.3 billion). Forbearance stock remained stable with decreases in forborne exposure in the property and retail and leisure sectors, offset by the flow into services.
- Heightened Monitoring and Risk of Credit Loss – Exposure decreased from £2.5 billion at 31 December 2017, to £2.4 billion at 31 December 2018. There was also a decrease in the number of customers classified as Heightened Monitoring and Risk of Credit Loss during the year. Despite the current economic uncertainty in the UK, the portfolio has remained stable.

Credit risk – Banking activities continued
Portfolio summary – sector analysis (audited)
Loan sector concentration
The table below summarises gross loans to banks and customers (excluding reverse repos) and related credit metrics by sector, on an IAS 39 basis.

2017	Gross loans £m	REIL £m	Provisions £m	Credit metrics: REIL as a % of gross loans £m	Credit metrics: Provisions as a % of REIL %	Credit metrics: Provisions as a % of gross loans %	Impairment losses/ (releases) £m	Amounts written-off £m
Central and local government	1,491	—	—	—	—	—	—	—
Finance	2,670	6	3	0.2	50	0.1	—	4
Personal - mortgage (1)	118,047	433	79	0.4	18	0.1	(6)	8
- unsecured	10,505	658	545	6.3	83	5.2	186	295
Property	13,739	392	141	2.9	36	1.0	(27)	64
Construction	2,184	147	68	6.7	46	3.1	26	22
Of which: commercial real estate	*10,441*	*452*	*145*	*4.3*	*32*	*1.4*	*(28)*	*66*
Manufacturing	5,287	60	26	1.1	43	0.5	(1)	13
Finance leases and instalment credit	9,901	183	74	1.8	40	0.7	21	10
Retail, wholesale and repairs	7,574	186	92	2.5	49	1.2	37	49
Transport and storage	1,639	19	13	1.2	68	0.8	5	5
Health, education and leisure	6,424	219	95	3.4	43	1.5	54	27
Hotels and restaurants	3,112	71	32	2.3	45	1.0	(7)	31
Utilities	649	—	—	—	—	—	—	—
Other	10,106	109	61	1.1	56	0.6	14	49
Latent	—	—	210	—	—	—	9	—
Total customer	193,328	2,483	1,439	1.3	58	0.7	311	577
Total banks	79,845	—	—	—	—	—	—	—

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

Credit risk – Banking activities continued

Credit risk enhancement and mitigation(audited)

The table below summarises exposures of modelled portfolios within the scope of the ECL framework and related credit risk enhancement and mitigation (CREM). Excluded from this analysis are the non modelled portfolios, primarily Private Banking mortgage portfolio, the most material of the property collateralised portfolios, which are discussed in the Personal portfolio section, including loan-to-value ratios. Refer to Policy elections and simplifications relating to IFRS9 section for details on non-modelled portfolios.

	Gross		Maximum credit risk		CREM by type			CREM coverage		Exposure post CREM	
	exposure	ECL	Total	Stage 3	Financial (1)	Property	Other (2)	Total	Stage 3	Total	Stage 3
2018	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Financial assets											
Cash balances at central banks	44.3	—	44.3	—	—	—	—	—	—	44.3	—
Loans - amortised cost (3)	197.9	1.6	196.3	1.7	3.6	133.2	13.0	149.8	1.5	46.5	0.2
Personal (4)	124.0	0.8	123.2	0.8	—	115.0	—	115.0	0.7	8.2	0.1
Wholesale (5)	73.9	0.8	73.1	0.9	3.6	18.2	13.0	34.8	0.8	38.3	0.1
Debt securities	40.4	—	40.4	—	—	—	—	—	—	40.4	—
Total financial assets	282.6	1.6	281.0	1.7	3.6	133.2	13.0	149.8	1.5	131.2	0.2
Contingent liabilities and commitments											
Personal (6)	21.5	—	21.5	0.2	—	1.2	—	1.2	—	20.3	0.2
Wholesale	64.7	—	64.7	0.1	0.1	3.0	3.2	6.3	—	58.4	0.1
Total off balance sheet	86.2	—	86.2	0.3	0.1	4.2	3.2	7.5	—	78.7	0.3
Total exposures	368.8	1.6	367.2	2.0	3.7	137.4	16.2	157.3	1.5	209.9	0.5

Notes:
(1) Financial collateral includes cash and securities collateral.
(2) Other collateral 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 RBS a legal right to set off the financial asset against a financial liability due to the same counterparty.
(3) The Group 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. RBS obtains collateral in the form of securities in reverse repurchase agreements. Collateral values are capped at the value of the loan.
(4) Stage 3 mortgages exposures have relatively limited uncovered exposure reflecting the security held. On unsecured credit cards and other personal borrowing, the residual uncovered amount reflects historical experience of continued cash recovery post default through on-going engagement with customers.
(5) 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.
(6) At 31 December 2018, £0.2 billion of Personal Stage 3 balances primarily related to loan commitments, the draw down of which was effectively prohibited.

2017	Gross exposure £m	IFRS offset (1) £m	Carrying value £m	Balance sheet offset (2) £m	Exposure post credit offset (3) £m
Cash and balances at central banks	35,799	—	35,799	—	35,799
Derivatives	2,315	—	2,315	(115)	2,200
Loans - amortised cost	193,801	—	193,801	(6,149)	187,652
Amounts due from holding companies and fellow subsidiaries	77,926	—	77,926	(1,706)	76,220
Other financial assets	1,665	—	1,665	—	1,665
Total third party excluding disposal groups	311,506	—	311,506	(7,970)	303,536
Disposal groups	43,807	(19,512)	24,295	(233)	24,062
Total third party including disposal groups, gross of short positions	355,313	(19,512)	335,801	(8,203)	327,598
Short positions	(2,436)	—	(2,436)	—	(2,436)
Net of short positions	352,877	(19,512)	333,365	(8,203)	325,162

Notes:
(1) Relates to offset arrangements that comply with IFRS criteria and transactions cleared through and novated to central clearing houses, primarily London Clearing House and US Government Securities Clearing Corporation.
(2) This reflects the amounts by which the Group's credit risk is reduced through master netting and cash management pooling arrangements. Derivative master netting agreements include cash pledged with counterparties in respect of net derivative liability positions and are included in lending.
(3) The Group holds collateral in respect of net exposures above. For individual loans and advances to banks and customers, this collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant and equipment, inventories and trade debtors; and guarantees of lending from parties other than the borrower. The Group obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

Capital and risk management

Credit risk – Banking activities continued

Personal portfolio (audited)

Disclosures in the Personal portfolio section include drawn exposure (gross of provisions). Loan-to-value (LTV) ratios are split by stage under IFRS 9 at 31 December 2018 and by performing and non-performing status under IAS 39 at 31 December 2017.

	2018			2017		
Personal lending	UK PBB £m	Private Banking £m	Total £m	UK PBB £m	Private Banking £m	Total £m
Mortgages	115,126	8,505	123,631	110,423	7,889	118,312
Owner occupied	101,801	7,438	109,239	95,196	6,796	101,992
Buy-to-let	13,325	1,067	14,392	15,227	1,093	16,320
Interest only - variable	4,894	3,646	8,540	6,974	3,838	10,812
Interest only - fixed	10,341	3,435	13,776	10,594	2,711	13,305
Mixed (1)	4,255	—	4,255	4,131	—	4,131
Impairment provisions (2)	131	5	136	101	5	106
Other personal lending (3)	8,903	1,580	10,483	8,710	1,573	10,283
Impairment provisions (2)	702	17	719	631	15	646
Total personal lending	124,029	10,085	134,114	119,133	9,462	128,595
Mortgage LTV ratios						
- Total portfolio	57%	56%	57%	57%	55%	57%
- Stage 1	57%	55%	57%	57%	55%	57%
- Stage 2	59%	58%	59%			
- Stage 3	56%	58%	56%	57%	59%	57%
- Buy-to-let	53%	53%	53%	54%	54%	54%
- Stage 1	53%	53%	53%			
- Stage 2	57%	53%	57%			
- Stage 3	59%	67%	60%			
Gross new mortgage lending	27,884	1,741	29,625	27,566	2,105	29,671
Owner occupied exposure	27,004	1,590	28,594	25,916	1,776	27,692
Weighted average LTV	69%	62%	69%	70%	63%	70%
Buy-to-let	880	151	1,031	1,650	329	1,979
Weighted average LTV	61%	55%	60%	62%	56%	61%
Interest only variable rate	26	656	682	270	848	1,118
Interest only fixed rate	1,094	733	1,827	1,671	825	2,496
Mixed (1)	827	—	827	856	—	856
Mortgage forbearance						
Forbearance flow	285	11	296	276	31	307
Forbearance stock	817	8	825	823	7	830
Current	*437*	*6*	*443*	*494*	*6*	*500*
1-3 months in arrears	*227*	—	*227*	*192*	—	*192*
>3 months in arrears	*153*	*2*	*155*	*137*	*1*	*138*

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.
(2) 31 December 2018 data was prepared under IFRS 9. 31 December 2017 data was prepared under IAS 39.
(3) Excludes loans that are commercial in nature, for example loans guaranteed by a company and commercial real estate lending to Personal customers.

Key points (audited)

- Overall – The overall credit risk profile of the Personal portfolio, and its performance against credit risk appetite, remained stable during 2018.
- Total lending – Total mortgage lending grew by £5.3 billion with new lending partly offset by redemptions and repayments.
- New mortgage lending was similar to 2017. The existing mortgage stock and new business were closely monitored against agreed risk appetite parameters. These included loan-to-value ratios, buy-to-let concentrations, new-build concentrations and credit quality. Underwriting standards were maintained during the period.
- Owner occupied and buy-to-let – Most of the mortgage growth was in the owner-occupied portfolio. New mortgages in the buy-to-let portfolio remained subdued.
- LTVs – The mortgage portfolio loan-to-value ratio was stable.
- Interest only – By value, the proportion of mortgages on interest-only and mixed terms (capital and interest only) reduced, driven by fewer buy-to-let mortgages.
- Regional mortgage analysis – For UK PBB 45% of mortgage lending was in Greater London and the South East (31 December 2017 – 47%). The level of exposure in this region remained broadly unchanged, reflecting lower demand for buy-to-let properties as well as mortgage redemptions. The weighted average loan-to-value for these regions was 53% (31 December 2017 – 52%) compared to 57% for all regions.
- Provisions – As expected, total ECL – including ECL for unsecured lending – generally increased under the IFRS 9 methodology compared to provisions calculated under IAS 39.
- Other lending – Total unsecured balances were stable in 2018 with modest increases in PBB loan and credit card balances offset by a reduction in overdrafts. Overdraft balances have shown a modest decline year-on-year.
- Other lending asset quality – While the unsecured portfolio grew during 2018, credit quality remained stable, reflecting active portfolio management. Credit standards and controls were tightened across all three unsecured products to ensure that marginal performance remained within risk appetite.

Credit risk – Banking activities continued
Personal portfolio (audited)
Mortgage LTV distribution by stage
The table below summarises gross mortgage lending and related ECL by LTV band. Mortgage lending not within the scope of IFRS 9 ECL reflected portfolios carried at fair value.

UK PBB 2018	Drawn exposure - total book Stage 1 £m	Stage 2 £m	Stage 3 £m	Not within IFRS 9 ECL scope £m	Total £m	Of which: Gross new lending £m	Impairment provision Stage 1 £m	Stage 2 £m	Stage 3 £m	Total (1) £m	Provisions coverage (2) Stage 1 %	Stage 2 %	Stage 3 %	Total %
≤50%	37,349	2,297	305	141	40,092	4,476	1	9	35	45	—	0.4%	11.6%	0.1%
>50% and ≤70%	37,788	2,496	275	45	40,604	8,067	2	15	23	40	—	0.6%	8.4%	0.1%
>70% and ≤80%	18,193	1,131	84	14	19,422	7,095	1	8	6	15	—	0.7%	7.5%	0.1%
>80% and ≤90%	11,513	882	43	12	12,450	7,086	2	8	4	14	—	1.0%	9.7%	0.1%
>90% and ≤100%	2,124	126	13	7	2,270	987	—	3	2	5	—	2.5%	12.1%	0.2%
>100% and ≤110%	47	25	5	1	78	—	—	1	1	2	0.1%	4.7%	13.9%	2.4%
>110% and ≤130%	51	37	7	2	97	—	—	2	1	3	0.1%	5.2%	14.8%	3.1%
>130% and ≤150%	22	23	6	—	51	—	—	1	1	2	0.1%	6.2%	13.5%	4.4%
>150%	3	9	3	—	15	—	—	1	1	2	0.1%	6.2%	17.3%	7.2%
Total with LTVs	107,090	7,026	741	222	115,079	27,711	6	48	74	128	—	0.7%	9.9%	0.1%
Other	33	8	3	3	47	173	—	1	2	3	—	6.9%	57.5%	5.4%
Total	107,123	7,034	744	225	115,126	27,884	6	49	76	131	—	0.7%	10.1%	0.1%

UK PBB 2017	Drawn exposure - total portfolio Performing £m	Non-performing £m	Total £m	Of which: Gross new lending £m
≤50%	39,250	304	39,554	4,130
>50% and ≤70%	38,821	291	39,112	7,604
>70% and ≤80%	17,551	83	17,634	7,077
>80% and ≤90%	11,531	44	11,575	7,468
>90% and ≤100%	2,100	17	2,116	1,127
>100% and ≤110%	85	7	92	1
>110% and ≤130%	108	8	115	1
>130% and ≤150%	55	5	59	—
>150%	25	8	33	1
Total with LTVs	109,524	767	110,291	27,409
Other	123	9	132	158
Total	109,647	776	110,423	27,566

Notes:
(1) Excludes a non-material amount of provisions held on relatively small legacy portfolios.
(2) ECL provisions coverage is ECL provisions divided by drawn exposure.

Key point
- ECL coverage rates increase through the LTV bands; the value of exposures in the highest LTV bands is limited. The relatively high coverage level in the lowest LTV band included the effect of time-discounting on expected recoveries. Additionally, this also reflected the modelling approach that recognised an element of expected loss on mortgages that are not subject to formal repossession activity.

Credit risk – Banking activities continued

Commercial real estate (CRE)

The CRE portfolio comprises exposures to entities involved in the development of, or investment in, commercial and residential properties (including house builders but excluding housing associations, construction and building materials). The sector is reviewed regularly at senior executive committees. Reviews include portfolio credit quality, capital consumption and control frameworks. All disclosures in the CRE section are based on current exposure (gross of provisions and risk transfer). Current exposure is defined as: loans; the amount drawn under a credit facility plus accrued interest; contingent obligations; the issued amount of the guarantee or letter of credit; derivatives - the mark to market value, netted where netting agreements exist and net of legally enforceable collateral.

By sub sector	2018 £m	2017 £m
Investment		
Residential (1)	2,362	2,209
Office (2)	984	763
Retail (3)	1,802	1,747
Industrial (4)	1,209	1,094
Mixed/other (5)	1,901	2,585
	8,258	8,398
Development		
Residential (1)	1,501	1,564
Office (2)	4	12
Retail (3)	68	35
Industrial (4)	61	34
Mixed/other (5)	27	16
	1,661	1,661
Total (6)	9,919	10,059

Notes:
(1) Residential properties including houses, flats and student accommodation.
(2) Office properties including offices in central business districts, regional headquarters and business parks.
(3) Retail properties including high street retail, shopping centres, restaurants, bars and gyms.
(4) Industrial properties including distribution centres, manufacturing and warehouses.
(5) Mixed usage or other properties that do not fall within the other categories above. Mixed generally relates to a mixture of retail/office with residential.
(6) 98% (2017 – 99%) of the total exposure relates to the UK.

Key points

- Overall – The vast majority of the CRE portfolio is managed in the UK. Business appetite and strategy remain aligned across the segments.
- 2018 trends – Growth in the commercial property market slowed during 2018.
- Performance varied widely by sub-sector with strong growth from industrials contrasting with material decline in parts of the retail sector.
- Asset quality – The CRE retail portfolio had a low default rate, with a limited number of new defaults. The sub-sector was monitored on a regular basis and credit quality was in line with the wider CRE portfolio.
- Economics – Fundamentals such as rental incomes, property values and investor/occupier demand for other commercial sub-sectors appeared more robust, however, all are exposed to some degree to the risk of a disorderly exit from the EU. Conditions for the mainstream residential sector remained resilient, supported by mortgage availability and high levels of employment. However, the higher value end of the market was characterised by low transaction volumes.
- Risk appetite – Lending criteria for commercial real estate were at conservative levels, contributing to materially reduced leverage for new origination in London offices and parts of the retail sector.

Credit risk – Banking activities continued
Commercial real estate (CRE)
CRE LTV distribution by stage (audited)

The table below summarises CRE current exposure and related ECL by LTV band.

	Current exposure (gross of provisions) (1,2)					ECL provisions				ECL provisions coverage (4)			
2018	Stage 1 £m	Stage 2 £m	Stage 3 £m	Not within IFRS 9 scope (3) £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 %	Stage 2 %	Stage 3 %	Total %
≤50%	3,118	128	33	787	4,066	2	2	6	10	0.1%	1.2%	17.9%	0.3%
>50% and ≤70%	1,607	66	33	686	2,392	2	1	8	11	0.1%	1.2%	25.0%	0.7%
>70% and ≤80%	192	15	24	4	235	—	—	3	3	0.2%	2.6%	13.5%	1.7%
>80% and ≤90%	13	6	12	1	32	—	—	1	1	0.2%	0.7%	7.6%	3.1%
>90% and ≤100%	17	4	8	1	30	—	—	3	3	0.2%	3.5%	42.0%	11.8%
>100% and ≤110%	46	1	8	—	55	—	—	3	3	0.3%	2.4%	39.0%	5.7%
>110% and ≤130%	4	1	17	—	22	—	—	4	4	0.4%	5.3%	21.8%	17.5%
>130% and ≤150%	3	—	3	—	6	—	—	2	2	0.3%	7.4%	56.1%	29.9%
>150%	12	3	17	—	32	—	—	13	13	0.2%	2.3%	70.6%	37.4%
Total with LTVs	5,012	224	155	1,479	6,870	4	3	43	50	0.1%	1.4%	27.3%	0.9%
Total portfolio average LTV %	46%	50%	98%	47%	47%	—	—	—	—	—	—	—	—
Other (5)	1,402	109	49	(172)	1,388	3	4	30	37	0.2%	3.6%	61.6%	2.4%
Development (6)	1,292	125	90	154	1,661	6	2	41	49	0.4%	1.3%	45.8%	3.2%
Total	7,706	458	294	1,461	9,919	13	9	114	136	0.2%	1.9%	38.6%	1.6%

2017	Performing £m	Non-performing £m	Total £m
≤50%	3,874	44	3,918
>50% and ≤70%	2,536	73	2,609
>70% and ≤80%	81	33	114
>80% and ≤90%	68	22	90
>90% and ≤100%	47	15	62
>100% and ≤110%	26	18	44
>110% and ≤130%	20	20	40
>130% and ≤150%	28	10	38
>150%	69	29	98
Total with LTVs	6,749	264	7,013
Total portfolio average LTV %	49%	102%	51%
Other (5)	1,347	38	1,385
Development (6)	1,542	119	1,661
Total	9,638	421	10,059

Notes:
(1) CRE current exposure comprises gross lending, interest rate hedging derivatives and other assets carried at fair value that are managed as part of the overall CRE portfolio.
(2) The exposure in Stage 3 mainly related to legacy assets.
(3) Includes exposures relating to non-modelled portfolios and other exposures carried at fair value, including derivatives.
(4) The ECL provisions coverage calculation is ECL provisions divided by current exposure.
(5) Relates predominantly to business banking, rate risk management products and unsecured corporate lending.
(6) Relates to the development of commercial and residential properties. LTV is not a meaningful measure for this type of lending activity.

Credit risk – Banking activities continued

Flow statements (audited)

The ECL flow statements analyse the key elements that drive the movement of ECL and related income statement over the reporting period. The key themes are:

- The flow statements capture the changes in ECL as well as the changes in related financial assets used in determining ECL. 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.
- Financial assets presented in the flow statements 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) – these transfers 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 for the period (likewise there is an ECL benefit for accounts improving stage).
- Changes in risk parameters – captures 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. Note: other (P&L only items) only affects the income statement and does not impact the 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 amounts of ECL flows from Stage 3 to Stage 1 during the year. This does not however indicate that accounts can return from Stage 3 to Stage 1 directly. On a similar basis, flows from Stage 1 to Stage 3 were observed, however this also included legitimate transfers due to unexpected default events. The small number of write-offs in Stage 1 and 2 reflect the effect of staging at the start of the analysis period.
- The impact of model changes during 2018 were not material at total level or on the portfolios disclosed below.
- Inter-Group transfers were a feature of the ECL flows during 2018 as a result of ring-fencing related changes, but net to zero effect a RBS Group-wide level. Preparation for ring-fencing resulted in significant increases in short term exposures to banks and central governments – reflected as origination within other changes in net exposure in the flow statements.

	Stage 1		Stage 2		Stage 3		Total	
	Financial assets	ECL	Financial assets	ECL	Financial assets	ECL	Financial assets	ECL
Group total	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2018	207,456	160	16,110	318	3,149	1,305	226,715	1,783
Currency translation and other adjustments	645	—	11	3	6	(9)	662	(6)
Inter-Group transfers	2,529	2	731	18	65	25	3,325	45
Transfers from Stage 1 to Stage 2	(12,423)	(37)	12,423	37	—	—	—	—
Transfers from Stage 2 to Stage 1	8,995	116	(8,995)	(116)	—	—	—	—
Transfers to Stage 3	(427)	(3)	(1,173)	(74)	1,600	77	—	—
Transfers from Stage 3	138	9	388	34	(526)	(43)	—	—
Net re-measurement of ECL on stage transfer		(104)		195		314		405
Changes in risk parameters (model inputs)		19		56		78		153
Other changes in net exposure	59,923	25	(2,090)	(3)	(746)	(64)	57,087	(42)
Other (P&L only items - primarily fortuitous recoveries)		(1)		5		(75)		(71)
Income statement (releases)/charges		(61)		253		253		445
Amounts written-off	(2)	(2)	(12)	(12)	(598)	(598)	(612)	(612)
Other movements		(1)		(4)		(43)		(48)
At 31 December 2018	266,834	184	17,393	452	2,950	1,042	287,177	1,678
Net carrying amount	266,650		16,941		1,908		285,499	

The following flow statements provide insight into the material portfolios.

Personal

The following flow statements are at a portfolio level.

UK PBB - mortgages	Stage 1 Financial assets	Stage 1 ECL	Stage 2 Financial assets	Stage 2 ECL	Stage 3 Financial assets	Stage 3 ECL	Total Financial assets	Total ECL
At 1 January 2018	101,618	8	7,260	41	778	96	109,656	145
Transfers from Stage 1 to Stage 2	(3,802)	(1)	3,802	1	—	—	—	—
Transfers from Stage 2 to Stage 1	3,140	11	(3,140)	(11)	—	—	—	—
Transfers to Stage 3	(43)	—	(214)	(3)	257	3	—	—
Transfers from Stage 3	5	—	131	13	(136)	(13)	—	—
Net re-measurement of ECL on stage transfer		(10)		11		11		12
Changes in risk parameters (model inputs)		1		3		30		34
Other changes in net exposure	6,700	—	(570)	(3)	(154)	(8)	5,976	(11)
Other (P&L only items)		(1)		1		(5)		(5)
Income statement (releases)/charges		(10)		12		28		30
Amounts written-off	—	—	(1)	(1)	(22)	(22)	(23)	(23)
Other movements		(1)		(1)		(20)		(22)
At 31 December 2018	107,618	8	7,268	50	723	77	115,609	135
Net carrying amount	107,610		7,218		646		115,474	

Key points

- Overall ECL reduction was primarily driven by business-as-usual write-offs in Stage 3.
- Stage 1 ECL levels remained steady despite portfolio growth during 2018 as a result of modest PD reduction, with Stage 2 ECL showing an increase as a result of some additional forward-looking provisions being taken during the year.
- Transfers from Stage 3 back to the performing book were higher than those in Personal unsecured lending, due to the higher cure activity typically seen in mortgages.
- The increase in Stage 3 ECL changes in risk parameters reflected the monthly assessment of the loss requirement, capturing underlying changes in risk and forward-looking assessments.
- Write-off of any residual shortfall following the sale of a repossessed property typically occurs within five years, although this period can be longer, reflecting the ongoing support for customers who engage constructively with the Group.

Credit risk - Banking activities continued

Flow statements (audited)

	Stage 1		Stage 2		Stage 3		Total	
	Financial assets	ECL	Financial assets	ECL	Financial assets	ECL	Financial assets	ECL
UK PBB - Personal cards	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2018	2,008	37	714	70	73	52	2,795	159
Transfers from Stage 1 to Stage 2	(526)	(11)	526	11	—	—	—	—
Transfers from Stage 2 to Stage 1	530	35	(530)	(35)	—	—	—	—
Transfers to Stage 3	(26)	(1)	(62)	(14)	88	15	—	—
Transfers from Stage 3	—	—	2	1	(2)	(1)	—	—
Net re-measurement of ECL on stage transfer		(28)		47		46		65
Changes in risk parameters (model inputs)		(9)		(3)		(3)		(15)
Other changes in net exposure	(89)	3	257	14	(31)	—	137	17
Other (P&L only items)		—		1		2		3
Income statement (releases)/charges		(34)		59		45		70
Amounts written-off	(1)	(1)	(3)	(3)	(57)	(57)	(61)	(61)
Other movements		1		(1)		(4)		(4)
At 31 December 2018	1,896	26	904	87	71	48	2,871	161
Net carrying amount	1,870		817		23		2,710	

Key points

- Overall ECL remained steady. However, Stage 2 ECL increased primarily due to increased levels of Stage 2 inflows in the first half of the year. This was the result of activity to calibrate and refine the criteria used to identify significant increase in credit risk, with underlying performance stable.
- Transfers from Stage 2 to Stage 1 were higher than in other Personal portfolios, primarily due to the ECL assessment period being reset when cards are re-issued.
- ECL transfers from Stage 3 back to the performing book were relatively small as expected.
- The amounts in other (P&L only items) mainly reflected cash recoveries after write-off. These benefited the income statement without affecting ECL.
- Amounts written-off primarily represented charge-offs (analogous to write-off) which typically occurs after 12 missed payments, and also 2018 debt sale activity.

UK PBB - other personal unsecured								
At 1 January 2018	3,445	37	1,406	132	539	444	5,390	613
Transfers from Stage 1 to Stage 2	(1,140)	(15)	1,140	15	—	—	—	—
Transfers from Stage 2 to Stage 1	576	34	(576)	(34)	—	—	—	—
Transfers to Stage 3	(39)	(1)	(143)	(40)	182	41	—	—
Transfers from Stage 3	1	—	12	3	(13)	(3)	—	—
Net re-measurement of ECL on stage transfer		(28)		89		90		151
Changes in risk parameters (model inputs)		4		49		(2)		51
Other changes in net exposure	1,089	15	(274)	(8)	(78)	(5)	737	2
Other (P&L only items - primarily fortuitous recoveries)		—		(1)		(27)		(28)
Income statement (releases)/charges		(9)		129		56		176
Amounts written-off	(1)	(1)	(8)	(8)	(248)	(248)	(257)	(257)
Other movements		(1)		(2)		(14)		(17)
At 31 December 2018	3,931	44	1,557	196	382	303	5,870	543
Net carrying amount	3,887		1,361		79		5,327	

Key points

- Overall ECL reduction was mainly driven by debt sale activity and business-as-usual write-offs in Stage 3, both reflected in amounts written-off.
- Increases in Stage 2 reflected the underlying performance of recent new business growth maturing. Additionally, the ECL overlay for economic uncertainty contributed to the uplift captured in changes in risk parameters.
- The portfolio continued to experience cash recoveries after write-off, reported in other (P&L only items). This benefited the income statement without affecting ECL.
- Write-off occurs once recovery activity with the customer has been concluded and there are no further recoveries expected, but no later than six years after default.

Credit risk - Banking activities continued

Flow statements (audited)

UK PBB - business banking	Stage 1 Financial assets £m	Stage 1 ECL £m	Stage 2 Financial assets £m	Stage 2 ECL £m	Stage 3 Financial assets £m	Stage 3 ECL £m	Total Financial assets £m	Total ECL £m
At 1 January 2018	4,967	22	536	23	188	161	5,691	206
Transfers from Stage 1 to Stage 2	(574)	(3)	574	3	—	—	—	—
Transfers from Stage 2 to Stage 1	301	10	(301)	(10)	—	—	—	—
Transfers to Stage 3	(26)	(1)	(47)	(6)	73	7	—	—
Transfers from Stage 3	1	1	8	2	(9)	(3)	—	—
Net re-measurement of ECL on stage transfer		(10)		20		32		42
Changes in risk parameters (model inputs)		(5)		1		(8)		(12)
Other changes in net exposure	248	4	(26)	3	(27)	(19)	195	(12)
Other (P&L only items)		(1)		—		(29)		(30)
Income statement (releases)/charges		(12)		24		(24)		(12)
Amounts written-off	—	—	(1)	(1)	(60)	(60)	(61)	(61)
Other movements		—		—		(1)		(1)
At 31 December 2018	4,917	18	743	35	165	109	5,825	162
Net carrying amount	4,899		708		56		5,663	

Key points

- Overall ECL reduction was mainly driven by business-as-usual write-offs in Stage 3.
- Stage 2 ECL did increase during the year as a result of net Stage 2 inflows from Stage 1, partly driven by PD model refinements throughout the year.
- The portfolio continued to experience cash recoveries after write-off, reported in other (P&L only items). This benefited the income statement without affecting ECL.
- Write-off occurs once recovery activity with the customer has been concluded and there are no further recoveries expected, but no later than five years after default.

Wholesale

Commercial Banking	Stage 1 Financial assets £m	Stage 1 ECL £m	Stage 2 Financial assets £m	Stage 2 ECL £m	Stage 3 Financial assets £m	Stage 3 ECL £m	Total Financial assets £m	Total ECL £m
At 1 January 2018	50,450	39	5,721	38	1,294	508	57,465	585
Currency translation and other adjustments	204	—	9	(1)	7	(6)	220	(7)
Inter-Group transfers	2,840	1	774	22	62	25	3,676	48
Transfers from Stage 1 to Stage 2	(6,107)	(7)	6,107	7	—	—	—	—
Transfers from Stage 2 to Stage 1	4,352	24	(4,352)	(24)	—	—	—	—
Transfers to Stage 3	(234)	—	(699)	(11)	933	11	—	—
Transfers from Stage 3	124	7	235	15	(359)	(22)	—	—
Net re-measurement of ECL on stage transfer		(26)		24		133		131
Changes in risk parameters (model inputs)		31		9		61		101
Other changes in net exposure	904	3	(1,392)	(6)	(337)	(30)	(825)	(33)
Other (P&L only items)		(1)		3		3		5
Income statement charges		7		30		167		204
Amounts written-off	—	—	—	—	(204)	(204)	(204)	(204)
Other movements		—		—		(4)		(4)
At 31 December 2018	52,533	72	6,403	73	1,396	472	60,332	617
Net carrying amount	52,461		6,330		924		59,715	

Key points

- Stage 3 charges were mainly driven by a charge on new to default exposures where the ECL can increase significantly following an individual assessment.
- Stage 1 and Stage 2 changes to risk parameters largely reflected the increase in ECL for economic uncertainty and a change to the forward-looking modelling approach for point-in-time PDs, where PDs now revert to long run average after one year rather than five years.
- Inter-Group transfers reflected the impact of transfers completed in preparation of ring-fencing.

Capital and risk management

Credit risk – Banking activities continued
Flow statements (audited)

Private Banking	Stage 1 Financial assets £m	Stage 1 ECL £m	Stage 2 Financial assets £m	Stage 2 ECL £m	Stage 3 Financial assets £m	Stage 3 ECL £m	Total Financial assets £m	Total ECL £m
At 1 January 2018	12,381	17	395	9	253	24	13,029	50
Currency translation and other adjustments	12	—	1	2	—	—	13	2
Inter-Group transfers	23	—	—	—	—	—	23	—
Transfers from Stage 1 to Stage 2	(259)	(1)	259	1	—	—	—	—
Transfers from Stage 2 to Stage 1	91	2	(91)	(2)	—	—	—	—
Transfers to Stage 3	(59)	—	(8)	—	67	—	—	—
Transfers from Stage 3	6	—	1	—	(7)	—	—	—
Net re-measurement of ECL on stage transfer		(2)		3		1		2
Changes in risk parameters (model inputs)		(3)		(2)		2		(3)
Other changes in net exposure	1,087	—	(63)	(1)	(114)	(2)	910	(3)
Other (P&L only items)		—		—		(2)		(2)
Income statement releases		(5)		—		(1)		(6)
Amounts written-off	—	—	—	—	(7)	(7)	(7)	(7)
Other movements		—		—		(1)		(1)
At 31 December 2018	13,282	13	494	10	192	17	13,968	40
Net carrying amount	13,269		484		175		13,928	

Key points

- ECL reduced due to a combination of write-offs and impairment releases.
- The majority of the release was in Stage 1, due to a reduction in loss rates for retail exposures.
- Exposure increased in Stage 1 reflecting growth in the portfolio (primarily mortgages driven) with minimal ECL impact due to high credit quality.

Asset quality (audited)
Asset quality analysis is based on internal asset quality ratings which have ranges for the probability of default. Customers are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades across the Group map to both an asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across portfolios.

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. This relationship is established by observing S&P's default study statistics, notably the one year default rates for each S&P rating grade. A degree of judgement is required to relate the probability of default ranges associated with the master grading scale to these default rates given that, for example, the S&P published default rates do not increase uniformly by grade and the historical default rate is nil for the highest rating categories.

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

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

Credit risk continued

Key IFRS 9 terms and differences to the prior IAS accounting standard and regulatory framework (audited)

Attribute	IFRS 9	IAS 39	Regulatory (CRR)
Default/credit impairment	To determine the risk of a default occurring, management applies a default definition that is consistent with the Basel/regulatory definition of default. Assets that are defaulted are shown as credit impaired. RBS Group uses 90 days past due as a consistent measure for default across all product classes. The population of credit impaired assets is broadly consistent with IAS 39, though measurement differs because of the application of MES. Assets that were categorised as potential problems with no impairment provision are now categorised as Stage 3.	Default aligned to loss events, all financial assets where an impairment event had taken place – 100% probability of default and an internal asset quality grade of AQ10 – were classed as non-performing. Impaired financial assets were those for which there was objective evidence that the amount or timing of future cash flows had been adversely impacted since initial recognition.	A default shall be considered to have occurred with regard to a particular financial asset when either or both of the following have taken place: – RBS Group considers that the customer is unlikely to pay its credit obligations without recourse by the institution to actions such as realising security; – The customer is past due more than 90 days. For Personal exposures, the definition of default may be applied at the level of an individual credit facility rather than in relation to the total obligations of a borrower.
Probability of default (PD)	PD is the likelihood of default assessed on the prevailing economic conditions at the reporting date (point in time), adjusted to take into account estimates of future economic conditions that are likely to impact the risk of default; it will not equate to a long run average.	Regulatory PDs adjusted to point in time metrics were used in the latent provision calculation.	The likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon. For Wholesale, PD models reflect losses that would arise through-the-cycle; this represents a long run average view of default levels. For Personal, the prevailing economic conditions at the reporting date (point-in-time) are used.
Significant increase in credit risk (SICR)	A framework incorporating both quantitative and qualitative measures aligned to the RBS Group's current risk management framework has been established. Credit deterioration will be a management decision, subject to approval by governing bodies such as the Provisions Committee. The staging assessment requires a definition of when a SICR has occurred; this moves the loss calculation for financial assets from a 12 month horizon to a lifetime horizon. Management has established an approach that is primarily informed by the increase in lifetime probability of default, with additional qualitative measures to account for assets where PD does not move, but a high risk factor is determined	Not applicable.	Not applicable.
Forward-looking and multiple scenarios	The evaluation of future cash flows, the risk of default and impairment loss should take into account expectations of economic changes that are reasonable. More than one outcome should be considered to ensure that the resulting estimation of impairment is not biased towards a particular expectation of economic growth.	Financial asset carrying values based upon the expectation of future cash flows.	Not applicable.

Credit risk continued

Key IFRS 9 terms and differences to the prior IAS accounting standard and regulatory framework (audited)

Attribute	IFRS 9	IAS 39	Regulatory (CRR)
Loss given default (LGD)	LGD is a current assessment of the amount that will be recovered in the event of default, taking account of future conditions. It may occasionally equate to the regulatory view albeit with conservatism and downturn assumptions generally removed.	Regulatory LGD values were often used for calculating collective and latent provisions; bespoke LGDs were also used.	An estimate of the amount that will not be recovered in the event of default, plus the cost of debt collection activities and the delay in cash recovery. LGD is a downturn based metric, representing a prudent view of recovery in adverse economic conditions.
Exposure at default (EAD)	Expected balance sheet exposure at default. It differs from the regulatory method as follows: – It includes the effect of amortisation; and – It caps exposure at the contractual limit.	Based on the current drawn balance plus future committed drawdowns.	Models are used to provide estimates of credit facility utilisation at the time of a customer default, recognising that customers may make further drawings on unused credit facilities prior to default or that exposures may increase due to market movements. EAD cannot be lower than the reported balance sheet, but can be reduced by a legally enforceable netting agreement.
Date of initial recognition	The reference date used to assess a significant increase in credit risk is as follows. Term lending: the date the facility became available to the customer. Wholesale revolving products: the date of the last substantive credit review (typically annual) or, if later, the date facility became available to the customer. Retail Cards: the account opening date or, if later, the date the card was subject to a regular three year review or the date of any subsequent limit increases. Current accounts/overdrafts: the account opening date or, if later, the date of initial granting of overdraft facility or of limit increases.	Not applicable for impairment but defined as the date when the entity becomes a party to the contractual provisions of the instrument.	Not applicable.
Modification	A modification occurs when the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in derecognition. A modification requires immediate recognition in the income statement of any impact on the carrying value and effective interest rate (EIR) or examples of modification events include forbearance and distressed restructuring. The financial impact is recognised in the income statement as an impairment release/(loss).	Modification was not separately defined but accounting impact arose as an EIR adjustment on changes that were not derecognition or impairment events.	Not applicable.

Non-traded market risk

Definition

Non-traded market risk is the risk to the value of assets or liabilities outside the trading 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.

The following disclosures in this section are audited:
- Internal VaR.
- Foreign exchange risk.

Sources of risk

The Group's non-traded market risk largely comprises interest rate risk, credit spread risk and foreign exchange risk.

Interest rate risk

Non-traded interest rate risk (NTIRR) arises from the provision to customers of a range of banking products 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. For more detail, refer to page 51.

Credit spread risk

Credit spread risk arises from the potential adverse economic impact of a change in the spread between bond yields and swap rates, where the bond portfolios are accounted at fair value through equity.

Non-traded market risk continued

Foreign exchange risk

Non-traded foreign exchange risk arises from two main sources:

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

Key developments in 2018

- In 2018, the Group implemented a hedging programme for its structural exposures. Previously these were hedged at RBS Group level.
- The Group began to monitor its overall net interest earnings sensitivity to interest rate movements in 2018. Previously this sensitivity was monitored at RBS Group level.
- Structural foreign exchange exposures decreased in 2018, mainly as a result of transfers of investments in foreign operations to NatWest Markets.
- During 2018, as part of ring-fencing implementation, liquidity portfolios were transferred to the Group. This has increased the Group's credit spread risk profile.

Risk governance

Responsibility for identifying, measuring, monitoring and controlling market risk arising from non-trading activities lies with the relevant business. Oversight is provided by the Treasury Risk function, which reports into the Director of Financial Risk & Analytics.

Risk positions are reported monthly to the NatWest Holdings Executive Risk Committee and quarterly to the NatWest Holdings Board Risk Committee, as well as to the NatWest Holdings Asset & Liability Management Committee (monthly in the case of interest rate risk and quarterly in the case of foreign exchange risk).

Market risk policy statements set out the governance and risk management framework.

Risk appetite

The RBS Group's qualitative appetite is set out in the non-traded market risk appetite statement.

Its quantitative appetite is expressed in terms of exposure limits. These limits comprise both board risk measures (which are approved by the RBS Group Board on the recommendation of the Board Risk Committee) and key risk measures (which are approved by the ALCo).

The Group's limit framework comprises value-at-risk (VaR), stressed value-at-risk (SVaR), sensitivities and earnings-at-risk limits.

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

To ensure approved limits are not breached and that the Group remains within its risk appetite, triggers have been set such that if exposures exceed a specified level, action plans are developed and implemented.

For further information on risk appetite, refer to page 12.

Risk controls

For information on risk controls, refer to page 13.

Risk monitoring and mitigation

Interest rate risk

NTIRR factors are grouped into the following categories:

- Gap risk – arises from the timing of rate changes in non-trading book instruments. The extent of gap risk depends on whether changes to the term structure of interest rates occur consistently across the yield curve (parallel risk) or differentially by period (non-parallel risk).
- Basis risk – captures the impact of relative changes in interest rates for financial instruments that have similar tenors but are priced using different interest rate indices, or on the same interest rate indices but with different tenors.
- Option risk – arises from option derivative positions or from optional elements embedded in assets, liabilities and/or off-balance sheet items, where the Group or its customer can alter the level and timing of their cash flows. Option risk also includes pipeline risk.

Due to the long-term nature of many retail and commercial portfolios – and their varied interest rate repricing characteristics and maturities – net interest income is likely to vary from period to period, even if interest rates remain the same. New business originated in any period will alter the Group's interest rate sensitivity if the resulting portfolio differs from portfolios originated in prior periods, depending on the extent to which exposure has been hedged. To manage exposures within appetite, the Group aggregates its interest rate positions and hedges these externally using cash and derivatives (primarily interest rate swaps).

Credit spread risk

The Group's bond portfolios primarily comprise high-quality securities maintained as a liquidity buffer to ensure the Group can continue to meet its obligations in the event that access to wholesale funding markets is restricted. Additionally other high-quality bond portfolios are held for collateral purposes and to support payment systems.

Credit spread risk is monitored daily through sensitivities and VaR measures. The dealing authorities in place for the bond portfolios further mitigate the risk by imposing constraints by duration, asset class and credit rating. Exposures and limit utilisations are reported to senior management on a daily basis.

Foreign exchange risk

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

Non-traded market risk continued

Risk measurement

The market risk exposures arising as a result of the Group's retail and commercial banking activities are measured using a combination of value-based metrics (VaR and sensitivities) and earnings-based metrics. The following table presents one-day internal banking book VaR at a 99% confidence level, split by risk type.

Ring-fencing-related transfers were implemented over a period from 30 April 2018 to 30 June 2018. Therefore, the VaR disclosures below cover the half-year from 30 June 2018 to 31 December 2018. In addition, the period end position at 31 December 2017 is presented for information purposes, reflecting the Group's position prior to the transfers.

	For the six months ending 31 December 2018				30 June 2018	31 December 2017
	Average £m	Maximum £m	Minimum £m	Period-end £m	Period-end £m	Period-end £m
Interest rate	4.1	5.6	2.4	4.0	10.1	126.1
Euro	0.2	0.2	0.1	0.2	0.8	
Sterling	4.2	5.8	2.4	4.0	10.0	
US dollar	0.2	0.4	0.1	0.1	0.4	
Other	0.1	0.1	0.1	0.1	0.1	
Credit spread	59.9	78.2	48.8	78.2	48.4	0.5
Pipeline risk	0.6	1.0	0.3	0.3	0.4	0.4
Diversification (1)	—			(3.7)	(3.5)	(1.5)
Total	60.1	78.8	48.5	78.8	55.4	125.5

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

Key point

- The main component of the VaR is credit spread risk. VaR peaked at year-end, mainly driven by higher volatility in credit spreads due to economic uncertainty that affected the UK Gilts portfolio.

Structural hedging

The Group has the benefit of a significant pool of stable, non and low interest bearing liabilities, principally comprising equity and money transmission accounts. The RBS Group has a policy of hedging these balances, either by investing directly in longer-term fixed-rate assets (primarily fixed-rate mortgages) or by using interest rate swaps, in order to provide a consistent and predictable revenue stream from these balances.

Prior to 2018, the Group had exposure to longer-term fixed-rate assets (primarily fixed-rate mortgages), but it had not fully implemented the RBS Group policy. The RBS Group's structural hedge was managed at RBS Group level rather than at the Group level.

During 2018, the Group implemented a structural hedging programme. Interest rate swaps to support the Group's structural hedging requirements were novated from NatWest Markets Plc.

During 2018, subsidiary structural hedges relating to Coutts UK and Ulster Bank Limited were also transferred from NatWest Markets Plc to the Group.

At 31 December 2018, the Group's structural hedge had a notional of £112 billion with an average life of approximately three years. This includes a notional of £11 billion relating to Coutts UK and Ulster Bank Limited.

Interest rate risk

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

The Group uses VaR as its value-based approach and sensitivity of net interest income (NII) as its earnings-based approach.

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

Value-at-risk

VaR is a statistical estimate of the potential change in the market value of a portfolio (and, thus, the impact on the income statement) over a specified time horizon at a given confidence level. The Group's standard VaR metrics – which assume a time horizon of one trading day and a confidence level of 99% – are based on interest rate repricing gaps at the reporting date. Daily rate moves are modelled using observations from the last 500 business days. These incorporate customer products plus associated funding and hedging transactions as well as non-financial assets and liabilities. Behavioural assumptions are applied as appropriate.

The non-traded interest rate risk VaR metrics for the Group's retail and commercial banking activities are included in the banking book VaR table above. The VaR captures the risk resulting from mismatches in the repricing dates of assets and liabilities. It includes any mismatch between structural hedges and stable non and low interest-bearing liabilities such as equity and money transmission accounts as regards their interest rate repricing behavioural profile.

Sensitivity of net interest earnings

Net interest earnings are sensitive to changes in the level of interest rates because changes to coupons on some customer products do not always match changes in market rates of interest or central bank policy rates.

Earnings sensitivity to rate movements is derived from a central forecast over a 12-month period. A simplified scenario is shown below based on the period-end balance sheet (assuming that non-interest rate variables remain constant). Market-implied forward rates are used to generate the base case earnings forecast, which is then subject to interest rate shocks. The variance between the central forecast and the shock gives an indication of underlying sensitivity to interest rate movements.

The sensitivity of net interest earnings table shows the expected impact, over 12 months, to an immediate upward or downward change of 25 and 100 basis points to all interest rates. Yield curves are expected to move in parallel though interest rates are assumed to floor at zero per cent or, for euro rates, at the current negative rate.

Capital and risk management

Non-traded market risk continued

The main driver of earnings sensitivity relates to interest rate pass-through assumptions on customer products. The scenario also captures the impact of the reinvestment of maturing structural hedges at higher or lower rates than the base-case earnings sensitivity and mismatches in the repricing dates of loans and deposits.

However, reported sensitivities should not be considered a guide to future performance. They do not capture potential management action in response to sudden changes in the interest rate environment. Actions that could reduce NII sensitivity and mitigate adverse impacts are changes in pricing strategies on customer loans and deposits as well as hedging. Management action may also be targeted at stabilising total income taking into account non-interest income in addition to NII.

	Parallel shifts in yield curve			
2018	+25 basis points £m	-25 basis points £m	+100 basis points £m	-100 basis points £m
12 month interest earnings sensitivity	102	(141)	431	(518)

Sensitivity of fair value through other comprehensive income (FVOCI) to interest rate movements.

The Group holds most of the bonds in its liquidity portfolio at fair value. Valuation changes that are not hedged (or not in effective hedge accounting relationships) are recognised in FVOCI reserves. This is a significant component of credit spread risk as it relates to the difference in valuation between bonds and interest rate swaps.

The table below shows an estimate of the sensitivity of FVOCI reserves to a parallel shift in all rates. In this analysis, interest rates have not been floored at zero. Hedges are assumed to be fully effective. Hedge ineffectiveness would be expected to result in a portion of the reserve gains or losses shown below being recognised in P&L instead of reserves. Hedge ineffectiveness P&L is monitored and the effectiveness of fair value hedge relationships are regularly tested in accordance with IFRS requirements. A movement in the FVOCI reserve would have an impact on the CET1 capital in addition to tangible net asset value.

	Parallel shifts in yield curve			
2018	+25 basis points £m	-25 basis points £m	+100 basis points £m	-100 basis points £m
FVOCI reserves	(32)	32	(131)	121

Foreign exchange risk (audited)

The table below shows structural foreign currency exposures.

2018	Net investments in foreign operations £m	Net investment hedges £m	Structural foreign currency exposures £m
Euro	169	(159)	10
Swiss franc	(26)	—	(26)
Other non-sterling	267	(56)	211
	410	(215)	195
31 December 2017			
Euro	176	(120)	56
Swiss franc	449	—	449
Other non-sterling	698	21	719
	1,323	(99)	1,224

Key point

- The reduction in Swiss franc and other non-sterling exposures was mainly driven by the impact of ring-fencing transfers in 2018. Coutts & Co. Ltd. and NatWest Group Holdings Corporation were transferred from NWB Plc to NWM Plc.

Pension risk

Definition

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

Sources of risk

The Group has exposure to pension risk through its defined benefit schemes worldwide. The Main section of The Royal Bank of Scotland Group Pension Fund (the Main section) is the largest source of pension risk as NatWest Bank is the principal employer to the Main section with £43.8 billion of assets and £35.5 billion of liabilities at 31 December 2018 (2017 – £44.7 billion assets and £37.9 billion liabilities). Further detail on the Group's pension obligations can be found in Note 5 on the accounts.

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

Key developments in 2018

- A Memorandum of Understanding between the RBS Group and the Trustee of the Main section was reached in April 2018, which enabled RBS Group to bring the pension scheme into alignment with ring-fencing rules and reduce exposure to pension risk.
- The RBS Group made a £2 billion contribution to the Main section in H2 2018 and it was agreed this could be followed by up to a further £1.5 billion of dividend linked contributions to be paid from 2020, capped at £500 million per year.
- The contribution to the scheme facilitated a reduction in the risk profile of the fund, principally the sale of approximately £6 billion of quoted equity exposure and the purchase of further interest rate and inflation hedging.

Risk governance

The Pension Committee is chaired by the RBS Group Chief Financial Officer. It receives its authority from the RBS Group Executive Committee and formulates the RBS Group's view of pension risk. The Pension Committee is a key component of the RBS Group's approach to managing pension risk and it reviews and monitors risk management, asset strategy and financing issues on behalf of the RBS Group. It also considers investment strategy proposals from the Trustee. For further information on Risk governance, refer to page 11.

Risk appetite

The RBS Group maintains an independent view of the risk inherent in its pension funds. The Group has an annually reviewed pension risk appetite statement incorporating defined metrics against which risk is measured. The RBS Group undertakes regular pension risk monitoring and reporting to the RBS Group Board, the RBS Group Board Risk Committee and the Pension Committee on the material pension schemes that the RBS 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 RBS Group Executive Risk Committee and the RBS Group Board Risk Committee four times a year in the Risk Management Quarterly Report.

The RBS Group also undertakes stress tests and scenario analyses 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. 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 Group's and overall RBS Group stress test results.

NatWest Bank Plc is the principal employer of the Main scheme, and could be required to fund any deficit that arises.

Risk mitigation

The trustee has taken measures to mitigate inflation and interest rate risks, both by investing in suitable financial assets and by entering into inflation and interest rate swaps. The Main section also uses derivatives to manage the allocation of the portfolio to different asset classes and to manage risk within asset classes. The contribution made to the Main section also facilitated a £6 billion reduction in quoted equity exposure and an increase in interest rates and inflation hedging in 2018.

Compliance & conduct risk

Definition

Compliance risk is the risk that the behaviour of the 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 the 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 the 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. As set out in Note 29 on the accounts, the RBS Group and certain members of staff are party to legal proceedings and are subject to investigation and other regulatory action in the UK, the US and other jurisdictions.

Key developments in 2018

- An enhanced compliance and conduct risk framework was developed, setting minimum standards for the management and measurement of compliance and conduct risks across the RBS Group.
- Enhanced product monitoring and reporting was introduced.
- Controls, systems and processes were revised to ensure compliance with the UK's ring-fencing rules.
- PPI remediation continued in advance of the FCA's August 2019 deadline for claims (refer to Note 21 on the accounts).
- Work to address legacy GRG complaints continued. The process closed to new complaints in the UK on 22 October 2018.
- Product and pricing continued to be simplified for new and existing customers.

Risk governance

The RBS Group defines appropriate standards of compliance and conduct and ensures adherence to those standards through its risk management framework.

Risk appetite

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

Compliance and conduct risk continued

Risk controls
The RBS Group operates a range of controls to ensure its business is conducted in accordance with legal and regulatory requirements, as well as delivering good customer outcomes. A suite of policies addressing compliance and conduct risks set appropriate standards across RBS. 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 undertaken, as appropriate.

Risk monitoring and measurement
Compliance and conduct risks are measured and managed through continuous assessment and reporting to the RBS Group's senior risk committees and at RBS Group 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 the RBS Group with specific areas of focus in the customer-facing franchises and legal entities. Examples of mitigation include consideration of customer needs in business and product planning, targeted training, complaints management, as well as independent assurance activity. Internal policies help support a strong customer focus across the RBS Group. Independent assessments of compliance with applicable regulations are also carried out at a legal entity level.

Financial crime

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

Key developments in 2018
- In October 2018, the Federal Reserve Board terminated a Cease & Desist Order originally imposed in December 2013. The Order, which related to RBS Group and RBS plc's historical compliance with Office of Foreign Assets Control (OFAC) economic sanctions regulations, was terminated following a multi-year programme of work to establish a robust, sustainable OFAC Sanctions compliance framework.
- While the financial crime governance framework was strengthened during 2018 – along with the introduction of enhanced control effectiveness assurance processes, enhancements to existing risk assessment models, the introduction of a new Anti-Tax Evasion risk assessment; and improved monitoring controls and enhanced investigation processes – the journey of improvement continues.

Risk governance
Financial crime risk is principally governed through the Financial Crime Risk Executive Committee, which is chaired by the Chief Financial Crime Officer. The committee reviews and, where appropriate, escalates material risks and issues to the RBS Group Executive Risk Committee and the Group Board Risk Committee.

Risk appetite
The Group has no appetite to operate in an environment where systems and controls do not enable the Group to identify, assess, monitor, manage and mitigate financial crime risk. The Group's systems and controls must be comprehensive and proportionate to the nature, scale and complexity of its businesses. The Group has no tolerance to systematically or repeatedly breach relevant financial crime regulations and laws.

Risk mitigation
Through the financial crime framework, the Group 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 Group ensures that centralised expertise is available to detect and disrupt threats to the Group 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.

Risk controls
The Group operates a framework of preventative and detective controls designed to ensure the Group 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 RBS Group's senior risk committees and the Board. Quantitative and qualitative data is reviewed and assessed to measure whether financial crime risk is within the Group's risk appetite.

Operational risk

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

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

Key developments in 2018
- Risk provided oversight of several bank-wide programmes including the Transformation portfolio, structural reform, European Commission (EC) State Aid obligations and Brexit preparations.
- Key corporate structural reform milestones were delivered, including the implementation of the Financial Services Markets Act Part VII and migration activities to separate the ring-fence bank from the non ring-fenced bank.
- The Group is well positioned to deliver the activities required to support the Business Banking Switch Scheme that is due to commence in 2019, as part of the Group's final EC State Aid obligation.
- The Group has established an Innovation Risk Oversight team to provide bank-wide oversight of its innovation portfolio to help deliver safely and at pace
- The Group continued to review its well established incident management and coordination procedures to manage the persistent and evolving nature of information and cyber security risks.

Operational risk continued

- Internal security improvement programmes and controls were developed and strengthened to protect the Group and its customers. The Group uses proactive threat management and intelligence processes to identify, manage and mitigate credible threats.
- The Group continued to reduce and simplify its technology estate through strategic investment and Technology transformation initiatives in order to limit opportunities for hackers and fraudsters. Improvements in capability were also made to the Security Operations Centre, strengthening controls to prevent data leakage, enhance malware defences and management of user access to key systems.
- Internal training programmes ensure all employees are aware of the threats facing the Group and remain vigilant to unauthorised attempts to access systems and data.

Risk governance

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

The operational risk function, which is the second line of defence, delivers a robust operational risk management framework and culture across the Group.

The Operational Risk function is responsible for the execution and continuous improvement of the operational risk management framework.

The Operational Risk Executive Committee is responsible for reviewing operational risk exposure; identifying and assessing both current and emerging material operational risks; reviewing and monitoring the operational risk profile; and reviewing and approving material operational risk policy changes.

Risk appetite

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

The Group-wide operational risk appetite statement encompasses the full range of operational risks faced by its legal entities, franchises and functions, supported by board risk measures which, should the limit be breached, would impact on our ability to achieve business plans and threaten stakeholder confidence. Strategic measures and Group-wide material risks are reviewed at least annually and approved at Group Board.

Risk controls

The Control Environment Certification (CEC) process is a half yearly self-assessment by the CEO of the Group's business units, as well as the heads of the support and control functions, providing a view on the adequacy and effectiveness of the internal control environment in a consistent and comparable manner.

CEC covers material risks and the underlying key controls, including financial, operational and compliance controls, as well as supporting risk management frameworks. The CEC outcomes, including forward-looking assessments for the next two half-yearly cycles and progress on control environment improvements, are reported to the Board, Audit Committee and Board Risk Committee. They are also shared with external auditors.

Risk monitoring and measurement

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 the Group's Risk Directory. Risk assessments are refreshed at least annually to ensure they remain relevant and capture any emerging risks, with associated trigger processes to ensure risks are reassessed at key periods of change.

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

The Group uses the standardised approach to calculate its Pillar 1 operational risk capital requirement. This is based on multiplying three years' average historical gross income by coefficients set by the regulator based on business line. As part of the wider Internal Capital Adequacy Assessment Process an operational risk economic capital model is used to assess Pillar 2A, which is a risk-sensitive add-on to Pillar 1.The model uses historical loss data (internal and external) and forward-looking scenario analysis that is provided by Operational Risk to provide a risk-sensitive view of the Group's P2A capital requirement.

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

Refer to the Capital, liquidity and funding risk section for operational risk capital requirement figures.

Event and loss data management

The operational risk event and loss data management process ensures the Group captures and records operational risk loss events that meet defined criteria. Loss data is used for regulatory and industry reporting and is included in capital modelling when calculating economic capital for operational risk. The most serious events are escalated in a simple, standardised process to all senior management, by way of a Group Notifiable Event Process.

All losses and recoveries associated with an operational risk event are reported against their financial accounting date. A single event can result in multiple losses (or recoveries) that may take time to crystallise. Losses and recoveries with a financial accounting date in 2018 may relate to events that occurred, or were identified in, prior years. The Group purchases insurance against specific losses and to comply with statutory or contractual requirements.

Operational resilience

The Group manages and monitors operational resilience through its risk and control assessments methodology. As challenges to operational resilience become more demanding, given a hostile cyber environment and a greater focus on serving customers through digital platforms, the Group is working with supervisory authorities in the UK to ensure the provision of its products and services can be maintained regardless of the cause of disruption.

This is underpinned by setting, monitoring and testing tolerances for key business services, which define the amount of disruption that could be tolerated.

Risk mitigation

Risks are mitigated by applying key preventative and detective controls, an integral step in the risk assessment methodology which determines residual risk exposure. Control owners are accountable for the design, execution, performance and maintenance of key controls. Key controls are regularly assessed for adequacy and tested for effectiveness. The results are monitored and, where a material change in performance is identified, the associated risk is re-evaluated.

Capital and risk management

Business risk

Definition

Business risk is the risk that the Group does not have a strategy that is sufficiently well defined to provide clarity on its long-term ambitions to key internal and external stakeholders, or that it is not able to execute upon its chosen strategy as communicated to the market, regulators and other key stakeholders. The risk is that the Group does not deliver its expected business performance which could give rise to a deterioration in stakeholder trust and confidence and/or a breach of regulatory thresholds. The Group may not be able to execute its chosen strategy if there are material changes to its internal or external operating environment.

Sources of risk

Business risk arises as a result of the Group's exposure to the macro-economy (including economic and political factors), the competitive environment, regulatory and technological changes. In addition, internal factors such as the ability to deliver complex change, volatility in sales volumes, input costs, and other operational risks affect the Group's ability to execute its chosen strategic business plan as intended and thus contribute to business risk.

Key developments in 2018

- In preparation for ring-fencing the RBS Group completed a business restructure. The UK Personal & Business Banking and Commercial Banking business of NatWest Markets (formerly RBS plc renamed in 2018) were transferred to the Group.
- RBS Group also restructured the NatWest Markets Plc (former RBS plc) capital structure. The shares in NatWest Holdings Limited, which owns the ring-fenced sub-group, were distributed to RBS Group. This separated the ring-fenced sub-group from the non-ring-fenced entities, as required by ring-fencing legislation. RBS Group also transferred the customer interest rate and foreign exchange derivatives business of National Westminster Bank Plc to NatWest Markets Plc.
- NatWest Bank Plc entered into a Memorandum of Understanding with the Trustees of the Main Scheme of the RBS Group Pension Fund to address the historical funding weakness of the pension scheme, recognising a pre-tax £2.0 billion contribution against reserves and an equivalent reduction in CET1 capital.

Risk governance

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

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

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

Risk appetite

Risk Appetite defines the level and types of risk the Group is willing to accept in order to achieve its strategic objectives and business plans. The Group articulates its appetite for business risk through the implementation of qualitative risk appetite statements and quantitative risk measures at franchise and function level. These statements and measures help determine the level and types of business risk RBS is willing to accept.

Risk controls

For more information on risk controls, refer to page 13.

Risk monitoring and measurement

Business risk is identified and managed at the product and transaction level. Estimated revenue, costs and capital are key considerations in the design of any new product or in any new investment decision. Business risk is reported, assessed and challenged at every governance level within the organisation. Each franchise monitors its financial performance relative to plans and reports this on a regular basis to the finance directors of each franchise.

Risk mitigation

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

Reputational risk

Definition

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

Sources of risk

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

Key developments in 2018

- Metrics were reviewed and enhanced to help measure reputational risk across the Group.
- Risk appetite positions for countries and sectors identified as presenting heightened reputational risk continued to be reviewed and strengthened.

Risk governance

A reputational risk policy supports reputational risk management across the Group. Reputational risk committees review relevant issues at an individual franchise or entity level, while the RBS Group Reputational Risk Committee – which has delegated authority from the Executive Risk Committee – opines on cases, issues, sectors and themes that represent a material reputational risk to the RBS Group. The Board Risk Committee oversees the identification and reporting of reputational risk. The Sustainable Banking Committee has a specific focus on environmental, social and ethical issues.

Risk appetite

The Group manages and articulates its appetite for reputational risk through a qualitative reputational risk appetite statement and quantitative measures. The Group seeks a continued improvement in the identification, assessment and management of customers, transactions, products and issues that present a material reputational risk.

Risk controls

For more information on risk controls, refer to page 13.

Risk monitoring and measurement

Primary reputational risk measures are in place to assess internal activity relating to the management of reputational risk, including training. A number of secondary risk measures – including measures also used in the management of operational, conduct and financial risks – are used to assess relevant external factors. Quarterly reports on performance against these measures are provided to the Executive Risk Committee and Board Risk Committee.

Risk mitigation

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

The most material threats to the Group's reputation continued to originate from historical and more recent conduct issues. As a result, the Group has been the subject of investigations and reviews by a number of regulators and governmental authorities, some of which have resulted in fines, settlements and public censure. Refer to the Litigation, investigations and reviews section of Note 29 on the accounts.

Report of the directors

The directors present their report together with the audited accounts for the year ended 31 December 2018.

Other information incorporated into this report by reference can be found at:

	Page/Note
RBS Group ring-fencing	1
Board of directors and secretary	2
Financial review	4
Segmental analysis	Note 4
Share capital and reserves	Note 22
Post balance sheet events	Note 38
Risk factors	132

Group structure
National Westminster Bank Plc (the 'Bank') is a wholly-owned subsidiary of NatWest Holdings Limited ('NWH Ltd', 'NatWest Holdings' or the 'intermediate holding company'). The ultimate holding company is The Royal Bank of Scotland Group plc ('RBSG' or the 'ultimate parent company), which is incorporated in Great Britain and has its registered office at 36 St Andrew Square, Edinburgh EH2 2YB. The 'Group' or 'NatWest Group' comprises the Bank and its subsidiary and associated undertakings. Details of the principal subsidiary undertakings and their activities are shown in Note 15 on the accounts. A full list of related undertakings of the Bank is shown in Note 39 on the accounts. 'RBS Group' comprises The Royal Bank of Scotland Group plc (the 'ultimate holding company') and its subsidiary and associated undertakings.

The financial statements of The Royal Bank of Scotland Group plc can be obtained from RBS Corporate Governance and Regulatory Affairs, RBS Gogarburn, Edinburgh, EH12 1HQ, the Registrar of Companies or through the RBS Group's website rbs.com.

Strategic report
Activities
The Group is engaged principally in providing a wide range of banking and other financial services.

Results and dividends
The profit attributable to the ordinary shareholders of the Group for the year ended 31 December 2018 was £2,619 million compared with a profit of £2,065 million for the year ended 31 December 2017, as set out in the consolidated income statement on page 72.

The Bank paid an ordinary dividend to RBSG in 2018 totalling £292 million. No dividend was paid in 2017.

Employees
As at 31 December 2018, the Group employed 56,800 people (full-time equivalent basis, including temporary workers). Details of related costs are included in Note 3 on the consolidated accounts.

Following the completion of the ring-fencing exercise, the Bank provides the majority of shared services (including technology) and operational processes under Intra-Group Agreements.

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

Our Values, which guide the way the 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 bank-wide Code of Conduct).

Engaging colleagues
Engaging colleagues is crucial to achieving RBS Group's ambition. Every year colleagues are asked to share their thoughts on what it's like to work for the RBS Group via a colleague opinion survey. The results from the 2018 survey are the most positive ever reported since engagement started to be measured in 2002. All key measures have improved and the RBS Group is now above the global financial norms in all comparable survey categories. The continued strengthening of the culture in the RBS Group was also echoed in this year's improved Banking Standards Board assessment which provided further proof of progress across a range of measures.

Rewarding employees
The RBS Group's approach to performance management provides clarity for employees about how their contribution links to the RBS Group's ambition.

The RBS Group has made further progress on making sure employees are paid fairly for the work they do with simple and transparent pay structures, and in the UK the RBS Group's rates continue to exceed the Living Wage. More information can be found on page 62 of the 2018 Annual Report and Accounts of the RBS Group.

Developing colleagues
The RBS Group offers a wide range of additional learning opportunities. In 2018 the NextGen talent development programme was launched for high-potential colleagues at managerial level, helping them become the future leaders the RBS Group will need.

There is also a range of Female Development Programmes supporting women to reach their full potential, and helping the RBS Group in the aspiration to be fully gender balanced by 2030.

2018 also saw Sales Excellence, the RBS Group's bank-wide sales programme, get underway, teaching the tools and techniques that enable those in sales roles to be the best at ethical, needs-based selling. More information can be found on page 15 of the 2018 Annual Report and Accounts of the RBS Group and on the Sustainable Banking pages on rbs.com.

Youth Employment
In 2018, the RBS Group welcomed 516 people across the Graduate and Apprenticeship schemes as well as around 150 Interns into internship programmes.

Health and wellbeing of colleagues
As a strong component of making the RBS Group a great place to work, wellbeing has successfully delivered against three pillars – physical, mental, and social; and in 2018 built momentum on the fourth pillar, financial wellbeing. Further details can be found on page 16 of the 2018 Annual Report and Accounts of the RBS Group and on the Sustainable Banking pages on rbs.com.

Employee consultation
The RBS Group recognises employee representatives such as trade unions and work councils in a number of businesses and countries, and management regularly discuss developments and updates on the progress of its strategic plans with the European Employee Council (EEC). The RBS Group has ongoing engagement and discussion with those bodies given the scale of change taking place across the RBS Group.

Colleague Voice
In response to changes which have been made to the UK Corporate Governance Code, the RBS Group has established a Colleague Advisory Panel ("the Panel") which is chaired by Lena Wilson, Non-executive Director. The purpose of the Panel is to promote greater colleague voice in the boardroom and provide an additional way for the Board to engage directly with colleagues. The Panel consists of existing employee representatives (e.g. Unite, Financial Services Union (FSU), EEC, Employee Led Networks, Junior Management/Colleague Focus Groups and colleagues who have volunteered to be involved). Colleagues from locations outside of the UK and Ireland also sit on the Panel to ensure a broad, diverse range of views. In total, there are approximately 20 colleagues (or their representatives) who attend each Panel meeting. The Panel does not duplicate existing methods to inform and consult, in particular with employee representatives, focusing instead on broader strategic issues facing the RBS Group. The design of the Panel has been built around having two-way dialogue with clear outputs from the sessions and follow-up to ensure it is viewed as a valuable addition to existing colleague voice methods. More detail can be found on page 14 of the 2018 Annual Report and Accounts of the RBS Group.

Inclusion
Building a more inclusive RBS Group is essential for customers and colleagues. The ambition to be number one for customer service, trust and advocacy will only be achieved by understanding the needs of all colleagues and customers.

The RBS Group's inclusion guidelines apply to all colleagues globally and cover being LGBT Innovative, Gender Balanced, Disability Smart, Ethnically Diverse, all leading to Inclusive Culture. Detailed information can be found on page 16 of the 2018 Annual Report and Accounts of the RBS Group and on the Sustainable Banking pages on rbs.com.

Report of the directors

The RBS Group has been recognised for work on Equality, Diversity and Inclusion in 2018 by retaining position in the Times Top 50 Employers for Women; being recognised again as a Top 10 Employer for Working Families; being rated as an Exemplary Level Employer by Carer Positive Scotland; being named a Stonewall Global Diversity Champion; being Platinum Ranked by Business in the Community for both Gender and Ethnicity work; and being upgraded to Gold Rated Disability Standard for the Business Disability Forum. The RBS Group was also proud to be named Employer of the Year by Women in Finance 2018.

Going concern

The Group's business activities and financial position, the factors likely to affect its future development and performance and its objectives and policies in managing the financial risks to which it is exposed, and its capital are discussed in the Business review. The risk factors which could materially affect the Group's future results are set out on pages 132 to 141. The Group's regulatory capital resources and significant developments in 2018, and anticipated future developments are detailed in the Capital, liquidity and funding section on pages 17 to 24. This section also describes the Group's funding and liquidity profile, including changes in key metrics and the build up of liquidity reserves.

Having reviewed the Bank's forecasts, projections and other relevant evidence, the directors have a reasonable expectation that the Bank will continue in operational existence for the foreseeable future. Accordingly, the financial statements of the Bank have been prepared on a going concern basis.

Corporate governance

Internal control over financial reporting

The internal controls over financial reporting for the Group are consistent with those at the RBS Group level. The Group has designed and assessed the effectiveness of its internal control over financial reporting as of 31 December 2018 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 Group Audit Committee along with management's remediation plans.

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

Double Independent Non-Executive Directors

An integral part of our ring-fencing governance arrangements is the appointment of "Double Independent Non-Executive Directors" or "DINEDs" to the NWH Ltd sub-group boards (NWH Ltd, the Bank, Ulster Bank Limited and The Royal Bank of Scotland plc), and board committees.

The DINEDs are independent in two respects: (i) independent of management as non-executives; and (ii) independent of the rest of the RBS Group by virtue of their NWH Ltd sub group-only directorships. They play a critical role in our ring-fencing governance structure, with an enhanced role in managing any conflicts which may arise between the interests of NWH Ltd and RBSG. The DINEDs attend RBSG Board meetings in an observer capacity.

On 30 April 2018 Yasmin Jetha stood down as a director of RBSG allowing her to assume DINED status. A further 3 DINEDs were appointed to the NWH Ltd sub-group boards with effect from 1 May 2018: Francesca Barnes, Graham Beale and Ian Cormack.

Board of directors

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 the 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 includes key aspects of the Group's affairs reserved for the Board's decision and are reviewed at least annually.

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

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

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

The governance arrangements for the committees have been designed to enable RBSG to exercise appropriate oversight and to ensure that, as far as is reasonably practicable, the NWH Ltd sub-group is able to take decisions independently of the wider RBS Group. The Audit, Performance & Remuneration, Nominations and Executive Committees of NWH Ltd operate as the Audit, Performance & Remuneration, Nominations and Executive Committees of each of, NWH Ltd, the Bank, Ulster Bank Limited and The Royal Bank of Scotland plc, with meetings running concurrently.

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

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

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

The Nominations Committee comprises four non-executive directors, and is chaired by the Chairman of the Bank. 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 Chief Executive Officer in managing the Bank's businesses. It is responsible for managing and overseeing strategic, financial capital, risk and operational issues.

Directors

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

All directors of the Bank are required to stand for election or re-election at the Annual General Meeting.

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 2018 are shown in the Corporate governance, Annual report on remuneration section of the

2018 Annual Report and Accounts of the RBS Group. 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 any of the subsidiaries of the Bank, during the period from 1 January 2018 to 14 February 2019.

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 Group'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.

Political donations
During 2018, no political donations were made in the UK or EU, nor any political expenditure incurred in the UK or EU.

Directors' disclosure to auditors
Each of the directors at the date of approval of this report confirms that:
(a) so far as the director is aware, there is no relevant audit information of which the bank's auditors are unaware; and
(b) the director has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the bank's auditors are aware of that information.

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

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

By order of the Board

Aileen Taylor
Company Secretary
14 February 2019

National Westminster Bank Plc
is registered in England No. 929027

Statement of directors' responsibilities

This statement should be read in conjunction with the responsibilities of the auditor set out in their report on pages 63 to 71.

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

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

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

The directors confirm that to the best of their knowledge:

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

By order of the Board

Howard Davies
Chairman

Ross McEwan
Chief Executive

Katie Murray
Chief Financial Officer

14 February 2019

Board of directors

Chairman
Howard Davies

Executive directors
Ross McEwan
Katie Murray
Alison Rose-Slade

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
Dr Lena Wilson

Financial statements

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

Opinion

We have audited the financial statements (see table below) of National Westminster Bank Plc (the Bank) and its subsidiaries (together, the 'Group') for the year ended 31 December 2018. In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Bank affairs as at 31 December 2018 and of the Group's profit for the year then ended;
- the financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Bank financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of National Westminster Bank Plc which comprise:

Group	Bank
• Consolidated balance sheet as at 31 December 2018; • Consolidated income statement for the year then ended; • Consolidated statement of comprehensive income for the year then ended; • Consolidated statement of changes in equity for the year then ended; • Consolidated cash flow statement for the year then ended; • Related Notes 1 to 39 to the financial statements; • Accounting Policies; and • Capital and risk management section of the Strategic report identified as 'audited'.	• Balance sheet as at 31 December 2018; • Statement of changes in equity for the year then ended; • Cash flow statement for the year then ended; and • Related Notes 1 to 39 to the financial statements which refer to the Bank.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the Bank financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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 Group and Bank 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 listed 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

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

- 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 Group's or the Bank'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.

Separate opinion in relation to IFRSs as issued by the IASB

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

Key audit matters

Key audit matters are those matters that, in our professional judgment, 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.

Risk	Our response to the risk
Provisions for conduct, litigation and regulatory matters, customer remediation and claims	
The continued litigious environment and heightened regulatory scrutiny gives rise to a high level of judgement in determining appropriate provisions and disclosures. At 31 December 2018, the Group has reported £1.1 billion (2017: £1.4 billion) of provisions for liabilities and charges, including £0.7 billion (2017: £1.1 billion) conduct and litigation claims, including Payment Protection Insurance (PPI) and the Financial Conduct Authority (FCA) review of the Group's treatment of Small and Medium-sized Enterprises (SMEs) in Note 21 of the financial statements. Management judgement is needed to determine whether an obligation exists and a provision should be recorded at 31 December 2018 in accordance with the accounting criteria set under IAS 37. The most significant areas of judgement are: • Adequacy of provisions: judgement is involved in the determination of whether an outflow in respect of identified material conduct or legal matters are probable and can be estimated reliably and the appropriateness of assumptions and judgements used in the estimation of material provisions; and • Adequacy of disclosures of provision for liabilities and charges and contingent liabilities.	We tested the design and operating effectiveness of key controls over the identification, estimation, monitoring and disclosure of provisions considering the potential for management override of controls. The controls tested included those designed and operated by management to identify and monitor claims, and to assess the completeness and accuracy of data used to estimate provisions. We examined the relevant regulatory and legal correspondence to assess developments in key cases. For the cases which were settled during the period, we verified the actual outflows, compared with the level of existing provision, considered whether further risk existed, and evaluated the level of disclosures provided. For the significant provisions made, such as PPI and the FCA review of RBS's treatment of SMEs, we understood, assessed and challenged the provisioning methodology. We tested the underlying data and assumptions used in the determination of the provisions recorded, including expected claim rates, legal costs, and the timing of settlement. We also considered the accuracy of management's historical estimates and peer bank settlements in similar cases. We also developed our own range of reasonable alternative estimates and compared them to management's provision. We received confirmations from the Group's external counsel for significant matters to confirm the existence of the obligation and management's estimate of the outflow at year-end. We corroborated management's conclusion by challenging the underlying information used in estimating the provisions including consideration of alternate sources. We considered regulatory developments and, for key cases, assessed the reasonableness of the assumptions used by management by comparing to the results of our independently performed benchmarking and sensitivity analysis. Where appropriate, we involved our conduct risk specialists. We also verified historical data and whether it supported current estimates. We tested the disclosures provided on conduct, litigation and regulatory provisions to determine whether they complied with accounting standards. Given the inherent estimation uncertainty and the judgmental nature of these provisions, we evaluated the appropriateness of the disclosure made in the financial statements.

Key observations communicated to the Audit Committee

We are satisfied that the Group's provisions for conduct, litigation and regulatory matters, customer remediation and claims are within a reasonable range and recognised in accordance with IFRS. We did not identify any material unrecorded provisions.
We highlighted the following matters to the Audit Committee:

- The PPI provision remains sensitive to key assumptions, the most significant of which is future complaint volumes. Management's estimate was within our range of outcomes based on reasonable alternative assumptions; and
- The provision related to the FCA review of the Group's treatment of SMEs is sensitive to a number of assumptions. Management's estimate is within an acceptable range based on the current information available.

Relevant references in the Annual Report and Accounts

Accounting policies
Note 21 on the financial statements

Note:
(1) NatWest Holdings Audit Committee covers the ring-fenced bank legal entities of the RBS Group, including the Group.

Risk	Our response to the risk
Impairment of loans	
On 1 January 2018, a new accounting standard for financial instruments (IFRS 9) became effective, which introduced impairment based on expected credit losses, rather than the incurred loss model previously applied under IAS 39. At 31 December 2018 the Group reported total gross loans of £216 billion and £1.7 billion of expected credit loss provisions. Key judgements and estimates in respect of the timing and measurement of expected credit losses ('ECL') include: • Allocation of assets to stage 1, 2, or 3 using criteria in accordance with the accounting standard; • Accounting interpretations and modelling assumptions used to build the models that calculate the ECL; • Completeness and accuracy of data used to calculate the ECL; • Inputs and assumptions used to estimate the impact of multiple economic scenarios; • Completeness and valuation of post model adjustments; • Measurements of individually assessed provisions including the assessment of multiple scenarios; and • Accuracy and adequacy of the financial statement disclosures.	As IFRS 9 was adopted at the start of the year, we performed audit procedures on the opening balances to gain assurance on the transition from IAS 39. This included evaluating the accounting interpretations for compliance with IFRS 9 and testing the adjustments and disclosures made on transition. We tested the design and operating effectiveness of key controls across the processes relevant to the ECL. This included the allocation of assets into stages, model governance, data accuracy and completeness, credit monitoring, multiple economic scenarios, post model adjustments, individual provisions and production of journal entries and disclosures. We observed the key executive finance and risk committees where the inputs, assumptions and adjustments to the ECL were discussed and approved. We performed an overall assessment of the ECL provision levels by stage to determine if they were reasonable considering the Group's portfolio, risk profile, credit risk management practices and the macroeconomic environment. We considered trends in the economy and industries to which the Group is exposed. We challenged the criteria used to allocate an asset to stage 1, 2 or 3 in accordance with IFRS 9; this included peer benchmarking to assess staging levels. We tested assets in stage 1, 2 and 3 to verify that they were allocated to the appropriate stage. With the support of our internal modelling specialists, we tested the assumptions, inputs and formulas used in a sample of ECL models. This included assessing the appropriateness of model design and formulas used, considering alternative modelling techniques and recalculating the Probability of Default, Loss Given Default and Exposure at Default for a sample of models. To verify data quality, we tested the data used in the ECL calculation by reconciling to source systems. To test credit monitoring, we recalculated the risk ratings for a sample of performing loans. With the support of our internal economic specialists, we assessed the base case and alternative economic scenarios, including challenging probability weights and comparing to other scenarios from a variety of external sources, as well as EY internally developed forecasts. We assessed whether forecasted macroeconomic variables were appropriate, such as GDP, unemployment, interest rates and House Price Index. With the support of our modelling specialists we challenged the correlation and impact of the macroeconomic factors to the ECL including how non-linearity was captured. We 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. We assessed the appropriateness of the scenarios used and calculation of the overlay in response to Brexit related economic uncertainty. With the support of our internal valuation specialists, we recalculated a sample of individually assessed provisions including comparing to alternative scenarios and challenging probability weights assigned. The sample was based on a number of factors including higher risk sectors such as construction, retail, automotive, commercial real estate, shipping and oil and gas We assessed the adequacy and appropriateness of disclosures for compliance with the accounting standards including disclosure of transition from IAS 39.

Key observations communicated to the Audit Committee

We are satisfied that credit impairment provisions were reasonable and in compliance with IFRS 9.

We highlighted the following matters to the Audit Committee:

- Control deficiencies were identified on the transition to IFRS 9 and several compensating controls were implemented notably in the process to produce the financial statement disclosures;
- Our testing and sensitivity analysis on the staging criteria did not identify material differences and overall, we concluded that the stage allocation at 31 December 2018 was reasonable;
- Our testing of models and model assumptions did not highlight material differences; and

For individually assessed impairments, in a few instances we reported judgemental differences in respect of the extent of the impairment identified, however none of these differences were considered material.

Relevant references in the Annual Report and Accounts

Credit Risk section of the Capital and risk management section
Accounting policies
Note 13 on the financial statements

Risk	Our response to the risk
Future profitability estimates impacting the recognition of deferred tax and, in the Bank accounts, investments in subsidiaries.	
At 31 December 2018 the Group had reported deferred tax assets of £1.6 billion (2017: £1.1 billion). The Bank has reported investments in subsidiaries of £2.5 billion (2017: £2.5 billion). The recognition and carrying value of deferred tax assets and, in the Bank accounts, investments in subsidiaries are based on estimates of future profitability which require significant management judgement. The recognition of deferred tax assets considers the future profit forecasts of the legal entities as well as interpretation of recent changes to tax rates and laws. Key judgements and estimates include: • Revenue and cost forecasts which are impacted by the Group's transformation programme; • Key assumptions used in the recoverability and valuation assessments (discount rates, growth rates, macroeconomic assumptions, etc.); and • Assumptions regarding the economic consequences of Brexit and other political developments over an extended period.	We tested the design and operating effectiveness of key controls over the preparation and review of the forecasts, the significant assumptions, inputs, calculations, methodologies and judgements. With the support of our internal economic specialists, we tested whether key macroeconomic assumptions, including Brexit considerations, used in the Group's forecasting process were reasonable. Given the uncertainty on Brexit and its consequential impact on the macro-economic assumptions and resulting forecasts, we considered the need for additional disclosures in the financial statements. We assessed the reasonableness of revenue forecasts by challenging the underlying business strategies, comparing to expected market trends and considering anticipated balance sheet growth. We evaluated how the discount rates and long-term growth rates used by management compared to our reasonable ranges which were informed by peer practice, external market data and calculations performed by our valuation specialists. We tested how previous management forecasts including the impact of cost reduction programmes compared to actual results to evaluate the accuracy of the forecasting process. We assessed the achievability of future cost reduction plans by reviewing and challenging the details of the underlying initiatives and how key cost ratios compared to peer banks and commentaries from external analysts. We evaluated how management considered alternative assumptions and performed our own sensitivity and scenario analyses on certain key assumptions. With the support of our taxation specialists, we assessed the estimate of future taxable profits used to calculate the level of deferred tax assets recognised, including an assessment of the time horizon used for the recoverability of losses and other temporary differences.

Key observations communicated to the Audit Committee

We highlighted the following matters to the Audit Committee:

- Sensitivity analysis of the value in use and headroom to changes in the key assumptions in the forecasts supported the carrying value of investment in subsidiaries;
- Our stress testing of the Group's forecast cost reduction including the amount and timing supported the Group's conclusion that no impairment was required to the investment in subsidiaries; and
- We noted the inherent uncertainty predicting revenue and costs over the five-year forecasts period, particularly with respect to the impact of Brexit, and other political developments, and disruptions in the business model over an extended period.

We are satisfied that the carrying values of deferred tax assets and, in the Bank accounts, investments in subsidiaries are reasonable and the related disclosures are compliant with IFRS.

Relevant references in the Annual Report and Accounts

Accounting policies
Note 7 and 15 on the financial statements.

Risk	Our response to the risk
Financial impact of structural reform	
The Independent Commission on Banking's (ICB) structural reform required banks to ensure certain activities and services are undertaken in a ring-fenced bank (RFB) by 1 January 2019. The Group's implementation of structural reform resulted in the reorganisation of some of the legal entities in the RBS Group and the transfer of assets and liabilities between the RFB and other entities of the group. These transfers mainly related to the transfer of customer loans (£64.5 billion) and customer deposits (£74.6 billion) from NWM plc to RBS plc. Ring-fencing related transfers also included the transfer of the RBS Treasury function and related balances to NatWest Bank plc from NatWest Markets plc. Accounting and reporting risks arising include: • Appropriate application of accounting standards in recording the value of assets and liabilities transferred between legal entities, specifically with respect to fair value and hedge accounting in the financial statements of the relevant entities; • Future profitability estimates at a legal entity level, given the transfer of activities and services, and the impact on the impairment assessment of the carrying value of investments in subsidiaries; • Accuracy of costs recorded in each legal entity given changes to the Group's approach to cost recharging and cost allocation; • Impact of the restructuring of the group and movement of legal entities including the carrying value of investments and reserves including foreign exchange reserves; and • Accuracy of financial reporting given changes to the legal entity financial reporting closing processes to reflect changes in the Group.	With the support of our regulatory specialists we understood the implications of ICB for the Group and gained an understanding of management's process for implementing the ring-fencing regulation. We also examined the relevant regulatory correspondence to understand the impact and resolution of any significant findings that might impact financial reporting. We challenged management's assessment of the accounting impacts of ICB, including the accounting treatment for transfers of businesses and legal entities and the appropriateness of the interpretations used on areas of judgement, including hedge accounting and pensions, as well as the valuation of the assets moved. We analysed significant changes to financial information arising from legal entity changes and assessed if they were in line with our expectations. We tested the design and operating effectiveness of key controls and performed substantive procedures over the transfer of balances between legal entities. We assessed the control environment for the impairment of value of investments based on the post-ringfencing profit forecasts for each legal entity, considering the implications of other changes across legal entities on forecasted profitability. We tested controls over changes to the carrying value of investments and reserves to ensure they correctly reflected changes in ownership. This included transfers and recycling of reserves, including merger reserves, cash flow hedge reserves and foreign exchange reserves. We challenged the criteria applied to identified recycling events. We tested the design and operating effectiveness of the Group's key controls over legal entity recharges, including the governance and implementation of changes to legal entity recharges due to ICB. We tested adherence to internally agreed policies at a legal entity level, including assessments on the appropriateness of transfer pricing mark-ups applied. We tested the design and operating effectiveness of the Group's key controls over financial reporting as it relates to the implications of ICB and the relevant disclosures. We assessed the quality of the disclosures including any need for additional notes.

Key observations communicated to the Audit Committee

We are satisfied that the impact of structural reform has been properly accounted for and disclosed in accordance with IFRS. We highlighted the following matters to the Audit Committee:

- Processes and controls in place over the transfer of balances including the measurement of assets transferred were designed and operated effectively; and
- A control deficiency was identified in relation to foreign exchange reserves. Additional procedures were performed and audit differences identified were not considered material.

Relevant references in the Annual Report and Accounts

Accounting policies
Note 23 of the financial statements

Risk	Our response to the risk
Pension valuation and retirement benefit obligations	
The Group operates a number of defined benefit schemes which in total are significant in the context of the overall balance sheet. At 31 December 2018 the Group reported a net pension liability of £18 million (2017: £9 million) comprising £23 million of schemes in surplus and £41 million of schemes in deficit (2017: £22 million and £31 million, respectively). The net pension asset is sensitive to changes in the key judgements and estimates, which include: • Actuarial assumptions and inputs including the discount rate, inflation, pension payment and longevity to determine the valuation of retirement benefit liabilities; • Pricing inputs and calibrations for illiquid or complex model-dependent valuations of certain investments held by the schemes; • Quantification of trustee's rights to unilaterally augment benefits (Augmentation cap) to determine the recognition of surplus; and • Equalisation adjustments following the recent court ruling in respect of Guaranteed Minimum Pension (GMP)	We tested the design and operating effectiveness of key controls over the actuarial assumptions setting process, the data inputs used in the actuarial calculation and the measurement of the fair value of the schemes' assets. With the support of our actuarial specialists, we challenged the actuarial assumptions by comparing them to our independently obtained sources and market practice. We challenged the impact on pension liabilities of changes in financial, demographic and longevity assumptions over the year and whether these were in line with our own expectations. With the support of our valuation specialists, we challenged the appropriateness of management's valuation methodology including the judgements made in determining significant assumptions used in the valuation of complex and illiquid pension assets. We tested the fair value of scheme assets by independently calculating fair value for a sample of the assets held. Our sample included cash, equity instruments, derivative financial instruments and illiquid assets. In readiness for compliance with the requirements of the UK ring-fencing legislation, a Memorandum of Understanding (MoU) was entered into with the Trustees of RBS Group Pension Fund. We read the MoU, assessed the implications and challenged the appropriateness of the accounting treatment in accordance with relevant accounting standards. With the support of our actuarial specialists, we challenged the estimation of the augmentation cap and GMP equalisation adjustments including the inputs used in the calculation. We also assessed the methodology and judgements made in calculating these estimates and the associated accounting treatment in accordance with IAS 19 and IFRIC 14. We assessed the adequacy of the disclosures made in the financial statements, including the appropriateness of the key assumptions and sensitivities disclosed.

Key observations communicated to the Audit Committee

We are satisfied that the valuation and disclosure of the retirement benefit obligations are reasonable and in accordance with IFRS. We highlighted the following matters to the Audit Committee:

- Our benchmarking of key actuarial assumptions including the discount rate, inflation, mortality and pension payments. We concluded that assumptions tested were within a reasonable range;
- Independent valuation of a sample of pension assets identified no material differences; and
- Management's estimate of the impact of the GMP liability was materially consistent with our independent estimate using our own model.

Relevant references in the Annual Report and Accounts

Accounting policies
Note 5 on the financial statements

Risk	Our response to the risk
IT systems and controls impacting financial reporting	
The IT environment is complex and pervasive to the operations of the Group 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. Such controls contribute to mitigating the risk of potential fraud or errors as a result of changes to applications and data. Our audit approach relies upon IT applications and the related control environment including: • User access management across application, database and operating systems; • Changes to the IT environment, including transformation that changes the IT landscape; • IT operational controls; • IT application or IT dependent controls; and • Evaluation of IT control environment at third party service providers.	We assessed and challenged the design and operating effectiveness of IT controls over the applications, operating systems and databases that are relevant to financial reporting. We assessed automated controls within business processes and the reliability of relevant reports used as part of a manual control. This included challenging the integrity of system interfaces, the completeness and accuracy of data feeds, automated calculations and specific input controls. We assessed and challenged system migrations and related technology changes resulting from transformation programmes and the implementation of ICB that were material to financial reporting. Where we identified systems outsourced to third party service providers we challenged IT general controls through the relevant Service Organisation Controls Reports produced by third parties and tested assessed required complementary controls performed by the Group. Where control deficiencies were identified, we tested remediation activities performed by management and compensating controls in place and assessed where necessary to mitigate any residual risk.

Key observations communicated to the Audit Committee

We are satisfied that IT controls relevant to financial reporting operated effectively at year-end. We highlighted the following matters to the Audit Committee:

- Instances of user access related deficiencies were identified. Compensating controls were tested or alternate procedures were performed; and
- Exceptions were reported in some Service Organisation Controls Reports provided by third parties including Cloud providers. We tested compensating controls with no issues noted.

Relevant references in the Annual Report and Accounts

Accounting policies

In the prior year, our auditor's report included key audit matters in relation to costs recharged to or from other RBS Group companies and provision for restructuring costs. In 2018, given materiality and our assessment of the risk, these were not considered key audit matters.

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 each component of the Group. Taken together, this enables us to form an opinion on the financial statements. We take into account the size and risk profile of the component and its activities, the organisation of the Group and effectiveness of group-wide controls, changes in the business environment and other factors such as recent internal audit results when assessing the level of work to be performed at each component. The scoping below is consistent with the prior year.

Component	Scope	Key locations
UK Personal & Business Banking	Full	United Kingdom
Commercial Banking	Full	United Kingdom
Private Banking	Specific	United Kingdom
Central items, Treasury and Services	Full	United Kingdom, India, Poland

The table below illustrates the coverage obtained from the work performed by our audit teams, the coverage includes the full scope components presented in disposal groups as noted above. We considered total assets, total equity and absolute value of the amounts in the income statement (meaning the magnitude of the amounts without regard to their positive or negative value) to verify we had appropriate overall coverage on the income statement.

	Full scope (1)	Specific scope (2)	Other procedures (3)	Total
Total assets	85%	14%	1%	100%
Total equity	71%	27%	2%	100%
Absolute value of the income statement	92%	4%	4%	100%

The audit scope of Specific scope component may not have included testing of all significant accounts within the component. However, the testing will have contributed to the total coverage of significant accounts tested for the overall Group.

Notes:
(1) Full scope audit procedures on all significant accounts.
(2) Specific scope: audit procedures on selected accounts
(3) Other procedures: considered in analytical procedures.

Involvement with component teams

In establishing our overall approach to the Group audit, we determined the type of work that needed to be undertaken in each of the components by us, as the primary audit engagement team, or by component auditors in the United Kingdom or from other EY global network firms operating under our instruction.
The primary audit engagement team interacted regularly with the component audit teams where appropriate throughout the course of the audit, which included holding planning meetings, maintaining regular communications on the status of the audits, reviewing key working papers and taking responsibility for the scope and direction of the audit process. The primary audit engagement team also participated in meetings with key management personnel in the components and, for certain overseas locations, implemented a programme of planned visits. These visits involved discussing the audit approach with the component team and any issues arising from their work, as well as meeting with local management. This, together with the additional procedures performed at Group level, gave us appropriate evidence for our opinion on the Group financial statements.

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 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 Group and Bank to be £175 million (2017 materiality: £160 million), which is 5% of profit before tax of the Group and 1% of equity of the Bank (2017 materiality basis was equity). As the Group has been profitable for the past two years, we changed our basis of materiality to profit before tax. This measure is consistent with the wider industry and is the standard for listed and regulated entities and we believe it reflects the most useful measure for users of the financial statements. The materiality of the Bank is based on equity as we consider this to be the most appropriate factor to the users of the financial statements.

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 corrected misstatements exceed materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 50% of our planning materiality, namely £88 million (2017: £80 million). We have set performance materiality at this percentage (which is at the lowest end of the range of our audit methodology) based on various considerations including the past history of misstatements, the effectiveness of the control environment and other factors affecting the entity and its financial reporting.

Audit work of component teams for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component team is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the range of performance materiality allocated by the primary audit engagement team to components was between £60 million and £30 million.

Reporting threshold

An amount below which identified misstatements are considered to be clearly trivial.

We agreed with the Audit Committee that we would report to them all corrected and uncorrected audit misstatements in excess of £8 million, which is set at 5% of planning materiality, as well as misstatements below that threshold that, in our view, warranted reporting on qualitative grounds.

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

Other information

The other information comprises the information included in the Annual Report and Accounts, including the Strategic report, Report of the directors, Statement of directors' responsibilities, and Forward-looking statements, 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 this 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, the part of the directors' remuneration disclosure to be audited has been properly prepared in accordance with the Companies Act 2006.
In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic report and the Report of the directors for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic report and the Report of the directors 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 Group and the Bank and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic report or the Report of the directors.
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 by the Group, or returns adequate for our audit have not been received from branches not visited by us; or
- the Bank financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, 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 Group and Bank'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 Group or the Bank 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.

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. We

obtained an understanding of the legal and regulatory frameworks that are applicable to the Group and have a direct impact on the preparation of the financial statements.
We determined that the most significant are:

- The regulations, licence conditions and supervisory requirements of the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).
- Companies Act 2006
- Financial Reporting Council (FRC) and the UK Corporate Governance Code
- Tax Legislation (governed by HM Revenue and Customs)

We understood how the Group is complying with those frameworks by reviewing the RBS Policy Framework, holding discussions with the Group's general counsel, external counsel compliance group, regulatory group, internal audit, amongst others. We inquired as to any known instances of non-compliance or suspected non-compliance with laws and regulations. We also reviewed the Group's Complaints Management Policy and Whistleblowing Policy. We assessed the susceptibility of the Group's financial statements to material misstatement, including how fraud might occur by holding discussions with senior management, including the Chief Executive, Chief Financial Officer, Chief Risk Officer, Head of Internal Audit and Audit Committee Chairman. We also reviewed the Group's 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

- Following the recommendation of the Audit Committee we were appointed by the Group at its annual general meeting on 4 May 2016 to audit the financial statements of the Group for the period ending 31 December 2016 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments is 3 years, covering periods from our appointment through 31 December 2018.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Bank and we remain independent of the Group and the Bank 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.

Jonathan Bourne (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London, United Kingdom
14 February 2019

Note:
(1) The maintenance and integrity of the RBS Group web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated income statement for the year ended 31 December 2018

	Note	2018 £m	2017 £m
Interest receivable		6,968	6,271
Interest payable		(1,154)	(790)
Net interest income	1	5,814	5,481
Fees and commissions receivable		2,113	2,054
Fees and commissions payable		(462)	(499)
Other operating income		2,067	1,111
Non-interest income	2	3,718	2,666
Total income		9,532	8,147
Staff costs		(2,184)	(844)
Premises and equipment		(757)	(273)
Other administrative expenses		(2,132)	(2,921)
Depreciation and amortisation		(521)	(282)
Operating expenses	3	(5,594)	(4,320)
Profit before impairment losses		3,938	3,827
Impairment losses	13	(428)	(311)
Operating profit before tax		3,510	3,516
Tax charge	7	(771)	(812)
Profit from continuing operations		2,739	2,704
Loss from discontinued operations net of tax	24	(3)	(635)
Profit for the year		2,736	2,069
Attributable to:			
Ordinary shareholders		2,619	2,065
Paid-in equity holders		111	—
Non-controlling interests		6	4
		2,736	2,069

Consolidated statement of comprehensive income for the year ended 31 December 2018

	Note	2018 £m	2017 £m
Profit for the year		2,736	2,069
Items that do not qualify for reclassification			
Remeasurement of retirement benefit schemes	5		
- contribution in preparation for ring-fencing (1)		(2,000)	—
- other movements		47	(22)
Fair value through other comprehensive income (FVOCI) financial assets (2)		(44)	—
Tax		530	8
		(1,467)	(14)
Items that do qualify for reclassification			
Fair value through other comprehensive income (FVOCI) financial assets (2)		(115)	(312)
Currency translation		(811)	(805)
Tax		32	5
		(894)	(1,112)
Other comprehensive loss after tax		(2,361)	(1,126)
Total comprehensive income for the year		375	943
Attributable to:			
Ordinary shareholders		259	939
Paid-in equity holders		111	—
Non-controlling interests		5	4
		375	943

Notes:
(1) On 17 April 2018 the RBS Group agreed a Memorandum of Understanding (MoU) with the Trustees of the RBS Group Pension Fund in connection with the requirements of ring-fencing. NatWest Markets Plc cannot continue to be a participant in the Main section and separate arrangements are required for its employees and agreed to contribute £1.2 billion to the ring-fenced bank. Under the MoU NatWest made a contribution of £2 billion on 9 October 2018 to strengthen funding of the Main section in recognition of the changes in covenant.
(2) Refer to Note 36 for further information on the impact of IFRS 9 on classification and basis of preparation, year ended 31 December 2018 prepared under IFRS 9 and year ended 31 December 2017 under IAS 39.
(3) A loss of £3 million in 2018 (2017 - £635 million loss) from discontinued operations was attributable to ordinary shareholders.

The accompanying notes on pages 82 to 131, the accounting policies on pages 77 to 81 and the audited sections of the Financial Review: Capital and risk management on pages 9 to 57 form an integral part of these financial statements.

Balance sheet as at 31 December 2018

		Group		Bank	
		2018	2017	2018	2017
	Note	£m	£m	£m	£m
Assets					
Cash and balances at central banks	10	45,032	35,799	43,966	34,763
Derivatives	9	1,253	2,315	1,277	2,277
Loans to banks - amortised cost	10	6,406	1,919	5,875	1,635
Loans to customers - amortised cost	10	203,647	191,882	171,433	160,614
Amounts due from holding companies and fellow subsidiaries	10	5,206	77,930	30,780	54,211
Securities subject to repurchase agreements		9,890	—	9,890	—
Other financial assets excluding securities subject to repurchase agreements		31,336	1,665	30,944	1,073
Other financial assets	10	41,226	1,665	40,834	1,073
Investment in group undertakings	15	—	—	2,466	2,546
Other assets	17	7,168	29,333	4,993	2,598
Total assets		309,938	340,843	301,624	259,717
Liabilities					
Bank deposits	10	17,563	20,544	17,557	20,528
Customer deposits	10	237,770	226,423	204,279	194,055
Amounts due to holding companies and fellow subsidiaries	10	22,542	44,599	50,958	23,311
Derivatives	9	779	3,178	1,185	3,117
Other financial liabilities	19	6,497	575	5,889	139
Subordinated liabilities	20	1,275	1,240	1,267	1,231
Other liabilities	21	3,638	27,917	2,213	1,981
Total liabilities		290,064	324,476	283,348	244,362
Owners' equity	22	19,867	16,286	18,276	15,355
Non-controlling interests		7	81	—	—
Total equity		19,874	16,367	18,276	15,355
Total liabilities and equity		309,938	340,843	301,624	259,717

Owners' equity of the Bank as at 31 December 2018 includes the profit for the year of £1,611 million (2017 - £26 million).

The accompanying notes on pages 82 to 131; the accounting policies on pages 77 to 81 and the audited sections of the Financial review: Capital and risk management on pages 9 to 57 form an integral part of these financial statements.

The accounts were approved by the Board of directors on 14 February 2019 and signed on its behalf by:

Howard Davies	Ross McEwan	Katie Murray	National Westminster Bank Plc
Chairman	Chief Executive	Chief Financial Officer	Registration No. 929027

Statement of changes in equity for the year ended 31 December 2018

	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Called-up share capital - at 1 January and 31 December	1,678	1,678	1,678	1,678
Paid-in equity at 1 January	—	—	—	—
Securities issued during the year (1)	2,370	—	2,370	—
At end of period	2,370	—	2,370	—
Share premium - at 1 January and 31 December	2,225	2,225	2,225	2,225
Merger reserve - at 1 January	—	—	—	—
Transfer from fellow subsidiary (2)				
- gross	473	—	(460)	—
- tax	124	—	124	—
Amortisation	(185)	—	42	—
At 31 December	412	—	(294)	—
FVOCI reserve - at 1 January (3)	(5)	307	1	1
Implementation of IFRS 9 on 1 January 2018	46	—	—	—
Unrealised (losses)/gains	(85)	128	(86)	—
Realised gains	(74)	(440)	(34)	—
Tax	32	—	32	—
Transfer from fellow subsidiary (2)				
- gross	460	—	460	—
- tax	(124)	—	(124)	—
At 31 December	250	(5)	249	1
Cash flow hedging reserve - at 1 January	—	—	—	—
Amount recognised in equity	—	—	—	(55)
Amount transferred from equity to earnings	—	—	—	55
At 31 December	—	—	—	—
Foreign exchange reserve - at 1 January	826	1,626	(10)	(10)
Retranslation of net assets	45	(35)	2	—
Foreign currency losses on hedges of net assets	(9)	(77)	—	—
Tax	—	5	—	—
Recycled to profit or loss on transfer of businesses	(847)	(693)	(5)	—
At 31 December (4)	15	826	(13)	(10)
Capital redemption reserve - at 1 January	796	647	796	647
Redemption of debt preference shares	—	149	—	149
At 31 December	796	796	796	796
Retained earnings - at 1 January	10,766	9,097	10,665	10,756
Implementation of IFRS 9 on 1 January 2018 (3)	(317)	—	(270)	—
Profit/(loss) attributable to ordinary shareholders				
- continuing operations	2,622	2,700	1,500	26
- discontinued operations	(3)	(635)	—	—
Tax on paid-in equity dividends	30	—	30	—
Distribution of subsidiary (5)	(902)	—	(292)	—
Redemption of debt preference shares	—	(157)	—	(157)
Capital contribution (6)	1,200	51	1,200	51
Realised losses in period on FVOCI equity shares	(6)	—	—	—
Remeasurement of the retirement benefit schemes				
- contribution in preparation for ring-fencing (6)	(2,000)	—	(2,000)	—
- other movements	47	(22)	(25)	(19)
- tax	530	8	530	8
Share-based payments	(31)	—	(31)	—
Amortisation of merger reserve	185	—	(42)	—
Loss on transfer of fellow subsidiary (7)	—	(276)	—	—
At 31 December	12,121	10,766	11,265	10,665
Owners' equity at 31 December	19,867	16,286	18,276	15,355

Statement of changes in equity for the year ended 31 December 2018

	Group		Bank	
	2018	2017	2018	2017
	£m	£m	£m	£m
Non-controlling interests - at 1 January	81	420	—	—
Currency translation adjustments and other movements	(1)	—	—	—
Profit attributable to non-controlling interests	6	4	—	—
Dividends paid	(5)	(5)	—	—
Acquisition of business	—	8	—	—
Equity withdrawn and disposals (5,8)	(74)	(346)	—	—
At 31 December	7	81	—	—
Total equity at 31 December	19,874	16,367	18,276	15,355
Total equity is attributable to:				
Ordinary shareholders	17,497	16,286	15,906	15,355
Paid-in equity holders	2,370	—	2,370	—
Non-controlling interests	7	81	—	
	19,874	16,367	18,276	15,355

Notes:
(1) AT1 capital notes totalling £2.4 billion issued in April 2018 in preparation for ring-fencing.
(2) During 2018 the RBS Treasury and shared service activities transferred to the Bank from NWM Plc at net asset value. As described in accounting policy 3, the assets, liabilities and IFRS reserves were recognised at inherited values. The difference has been recognised in the merger reserve.
(3) Refer to Note 36 for further information on the impact of IFRS 9 on classification and basis of preparation, year ended 31 December 2018 prepared under IFRS 9 and prior years under IAS 39.
(4) The hedging element of the foreign exchange reserve relates to continuing hedges.
(5) On 2 March 2018, in preparation for ring-fencing, NatWest Group Holdings Corp, parent of NatWest Markets Securities Inc., was distributed to NatWest Markets Plc.
(6) On 17 April 2018 the RBS Group agreed a Memorandum of Understanding (MoU) with the Trustees of the RBS Group Pension Fund in connection with the requirements of ring-fencing. NatWest Markets Plc cannot continue to be a participant in the Main section and separate arrangements are required for its employees and agreed to contribute £1.2 billion to the ring-fenced bank. Under the MoU NatWest made a contribution of £2 billion on 9 October 2018 to strengthen funding of the Main section in recognition of the changes in covenant.
(7) Loss in 2017 relates to the legal entity transfer of Lombard North Central Plc in preparation for ring-fencing.
(8) Ulster Bank (Ireland) Holdings Unlimited Company was sold to NatWest Holdings Limited on 1 January 2017 in preparation for ring-fencing under ICB.

The accompanying notes on pages 82 to 131, the accounting policies on pages 77 to 81 and the audited sections of the Financial Review: Capital and risk management on pages 9 to 57 form an integral part of these financial statements.

Cash flow statement for the year ended 31 December 2018

	Note	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Cash flows from operating activities					
Operating profit before tax from continuing operations		3,510	3,516	2,238	665
Loss before tax from discontinued operations		(3)	(642)	—	—
Interest on subordinated liabilities		177	218	175	55
Impairment losses on loans to banks and customers		(232)	(224)	(278)	(215)
(Profit)/loss on sale of subsidiaries and associates		(7)	420	—	67
Profit on sale of securities		(32)	(440)	(36)	—
Defined benefit pension schemes		(1,959)	(26)	(2,025)	(17)
Provisions: expenditure in excess of charges		(579)	(3,238)	(500)	(340)
Depreciation, amortisation and impairment of property, plant, equipment, goodwill and intangibles		494	164	399	107
Write back of investment in subsidiaries		—	—	481	7,838
Elimination of foreign exchange differences		(642)	22	(654)	79
Other non-cash items		(132)	(908)	(2,015)	65
Net cash inflow/(outflow) from trading activities		595	(1,138)	(2,215)	8,304
Decrease/(increase) in net loans to banks and customers		5,328	(16,894)	(33,284)	(13,777)
(Increase)/decrease in securities		(232)	4,112	—	7
(Increase)/decrease in other assets		(6,466)	(7,631)	417	(162)
(Increase)/decrease in derivative assets and liabilities		(855)	112	(750)	(16)
(Decrease)/increase in settlement balance assets and liabilities and short positions		—	(573)	—	33
(Decrease)/increase in banks and customers deposits		(18,585)	19,085	29,925	31,916
Increase in debt securities in issue		2,349	95	2,102	—
Increase/(decrease) in other liabilities		3,784	18,485	(122)	12
Changes in operating assets and liabilities		(14,677)	16,791	(1,712)	18,013
Income taxes paid		(360)	(190)	(108)	(35)
Net cash flows from operating activities (1)		(14,442)	15,463	(4,035)	26,282
Cash flows from investing activities					
Sale and maturity of securities		6,171	469	5,742	3
Purchase of securities		(3,219)	(1,567)	(2,791)	(1,064)
Sale of property, plant and equipment		288	319	59	81
Purchase of property, plant and equipment		(516)	(283)	(262)	(65)
Net investment in business interests and intangible assets	30	(36,949)	5,543	(33,651)	(3,622)
Net cash flows from investing activities		(34,225)	4,481	(30,903)	(4,667)
Cash flows from financing activities					
Issue of other equity instruments: Additional Tier 1 capital notes		2,370	—	2,370	—
Issue of subordinated liabilities		1,531	507	1,486	—
Capital contribution		1,200	51	1,200	51
Redemption of non-controlling interests		—	(346)	—	—
Redemption of subordinated liabilities		(3,000)	(936)	(3,000)	—
Redemption of preference shares		—	(178)	—	(178)
Service cost of other equity instruments		(116)	(5)	(111)	—
Interest on subordinated liabilities		(182)	(222)	(179)	(57)
Net cash flows from financing activities		1,803	(1,129)	1,766	(184)
Effects of exchange rate changes on cash and cash equivalents		241	(639)	220	(138)
Net (decrease)/increase in cash and cash equivalents		(46,623)	18,176	(32,952)	21,293
Cash and cash equivalents at 1 January		97,940	79,764	82,444	61,151
Cash and cash equivalents at 31 December	32	51,317	97,940	49,492	82,444

Note:
(1) Includes interest received for Group of £6,637 million (2017 - £6,263 million) and interest paid of £1,083 million (2017 - £798 million), and for Bank interest received of £5,866 million (2017 – £5,154 million) and interest paid of £1,165 million (2017 - £567 million).

The accompanying notes on pages 82 to 131, the accounting policies on pages 77 to 81 and the audited sections of the Financial Review: Capital and risk management on pages 9 to 57 form an integral part of these financial statements.

Accounting policies

1 Presentation of accounts
The accounts, set out on pages 72 to 131 including these accounting policies on pages 77 to 81 and the audited sections of the Financial review: Capital and risk management on pages 9 to 57, are prepared on a going concern basis (see the Report of the directors, page 58) and in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB) and interpretations as issued by the IFRS Interpretations Committee of the IASB and adopted by the European Union (EU) (together IFRS).

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

With the exception of investment property and certain financial instruments as described in Accounting policies 10, 15 and 23, the accounts are presented on a historical cost basis.

NatWest Group Holdings Corp was classified as a disposal group at 31 December 2017. It was measured at fair value less costs to sell. Refer to Note 9 for further information.

Adoption of IFRS 9
Refer to Note 36 for details of the adoption of IFRS 9.

Other amendments to IFRS
IFRS 15 'Revenue from Contracts with Customers' has been adopted with effect from 1 January 2018. The Accounting policy is updated to reflect the terminology in the new standard but it has had no effect on financial information reported in the current or comparative periods. Interest income and expense continues to be recognised using the effective interest rate method for financial instruments measured at historical cost. There has been no restatement of profit or loss for comparative periods.

Other amendments to IFRS effective for 2018, including IFRS 2 'Share-based payments' and IAS 40 'Investment Property' have not had a material effect on the Group's financial statements.

2. Basis of consolidation
The consolidated accounts incorporate the financial statements of the company and entities (including certain structured entities) that are controlled by the Group. The Group controls another entity (a subsidiary) when it is exposed, or has rights, to variable returns from its involvement with that entity and has the ability to affect those returns through its power over the other entity; power generally arises from holding a majority of voting rights. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated accounts at their fair value. A subsidiary is included in the consolidated financial statements from the date it is controlled by the Group until the date the Group ceases to control it through a sale or a significant change in circumstances.

On the acquisition of a business from a group company, the assets, liabilities and IFRS reserves, such as the cash flow hedging reserve, are recognised at inherited values. Inherited values are taken from the consolidated accounts of the Royal Bank of Scotland Group plc and include the accounting history since initial recognition.

The acquirer recognises in merger reserve any difference between the consideration paid and the net items recognised at inherited values.

Changes in the Group's interest in a subsidiary that do not result in the Group ceasing to control that subsidiary are accounted for as equity transactions.

All intergroup balances, transactions, income and expenses are eliminated on consolidation. The consolidated accounts are prepared under uniform accounting policies.

3. Recognition of Business transfers
On the acquisition of a business from a Group company, the assets, liabilities and IFRS reserves are recognised at inherited values.

Inherited values are taken from the consolidated accounts of RBSG plc and include the accounting history since initial recognition. The acquirer recognises in merger reserve, any difference between the consideration paid and the net items recognised at inherited values.

4. Revenue recognition
Interest income or expense on financial instruments that are measured at amortised cost and fair value through comprehensive income are determined using the effective interest rate method. The effective interest rate 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. Negative effective interest accruing to financial assets is presented in interest payable.

Net interest income in the income statement only relates to financial instruments measured at amortised cost; the interest on debt instruments classified as fair value through OCI; and the effective part of any related accounting hedging instruments. 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 each service is performed. The price is usually fixed and always determinable.

5. Assets held for sale and discontinued operations
A non-current asset (or disposal group) is classified as held for sale if the Group will recover its carrying amount principally through a sale transaction rather than through continuing use. A non-current asset (or disposal group) classified as held for sale is measured at the lower of its carrying amount and fair value less costs to sell. If the asset (or disposal group) is acquired as part of a business combination it is initially measured at fair value less costs to sell.

Asset and liabilities of disposal groups classified as held for sale and non-current assets classified as held for sale are shown separately on the face of the balance sheet.

The results of discontinued operations - comprising the post-tax profit or loss of discontinued operations and the post-tax gain or loss recognised either on measurement to fair value less costs to sell or on disposal of the discontinued operation - are shown as a single amount on the face of the income statement; an analysis of this amount is presented in Note 19 on the accounts. A discontinued operation is a cash generating unit or a group of cash generating units that either has been disposed of, or is classified as held for sale, and (a) represents a separate major line of business or geographical area of operations, (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or (c) is a subsidiary acquired exclusively with a view to resale.

6. 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 RBS Group or by RBSG shares. Variable compensation that is settled in cash or debt instruments is charged to profit or loss over the period from the start of the year to which the variable compensation relates to the expected settlement date taking account of forfeiture and clawback criteria.

For defined benefit schemes, the defined benefit obligation is measured on an actuarial basis using the projected unit credit method and discounted at a rate determined by reference to market yields at the end of the reporting period on high quality corporate bonds of equivalent term and currency to the scheme liabilities. Scheme assets are measured at their fair value. The difference between scheme assets and scheme liabilities, the net defined benefit asset or liability, is recognised in the balance sheet. A defined benefit asset is limited to the present value of any economic benefits available to the Group in the form of refunds from the plan or reduced contributions to it.

The charge to profit or loss for pension costs (recorded in operating expenses) comprises:

- the current service cost
- interest, computed at the rate used to discount scheme liabilities, on the net defined benefit liability or asset
- past service cost resulting from a scheme amendment or curtailment
- gains or losses on settlement.

A curtailment occurs when the Group significantly reduces the number of employees covered by a plan. A plan amendment occurs when the Group introduces, or withdraws, a defined benefit plan or changes the benefits payable under an existing defined benefit plan. Past service cost may be either positive (when benefits are introduced or changed so that the present value of the defined benefit obligation increases) or negative (when benefits are withdrawn or changed so that the present value of the defined benefit obligation decreases). A settlement is a transaction that eliminates all further obligation for part or all of the benefits.

Actuarial gains and losses (i.e. gains or and losses on re-measuring the net defined benefit asset or liability) are recognised in other comprehensive income in full in the period in which they arise.

7. Intangible assets and goodwill

Intangible assets acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to profit or loss over the assets' estimated economic lives using methods that best reflect the pattern of economic benefits and is included in Depreciation and amortisation. These estimated useful economic lives are:

Computer software	3 to 12 years
Other acquired intangibles	5 to 10 years

Expenditure on internally generated goodwill and brands is written-off as incurred. Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have been established. These costs include payroll, the costs of materials and services, and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred as are all training costs and general overheads. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

Intangible assets include goodwill arising on the acquisition of subsidiaries and joint ventures. Goodwill on the acquisition of a subsidiary is the excess of the fair value of the consideration transferred, the fair value of any existing interest in the subsidiary and the amount of any non-controlling interest measured either at fair value or at its share of the subsidiary's net assets over the Group's interest in the net fair value of the subsidiary's identifiable assets, liabilities and contingent liabilities. Goodwill arises on the acquisition of a joint venture when the cost of investment exceeds the Group's share of the net fair value of the joint venture's identifiable assets and liabilities. Goodwill is measured at initial cost less any subsequent impairment losses. Goodwill arising on the acquisition of associates is included within their carrying amounts. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

8. Property, plant and equipment

Items of property, plant and equipment (except investment property - see Accounting policy 10) are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, these are accounted for separately.

Depreciation is charged to profit or loss on a straight-line basis so as to write-off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases) over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Freehold land is not depreciated.

The estimated useful lives of the Group's property, plant and equipment are:

Freehold buildings	50 years
Long leasehold property (leases with more than 50 years to run)	50 years
Short leaseholds	unexpired period of 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.

9. Impairment of intangible assets and property, plant and equipment

At each balance sheet date, the Group assesses whether there is any indication that its intangible assets, or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss if any. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

If an asset does not generate cash flows that are independent from those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. For the purposes of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units or groups of cash-generating units expected to benefit from the combination. The recoverable amount of an asset or cash-generating unit is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash-generating unit that have not been taken into account in estimating future cash flows. If the recoverable amount of an intangible or tangible asset is less than its carrying value, an impairment loss is recognised immediately in profit or loss and the carrying value of the asset reduced by the amount of the loss. A reversal of an impairment loss on intangible assets (excluding goodwill) or property, plant and equipment 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. Impairment losses on goodwill are not reversed.

10. Investment property

Investment property comprises freehold and leasehold properties that are held to earn rentals or for capital appreciation or both. Investment property is not depreciated but is stated at fair value. Fair value is based on current prices for similar properties in the same location and condition. Any gain or loss arising from a change in fair value is recognised in profit or loss. Rental income from investment property is recognised on a straight-line basis over the term of the lease in Other operating income. Lease incentives granted are recognised as an integral part of the total rental income.

11. Foreign currencies

The Group's consolidated financial statements are presented in sterling which is the functional currency of the company.

Transactions in foreign currencies are recorded in the functional currency at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the foreign exchange rates ruling at the balance sheet date. Foreign exchange differences arising on the settlement of foreign currency transactions and from the translation of monetary assets and liabilities are reported in income from trading activities except for differences arising on cash flow hedges and hedges of net investments in foreign operations (see Accounting policy 23).

Non-monetary items denominated in foreign currencies that are stated at fair value are translated into the relevant functional currency at the foreign exchange rates ruling at the dates the values are determined. Translation differences arising on non-monetary items measured at fair value are recognised in profit or loss except for differences arising on non-monetary financial assets classified as available for sale, for example equity shares, which are recognised in other comprehensive income unless the asset is the hedged item in a fair value hedge.

Assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into sterling at foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of a foreign operation are recognised in other comprehensive income. The amount accumulated in equity is reclassified from equity to profit or loss on disposal of a foreign operation. Foreign exchange differences arising on the translation of a foreign operation are recognised in other comprehensive income. The amount accumulated in equity is reclassified from equity to profit or loss on disposal of a foreign operation.

12. Leases

As lessor

Contracts with customers to lease assets are classified as finance leases if they transfer substantially all the risks and rewards of ownership of the asset to the customer; all other contracts with customers to lease assets are classified as operating leases.

Finance lease receivables are included in the balance sheet, within net loans to customers, at the amount of the net investment in the lease being the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Finance lease income is allocated to accounting periods so as to give a constant periodic rate of return before tax on the net investment and included in Interest receivable. Unguaranteed residual values are subject to regular review; if there is a reduction in their value, income allocation is revised and any reduction in respect of amounts accrued is recognised immediately.

Rental income from operating leases is recognised in income on a straight-line basis over the lease term unless another systematic basis better represents the time pattern of the asset's use. Operating lease assets are included within Property, plant and equipment and depreciated over their useful lives (see Accounting policy 8). Operating lease rentals receivable are included in Other operating income.

As lessee

The Group's contracts to lease assets are principally operating leases. Operating lease rental expense is included in Premises and equipment costs and recognised as an expense on a straight-line basis over the lease term unless another systematic basis better represents the benefit to the Group.

13. Provisions

The Group recognises a provision for a present obligation resulting from a past event when it is more likely than not that it will be required to transfer economic benefits to settle the obligation and the amount of the obligation can be estimated reliably.

Provision is made for restructuring costs, including the costs of redundancy, when the Group has a constructive obligation to restructure. An obligation exists when the Group has a detailed formal plan for the restructuring and has raised a valid expectation in those affected by starting to implement the plan or by announcing its main features.

If the Group has a contract that is onerous, it recognises the present obligation under the contract as a provision. An onerous contract is one where the unavoidable costs of meeting the Group's contractual obligations exceed the expected economic benefits. When the Group vacates a leasehold property, a provision is recognised for the costs under the lease less any expected economic benefits (such as rental income).

Contingent liabilities are possible obligations arising from past events, whose existence will be confirmed only by uncertain future events, or present obligations arising from past events that are not recognised because either an outflow of economic benefits is not probable or the amount of the obligation cannot be reliably measured. Contingent liabilities are not recognised but information about them is disclosed unless the possibility of any outflow of economic benefits in settlement is remote.

14. Tax

Income tax expense or income, comprising current tax and deferred tax, is recorded in the income statement except income tax on items recognised outside profit or loss which is credited or charged to other comprehensive income or to equity as appropriate.

Current tax is income tax payable or recoverable in respect of the taxable profit or loss for the year arising in profit or loss, other comprehensive income or equity. Provision is made for current tax at rates enacted or substantively enacted at the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that the asset will be recovered. Deferred tax is not recognised on temporary differences that arise from initial recognition of an asset or a liability in a transaction (other than a business combination) that at the time of the transaction affects neither accounting, nor taxable profit or loss. Deferred tax is calculated using tax rates expected to apply in the periods when the assets will be realised or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, at the balance sheet date.

Deferred tax assets and liabilities are offset where the Group has a legally enforceable right to offset and where they relate to income taxes levied by the same taxation authority either on an individual Group company or on Group companies in the same tax group that intend, in future periods, to settle current tax liabilities and assets on a net basis or on a gross basis simultaneously.

15. Financial instruments

On initial recognition, financial instruments are measured at fair value. Subsequently they are classified as follows: designated at fair value through profit or loss; amortised cost, the default class for liabilities; fair value through profit or loss, the default class for assets; or financial assets may be designated as at fair value through other comprehensive income. 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.

Designated as at fair value through profit or loss – a financial instrument may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both, that the Group manages and evaluates on a fair value basis; or (c) relates to a financial liability that contains an embedded derivative which is not evidently closely related to the host contract. Financial assets that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Gains and losses are recognised in profit or loss as they arise.

Amortised cost assets – have to meet both the following criteria:

(a) the asset is held within a business model whose objective is solely to hold assets to collect contractual cash flows; and
(b) the contractual terms of the financial asset are solely payments of principal and interest on the outstanding balance.

Amortised cost liabilities – all liabilities that are not subsequently measured at fair value are measured at amortised cost.

Assets designated at fair value through other comprehensive income – An equity instrument may be designated irrevocably at fair value through other comprehensive income. Other assets have to meet both the following criteria:

(a) the asset is held within a business model whose objective is both to hold assets to collect contractual cash flows and selling financial assets; and
(b) the contractual terms of the financial asset are solely payments of principal and interest on the outstanding balance.

Fair value through profit or loss - a financial liability is measured at fair value if it arises from: a financial guarantee contract; a commitment to lend at below market rates; an obligation arising from the failed sale of an asset; or a contingent consideration for a business acquisition. Fair value through profit or loss is the default classification for a financial asset.

Reclassifications – financial liabilities cannot be reclassified. Financial assets are only reclassified where there has been a change in the business model.

Fair value – The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Business model assessment – business models are assessed at portfolio level, being the level at which they are managed. 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. The criteria for classifying cash flows as solely principal and interest are assessed against the contractual terms of a facility, with attention to leverage features; prepayment and extension terms; and triggers that might reset the effective rate of interest.

16. Impairments

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. 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. Loss allowances for lease receivables are always made on a lifetime basis.

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 rebased from 12 month to lifetime expectations.

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. Where the Group's interest in equity shares following the exchange is such that the Group controls an entity, that entity is consolidated. The costs of loss allowances on assets held at amortised cost are presented as impairments in the income statement. Allowances in respect financial guarantees and loan commitments are presented in administrative expenses.

Impaired loans and receivables are written off, when the Group concludes that there is no longer any realistic prospect of recovery of part or all of the loan. For loans that are individually assessed for impairment, the timing of write off is determined on a case-by-case basis. Such loans are reviewed regularly and write off will be prompted by bankruptcy, insolvency, renegotiation and similar events.

The typical time frames from initial impairment to write off for the Group's collectively-assessed portfolios are:

- Retail mortgages: write off usually occurs within five years, or when an account is closed if earlier.
- Credit cards: the irrecoverable amount is written off after 12 months; three years later any remaining amounts outstanding are written off. Overdrafts and other unsecured loans: write off occurs within six years.
- 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.

17. Financial guarantee contracts
Under a financial guarantee contract, the Group, in return for a fee, undertakes to meet a customer's obligations under the terms of a debt instrument if the customer fails to do so. A financial guarantee is recognised as a liability; initially at fair value and, if not designated as at fair value through profit or loss, subsequently at the higher of its initial value less cumulative amortisation and any provision under the contract measured in accordance with Accounting policy 13. Amortisation is calculated so as to recognise fees receivable in profit or loss over the period of the guarantee.

18. Loan commitments
Provision is made for loan commitments, other than those classified as held-for-trading, Syndicated loan commitments in excess of the level of lending under the commitment approved for retention by the Group are classified as held-for-trading and measured at fair value.

19. Derecognition
A financial asset is derecognised when the contractual right to receive cash flows from the asset has expired or when it has been transferred and the transfer qualifies for derecognition. A transfer requires that the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Group assesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. The asset remains on the balance sheet if substantially all the risks and rewards have been retained. It is derecognised if substantially all the risks and rewards have been transferred. If substantially all the risks and rewards have been neither retained nor transferred, the Group assesses whether or not it has retained control of the asset. If the Group has retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement; if the Group has not retained control of the asset, it is derecognised.

A financial liability is removed from the balance sheet when the obligation is discharged, or is cancelled, or expires. On the redemption or settlement of debt securities (including subordinated liabilities) issued by the Group, the Group derecognises the debt instrument and records a gain or loss being the difference between the debt's carrying amount and the cost of redemption or settlement. The same treatment applies where the debt is exchanged for a new debt issue that has terms substantially different from those of the existing debt.

The assessment of whether the terms of the new debt instrument are substantially different takes into account qualitative and quantitative characteristics including a comparison of the present value of the cash flows under the new terms with the present value of the remaining cash flows of the original debt issue discounted at the effective interest rate of the original debt issue.

20. Sale and repurchase transactions
Securities subject to a sale and repurchase agreement under which substantially all the risks and rewards of ownership are retained by the Group continue to be shown on the balance sheet and the sale proceeds recorded as a financial liability. Securities acquired in a reverse sale and repurchase transaction under which the Group is not exposed to substantially all the risks and rewards of ownership are not recognised on the balance sheet and the consideration paid is recorded as a financial asset. Securities borrowing and lending transactions are usually secured by cash or securities advanced by the borrower. Borrowed securities are not recognised on the balance sheet or lent securities derecognised. Cash collateral given or received is treated as a loan or deposit; collateral in the form of securities is not recognised. However, where securities borrowed are transferred to third parties, a liability for the obligation to return the securities to the stock lending counterparty is recorded.

21. Netting
Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when, and only when, the Group currently has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. The Group is party to a number of arrangements, including master netting agreements, that give it the right to offset financial assets and financial liabilities, but where it does not intend to settle the amounts net or simultaneously, the assets and liabilities concerned are presented gross.

22. Capital instruments
The Group classifies a financial instrument that it issues as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms and as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities.

The components of a compound financial instrument issued by the Group are classified and accounted for separately as financial assets, financial liabilities or equity as appropriate.

Incremental costs and related tax that are directly attributable to an equity transaction are deducted from equity.

The consideration for any ordinary shares of the company purchased by the Group (treasury shares) is deducted from equity. On the cancellation of treasury shares their nominal value is removed from equity and any excess of consideration over nominal value is treated in accordance with the capital maintenance provisions of the Companies Act.

On the sale or reissue of treasury shares the consideration received and related tax are credited to equity, net of any directly attributable incremental costs.

23. Derivatives and hedging
In accordance with IAS 39 'Hedge relationships', derivative financial instruments are initially recognised, and subsequently measured, at fair value.

A derivative embedded in a contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract; unless the host is a financial asset or 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 ordinary activities except for gains and losses on those derivatives that are managed together with financial instruments designated at fair value; these gains and losses are included in Other operating income.

The Group enters into three types of hedge relationship: hedges of changes in the fair value of a recognised asset or liability or unrecognised firm commitment (fair value hedges); hedges of the variability in cash flows from a recognised asset or liability or a highly probable forecast transaction (cash flow hedges); and hedges of the net investment in a foreign operation.

Hedge relationships are formally designated and documented at inception. The documentation identifies the hedged item and the hedging instrument and details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in fair values or cash flows attributable to the hedged risk, consistent with the documented risk management strategy, hedge accounting is discontinued. Hedge accounting is also discontinued if the Group revokes the designation of a hedge relationship.

Fair value hedge - in a fair value hedge, the gain or loss on the hedging instrument is recognised in profit or loss. The gain or loss on the hedged item attributable to the hedged risk is recognised in profit or loss and, where the hedged item is measured at amortised cost, adjusts the carrying amount of the hedged item. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; or if the hedging instrument expires or is sold, terminated or exercised; or if hedge designation is revoked. If the hedged item is one for which the effective interest rate method is used, any cumulative adjustment is amortised to profit or loss over the life of the hedged item using a recalculated effective interest rate.

Cash flow hedge - in a cash flow hedge, the effective portion of the gain or loss on the hedging instrument is recognised in other comprehensive income and the ineffective portion in profit or loss.

When the forecast transaction results in the recognition of a financial asset or financial liability, the cumulative gain or loss is reclassified from equity to profit or loss in the same periods in which the hedged forecast cash flows affect profit or loss. Otherwise the cumulative gain or loss is removed from equity and recognised in profit or loss at the same time as the hedged transaction. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; if the hedging instrument expires or is sold, terminated or exercised; if the forecast transaction is no longer expected to occur; or if hedge designation is revoked.

The discontinuance of hedge accounting (except where a forecast transaction is no longer expected to occur), the cumulative unrealised gain or loss is reclassified from equity to profit or loss when the hedged cash flows occur or, if the forecast transaction results in the recognition of a financial asset or financial liability, when the hedged forecast cash flows affect profit or loss. Where a forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss is reclassified from equity to profit or loss immediately.

Hedge of net investment in a foreign operation - in the hedge of a net investment in a foreign operation, the portion of foreign exchange differences arising on the hedging instrument determined to be an effective hedge is recognised in other comprehensive income. Any ineffective portion is recognised in profit or loss. Non-derivative financial liabilities as well as derivatives may be the hedging instrument in a net investment hedge. On disposal or partial disposal of a foreign operation, the amount accumulated in equity is reclassified from equity to profit or loss.

24. Cash and cash equivalents

In the cash flow statement, cash and cash equivalents comprises cash and deposits with banks with an original maturity of less than three months together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

25. Shares in Group entities

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

Critical accounting policies and key sources of estimation uncertainty

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law and IFRS require the directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's 'Conceptual Framework for Financial Reporting'. The judgements and assumptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results

Critical accounting policy	Note
Deferred tax	7
Loan impairment provisions	13
Provisions for liabilities and charges	21

Accounting developments

International Financial Reporting Standards

A number of IFRSs and amendments to IFRS were in issue at 31 December 2018 that would affect RBS Group from 1 January 2019 or later.

Effective 1 January 2019

IFRS 16 'Leases' was issued in January 2016 to replace IAS 17 'Leases'. The Group will apply the standard with effect from 1 January 2019. Lessees will capitalise operating leases through the recognition of assets representing the contractual rights of use. The present value of contractual payments will be recognised as lease liabilities.

The Group has new models and processes to implement IFRS 16. The most significant impact from initially applying IFRS 16 will be to recognise rights of use assets in respect of branches and office properties leased by the Group under contracts classified as operating leases under IAS 17. The present value of other contracts is immaterial. The Group will apply IFRS 16 on a modified retrospective basis without restating prior years and electing for the following exemptions on transition at 1 January 2019. The Group will

- apply IFRS 16 to contracts previously identified as leases by IAS 17
- use the incremental borrowing rate as the discount rate
- not apply IFRS 16 to operating leases with a remaining lease term of less than 12 months or low value leases (non property leases)
- rely on the assessment of whether the lease contract is onerous under IAS 37 at 31 December 2018 as an alternative to performing an impairment review of the right of use assets created on 1 January 2019 Where this is the case the carrying amount of the assets will be adjusted by the onerous lease provision.
- exclude initial direct costs from the measurement of the right of use asset.

The opening balance sheet of the Group at 1 January 2019 will be adjusted to create a right of use asset of approximately £1.0 billion A lease liability will also be recognised of £1.5 billion. Retained earnings will decrease by £0.2 billion after tax.

The opening balance sheet of the Bank at 1 January 2019 will be adjusted to create a right of use asset of approximately £0.9 billion. A lease liability will also be recognised of £1.5 billion. Retained earnings will decrease by £0.2 billion after tax.

Application of IFRS 16 by the Group is not expected to have a significant impact on lessor accounting or for finance lease accounting by lessees.

Effective after 2019

IFRS 17 'Insurance contracts' was issued in May 2017 to replace IFRS 4 and to establish a comprehensive standard for inceptors of insurance policies. The effective date is 1 January 2021, subject to IASB's approval of a deferral until 1 January 2022.

In February 2018 the IASB amended IAS 19 'Employee Benefits' to clarify the need to update assumptions whenever there is a plan amendment, curtailment or settlement.

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

Notes on the accounts

1 Net interest income

	2018 £m	2017 £m
Loans to banks - amortised cost	620	393
Loans to customers - amortised cost	6,086	5,866
Other financial assets	262	12
Interest receivable (1)	6,968	6,271
Balances with banks	276	144
Customer deposits: demand	158	123
Customer deposits: savings	373	217
Customer deposits: other time	69	78
Other financial liabilities	100	5
Subordinated liabilities	177	218
Internal funding of trading businesses	1	5
Interest payable (1)	1,154	790
	5,814	5,481

2 Non-interest income

	2018 £m	2017 £m
Net fees and commissions	1,651	1,555
Other operating income		
Operating lease and other rental income	229	248
Changes in the fair value of financial assets and liabilities designated as fair value through profit or loss	—	2
Changes in fair value of other financial assets held at mandatory fair value through profit or loss	45	—
Hedge ineffectiveness	4	—
Cost of economic hedging	112	25
Profit on disposal of amortised cost assets	28	54
Profit on disposal of fair value through other comprehensive income assets (2)	32	440
Profit on sale of property, plant and equipment	40	68
Profit on disposal of subsidiaries and associates	906	285
Other income (3)	671	(11)
	2,067	1,111
	3,718	2,666

Notes:
(1) Negative interest on Loans to banks is classed as interest payable and on Customer deposits is classed as interest receivable.
(2) 2017 Includes £444 million gain realised in relation to NatWest's equity holding in RBSI.
(3) Includes income from recharging shared services to other RBS Group subsidiaries following the transfers completed in preparation for ring-fencing in Q2 2018 and income from activities other than banking.

3 Operating expenses

	2018 £m	2017 £m
Wages, salaries and other staff costs (1)	1,735	647
Social security costs	168	52
Pension costs	281	145
Staff costs	2,184	844
Premises and equipment	757	273
Depreciation and amortisation	521	282
Other administrative expenses	2,119	2,921
Administrative expenses	3,397	3,476
Write down of other intangible assets (Note 16)	13	—
	5,594	4,320

Notes:
(1) The increase in 2018 compared to 2017 mainly includes the impact of the Group becoming the provider of shared services to the RBS Group Q2 2018 in preparation for ring-fencing, direct costs incurred are recovered through legal entity recharging and recorded in Other income. For the period before the transfer the Group was a net receiver of shared services from NatWest Markets Plc.
(2) Includes litigation and conduct costs. Further details are provided in Note 21.

3 Operating expenses continued

The average number of persons employed in continuing operations, rounded to the nearest hundred, in the Group during the year, excluding temporary staff, was 41,300 (2017 – 14,700); on the same basis, there were 300 people employed in discontinued operations (2017 – 2,100). The number of people employed by the Group in continued operations at 31 December 2018, excluding temporary staff was as follows:

	2018	2017
Personal & Business Banking	22,900	10,200
Commercial Banking	7,800	300
Private Banking	1,800	1,400
Commercial & Private Banking	9,600	1,700
Central & Other	22,900	2,500
Total	55,400	14,400
UK	40,100	12,800
Europe	1,400	1,600
Rest of the World	13,900	—
Total	55,400	14,400

The significant increase in headcount in 2018 represents staff transferred from the Royal Bank of Scotland plc (renamed NWM Plc) in 2018) to the Group in preparation for ring-fencing. During 2018, central and support staff that wholly support Group reportable segments were moved from Central items & other to the relevant segment. Central and support staff that wholly support businesses outside the ring-fence are reported in Central items & other and in 2019 will be moved operationally from the Group into the relevant non-ring-fenced entity, the majority to NWM.

There were no people employed in discontinued operations at 31 December 2018 (2017 – 800).

4 Segmental analysis

Reportable operating segments

The reportable operating segments are as follows:

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

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

Central items & other includes corporate functions, such as RBS Treasury, finance, risk management, compliance, legal, communications and human resources. Central functions manages RBS Group capital resources and RBS Group-wide regulatory projects and provides services to the reportable segments. Balances in relation to legacy litigation issues and the business are included in Central items in the relevant periods.

2018	Net interest income £m	Net fees and commissions £m	Other non-interest income £m	Total income £m	Operating expenses £m	Depreciation and amortisation £m	Impairment (losses)/ releases £m	Operating profit £m
UK Personal & Business Banking	3,773	793	185	4,751	(2,721)	—	(251)	1,779
Commercial Banking	1,605	655	241	2,501	(1,310)	(122)	(204)	865
Private Banking	444	213	27	684	(451)	(2)	8	239
Commercial & Private Banking	2,049	868	268	3,185	(1,761)	(124)	(196)	1,104
Central items & other	(8)	(10)	1,614	1,596	(591)	(397)	19	627
Total	5,814	1,651	2,067	9,532	(5,073)	(521)	(428)	3,510
2017								
UK Personal & Business Banking	3,721	802	(28)	4,495	(2,490)	—	(186)	1,819
Commercial Banking	1,566	603	228	2,397	(888)	(152)	(119)	1,238
Private Banking	386	159	25	570	(388)	—	(5)	177
Commercial & Private Banking	1,952	762	253	2,967	(1,276)	(152)	(124)	1,415
Central items & other	(192)	(9)	886	685	(272)	(130)	(1)	282
Total	5,481	1,555	1,111	8,147	(4,038)	(282)	(311)	3,516

4 Segmental analysis continued

Total revenue	2018 External £m	2018 Inter segment £m	2018 Total £m	2017 External £m	2017 Inter segment £m	2017 Total £m
UK Personal & Business Banking	5,511	66	5,577	5,291	—	5,291
Commercial Banking	2,525	46	2,571	2,313	24	2,337
Private Banking	645	181	826	647	20	667
Commercial & Private Banking	3,170	227	3,397	2,960	44	3,004
Central items & other	2,467	(293)	2,174	1,185	(44)	1,141
Total	11,148	—	11,148	9,436	—	9,436

Total income	2018 External £m	2018 Inter segment £m	2018 Total £m	2017 External £m	2017 Inter segment £m	2017 Total £m
UK Personal & Business Banking	4,699	52	4,751	4,493	2	4,495
Commercial Banking	2,731	(230)	2,501	2,455	(58)	2,397
Private Banking	556	128	684	573	(3)	570
Commercial & Private Banking	3,287	(102)	3,185	3,028	(61)	2,967
Central items & other	1,546	50	1,596	626	59	685
Total	9,532	—	9,532	8,147	—	8,147

Analysis of net fees and commissions

2018	UK PBB £m	Commercial Banking £m	Private Banking £m	Central items & other £m	Total £m
Fees and commissions receivable					
- Payment services	343	257	31	—	631
- Credit and debit card fees	361	63	12	—	436
- Lending (credit facilities)	379	195	2	—	576
- Brokerage	48	—	5	—	53
- Investment management, trustee and fiduciary services	42	26	179	—	247
- Trade finance	—	101	1	—	102
- Underwriting fees	20	1	—	—	21
- Other	8	43	15	(19)	47
Total	1,201	686	245	(19)	2,113
Fees and commissions payable	(408)	(31)	(32)	9	(462)
Net fees and commissions	793	655	213	(10)	1,651
2017					
Fees and commissions receivable					
- Payment services	316	243	34	—	593
- Credit and debit card fees	397	66	12	—	475
- Lending (credit facilities)	401	134	2	—	537
- Brokerage	48	—	4	—	52
- Investment management, trustee and fiduciary services	65	35	118	—	218
- Trade finance	—	135	1	—	136
- Other	4	21	15	3	43
Total	1,231	634	186	3	2,054
Fees and commissions payable	(429)	(31)	(27)	(12)	(499)
Net fees and commissions	802	603	159	(9)	1,555

	2018 Assets £m	2018 Liabilities £m	2018 Cost to acquire fixed assets and intangible assets £m	2017 Assets £m	2017 Liabilities £m	2017 Cost to acquire fixed assets and intangible assets £m
UK Personal & Business Banking	137,017	141,108	—	133,688	140,505	—
Commercial Banking	65,500	76,537	277	59,870	87,787	208
Private Banking	14,110	26,626	11	29,244	28,115	—
Commercial & Private Banking	79,610	103,163	288	89,114	115,902	208
Central items & other	93,311	45,793	539	118,041	68,069	92
Total	309,938	290,064	827	340,843	324,476	300

4 Segmental analysis continued

Geographical segments

The geographical analysis in the tables below has been compiled on the basis of location of office where the transactions are recorded.

2018	UK £m	USA £m	Europe £m	RoW £m	Total £m
Total revenue	10,893	—	255	—	11,148
Net interest income	5,861	—	(47)	—	5,814
Net fees and commissions	1,651	—	—	—	1,651
Other operating income	1,775	—	292	—	2,067
Total income	9,287	—	245	—	9,532
Operating profit/(loss) before tax	3,484	—	58	(32)	3,510
Total assets	309,209	—	378	351	309,938
Total liabilities	289,710	—	124	230	290,064
Net assets attributable to equity owners and non-controlling interests	19,499	—	254	121	19,874
Contingent liabilities and commitments	74,145	—	23	—	74,168
Cost to acquire property, plant and equipment and intangible assets	779	—	48	—	827

2017	UK £m	USA £m	Europe £m	RoW £m	Total £m
Total revenue	9,320	—	116	—	9,436
Net interest income	5,502	—	(21)	—	5,481
Net fees and commissions	1,554	—	1	—	1,555
Other operating income	1,001	—	110	—	1,111
Total income	8,057	—	90	—	8,147
Operating profit/ (loss) before tax	3,564	—	(36)	(12)	3,516
Total assets	312,818	25,696	2,308	21	340,843
of which total assets held for sale	—	24,526	—	—	24,526
Total liabilities	299,486	23,850	1,132	8	324,476
of which total liabilities held for sale	—	23,849	—	—	23,849
Net assets attributable to equity owners and non-controlling interests	13,332	1,846	1,176	13	16,367
Contingent liabilities and commitments	54,958	—	3	—	54,961
Cost to acquire property, plant and equipment and intangible assets	290	—	10	—	300

5 Pensions

Defined contribution schemes

The Group sponsors a number of defined contribution pension schemes in different territories, which new employees are offered the opportunity to join.

Defined benefit schemes

The Group sponsors a number of pension schemes in the UK and overseas, including the Main section of The Royal Bank of Scotland Group Pension Fund (the “Main section”) which operates under UK trust law and is managed and administered on behalf of its members in accordance with the terms of the trust deed, the scheme rules and UK legislation.

Pension fund trustees are appointed to operate each fund and ensure benefits are paid in accordance with the scheme rules and national law. The trustees are the legal owner of a scheme’s assets, and have a duty to act in the best interests of all scheme members.

The schemes generally provide a pension of one-sixtieth of final pensionable salary for each year of service prior to retirement up to a maximum of 40 years and are contributory for current members. These have 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 Group.

The Main section corporate trustee is RBS Pension Trustee Limited (the Trustee), a wholly owned subsidiary of the Bank, Principal Employer of the Main section. The Board of the Trustee comprises four member trustee directors selected from eligible active staff, deferred and pensioner members who apply and six appointed by the Group. Under UK legislation a defined benefit pension scheme is required to meet the statutory funding objective of having sufficient and appropriate assets to cover its liabilities (the pensions that have been promised to members).

Similar governance principles apply to the Group’s other pension schemes.

Investment strategy

The assets of the Main section, which is typical of other group schemes, represent 97% of plan assets at 31 December 2018 (2017 - 97%) and are invested in a diversified portfolio as shown below.

The Main section employs derivative instruments to achieve a desired asset class exposure and to reduce the section’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 Main section	2018 Quoted %	2018 Unquoted %	2018 Total %	2017 Quoted %	2017 Unquoted %	2017 Total %
Equities	3.7	5.2	9	21.9	4	26
Index linked bonds	40	—	40	30.6	—	31
Government bonds	13	—	13	9.2	—	9
Corporate and other bonds	12	5	17	15.8	1	17
Real estate	—	6	6	—	5	5
Derivatives	—	6	6	—	8	8
Cash and other assets	—	9	9	—	4	4
	69	31	100	78	23	100.0(

The Main section's holdings of derivative instruments are summarised in the table below:

	2018 Notional amounts £bn	2018 Fair value Assets £m	2018 Fair value Liabilities £m	2017 Notional amounts £bn	2017 Fair value Assets £m	2017 Fair value Liabilities £m
Inflation rate swaps	13	347	502	11	310	555
Interest rate swaps	55	8,132	5,362	44	8,161	4,779
Currency forwards	10	22	164	12	160	34
Equity and bond call options	1	277	—	2	428	—
Equity and bond put options	4	3	1	3	3	1
Other	4	1,027	1,092	4	327	444

Swaps have been executed at prevailing market rates and within standard market bid/offer spreads with a number of counterparty banks, including NatWest Markets Plc.

At 31 December 2018, the gross notional value of the swaps was £72 billion (2017 - £57 billion) and had a net positive fair value of £2,557 million (2017 - £3,045 million) against which the banks had posted approximately 103% collateral.

The schemes do not invest directly in the Group but can have exposure to the Group. The trustees of the respective UK schemes are responsible for ensuring that indirect investments in the Group do not exceed the 5% regulatory limit.

Changes in value of net pension liability/(asset)	Group Fair value of plan assets £m	Group Present value of defined benefit obligation £m	Group Asset ceiling/ minimum funding (1) £m	Group Net pension liability/ (asset) £m	Bank Fair value of plan assets £m	Bank Present value of defined benefit obligation £m	Bank Asset ceiling/ minimum funding (1) £m	Bank Net pension liability/ (asset) £m
At 1 January 2017	45,311	40,010	5,315	14	43,824	38,848	4,973	(3)
Currency translation and other adjustments	(2)	(1)	3	4	—	—	—	—
Income statement	1,188	1,177	142	131	1,155	1,131	134	110
Statement of comprehensive income	1,602	(4)	1,628	22	1,580	(9)	1,608	19
Contributions by employer	157	—	—	(157)	127	—	—	(127)
Contributions by plan participants and other scheme members	140	140	—	—	141	141	—	—
Benefits paid	(2,233)	(2,233)	—	—	(2,175)	(2,175)	—	—
Transfer to/from fellow subsidiaries	36	31	—	(5)	1	1	—	—
At 1 January 2018	46,199	39,120	7,088	9	44,653	37,937	6,715	(1)
Currency translation and other adjustments	5	8	—	3	—	—	—	—
Income statement								
Net interest expense	1,155	964	179	(12)	1,123	940	171	(12)
Current service cost	—	206	—	206	—	191	—	191
Less direct contributions from other scheme members	—	(46)	—	(46)	—	(53)	—	(53)
Past service cost	—	14	—	14	—	14	—	14
Loss on curtailments or settlement	—	69	—	69	—	—	—	—
	1,155	1,207	179	231	1,123	1,092	171	140
Statement of comprehensive income								
Return on plan assets excluding recognised interest income	(1,937)	—	—	1,937	(1,892)	—	—	1,892
Experience gains and losses	—	124	—	124	—	122	—	122
Effect of changes in actuarial financial assumptions	—	(2,383)	—	(2,383)	—	(2,340)	—	(2,340)
Effect of changes in actuarial demographic assumptions	—	813	—	813	—	819	—	819
Attributable contributions required by ring fencing	—	—	2,000	2,000	—	—	2,000	2,000
Other movements in the year	—	—	(538)	(538)	—	—	(468)	(468)
	(1,937)	(1,446)	1,462	1,953	(1,892)	(1,399)	1,532	2,025
Contributions by employer	2,190	—	—	(2,190)	2,165	—	—	(2,165)
Contributions by plan participants and other scheme members	56	56	—	—	61	61	—	—
Liabilities extinguished upon settlement	(259)	(259)	—	—	—	—	—	—
Benefits paid	(2,090)	(2,090)	—	—	(2,027)	(2,027)	—	—
Transfer to/from fellow subsidiaries (2)	(258)	(161)	(85)	12	(276)	(198)	(78)	—
At 31 December 2018	45,061	36,435	8,644	18	43,807	35,466	8,340	(1)

Notes:
(1) The Group recognises the net pension scheme surplus or deficit as a net asset or liability. In doing so, the funded status is adjusted to reflect any schemes with a surplus that the Group may not be able to access, as well as any minimum funding requirement to pay in additional contributions. This is most relevant to the Main section, where the current surplus is not recognised.
(2) Includes adjustment for assets of £276 million and liabilities of £198 million transferred at no consideration to establish two separate sections of the RBS Group Pension Fund because ring-fencing rules do not allow employees outside the ring-fenced group to be members of the Main section.
(3) The Group expects to make contributions to the Main section of £218 million in 2019.

Amounts recognised on the balance sheet	All schemes 2018 £m	All schemes 2017 £m
Fund assets at fair value	45,061	46,199
Present value of fund liabilities	36,435	39,120
Funded status	8,626	7,079
Asset ceiling/minimum funding	8,644	7,088
	(18)	(9)

Net pension (liability)/asset comprises	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Net assets of schemes in surplus (included in Other assets, Note 17)	23	22	15	16
Net liabilities of schemes in deficit (included in Other liabilities, Note 21)	(41)	(31)	(14)	(15)
	(18)	(9)	1	1

Notes on the accounts

5 Pensions continued

Funding and contributions by the Group

In the UK, the trustees of defined benefit pension schemes are required to perform funding valuations every three years. The trustees and the sponsor, 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. Similar arrangements apply in the other territories where the Group sponsors defined benefit pension schemes. The last funding valuation of the Main section was at 31 December 2017 and next funding valuation is due at 31 December 2020, to be agreed by 31 March 2022.

The triennial funding valuation of the Main section as at 31 December 2017 determined the funding level to be 96%, pension liabilities to be £47 billion and the deficit to be £2 billion, which was eliminated by a £2 billion cash payment in October 2018. The average cost of the future service of current members is 44% of basic salary before administrative expenses and contributions from those members.

In October 2018 the Court ruled on the requirement to and method for equalising guaranteed minimum pension benefits arising between 1990 and 1997 between men and women. In 2017 the Group considered that equalisation would change the Main section's defined benefit obligation by 0.2%.The estimate was updated following the clarity provided by the Court ruling and the impact of any future conversion exercise to rectify the position. The £98 million cost on revision of the previous estimate of the financial assumptions in respect of equalisation is recognised in equity.

Assumptions

Placing a value on the Group's defined benefit pension schemes' liabilities requires the Group's management to make a number of assumptions, with the support of independent actuaries. The ultimate cost of the defined benefit obligations depends 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.

The most significant assumptions used for the Main section are shown below:

	Principal IAS 19 actuarial assumptions		Principal assumptions of 2017 triennial valuation
	2018 %	2017 %	2017
Discount rate	2.9	2.6	Fixed interest swap yield curve plus 0.8% per annum
Inflation assumption (RPI)	3.2	3.1	RPI swap yield curve
Rate of increase in salaries	1.8	1.8	
Rate of increase in deferred pensions	3.1	3.0	
Rate of increase in pensions in payment	2.9	2.9	Modelled allowance for relevant caps and floors
Lump sum conversion rate at retirement	20	21	18%
Longevity at age 60:	years	years	
Current pensioners			
Males	27.2	27.2	28.1
Females	29.0	28.7	29.7
Future pensioners, currently aged 40			
Males	28.4	28.6	29.3
Females	30.5	30.4	31.5

Discount rate

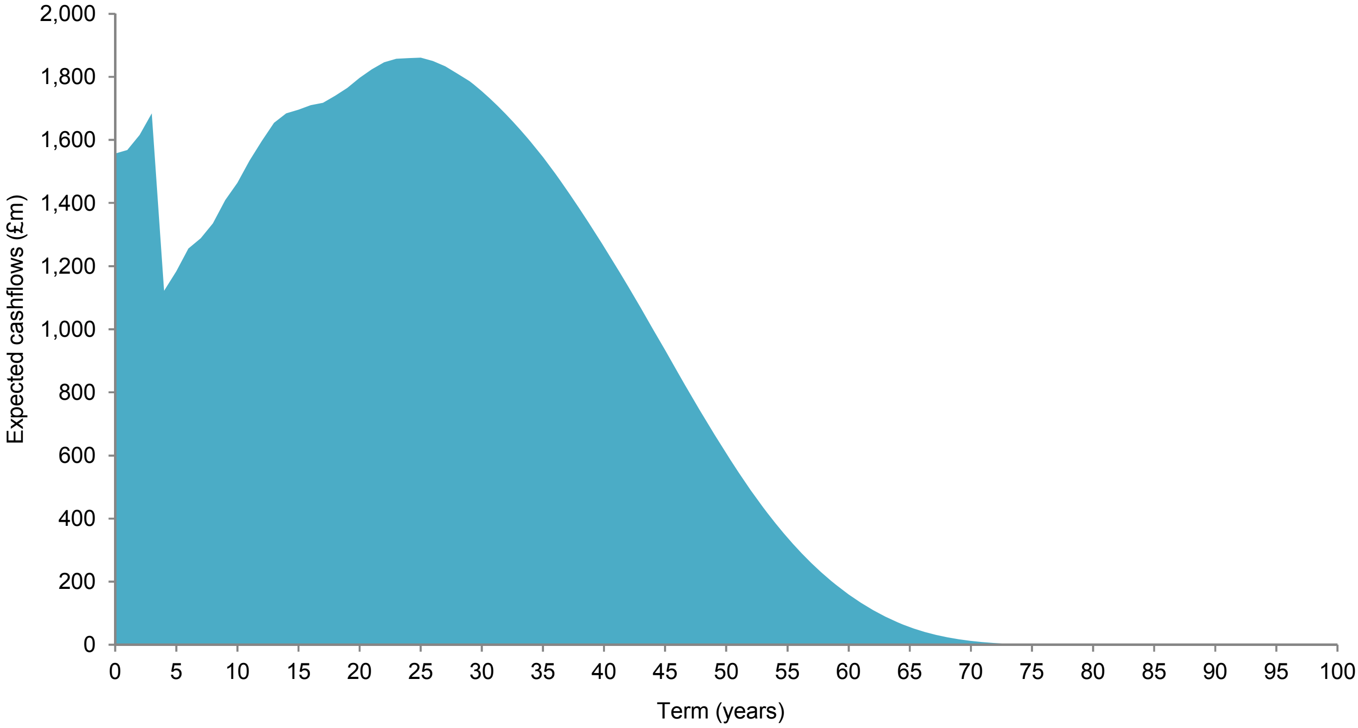
The IAS 19 valuation uses a single discount rate by reference to the yield on a basket of 'high quality' sterling corporate bonds. For the triennial valuation discounting is by reference to a yield curve.

The weighted average duration of the Main section's defined benefit obligation at 31 December 2018 is 20 years (2017 - 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. Sensitivity to the main assumptions is presented below.

5 Pensions continued

The chart below shows the projected benefit payment pattern for the Main section in nominal terms. These cashflows are based on the most recent formal actuarial valuation, effective 31 December 2017.



The larger outflow in the first four years represents the expected level of transfers out to 31 December 2021.

The table below shows how the present value of the defined benefit obligation of the Main section would change if the key assumptions used were changed independently. In practice, the variables are somewhat correlated and do not move completely in isolation.

2018	(Decrease)/ increase in value of assets £m	(Decrease)/ increase in value of liabilities £m	Increase in net pension assets/ (obligations) £m
0.25% increase in interest rates/discount rate	(2,214)	(1,644)	(570)
0.25% increase in inflation	1,487	1,199	288
0.25% increase in credit spreads	(5)	(1,644)	1,639
Longevity increase of one year	—	1,414	(1,414)
0.25% additional rate of increase in pensions in payment	—	1,215	(1,215)
Increase in equity values of 10% (1)	419	—	419
2017			
0.25% increase in interest rates/discount rate	(2,218)	(1,964)	(254)
0.25% increase in inflation	1,289	1,329	(40)
0.25% increase in credit spreads	(7)	(1,964)	1,957
Longevity increase of one year	—	1,478	(1,478)
0.25% additional rate of increase in pensions in payment	—	1,328	(1,328)
Increase in equity values of 10% (1)	909	—	909

Note:
(1) Includes both quoted and private equity.

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

Membership category	2018 %	2017 %
Active members	12.9	16.2
Deferred members	48.6	47.3
Pensioners and dependants	38.5	36.5
	100.0	100.0

5 Pensions continued

The experience history of Group schemes is shown below:

History of defined benefit schemes	Group 2018 £m	Group 2017 £m	Group 2016 £m	Group 2015 £m	Group 2014 £m	Bank 2018 £m	Bank 2017 £m	Bank 2016 £m	Bank 2015 £m	Bank 2014 £m
Fair value of plan assets	45,061	46,199	45,311	32,485	32,132	43,807	44,653	43,824	30,703	30,077
Present value of plan obligations	36,435	39,120	40,010	32,896	34,261	35,466	37,937	38,848	30,964	31,776
Net surplus/(deficit)	8,626	7,079	5,301	(411)	(2,129)	8,341	6,716	4,976	(261)	(1,699)
Experience (losses)/gains on plan liabilities	(124)	(107)	766	276	25	(122)	(108)	658	233	3
Experience (losses)/gains on plan assets	(1,937)	1,602	8,824	(427)	4,848	(1,892)	1,580	8,562	(415)	4,629
Actual return on plan assets	(782)	2,790	10,198	707	6,055	(769)	2,735	9,872	703	5,766
Actual return on plan assets	(1.7%)	6.2%	31.4%	2.2%	23.2%	(1.7%)	6.2%	32.2%	2.3%	23.8%

6 Auditor’s remuneration

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

	2018 £m	2017 £m
Fees payable for the audit of the Group’s annual accounts	9.8	1.2
Fees payable to the auditor and its associates for other services to the Group		
- the audit of the Bank's subsidiaries pursuant to legislation	1.6	1.5
Total audit and audit-related assurance service fees	11.4	2.7

Fees payable to the auditor for non-audit services are disclosed in the consolidated financial statements of The Royal Bank of Scotland Group plc.

7 Tax

	2018 £m	2017 £m
Current tax		
Charge for the year	(758)	(781)
(Under)/over provision in respect of prior years	(63)	19
	(821)	(762)
Deferred tax		
Credit/(charge) for the year	18	(12)
Increase in the carrying value of deferred tax assets	7	—
Over/(under) provision in respect of prior years	25	(38)
Tax charge for the year	(771)	(812)

The actual tax charge differs from the expected tax charge computed by applying the standard rate of UK corporation tax of 19% (2017 – 19.25%) as follows:

	2018 £m	2017 £m
Expected tax charge	(667)	(677)
Losses and temporary differences in year where no deferred tax asset recognised	(13)	(2)
Foreign profits taxed at other rates	(7)	(2)
UK tax rate change impact (1)	(5)	—
Items not allowed for tax		
- losses on disposal and write-downs	(24)	(77)
- UK bank levy	(20)	—
- regulatory and legal actions	(18)	(29)
- other disallowable items	(27)	(31)
Non-taxable items (2)	243	228
Taxable foreign exchange movements	—	3
Losses brought forward and utilised	—	3
Increase carrying value of deferred tax assets in respect of:		
- UK losses	7	—
Banking surcharge	(202)	(209)
Adjustments in respect of prior years (3)	(38)	(19)
Actual tax charge	(771)	(812)

Notes:
(1) 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.
(2) Principally relates to non-taxable transfers to the wider RBS Group, under UK ring- fencing regime restructuring.
(3) Prior year tax adjustments incorporate refinements to tax computations made on submission and agreement with the tax authorities. Current taxation balances include provisions in respect of uncertain tax positions, in particular in relation to restructuring and other costs where the taxation treatment remains subject to agreement with the relevant tax authorities.

Tax continued

Judgment: Tax contingencies

The Group's income tax charge and its provisions for income taxes necessarily involves a significant degree of estimation and judgement. The tax treatment of some transactions is uncertain and tax computations are yet to be agreed with the tax authorities in a number of jurisdictions. The Group recognises anticipated tax liabilities based on all available evidence and, where appropriate, in the light of external advice. Any difference between the final outcome and the amounts provided will affect current and deferred income tax assets and charges in the period when the matter is resolved.

Deferred tax

	Group		Bank	
	2018 £m	2017 £m	2018 £m	2017 £m
Deferred tax liability	225	22	—	—
Deferred tax asset	(1,590)	(1,079)	(1,546)	(1,060)
Net deferred tax asset	(1,365)	(1,057)	(1,546)	(1,060)

Net deferred tax asset comprised:

	Group						
	Pension £m	Accelerated capital allowances £m	Expense Provisions £m	Financial instruments £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2017	(715)	6	(63)	1	(619)	22	(1,368)
Acquisitions and disposals of subsidiaries	—	30	—	—	—	—	30
Charge/(credit) to income statement	3	(32)	20	—	64	(5)	50
Charge/(credit) to other comprehensive income	230	—	—	—	—	(1)	229
Currency translation and other adjustments	3	—	(3)	—	—	2	2
At 1 January 2018	(479)	4	(46)	1	(555)	18	(1,057)
Implementation of IFRS9 on 1 January 2018	—	—	—	(100)	—	—	(100)
Acquisitions and disposals of subsidiaries	(3)	(203)	(49)	180	—	27	(48)
(Credit)/charge to income statement	(48)	(26)	9	(13)	31	(3)	(50)
(Credit)/charge to other comprehensive income	(84)	—	—	(32)	—	1	(115)
Currency translation and other adjustments	—	5	—	—	—	—	5
At 31 December 2018	(614)	(220)	(86)	36	(524)	43	(1,365)

	Bank						
	Pension £m	Accelerated capital allowances £m	Expense provisions £m	Financial instruments £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2017	(712)	(10)	(51)	—	(605)	13	(1,365)
Charge/(credit) to income statement	6	(6)	14	—	64	(2)	76
Charge/(credit) to other comprehensive income	229	—	—	—	—	(1)	228
Currency translation and other adjustments	—	—	—	—	—	1	1
At 1 January 2018	(477)	(16)	(37)	—	(541)	11	(1,060)
Implementation of IFRS9 on 1 January 2018	—	—	—	(90)	—	—	(90)
Acquisitions and disposals of subsidiaries	—	(403)	(43)	124	—	22	(300)
(Credit)/charge to income statement	(48)	16	6	10	36	(1)	19
(Credit)/charge to other comprehensive income	(85)	—	—	(32)	—	1	(116)
Currency translation and other adjustments	—	—	—	—	—	1	1
At 31 December 2018	(610)	(403)	(74)	12	(505)	34	(1,546)

7 Tax continued

Deferred tax assets in respect of unused tax losses are recognised if the losses can be used to offset probable future taxable profits after taking into account the expected reversal of other temporary differences. Recognised deferred tax assets in respect of tax losses are analysed further below.

	2018 £m	2017 £m
UK tax losses carried forward		
- National Westminster Bank Plc	505	541
- Ulster Bank Limited	19	14
	524	555

Critical accounting policy: Deferred tax
The deferred tax assets of £1,590 million as at 31 December 2018 (2017 - £1,079 million) principally comprises losses which arose in the UK, 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.

Judgment - The Group has considered the carrying value of deferred tax assets 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.

UK tax losses - Under UK tax rules, tax losses can be carried forward indefinitely. As the recognised tax losses in the Group 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 2018 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.

National Westminster Bank Plc – A deferred tax asset of £505 million has been recognised in respect of total losses of £2,936 million. The losses arose principally as a result of significant impairment and conduct charges between 2009 and 2012 during challenging economic conditions in the UK banking sector. National Westminster Bank plc returned to tax profitability during 2015 and expects the deferred tax asset to be consumed by future taxable profits by the end of 2023.

Unrecognised deferred tax
2017 has been re-presented to show continued operation only.

Deferred tax assets of £10 million (2017 - £16 million) have not been recognised in respect of tax losses and other temporary differences carried forward of £57 million (2017 - £94 million) in jurisdictions where doubt exists over the availability of future taxable profits. The tax losses and other temporary differences carried forward have no expiry date.

Deferred tax liabilities of £115 million (2017 - £117 million) have not been recognised in respect of retained earnings of overseas subsidiaries and held-over gains on the incorporation of overseas branches. Retained earnings of overseas subsidiaries are expected to be reinvested indefinitely or remitted to the UK free from further taxation. No taxation is expected to arise in the foreseeable future in respect of held-over gains. Changes to UK tax legislation largely exempts from UK tax, overseas dividends received on or after 1 July 2009.

8 Profit/(loss) dealt with in the accounts of the Bank

As permitted by section 408(3) of the Companies Act 2006, no income statement for the Bank has been presented as a primary financial statement.

Notes on the accounts

9 Derivatives

Companies in the Group transact derivatives to manage balance sheet foreign exchange, interest rate and credit risk.

	Group					
	2018			2017		
	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m
Exchange rate contracts	9	115	68	17	285	290
Interest rate contracts	330	1,120	711	191	2,030	2,888
Credit derivatives	—	18	—	—	—	—
		1,253	779		2,315	3,178

	Bank					
	2018			2017		
	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m
Exchange rate contracts	12	114	286	16	280	284
Interest rate contracts	337	1,145	899	182	1,997	2,833
Credit derivatives	—	18	—	—	—	—
		1,277	1,185		2,277	3,117

Refer to Note 10 for amounts due to/from fellow RBS Group subsidiaries.

The Group enters into fair value hedges and hedges of net investments in foreign operations.

The majority of the Group's interest rate hedges relate to the management of the Group's non-trading interest rate risk. The Group manages this risk within approved limits. Residual risk positions are hedged with derivatives principally interest rate swaps. Suitable larger financial instruments are fair value hedged.

The majority of the Group's fair value hedges involve interest rate swaps hedging the fixed interest rate risk in recognised financial assets and financial liabilities.

For fair value hedge relationships of interest rate risk, the hedged items are typically large corporate fixed-rate loans, government securities, fixed rate finance leases, fixed rate medium-term notes or preference shares classified as debt. The hedged risk is the risk of changes in the hedged items fair value attributable to changes in the benchmark interest rate embedded in the hedged item. This risk component is identified using the risk management systems of the Group. This risk component comprises the majority of the hedged items fair value risk.

For fair value hedge relationships the Group determines that there is an economic relationship between the hedged items and hedging instrument via assessing the initial and ongoing effectiveness by comparing movements in the fair value of the hedged item attributable to the hedged risk with movements in the fair value of the expected changes in cash flows from the hedging interest rate swap. Hedge effectiveness is measured on a cumulative basis over a time period management feels appropriate. The Group uses either the actual ratio between the hedged item and hedging instrument(s) or one that minimises hedge ineffectiveness to establish the hedge ratio for hedge accounting.

The Group hedges currency risk in respect of its net investment in foreign currency denominated operations with currency borrowings and forward foreign exchange contracts. The Group reviews the value of the investments net assets, executing hedges where appropriate, to reduce the sensitivity of capital ratios to foreign exchange movements.

Included in the tables above are derivatives held for hedging purposes as follows:

	Group				
	2018			2017	
	Notional £bn	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedging - interest rate contracts	35.9	587	776	—	—

	Bank				
	2018			2017	
	Notional £bn	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedging - Interest rate contracts	35.8	587	765	—	—

9 Derivatives continued

The following table shows the period in which the hedging contract ends:

	Group							
	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years	20+ years	Total
Fair value hedging								
Hedging assets - interest rate risk (£bn)	1.0	1.7	9.8	4.1	6.6	2.1	3.3	28.6
Hedging liabilities - interest rate risk (£bn)	—	—	2.1	3.8	1.4	—	—	7.3

	Bank							
	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years	20+ years	Total
Fair value hedging								
Hedging assets - interest rate risk (£bn)	1.0	1.7	9.8	4.1	6.5	2.1	3.3	28.5
Hedging liabilities - interest rate risk (£bn)	-	-	2.1	3.8	1.4	-	-	7.3

	Group		
2018	Carrying value (CV) of hedged assets and liabilities £m	Impact on hedged items included in CV £m	Impact on hedged items cases to be adjusted for hedging gains or losses £m
Fair value hedging - interest rate			
Loans to customers - amortised cost	199	27	—
Other financial assets - securities	30,991	375	10
Total assets	31,190	402	10
Other financial liabilities - debt securities in issue	7,528	228	—
Total liabilities	7,528	228	—

	Bank		
2018	Carrying value (CV) of hedged assets and liabilities £m	Impact on hedged items included in CV £m	Impact on hedged items ceased to be adjusted for hedging gains or losses £m
Fair value hedging - interest rate			
Loans to customers - amortised cost	133	16	—
Other financial assets - securities	30,991	375	10
Total assets	31,124	391	10
Other financial liabilities - debt securities in issue	7,528	228	—
Total liabilities	7,528	228	—

Hedge ineffectiveness recognised in other operating income comprised:

	Group	
	2018 £m	2017 £m
Fair value hedging		
Gains on the hedged items attributable to the hedged risk	592	—
Losses on the hedging instruments	(588)	—
Total	4	—

The main sources of ineffectiveness for interest rate risk hedge accounting relationships are:

- the effect of the counterparty credit risk on the fair value of the interest rate swap, which is not reflected in the fair value of the hedged item attributable to the change in interest rate; and
- upfront present values on the hedging derivatives where hedge accounting relationships have been designated after the trade date.

Additional information on net investment hedging can be found in the statement of Changes in Equity.

Notes on the accounts

10 Financial instruments - classification

The following tables analyse the Group's financial assets and liabilities in accordance with the categories of financial instruments on an IFRS 9/IAS 39 basis at 31 December 2017. Assets and liabilities outside the scope of IFRS 9/IAS 39 are shown within other assets and other liabilities.

	Group					
Assets	MFVTPL (1) £m	DFV (2) £m	FVOCI (3) £m	Amortised cost £m	Other assets £m	Total £m
Cash and balances at central banks	—	—	—	45,032		45,032
Derivatives	1,253					1,253
Loans to banks - amortised cost (4)				6,406		6,406
Loans to customers - amortised cost				203,647		203,647
Amounts due from holding companies and fellow subsidiaries	26	10	—	5,165	5	5,206
Other financial assets (5)	280	—	35,400	5,546	—	41,226
Other assets					7,168	7,168
31 December 2018	1,559	10	35,400	265,796	7,173	309,938

	Held-for-trading £m	DFV (2) £m	Available-for-sale £m	Loans and receivables £m	Other assets £m	Total £m
Cash and balances at central banks	—	—	—	35,799		35,799
Derivatives	2,315					2,315
Loans to banks - amortised cost (4)				1,919		1,919
Loans to customers - amortised cost				191,882		191,882
Amounts due from holding companies and fellow subsidiaries	22	132	—	77,772	4	77,930
Other financial assets (5)	7	34	562	1,062	—	1,665
Other assets					29,333	29,333
31 December 2017	2,344	166	562	308,434	29,337	340,843

	Group				
Liabilities	Held-for trading £m	DFV (2) £m	Amortised cost £m	Other liabilities £m	Total £m
Bank deposits (6)			17,563		17,563
Customer deposits (7)			237,770		237,770
Amounts due to holding companies and fellow subsidiaries	17	—	22,525	—	22,542
Derivatives	779				779
Other financial liabilities	50	20	6,427		6,497
Subordinated liabilities	—	—	1,275		1,275
Other liabilities			857	2,781	3,638
31 December 2018	846	20	286,417	2,781	290,064

	Held-for-trading £m	DFV (2) £m	Amortised cost £m	Other liabilities £m	Total £m
Bank deposits (6)			20,544		20,544
Customer deposits (7)			226,423		226,423
Amounts due to holding companies and fellow subsidiaries	608	—	43,984	7	44,599
Derivatives	3,178				3,178
Other financial liabilities	9	166	400		575
Subordinated liabilities	—	—	1,240		1,240
Other liabilities			808	27,109	27,917
31 December 2017	3,795	166	293,399	27,116	324,476

For the notes to this table refer to page 96.

10 Financial instruments - classification continued

The above includes amounts due from/to:

	Group			
	2018		2017	
	Immediate holding company (5) £m	Fellow subsidiaries £m	Intermediate holding company (8) £m	Fellow subsidiaries £m
Assets				
Derivatives	61	1,143	1,703	6
Loans to banks - amortised cost	—	4,635	77,515	257
Loans to customers - amortised cost	40	490	—	—
Liabilities				
Bank deposits	—	13,564	31,915	780
Customer deposits	4,409	83	—	6,774
Subordinated liabilities	2,904	—	4,515	—
Derivatives	—	744	2,951	15

Notes:
(1) Mandatory fair value through profit or loss.
(2) Designated as at fair value through profit or loss.
(3) Fair value through other comprehensive income.
(4) Includes items in the course of collection from other banks of £386 million (2017 - £593 million).
(5) Includes equity shares of £1 million (2017 - £9 million).
(6) Includes items in the course of transmission to other banks of £131 million (2017 - £198 million).
(7) The carrying amount of other customer accounts designated as at fair value through profit or loss is £1 million (2017 - £26 million) higher than the principal amount. No amounts have been recognised in the profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial both during the period and cumulatively.
(8) Refer to note 37 for holding company details.

The Bank's financial assets and liabilities include:

	Group	
	2018	2017
Reverse repos		
Loans to banks - amortised cost	3,539	—
Other financial assets	9,890	—
Repos		
Bank deposits	518	—
Customer deposits	3,774	—

	Bank					
Assets	MFVTPL (1) £m	DFV (2) £m	FVOCI (3) £m	Amortised cost £m	Other assets £m	Total £m
Cash and balances at central banks	—	—	—	43,966		43,966
Derivatives	1,277					1,277
Loans to banks - amortised cost (4)				5,875		5,875
Loans to customers - amortised cost				171,433		171,433
Amounts due from holding companies and fellow subsidiaries	88	10	—	30,497	185	30,780
Other financial assets	280	—	35,398	5,156		40,834
Investment in group undertakings					2,466	2,466
Other assets					4,993	4,993
31 December 2018	1,645	10	35,398	256,927	7,644	301,624
	Held-for-trading £m	DFV (2) £m	Available-for-sale £m	Loans and receivables £m	Other assets £m	Total £m
Cash and balances at central banks	—	—	—	34,763		34,763
Derivatives	2,277					2,277
Loans to banks - amortised cost (4)				1,635		1,635
Loans to customers - amortised cost				160,614		160,614
Amounts due from holding companies and fellow subsidiaries	22	130	—	54,059	—	54,211
Other financial assets	7	—	7	1,059		1,073
Investment in group undertakings					2,546	2,546
Other assets					2,598	2,598
31 December 2017	2,306	130	7	252,130	5,144	259,717

For the notes to this table refer to page 97.

10 Financial instruments - classification continued

Liabilities	Bank Held-for-trading £m	DFV (2) £m	Amortised cost £m	Other liabilities £m	Total £m
Bank deposits (5)	—	—	17,557		17,557
Customer deposits (6)	—	—	204,279		204,279
Amounts due to holding company and fellow subsidiaries	—	—	50,958	—	50,958
Derivatives	1,185				1,185
Other financial liabilities	50	10	5,829		5,889
Subordinated liabilities	—	—	1,267		1,267
Other liabilities			34	2,179	2,213
31 December 2018	1,235	10	279,924	2,179	283,348

	Held-for-trading £m	DFV (2) £m	Amortised cost £m	Other liabilities £m	Total £m
Bank deposits (5)	—	—	20,528		20,528
Customer deposits (6)	—	—	194,055		194,055
Amounts due to holding company and fellow subsidiaries	608	—	22,694	9	23,311
Derivatives	3,117				3,117
Other financial liabilities	9	130	—		139
Subordinated liabilities	—	—	1,231		1,231
Other liabilities				1,981	1,981
31 December 2017	3,734	130	238,508	1,990	244,362

The above includes amounts due from/to:

	Bank 2018 Immediate holding company (7) £m	Fellow subsidiaries £m	Subsidiaries £m	2017 Immediate and intermediate holding companies (7) £m	Fellow subsidiaries £m	Subsidiaries £m
Assets						
Derivatives	61	1,139	47	1,697	—	—
Loans to banks - amortised cost	1,514	2,396	7,884	53,672	95	234
Loans to customers - amortised cost	40	218	18,445	—	5	53
Liabilities						
Bank deposits	4,509	5,381	25,132	10,428	740	161
Customer deposits	5,130	—	6,331	—	6,754	202
Subordinated liabilities	2,904	—	—	4,409	—	—
Derivatives	—	739	414	2,908	—	—

Notes:
(1) Mandatory fair value through profit or loss
(2) Designated as at fair value through profit or loss
(3) Fair value through other comprehensive income
(4) Includes items in the course of collection from other banks of £353 million (2017 - £562 million).
(5) Includes items in the course of transmission to other banks of £129 million (2017 - £192 million).
(6) The carrying amount of other customer accounts designated as at fair value through the profit or loss is £1 million (2017 - £27 million) higher than the principal amount. No amounts have been recognised in the profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial both during the period and cumulatively.
(7) Refer to note 37 for holding company details.

10 Financial instruments – classification continued

The Bank's financial assets and liabilities include:

	Bank 2018	Bank 2017
Reverse repos		
Loans to banks - amortised cost	3,539	—
Repos		
Bank deposits	518	—
Customer deposits	3,774	—

The tables below present information on financial assets and liabilities that are offset on the balance sheet under IFRS or subject to enforceable master netting agreements together with financial collateral received or given.

	Instruments which can be offset			Potential to offset not recognised by IFRS					
2018	Gross £m	IFRS offset £m	Balance sheet £m	Effect of master netting and similar agreements £m	Cash collateral £m	Other financial collateral £m	Net amount after the effect of netting arrangements and related collateral £m	Instruments outside netting arrangements £m	Balance sheet total total £m
Derivative assets	2,976	(2,969)	7	—	—	—	7	1,246	1,253
Derivative liabilities	4,366	(4,338)	28	—	—	—	28	751	779
Net position (1)	(1,390)	1,369	(21)	—	—	—	(21)	495	474
2017									
Derivative assets	2,054	—	2,054	(1,806)	(8)	(144)	96	261	2,315
Derivative liabilities	3,051	—	3,051	(1,806)	—	—	1,245	127	3,178
Net position (1)	(997)	—	(997)	—	(8)	(144)	(1,149)	134	(863)

Notes:
(1) The net IFRS offset balance of £1,369 million (2017 - nil) relates to variation margin netting reflected on other balance sheet lines.
(2) The effect of master netting agreements on derivatives within the Bank was nil (2017 - £1,804 million).

Notes on the accounts

11 Financial instruments - valuation

In accordance with Accounting policies 15 and 23, 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 Group maximises the use of relevant observable inputs and minimises the use of unobservable inputs.

Modelled approaches may be used to measure instruments classed as Level 2 or 3. Estimation expertise is required in the selection, implementation and calibration of appropriate models. The resulting modelled valuations are considered for accuracy and reliability. Portfolio level adjustments consistent with IFRS 13 are raised to incorporate counterparty credit risk, funding and margining risks. Expert judgement is used in the initial measurement of modelled products by control teams.

Where the Group manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk,it measures the fair value of a group of financial assets and financial liabilities on the basis of the price that it would receive to sell a net long position (i.e. an asset) for a particular risk exposure or to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction at the measurement date under current market conditions.

Credit valuation adjustments are made when valuing derivative financial assets to incorporate counterparty credit risk. Adjustments are also made when valuing financial liabilities measured at fair value to reflect the Group's own credit standing.

Where the market for a financial instrument is not active, fair value is established using a valuation technique. These valuation techniques involve a degree of estimation, the extent of which depends on the instrument's complexity and the availability of market-based data. Further details about the valuation methodologies and the sensitivity to reasonably possible alternative assumptions of the fair value of financial instruments valued using techniques where at least one significant input is unobservable are given below.

	2018			2017		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
	£m	£m	£m	£m	£m	£m
Assets						
Derivatives	—	1,244	9	—	2,291	24
Amounts due from holding companies and fellow subsidiaries	—	36	—	—	154	—
Other financial assets						
Securities	31,476	3,924	—	396	161	39
Loans - MFVTPL	—	280	—	—	—	7
Total financial assets held at fair value	31,476	5,484	9	396	2,606	70
Liabilities						
Derivatives	—	738	41	—	3,161	17
Amounts due to holding companies and fellow subsidiaries	—	17	—	—	608	—
Other financial liabilities						
Deposits - HFT	—	50	—	—	9	—
Deposits - DFV	—	20	—	—	166	—
Total financial liabilities held at fair value	—	825	41	—	3,944	17

Notes:
(1) Transfers between levels are deemed to have occurred at the beginning of the quarter in which the instruments were transferred.
(2) The determination of an instrument's level cannot be made at a global product level as a single product type can be in more than one level. For example, a single name corporate credit default swap could be in level 2 or level 3 depending on whether the reference counterparty's obligations are liquid or illiquid.

11 Financial instruments – valuation continued

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 CLOs, most bank loans, repos and reverse repos, less liquid listed equities, state and municipal obligations, most notes issued, and certain money market securities and loan commitments and most OTC derivatives.

Level 3 - instruments 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, certain emerging markets and derivatives with unobservable model inputs.

Valuation Techniques

NatWest derives the fair value of its instruments 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:

Bond prices - quoted prices are generally available for government bonds, certain corporate securities and some mortgage-related products.

Credit spreads - where available, these are derived from prices of credit default swaps or other credit based instruments, such as debt securities. For others, credit spreads are obtained from 3rd 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.

Financial instruments - Valuation (continued)

Commodity prices - many commodities are actively traded in spot and forward contracts and futures on exchanges in London, New York and other commercial centres.

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

Prepayment rates - the fair value of a financial instrument that can be prepaid by the issuer or borrower differs from that of an instrument that cannot be prepaid. In valuing pre-payable instruments that are not quoted in active markets, NatWest considers the value of the prepayment option.

Recovery rates/loss given default - these are used as an input to valuation models and reserves for asset-backed securities and other credit products as an indicator of severity of losses on default. Recovery rates are primarily sourced from market data providers or inferred from observable credit spreads.

Valuation Control

NatWest's control environment for the determination of the fair value of financial instruments includes formalised protocols for the review and validation of fair values independent of the businesses entering into the transactions.

Independent Price Verification (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 monthly, for all fair value positions. The IPV control includes formalised reporting and escalation of any valuation differences in breach of established thresholds.

The Modelled Product Review Committee sets the policy for model documentation, testing and review, and prioritises models with significant exposure being reviewed by the NatWest Model Risk team. Valuation Committees are made up of valuation specialists and senior business representatives from various functions and oversees pricing, reserving and valuations issues. These committees meet monthly to review and ratify any methodology changes. The Executive Valuation Committee meets quarterly to address key material and subjective valuation issues, to review items escalated by Valuation Committees and to discuss other relevant matters including prudential valuation.

11 Financial instruments – valuation continued

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

Financial instruments – Valuation -Areas of judgment

The majority of NatWest financial instruments carried at fair value are classified as Level 2: inputs are observable either directly (i.e. as a price) or indirectly (i.e. derived from prices).

Active and inactive markets

A key input in the decision making process for the allocation of assets to a particular level is market activity. In general, the degree of valuation uncertainty depends on the degree of liquidity of an input.

Where markets are liquid, little judgment is required. However, when the information regarding the liquidity in a particular market is not clear, a judgment may need to be made. This can be more difficult as assessing the liquidity of a market is not always straightforward. For an equity traded on an exchange, daily volumes of trading can be seen, but for an over-the-counter (OTC) derivative assessing the liquidity of the market with no central exchange is more difficult.

A key related matter is where a market moves from liquid to illiquid or vice versa. Where this change is considered to be temporary, the classification is not changed. For example, if there is little market trading in a product on a reporting date but at the previous reporting date and during the intervening period the market has been considered to be liquid, the instrument will continue to be classified in the same level in the hierarchy. This is to provide consistency so that transfers between levels are driven by genuine changes in market liquidity and do not reflect short term or seasonal effects. Material movements between levels are reviewed quarterly.

The breadth and depth of the IPV data allows for a rules based quality assessment to be made of market activity, liquidity and pricing uncertainty, which assists with the process of allocation to an appropriate level. Where suitable independent pricing information is not readily available, the quality assessment will result in the instrument being assessed as Level 3.

Modelled products

For modelled products the market convention is to quote these trades through the model inputs or parameters as opposed to a cash price equivalent. A 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.

11 Financial instruments: fair value of financial instruments not carried at fair value

The following table shows the carrying value and fair value of financial instruments carried at amortised cost on the balance sheet.

	Group						Bank					
	Items where fair value approximates carrying value	Carrying value	Fair value	Fair value hierarchy level			Items where fair value approximates carrying value	Carrying value	Fair value	Fair value hierarchy level		
2018	£bn	£bn	£bn	Level 1 £bn	Level 2 £bn	Level 3 £bn	£bn	£bn	£bn	Level 1 £bn	Level 2 £bn	Level 3 £bn
Financial assets												
Cash and balances at central banks	45.0						44.0					
Loans to banks	0.4	6.0	6.0	—	5.4	0.6	0.4	5.5	5.5	—	5.2	0.3
Loans to customers		203.6	202.3	—	0.1	202.2		171.4	170.3	—	—	170.3
Amounts due from holding companies and fellow subsidiaries		5.2	5.3	—	0.7	4.6		30.5	30.8	—	15.7	15.1
Other financial assets												
Securities		5.3	5.4	3.6	1.5	0.3		5.0	5.0	3.6	1.4	—
Settlement balances	0.2						0.2					
Financial liabilities												
Bank deposits	3.0	14.6	13.9	—	13.9	—	3.0	14.6	13.9	—	13.9	—
Customer deposits	203.0	34.8	35.4	—	9.0	26.4	184.4	19.9	20.5	—	9.0	11.5
Amounts due to holding companies and fellow subsidiaries	5.7	16.8	17.1	—	6.8	10.3	3.1	47.9	48.1	—	15.6	32.5
Other financial liabilities												
Debt securities in issue		6.3	6.4	—	5.5	0.9		5.7	5.8	—	5.5	0.3
Settlement balances	0.1						0.1					
Subordinated liabilities		1.3	1.2	—	1.2	—		1.3	1.2	—	1.2	—
Other liabilities - notes in circulation	0.8						—					
2017												
Financial assets												
Cash and balances at central banks	35.8						34.8					
Loans to banks	0.6	1.3	1.3	—	1.0	0.3	0.6	1.0	1.0	—	0.9	0.1
Loans to customers		191.9	191.3	—	0.2	191.1		160.6	160.0	—	—	160.0
Amounts due from holding companies and fellow subsidiaries		77.8	78.2	—	—	78.2		54.1	54.6	—	0.2	54.4
Other financial assets												
Securities		1.1	1.1	—	—	1.1		1.1	1.1	—	—	1.1
Financial liabilities												
Bank deposits	3.1	17.4	17.5	—	17.0	0.5	3.1	17.4	17.5	—	17.0	0.5
Customer deposits	206.2	20.2	20.1	—	4.9	15.2	187.0	7.1	7.0	—	4.9	2.1
Amounts due to holding companies and fellow subsidiaries	15.8	28.2	29.5	—	4.5	25.0	1.6	21.1	22.3	—	4.5	17.8
Other financial liabilities												
Debt securities in issue		0.4	0.4	—	—	0.4		—	—	—	—	—
Subordinated liabilities		1.2	1.4	—	1.4	—		1.2	1.4	—	1.4	—
Other liabilities - notes in circulation	0.8						—					

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Quoted market values are used where available; otherwise, fair values have been estimated based on discounted expected future cash flows and other valuation techniques. These techniques involve uncertainties and require assumptions and judgments covering prepayments, credit risk and discount rates. Furthermore there is a wide range of potential valuation techniques. Changes in these assumptions would significantly affect estimated fair values. The fair values reported would not necessarily be realised in an immediate sale or settlement.

The assumptions and methodologies underlying the calculation of fair values of financial instruments at the balance sheet date are as follows:

Short-term financial instruments

For certain short-term financial instruments: cash and balances at central banks, items in the course of collection from other banks, settlement balances, items in the course of transmission to other banks, customer demand deposits and notes in circulation, carrying value is a reasonable approximation of fair value.

Loans to banks and customers

In estimating the fair value of net loans to customers and banks measured at amortised cost, the Group's loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans. Two principal methods are used to estimate fair value:

(a) Contractual cash flows are discounted using a market discount rate that incorporates the current spread for the borrower or where this is not observable, the spread for borrowers of a similar credit standing. This method is used for portfolios where counterparties have external ratings:

(b) Expected cash flows (unadjusted for credit losses) are discounted at the current offer rate for the same or similar products. This approach is adopted for lending portfolios in UK PBB, Commercial Banking (SME loans) and Private Banking in order to reflect the homogeneous nature of these portfolios.

For certain portfolios where there are very few or no recent transactions a bespoke approach is used.

Securities

The majority of debt securities are valued using quoted prices in active markets, or using quoted prices for similar assets in active markets. Fair values of the rest are determined using discounted cash flow valuation techniques.

Bank and customer deposits

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

Debt securities in issue and subordinated liabilities

Fair values are determined using quoted prices for similar liabilities where available or by reference to valuation techniques, adjusting for own credit spreads where appropriate.

12 Financial instruments - maturity analysis

Remaining maturity

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

	Group					
	2018			2017		
	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	45,032	—	45,032	35,799	—	35,799
Derivatives	116	1,137	1,253	217	2,098	2,315
Loans to banks - amortised cost	6,330	76	6,406	1,919	—	1,919
Loans to customers - amortised cost	41,929	161,718	203,647	41,946	149,936	191,882
Amounts due from holding companies and fellow subsidiaries (1)	4,879	322	5,201	63,213	14,713	77,926
Other financial assets	5,525	35,701	41,226	441	1,224	1,665
Liabilities						
Bank deposits	3,540	14,023	17,563	3,529	17,015	20,544
Customer deposits	236,590	1,180	237,770	225,269	1,154	226,423
Derivatives	20	759	779	228	2,950	3,178
Amounts due to holding companies and fellow subsidiaries (2)	17,733	4,809	22,542	28,146	16,446	44,592
Other financial liabilities	531	5,966	6,497	160	415	575
Subordinated liabilities	23	1,252	1,275	13	1,227	1,240

	Bank					
	2018			2017		
	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	43,966	—	43,966	34,763	—	34,763
Derivatives	116	1,161	1,277	209	2,068	2,277
Loans to banks - amortised cost	5,808	67	5,875	1,635	—	1,635
Loans to customers - amortised cost	27,584	143,849	171,433	26,586	134,028	160,614
Amounts due from holding companies and fellow subsidiaries (1)	15,483	15,112	30,595	46,875	7,336	54,211
Other financial assets	5,134	35,700	40,834	4	1,069	1,073
Liabilities						
Bank deposits	3,533	14,024	17,557	3,513	17,015	20,528
Customer deposits	203,102	1,177	204,279	192,929	1,126	194,055
Derivatives	21	1,164	1,185	217	2,900	3,117
Amounts due to holding companies and fellow subsidiaries (2)	31,369	19,589	50,958	10,592	12,710	23,302
Other financial liabilities	521	5,368	5,889	130	9	139
Subordinated liabilities	15	1,252	1,267	13	1,218	1,231

Notes:
(1) Amounts due from holding companies and fellow subsidiaries relate to non-financial instruments of £5 million (2017 - £4 million) for Group and £185 million (2017 – nil) for the Bank have been excluded from the tables.
(2) Amounts due to holding companies and fellow subsidiaries relate to non-financial instruments of nil (2017 - £7 million) for Group and nil (2017 – £9 million) for the Bank have been excluded from the tables.

12 Financial instruments - maturity analysis continued

Financial liabilities are included at the earliest date on which the counterparty can require repayment regardless of whether or not such early repayment results in a penalty. If repayment is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the liability is included at the earliest possible date that the conditions could be fulfilled without considering the probability of the conditions being met. For example, if a structured note automatically prepays when an equity index exceeds a certain level, the cash outflow will be included in the less than three months period whatever the level of the index at the year end.

The settlement date of debt securities issued by certain securitisation vehicles consolidated by the Group depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date.

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

Held-for-trading liabilities amounting to £0.1 billion (2017 - £3.8 billion) for the Group and £0.5 billion (2017 - £3.7 billion) for the Bank have been excluded from the tables.

On balance sheet liabilities

The tables below show the timing of cash outflows to settle financial liabilities, prepared on the following basis:

	Group					
2018	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Liabilities by contractual maturity						
Bank deposits	3,539	—	12,023	2,003	—	—
Customer deposits	232,878	3,719	1,163	—	—	18
Amounts due to holding companies and fellow subsidiaries	16,739	1,238	738	849	3,699	933
Derivatives held for hedging	64	62	266	106	158	152
Other financial liabilities	355	268	3,218	114	2,324	399
Subordinated liabilities	6	64	413	78	196	392
Other liabilities (1)	821	—	—	—	—	—
	254,402	5,351	17,821	3,150	6,377	1,894
Guarantees and commitments notional amount						
Guarantees (2)	901	—	—	—	—	—
Commitments (3)	71,349	—	—	—	—	—
	72,250	—	—	—	—	—
2017						
Liabilities by contractual maturity						
Bank deposits	3,565	64	3,170	14,024	—	—
Customer deposits	225,448	921	57	—	1	2
Amounts due to holding companies and fellow subsidiaries	28,615	1,276	4,146	2,460	5,302	4,111
Derivatives held for hedging	—	1	3	2	4	1
Other financial liabilities	92	100	107	87	617	—
Subordinated liabilities	4	48	112	384	162	324
Other liabilities (1)	803	—	—	—	—	—
	258,527	2,410	7,595	16,957	6,086	4,438
Guarantees and commitments notional amount						
Guarantees (2)	674	—	—	—	—	—
Commitments (3)	53,132	—	—	—	—	—
	53,806	—	—	—	—	—

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

12 Financial instruments - maturity analysis continued

	Bank					
2018	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Liabilities by contractual maturity						
Bank deposits	3,533	—	12,023	2,003	—	—
Customer deposits	199,916	3,189	1,159	—	—	18
Amounts due to holding companies and fellow subsidiaries	27,545	4,086	5,181	849	15,953	933
Derivatives held for hedging	63	61	261	104	155	151
Other financial liabilities	349	263	3,218	114	2,126	—
Subordinated liabilities	6	56	413	78	196	392
	231,412	7,655	22,255	3,148	18,430	1,494
Guarantees and commitments notional amount						
Guarantees (2)	804	—	—	—	—	—
Commitments (3)	65,484	—	—	—	—	—
	66,288	—	—	—	—	—
2017						
Liabilities by contractual maturity						
Bank deposits	3,549	64	3,170	14,024	—	—
Customer deposits	193,465	589	1	—	1	2
Amounts due to holding companies and fellow subsidiaries	11,639	551	2,355	1,243	4,812	4,018
Other financial liabilities	65	56	9	—	—	—
Subordinated liabilities	4	48	104	384	162	324
	208,722	1,308	5,639	15,651	4,975	4,344
Guarantees and commitments notional amount						
Guarantees (2)	562	—	—	—	—	—
Commitments (3)	46,822	—	—	—	—	—
	47,384	—	—	—	—	—

Notes:
(1) Other liabilities includes notes in circulation.
(2) The Group is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Group expects most guarantees it provides to expire unused.
(3) The Group has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Group does not expect all facilities to be drawn, and some may lapse before drawdown.

13 Loan impairment provisions

Loan exposure and impairment metrics

The table below summarises loans and related credit impairment measures on an IFRS 9 basis at 31 December 2018 and 1 January 2018 and on an IAS 39 basis at 31 December 2017.

	31 December 2018 £m	1 January 2018 £m	31 December 2017 £m
Loans - amortised cost			
Stage 1	191,478	178,078	
Stage 2	16,732	14,288	
Stage 3	3,005	2,605	
Inter-Group	5,046	77,772	
	216,261	272,743	193,801
ECL provisions (1)			
- Stage 1	179	150	
- Stage 2	449	323	
- Stage 3	1,043	1,293	
- Inter-Group	1	17	
	1,672	1,783	1,439
ECL provision coverage (2,3)			
- Stage 1 %	0.09	0.08	
- Stage 2 %	2.68	2.26	
- Stage 3 %	34.71	49.63	
- Inter-Group	0.01	0.02	
	0.77	0.91	0.74
ECL charge (4)			
- Third party	445		
- Inter-Group	(17)		
	428		311
Impairment losses			
ECL loss rate - annualised (basis points) (4)	21.07		16.05
Amounts written off	612		577

Notes:
(1) ECL provisions in the above table are provisions on loan assets only. Other ECL provisions, not included above, relate to cash, debt securities and contingent liabilities, and amount to £7 million, of which FVOCI is £2 million.
(2) ECL provisions coverage is ECL provisions divided by loans - amortised cost.
(3) ECL provisions coverage and ECL loss rates are calculated on third party loans and related ECL provision and charge respectively.
(4) ECL charge balances include a £2 millions charge relating to other financial assets, of which £2 million charge relates to assets at FVOCI, and £17 million release relating to contingent liabilities.

Credit risk enhancement and mitigation

For information on Credit risk enhancement and mitigation held as security, refer to capital and risk management – credit risk on page 40.

Critical accounting policy: Loan impairment provisions

The Group's 2017 loan impairment provisions were established in accordance with IAS 39 in respect of incurred losses. They comprised individual and collective components as more fully explained in the 2017 Annual Report and Accounts. In 2018 the loan impairment provisions have been established in accordance with IFRS 9. Accounting policy 16 sets out how the expected loss approach is applied. At 31 December 2018, customer loan impairment provisions amounted to £1,672 million (2017 - £1,439 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 creditworthiness of the borrower, its modelling of expected performance and the application of economic forecasts. All three elements require judgments that are potentially significant to the estimate of impairment losses. Further information and sensitivity analysis in accordance with IFRS 7 are on page 33.

13 Loan impairment provisions continued

IFRS 9 ECL model design principles
To meet IFRS 9 requirements for ECL estimation, PD, LGD and 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.

14 Other financial assets

	Group								
	Debt securities								
	Central and local government			Other		Equity	Other	Settlement	
	UK	US	Other	debt	Total	shares	loans	balances	Total
2018	£m	£m	£m	£m	£m	£m	£m	£m	£m
Mandatory fair value through profit or loss	—	—	—	—	—	—	280	—	280
Fair value through other comprehensive income	17,194	8,836	5,446	3,924	35,400	—	—	—	35,400
Amortised cost	3,584	—	—	1,760	5,344	—	—	202	5,546
Total	20,778	8,836	5,446	5,684	40,744	—	280	202	41,226
2017									
Held-for-trading	—	—	—	—	—	—	7	—	7
Designated as at fair value through profit or loss	—	—	—	—	—	34	—	—	34
Available-for-sale	391	—	2	160	553	9	—	—	562
Loans and receivables	—	—	—	1,059	1,059	—	—	3	1,062
Total	391	—	2	1,219	1,612	43	7	3	1,665

	Bank								
	Debt securities								
	Central and local government			Other		Equity	Other	Settlement	
	UK	US	Other	debt	Total	shares	loans	balances	Total
2018	£m	£m	£m	£m	£m	£m	£m	£m	£m
Mandatory fair value through profit or loss	—	—	—	—	—	—	280	—	280
Fair value through other comprehensive income	17,193	8,836	5,446	3,923	35,398	—	—	—	35,398
Amortised cost	3,484	—	—	1,470	4,954	—	—	202	5,156
Total	20,677	8,836	5,446	5,393	40,352	—	280	202	40,834
2017									
Held-for-trading	—	—	—	—	—	—	7	—	7
Available-for-sale	—	—	—	—	—	7	—	—	7
Loans and receivables	—	—	—	1,059	1,059	—	—	—	1,059
Total	—	—	—	1,059	1,059	7	7	—	1,073

The movement in Other financial assets in 2018 principally relates to the transfer of the RBS Group Treasury function from NatWest Markets Plc to the Bank in preparation for ring-fencing. Refer to Note 23 for further details.

15 Investments in Group undertakings

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

	Bank	
	2018 £m	2017 £m
At 1 January	2,546	6,931
Currency translation and other adjustments	3	2
Additional investments in Group undertakings	436	2,879
Acquisitions	369	738
Disposals	(407)	(166)
Impairment of investments	(481)	(7,838)
At 31 December	2,466	2,546

In 2018 additions principally relate to the acquisition of RBS Services India Private Limited and Silvermere Holdings Limited. Additional investments in Group undertakings relate mainly to NatWest Group Holdings Corporation and Coutts & Company.

Disposal in 2018 relates to NatWest Group Holdings Corporation disposal to NatWest Market Plc. The impairment in 2018 mainly relates to National Westminster International Holdings B.V..

The principal subsidiary undertakings of the Bank are shown below. Their capital consists of ordinary shares which are unlisted.

All of the subsidiary undertakings are owned directly or indirectly through intermediate holding companies, and are all wholly-owned. All of these subsidiary undertakings are included in the Group's consolidated financial statements and have an accounting reference date of 31 December.

	Nature of business	Country of incorporation and principal area of operations
Coutts & Company (1)	Private banking	Great Britain
Ulster Bank Limited	Banking	Northern Ireland
Lombard North Central PLC	Leasing	Great Britain

Note:
(1) Coutts & Company is incorporated with unlimited liability. Its registered office is 440 Strand, London WC2R OQS.

The above information is provided in relation to the principal related undertakings as permitted by Section 410(2) of the Companies Act 2006. Full information on all related undertakings will be included in the Annual Return filled with the UK Companies house.

Notes on the accounts

16 Intangible assets

	Group					
	2018			2017		
	Goodwill £m	Other (1) £m	Total £m	Goodwill £m	Other (1) £m	Total £m
Cost						
At 1 January	618	1,340	1,958	510	1,305	1,815
Transfers to disposal groups	—	—	—	—	(46)	(46)
Currency translation and other adjustments	5	1	6	(3)	(5)	(8)
Acquisitions of subsidiaries	48	2	50	—	—	—
Transfers from/to holding companies and fellow subsidiaries	—	880	880	111	81	192
Additions	—	277	277	—	25	25
Disposals and write-off of fully amortised assets	—	(542)	(542)	—	(20)	(20)
At 31 December	671	1,958	2,629	618	1,340	1,958
Accumulated amortisation and impairment						
At 1 January	608	828	1,436	510	821	1,331
Transfers to disposal groups	—	—	—	—	(46)	(46)
Currency translation and other adjustments	5	1	6	(3)	(5)	(8)
Transfers from/to holding companies and fellow subsidiaries	—	413	413	101	8	109
Disposals and write-off of fully amortised assets	—	(515)	(515)	—	(19)	(19)
Charge for the year	—	218	218	—	69	69
Write down of goodwill and intangible assets	—	13	13	—	—	—
At 31 December	613	958	1,571	608	828	1,436
Net book value at 31 December	58	1,000	1,058	10	512	522

	Bank	
	2018 £m	2017 £m
Cost		
At 1 January	1,288	1,235
Currency translation and other adjustments	2	—
Transfers from/to fellow subsidiaries	880	63
Additions	264	10
Disposals and write-off of fully amortised assets	(542)	(20)
At 31 December	1,892	1,288
Accumulated amortisation		
At 1 January	798	758
Currency translation and other adjustments	1	—
Transfers from/to fellow subsidiaries	413	(6)
Disposals and write-off of fully amortised assets	(515)	(20)
Charge for the year	216	66
Write down of intangible assets	13	—
At 31 December	926	798
Net book value at 31 December	966	490

Note:
(1) Principally internally generated software.

Intangible assets are reviewed for indicators of impairment. In 2018 £13 million (2017 - £nil million) of previously capitalised software was impaired primarily as a result of software which is no longer expected to yield future economic benefit.

Impairment testing involves the comparison of the carrying value of each cash-generating unit (CGU) with its recoverable amount. The carrying values of the segments reflect the equity allocations made by management which are consistent with the Group’s capital targets. Recoverable amount is the higher of fair value and value in use. Value in use is the present value of expected future cash flows from the CGU. Fair value is the price that would be received to sell an asset in an orderly transaction between market participants.

The recoverable amounts for all CGUs at 31 December 2018 were based on value in use, using management's latest five-year revenue and cost forecasts. The long-term growth rates have been based on expected nominal growth of the CGUs. The pre-tax risk discount rates are based on those observed to be applied to businesses regarded as peers of the CGUs.

Critical estimates

Impairment testing involves a number of judgemental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of discount rates appropriate to each business; estimation of the fair value of the CGUs; and the valuation of separable assets of each business whose goodwill is reviewed.

Notes on the accounts

17 Other assets

	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Prepayments	395	47	346	21
Accrued income	177	172	122	117
Tax recoverable	19	2	—	—
Pension schemes in net surplus (Note 5)	23	22	15	16
Deferred tax (Note 7)	1,590	1,079	1,546	1,060
Interests in associates	1	21	—	—
Property, plant and equipment (Note 18)	3,506	2,580	1,640	692
Intangible assets (Note 16)	1,058	522	966	490
Assets of disposal groups (Note 24)	58	24,526	57	41
Other assets	341	362	301	161
	7,168	29,333	4,993	2,598

18 Property, plant and equipment

2018	Group: Investment properties £m	Business property plant and equipment £m	Operating lease assets £m	Total £m
Cost or valuation				
At 1 January	1,048	1,693	1,044	3,785
Transfers to disposal groups	—	(144)	—	(144)
Currency translation and other adjustments	9	5	—	14
Transfers (to)/from fellow subsidiaries	(68)	3,372	17	3,321
Additions	46	276	228	550
Change in fair value of investment properties - continuing operations	(6)	—	—	(6)
Disposals and write-off of fully depreciated assets	(21)	(252)	(230)	(503)
At 31 December	1,008	4,950	1,059	7,017
Accumulated impairment, depreciation and amortisation				
At 1 January	—	757	448	1,205
Transfers to disposal groups	—	(82)	—	(82)
Currency translation and other adjustments	—	1	—	1
Transfers from fellow subsidiaries	—	2,390	16	2,406
Disposals and write-off of fully depreciated assets	—	(188)	(134)	(322)
Charge for the year	—	183	120	303
At 31 December	—	3,061	450	3,511
Net book value at 31 December	1,008	1,889	609	3,506

2017	Investment properties £m	Business property plant and equipment £m	Operating lease assets £m	Total £m
Cost or valuation				
At 1 January	1,040	2,588	—	3,628
Transfers to disposal groups	—	(697)	—	(697)
Currency translation and other adjustments	18	(58)	—	(40)
Transfers from/to fellow subsidiaries	—	38	1,291	1,329
Additions	8	68	199	275
Change in fair value of investment properties - continuing operations	(18)	—	—	(18)
Disposals and write-off of fully depreciated assets	—	(246)	(446)	(692)
At 31 December	1,048	1,693	1,044	3,785
Accumulated impairment, depreciation and amortisation				
At 1 January	—	1,468	—	1,468
Transfers to disposal groups	—	(529)	—	(529)
Currency translation and other adjustments	—	(47)	—	(47)
Transfers from/to fellow subsidiaries	—	23	571	594
Disposals and write-off of fully depreciated assets	—	(176)	(265)	(441)
Charge for the year				
- from continuing operations	—	71	142	213
- from discontinued operations	—	2	—	2
Write down of property, plant and equipment				
- discontinuing operations	—	(55)	—	(55)
At 31 December	—	757	448	1,205
Net book value at 31 December	1,048	936	596	2,580

18 Property, plant and equipment continued

2018	Bank Business property plant and equipment £m
Cost or valuation	
At 1 January	1,319
Transfers to disposal groups	(138)
Transfers from fellow subsidiaries	3,262
Additions	267
Disposals and write-off of fully depreciated assets	(242)
At 31 December	4,468
Accumulated impairment, depreciation and amortisation	
At 1 January	627
Transfers to disposal groups	(80)
Transfers from fellow subsidiaries	2,296
Disposals and write-off of fully depreciated assets	(183)
Charge for the year	168
At 31 December	2,828
Net book value at 31 December	1,640

2017	
Cost or valuation	
At 1 January	1,533
Transfer to disposal groups	(73)
Transfers from holding company and fellow subsidiaries	26
Additions	57
Disposals and write-off of fully depreciated assets	(224)
At 31 December	1,319
Accumulated impairment, depreciation and amortisation	
At 1 January	746
Transfers to disposal groups	(32)
Transfers from holding company and fellow subsidiaries	15
Disposals and write-off of fully depreciated assets	(159)
Charge for the year	57
At 31 December	627
Net book value at 31 December	692

Investment property valuations principally employ present value techniques that discount expected cash flows. Expected cash flows reflect rental income, occupancy and residual market values; valuations are sensitive to changes in these factors. The investment property fair value measurements are categorised as level 3. A 5% change in the most sensitive assumption, residual values, is £40 million.

Valuations were carried out by qualified surveyors who are members of the Royal Institution of Chartered Surveyors, or an equivalent overseas body; property with a fair value of £108 million (2017 - £183 million) was valued by independent valuers.

Rental income from investment properties was £79 million (2017 - £81 million). Direct operating expenses of investment properties were £10 million (2017 - £9 million).

19 Other financial liabilities

	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Bank deposits - held-for-trading	12	—	12	—
Customer deposits	—	—	—	—
- designated as at fair value through profit or loss	20	166	10	130
- held-for-trading	38	9	38	9
Settlement balances	131	4	131	—
Debt securities in issue - amortised cost	6,296	396	5,698	—
Total	6,497	575	5,889	139

20 Subordinated liabilities

	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Dated loan capital	316	314	308	305
Undated loan capital	816	783	816	783
Preference shares	143	143	143	143
	1,275	1,240	1,267	1,231

Note:
(1) The table above excludes amounts due to holding company and fellow subsidiaries of £2,904 million (2017 - £4,515 million) for the Group and £2,904 million (2017 - £4,409 million) for the Bank. Refer to intercompany tables on page 96 and 97.

The preference shares issued by the company are classified as liabilities; these securities remain subject to the capital maintenance rules of the Companies Act 2006.

The following tables analyse third party subordinated liabilities:

Dated loan capital	Capital treatment	2018 £m	2017 £m
National Westminster Bank Plc			
£300 million 6.50% notes 2021 (not callable)	Tier 2	308	305

Notes:
(1) In the event of certain changes in tax laws, dated loan capital issues may be redeemed in whole, but not in part, at the option of the issuer, at the principal amount thereof plus accrued interest, subject to prior regulatory approval.
(2) Except as stated above, claims in respect of the Group's dated loan capital are subordinated to the claims of other creditors. None of the Group's dated loan capital is secured.
(3) Interest on all floating rate subordinated notes is calculated by reference to market rates.

Undated loan capital	Capital treatment	2018 £m	2017 £m
National Westminster Bank Plc			
US$193 million floating rate notes (callable semi-annually) (5)	Tier 2	153	144
US$229 million floating rate notes (callable semi-annually) (5)	Tier 2	181	171
US$285 million floating rate notes (callable semi-annually) (5)	Tier 2	223	211
€178 million floating rate notes (callable quarterly) (5)	Tier 2	160	158
€10 million floating rate notes (callable quarterly) (5)	Tier 2	9	9
£53 million 7.125% notes (callable every five years from October 2022)	Tier 2	55	55
£35 million 11.50% notes (callable December 2022) (1)	Tier 2	35	35
		816	783

Notes:
(1) Exchangeable at the option of the issuer into 8.392% (gross) non-cumulative preference shares of £1 each of National Westminster Bank Plc at any time.
(2) The company can satisfy interest payment obligations by issuing sufficient ordinary shares to appointed Trustees to enable them, on selling these shares, to settle the interest payment.
(3) Except as stated above, claims in respect of the Group's undated loan capital are subordinated to the claims of other creditors. None of the Group's undated loan capital is secured.
(4) In the event of certain changes in tax laws, undated loan capital issues may be redeemed in whole, but not in part, at the option of the Group, at the principal amount thereof plus accrued interest, subject to prior regulatory approval.
(5) Interest on all floating rate subordinated notes is calculated by reference to market rates.

20 Subordinated liabilities continued

Preference shares *(1)*	Capital treatment	2018 £m	2017 £m
National Westminster Bank Plc			
£140 million 9.00% Series A non-cumulative preference shares of £1 (not callable)	Tier 1	143	143

Note:
(1) Further details of the contractual terms of the preference shares are given in Note 22.

Redemptions in the period *(values as at date of transaction)*	Capital treatment	2018 £m	2017 £m
National Westminster Bank Plc			
US$300 million 8.6250% non-cumulative preference shares (callable)	Tier 1	—	178

The following tables analyse intercompany subordinated liabilities:

Dated loan capital	Capital treatment	2018 £m	2017 £m
National Westminster Bank Plc			
US$1,900 million floating rate loan capital 2024	Tier 2	1,504	—
£2,000 million floating rate notes 2023 (callable January 2018)	Tier 2	—	2,008
£1,000 million floating rate notes 2019 (callable quarterly)	Tier 2	—	1,000
		1,504	3,008
Undated loan capital			
National Westminster Bank Plc			
£700 million floating rate notes (callable every five years from January 2018)	Tier 2	700	700
£700 million floating rate notes (callable quarterly from September 2016)	Tier 2	700	701
		1,400	1,401
Issuance in the period (value as at date of transaction)			
National Westminster Bank Plc			
US$1,900 million floating rate loan capital 2024	Tier 2	1,486	—
Coutts & Company			
£45 million floating rate loan capital 2028	Tier 2	45	—
		1,531	—
Redemptions in the period (values as at date of transaction)			
National Westminster Bank Plc			
£2,000 million floating rate notes 2023	Tier 2	2,000	—
£1,000 million floating rate notes 2019	Tier 2	1,000	—
		3,000	—
Ulster Bank Limited			
£100 million floating rate subordinated loan capital 2019	Tier 2	—	100
€120 million perpetual floating rate notes 2020	Tier 2	—	107
€60 million perpetual floating rate notes 2020	Tier 2	—	53
€280 million subordinated loan capital December 2022	Tier 2	—	249
€400 million subordinated loan December 2017	Tier 2	—	355
		—	864
Coutts & Company			
€20 million floating rate subordinated loan capital 2023	Tier 2	—	18
£30 million floating rate subordinated loan capital 2023	Tier 2	—	30
£13.3 million 0.7294% undated subordinated notes	Tier 2	—	13
US$15 million 0.4691% undated subordinated notes	Tier 2	—	11
		—	72

The Group has now resumed payments on all discretionary non-equity capital instruments following the end of the European Commission ban in 2012. Future coupons and dividends on hybrid capital instruments will only be paid subject to, and in accordance with, the terms of the relevant instruments.

The preference shares issued by the company are classified as liabilities; these securities remain subject to the capital maintenance rules of the Companies Act 2006.

21 Other liabilities

	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Notes in circulation	821	803	—	—
Current tax	100	378	84	335
Accruals	670	280	588	193
Deferred income	233	170	203	137
Deferred tax (Note 7)	225	22	—	—
Retirement benefit liabilities (Note 5)	41	31	14	15
Liabilities held for disposal	—	23,849	—	—
Provisions for liabilities and charges	1,143	1,398	1,045	1,192
Other liabilities	405	986	279	109
	3,638	27,917	2,213	1,981

Provisions for liabilities and charges	Group				
	Payment protection insurance £m	Other customer redress £m	Litigation and other regulatory £m	Other (2) £m	Total £m
At 1 January 2018	632	386	65	315	1,398
Implementation of IFRS 9 on 1 January 2018 (1)	—	—	—	44	44
ECL impairment charge	—	—	—	(7)	(7)
Transfer from accruals and other liabilities	—	3	—	—	3
Currency translation and other movements	—	—	—	9	9
Transfers in preparation for ring-fencing	—	(9)	(20)	304	275
Charge to income statement	125	92	6	167	390
Releases to income statement	(17)	(59)	(5)	(133)	(214)
Provisions utilised	(329)	(197)	(8)	(221)	(755)
At 31 December 2018	411	216	38	478	1,143

Provisions for liabilities and charges	Bank				
	Payment protection insurance £m	Other customer redress £m	Litigation and other regulatory £m	Property and other (2) £m	Total £m
At 1 January 2018	622	326	2	242	1,192
Implementation of IFRS 9 on 1 January 2018 (1)	—	—	—	40	40
ECL impairment charge	—	—	—	(6)	(6)
Transfer from accruals and other liabilities	—	4	—	—	4
Transfers in preparation for ring-fencing	—	(10)	—	325	315
Charge to income statement	124	86	1	160	371
Releases to income statement	(17)	(25)	—	(128)	(170)
Provisions utilised	(324)	(184)	(3)	(190)	(701)
At 31 December 2018	405	197	—	443	1,045

Notes:
(1) Refer to note 35 for further details on the impact of IFRS 9 on classification and basis of preparation.
(2) Materially comprises provisions relating to property closures and restructuring costs.

Payment protection insurance

To reflect the increased volume of complaints following the FCA's introduction of an August 2019 PPI timebar, as outlined in FCA announcement CP17/3 and the introduction of new Plevin (unfair commission) complaint handling rules, the Group increased its provision for PPI by £125 million in 2018 (2017 - £107 million, 2016 - £362 ,million) bringing the cumulative charge to £3.2 billion, of which £2.5 billion (78%) in redress and £0.3 billion in administrative expenses had been paid by 31 December 2018. Of the £3.2 billion cumulative charge, £2.9 billion relates to redress and £0.3 billion to administrative expenses. The Bank increased its provision by £124 million (2017 - £107 million, 2016 - £362 million) bringing the cumulative charge to £3.1 billion, of which £2.4 billion (77%) in redress and £0.3 billion in administrative expenses had been paid by 31 December 2018. Of the £3.1 billion cumulative charge, £2.8 billion relates to redress and £0.3 billion to administrative expenses.

The principal assumptions underlying the Group's provision in respect of PPI sales are: assessment of the total number of complaints that the Group will receive; the proportion of these that will result in redress; and the average cost of such redress. The number of complaints has been estimated from an analysis of the Group's portfolio of PPI policies sold by vintage and by product. Estimates of the percentage of policyholders that will lodge complaints (the take up rate) and of the number of these that will be upheld (the uphold rate) have been established based on recent experience, guidance in FCA policy statements and the expected rate of responses from proactive customer contact. The average redress assumption is based on recent experience and FCA calculation rules.

21 Other liabilities continued

The table below shows the sensitivity of the provision to changes in the principle assumptions (all other assumptions remaining the same).

Assumptions	Actual to date	Future expected	Sensitivity: Change in assumption %	Sensitivity: Consequential change in provision £m
Customer initiated complaints (1)	1,630k	152k	+/-5	+/-10
Uphold rate (2)	89%	90%	+/-1	+/-2
Average redress (3)	£1,664	£1,512	+/-5	+/-10
Processing costs per claim (4)	£152	£151	+/- 10k claims	+/-1.5

Notes:
(1) Claims received directly by the Group to date, including those received via CMCs and Plevin (commission) only. Excluding those for proactive mailings and where no PPI policy exists.
(2) Average uphold rate per customer initiated claims received directly by the Group to end of timebar for both PPI (mis-sale) and Plevin (commission), excluding those for which no PPI policy exists.
(3) Average redress for PPI (mis-sale) and Plevin (commission) pay-outs.
(4) Processing costs per claim on a valid complaints basis, includes direct staff costs and associated overhead - excluding FOS fees.

Critical accounting policy: Provisions for liabilities

Judgment is involved in determining whether an obligation exists, and in estimating the probability, timing and amount of any outflows. Where the Group can look to another party such as an insurer to pay some or all of the expenditure required to settle a provision, any reimbursement is recognised when, and only when, it is virtually certain that it will be received.

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.

Background information on all material provisions is given in Note 29.

22 Share capital and reserves

Allotted, called up and fully paid	2018 £m	2017 £m	Number of shares 2018 000s	Number of shares 2017 000s
Ordinary shares of £1	1,678	1,678	1,678,177	1,678,177
Non-cumulative preference shares of £1	140	140	140,000	140,000

Ordinary shares

The Bank paid an ordinary dividend to RBSG in 2018 totalling £292 million. No dividend was paid in 2017.

Preference shares

The 9% non-cumulative preference shares Series A of £1 each are non-redeemable.

In 2017 the non-cumulative preference shares Series C of US$25 were redeemed in whole.

The holders of sterling preference shares are entitled, on the winding-up of the Bank, to priority over the ordinary shareholders as regards payment of capital. Otherwise the holders of preference shares are not entitled to any further participation in the profits or assets of the Bank and accordingly these shares are classified as non-equity shares.

The holders of sterling preference shares are not entitled to receive notice of, attend, or vote at any general meeting unless the business of the meeting includes the consideration of a resolution for the winding-up of the Bank or the sale of the whole of the business of the Bank or any resolution directly affecting any of the special rights or privileges attached to any of the classes of preference shares.

Under IFRS, the Group's preference shares are classified as debt and are included in subordinated liabilities on the balance sheet (see Note 20).

Reserves

Under UK companies legislation, when shares are redeemed or purchased wholly or partly out of the company's profits, the amount by which the company's issued share capital is diminished must be transferred to the capital redemption reserve. The capital maintenance provisions of UK companies legislation apply to the capital redemption reserve as if it were part of the company's paid up share capital.

UK law prescribes that only reserves of the Bank are taken into account for the purpose of making distributions and the permissible applications of the share premium account and capital redemption reserve of £608 million (2017 - £608 million) included within other reserves.

The Group received capital contributions of £1,200 million (2017 - £51 million) from the holding company for which no additional share capital was issued. As such, these were recorded as capital contributions in retained earnings.

The Group optimises capital efficiency by maintaining reserves in subsidiaries, including regulated entities. Certain preference shares and subordinated debt are also included within regulatory capital. The remittance of reserves to the parent or the redemption of shares or subordinated capital by regulated entities may be subject to maintaining the capital resources required by the relevant regulator.

Merger reserve

During 2018 the Bank acquired RBS Treasury at net asset value. The assets, liabilities and IFRS reserves were recognised at inherited values. The difference has been recognised in the merger reserve.

Notes on the accounts

23 Acquisition of RBS Treasury business

As part of preparations for ring-fencing that takes effect from 1 January 2019, the Group acquired the RBS Group Treasury and other business during the first half of 2018 for a consideration of net asset value. In accordance with RBS Group policy, the Group paid book value and recognised the assets and liabilities at inherited values. Inherited values were those recognised by RBS Group and included the accounting history since initial recognition by RBS Group. It also included the inheritance of the IFRS reserve of £460 million in respect of instruments recognised at fair value through other comprehensive income. The merger reserve arising as a result of the transfers will be transferred to retained earnings as the underlying instruments are released.

Assets and liabilities of business acquired	Impact of acquisition £bn
Assets	
Cash and balances at central banks	15.4
Derivatives	2.1
Loans to banks - amortised cost	0.7
Loans to customers - amortised cost	4.5
Other financial assets	41.9
	64.6
Liabilities	
Bank deposits	1.6
Customer deposits	3.2
Derivatives	1.8
Other financial liabilities	5.1
	11.7
Net assets	52.9

The consideration was substantially satisfied by reductions in the amounts due from NatWest Markets Plc.

24 Discontinued operations

As part of implementing the legislation following the recommendations of the Independent Commission on Banking, NatWest Group Holdings Corp (NWGH), which was a direct subsidiary of NatWest and which wholly owned NatWest Markets Securities Inc. (formerly RBS Securities Inc.; renamed in 2018), was transferred to RBSG in H1 2018 in preparation for ring-fencing. Accordingly, NWGH was classified as a disposal group at 31 December 2017 and presented as a discontinued operation, with comparative income statement and related notes re-presented.

Profit from discontinued operations, net of tax

	2018 £m	2017 £m
NWGH		
Interest income	—	—
Interest expense	(1)	(17)
Net interest income	(1)	(17)
Other income	15	99
Total income	14	82
Operating expenses	(17)	(724)
Loss before impairment losses	(3)	(642)
Impairment losses	—	—
Operating loss before tax	(3)	(642)
Tax credit	—	7
Loss from NWGH discontinued operations, net of tax	(3)	(635)

Note:
(1) Other comprehensive loss from discontinued operations for the year ended 31 December 2018 was £381 million (2017 - £67 million loss).

Operating cash flows attributable to discontinued operations

	2018 £m	2017 £m
Net cash flows from operating activities	—	(795)
Net cash flows from investing activities	—	4
Net cash flows from financing activities	—	502
Net increase in cash and cash equivalents	—	(361)

Notes on the accounts

25 Leases

Minimum amounts receivable under non-cancellable leases:

Year in which receipt will occur	Finance lease contracts and hire purchase agreements: Gross amounts £m	Present value adjustments £m	Other movements £m	Future drawdowns £m	Present value £m	Operating lease assets: future minimum lease rentals £m
2018						
Within 1 year	2,983	(196)	(83)	(70)	2,634	127
After 1 year but within 5 years	4,213	(322)	(100)	—	3,791	271
After 5 years	1,789	(662)	(38)	—	1,089	16
Total	8,985	(1,180)	(221)	(70)	7,514	414
2017						
Within 1 year	2,817	(203)	(96)	(70)	2,448	129
After 1 year but within 5 years	3,736	(261)	(94)	—	3,381	256
After 5 years	467	(112)	(27)	—	328	16
Total	7,020	(576)	(217)	(70)	6,157	401

	2018 £m	2017 £m
Nature of operating lease assets on the balance sheet		
Transportation	313	280
Cars and light commercial vehicles	11	45
Other	285	271
	609	596
Amounts recognised as income and expense		
Finance leases - contingent rental income	(44)	—
Operating leases - minimum rentals payable	179	80
Finance lease contracts and hire purchase agreements		
Accumulated allowance for uncollectable minimum receivables	62	63

Residual value exposures

The table below gives details of the unguaranteed residual value included in the carrying value of finance lease receivables and operating lease assets (refer to page 110).

	2018 Year in which residual value will be recovered: Within 1 year £m	After 1 year but within 2 years £m	After 2 years but within 5 years £m	After 5 years £m	Total £m	2017 Year in which residual value will be recovered: Within 1 year £m	After 1 year but within 2 years £m	After 2 years but within 5 years £m	After 5 years £m	Total £m
Operating leases										
- transportation	25	15	94	14	148	26	22	69	17	134
- cars and light commercial vehicles	1	1	2	—	4	5	7	7	—	19
- other	26	19	37	10	92	21	24	30	9	84
Finance lease contracts	28	32	67	38	165	32	20	72	27	151
Hire purchase agreements	55	2	—	—	57	64	2	1	—	67
	135	69	200	62	466	148	75	179	53	455

Acting as a lessor the Group provides asset finance to its customers. It purchases plant, equipment and intellectual property; renting them to customers under lease arrangements that, depending on their terms, qualify as either operating or finance leases.

26 Structured entities

A structured entity (SE) is an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose, they do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions. As well as being a key element of securitisations, SEs are also used in fund management activities to segregate custodial duties from the fund management advice.

Consolidated structured entities

Securitisations

In a securitisation, assets, or interests in a pool of assets, are transferred generally to a SE which then issues liabilities to third party investors. The majority of securitisations are supported through liquidity facilities or other credit enhancements. The Group arranges securitisations to facilitate client transactions and undertakes own asset securitisations to sell or to fund portfolios of financial assets.

The Group also acts as an underwriter and depositor in securitisation transactions in both client and proprietary transactions.

The Group's involvement in client securitisations takes a number of forms. It may: sponsor or administer a securitisation programme; provide liquidity facilities or programme-wide credit enhancement; and purchase securities issued by the vehicle.

Other credit risk transfers securitisations

The Group also transfers credit risk on originated loans and mortgages without the transfer of the assets to an SE. As part of this, the Group enters into credit derivative and financial guarantee contracts with consolidated SEs. At 31 December 2018, debt securities in issue by such SEs (and held by third parties) were £596 million (2017 - £398 million). The associated loans and mortgages at 31 December 2018 were £8,402 million (2017 - £6,092 million).

Covered bond programme

Certain loans to customers have been assigned to bankruptcy remote limited liability partnerships to provide security for issues of debt securities by the Group. The Group retains all of the risks and rewards of these loans. The partnerships are consolidated by the Group, the loans retained on the Group's balance sheet and the related covered bonds included within debt securities in issue of the Group. At 31 December 2018, £7,086 million of loans to customers have been assigned to bankruptcy remote limited liability partnerships to provide security for issues of debt securities by the Group of £5,367 million (2017: loans to customers - £8,915 million, debt securities in issue – £6,307 million).

Unconsolidated structured entities

The Group's interests in unconsolidated structured entities are analysed below.

	2018			2017		
	Asset backed Securitisation vehicles	Investment funds and other	Total	Asset backed Securitisation vehicles	Investment funds and other	Total
Non trading assets	£m	£m	£m	£m	£m	£m
Loans to customers	39	235	274	—	29	29
Other financial assets	1,830	—	1,830	1,059	—	1,059
Total	1,869	235	2,104	1,059	29	1,088
Liquidity facilities/loan commitments	2	89	91	—	55	55
Maximum exposure	1,871	324	2,195	1,059	84	1,143

27 Asset transfers

Transfers that do not qualify for derecognition

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

Under standard terms for repurchase transactions in the UK and US markets, the recipient of collateral has an unrestricted right to sell or re-pledge it, subject to returning equivalent securities on settlement of the transaction.

Securities sold under repurchase transactions are not derecognised if the Group retains substantially all the risks and rewards of ownership. The fair value (and carrying value) of securities transferred under such repurchase transactions included on the balance sheet, are set out below. All of these securities could be sold or re-pledged by the holder.

During 2018 the RBS Group Treasury function transferred from NatWest Markets Plc to the Bank in preparation for ring-fencing. The movement in assets that have failed de-recognition shown in the table below primarily relates to this transfer. Refer to Note 23 for further information.

	Group		Bank	
The following assets have failed derecognition	2018 £m	2017 £m	2018 £m	2017 £m
Other financial assets (1)	9,890	—	9,890	—

Note:
(1) Associated liabilities were £9,871 million for both the Group and the Bank (2017- nil).

Assets pledged as collateral

The Group pledges collateral with its counterparties in respect of derivative liabilities and bank and other borrowings.

	Group		Bank	
Assets pledged against liabilities	2018 £m	2017 £m	2018 £m	2017 £m
Loans to banks - amortised cost	654	240	607	213
Loans to customers - amortised cost	21,682	24,138	21,682	24,138
Other financial assets	724	2,004	724	—
	23,060	26,382	23,013	24,351
Liabilities secured by assets				
Bank deposits	14,014	17,014	14,014	17,014
Derivatives	724	—	724	—
	14,738	17,014	14,738	17,014

The following table analyses assets that have been transferred but have failed the derecognition rules under IFRS 9 and therefore continue to be recognised on the Bank's balance sheet.

Asset type	2018 £m	2017 £m
UK mortgages - covered bond programme (1)	7,086	8,915

Note:
(1) The associated liabilities are £6,948 million (2017 - £8,904 million).

Notes on the accounts

28 Capital resources

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

	2018 £m	2017 £m
Shareholders' equity (excluding non-controlling interests)		
Shareholders' equity	18,276	15,355
Other equity instruments	(2,370)	—
	15,906	15,355
Regulatory adjustments and deductions		
Defined benefit pension fund adjustment	(11)	(11)
Deferred tax assets	(462)	(537)
Prudential valuation adjustments	(18)	(1)
Qualifying deductions exceeding AT1 capital	—	(41)
Goodwill and other intangible assets	(966)	(490)
Expected losses less impairments	(193)	(511)
Instruments of financial sector entities where the institution has a significant investment	(538)	(456)
Significant investments in excess of secondary capital	(574)	—
Other regulatory adjustments	(6)	(7)
	(2,768)	(2,054)
CET1 capital	13,138	13,301
Additional Tier 1 (AT1) capital		
Qualifying instruments and related share premium	2,370	—
Qualifying instruments and related share premium subject to phase out	117	140
	2,487	140
Tier 1 capital		
Instruments of financial sector entities where the institution has a significant investment	(236)	(181)
Qualifying deductions exceeding AT1 capital	—	41
	(236)	(140)
Tier 1 capital	15,389	13,301
Qualifying Tier 2 capital		
Qualifying instruments and related share premium	3,376	4,412
Instruments of financial sector entities where the institution has a significant investment	(275)	(177)
Tier 2 capital	3,101	4,235
Total regulatory capital	18,490	17,536

In the management of capital resources, the Bank is governed by the RBS Group's policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the RBS Group has regard to the supervisory requirements of the PRA. The PRA uses capital ratios as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks); by international agreement, the Pillar 1 capital ratios, excluding capital buffers should be not less than 8% with a Common equity Tier 1 component of not less than 4%. The Bank has complied with the PRA's capital requirements throughout the year.

A number of subsidiaries and sub-groups within the Group, principally banking entities, are subject to various individual regulatory capital requirements in the UK and overseas. Furthermore, the payment of dividends by subsidiaries and the ability of members of the RBS Group to lend money to other members of the RBS Group may be subject to restrictions such as local regulatory or legal requirements, the availability of reserves and financial and operating performance.

Notes on the accounts

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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 2018. Although the Group is exposed to credit risk in the event of non-performance of the obligations undertaken by customers, the amounts shown do not, and are not intended to, provide any indication of the Group's expectation of future losses.

	Group		Bank	
	2018 £m	2017 £m	2018 £m	2017 £m
Contingent liabilities and commitments				
Guarantees and assets pledged as collateral security	901	674	804	562
Other contingent liabilities	1,321	871	1,279	823
Standby facilities, credit lines and other commitments	71,946	53,416	66,071	47,095
	74,168	54,961	68,154	48,480

Note:
(1) In the normal course of business, the Bank guarantees specified third party liabilities of certain subsidiaries; it also gives undertakings that individual subsidiaries will fulfil their obligations to third parties under contractual or other arrangements.

Banking commitments and contingent obligations, which have been entered into on behalf of customers and for which there are corresponding obligations from customers, are not included in assets and liabilities. The Group's maximum exposure to credit loss, in the event of its obligation crystallising and all counterclaims, collateral or security proving valueless, is represented by the contractual nominal amount of these instruments included in the table above. These commitments and contingent obligations are subject to the Group's normal credit approval processes.

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

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

Standby facilities and credit lines - under a loan commitment the Group agrees to make funds available to a customer in the future. Loan commitments, which are usually for a specified term, may be unconditionally cancellable or may persist, provided all conditions in the loan facility are satisfied or waived.

Commitments to lend include commercial standby facilities and credit lines, liquidity facilities to commercial paper conduits and unutilised overdraft facilities.

Other commitments - these include documentary credits, which are commercial letters of credit providing for payment by the Group to a named beneficiary against presentation of specified documents, forward asset purchases, forward deposits placed and undrawn note issuance and revolving underwriting facilities, and other short-term trade related transactions.

Capital Support Deed

The Bank, together with 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 Bank may also be obliged to make onward distribution to its ordinary shareholders of dividends or other capital distributions received from subsidiaries that are party to the CSD. The CSD also provides that, in certain circumstances, funding received by the Bank from other parties to the CSD becomes immediately repayable, such repayment being limited to the Bank's available resources.

Contractual obligations for future expenditure not provided for in the accounts

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

	Group		Bank	
	2018 £m	2017 £m	2018 £m	2017 £m
Operating leases				
Minimum rentals payable under non-cancellable leases (1)				
- within 1 year	176	74	155	70
- after 1 year but within 5 years	597	224	523	212
- after 5 years	1,491	799	1,209	531
	2,264	1,097	1,887	813
Other capital expenditure	16	—	14	—
Contracts to purchase goods or services (2)	537	117	416	—
	2,817	1,214	2,317	813

Notes:
(1) Predominantly property leases.
(2) Of which due within 1 year: £251 million (2017 - £25 million).

29 Memorandum items continued

Trustee and other fiduciary activities

In its capacity as trustee or other fiduciary role, the Group may hold or place assets on behalf of individuals, trusts, companies, pension schemes and others. The assets and their income are not included in the Group's financial statements. The Group earned fee income of £218 million (2017 - £213 million) from these activities.

The Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS), the UK's statutory fund of last resort for customers of authorised financial services firms, pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the industry. In relation to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year (which runs from 1 April to 31 March), subject to annual maxima set by the Prudential Regulation Authority. In addition, the FSCS has the power to raise levies on a firm that has ceased to participate in the scheme and is in the process of ceasing to be authorised for the costs that it would have been liable to pay had the FSCS made a levy in the financial year it ceased to be a participant in the scheme.

The FSCS had borrowed from HM Treasury to fund compensation costs associated with the failure of Bradford & Bingley, Heritable Bank, Kaupthing Singer & Friedlander, Landsbanki 'Icesave' and London Scottish Bank plc. The industry has now repaid all outstanding loans with the final £4.7 billion being repaid in June 2018. The loan was interest bearing with the reference rate being the higher of 12 month LIBOR plus 111 basis points or the relevant gilt rate for the equivalent cost of borrowing from HMT.

The Group has accrued £1.4 million for its share of estimated FSCS levies.

Litigation, investigations and reviews

NatWest and its subsidiary and associated undertakings ("NatWest Group") are party to legal proceedings and the subject of investigation and other regulatory and governmental action ('Matters') in the United Kingdom (UK), the United States (US), the European Union (EU) and other jurisdictions.

NatWest Group recognises a provision for a liability in relation to these Matters when it is probable that an outflow of economic benefits will be required to settle an obligation resulting from past events, and a reliable estimate can be made of the amount of the obligation.

In many proceedings and investigations, it is not possible to determine whether any loss is probable or to estimate reliably the amount of any loss, either as a direct consequence of the relevant proceedings and investigations or as a result of adverse impacts or restrictions on NatWest Group's reputation, businesses and operations. Numerous legal and factual issues may need to be resolved, including through potentially lengthy discovery and document production exercises and determination of important factual matters, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a liability can reasonably be estimated for any claim. NatWest Group cannot predict if, how, or when such claims will be resolved or what the eventual settlement, damages, fine, penalty or other relief, if any, may be, particularly for claims that are at an early stage in their development or where claimants seek substantial or indeterminate damages.

There are situations where NatWest Group may pursue an approach that in some instances leads to a settlement agreement. This may occur in order to avoid the expense, management distraction or reputational implications of continuing to contest liability, or in order to take account of the risks inherent in defending claims or investigations, even for those Matters for which NatWest Group believes it has credible defences and should prevail on the merits.

The uncertainties inherent in all such Matters affect the amount and timing of any potential outflows for both Matters with respect to which provisions have been established and other contingent liabilities. The future outflow of resources in respect of any Matter may ultimately prove to be substantially greater than or less than the aggregate provision that NatWest Group has recognised. Where (and as far as) liability cannot be reasonably estimated, no provision has been recognised.

Other than those discussed below, NatWest Group is not involved in governmental, legal or regulatory proceedings (including those which are pending or threatened) that are expected to be material, individually or in aggregate. NatWest Group expects that in future periods, additional provisions, settlement amounts and customer redress payments will be necessary, in amounts that are expected to be substantial in some instances.

For a discussion of certain risks associated with NatWest Group's litigation, investigations and reviews, see the Risk Factor relating to legal, regulatory and governmental actions and investigations set out on page 140.

Litigation

London Interbank Offered Rate (LIBOR) and other rates litigation

In January 2019, a class action antitrust complaint was filed in the United States District Court for the Southern District of New York alleging that the defendants (USD ICE LIBOR panel banks and affiliates) have conspired to suppress USD ICE LIBOR from 2014 to the present by submitting incorrect information to ICE about their borrowing costs. The RBS Group defendants are NatWest, RBSG, NatWest Markets Plc, and NatWest Markets Securities Inc.

US Anti-Terrorism Act litigation

NatWest is defending lawsuits filed in the United States District Court for the Eastern District of New York by a number of US nationals (or their estates, survivors, or heirs) who were victims of terrorist attacks in Israel. The plaintiffs allege that NatWest is liable for damages arising from those attacks pursuant to the US Anti-Terrorism Act because NatWest previously maintained bank accounts and transferred funds for the Palestine Relief & Development Fund, an organisation which plaintiffs allege solicited funds for Hamas, the alleged perpetrator of the attacks.

In October 2017, the trial court dismissed claims against NatWest with respect to two of the 18 terrorist attacks at issue. On 14 March 2018, the trial court granted a request by NatWest for leave to file a renewed summary judgment motion in respect of the remaining claims, which has now been filed. No trial date has been set.

Investigations and reviews

NatWest Group's businesses and financial condition can be affected by the actions of various governmental and regulatory authorities in the UK, the US, the EU and elsewhere. NatWest Group and/or RBS Group has engaged, and will continue to engage, in discussions with relevant governmental and regulatory authorities, including in the UK, the US, the EU and elsewhere, on an ongoing and regular basis, and in response to informal and formal inquiries or investigations, regarding operational, systems and control evaluations and issues including those related to compliance with applicable laws and regulations, including consumer protection, business conduct, competition/anti-trust, anti-bribery, anti-money laundering and sanctions regimes.

Any matters discussed or identified during such discussions and inquiries may result in, among other things, further inquiry or investigation, other action being taken by governmental and regulatory authorities, increased costs being incurred by NatWest Group, remediation of systems and controls, public or private censure, restriction of NatWest Group's business activities and/or fines. Any of the events or circumstances mentioned in this paragraph or below could have a material adverse effect on NatWest Group, its business, authorisations and licences, reputation, results of operations or the price of securities issued by it.

29 Memorandum items continued

NatWest Group is co-operating fully with the investigations and reviews 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 closed on 22 October 2018 for new complaints in the UK and, with the exception of a small cohort of potential complainants for whom there is an extended deadline, on 31 December 2018 for new complaints in the Republic of Ireland.

RBS Group made a provision of £400 million in 2016, in respect of the above redress steps, of which £270 million had been utilised by 31 December 2018. An additional provision of £50 million was taken at 31 December 2018 reflecting the increased costs of the complaints process.

The FCA published a summary of the Skilled Person's report in November 2017. The UK House of Commons Treasury Select Committee, seeking to rely on Parliamentary powers, published the full version of the Skilled Person's report on 20 February 2018. On 31 July 2018, the FCA confirmed that it had concluded its investigation and that it does not intend to take disciplinary or prohibitory action against any person in relation to these matters. It has subsequently indicated that it will shortly publish a final summary of its investigative work.

Investment advice review

As a result of an FSA review in 2013, the FCA required RBS Group to carry out a past business review and customer contact exercise on a sample of historic customers who received investment advice on certain lump sum products, during the period from March 2012 until December 2012. The review was conducted by an independent Skilled Person under section 166 of the Financial Services and Markets Act 2000. Redress was paid to certain customers in that sample group.

RBS Group later agreed with the FCA that it would carry out a wider review/remediation exercise relating to certain investment, insurance and pension sales from 1 January 2011 to 1 April 2015. That exercise is materially complete. Phase 2 (covering sales in 2010) started in April 2018 and was targeted for completion by the end of 2018, however the deadline has now been extended to April 2019.

In addition, RBS Group agreed with the FCA that it would carry out a remediation exercise, for a specific customer segment who were sold a particular structured product. Redress was paid to certain customers who took out the structured product.

NatWest Group provisions in relation to these matters totalled £160 million as at 31 December 2018, of which £106 million had been utilised by that date.

Packaged accounts

RBS Group has had dedicated resources in place since 2013 to investigate and resolve packaged account complaints on an individual basis. NatWest Group provisions for this matter totalled £252 million as at 31 December 2018. The FCA conducted a thematic review of packaged bank accounts across the UK from October 2014 to April 2016, the results of which were published in October 2016. RBS Group made amendments to its sales process and complaints procedures to address the findings from that review.

FCA investigation into the RBS Group's compliance with the Money Laundering Regulations 2007

On 21 July 2017, the FCA notified RBS Group that it was undertaking an investigation into the RBS Group's compliance with the Money Laundering Regulations 2007 in relation to certain customers. Following amendment to the scope of the investigation, there are currently two areas under review: (1) compliance with Money Laundering Regulations in respect of Money Service Business customers; and (2) the Suspicious Transactions regime in relation to the events surrounding particular customers. The investigations in both areas are assessing both criminal and civil culpability. RBS Group is cooperating with the investigations, including responding to several information requests from the FCA.

Systematic Anti-Money Laundering Programme assessment

In December 2018, the FCA commenced a Systematic Anti-Money Laundering Programme assessment of RBS Group. RBS Group is responding to requests for information from the FCA.

Payment Protection Insurance (PPI)

Since 2011, RBS Group has been implementing the FCA's policy statement for the handling of complaints about the mis-selling of PPI (Policy Statement 10/12). In August 2017, the FCA's new rules and guidance on PPI complaints handling (Policy Statement 17/3) came into force. The Policy Statement introduced new so called 'Plevin' rules, under which customers may be eligible for redress if the bank earned a high level of commission from the sale of PPI, but did not disclose this detail at the point of sale. The Policy Statement also introduced a two year PPI deadline, due to expire in August 2019, before which new PPI complaints must be made. NatWest Group is implementing the Policy Statement.

NatWest Group has made provisions totalling £3.2 billion to date for PPI claims, including an additional provision of £125 million taken at Q3 2018, reflecting greater than predicted complaints volumes. Of the £3.2 billion cumulative provision, £2.8 billion had been utilised by 31 December 2018.

FCA mortgages market study

In December 2016, the FCA launched a market study into the provision of mortgages. On 4 May 2018 the interim report was published. This found that competition was working well for many customers but also proposed remedies to help customers shop around more easily for mortgages. Following a period of consultation, the final report is due to be published in Q1 2019.

FCA strategic review of retail banking models

On 11 May 2017 the FCA announced a two phase strategic review of retail banking models. The FCA used the review to understand how these models operate, including how 'free if in credit' banking is paid for and the impact of changes such as increased use of digital channels and reduced branch usage.

On 18 December 2018, the FCA published its final report containing a number of findings, including that personal current accounts are an important source of competitive advantage for major banks. Following the review, the FCA is to continue to monitor retail banking models, analyse new payments business models and undertake exploratory work to understand certain aspects of SME banking.

Notes on the accounts

30 Analysis of the net investment in business interests and intangible assets

Acquisitions and disposals	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
Value recognised for business transferred from fellow subsidiary	(37,178)	(439)	(32,996)	(738)
Additional investments in Group undertakings	—	—	(805)	(2,879)
Fair value given for business acquired	(48)	(90)	—	—
Net outflow of cash in respect of purchases	(37,226)	(529)	(33,801)	(3,617)
Disposal of investment in group undertakings	32	—	115	166
Other assets sold	1,423	6,525	(20)	7
Non-cash consideration	(902)	(7)	292	(111)
(Loss)/profit on disposal	—	(420)	—	(67)
Net cash and cash equivalents disposed	1	—	—	—
Net inflow/(outflow) of cash in respect of disposals	554	6,098	387	(5)
Dividends received from associates	—	(1)	—	—
Net cash expenditure on intangible assets	(277)	(25)	(237)	—
Net inflow/(outflow)	(36,949)	5,543	(33,651)	(3,622)

31 Analysis of changes in financing during the year

	Group				Bank			
	Share capital and share premium		Subordinated liabilities		Share capital and share premium		Subordinated liabilities	
	2018 £m	2017 £m	2018 £m	2017 £m	2018 £m	2017 £m	2018 £m	2017 £m
At 1 January	3,903	3,903	5,755	7,295	3,903	3,903	5,640	5,890
Issue of subordinated liabilities	—	—	1,531	507	—	—	1,486	—
Repayment of subordinated liabilities	—	—	(3,000)	(936)	—	—	(3,000)	—
Issue of capital notes	2,370	—	—	—	2,370	—	—	—
Redemption of preference shares	—	—	—	(178)	—	—	—	(178)
Net cash outflow from financing	2,370	—	(1,469)	(607)	2,370	—	(1,514)	(178)
Currency translation and other adjustments	412	—	(108)	(933)	(294)	—	44	(72)
At 31 December	6,685	3,903	4,178	5,755	5,979	3,903	4,170	5,640

32 Analysis of cash and cash equivalents

	Group 2018 £m	Group 2017 £m	Bank 2018 £m	Bank 2017 £m
At 1 January				
- cash	35,799	59,474	34,763	51,732
- cash equivalents	62,141	20,290	47,681	9,419
	97,940	79,764	82,444	61,151
Net cash inflow/(outflow)	(46,623)	18,176	(32,952)	21,293
At 31 December	51,317	97,940	49,492	82,444
Comprising:				
Cash and balances at central banks	45,032	35,799	43,966	34,763
Net loans to banks	6,285	62,141	5,526	47,681
Cash and cash equivalents	51,317	97,940	49,492	82,444

Note:
(1) Includes cash collateral posted with bank counterparties in respect of derivative liabilities of £47 million (2017 - nil)

The Bank and certain subsidiary undertakings are required to maintain balances with central banks which, at 31 December 2018, amounted to £0.6 billion (2017 - £0.2 billion).

Notes on the accounts

33 Directors' and key management remuneration

As noted in the Strategic Report the composition of the Bank's board of directors changed on 30 April 2018 in preparation for ring-fencing.

Up to 30 April 2018 the directors of the Bank were aligned to the directors of the ultimate holding company RBSG. From 30 April 2018 the executive and non executive directors of the Bank were aligned to the intermediate holding company NatWest Holdings. In both periods the directors 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 2018 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 2018 Annual Report and Accounts of the RBS Group, in line with regulations applying to RBSG as a premium listed company.

Directors' remuneration	2018 £000	2017 £000
Non-executive directors emoluments	2,209	1,747
Chairman and executive directors emoluments		
- emoluments	4,802	5,299
	7,011	7,046
Amounts receivable under long-term incentive plans and share option plans	—	1,225
Total	7,011	8,271

The total emoluments and amounts receivable under long-term incentive plans and share option plans of the highest paid director were £2,467k (2017 £3,688k).
No directors accrued benefits under defined benefit schemes or money purchase schemes during 2018 and 2017. The executive directors may participate in the 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:

	2018 £000	2017 £000
Short-term benefits	17,461	19,019
Post-employment benefits	60	434
Share-based payments	—	3,558
	17,521	23,011

Key management comprises members of the Bank Executive Committee.

34 Transactions with directors and key management

At 31 December 2018, amounts outstanding in relation to transaction, arrangements and agreements entered into by authorised institutions in the Group, as defined in UK legislation, were £705,832 in respect of loans to six persons who were directors of the company at any time during the financial period.

For the purposes of IAS 24 'Related Party Disclosures', key management comprise directors of the company and members of the Bank Executive Committee. Applying the captions in the Group's primary financial statements the following amounts (1) are attributable, in aggregate, to key management:

	2018 £000	2017 £000
Loans to customers	1,530	3,897
Customer deposits	28,728	20,749

Key management have banking relationships with Group entities which are entered into in the normal course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with other persons of a similar standing or, where applicable, with other employees. These transactions did not involve more than the normal risk of repayment or present other unfavourable features. Key management had no reportable transactions or balances with the ultimate holding company.

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

35 Adoption of IFRS 9

The Group's accounting policies have significantly changed on the adoption of IFRS 9 'Financial Instruments' with effect from 1 January 2018. Prior years are re-presented but there has been no restatement of prior year data.

IFRS 9 changed the classification categories of financial assets from IAS 39. Held-for-trading assets were classified to mandatory fair value through profit or loss; loans and receivables were classified to amortised cost; and available-for-sale assets were classified as fair value through other comprehensive income unless they were deemed to be in a fair value business model or failed the contractual cash flow requirements under IFRS 9. There were no changes in the classification and measurement of financial liabilities.

Loans to customers of £437 million were reclassified from loans and receivables under IAS 39 to fair value through profit or loss under IFRS 9. As a result, their carrying value decreased by £9 million.

The net increase to loan impairments under IAS 39 was £364 million under the expected credit loss requirements of IFRS 9, including £44 million under provisions for contingent liabilities and commitments.

The impact on the Group's balance sheet at 1 January 2018 and the key movements in relation to the impact on classification and measurement expected credit losses and tax are as follows:

	Group						
				IFRS 9 impact			
	31 December 2017 (IAS 39) £m	New presentation £m	31 December 2017 re-presented £m	Classification & Measurement £m	Expected credit losses £m	Tax £m	1 January 2018 (IFRS 9) £m
Assets							
Cash and balances at central banks	35,799	—	35,799	—	—	—	35,799
Derivatives		2,315	2,315	—	—	—	2,315
Loans and advances to banks	79,845	(79,845)	—				
Loans to banks - amortised cost		1,919	1,919	—	(2)	—	1,917
Loans and advances to customers	191,889	(191,889)	—				
Loans to customers - amortised cost		191,882	191,882	(482)	(301)	—	191,099
Amounts due from holding companies and fellow subsidiaries		77,930	77,930	—	(17)	—	77,913
Debt securities	1,612	(1,612)	—				
Equity shares	43	(43)	—				
Other financial assets		1,665	1,665	475	—	—	2,140
Settlement balances	3	(3)	—				
Derivatives	2,315	(2,315)	—				
Other assets	29,337	(4)	29,333	—	—	97	29,430
Total assets	340,843	—	340,843	(7)	(320)	97	340,613
Liabilities							
Deposits by banks	53,847	(53,847)	—				
Bank deposits		20,544	20,544	—	—	—	20,544
Customer accounts	233,372	(233,372)	—				
Customer deposits		226,423	226,423	—	—	—	226,423
Amounts due to holding companies and fellow subsidiaries		44,599	44,599	—	—	—	44,599
Debt securities in issue	396	(396)	—				
Settlement balances	4	(4)	—				
Derivatives	3,178	—	3,178	—	—	—	3,178
Other financial liabilities		575	575	—	—	—	575
Subordinated liabilities	5,755	(4,515)	1,240	—	—	—	1,240
Other liabilities	27,924	(7)	27,917	—	44	(3)	27,958
Total liabilities	324,476	—	324,476	—	44	(3)	324,517
Total equity	16,367	—	16,367	(7)	(364)	100	16,096
Total liabilities and equity	340,843	—	340,843	(7)	(320)	97	340,613

35 Adoption of IFRS 9 continued

	Bank						
				IFRS 9 impact			
	31 December 2017 (IAS 39) £m	New presentation £m	31 December 2017 re-presented £m	Classification & Measurement £m	Expected credit losses £m	Tax £m	1 January 2018 (IFRS 9) £m
Assets							
Cash and balances at central banks	34,763	—	34,763	—	—	—	34,763
Derivatives		2,277	2,277	—	—	—	2,277
Loans and advances to banks	55,788	(55,788)	—				
Loans to banks - amortised cost		1,635	1,635	—	—	—	1,635
Loans and advances to customers	160,679	(160,679)	—				
Loans to customers - amortised cost		160,614	160,614	(474)	(267)	—	159,873
Amounts due from holding companies and fellow subsidiaries		54,211	54,211	—	(7)	—	54,204
Debt securities	1,059	(1,059)	—				
Equity shares	7	(7)	—				
Investment in group undertakings	2,546	(2,546)	—				
Other financial assets		1,073	1,073	428	—	—	1,501
Derivatives	2,277	(2,277)	—				
Investment in group undertakings		2,546	2,546	—	—	—	2,546
Other assets	2,598	—	2,598	—	—	90	2,688
Total assets	259,717	—	259,717	(46)	(274)	90	259,487
Liabilities							
Deposits by banks	32,465	(32,465)	—				
Bank deposits		20,528	20,528	—	—	—	20,528
Customer accounts	201,150	(201,150)	—				
Customer deposits		194,055	194,055	—	—	—	194,055
Amounts due to holding companies and fellow subsidiaries		23,311	23,311	—	—	—	23,311
Derivatives	3,117	—	3,117	—	—	—	3,117
Other financial liabilities		139	139	—	—	—	139
Subordinated liabilities	5,640	(4,409)	1,231	—	—	—	1,231
Other liabilities	1,990	(9)	1,981	—	40	—	2,021
Total liabilities	244,362	—	244,362	—	40	—	244,402
Total equity	15,355	—	15,355	(46)	(314)	90	15,085
Total liabilities and equity	259,717	—	259,717	(46)	(274)	90	259,487

The table below reflects the impact of IFRS 9 on total equity:

	Group £m	Bank £m
At 31 December 2017 - under IAS 39	16,367	15,355
Classification & measurement	(7)	(46)
- Mandatory fair value through profit or loss assets - adjustments following business model reviews (SPPI)	(9)	(9)
- Equity shares held at cost under IAS 39 - fair value adjustments through FVOCI reserve	46	—
- Additional write-down of amortised cost assets	(44)	(37)
Expected credit losses	(364)	(314)
- Amortised cost assets	(320)	(274)
- Contingent liabilities and commitments	(44)	(40)
Tax	100	90
At 1 January 2018 - under IFRS on transition to IFRS 9	16,096	15,085

36 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.

In 2015, HM Treasury sold 630 million of the company's ordinary shares. In June 2018 HMT sold a further 925 million of the company's ordinary shares. At 31 December 2018, HM Treasury's holding in the company's ordinary shares was 62.3%.

The Group enters into transactions with many of these bodies on an arm's length basis. Transactions include the payment of: taxes principally UK corporation tax (see Note 7) and value added tax; national insurance contributions; local authority rates; and regulatory fees and levies; together with banking transactions such as loans and deposits undertaken in the normal course of banker-customer relationships.

Bank of England facilities

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

Members of the Group that are UK authorised institutions are required to maintain non-interest bearing (cash ratio) deposits with the Bank of England amounting to 0.296% of their average eligible liabilities in excess of £600 million. They also have access to Bank of England reserve accounts: sterling current accounts that earn interest at the Bank of England Rate.

Service entity

On 30 April 2018, in preparation for ring-fencing, the Bank became the main provider of shared service activities for the RBS Group. This includes Treasury services supporting, as well as providing, services to both the ring-fenced bank (RFB) and non-ring-fenced bank (NRFB).

Other related parties

(a) In their roles as providers of finance, Group companies provide development and other types of capital support to businesses. These investments are made in the normal course of business and on arm's length terms. In some instances, the investment may extend to ownership or control over 20% or more of the voting rights of the investee company. However, these investments are not considered to give rise to transactions of a materiality requiring disclosure under IAS 24.
(b) The Group recharges The Royal Bank of Scotland Group Pension Fund with the cost of administration services incurred by it. The amounts involved are not material to the Group.
(c) In accordance with IAS 24, transactions or balances between Group entities that have been eliminated on consolidation are not reported.
(d) The captions in the primary financial statements of the parent company include amounts attributable to subsidiaries. These amounts have been disclosed in aggregate in the relevant notes to the financial statements.

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

	2018 £m	2017 £m
Income		
Interest receivable	321	363
Interest payable	(286)	(396)
Fees and commissions receivable	—	11
Fees and commissions payable	(1)	(2)
Other administrative expenses	(747)	(2,358)
	(713)	(2,382)
Discontinued operations		
Net expenses	(1)	(29)
	(1)	(29)

37 Ultimate holding company

The Group's ultimate holding company is The Royal Bank of Scotland Group plc (RBSG) and its intermediate parent company NatWest Holdings Limited (NatWest Holdings or 'the intermediate holding company').

All companies are incorporated in Great Britain and RBSG is registered in Scotland and NatWest Holdings is registered in England. As at 31 December 2018, The Royal Bank of Scotland Group plc heads the largest group in which the Group is consolidated. Copies of the consolidated accounts of both companies may be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, PO Box 1000, Edinburgh EH12 1HQ.

Following placing and open offers by The Royal Bank of Scotland Group plc in December 2008 and April 2009, the UK Government, through HM Treasury, currently holds 62.3% of the issued ordinary share capital of the ultimate holding company and is therefore the Group's ultimate controlling party.

38 Post balance sheet events

There have been no other significant events between 31 December 2018 and the date of approval of these accounts which would require a change to or additional disclosure in the accounts.

39 Related undertakings

Group legal entities and activities at 31 December 2018

In accordance with the Companies Act 2006, the company's related undertakings and the accounting treatment for each are listed below. All undertakings are wholly-owned by the company or subsidiaries of the company and are consolidated by reason of contractual control (Section 1162(2) CA 2006), unless otherwise indicated. Group interest refers to ordinary shares of equal values and voting rights unless further analysis is provided in the notes. Activities are classified in accordance with Annex I to the Capital Requirements Directive ("CRD IV") and the definitions in Article 4 of the Capital Requirements Regulation

The following table details active related undertakings incorporated in the UK which are 100% owned by the Group and fully consolidated for accounting purposes.

Entity name	Activity	Regulatory treatment	Notes
Caledonian Sleepers Rail Leasing Ltd	BF	FC	(1)
Coutts & Company	CI	FC	(11)
Coutts Finance Company	BF	FC	(11)
Digi Ventures Ltd	OTH	FC	(7)
Esme Loans Ltd	BF	FC	(7)
Euro Sales Finance Ltd	BF	FC	(7)
FreeAgent Central Ltd	SC	FC	(27)
FreeAgent Holdings PLC	SC	FC	(27)
G L Trains Ltd	BF	FC	(1)
Gatehouse Way Developments Ltd	INV	DE	(1)
KUC Properties Ltd	BF	DE	(5)
Land Options (West) Ltd	INV	DE	(5)
Leckhampton Finance Ltd	BF	FC	(30)
Lombard & Ulster Ltd	BF	FC	(2)
Lombard Business Finance Ltd	BF	FC	(8)
Lombard Business Leasing Ltd	BF	FC	(8)
Lombard Charterhire Ltd	BF	FC	(8)
Lombard Corporate Finance (December 1) Ltd	BF	FC	(30)
Lombard Corporate Finance (December 3) Ltd	BF	FC	(30)
Lombard Corporate Finance (June 2) Ltd	BF	FC	(30)
Lombard Discount Ltd	BF	FC	(8)
Lombard Finance Ltd	BF	FC	(8)
Lombard Industrial Leasing Ltd	BF	FC	(30)
Lombard Initial Leasing Ltd	BF	FC	(8)
Lombard Lease Finance Ltd	BF	FC	(30)
Lombard Leasing Company Ltd	BF	FC	(30)
Lombard Leasing Contracts Ltd	BF	FC	(1)
Lombard Lessors Ltd	BF	FC	(8)
Lombard Maritime Ltd	BF	FC	(8)
Lombard North Central Leasing Ltd	BF	FC	(8)
Lombard North Central PLC	BF	FC	(8)
Lombard Property Facilities Ltd	BF	FC	(1)
Lombard Technology Services Ltd	BF	FC	(8)
National Westminster Properties No. 1 Ltd	SC	DE	(7)
NatWest Capital Finance Ltd	BF	FC	(1)
NatWest Corporate Investments	BF	DE	(7)
NatWest Invoice Finance Ltd	OTH	FC	(7)
NatWest Property Investments Ltd	INV	DE	(7)
Northern Isles Ferries Ltd	BF	FC	(30)
Pittville Leasing Ltd	BF	FC	(30)
Premier Audit Company Ltd	BF	DE	(7)
R.B. Capital Leasing Ltd	BF	FC	(30)
R.B. Leasing (September) Ltd	BF	FC	(30)
R.B. Quadrangle Leasing Ltd	BF	FC	(30)
RBS Asset Finance Europe Ltd	BF	FC	(30)
RBS Asset Management (ACD) Ltd	BF	FC	(11)
RBS Asset Management Holdings	BF	FC	(11)
RBS Invoice Finance Ltd	BF	FC	(7)
RBSG Collective Investments	BF	FC	(5)
RBSSAF (2) Ltd	BF	FC	(30)
RBSSAF (25) Ltd	BF	FC	(30)
RBSSAF (7) Ltd	BF	FC	(30)
RBSSAF (8) Ltd	BF	FC	(30)
Royal Bank Invoice Finance Ltd	BF	FC	(7)
Royal Bank Leasing Ltd	BF	FC	(5)
Royal Bank of Scotland (Industrial Leasing) Ltd	BF	FC	(5)
Royal Scot Leasing Ltd	BF	FC	(5)
RoyScot Trust plc	BF	FC	(8)
Safetosign Ltd	SC	FC	(10)
The Royal Bank of Scotland Group Independent Financial Services Ltd	BF	FC	(5)
The Royal Bank of Scotland Invoice Discounting Ltd	BF	FC	(7)
Ulster Bank Ltd	CI	FC	(2)
Ulster Bank Pension Trustees Ltd	TR	DE	(2)
Voyager Leasing Ltd	BF	FC	(30)
Walton Lake Developments Ltd	INV	DE	(1)

The following table details active related undertakings incorporated outside the UK which are 100% owned by the Group and fully consolidated for accounting purposes.

Entity name	Activity	Regulatory treatment	Notes
Airside Properties AB	BF	FC	(16)
Airside Properties ASP Denmark AS	BF	FC	(19)
Airside Properties Denmark AS	BF	FC	(19)
Arkivborgen KB	BF	FC	(16)
Artul Kiinteistöt Oy	BF	FC	(18)
Backsmedjan KB	BF	FC	(16)
BD Lagerhus AS	BF	FC	(17)
Bil Fastigheter i Sverige AB	BF	FC	(16)
Bilfastighet i Täby AB	BF	FC	(16)
Bilfastighet i Akalla AB	BF	FC	(15)
Braheberget KB	BF	FC	(16)
Brödmagasinet KB	BF	FC	(16)
Eiendomsselskapet Apteno La AS	BF	FC	(17)
Eurohill 4 KB	BF	FC	(16)
Förvaltningsbolaget Dalkyrkan KB	BF	FC	(16)
Förvaltningsbolaget Predio 3 KB	BF	FC	(16)
Fab Ekenäs Formanshagen 4	BF	FC	(18)
Fastighet Kallebäck 2:4 I Göteborg	BF	FC	(16)
Fastighets AB Flöjten I Norrköping	BF	FC	(16)
Fastighets AB Hammarbyvagnen	BF	FC	(16)
Fastighets AB Kabisten 1	BF	FC	(16)
Fastighets AB Stockmakaren	BF	FC	(16)
Fastighets AB Xalam	BF	FC	(16)
Fastighets Aktiebolaget Sambiblioteket	BF	FC	(16)
Fastighetsbolaget Holma I Höör AB	BF	FC	(16)
Forskningshöjden KB	BF	FC	(16)
Forssa Liikekiinteistöt Oy	BF	FC	(18)
Gredelinen KB	BF	FC	(16)
Grinnhagen KB	BF	PC	(16)
Hatros 1 AS	BF	FC	(17)
Horrsta 4:38 KB	BF	FC	(16)
IR Fastighets AB	BF	FC	(16)
IR IndustriRenting AB	BF	FC	(16)
Kallebäck Institutfastigheter AB	BF	FC	(16)
Kastrup Commuter K/S	BF	FC	(19)
Kastrup Hangar 5 K/S	BF	FC	(19)

39 Related undertakings continued

Entity name	Activity	Regulatory treatment	Notes
Kastrup V&L Building K/S	BF	FC	(19)
KB Eurohill	BF	FC	(16)
KB IR Gamlestaden	BF	FC	(16)
KB Lagermannen	BF	FC	(16)
KB Likriktaren	BF	DE	(16)
Kiinteistö Oy Pennalan Johtotie 2	BF	FC	(18)
Koy Espoon Entresse II	BF	FC	(18)
Koy Espoon Niittysillantie 5	BF	FC	(18)
Koy Helsingin Mechelininkatu 1	BF	FC	(18)
Koy Helsingin Osmontie 34	BF	FC	(18)
Koy Helsingin Panuntie 11	BF	FC	(18)
Koy Helsingin Panuntie 6	BF	FC	(18)
Koy Iisalmen Kihlavirta	BF	FC	(18)
Koy Jämsän Keskushovi	BF	FC	(28)
Koy Kokkolan Kaarlenportti Fab	BF	FC	(18)
Koy Kouvolan Oikeus ja Poliisitalo	BF	FC	(18)
Koy Lohjan Huonekalutalo	BF	FC	(18)
Koy Millennium	BF	FC	(18)
Koy Nummelan Portti	BF	FC	(18)
Koy Nuolialan päiväkoti	BF	FC	(18)
Koy Päiväläisentie 1-6	BF	FC	(18)
Koy Peltolantie 27	BF	FC	(18)
Koy Puotikuja 2 Vaasa	BF	FC	(18)
Koy Raision Kihlakulma	BF	FC	(18)
Koy Ravattulan Kauppakeskus	BF	FC	(18)
Koy Tapiolan Louhi	BF	FC	(18)
Koy Vapaalan Service-Center	BF	DE	(18)
Läkten 1 KB	BF	FC	(16)
LerumsKrysset KB	BF	FC	(16)
Limstagården KB	BF	FC	(16)
Lombard Ireland Group Holdings Unlimited Company	BF	FC	(31)
Lombard Ireland Ltd	BF	FC	(31)
Mjälgen KB	BF	FC	(16)
National Westminster International Holdings B.V.	BF	FC	(5)
Nordisk Renting AB	BF	FC	(16)
Nordisk Renting AS	BF	FC	(17)
Nordisk Renting Kapital AB	BF	FC	(16)
Nordisk Renting OY	BF	FC	(18)
Nordisk Specialinvest AB	BF	FC	(16)
Nordiska Strategifastigheter Holding AB	BF	FC	(16)
Nybergflata 5 AS	BF	FC	(23)
Pyrrhula 6,7 AB	BF	FC	(16)
RBS Asset Management (Dublin) Ltd	BF	FC	(22)
RBS Deutschland Holdings GmbH	BF	FC	(25)
RBS Polish Financial Advisory Services sp. z o.o.	BF	FC	(32)
RBS Services (Switzerland) Ltd	SC	FC	(26)
RBS Services India Private Ltd	SC	FC	(20)
Ringdalveien 20 AS	BF	FC	(17)
SFK Kommunfastigheter AB	BF	FC	(16)
Sjöklockan KB	BF	FC	(16)
Skinnarängen KB	BF	FC	(16)
Solbänken KB	BF	FC	(16)
Strand European Holdings AB	BF	FC	(16)
Svenskt Fastighetskapital AB	BF	FC	(16)
Svenskt Energikapital AB	BF	FC	(16)
Svenskt Fastighetskapital Holding AB	BF	FC	(16)
Tingsbrogården KB	BF	FC	(16)
Tygverkstaden 1 KB	BF	DE	(16)

The following table details active related undertakings which are 100% owned by the Group ownership but are not consolidated for accounting purposes.

Entity name	Activity	Regulatory treatment	Notes
West Granite Homes Inc.	INV	DE	(13)

The following table details active related undertakings incorporated in the UK where the Group ownership is less than 100%.

Entity name	Activity	Accounting treatment	Regulatory treatment	Group %	Notes
GWNW City Developments Ltd	BF	EAJV	DE	50	(21)
Jaguar Cars Finance Ltd	BF	FC	FC	50	(8)
JCB Finance (Leasing) Ltd	BF	FC	FC	75	(29)
JCB Finance Ltd	BF	FC	FC	75	(29)
Landpower Leasing Ltd	BF	FC	FC	75	(29)
London Rail Leasing Ltd	BF	EAJV	PC	50	(12)
NatWest Covered Bonds (LM) Ltd	BF	IA	PC	20	(9)
NatWest Covered Bonds LLP	BF	FC	FC	73	(1)
Silvermere Holdings Ltd	BF	FC	FC	95	(5)

The following table details active related undertakings incorporated outside the UK where the Group ownership is less than 100%.

Entity name	Activity	Accounting treatment	Regulatory treatment	Group %	Notes
Förvaltningsbolaget Klöverbacken Skola KB	BF	FC	FC	51	(16)
Nightingale CRE 2018-1 Ltd	BF	FC	FC	0	(10)
Nightingale Securities 2017-1 Ltd	BF	FC	DE	0	(10)
Optimus KB	BF	FC	PC	51	(16)
Pharos Estates Ltd	OTH	EAA	DE	49	(4)
Stora Kvarnen KB	BF	FC	FC	51	(16)
WiĞniowy Management sp. Z.o.o.	SC	EAA	DE	25	(24)

The following table details active related undertakings that are not active (actively being dissolved).

Entity name	Accounting treatment	Regulatory treatment	Group %	Notes
CNW Group Ltd	FC	FC	100	(7)
Dixon Motors Developments Ltd	FC	DE	100	(1)
Greenwich NatWest Ltd	FC	FC	100	(7)
NatWest Finance Ltd	FC	DE	100	(7)
NatWest Nominees Ltd	FC	DE	100	(1)
Property Ventures (B&M) Ltd	FC	DE	100	(1)
RBS Invoice Finance (Holdings) Ltd	FC	FC	100	(7)
Riossi Ltd	FC	DE	100	(8)
Springwell Street Developments (No 1) Ltd	FC	FC	100	(8)
The Royal Bank of Scotland Finance (Ireland)	FC	FC	100	(6)
Ulster Bank Commercial Services (NI) Ltd	FC	FC	100	(3)
West Register (Northern Ireland) Property Ltd	FC	DE	100	(2)
WR (NI) Property Investments Ltd	FC	DE	100	(2)
WR (NI) Property Realisations Ltd	FC	DE	100	(2)

39 Related undertakings continued

The following table details related undertakings that are dormant.

Entity name	Accounting treatment	Regulatory treatment	Group %	Notes
Dixon Vehicle Sales Ltd	FC	FC	100	(1)
Dunfly Trustee Ltd	FC	FC	100	(1)
JCB Finance Pension Ltd	FC	DE	88	(2)
National Westminster Ltd	FC	FC	100	(1)
NatWest FIS Nominees Ltd	FC	FC	100	(1)
NatWest PEP Nominees Ltd	FC	FC	100	(1)
NatWest Security Trustee Company Ltd	FC	FC	100	(7)
Nordisk Renting A/S	FC	FC	100	(14)
Nordisk Renting HB	FC	FC	100	(16)
R.B. Leasing (March) Ltd	FC	FC	100	(30)
RBS Investment Executive Ltd	NC	DE	100	(5)
RBS Pension Trustee Ltd	NC	DE	100	(1)
RBS Secretarial Services Ltd	FC	FC	100	(5)
RBSG Collective Investments Nominees Ltd	FC	FC	100	(5)
Strand Nominees Ltd	FC	FC	100	(11)
Syndicate Nominees Ltd	FC	FC	100	(1)

The following table details the overseas branches of the Group.

Subsidiary	Geographic location
National Westminster Bank plc	Finland, France, Germany, Italy, Netherlands, Norway, Spain, Sweden

Key:

BF	Banking and financial institution
CI	Credit institution
INV	Investment (shares or property) holding company
SC	Service company
TR	Trustee
OTH	Other
DE	Deconsolidated
FC	Full consolidation
PC	Pro-rata consolidation
EAA	Equity accounting – Associate
EAJV	Equity accounting – Joint venture
IA	Investment accounting
NC	Not consolidated

Notes:

	Registered addresses (UK unless stated otherwise)	Country of incorporation
(1)	1 Princes Street, London, EC2R 8BP, England	UK
(2)	11-16 Donegall Square East, Belfast, BT1 5UB, Northern Ireland	UK
(3)	2 Donegall Square West, Belfast, BT2 7GP, Northern Ireland	UK
(4)	24 Demostheni Severi, 1st Floor, Nicosia, 1080	Cyprus
(5)	24/25 St Andrew Square, Edinburgh, EH2 1AF, Scotland	UK
(6)	24/26 City Quay, Dublin 2	RoI
(7)	250 Bishopsgate, London, EC2M 4AA, England	UK
(8)	280 Bishopsgate, London, EC2M 4RB, England	UK
(9)	35 Great St Helen's, London, EC3A 6AP, England	UK
(10)	44 Esplanade, St Helier, JE4 9WG	Jersey
(11)	440 Strand, London, WC2R 0QS, England	UK
(12)	99 Queen Victoria Street, London, EC4V 4EH, England	UK
(13)	Bellevue Parkway, Suite 210, Wilmington, Delaware, DE 19809	USA
(14)	c/o Adv Jan-Erik Svensson, HC Andersens Boulevard 12, Kopenhaum V, 1553	Denmark
(15)	C/O Nordisk Renting AB, 151 36 Sodertalje Stockholm County	Sweden
(16)	c/o Nordisk Renting AB, Box 14044, SE-104 40, Stockholm	Sweden
(17)	c/o Nordisk Renting AS, 9 Estaje, Klingenberggata 7, NO-0161, Oslo	Norway
(18)	c/o Nordisk Renting OY, Eteläesplanadi 12, Box 14044, FI-00130, Helsinki	Finland
(19)	c/o Visma Services, Lyskaer 3 CD, Herlev, 104 40	Denmark
(20)	DLF Cyber City, Tower C, DLF Phase III, Haryana, 122 002	India
(21)	Gate House, Turnpike Road, High Wycombe, Buckinghamshire, HP12 3NR, England	UK
(22)	Guild House, Guild Street, IFSC, D01 K2C5, Dublin 1	RoI
(23)	H. Heyerdahlsgate 1, Postboks 2020 Vika, Oslo	Norway
(24)	Ilzecka 26 Street, Warsaw, 02-135	Poland
(25)	Junghofstrasse 22, Frankfurt am Main, D-60311	Germany
(26)	Lerchenstrasse 18, Zurich, CH 8022	Switzerland
(27)	One Edinburgh Quay, 133 Fountainbridge, Edinburgh, Scotland, EH3 9QG	UK
(28)	Södra esplanaden, 12 c/o Nordisk Renting Oy, FI-00130, Helsinki	Finland
(29)	The Mill, High Street, Rocester, ST14 5JW, England	UK
(30)	The Quadrangle, The Promenade, Cheltenham, GL50 1PX, England	UK
(31)	Ulster Bank Group Centre, George's Quay, Dublin 2	RoI
(32)	Wisniowy Business Park, ul 1-go Sierpnia 8a, Warsaw 02-134	Poland

Risk factors

Principal Risks and Uncertainties

Set out below are certain risk factors that could adversely affect the Group's future results, its financial condition and prospects and cause them to be materially different from what is forecast or expected and either directly or indirectly impact the value of its securities in issue.

These risk factors are broadly categorised and should be read in conjunction with the forward looking statements section, the strategic report and the capital and risk management section of this annual report and should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties facing the Group.

Operational and IT resilience risk

The Group is subject to increasingly sophisticated and frequent cyberattacks.

The Group is experiencing continued cyberattacks across the entire Group, with an emerging trend of attacks against the Group's supply chain, re-enforcing the importance of due diligence and close working with the third parties on which the Group relies. The Group is reliant on technology, which is vulnerable to attacks, with cyberattacks increasing in terms of frequency, sophistication, impact and severity. As cyberattacks evolve and become more sophisticated, the Group will be required to invest additional resources to upgrade the security of its systems. In 2018, the Group was subjected to a small but increasing number of Distributed Denial of Service ('DDOS') attacks, which are a pervasive and significant threat to the global financial services industry. The Group fully mitigated the impact of these attacks whilst sustaining full availability of services for its customers. Hostile attempts are made by third parties to gain access to and introduce malware (including ransomware) into the Group's IT systems, and to exploit vulnerabilities. The Group has information security controls in place, which are subject to review on a continuing basis, but there can be no assurance that such measures will prevent all DDOS attacks or other cyberattacks in the future. See also, 'The Group's operations are highly dependent on its IT systems'.

Any failure in the Group's cybersecurity policies, procedures or controls, may result in significant financial losses, major business disruption, inability to deliver customer services, or loss of data or other sensitive information (including as a result of an outage) and may cause associated reputational damage. Any of these factors could increase costs (including costs relating to notification of, or compensation for customers, credit monitoring or card reissuance), result in regulatory investigations or sanctions being imposed, or may affect the Group's ability to retain and attract customers. Regulators in the UK, US and Europe continue to recognise cybersecurity as an increasing systemic risk to the financial sector and have highlighted the need for financial institutions to improve their monitoring and control of, and resilience (particularly of critical services) to cyberattacks, and to provide timely notification of them, as appropriate.

Additionally, parties may also fraudulently attempt to induce employees, customers, third party providers or other users who have access to the Group's systems to disclose sensitive information in order to gain access to the Group's data or that of the Group's customers or employees. Cybersecurity and information security events can derive from human error, fraud or malice on the part of the Group's employees or third parties, including third party providers, or may result from accidental technological failure.

In accordance with the EU General Data Protection Regulation ('GDPR'), the Group is required to ensure it timely implements appropriate and effective organisational and technological safeguards against unauthorised or unlawful access to the data of the Group, its customers and its employees. In order to meet this requirement, the Group relies on the effectiveness of its internal policies, controls and procedures to protect the confidentiality, integrity and availability of information held on its IT systems, networks and devices as well as with third parties with whom the Group interacts and a failure to monitor and manage data in accordance with the GDPR requirements may result in financial losses, regulatory fines and investigations and associated reputational damage. In addition, whilst the Group takes appropriate measures to prevent, detect and minimise attacks, the Group's systems, and those of third party providers, are subject to frequent cyberattacks.

The Group expects greater regulatory engagement, supervision and enforcement in relation to its overall resilience to withstand IT systems and related disruption, either through a cyberattack or some other disruptive event. However, due to the Group's reliance on technology and the increasing sophistication, frequency and impact of cyberattacks, it is likely that such attacks could have a material impact on the Group.

Operational risks are inherent in the Group's businesses.

Operational risk is the risk of loss resulting from inadequate or failed internal processes, procedures, people or systems, or from external events, including legal risks. As at 31 December 2018, the Group offered a diverse range of products and services supported by 55,400 employees; it therefore has complex and diverse operations. As a result, operational risks or losses can arise from a number of internal or external factors. These risks are also present when the Group relies on outside suppliers or vendors to provide services to it or its customers, as is increasingly the case as the Group implements new technologies, innovates and responds to regulatory and market changes.

Operational risks continue to be heightened as a result of the RBS Group's current cost-reduction measures and conditions affecting the financial services industry generally (including Brexit and other geo-political developments) as well as the legal and regulatory uncertainty resulting therefrom. This may place significant pressure on the Group's ability to maintain effective internal controls and governance frameworks. In particular, new governance frameworks have recently been put into place throughout the RBS Group for certain RBS Group entities (including the Group) and certain stand-alone market-facing capabilities have been established for the Group and Group entities, due to the implementation of the UK ring-fencing regime and the resulting legal entity structure. See also, 'The Group, including the Bank, is required to comply with regulatory requirements in respect of the implementation of the UK ring-fencing regime'. The Group is also dependent on the RBS Group for certain shared critical services. The effective management of operational risks is critical to meeting customer service expectations and retaining and attracting customer business.

Although the Group has implemented risk controls and loss mitigation actions, and significant resources and planning have been devoted to mitigate operational risk, there is uncertainty as to whether such actions will be effective in controlling each of the operational risks faced by the Group.

The Group's operations are highly dependent on its IT systems.

The Group's operations are highly dependent on the ability to process a very large number of transactions efficiently and accurately while complying with applicable laws and regulations. The proper functioning of the Group's payment systems, financial and sanctions controls, risk management, credit analysis and reporting, accounting, customer service and other IT systems, as well as the communication networks between their branches and main data processing centres, are critical to the Group's operations.

Individually or collectively, any critical system failure, prolonged loss of service availability or material breach of data security could cause serious damage to the Group's ability to provide services to its customers, which could result in significant compensation costs or regulatory sanctions (including fines resulting from regulatory investigations), or a breach of applicable regulations. In particular, failures or breaches resulting in the loss or publication of confidential customer data could cause long-term damage to the Group's reputation and could affect its regulatory approvals, competitive position, business and brands, which could undermine its ability to attract and retain customers. This risk is heightened as the Group continues to innovate and offer new digital solutions to its customers as a result of the trend towards online and mobile banking.

In 2018, the Group upgraded its IT systems and technology and expects to continue to make considerable investments to further simplify, upgrade and improve its IT and technology capabilities (including migration to the Cloud) to make them more cost-effective, improve controls and procedures, strengthen cyber security, enhance digital services provided to its customers and improve its competitive position. Should such investment and rationalisation initiatives fail to achieve the expected results or prove to be insufficient due to cost challenges or otherwise, this could negatively affect the Group's operations, its reputation and ability to retain or grow its customer business or adversely impact its competitive position, thereby negatively impacting the Group's financial position.

The Group, including the Bank, is required to comply with regulatory requirements in respect of the implementation of the UK ring-fencing regime.
The UK ring-fencing regime came into force on 1 January 2019. As part of the transition to become compliant with the UK ring-fencing regime, the Bank has established stand-alone market-facing capabilities for derivatives, foreign exchange and fixed income, in order to manage funding and market risk in the Group. The Bank is now a direct member of GBP and EUR payment systems and a direct member of the London Clearing House and the Continuous Linked Settlement. The Group's ongoing compliance with the UK ring-fencing regime may entail significant costs, and may also impose significant operational, legal and execution risk in the Group's day-to-day activities.

In addition, the implementation of the UK ring-fencing regime may impact the Group's treasury operations, including internal and external funding arrangements and the Group's funding strategy as certain Group entities, including the Bank, will be required to access the debt capital markets as new stand-alone entities which may entail increased execution risk for the Group's funding plan and may increase the cost of funding for certain Group entities, including the Bank.

The Group relies on attracting, retaining and developing senior management and skilled personnel, and is required to maintain good employee relations.
The Group's current and future success depends on its ability to attract, retain and develop highly skilled and qualified personnel, including senior management, directors and key employees, in a highly competitive labour market and under internal cost reduction pressures. This entails risk, particularly in light of heightened regulatory oversight of banks and the increasing scrutiny of, and (in some cases) restrictions placed upon, employee compensation arrangements, in particular those of banks in receipt of government support such as the RBS Group, which may have an adverse effect on the Group's ability to hire, retain and engage well-qualified employees. The market for skilled personnel is increasingly competitive, especially for technology-focussed roles, thereby raising the cost of hiring, training and retaining skilled personnel. In addition, certain economic, market and regulatory conditions and political developments (including Brexit) may reduce the pool of candidates for key management and non-executive roles, including non-executive directors with the right skills, knowledge and experience, or increase the number of departures of existing employees.

Many of the Group's employees in the UK, Republic of Ireland and continental Europe are represented by employee representative bodies, including trade unions. Engagement with its employees and such bodies is important to the Group in maintaining good employee relations. Any failure to do so could impact the Group's ability to operate its business effectively.

A failure in the Group's risk management framework could adversely affect the Group, including its ability to achieve its strategic objectives.
Risk management is an integral part of all of the Group's activities and includes the definition and monitoring of the Group's risk appetite and reporting on its risk exposure and the potential impact thereof on its financial condition. Financial risk management is highly dependent on the use and effectiveness of internal stress tests and models and ineffective risk management may arise from a wide variety of factors, including lack of transparency or incomplete risk reporting, unidentified conflicts or misaligned incentives, lack of accountability control and governance, lack of consistency in risk monitoring and management or insufficient challenges or assurance processes. Failure to manage risks effectively could adversely impact the Group's reputation or its relationship with its customers, shareholders or other stakeholders.

The Group's operations are inherently exposed to conduct risks. These include business decisions, actions or incentives that are not responsive to or aligned with the Group's customers' needs or do not reflect the Group's customer-focussed strategy, ineffective product management, unethical or inappropriate use of data, outsourcing of customer service and product delivery, the possibility of alleged mis-selling of financial products and mishandling of customer complaints. Some of these risks have materialised in the past and ineffective management and oversight of conduct risks may lead to further remediation and regulatory intervention or enforcement. The Group's businesses are also exposed to risks from employee misconduct including non-compliance with policies and regulations, negligence or fraud (including financial crimes), any of which could result in regulatory fines or sanctions and serious reputational or financial harm to the Group.

The Group is seeking to embed a strong risk culture across the organisation and has implemented policies and allocated new resources across all levels of the organisation to manage and mitigate conduct risk and expects to continue to invest in its risk management framework. However, such efforts may not insulate the Group from future instances of misconduct and no assurance can be given that the Group's strategy and control framework will be effective. Any failure in the Group's risk management framework could negatively affect the Group and its financial condition through reputational and financial harm and may result in the inability to achieve its strategic objectives for their customers, employees and wider stakeholders.

The Group's operations are subject to inherent reputational risk.
Reputational risk relates to stakeholder and public perceptions of the Group arising from an actual or perceived failure to meet stakeholder expectations due to any events, behaviour, action or inaction by the Group, its employees or those with whom the Group is associated. This includes brand damage, which may be detrimental to the Group's business, including its ability to build or sustain business relationships with customers, and may cause low employee morale, regulatory censure or reduced access to, or an increase in the cost of, funding. Reputational risk may arise whenever there is a material lapse in standards of integrity, compliance, customer or operating efficiency and may adversely affect the Group's ability attract and retain customers. In particular, the Group's ability to attract and retain customers (and, in particular, corporate and retail depositors) may be adversely affected by, amongst others: negative public opinion resulting from the actual or perceived manner in which the Group or any other member of the RBS Group conducts or modifies its business activities and operations, media coverage (whether accurate or otherwise), employee misconduct, the Group's financial performance, IT systems failures or cyberattacks, the level of direct and indirect government support, or the actual or perceived practices in the banking and financial industry in general, or a wide variety of other factors.

Modern technologies, in particular online social networks and other broadcast tools which facilitate communication with large audiences in short time frames and with minimal costs, may also significantly enhance and accelerate the impact of damaging information and allegations.

Although the Group has implemented a Reputational Risk Policy to improve the identification, assessment and management of customers, transactions, products and issues which represent a reputational risk, the Group cannot be certain that it will be successful in avoiding damage to its business from reputational risk.

Economic and political risk

Uncertainties surrounding the UK's withdrawal from the European Union may adversely affect the Group.
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, the UK is scheduled to leave the EU on 29 March 2019. The terms of a Brexit withdrawal agreement negotiated by the UK Government were decisively voted against by Parliament on 15 January 2019. The UK Government and Parliament are currently actively engaged in seeking to determine the terms of this departure, including any 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.

As it currently stands, EU membership and all associated treaties will cease to apply at 23:00 on 29 March 2019, unless some form of transitional arrangement encompassing those associated treaties is agreed or there is unanimous agreement amongst the UK, other EU member states and the European Commission to extend the negotiation period.

The direct and indirect effects of the UK's exit from the EU and the European Economic Area ('EEA') are expected to affect many aspects of the Group's business and operating environment, including as described elsewhere in these risk factors, and may be material and/or cause a near-term impact on impairments. See also 'The Group faces increased political and economic risks and uncertainty in the UK and global markets'.

The longer term effects of Brexit on the RBS Group's operating environment are difficult to predict, and are subject to wider global macro-economic trends and events, but may significantly impact the Group and its customers and counterparties who are themselves dependent on trading with the EU or personnel from the EU and may result in, or be exacerbated by, periodic financial volatility and slower economic growth, in the UK in particular, but also in Republic of Ireland, Europe and potentially the global economy.

Significant uncertainty exists as to the respective legal and regulatory arrangements under which the Group and its subsidiaries will operate when the UK is no longer a member of the EU (see 'The RBS Group is in the process of seeking requisite permissions to implement its plans for continuity of business impacted by the UK's departure from the EU'. 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 Group's operations or legal entity structure, including attendant restructuring costs, level of impairments, capital requirements, regulatory environment and tax implications and as a result may adversely impact the Group's profitability, competitive position, viability, business model and product offering.

The RBS Group is seeking the requisite permissions to implement its plans for continuity of business impacted by the UK's departure from the EU.

The RBS Group is implementing plans designed to continue its ability to clear euro payments and minimise the impact on the Group's ability to serve non-UK EEA customers in the event that there is an immediate loss of access to the European Single Market on 29 March 2019 (or any alternative date) with no alternative arrangement for continuation of such activities under current rules (also known as 'Hard Brexit').

To ensure continued ability to clear Euro denominated payments, the RBS Group is finalising a third-country licence for the Frankfurt branch of the Bank. In addition, the RBS Group is working to satisfy the conditions of the Deutsche Bundesbank (DBB) for access to TARGET2 clearing and settlement mechanisms. Satisfying these DBB conditions, which include a country legal opinion, and accessing SEPA, Euro 1 and TARGET2 will allow the RBS Group (through the Bank's Frankfurt branch) to continue to clear cross-border payments in euros. The capacity to process these euro payments is a fundamental requirement for the daily operations and customers of all Group franchises, including PBB and CPB. The value of such payments is typically in excess of €50 billion in any one day with more than 300,000 transactions. This capacity is also critical for management of the RBS Group's euro-denominated central bank cash balances of around €23 billion. NatWest Markets Plc ('NWM Plc') will use the Bank's Frankfurt branch to clear its euro payments and has also applied for a third country license to maintain liquidity management and product settlement arrangements.

A draft license has recently been issued for NWB Frankfurt branch which the Group intends to finalise imminently. Once in place, the third country licence branch approvals would each become effective when the UK leaves the EU and the current passporting arrangements cease to apply. The RBS Group expects to have received the requisite third country licenses and access to SEPA, Euro 1 and TARGET2 ahead of the UK's departure from the EU. However, given the quantum of affected payments and lack of short term contingency arrangements, in the event that such euro clearing capabilities were not in place in time for a Hard Brexit or as required in the future, it could have a material impact on the RBS Group and the Group and its customers.

Additionally, to continue serving most of the RBS Group's EEA customers, the RBS Group has repurposed the banking licence of its Dutch subsidiary, NatWest Markets N.V. ('NWM NV'). As announced on 6 December 2018, the RBS Group has requested court permission for a FSMA transfer scheme to replicate the master trade documentation for NWM Plc's non-UK EEA customers and to transfer certain existing transactions from NWM Plc to NWM NV. Other transactions are expected to be transferred to NWM NV during 2019 (for example, certain transactions with Corporate and Sovereign customers and larger EEA customers from NWM Plc, and certain Western European corporate business from National Westminster Bank Plc). The volume and pace of business transfers to NWM NV will depend on the terms and circumstances of the UK's exit from the EU, as well as the specific contractual terms of the affected products.

These changes to the Group's operating model are costly and require further changes to its business operations and customer engagement. The regulatory permissions from the Dutch and German authorities will be 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, and may be subject to change in the future. Maintaining these permissions and the RBS Group's access to the euro payment infrastructure will be fundamental to its business going forward and further changes to the Group's business operations may be required.

The Group faces increased political and economic risks and uncertainty in the UK and global markets.

In the UK, significant economic and political uncertainty surrounds the terms of and timing of Brexit. (See also, 'Uncertainties surrounding the UK's withdrawal from the European Union may adversely affect the Group'). In addition, were there to be a change of UK Government as a result of a general election, the Group may face new risks as a result of a change in government policy, including more direct intervention by the UK government in financial markets, the regulation and ownership of public companies and the extent to which the government exercises its rights as a shareholder of the RBS Group. This could affect, in particular, the structure, strategy and operations of the RBS Group (including the Group) and may negatively impact the Group's operational performance and financial results.

The Group faces additional political uncertainty as to how the Scottish parliamentary process (including, as a result of any second Scottish independence referendum) may impact the Group. RBSG and a number of other RBS Group entities are headquartered and incorporated in Scotland. Any changes to Scotland's relationship with the UK or the EU (as an indirect result of Brexit or other developments) would impact the environment in which the RBS Group and its subsidiaries operate, and may require further changes to the RBS Group's (including the Group's structure), independently or in conjunction with other mandatory or strategic structural and organisational changes which could adversely impact the Group.

Actual or perceived difficult global economic conditions can create challenging economic and market conditions and a difficult operating environment for the Group's businesses and its customers and counterparties, thereby affecting its financial performance.

The outlook for the global economy over the medium-term remains uncertain due to a number of factors including: trade barriers and the increased possibility of trade wars, widespread political instability, an extended period of low inflation and low interest rates, and global regional variations in the impact and responses to these factors. Such conditions could be worsened by a number of factors including political uncertainty or macro-economic deterioration in the Eurozone, China or the US, increased instability in the global financial system and concerns relating to further financial shocks or contagion (for example, due to economic concerns in emerging markets), market volatility or fluctuations in the value of the pound sterling, new or extended economic sanctions, volatility in commodity prices or concerns regarding sovereign debt. This may be compounded by the ageing demographics of the populations in the markets that the Group serves, or rapid change to the economic environment due to the adoption of technology and artificial intelligence. Any of the above developments could impact the Group directly (for example, as a result of credit losses) or indirectly (for example, by impacting global economic growth and financial markets and the Group's customers and their banking needs).

In addition, the Group is exposed to risks arising out of geopolitical events or political developments, such as trade barriers, exchange controls, sanctions and other measures taken by sovereign governments that may hinder economic or financial activity levels. Furthermore, unfavourable political, military or diplomatic events, including secession movements or the exit of other member states from the EU, armed conflict, pandemics and widespread public health crises, state and privately sponsored cyber and terrorist acts or threats, and the responses to them by governments and markets, could negatively affect the business and performance of the Group.

Continued low interest rates have significantly affected and will continue to affect the Group's business and results.

Interest rate risk is significant for the Group, as monetary policy has been accommodative in recent years, including as a result of certain policies implemented by the Bank of England and HM Treasury such as the Term Funding Scheme, which have helped to support demand at a time of pronounced fiscal tightening and balance sheet repair. However, there remains considerable uncertainty as to the direction of interest rates and pace of change, as set by the Bank of England. Continued sustained low or negative interest rates could put pressure on the Group's interest margins and adversely affect the Group's profitability and prospects. In addition, a continued period of low interest rates and flat yield curves has affected and may continue to affect the Group's interest rate margin realised between lending and borrowing costs.

Conversely, while increases in interest rates may support Group income, sharp increases in interest rates could lead to generally weaker than expected growth, or even contracting GDP, reduced business confidence, higher levels of unemployment or underemployment, adverse changes to levels of inflation, and falling property prices in the markets in which the Group operates.

The Group expects to face significant risks in connection with climate change and the transition to a low carbon economy

The risks associated with climate change are subject to rapidly increasing prudential and regulatory, political and societal focus, both in the UK and internationally. Embedding climate risk into the Group's risk framework in line with expected regulatory expectations, and adapting the Group's operation and business strategy to address both the risks of climate change and the transition to a low carbon economy are likely to have a significant impact on the Group.

Multilateral and UK Government undertakings to limit increases in carbon emissions in the near and medium term will require widespread levels of adjustment across all sectors of the economy, with some sectors such as property, energy, infrastructure (including transport) and agriculture likely to be particularly impacted. The nature and timing of the far-reaching commercial, technological and regulatory changes that this transition will entail are currently uncertain but the impact of such changes may be disruptive, especially if such changes do not occur in an orderly or timely manner or are not effective in reducing emissions sufficiently. Furthermore, the nature and timing of the manifestation of the physical risks of climate change (which include more extreme specific weather events such as flooding and heat waves and longer term shifts in climate) are also uncertain, and their impact on the economy is predicted to be more acute if carbon emissions are not reduced on a timely basis or to the requisite extent. The potential impact on the economy includes, but is not limited to, lower GDP growth, significant changes in asset prices and profitability of industries, higher unemployment and the prevailing level of interest rates.

UK and international regulators are actively seeking to develop new and existing regulations that are directly and indirectly focussed on climate change and the associated financial risks. Such new regulations are being developed in parallel with an increasing market focus on the risks associated with climate change. In October 2018, the Group's prudential regulator, the PRA, published a draft supervisory standard which sets forth an expectation that regulated entities adopt a Board-level strategic approach to managing and mitigating the financial risks of climate change and embed the management of them into their governance frameworks, subject to existing prudential regulatory supervisory tools (including stress testing and individual and systemic capital requirements). Climate risk is also subject to various legislative actions and proposals by, among others, the European Commission's Sustainable Finance initiative that focuses on incorporating climate risk into its financial policy frameworks, including proposals (e.g. through amendments to MiFID II) for institutional investors (including pension funds) to consider and disclose climate risk criteria as part of their investment decision, and also proposals to consider changes to RWA methodologies. Furthermore, credit ratings agencies are increasingly taking into account environmental, social and governance ('ESG') factors, including climate risk, as part of the credit ratings analysis, as are investors in their investment decisions.

If the Group does not adequately embed climate risk into its risk framework to appropriately measure, manage and disclose the various financial and physical risks it faces associated with climate change, or fails to adapt its strategy and business model to the changing regulatory requirements and market expectations on a timely basis, it may have a material and adverse impact on the Group's level of business growth, its competitiveness, profitability, prudential capital requirements, credit ratings, cost of funding, results of operation and financial condition.

Changes in foreign currency exchange rates may affect the Group's results and financial position.

The Group's foreign exchange exposure arises from structural foreign exchange risk, including capital deployed in the Group's foreign subsidiaries, branches and joint arrangements, and non-trading foreign exchange risk, including customer transactions and profits and losses that are in a currency other than the functional currency of the transaction entity. The Group is required to issue instruments in foreign currencies that assist in meeting the Group's minimum requirements for own funds and eligible liabilities ('MREL'). The Group maintains policies and procedures designed to manage the impact of exposures to fluctuations in currency rates. Nevertheless, changes in currency rates, particularly in the sterling-US dollar and euro-sterling exchange rates, can adversely affect the value of assets, liabilities (including the total amount of MREL eligible instruments), income, RWAs, capital base and expenses and the reported earnings of the Bank's UK and non-UK subsidiaries and may affect the Group's reported consolidated financial condition.

Decisions of major central banks (including by the Bank of England, the ECB and the US Federal Reserve) and political or market events (including Brexit), which are outside of the Group's control, may lead to sharp and sudden variations in foreign exchange rates.

HM Treasury (or UKGI on its behalf) could exercise a significant degree of influence over the RBS Group.

In its November 2018 Autumn Budget, the UK Government announced its intention to continue the process of privatisation of RBSG and to carry out a programme of sales of RBSG ordinary shares with the objective of selling all of its remaining shares in RBSG by 2023-2024. On 5 June 2018, the UK Government (via HM Treasury and UK

Government Investments Limited ('UKGI')) disposed of approximately 7.7% of its stake in RBSG. As at 31 December 2018, the UK Government held 62.3% of the issued ordinary share capital of RBSG. There can be no certainty as to the continuation of the sell-down process or the timing or extent of such sell-downs.

UKGI manages HM Treasury's shareholder relationship with RBSG and, although HM Treasury has indicated that it intends to respect the commercial decisions of the RBS Group and that the RBS Group entities (including the Group) will continue to have their own independent board of directors and management team determining their own strategy, its position as a majority shareholder (and UKGI's position as manager of this shareholding) means that HM Treasury or UKGI could exercise a significant degree of influence over, among other things, the election of directors and appointment of senior management, the RBS Group's (including the Group's) capital strategy, dividend policy, remuneration policy or the conduct of the RBS Group's (including the Group's) operations, and HM Treasury's approach depends on government policy, which could change, including as a result of a general election. The exertion of such influence over RBS Group could in turn have an adverse effect on the governance or business strategy of the Group.

Financial resilience risk

The Group may not meet targets nor generate sustainable returns.

As part of the RBS Group's strategy, the Group has principally become a UK-focussed domestic banking group and is included in a number of financial, capital and operational targets for the RBS Group including in respect of: cost:income ratios, cost reductions leverage ratio targets, funding plans and requirements, reductions in RWAs and the timing thereof, employee engagement, diversity and inclusion as well as environmental, social and customer satisfaction targets.

The Group's ability to meet the RBS Group and the Group's respective targets and to successfully meet its strategy are subject to various internal and external factors and risks. These include, but are not limited to, market, regulatory, economic and political factors, developments relating to litigation, governmental actions, investigations and regulatory matters, and operational risks and risks relating to the Group's business model and strategy (including emerging risks associated with environmental, social and governance issues). A number of factors may impact the Bank's ability to maintain its current CET1 ratio, including impairments, limited organic capital generation or unanticipated increases in RWAs. In addition, the run-down of RWAs may be accompanied by the recognition of disposal losses which may be higher than anticipated.

The Group's ability to meet its respective cost:income ratio targets and the planned reductions in its annual underlying costs may vary considerably from year to year. Furthermore, the focus on meeting cost reduction targets may result in limited investment in other areas which could affect the Group's long-term product offering or competitive position and its ability to meet its other targets, including those related to customer satisfaction.

There is no certainty that the RBS Group's strategy will be successfully executed, that the Group will meet its targets and expectations, or that the Group will be a viable, competitive or profitable banking business.

The Group has significant exposure to counterparty and borrower risk.

The Group has exposure to many different industries, customers and counterparties, and risks arising from actual or perceived changes in credit quality and the recoverability of monies due from borrowers and other counterparties are inherent in a wide range of the Group's businesses. The Group is exposed to credit risk if a customer, borrower or counterparty defaults, or under IFRS 9, suffers a sufficiently significant deterioration of credit quality under SICR ('significant increases in credit risk') rules such that it moves to Stage 2 for impairment calculation purposes. The Group's lending strategy and associated processes may fail to identify or anticipate weaknesses or risks in a particular sector, market or borrower category, or fail to adequately value physical or financial collateral, which may result in an increase in default rates for loans, which may, in turn, impact the Group's profitability. See 'Capital and risk management — Credit Risk'.

The credit quality of the Group's borrowers and other counterparties is impacted by prevailing economic and market conditions and by the legal and regulatory landscape in the UK and any deterioration in such conditions or changes to legal or regulatory landscapes could worsen borrower and counterparty credit quality and consequently impact the Group's ability to enforce contractual security rights. See also, 'The Group faces increased political and economic risks and uncertainty in the UK and global markets'. In particular, developments relating to Brexit or the consequences thereof, may adversely impact credit quality in the UK, and the resulting negative economic outlook could drive an increased level of credit impairments reflecting the more forward-looking nature of IFRS 9.

Within the UK, the level of household indebtedness remains high although the pace of credit growth has slowed during 2018. The ability of such households to service their debts could be challenged by a period of high unemployment or increased interest rates. In particular, the Group may be affected by volatility in property prices both in the residential and commercial sectors (including as a result of Brexit) given that the Group's mortgage loan portfolio as at 31 December 2018, amounted to £124 billion, representing 59% of the Group's customer loan exposure. If property prices were to weaken this could lead to higher impairment charges, particularly if default rates consequently increase. In addition, the Group's credit risk may be exacerbated if the collateral that it holds cannot be realised as a result of market conditions or regulatory intervention or if it is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due to the Group. This is most likely to occur during periods of illiquidity or depressed asset valuations.

Concerns about, or a default by, a financial institution could lead to significant liquidity problems and losses or defaults by other financial institutions, since the commercial and financial soundness of many financial institutions is closely related and inter-dependent as a result of credit, trading, clearing and other relationships among these financial institutions. Any perceived lack of creditworthiness of a counterparty may lead to market-wide liquidity problems and losses for the Group. This systemic risk may also adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with which the Group interacts on a daily basis. See also, 'The Group may not be able to adequately access sources of liquidity and funding'.

As a result, borrower and counterparty credit quality may cause accelerated impairment charges under IFRS 9, increased repurchase demands, higher costs, additional write-downs and losses for the Group and an inability to engage in routine funding transactions.

The Group operates in markets that are highly competitive, with increasing competitive pressures and technology disruption.

The market for UK financial services is highly competitive, and the Group expects such competition to continue or intensify in response to customer behaviour, technological changes (including the growth of digital banking), competitor behaviour, new entrants to the market (including non-traditional financial services providers such as large retail or technology conglomerates), industry trends resulting in increased disaggregation or unbundling of financial services or conversely the re-intermediation of traditional banking services, and the impact of regulatory actions and other factors. In particular, developments in the financial sector resulting from new banking, lending and payment solutions offered by rapidly evolving incumbents, challengers and new entrants, notably with respect to payment services and products, and the introduction of disruptive technology may impede the Group's ability to grow or retain its market share and impact its revenues and profitability, particularly in its key UK retail banking segment. These trends may be catalysed by various regulatory and competition policy interventions, particularly as a result of the UK initiative on Open Banking and other remedies imposed by the Competition and Markets Authority ('CMA') which are designed to further promote competition within retail banking, as well as the competition-enhancing measures under the RBS Group's Alternative Remedies

Package. See also, 'The cost of implementing the Alternative Remedies Package could be more onerous than anticipated'.

Increasingly many of the products and services offered by the Group are, and will become, technology intensive for example Bó, Mettle, Esme, FreeAgent, APtimise and Path, some of the Group's recent fintech ventures. The Group's ability to develop digital solutions that comply with related regulatory changes has become increasingly important to retaining and growing the Group's customer business in the UK. There can be no certainty that the Group's innovation strategy (which includes investment in its IT capability intended to address the material increase in customer use of online and mobile technology for banking as well as selective acquisitions, which carry associated risks) will be successful or that it will allow the Group to continue to grow such services in the future. Certain of the Group's current or future competitors may be more successful in implementing innovative technologies for delivering products or services to their customers. The Group may also fail to identify future opportunities or derive benefits from disruptive technologies in the context of rapid technological innovation, changing customer behaviour and growing regulatory demands, including the UK initiative on Open Banking (PSD2), resulting in increased competition from both traditional banking businesses as well as new providers of financial services, including technology companies with strong brand recognition, that may be able to develop financial services at a lower cost base.

Furthermore, the Group's competitors may be better able to attract and retain customers and key employees and may have access to lower cost funding and/or be able to attract deposits on more favourable terms than the Group. Although the Group invests in new technologies and participates in industry and research led initiatives aimed at developing new technologies, such investments may be insufficient or ineffective, especially given the Group's focus on its cost savings targets, which may limit additional investment in areas such as financial innovation and therefore could affect the Group's offering of innovative products or technologies for delivering products or services to customers and its competitive position. Furthermore, the development of innovative products depends on the Group's ability to produce underlying high quality data, failing which its ability to offer innovative products may be compromised.

If the Group is unable to offer competitive, attractive and innovative products that are also profitable, it will lose market share, incur losses on some or all of its activities and lose opportunities for growth. In this context, the Group is investing in the automation of certain solutions and interactions within its customer-facing businesses, including through artificial intelligence. Such initiatives may result in operational, reputational and conduct risks if the technology used is defective, or is not fully integrated into the Group's current solutions or does not deliver expected cost savings. The investment in automated processes will likely also result in increased short-term costs for the Group.

In addition, recent and future disposals and restructurings by the Group, cost-cutting measures, as well as employee remuneration constraints, may also have an impact on the Group's ability to compete effectively and intensified competition from incumbents, challengers and new entrants in the Group's core markets could affect the Group's ability to maintain satisfactory returns. Furthermore, continued consolidation in certain sectors of the financial services industry could result in the Group's remaining competitors gaining greater capital and other resources, including the ability to offer a broader range of products and services and geographic diversity, or the emergence of new competitors.

The Group may not meet the prudential regulatory requirements for capital or manage its capital effectively, which could trigger certain management actions or recovery options.

The RBS Group and the Bank (on a standalone basis) are required by regulators in the UK, the EU and other jurisdictions in which they undertake regulated activities to maintain adequate financial resources. Adequate capital also gives the RBS Group (including the Group) financial flexibility in the face of turbulence and uncertainty in the global economy and specifically in their core UK and European markets.

As at 31 December 2018, the Bank's CET1 ratio was 17.4%. The RBS Group currently targets to maintain its CET1 ratio at circa 14% in the medium term. The RBS Group's target capital ratio is based on a combination of its expected regulatory requirements and internal modelling, including stress scenarios and management's and/or the PRA's views on appropriate buffers above minimum operating levels.

The RBS Group's current capital strategy for the Bank is based on: the expected accumulation of additional capital through the accrual of profits over time; the planned reduction of its RWAs through disposals and natural attrition; and other capital management initiatives which focus on improving capital efficiency through improved data and upstreaming of dividends from the Bank to RBSG.

A number of factors may impact the Group's ability to maintain its current CET1 ratio target and achieve its capital strategy. These include, amongst other things:

- a depletion of its capital resources through increased costs or liabilities, reduced profits or losses (including as a result of extreme one-off incidents such as cyber, fraud or conduct issues) or, sustained periods of low or lower interest rates, reduced asset values resulting in write-downs, impairments, changes in accounting policy, accounting charges or foreign exchange movements;
- a failure to reduce RWAs in accordance within the timeline contemplated by the RBS Group's capital plan;
- an increase in the quantum of RWAs in excess of that expected, including due to regulatory changes; and
- changes in prudential regulatory requirements including the Bank's Total Capital Requirement set by the PRA, including Pillar 2 requirements and regulatory buffers, as well as any applicable scalars.

In addition to regulatory capital, the Bank is required to maintain a set quantum of internal MREL set as a percentage of its RWAs, which comprises loss-absorbing senior funding and regulatory capital instruments internally issued up to RBSG. The Bank of England has identified single point-of-entry as the preferred resolution strategy for RBS Group. As a result, RBSG is the only RBS Group entity that is able to externally issue securities that count towards the RBS Group's MREL requirements, the proceeds of which can then be downstreamed to meet the internal MREL issuance requirements of its operating entities, including the Bank, as required. The inability of the Group to reduce its RWAs in line with assumptions in its funding plans could result in an increase of its internal MREL requirements.

If, under a stress scenario, the level of capital or MREL falls outside of risk appetite, there are a range of recovery management actions (focussed on risk reduction and mitigation) that the Group could take to manage its capital levels, which may not be sufficient to restore adequate capital levels. Under the EU Bank Recovery and Resolution Framework ('BRRD'), as implemented in the UK, a breach of the Group's applicable capital or leverage requirements may trigger the application of the RBS Group's recovery plan to remediate a deficient capital position. The RBS Group's regulator may request that the Group carry out certain capital management actions or, if the RBS Group's CET1 ratio falls below 7%, certain regulatory capital instruments issued by the RBS Group will be written-down or converted into equity and there may be an issue of additional equity by the RBS Group, which could result in the dilution of the RBS Group's existing shareholders. The success of such issuances will also be dependent on favourable market conditions and the RBS Group may not be able to raise the amount of capital required or on acceptable terms or at all. Separately, the RBS Group may address a shortage of capital by taking action to reduce leverage exposure and/or RWAs via asset or business disposals. Such actions may, in turn, affect, among other things, the Group's product offering, credit ratings, ability to operate its businesses, pursue its current strategies and pursue strategic opportunities, any of which may affect the underlying profitability of the Group and future growth potential. See also, 'The RBS Group (including the Group) may become subject to the application of UK statutory stabilisation or resolution powers which may result in, among other actions, the write-down or conversion of the Group's Eligible Liabilities'.

The Group may not be able to adequately access sources of liquidity and funding.
The Group is required to access sources of liquidity and funding through retail and wholesale deposits, as well as through the debt capital markets. As at 31 December 2018, the Group held £255 billion in deposits and the level of deposits may fluctuate due to factors outside the Group's control, such as a loss of confidence (including in other RBS Group entities), increasing competitive pressures for retail customer deposits or the reduction or cessation of deposits by foreign wholesale depositors, which could result in a significant outflow of deposits within a short period of time. See also, 'The Group has significant exposure to counterparty and borrower risk'. An inability to grow, or any material decrease in, the Group's deposits could, particularly if accompanied by one of the other factors described above, materially affect the Group's ability to satisfy its liquidity needs.

If the Group's liquidity position were to come under stress, and if the Group is unable to raise funds through deposits or in the debt capital markets on acceptable terms or at all, its liquidity position could be adversely affected and it might be unable to meet deposit withdrawals on demand or at their contractual maturity, to repay borrowings as they mature, to meet its obligations under committed financing facilities, to comply with regulatory funding requirements, to undertake certain capital and/or debt management activities, or to fund new loans, investments and businesses. The Group may need to liquidate unencumbered assets to meet its liabilities, including disposals of assets not previously identified for disposal to reduce its funding commitments. In a time of reduced liquidity, the Group may be unable to sell some of its assets, or may need to sell assets at depressed prices, which in either case could negatively affect the Group's results.

The Group is reliant on the RBS Group for capital and funding support, and is substantially reliant on RBSG's ability to issue sufficient amounts of external MREL securities and downstream the proceeds to the Group.
The Group receives capital and funding support from RBS Group. The Group will be required to issue instruments that are compliant with MREL as set forth by the Bank of England. As RBSG is the only entity that is able to issue securities that count towards the Group's MREL requirements, the Group's ability to meet its internal MREL requirements is substantially reliant on RBSG's ability to issue sufficient amounts of external MREL securities and downstream the proceeds to the Group. If RBSG is unable to issue adequate levels of MREL securities such that it is unable to downstream sufficient amounts to the Group, this could lead to a failure of the Group to meet its own individual internal MREL requirements as well as the internal MREL requirements of subsidiaries within the Group. See also, 'The Group may not meet the prudential regulatory requirements for capital or manage its capital effectively, which could trigger certain management actions or recovery options'.

Any reduction in the credit rating assigned to RBSG, any of its subsidiaries (including the Bank or other Group subsidiaries) or any of their respective debt securities could adversely affect the availability of funding for the Group, reduce its liquidity position and increase the cost of funding.
Rating agencies regularly review the RBS Group entity credit ratings, including those of RBSG, the Bank and NWM Plc, which could be negatively affected by a number of factors, including political and regulatory developments, changes in rating methodologies, changes in the relative size of the loss-absorbing buffers protecting bondholders and depositors, a challenging macroeconomic environment, the impact of Brexit, a potential second Scottish independence referendum, further reductions of the UK's sovereign credit rating, market uncertainty and the inability of the Group to produce sustained profits.

Any reductions in the long-term or short-term credit ratings of RBSG or the Bank, including in particular downgrades below investment grade, may affect the Group's access to money markets, reduce the size of its deposit base and trigger additional collateral or other requirements in derivatives contracts and other secured funding arrangements or the need to amend such arrangements, which could adversely affect the Group's cost of funding, its access to capital markets and could limit the range of counterparties willing to enter into transactions with the Group and therefore also adversely impact its competitive position.

The Group may be adversely affected if the RBS Group fails to meet the requirements of regulatory stress tests.
The RBS Group is subject to annual stress tests by its regulator in the UK and is also subject to stress tests by European regulators with respect to RBSG, NWM NV and Ulster Bank Ireland DAC. Stress tests are designed to assess the resilience of banks to potential adverse economic or financial developments and ensure that they have robust, forward-looking capital planning processes that account for the risks associated with their business profile. If the stress tests reveal that a bank's existing regulatory capital buffers are not sufficient to absorb the impact of the stress, then it is possible that the bank will need to take action to strengthen its capital position.

Failure by the RBS Group to meet the quantitative and qualitative requirements of the stress tests carried out by its regulators in the UK and elsewhere may result in the RBS Group's regulators requiring the RBS Group to generate additional capital, reputational damage, increased supervision and/or regulatory sanctions, restrictions on capital distributions and loss of investor confidence.

The Group could incur losses or be required to maintain higher levels of capital as a result of limitations or failure of various models.
Given the complexity of the Group's business, strategy and capital requirements, the Group relies on analytical models for a wide range of purposes, including to manage its business, assess the value of its assets and its risk exposure, as well as to anticipate capital and funding requirements (including to facilitate the RBS Group's mandated stress testing). In addition, the Group utilises models for valuation, credit approvals, calculation of loan impairment charges on an IFRS 9 basis, financial reporting and for financial crime and fraud risk management. The Group's models, and the parameters and assumptions on which they are based, are periodically reviewed and updated to maximise their accuracy.

Such models are inherently designed to be predictive in nature. Failure of these models, including due to errors in model design or inputs, to accurately reflect changes in the micro and macroeconomic environment in which the Group operates, to capture risks and exposures at the subsidiary level, to be updated in line with the RBS Group's or the Group's current business model or operations, or findings of deficiencies by the RBS Group's (and in particular, the Group's) regulators (including as part of the RBS Group's mandated stress testing) may result in increased capital requirements or require management action. The Group may also face adverse consequences as a result of actions by management based on models that are poorly developed, implemented or used, models that are based on inaccurate or compromised data or as a result of the modelled outcome being misunderstood, or by such information being used for purposes for which it was not designed.

The Group's financial statements are sensitive to the underlying accounting policies, judgements, estimates and assumptions.
The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income, expenses, exposures and RWAs. Due to the inherent uncertainty in making estimates (particularly those involving the use of complex models), future results may differ from those estimates. Estimates, judgements, assumptions and models take into account historical experience and other factors, including market practice and expectations of future events that are believed to be reasonable under the circumstances.

The accounting policies deemed critical to the Group's results and financial position, based upon materiality and significant judgements and estimates, which include loan impairment provisions, are set out in 'Critical accounting policies and key sources of estimation uncertainty' on page 81. New accounting standards and interpretations that have been issued by the International Accounting Standards Board but which have not yet been adopted by the Group are discussed in

'Accounting developments' on page 81.

Changes in accounting standards may materially impact the Group's financial results.

Changes in accounting standards or guidance by accounting bodies or in the timing of their implementation, whether immediate or foreseeable, could result in the Group having to recognise additional liabilities on its balance sheet, or in further write-downs or impairments and could also significantly impact the financial results, condition and prospects of the Group.

In January 2018, a new accounting standard for financial instruments (IFRS 9) became effective, which introduced impairment based on expected credit losses, rather than the incurred loss model previously applied under IAS 39. The Group expects IFRS 9 to create earnings and capital volatility and the Group took a £60 million impairment charge at 31 December 2018, reflecting the more uncertain economic outlook.

The valuation of financial instruments, including derivatives, measured at fair value can be subjective, in particular where models are used which include unobservable inputs. Generally, to establish the fair value of these instruments, the Group relies on quoted market prices or, where the market for a financial instrument is not sufficiently credible, internal valuation models that utilise observable market data. In certain circumstances, the data for individual financial instruments or classes of financial instruments utilised by such valuation models may not be available or may become unavailable due to prevailing market conditions. In such circumstances, the Group's internal valuation models require the Group to make assumptions, judgements and estimates to establish fair value, which are complex and often relate to matters that are inherently uncertain.

The Group will adopt IFRS 16 Leases with effect from 1 January 2019 as disclosed in the Accounting policies. This is expected to increase Other assets by £0.9 billion and Other liabilities by £1.5 billion. While adoption of this standard has no effect on the Group's cash flows, it will impact financial ratios which may influence investors' perception of the financial condition of the Group.

The RBS Group (including the Group) may become subject to the application of UK statutory stabilisation or resolution powers which may result in, among other actions, the write-down or conversion of the Group's Eligible Liabilities.

The Banking Act 2009, as amended ('Banking Act'), implements the BRRD in the UK and creates a special resolution regime ('SRR'). Under the SRR, HM Treasury, the Bank of England and the PRA and FCA (together 'Authorities') are granted substantial powers to resolve and stabilise UK-incorporated financial institutions. Five stabilisation options exist under the current SRR: (i) transfer of all of the business of a relevant entity or the shares of the relevant entity to a private sector purchaser; (ii) transfer of all or part of the business of the relevant entity to a 'bridge bank' wholly-owned by the Bank of England; (iii) transfer of part of the assets, rights or liabilities of the relevant entity to one or more asset management vehicles for management of the transferor's assets, rights or liabilities; (iv) the write-down, conversion, transfer, modification, or suspension of the relevant entity's equity, capital instruments and liabilities ('Eligible Liabilities'); and (v) temporary public ownership of the relevant entity. These tools may be applied to RBSG as the parent company or to the Group, as an affiliate, where certain conditions are met (such as, whether the firm is failing or likely to fail, or whether it is reasonably likely that action will be taken (outside of resolution) that will result in the firm no longer failing or being likely to fail). Moreover, the SRR provides for modified insolvency and administration procedures for relevant entities, and confers ancillary powers on the Authorities, including the power to modify or override certain contractual arrangements in certain circumstances. The Authorities are also empowered by order to amend the law for the purpose of enabling the powers under the SRR to be used effectively. Such orders may promulgate provisions with retrospective applicability.

Under the Banking Act, the Authorities are generally required to have regard to specified objectives in exercising the powers provided for by the Banking Act. One of the objectives (which is required to be balanced as appropriate with the other specified objectives) refers to the protection and enhancement of the stability of the financial system of the UK. Moreover, the 'no creditor worse off' safeguard contained in the Banking Act may not apply in relation to an application of the separate write-down and conversion power relating to capital instruments under the Banking Act, in circumstances where a stabilisation power is not also used; holders of debt instruments which are subject to the power may, however, have ordinary shares transferred to or issued to them by way of compensation.

Uncertainty exists as to how the Authorities may exercise the powers granted to them under the Banking Act. In addition, the determination that ordinary shares, securities and other obligations issued by RBS Group (including the Group) may be subject to write-down, conversion or 'bail-in' (as applicable) is unpredictable and may depend on factors outside of the Group's control. Moreover, the relevant provisions of the Banking Act remain untested in practice. However, if the Group (or any other RBS Group entity) is at or is approaching the point of non-viability such that regulatory intervention is required, any exercise of the resolution regime powers by the Authorities may adversely affect holders of the Group's securities that fall within the scope of 'bail-in' powers. This may result in various actions being undertaken in relation to the Group and any securities of the Group, including the write-down of certain of the Group's Eligible Liabilities which would adversely affect the financial results, condition and prospects of the Group.

Legal, regulatory and conduct risk

The Group's businesses are subject to substantial regulation and oversight, which are constantly evolving and may adversely affect the Group.

The Group is subject to extensive laws, regulations, corporate governance practice and disclosure requirements, administrative actions and policies in each jurisdiction in which it operates. Many of these have been introduced or amended recently and are subject to further material changes, which may increase compliance and conduct risks. The Group expects government and regulatory intervention in the financial services industry to remain high for the foreseeable future.

In recent years, regulators and governments have focussed on reforming the prudential regulation of the financial services industry and the manner in which the business of financial services is conducted. Among others, measures have included: enhanced capital, liquidity and funding requirements, implementation of the UK ring-fencing regime, implementation and strengthening of the recovery and resolution framework applicable to financial institutions in the UK, the EU and the US, financial industry reforms (including in respect of MiFID II), enhanced data privacy and IT resilience requirements, enhanced regulations in respect of the provision of 'investment services and activities', and increased regulatory focus in certain areas, including conduct, consumer protection regimes, anti-money laundering, anti-bribery, anti-tax evasion, payment systems, sanctions and anti-terrorism laws and regulations. This has resulted in the Group facing greater regulation and scrutiny in the UK and other countries in which it operates.

Recent regulatory changes, proposed or future developments and heightened levels of public and regulatory scrutiny in the UK, Europe and the US have resulted in increased capital, funding and liquidity requirements, changes in the competitive landscape, changes in other regulatory requirements and increased operating costs, and have impacted, and will continue to impact, product offerings and business models. In particular, the Group is required to comply with regulatory requirements in respect of the implementation of the UK ring-fencing regime (See also, 'The Group, including the Bank, is required to comply with regulatory requirements in respect of the implementation of the UK ring-fencing regime') and to ensure operational continuity in resolution; the steps required to ensure such compliance entail significant costs, and also impose significant operational, legal and execution risk. Serious consequences could arise should the Group be found to be non-compliant with such regulatory requirements. Such changes may also result in an increased number of regulatory investigations and proceedings and have increased the risks relating to the Group's ability to comply with the applicable body of rules and regulations in the manner and within the time frames required.

Any of these developments (including any failure to comply with new rules and regulations) could have a significant impact on the Group's authorisations and licenses, the products and services that the Group may offer, its reputation and the value of its assets, the Group's operations or legal entity structure, and the manner in which the Group conducts its business. Areas in which, and examples of where, governmental policies, regulatory and accounting changes and increased public and regulatory scrutiny could have an adverse impact (some of which could be material) on the Group include, but are not limited to, those set out above as well as the following:

- general changes in government, central bank, regulatory or competition policy, or changes in regulatory regimes that may influence investor decisions in the markets in which the Group operates;
- amendments to the framework or requirements relating to the quality and quantity of regulatory capital to be held by the Group as well as liquidity and leverage requirements, either on a solo, consolidated or subgroup level;
- changes to the design and implementation of national or supranational mandated recovery, resolution or insolvency regimes or the implementation of additional or conflicting loss-absorption requirements, including those mandated under UK rules, the BRRD, MREL or by the Financial Stability Board's ('FSB') recommendations on total loss-absorbing capacity ('TLAC');
- additional rules and regulatory initiatives and review relating to customer protection and resolution of disputes and complaints, including increased focus by regulators (including the Financial Ombudsman Service) on how institutions conduct business, particularly with regard to the delivery of fair outcomes for customers and orderly/transparent markets;
- rules and regulations relating to, and enforcement of, anti-corruption, anti-bribery, anti-money laundering, anti-terrorism, sanctions, anti-tax evasion or other similar regimes;
- the imposition of additional restrictions on the Group's ability to compensate its
- senior management and other employees and increased responsibility and liability rules applicable to senior and key employees;
- rules relating to foreign ownership, expropriation, nationalisation and confiscation of assets;
- changes to corporate governance practice and disclosure requirements, senior manager responsibility, corporate structures and conduct of business rules;
- financial market infrastructure reforms establishing new rules applying to investment services, short selling, market abuse, derivatives markets and investment funds;
- increased attention to the protection and resilience of, and competition and innovation in, UK payment systems and
- developments relating to the UK initiative on Open Banking and the European directive on payment services;
- new or increased regulations relating to customer data and privacy protection as well as IT controls and resilience, including the GDPR;
- the introduction of, and changes to, taxes, levies or fees applicable to the Group's operations, such as the imposition of a financial transaction tax, changes in tax rates, changes in the scope and administration of the Bank Levy, increases in the bank corporation tax surcharge in the UK, restrictions on the tax deductibility of interest payments or further restrictions imposed on the treatment of carry-forward tax losses that reduce the value of deferred tax assets and require increased payments of tax;
- laws and regulations in respect of climate change and sustainable finance (including ESG) considerations; and
- other requirements or policies affecting the Group and its profitability or product offering, including through the imposition of increased compliance obligations or obligations which may lead to restrictions on business growth, product offerings, or pricing.

Changes in laws, rules or regulations, or in their interpretation or enforcement, or the implementation of new laws, rules or regulations, including contradictory or conflicting laws, rules or regulations by key regulators or policymakers in different jurisdictions, or failure by the Group to comply with such laws, rules and regulations, may adversely affect the Group's business and results. In addition, uncertainty and insufficient international regulatory coordination as enhanced supervisory standards are developed and implemented may adversely affect the Group's ability to engage in effective business, capital and risk management planning.

The Group is subject to a number of legal, regulatory and governmental actions and investigations including conduct-related reviews and redress projects, the outcomes of which are inherently difficult to predict, and which could have an adverse effect on the Group.
The Group's operations are diverse and complex and it operates in legal and regulatory environments that expose it to potentially significant legal proceedings, and civil and criminal regulatory and governmental actions. The Group has settled a number of legal and regulatory actions over the past several years but continues to be, and may in the future be, involved in such actions in the UK, the US and other jurisdictions.

The legal and regulatory actions specifically referred to below are, in the Group's view, the most significant legal and regulatory actions to which the Group is currently exposed. However, the Group is also subject to a number of ongoing reviews, investigations and litigation proceedings relating to, among other matters, the setting of benchmark rates such as LIBOR and related derivatives trading, product mis-selling, customer mistreatment, anti-money laundering, antitrust and various other compliance issues. Legal and regulatory actions are subject to many uncertainties, and their outcomes, including the timing, amount of fines or settlements or the form of any settlements, which may be material and in excess of any related provisions, are often difficult to predict, particularly in the early stages of a case or investigation, and the Group's expectations for resolution may change.

In particular, the Group has for a number of years been involved in conduct-related reviews and redress projects, including a review of certain historic customer connections in its former Global Restructuring Group (GRG), management of claims arising from historic sales of payment protection insurance. In relation to the GRG review, the Group established a complaints process in November 2016, overseen by an independent third party. The complaints process closed on 22 October 2018 for new complaints in the UK and, with the exception of a small cohort of potential complainants for whom there is an extended deadline, on 31 December 2018 for new complaints in the Republic of Ireland. An additional provision of £50 million was taken in Q4 2018, reflecting greater than predicted complaints volumes in the week leading up to the closure of the complaints process. In addition, the Group continues to handle claims in relation to historic sales of payment protection insurance and took additional provisions of £125 million in Q3 2018, reflecting increased complaint volumes as the complaint deadline of 31 August 2019 approaches. See 'Litigation, investigations and reviews' of Note 29 on the consolidated for details of these matters. The Group has dedicated resources in place to manage claims and complaints relating to the above and other conduct-related matters. Provisions taken in respect of such matters include the costs involved in administering the various complaints processes. Any failure to administer such processes adequately, or to handle individual complaints fairly or appropriately, could result in further claims as well as the imposition of additional measures or limitations on the Group's operations, additional supervision by the Group's regulators, and loss of investor confidence.

Adverse outcomes or resolution of current or future legal or regulatory actions, including conduct-related reviews or redress projects, could result in restrictions or limitations on the Group's operations, and could adversely impact the Group's capital position or its ability to meet regulatory capital adequacy requirements. Failure to comply with undertakings made by the Group to its regulators may result in additional measures or penalties being taken against the Group.

The Group may not effectively manage the transition of LIBOR and other IBOR rates to alternative risk free rates.
UK and international regulators are driving a transition from the use of interbank offer rates

(IBOR's), including LIBOR, to alternative risk free rates (RFRs). In the UK, the FCA has asserted that they will not compel LIBOR submissions beyond 2021, thereby jeopardising its continued availability, and have strongly urged market participants to transition to RFRs, as the CFTC and other regulators in the United States. The Group has significant exposure to IBORs primarily on its commercial lending and legacy securities. Until there is market acceptance on the form of alternative RFRs for different products, the legal mechanisms to effect transition cannot be confirmed, and the impact cannot be determined nor any associated costs accounted for. The transition and uncertainties around the timing and manner of transition to RFRs represent a number of risks for the Group, its customers and the financial services industry more widely. These include risks related to: legal risks (as changes may be required to documentation for new or existing transactions); financial risks (which may arise from any changes in valuation of financial instruments linked to benchmarks rates and may impact the Group's cost of funds and its risk management related financial models); pricing risks (such as changes to benchmark rates could impact pricing mechanisms on certain instruments); operational risks (due to the potential requirement to adapt IT systems, trade reporting infrastructure and operational processes); and conduct risks (which may relate to communication regarding the potential impact on customers, and engagement with customers during the transition period).

It is therefore currently difficult to determine to what extent the changes will affect the Group, or the costs of implementing any relevant remedial action. Uncertainty as to the nature of such potential changes, alternative reference rates or other reforms and as to the continuation of LIBOR or EURIBOR may adversely affect financial instruments using LIBOR or EURIBOR as benchmarks. The implementation of any alternative RFRs may be impossible or impracticable under the existing terms of such financial instruments and could have an adverse effect on the value of, return on and trading market for such financial instruments.

The Group operates in markets that are subject to intense scrutiny by the competition authorities.
There is significant oversight by competition authorities of the markets which the Group operates in. The competitive landscape for banks and other financial institutions in the UK and the rest of Europe is rapidly changing. Recent regulatory and legal changes have and may continue to result in new market participants and changed competitive dynamics in certain key areas, such as in retail and SME banking in the UK where the introduction of new entrants is being actively encouraged by the UK Government.

The UK retail banking sector has been subjected to intense scrutiny by the UK competition authorities and by other bodies, including the FCA and the Financial Ombudsman Service, in recent years, including with a number of reviews/inquiries being carried out, including market reviews conducted by the CMA and its predecessor the Office of Fair Trading regarding SME banking and personal banking products and services, the Independent Commission on Banking and the Parliamentary Commission on Banking Standards.

These reviews raised significant concerns about the effectiveness of competition in the retail banking sector. The CMA's Retail Banking Market Order 2017 imposes remedies primarily intended to make it easier for consumers and businesses to compare personal current account ('PCA') and SME bank products, increase the transparency of price comparison between banks and amend PCA overdraft charging. These remedies impose additional compliance requirements on the RBS Group and the Group and could, in aggregate, adversely impact the Group's competitive position, product offering and revenues.

Adverse findings resulting from current or future competition investigations may result in the imposition of reforms or remedies which may impact the competitive landscape in which the Group operates or result in restrictions on mergers and consolidations within the financial sector.

The cost of implementing the Alternative Remedies Package could be more onerous than anticipated.
In connection with the implementation of the Alternative Remedies Package (regarding the business previously described as Williams & Glyn), an independent body ('Independent Body') has been established to administer the Alternative Remedies Package. The implementation of the Alternative Remedies Package has involved costs for the Group, including but not limited to the funding commitments of £425 million for the Capability and Innovation Fund and £350 million for the incentivised switching scheme, both being administered by the Independent Body. Implementation of the Alternative Remedies Package may involve additional costs for the Group and may also divert resources from the Group's operations and jeopardise the delivery and implementation of other significant plans and initiatives. In addition, under the terms of the Alternative Remedies Package, the Independent Body may require the Group to modify certain aspects of the Group's execution of the incentivised switching scheme, which could increase the cost of implementation. Furthermore, should the uptake within the incentivised switching scheme not be sufficient, the Independent Body has the ability to extend the duration of the scheme by up to twelve months, impose penalties of up to £50 million, and can compel the RBS Group to extend the customer base to which the scheme applies which may result in prolonged periods of disruption to a wider portion of the Group's business.

As a direct consequence of the incentivised switching scheme (which comprises part of the Alternative Remedies Package), the Group will lose existing customers and deposits, which in turn will have adverse impacts on the Group's business and associated revenues and margins. Furthermore, the capability and innovation fund (which also comprises part of the Alternative Remedies Package) is intended to benefit eligible competitors and negatively impact the Group's competitive position. To support the incentivised switching initiative, upon request by an eligible bank, the RBS Group has agreed to grant those customers which have switched to eligible banks under the incentivised switching scheme access to its branch network for cash and cheque handling services, which may impact customer service quality for the Group's own customers with consequent competitive, financial and reputational implications. The implementation of the incentivised switching scheme is also dependent on the engagement of the eligible banks with the incentivised switching scheme and the application of the eligible banks to and approval by the Independent Body. The incentivised transfer of SME customers to third party banks places reliance on those third parties to achieve satisfactory customer outcomes which could give rise to reputational damage to the Group if these are not forthcoming.

A failure to comply with the terms of the Alternative Remedies Package could result in the imposition of additional measures or limitations on the Group's operations, additional supervision by the Group's regulators, and loss of investor confidence.

Changes in tax legislation or failure to generate future taxable profits may impact the recoverability of certain deferred tax assets recognised by the Group.
In accordance with IFRS, the Group has recognised deferred tax assets on losses available to relieve future profits from tax only to the extent it is probable that they will be recovered. The deferred tax assets are quantified on the basis of current tax legislation and accounting standards and are subject to change in respect of the future rates of tax or the rules for computing taxable profits and offsetting allowable losses.

Failure to generate sufficient future taxable profits or further changes in tax legislation (including with respect to rates of tax) or accounting standards may reduce the recoverable amount of the recognised tax loss deferred tax assets, amounting to £1.4 billion as at 31 December 2018. Changes to the treatment of certain deferred tax assets may impact the Group's capital position. In addition, the Group's interpretation or application of relevant tax laws may differ from those of the relevant tax authorities and provisions are made for potential tax liabilities that may arise on the basis of the amounts expected to be paid to tax authorities. The amounts ultimately paid may differ materially from the amounts provided depending on the ultimate resolution of such matters.

Forward-looking statements

Cautionary statement regarding forward-looking statements
Certain sections in this document contain 'forward-looking statements' as that term is defined in the United States Private Securities Litigation Reform Act of 1995, such as statements that include the words 'expect', 'estimate', 'project', 'anticipate', 'commit', 'believe', 'should', 'intend', 'plan', 'could', 'probability', 'risk', 'Value-at-Risk (VaR)', 'target', 'goal', 'objective', 'may', 'endeavour', 'outlook', 'optimistic', 'prospects' and similar expressions or variations on these expressions.

In particular, this document includes forward-looking statements relating, but not limited to: future profitability and performance, including financial performance targets such as return on tangible equity; cost savings and targets, including cost:income ratios; litigation and government and regulatory investigations, including the timing and financial and other impacts thereof; the implementation of the Alternative Remedies Package; the continuation of the Group's balance sheet reduction programme, including the reduction of risk-weighted assets (RWAs) and the timing thereof; capital and strategic plans and targets; capital, liquidity and leverage ratios and requirements, including CET1 Ratio, RWA equivalents (RWAe), Pillar 2 and other regulatory buffer requirements, minimum requirement for own funds and eligible liabilities, and other funding plans; funding and credit risk profile; capitalisation; portfolios; net interest margin; customer loan and income growth; the level and extent of future impairments and write-downs, including with respect to restructuring and remediation costs and charges; and the Group's exposure to political risk, economic risk, climate change risk, operational risk, conduct risk, cyber and IT risk and credit rating risk and to various types of market risks, including interest rate risk, foreign exchange rate risk and commodity and equity price risk; customer experience including our Net Promotor Score (NPS); employee engagement and gender balance in leadership positions.

Limitations inherent to forward-looking statements
These statements are based on current plans, estimates, targets and projections, and are subject to significant inherent risks, uncertainties and other factors, both external and relating to the Group's strategy or operations, which may result in the Group being unable to achieve the current targets, predictions, expectations and other anticipated outcomes expressed or implied by such forward-looking statements. In addition, certain of these disclosures are dependent on choices relying on key model characteristics and assumptions and are subject to various limitations, including assumptions and estimates made by management. By their nature, certain of these disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated. Accordingly, undue reliance should not be placed on these statements. Forward-looking statements speak only as of the date we make them and we expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Group's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Important factors that could affect the actual outcome of the forward-looking statements
We caution you that a large number of important factors could adversely affect our results or our ability to implement our strategy, cause us to fail to meet our targets, predictions, expectations and other anticipated outcomes or affect the accuracy of forward-looking statements we describe in this document including in the risk factors and other uncertainties set out in the Group's 2018 Annual Report and Accounts and other risk factors and uncertainties discussed in this document.

These include the significant risks presented by: operational and IT resilience risk (including in respect of: the Group being subject to cyberattacks; operational risks inherent in the Group's business; the Group's operations being highly dependent on its IT systems; the Group being required to comply with regulatory requirements in respect of the implementation of the UK ring-fencing regime; the Group relying on attracting, retaining and developing senior management and skilled personnel and maintaining good employee relations; the Group's risk management framework; and reputational risk), economic and political risk (including in respect of: uncertainties surrounding the UK's withdrawal from the European Union; increased political and economic risks and uncertainty in the UK and global markets; continued low interest rates; climate change and the transition to a low carbon economy; changes in foreign currency exchange rates; and HM Treasury's ownership of RBSG and the possibility that it may exert a significant degree of influence over the RBS Group), financial resilience risk (including in respect of: the Group's ability to meet targets and generate sustainable returns; deteriorations in borrower and counterparty credit quality; the highly competitive markets in which the Group operates; the ability of the Group to meet prudential regulatory requirements for capital or manage its capital effectively; the ability of the Group to access adequate sources of liquidity and funding; the Group's reliance on RBS Group for capital and funding support; changes in the credit ratings of RBSG, any of its subsidiaries or any of its respective debt securities; the RBS Group's ability to meet requirements of regulatory stress tests; possible losses or the requirement to maintain higher levels of capital as a result of limitations or failure of various models; sensitivity of the Group's financial statements to underlying accounting policies, judgements, assumptions and estimates; changes in applicable accounting policies or rules; and the application of UK statutory stabilisation or resolution powers) and legal, regulatory and conduct risk (including in respect of: the Group's businesses being subject to substantial regulation and oversight; legal, regulatory and governmental actions and investigations; the replacement of LIBOR, EURIBOR and other benchmark rates; heightened regulatory and governmental scrutiny (including by competition authorities); implementation of the Alternative Remedies Package and the costs related thereto; and changes in tax legislation).

The forward-looking statements contained in this document speak only as at the date hereof, and the Group does not assume or undertake any obligation or responsibility to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The information, statements and opinions contained in this document do not constitute a public offer under any applicable legislation or an offer to sell or solicit of any offer to buy any securities or financial instruments or any advice or recommendation with respect to such securities or other financial instruments.