RBS Holdings N.V.

Annual Report and Accounts 2018

Annual report and accounts

Chairman's statement

In 2018 NatWest Markets N.V. (the Group) successfully repurposed its banking licence by obtaining a Declaration of No Objection (the 'DNO') from De Nederlandsche Bank (DNB) allowing it to begin new business activity and book go-forward customer business. This will minimise disruption to the RBS Group business and allow it to continue to serve customers in the context of the UK's departure from the EU. Substantial work was completed on entity re-purposing in 2018 with the business moving into new premises in Amsterdam and staffing changes to support customer-facing staff.

As part of preparing the entity to begin booking customer business, changes have been made to both the Managing and Supervisory Boards. The Managing Board has expanded from two to four members, with the addition of the Chief Risk Officer and Chief Operating Officer in the first quarter of 2019.

We have successfully opened branches in six European countries to ensure we are in close proximity to our customers in their markets. On 1 March 2019 we welcomed over fifty Corporate Coverage staff from NatWest Plc into the Group.

During Q1 2019, Robert Begbie and Chris Campbell have stepped down from the Supervisory Board and have been succeeded by Richard Place, CFO, NWM Plc, and Annelies van der Pauw, independent member. In addition, a third independent member, Anne Snel, has been appointed to the Supervisory Board. I am pleased that NatWest Markets N.V continues to lead on the diversity agenda with a gender-balanced Supervisory Board. Myself and the rest of the executive management of the Group are looking forward to working with them. In addition, Marije Elkenbracht joined the Managing Board as Chief Risk Officer on 15 February 2019 and Angelique Slach joined as Chief Operating Officer on 25 March 2019.

NatWest Markets N.V. began transacting new business on 25 March 2019 and this will ensure that the RBS Group's NatWest Markets business can continue to serve its customers when the UK leaves the EU.

As a result of this new business, €6.2 billion of assets and €6.6 billion of liabilities were transferred from NWM Plc over the weekend of 23/24 March 2019 ahead of commencement of business. Further transfers will follow both in Q2 2019 and beyond, but the continuing uncertainty about the final Brexit outcome does create some uncertainly about the exact scope of business that will move to NWM N.V. and the timings of all client migrations.

NatWest Markets N.V. is planned to be a well-capitalised entity with strong levels of loss absorbency and support from its parent, including down-streamed internal MREL and intra-group funding from NatWest Markets Plc. NatWest Markets N.V. plans to manage towards similar profiles for capital and balance sheet metrics as are being targeted for RBS Group's NatWest Markets business as a whole.

The table below provides the current and expected profile of NatWest Markets N.V.:

	Current profile	2020 expected profile
CET1	31.4%	c. 15%
Total capital	32.6%	>28%
RWA	€8.8bn	~€9bn
Funded assets (2)	€4.6bn	~€16bn

As of 1 January 2017, the Group is classified as a 'Less Significant Institution'. Consequently, De Nederlandsche Bank (DNB) has continued as the primary regulator for the Group.

Results of operations in 2018

Operating profit before tax was €409 million compared with a loss before tax of €115 million in 2017. Total income increased and expenses decreased in line with the business wind-down and work carried out in relation to the re-purposing of the banking licence. The Group's 2018 results included foreign exchange losses reported in income of €19 million compared with €163 million in 2017, following the repatriation of the proceeds from the disposal of foreign operations. Income in 2018 also included €46 million received in respect of a distribution to successful plaintiffs in the Madoff related class action and insurance recoveries of €248 million. Non-interest income included a €70 million termination fee relating to termination costs on the closure of a deal, and insurance recoveries of €248 million. Operating expenses were €22 million compared with €57 million in 2017.

Total assets reduced to €5.3 billion at the end of 2018 compared with €6.1 billion at the end of 2017 as a result of continued work and focus to decrease the NWM N.V. legacy assets and liabilities. In 2018 the Group did not originate new transactions with clients.

Assets of disposal groups were €1,317 million (2017 - nil), relating to the Alawwal Bank business. The Group accounted for its interest in Alawwal Bank as an associate up to 31 December 2018, at which point it concluded that Alawwal Bank met the IFRS criteria to be reclassified as held for disposal. Accordingly, the interest in associate in relation to Alawwal Bank is classified as a disposal group at 31 December 2018.

Alawwal Bank

The Company has a 40% interest in the equity of Alawwal Bank which is incorporated and operates in the Kingdom of Saudi Arabia. On 25 April 2017 Alawwal Bank announced the start of merger discussions with Saudi British Bank (SABB). Alawwal Bank is the last significant shared asset of the RFS Holding Consortium. On 4 October 2018, they announced that terms had been agreed and that they anticipate being able to complete the transaction in H1 2019. Under the current terms of the transaction, the current interest in associate would be replaced by a 10.8% investment in the newly merged entity which would no longer qualify to be accounted for as an associate. Refer to Note 13 on the consolidated accounts for further details.

Capital and RWA

The Group continues to be well capitalised. Total equity as at 31 December 2018 was €3.2 billion, an increase of €0.3 billion compared with 31 December 2017. At 31 December 2018, the Group's Total capital ratio was 32.6% with Common Equity Tier 1 (CET1) and Tier 1 ratios of 31.4%. The Group's total risk-weighted assets were €8.8 billion at 31 December 2018 (2017 - €11.1 billion) of which €6.5 billion (2017 - €7.4 billion) related to Alawwal Bank, which is proportionally consolidated due to the Group's 40% equity participation. Current year's profit, which has not yet been approved, is not reflected in the 2018 Capital ratios.

On behalf of the Managing Board, I would like to thank all employees who have worked tirelessly to support the re-purposing of the banking licence and to prepare the business to begin new customer activity from 25 March 2019 and Mr Begbie and Mr Campbell for their service as Supervisory Board members.

Harm Bots
Chairman of the Managing Board of RBS Holdings N.V.
Amsterdam, 18 April 2019

Notes:
(1) The targets, expectations and trends discussed in this section represent management's current expectations and are subject to change.
(2) Funded assets are total assets less derivative mark to market and intergroup assets.

Financial review

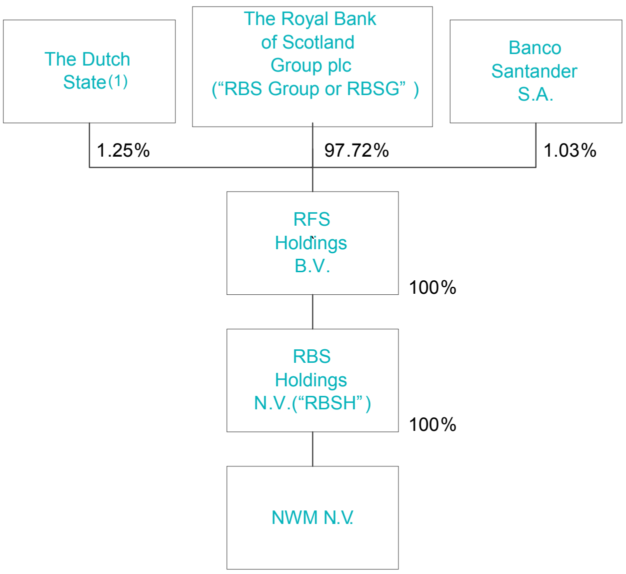
Presentation of information

In the Report and Accounts and unless specified otherwise, the terms 'company' and 'RBS Holdings' mean RBS Holdings N.V.. RBS Holdings N.V. is the parent company of one direct subsidiary, NatWest Markets N.V. (NWM N.V.), (formerly The Royal Bank of Scotland N.V. or RBS N.V., renamed in 2018), a consolidated group of companies and associated companies (together 'RBSH Group' or 'the Group'). The Royal Bank of Scotland Group plc (RBSG) is the ultimate holding company of RBSH Group. RBS Group refers to RBSG and its consolidated subsidiaries and associated companies. NWM Plc refers to NatWest Markets Plc (formerly RBS plc or The Royal Bank of Scotland plc, renamed in 2018).

The terms 'Consortium' and 'Consortium Members' refer to RBSG, Stichting Administratiekantoor Beheer Financiële Instellingen (the Dutch State, successor to Fortis) and Banco Santander S.A. (Santander) who jointly acquired RBS Holdings on 17 October 2007 through RFS Holdings B.V. (RFS Holdings). Since 31 December 2010, RBSG's shareholding in RFS Holdings has been 97.72%.

The company publishes its financial statements in 'euro', the European single currency. The abbreviations '€m' and '€bn' represent millions and thousands of millions of euros, respectively. Reference to '£' is to pounds sterling. The abbreviations '£m' and '£bn' represent millions and thousands of millions of pounds, respectively. Reference to '$' is to United States of America (US) dollars. The abbreviations '$m' and '$bn' represent millions and thousands of millions of dollars respectively.

RFS Holdings is controlled by RBSG, which is incorporated in the UK and registered at 36 St Andrew Square, Edinburgh, Scotland. The consolidated financial statements of RBSH Group are included in the consolidated financial statements of RBS Group.



(1) Interest is held by Stichting Administratiekantoor Beheer Financiële Instellingen.

Description of business

Introduction

The main businesses of NWM N.V., a licensed bank, are lending and financial instruments transactions with corporate and financial institutions.

On 1 January 2017, due to the balance sheet reduction, the Group's regulation in the Netherlands, and supervisions responsibilities, transferred from the European Central Bank (ECB), under the Single Supervisory Mechanism (a joint Supervisory Team comprising of ECB and De Nederlandsche Bank (DNB), which conducted the day to day prudential supervision oversight), back to DNB.

The Netherlands Authority for the Financial Markets, Autoriteit Financiële Markten (AFM), is responsible for the conduct supervision.

UK 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 banking business in ring-fenced banking entities under an intermediate holding company, NatWest Holdings Limited. NatWest Markets Plc (NWM Plc), NWM N.V. and RBS International (RBSI) are separate banks outside the ring-fence, and are subsidiaries of RBSG. The Group is currently an indirect subsidiary of RBSG plc. In parallel, work continues to decrease the Group's legacy assets and liabilities further.

Brexit

NatWest Markets N.V. (formerly The Royal Bank of Scotland N.V.), the Group's banking entity in the Netherlands, continues to implement its plan to be operationally ready to serve European Economic Area (EEA) customers when the UK leaves the European Union, in the event that there is a loss of access to the EU Single Market. In October 2018 approval was received from the Dutch regulator (DNB) for the repurposing of the existing NatWest Markets N.V. banking licence. NatWest Markets N.V. is expected to become a subsidiary of NWM Plc in 2019 subject to regulatory approval.

As part of the plan to ensure the RBS Group can continue to serve EEA customers after Brexit, the in-scope EEA component of business was transferred from UK entities to NatWest Markets N.V. on 25 March 2019. The activities transferred primarily relate to Markets and Corporate Lending portfolios for EEA customers currently served from NatWest Markets Plc and the ring-fenced bank. Based on planning, the Group anticipates the profile of NatWest Markets N.V. to change during 2019 to reflect the transfer of these business activities into the entity, and the continued wind-down of existing legacy positions (including Alawwal Bank).

Alawwal Bank

Alawwal Bank announced in 2017 that it was entering into merger discussions with Saudi British Bank (SABB), and in October 2018 announced a merger ratio applicable to Alawwal Bank shareholders. Alawwal Bank is in the process of obtaining regulatory and other clearances necessary to complete its proposed merger with SABB, which is expected to take place later in 2019, and further announcements are expected in due course. Refer to Note 13 on the consolidated accounts for further details.

International Financial Reporting Standards

Unless otherwise indicated, the financial information contained in this Annual Report has been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) and IFRS as issued by the International Accounting Standard Board (IASB).

Financial review

Summary consolidated income statement

	2018 €m	2017 €m
Net interest income	(9)	(1)
Fees and commissions receivable	3	19
Fees and commissions payable	(73)	(2)
Income from trading activities	138	(156)
Foreign exchange gains and losses related to net investment hedges reclassified to income following disposals of foreign operations (1)	(19)	(163)
Other operating income	395	242
Non-interest income	444	(60)
Total income	435	(61)
Operating expenses	(22)	(57)
Profit/(loss) before impairment (losses)/releases	413	(118)
Impairment (losses)/releases	(4)	3
Operating profit/(loss) before tax	409	(115)
Tax (charge)/credit	(138)	24
Profit/(loss) from continuing operations	271	(91)
Loss from discontinued operations, net of tax	—	(1)
Profit/(loss) for the year	271	(92)
Attributable to:		
Controlling interests	271	(92)

Note:
(1) Reclassified foreign exchange gains and losses are recognised on the repatriation of the proceeds of disposals. Such income includes gains and losses in respect of disposals in prior periods.

Operating profit before tax was €409 million compared with an operating loss of €115 million in 2017. This increase was due to higher total income which increased by €496 million compared to a loss of €61 million, lower operating expenses of €22 million compared with €57 million in 2017. Impairment losses were €4 million compared with releases of €3 million in 2017.

Profit attributable to controlling interests was €271 million compared with a loss of €92 million in 2017.

Net interest income was a net expense of €9 million compared with a net expense of €1 million in 2017. Interest receivable remained stable at €26 million (2017 - €25 million). Higher interest payable mainly due to an increase in inter-company customer deposits, was partly offset by a reduction in subordinated liabilities.

Non-interest income increased by €504 million to €444 million compared with a loss of €60 million in 2017. Net fees and commissions were a loss of €70 million (2017 - €17 million gain) and included a termination fee of €70 million relating to termination costs on the closure of a deal.

Income from trading activities was €138 million, compared with a loss of €156 million in 2017, primarily in relation to mark-to-market movements in derivatives and the run-down of trading book liabilities, and also included €46 million received in respect of a distribution to successful plaintiffs in the Madoff related class action.

Foreign exchange losses of €19 million (2017 - €163 million) were reported in income following the repatriation of the proceeds from the disposal of foreign operations. They represent the cumulative exchange movement recorded in equity during the lifetime of those foreign operations that were the subject of a net investment hedge.

Other operating income increased by €153 million to €395 million, compared with €242 million in 2017. This included a release of €54 million in relation to IBNER reserve (2017 - €40 million) and an increase in other income of €237 million to €265 million (2017 - €28 million), which in 2018 included insurance recoveries of €248 million.

This was partly offset by a decrease in the fair value of financial instruments designated at fair value through profit and loss of €72 million, to a loss of €2 million (2017 - €70 million gain).

Operating expenses decreased by €35 million to €22 million compared with €57 million in 2017. This was mainly due to decreases in administrative expenses of €41 million to €10 million. This was partly offset by staff costs which were up €2 million to €7 million and premises and equipment which increased by €4 million to €5 million, reflecting work carried out in preparation for new business activity.

Impairments were a loss of €4 million compared with a release of €3 million in 2017.

Tax charge for 2018 was €138 million compared with a credit of €24 million in 2017.

Financial review

Consolidated balance sheet as at 31 December 2018

	2018 €m	2017 €m
Assets		
Cash and balances at central banks	336	68
Derivatives	656	761
Loans to banks - amortised cost	392	352
Loans to customers - amortised cost	67	80
Amounts due from holding company and fellow subsidiaries	1,961	2,796
Other financial assets	402	531
Interest in associates	2	1,214
Assets of disposal groups	1,317	—
Other assets	158	274
Total assets	5,291	6,076
Liabilities		
Bank deposits	44	55
Customer deposits	61	58
Amounts due to holding company and fellow subsidiaries	417	1,073
Derivatives	364	549
Other financial liabilities	6	50
Subordinated liabilities	746	993
Other liabilities	420	414
Total liabilities	2,058	3,192
Total equity	3,233	2,884
Total liabilities and equity	5,291	6,076

Total assets were €5,291 million at 31 December 2018, a decrease of €785 million, or 13%, compared with €6,076 million at 31 December 2017, mainly driven by a decrease in amounts due from holding company and fellow subsidiaries and the run-down of the legacy business.

Cash and balances at central banks increased by €268 million to €336 million at 31 December 2018 reflecting an increase in cash placed with the DNB.

Loans to banks - amortised cost increased by €40 million, or 11%, to €392 million at 31 December 2018.

Loans to customers - amortised cost declined by €13 million, or 16%, to €67 million, reflecting continued repayments and business run-down.

Amounts due from holding company and fellow subsidiaries decreased by €835 million, or 30% to €1,961 million, of which €1,827 million related to loans to banks and €133 million to loans to customers.

Other financial assets decreased by €129 million, or 24%, to €402 million and included debt securities down €24 million to €256 million and equity shares down €97 million to €137 million.

Other assets decreased by €116 million, or 42%, to €158 million and included a decrease in prepayments and deferred expenses of €62 million to nil, current tax, down €29 million to €1 million and other assets which declined by €27 million to €134 million.

Assets of disposal groups were €1,317 million (2017 - nil), relating to the Alawwal Bank business. The Group accounted for its interest in Alawwal Bank as an associate up to 31 December 2018 at which point it concluded that Alawwal Bank met the IFRS criteria to be reclassified as held for disposal. Accordingly, the Interest in associate in relation to Alawwal Bank is classified as a disposal group at 31 December 2018. Refer to Note 13 for further details.

Derivative assets decreased by €105 million, or 14%, to €656 million, and derivative liabilities decreased by €185 million, or 34%, to €364 million. €436 million of the assets and €281 million of the liabilities are balances with fellow subsidiaries.

Bank deposits decreased by €11 million, or 20%, to €44 million,

Customer deposits were stable at €61 million, compared with €58 million at 31 December 2017.

Amounts due to holding company and fellow subsidiaries decreased by €656 million, or 61%, to €417 million, with €418 million relating to bank deposits.

Other financial liabilities decreased by €44 million, or 88%, to €6 million, mainly due to debt securities in issue which were nil (2017 - €27 million), reflecting decreases in medium-term notes and settlement balances which were also nil (2017 - €13 million).

Subordinated liabilities decreased by €247 million, or 25%, to €746 million primarily due to the liquidity management exercise to buy back Tier 2 subordinated liabilities which was completed in 2018, as part of the ongoing management of the capital structure and the impact of US dollar to Euro exchange rate movements during the year.

Other liabilities were stable at €420 million, compared with €414 million at 31 December 2017 and included an increase in current taxation of €84 million to €89 million and other liabilities which decreased by €2 million to €201 million. This was partly offset by a reduction in insurance reserves.

Total equity increased by €349 million, 12%, to €3,233 million, primarily reflecting the attributable profit for the period of €271 million (2017- €91 million loss) and own credit adjustments of €89 million gain (2017 - €65 million loss).

Top and emerging risks

While the Group monitors its top and emerging risks through its Risk & Control Committee, they are managed as part of the overall RBS Group top and emerging risk process. These are risks that could have a significant negative impact on the Group's ability to operate or meet its strategic objectives.

A summary of the RBS Group's top and emerging risks is detailed below.

Type	Risk	Mitigation
Operational and IT resilience	The RBS Group's information technology systems are complex, making recovery from failure challenging. The RBS Group'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 RBS Group's ability to do business and/or compromises data security. There is a risk that the RBS Group lacks sufficient capability or capacity at a senior level to deliver, or adapt to, change. A breach in data privacy, either within the RBS Group or in a third-party organisation, may lead to negative impacts. There is a risk that the RBS Group's data strategy is not adequate for the evolving landscape. There is a risk that the actions of a third-party supplier could negatively affect the RBS Group's reputation or profitability.	A major investment programme has improved systems resilience across the RBS Group. As the RBS Group continues to simplify and modernise infrastructure and applications, system sustainability has improved. A major security programme across the RBS Group has delivered control enhancements to mitigate the risk of cyber attack. The RBS Group continues to invest in its defences. The RBS Group monitors people risk closely and has plans in place to support retention of key roles, with wider programmes supporting engagement and training. The RBS Group continues to implement change in line with its project plans while assessing the implementation risks and mitigating where possible. The RBS Group operates a series of contract and service management controls – together with assurance reviews – to mitigate third-party risk.
Economic and political risk	The RBS Group remains vulnerable to changes and uncertainty in the economic, political and legal environment. Scenarios that could have a potentially material negative effect on the RBS Group include the impact of the UK's exit from the European Union; changes in UK government and UK government policy; a second Scottish independence referendum; a UK recession (including significant falls in house prices); global financial volatility, a protracted period of low interest rates in the UK, vulnerabilities in emerging market economies resulting in contagion in the RBS Group's core markets, a Eurozone crisis or major geopolitical instability. Accelerating climate change may lead to faster-than-anticipated climate-related impacts on the RBS Group and the wider economy.	The RBS Group uses a range 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. The RBS 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 RBS Group's target markets are highly competitive, which poses challenges in terms of achieving some strategic objectives. Moreover, changes in technology, customer behaviour and business models in these markets have accelerated.	The RBS Group 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 RBS 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 impacts of past business conduct resulting in future litigation and conduct charges could be substantial. The RBS Group is involved in a number of investigations, including: ongoing class action litigation, investigations into foreign exchange trading and rate-setting activities, continuing LIBOR-related litigation and investigations, into the treatment of small and medium-sized business customers in financial difficulty, anti-money laundering, sanctions, mis-selling (including mis-selling of payment protection insurance products). Settlements may result in additional financial penalties, non-monetary penalties or other consequences, which may be material. The transition from LIBOR and other IBOR rates to alternative risk-free rates may lead to heightened legal, business and conduct risks.	The RBS Group considers and incorporates the implications of proposed or potential regulatory activities in its strategic and financial plans. Building a healthy culture is a core priority. The RBS Group continues to focus on creating a solid platform for behavioural and cultural change. In addition, the RBS Group 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 RBS Group's control framework and in line with expected standards of conduct.

Top and emerging risks

Type	Risk	Mitigation
Financial crime	The financial crime threat continues to evolve in line with changes in technology, the economy and wider society. As risks relating to money laundering, terrorist financing, tax evasion, sanctions, bribery and corruption develop, understanding and responding to them appropriately remains a key area of focus. In 2018, the RBS Group continued its journey of improvement in relation to the policies, processes and systems used to combat financial crime. The RBS Group also maintained an emphasis on ensuring proportionate, risk-focused customer due diligence standards were in place, particularly for higher-risk customer segments. In addition, improvements to the financial crime control environment remained a key focus in accordance with the evolving nature of the risk.	The RBS Group is committed to ensuring it acts responsibly and ethically, both when pursuing its own business opportunities and when awarding business. Consequently it has embedded appropriate policies, mandatory procedures and controls to ensure its employees, and any other parties it does business with, understand these obligations and abide by them, whenever they act for the RBS Group. Anti-bribery and corruption (ABC) training is mandatory for all staff on an annual basis, with targeted training appropriate for certain roles. The RBS Group considers ABC risk in its business processes including, but not limited to, corporate donations, charitable sponsorships, political activities and commercial sponsorships. Where appropriate, there is a requirement for ABC contract clauses in written agreements.

In addition to the RBS Group's top and emerging risks, the following is specifically managed by the Group:

Type	Risk	Mitigation
Brexit transition	The UK government is seeking to determine the terms of the UK's departure from the European Union. The resulting economic, trading and legal relationships with both the European Union and other counterparties remain subject to significant uncertainty. The direct and indirect effects of the UK's exit from the EU and the European Economic Area (EEA) are expected to affect aspects of the RBS Group's business and operating environment and may be material and/or cause a near-term impact on impairment. The longer term effects of Brexit on the 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, or personnel from, the UK and may result in or be exacerbated by periodic financial volatility and slower economic growth in the UK, the rest of Europe and potentially the global economy. Significant uncertainty exists as to the respective legal and regulatory arrangements under which the Group will operate when the UK is no longer a member of 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 operations, including attendant restructuring costs, level of impairments, capital requirements, regulatory environment and tax implications and as a result may adversely affect profitability, competitive position, viability, business model and product offering.	The RBS Group is implementing plans designed to continue its (and the Group's) ability to service customers in the EEA in the event that there is an immediate loss of access to the European Single Market o with no alternative arrangement for continuation of such activities under current rules (also known as Hard Brexit). The Group received a Declaration of No Objection in October 2018, in relation to repurposing the existing banking licence to allow the Group to continue to serve EEA clients. The certainty around the various permissions from DNB also gives clarity towards the future operations. The Group has been running an extensive programme for Brexit preparedness to deliver against the No Deal Brexit. On 22 February 2019, the Group received FSMA scheme approval from the Court of Session in Scotland which enables the replication of master trade documentation and the transfer of the open trading positions from one entity to another. However, there still remain multiple regulatory and operational challenges in relation to the transfer of assets. At date of publication, the Group had appointed key leadership staff and good progress had been made towards the appointment of support staff for the proposed state of the Group post Brexit. The Group is continuing to work towards reducing both execution and regulatory risk.
Legacy portfolio	Failure to obtain the relevant corporate or regulatory approvals for the disposal of legacy assets – including an interest in Alawwal Bank – may result in heightened financial or regulatory risk.	A merger agreement has been entered into by Alawwal Bank and Saudi British Bank, subject to approvals, and is expected to conclude in H1 2019.

Capital and risk management

Presentation of information

Where indicated in the section headers, information in the Capital and risk management section (pages 7 to 33) 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. Capital and risk management of the Group is in line with capital and risk management of the 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 Group operates under the RBS Group's 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.

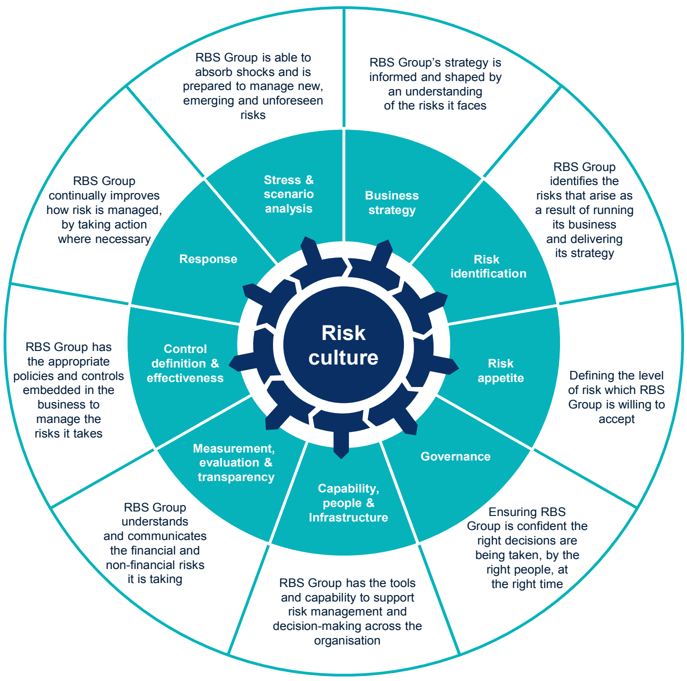
It is a key element of the RBS Group's risk management framework and culture, providing a structured approach to risk-taking within agreed boundaries.

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.

Capital and risk management

Risk management framework continued

All the 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 Group is to achieve its ambition to build a truly customer-focused bank. The Group has adopted the RBS Group's risk culture target 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 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 the Group's risk appetite; considering risk in all actions and decisions; escalating risks and issues early; taking action to mitigate risks; learning from mistakes and near-misses; challenging others' attitudes, ideas and actions; and reporting and communicating risks transparently.

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

Each 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 the RBS Group's required standards, the accountability review process is used to assess how this should be reflected in pay outcomes for those individuals concerned. 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.

Capital and risk management

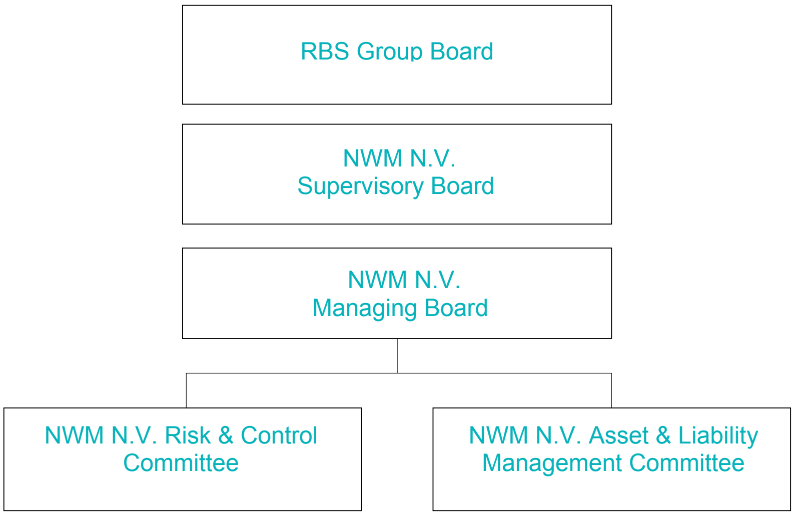
Risk management framework continued

Risk governance

Governance structure

As noted above, capital and risk management is conducted on an overall basis within the RBS Group. The risk functions and committees cover the RBS Group and the Group, reflecting the integrated manner in which the business is managed within the RBS Group. Service Level Agreements are in place between the Group and the RBS Group to accommodate this integrated risk management oversight, including procedures for escalation to the Managing Board as appropriate.

A number of committees and executives support the execution of the business plan and strategy. Two of these committees are dedicated to the Group and report to the Managing Board. These are shown in the structure chart and table below. Matters not specifically delegated are reserved for the Managing Board.



Risk management in the Group focuses on all material risks including credit, market, liquidity, operational, regulatory and conduct risk and business activities.

The day-to-day management of capital, liquidity, funding and non-traded market risk is the overall responsibility of the Managing Board and further delegated to the Asset & Liability Management Committee.

Capital and risk management

Risk management framework continued

The following table shows details of the Group's key boards and committees together with an overview of their responsibilities.

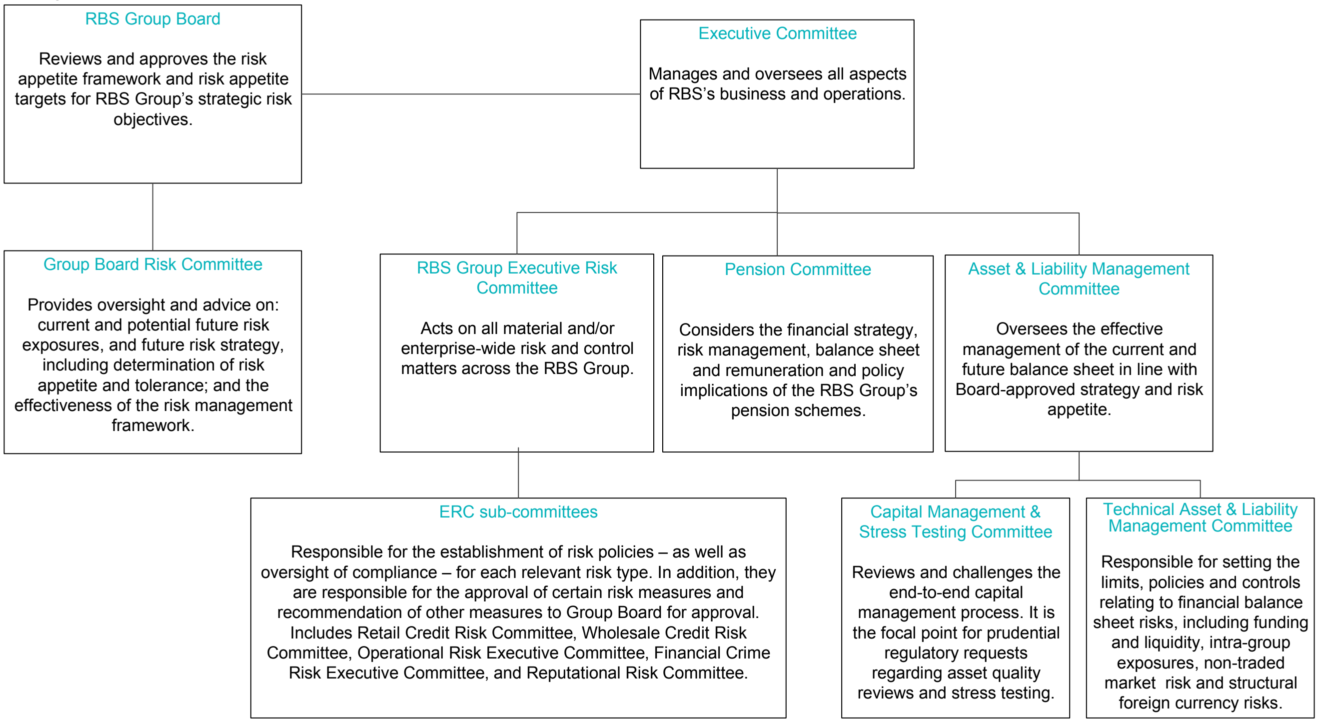
Board/Committee	Responsibilities
Supervisory Board Membership: Consists of five members. Two are executives of the RBS Group.	The Supervisory Board is responsible for supervising the Group's management, its general affairs, and the business connected with it, as well as advising the Managing Board. The Supervisory Board is responsible for the review of all matters relative to accounting policies, internal control, financial reporting functions, internal audit, external audit, risk management, regulatory compliance and the product approval process.
Managing Board Membership: Consists of four members: the Chairman and Chief Executive Officer (CEO), the Chief Financial Officer (CFO), the Chief Risk Officer (CRO) and the Chief Operating Officer (COO).	The Managing Board reports to the Supervisory Board. It is the principal decision-making forum for the Group, setting policy framework, operating structure and yearly plan (including objectives and budgets). All members of the Managing Board have responsibility for the Group. As well as their overall corporate responsibilities, the members of the Managing Board manage one or more units, for which they have primary responsibility.
Risk & Control Committee (RCC) Membership: Chaired by the CRO. Members include the CEO, the CFO, the COO, the N.V. Treasurer, the Senior Legal Officer, the Head of EEA Trading, the Head of EEA Financing & Risk Solutions and the Heads of the respective risk disciplines.	The responsibilities of the RCC include: • Advising the Managing Board on the risk appetite of the Group, and receiving direction from the Managing Board on the risk appetite. • Providing input to the Group risk-appetite-setting process in the context of the Group's overall risk appetite. • Overseeing the risk framework within the Group and reporting directly to the Managing Board on the performance of the framework and on issues arising from it. • Monitoring the actual risk profile of the Group, ensuring that this remains within the boundaries of the agreed risk appetite and escalating excesses to the Managing Board. Prior to escalation, the RCC can ask the appropriate risk committee in the RBS Group or the business that normally monitors and controls the risk item, to address any excess. The remit of the Committee also includes credit, market, operational and regulatory risks within the Group. Changes to the Terms of Reference of the RCC must be approved by the Managing Board. To execute its authority, the RCC has access to all relevant risk information relating to the Group available within the RBS Group, including escalations from and to Group or business committees.
Asset & Liability Management Committee (ALCo) Membership: Chaired by the CFO. Members include the CEO, the CRO, the COO, the N.V. Treasurer, the N.V. Head of EEA Trading, the N.V. Head of Flow Sales and the N.V. Head of EEA Financing & Risk Solutions.	The mandate of ALCo covers the following specific areas in respect of the Group: • The overall governance responsibility for the strategic management of the Group balance sheet. • The review, approval and allocation of balance sheet, capital, liquidity and funding limits. • The liquidity, funding, foreign exchange and interest rate exposures of the Group's balance sheet. • The balance sheet structure and risk-weighted assets position of the Group. • Decisions on capital repatriation and loss coverage. • Compliance with all regulatory requirements at all times. • The implementation and maintenance of transfer pricing policies (although setting the liquidity spread curve remains the responsibility of the RBS Group ALCo). • The approval and implementation within the Group of the RBS Group Treasury policies and procedures. • Responsible for oversight of retained business (shared assets).

Capital and risk management

Risk management framework continued

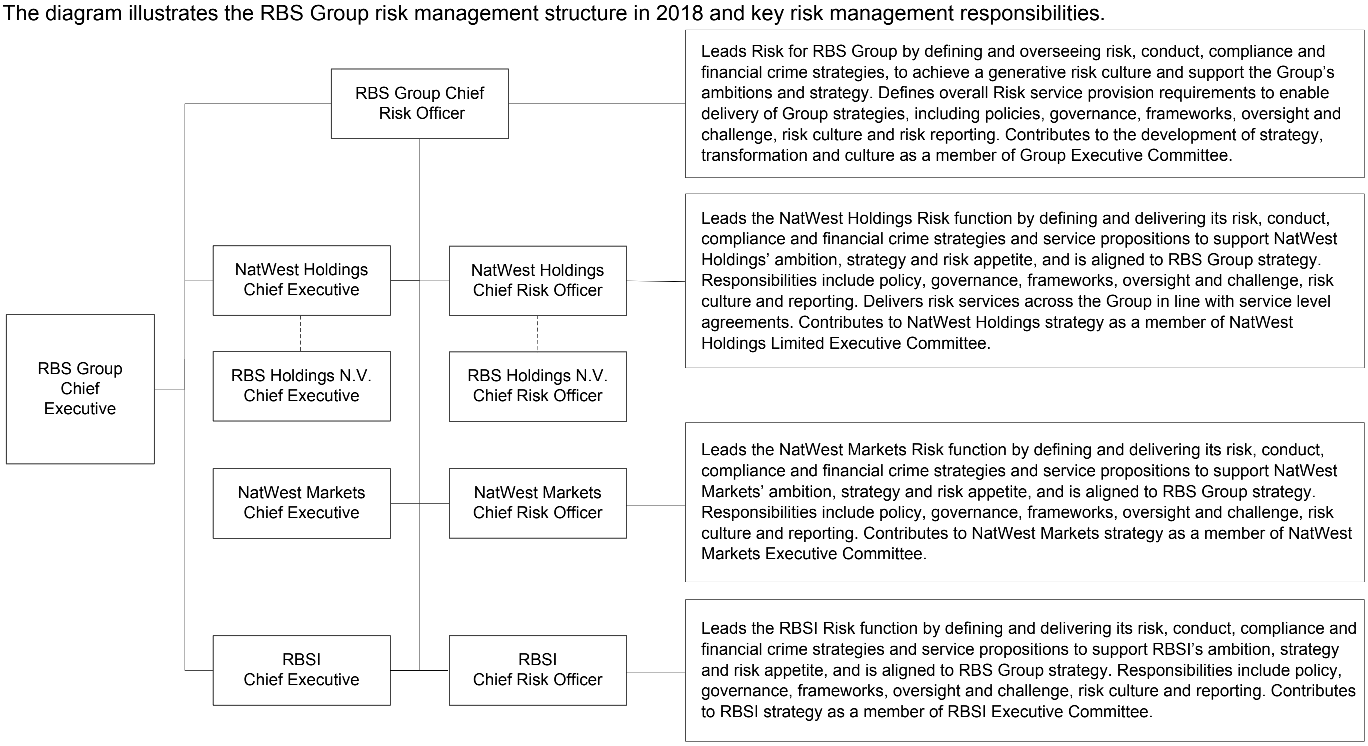
Committee structure

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



Risk management structure

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



Note:
(1) The RBS Group Risk function is led by the RBS Group Chief Risk Officer. The RBS Group Chief Risk Officer reports directly to the RBS Group Chief Executive and has a secondary reporting line to the chair of the Group Board Risk Committee as well as a right of access to the committee.

Capital and risk management

Risk management framework continued

Three lines of defence

The Group has adopted the RBS Group's 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 franchise, Technology and Services as well as some 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.
- Providing senior executives with quality assurance and controls testing required by policy and regulations, supporting management assertions around the robustness of the risk framework.

Third line of defence – Internal Audit

Responsibilities include:

- Providing assurance to the Supervisory Board 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 key jurisdictional regulators on specific risks and controls.

Risk appetite

Risk appetite defines the level and types of risk the 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 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 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.
- Assessing the level of embedding of risk appetite across the organisation.

The RBS Group Board approves the risk appetite framework annually.

Establishing risk appetite

In line with RBS Group's risk appetite framework, 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 RBS Group-wide level for all strategic risks and material risks, and at legal entity, franchise, and function level for all other risks.

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 Group 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.

In addition to following the RBS Group risk appetite, the Group sets risk appetite limits for its own most material risks. 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 Group 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 Group policies directly support the qualitative aspects of risk appetite. They ensure that appropriate controls are set and monitored.

Risk identification and measurement

Risk identification and measurement within the risk management process comprise:

- Regular assessment of the overall risk profile, incorporating market developments and trends, as well as external and internal factors.
- Monitoring of the risks associated with lending and credit exposures.
- Assessment of 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.

Capital and risk management

Risk management framework continued

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 by the Group and the rest of 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.

Regulatory oversight

With effect from 1 January 2017, the Group has been subject to the direct supervision of De Nederlandsche Bank (DNB) following the notification from the ECB in 2016 that the Group's classification had changed to 'Less Significant Institution'. Consequently, direct supervision by the ECB has ceased although specific ECB regulations continue to be applicable to the Group. During 2018, the Group applied for a declaration of no objection with DNB for its plan to be operationally ready to serve European Economic Area (EEA) customers when the UK leaves the European Union, in the event that there is a loss of access to the EU single market. DNB have granted the declaration of no objection in October 2018.

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, 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, market risk controls and surveillance 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. Assurance is also carried out on the Conduct risk framework including the review of compliance to conduct policies.

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 pricing models for valuation of positions and other models 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.

The models used for stress-testing purposes also play a key role in ensuring the Group holds sufficient capital, even in stressed market scenarios.

Key developments in 2018

The RBS Group 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. The RBS Group 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.

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. 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 suitability 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 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.

Capital and risk management

Capital, liquidity and funding risk

Definition

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

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 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 finance assets. Funding risk is the risk of not maintaining a diversified, stable and cost-effective funding base.

Liquidity and funding risks arise in a number of ways, including through the maturity transformation role that banks perform. The risks are dependent on factors such as:
- Maturity profile.
- Composition of sources and uses of funding.
- The quality and size of the liquidity portfolio.
- Wholesale market conditions.
- Depositor and investor behaviour.

For a description of sources of capital, liquidity and funding as utilised by the RBS Group, refer to the RBS Group Annual Report and Accounts 2018 on page 97.

Key developments in 2018
- CET1 capital reduced by €8 million during 2018, due to changes in controlling interests offset by regulatory adjustments for own credit, foreign currency reserve movements and the profit in the year (subject to approval).
- The CET1 and Tier 1 ratios increased to 31.4% (2017 - 24.9%), primarily driven by a reduction in RWAs, largely relating to Alawwal Bank (€0.9 billion reduction), further reductions of the legacy portfolio and intergroup exposures of adding up to (€1.4 billion). Total regulatory capital remained stable at €2.9 billion (2017 - €2.9billion). The total capital ratio of 32.6% was a significant increase compared to the prior year, due to lower RWAs.
- Subordinated debt decreased €0.2 billion in 2018 due to maturities, the effect of this was not seen in the Tier 2 capital as the instruments were already derecognised.
- The liquidity portfolio of €1.5 billion was €0.5 billion higher than 2017 as the cash balance from the reduction of the legacy portfolio were placed with DNB (€0.3 billion) and RBS Group. The funding level reduced to €1.3 billion reflecting lower balance sheet levels in 2018.

Regulatory framework

Capital requirements regulation and directive

The European Union has implemented the Basel III proposals and a number of important changes to the banking regulatory framework through the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD) collectively known as the CRD IV package (CRD IV).

CRD IV was implemented on 1 January 2014 on a phased basis with full implementation to be completed on 1 January 2019. As part of the implementation of CRD IV, the European Banking Authority's technical standards, which are legal acts specifying particular aspects of CRD IV, are either in progress to be finalised through adoption by the European Commission, or now in force.

CRD IV continues to require a total amount of capital equal to at least 8.0% of risk-weighted assets but the share that has to be of the highest quality, which is CET1 capital, of at least 4.5%.

The CRD IV package also introduces more stringent criteria for capital instruments, harmonised adjustments made to capital recognised for regulatory purposes and establishes new capital buffers to be phased in from 1 January 2014. Once fully implemented on 1 January 2019, the following minimum requirements must be met:
- Pillar 1 requirement of: CET1 of 4.5% of RWAs; Tier 1 of 6.0%; and total capital of 8.0%.
- Capital buffers: 'capital conservation buffer' of 2.5% of RWAs; 'countercyclical capital buffer' of up to 2.5%; an 'other systemically important institutions buffer' for domestically or EU important institutions and, if required by a member state, an additional 'systemic risk buffer'.
- Minimum Tier 1 leverage ratio of 3.0%.

The Group manages changes to capital requirements from new regulation (including model changes) and the resulting impact on the Common Equity Tier 1 ratio alongside its strategy of risk reduction and de-leveraging. For further information please refer to Capital management below.

Banking Union: Single Supervisory Mechanism

On 15 October 2013, the EU Council formally adopted the Regulation on the Single Supervisory Mechanism (SSM) which became operational on 4 November 2014. The SSM is a new framework for banking supervision in Europe with the aims of ensuring the safety and soundness of the European banking system and increasing financial integration and stability in Europe.

The ECB has to ensure that credit institutions not only meet the minimum prudential capital requirements set by the CRD IV but also have an additional buffer reflecting risks or elements of risks not covered by the minimum requirements in CRD IV. This is organised through the framework of the SSM.

The SSM has to ensure that credit institutions have sufficient capital to cover unexpected losses or survive severe stressed economic and market conditions. The capital joint decision is the key outcome of the Supervisory Review and Evaluation Process. In this process, the supervisor reviews the governance and internal control arrangements used by each individual bank to manage its risks (i.e. the Internal Capital Adequacy Assessment Process (ICAAP)).

Overall this framework governs relations between the ECB, national supervisors and banks, and is an important step towards banking union in the EU.

Capital management

The Group aims to maintain an appropriate level of capital to meet its business needs (which include requirements of its ultimate parent company, RBS Group) and regulatory requirements, whilst operating within an agreed risk appetite. Determination of appropriate capital levels involves regular Asset & Liability Management Committee (ALCo) capital monitoring, planning and forecasts, and ICAAP. Capital plans are subjected to internal governance reviews, eventually put through Managing Board oversight and approval, as well as review of the appropriate supervisory authority.

Capital planning

The Group operates a rigorous capital planning process via ALCo aimed at ensuring the capital position is controlled within the agreed parameters. This incorporates regular re-forecasts of the capital position of the Group. In the event that the projected position deteriorates below acceptable levels, the Group would revise business plans accordingly.
The Group manages changes to capital requirements from new regulation as well as model changes and the resulting impact on the Common Equity Tier 1 ratio, focusing on risk reduction and de-leveraging.

This is principally being achieved through the transfers to interested parties, including NatWest Markets Plc, and the continued run-off and disposal of assets as it focuses on the most productive returns on capital.

The overall impacts of known regulatory changes are fully factored into the capital plans of Group and its businesses.

Through the ICAAP, the Group makes a determination of its desired capital levels based on maintaining a target external credit rating and risk appetite within both current and emerging regulatory requirements.

Capital and risk management

Desired capital levels are evaluated through the application of internally defined stress tests that quantify changes in capital ratios under a range of scenarios.

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 and funding management
Liquidity and funding management follows a similar process to that outlined above for capital. Liquidity and funding risk tolerance forms part of the Group's risk appetite statement, which is reviewed and approved by the Group Managing Board.

The risk appetite statement defines key metrics, risk trigger levels and capacity for liquidity and funding management within the Group. The Board also sets the appetite for funding risk to ensure that stable sources of funding are used to fund the Group's core assets. The Group monitors its liquidity position against this risk tolerance on a daily basis. In setting risk limits the Board considers the nature of the Group's activities, overall risk appetite, market best practice and regulatory compliance.

In implementing the Group's liquidity risk management framework, a suite of tools are used to monitor, limit and stress test the risks within the balance sheet. Limits are established to manage the level of liquidity risk and these include thresholds for the amount and composition of funding sources, asset and liability mismatches, and funding concentrations.

Liquidity portfolio management
The size of the portfolio is determined by referencing RBS Group's liquidity risk appetite. RBS 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.

Within the liquidity portfolio the Group holds cash at central banks of €0.3 billion (2017 - €0.1 billion) and government and other high quality securities of €1.1 billion (2017 - €0.9 billion) which are principally obtained via reverse repo transactions with National Westminster Bank Plc.

Funding risk management
Reflecting further de-risking and simplification of the Group's balance sheet, funding is now concentrated with fellow subsidiaries of the RBS Group which have access to a broad funding base.

Governance
The ALCo is responsible for ensuring the Group maintains adequate capital, liquidity and funding at all times. The ALCo manages and plans the Group's adequacy levels taking into account current and projected levels and provides input to and oversees levels established within the framework of the ICAAP and ILAAP.

ALCo also plans and manages capital, liquidity and funding interaction with RBS Group. Such interaction would include, amongst other matters, ALCo considerations around the Group's strategic asset sales/transfers to RBS Group which would need to be capital neutral to RBS Group and are required to be structured in such way so as to satisfy DNB, ECB and PRA regulatory requirements. The ALCo is in turn ultimately governed by the Group's Managing Board, which approves ALCo and ICAAP and ILAAP decisions.

Capital ratios and risk-weighted assets
The Group aims to maintain an appropriate level of capital to meet its business needs and regulatory requirements. The Group's capital ratios and RWAs on a CRR transitional basis are set out below.

Capital ratios	2018 %	2017 %
Common Equity Tier 1 (CET1)	31.4	24.9
Tier 1	31.4	24.9
Total	32.6	25.9

Risk-weighted assets	€m	€m
Credit risk	8,164	10,052
Market risk	157	418
Operational risk	478	674
	8,799	11,144

Key points
- Within the total RWAs of €8,799 million (2017 - €11,144 million), €6,516 million (2017- €7,445) relates to the proportional consolidation of the Group's 40% interest in Alawwal Bank. This amount is made up of €6,484 million credit risk RWAs (2017 - €7,432 million) and €32 million market risk RWAs (2017 - €13 million), the decrease for credit risk in the year relates to both FX and asset reductions
- Market risk RWAs include €36 million relating to credit valuation adjustments (2017 - €70 million).
- The operational risk capital charge has decreased in 2018, reflecting the three year average operating income of Alawwal Bank factored in by the Group under the basic indicator approach to calculating RWAs and a nil operating income for the main entity in 2017.

Capital and risk management

Capital, liquidity and funding risk continued

Capital resources

The Group's regulatory capital resources on a CRR transitional basis were as follows:

	2018 €m	2017 €m
Tier 1		
Controlling interests	3,233	2,884
Adjustment for:		
- Goodwill and other intangible assets	—	(3)
- Other regulatory adjustments (1)	(471)	(111)
Core Tier 1 and Total Tier 1 capital	2,762	2,770
Tier 2		
Subordinated debt	234	238
Deductions from Tier 2 capital	(131)	(125)
Total Tier 2 capital	103	113
Total regulatory capital	2,865	2,883

Note:
(1) Includes reversal of own credit risk of €196 million (2017 - €106 million) plus the elimination of the profit that has not been approved yet.

CET1 flow statement

The table below analyses the movement in Common Equity Tier 1 capital during the year.

	€m
At 1 January 2018	2,770
Regulatory adjustment: fair value changes in own credit spreads	89
Foreign currency reserves	(24)
Result current year	271
Other	(344)
At 31 December 2018	2,762

Funding sources

The table below shows the Group's primary funding sources. Amounts due to holding companies and fellow subsidiaries are predominantly bank deposits. Balance sheet captions include balances held at all classifications under IFRS9/IAS39.

	2018		2017	
	€m	%	€m	%
Deposits by banks	47	3.7	59	2.7
Debt securities in issue - medium term notes and other bonds (including securitisations)	—	—	27	1.2
Subordinated liabilities	746	58.6	993	44.8
Total wholesale funding	793	62.3	1,079	48.7
Customer deposits	64	5.0	64	2.9
Amounts due to holding companies and fellow subsidiaries	417	32.7	1,073	48.4
Total funding	1,274	100.0	2,216	100.0

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.
- Banking activities (except where indicated).

Sources of risk

The Group is exposed to credit risk through lending, derivatives and off-balance sheet products such as trade finance and guarantees. The Group is also exposed to credit risk as a result of debt securities held for liquidity management purposes.

Risk governance

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 and that credit policy controls are being operated adequately and effectively.

The Risk & Control Committee, which operates under the delegated authority of the Managing Board, ensures that all material credit risks are identified, assessed, monitored, controlled and managed effectively (refer to page 9 for further details). The Risk & Control Committee receives input from various committees including the Credit Portfolio Risk Committee for the overall credit risk profile and sector/product/asset class concentrations, as well as input from the Risk of Credit Loss Committee, the Internal Model Review Committee and the Stress Testing Committee.

Risk appetite

The Group's approach to lending is governed by comprehensive credit risk appetite frameworks which are operated across the RBS Group. 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 Group 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 four formal frameworks used – and their basis for classification – are detailed in the following table.

	Basis for classification	
Framework	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 policies define mandatory controls, which are subject to assurance testing.

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 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%).

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 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

Capital and risk management

Credit risk continued

The mapping to the S&P ratings is used by the Group as one of several benchmarks for its 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 smaller corporate exposures or specialist corporate segments given that S&P does not typically assign ratings to such entities.

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.

Counterparty credit risk

Counterparty credit risk arises from the obligations of customers under derivative and securities financing transactions. It is a material part of the Group's credit risk.

In addition to the credit risk management practices set out in this section, the Group mitigates counterparty credit risk arising from both derivative and securities financing transactions 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

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. This process is facilitated through systems, strategies and policy rules to provide a credit decision.

Credit is only granted to customers following joint approval by an approver from the business and the credit risk function, or by two credit officers. 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.

Underwriting standards are monitored on an ongoing basis to ensure they remain adequate in the current market environment and are not weakened to sustain growth.

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

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 trade/transaction 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 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 (refer to 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.

Credit risk continued

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.

Restructuring

Problem debt portfolio customer relationships are mainly managed by the Restructuring team. 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.

Types of forbearance

The type of forbearance offered is tailored to the customer's individual circumstances and 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

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

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.

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 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 12 and Note 12 on the consolidated accounts).

Transition from IAS 39 to IFRS 9 (audited)

The RBS 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 expected credit loss (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 decreased by €3 million, a 5% reduction relative to IAS 39.

Key differences in moving from IAS 39 to IFRS 9 on impairment loss (audited)	Total €m
31 December 2017 – IAS 39 impairment provision	59
Impact of IFRS 9	(3)
1 January 2018 – IFRS 9 ECL	56

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.

Capital and risk management

Credit risk continued

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.
- *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.

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.

For the purpose of calculating ECL the central base case economic scenario is adjusted 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, historical credit loss rates show pronounced mean reversion behaviour and secondly, the accuracy of economic forecasts tends to drop significantly for horizons beyond one or two years.

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.

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 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 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.

IFRS 9 credit risk modelling (audited)

IFRS 9 introduced lifetime ECL for the measurement of credit impairment.

Capital and risk management

Credit risk continued

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

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.

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

EAD estimates

EAD values are estimated on the basis of credit conversion factor (CCF) models. The Group has observed historical, 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 updates CCF coefficients in the model frequently (typically annually) using the last five years of observed data.

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). The Group has adopted a framework to identify deterioration based primarily on movements in probability of default supported by additional backstops. The principles applied are consistent across the Group 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) 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. In broad terms, a doubling of PD would indicate a significant increase in credit risk. However, the PD uplift must be at least 0.1%.
- 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 and exposures managed within the Risk of Credit Loss framework.

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 – asset duration is based on annual counterparty review schedules and will be set to the next review date.

Capital and risk management

Credit risk – Banking activities
Disclosures in this section are audited where indicated.

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 12 and Note 12 on the consolidated 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 9 on the consolidated 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 €1,215 million AC and FVOCI balance (gross of ECL), €1,087 million or 89% was within the scope of the IFRS 9 ECL framework and comprised by stage: Stage 1 €971 million, Stage 2 €70 million and Stage 3 €46 million. Total assets within IFRS 9 ECL scope comprised the following by balance sheet caption and stage:

- Loans: €495 million of which Stage 1 €379 million, Stage 2 €70 million and Stage 3 €46 million.
- Other financial assets: €592 million, all relating to Stage 1.

Equity shares of €128 million were outside the IFRS 9 ECL framework by definition.

In scope assets also include €1,961 million of inter group assets.

Contingent liabilities and commitments

In addition to contingent liabilities and commitments disclosed in Note 22 on the consolidated accounts – reputationally-committed limits were also included in the scope of the IFRS 9 ECL framework. There were no contingent liabilities and commitments outside the scope of the IFRS 9 ECL framework. Total contingent liabilities (including financial guarantees) and commitments within IFRS 9 ECL scope were €1,831 million, all relating to Stage 1.

Portfolio summary (audited)

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

31 December 2018	31 December 2018 Total €m	1 January 2018 Total €m
Loans - amortised cost		
- Stage 1	379	256
- Stage 2	70	176
- Stage 3	46	33
- Inter-Group	1,961	2,646
Total	2,456	3,111
ECL provisions		
- Stage 2	4	1
- Stage 3	33	32
Total	37	33
ECL provisions coverage (1)		
- Stage 2 (%)	5.7	0.3
- Stage 3 (%)	71.7	97.5
Total	7.5	7.0
Other financial assets - Gross exposure	592	600
Other financial assets - ECL provision	1	23
ECL charge (2)		
- Third party	4	
Impairment losses		
- ECL loss rate (%) - third party	0.81	
- Amounts written-off	23	

Notes:
(1) ECL provisions coverage is ECL provisions divided by loans - amortised cost.
(2) ECL charge balance included €0.8 million relating to other financial assets at FVOCI and a €0.2 million release relating to contingent liabilities.

Capital and risk management

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. Except where indicated, the tables below report only third party exposures and related ECL provisions, charges and write-offs.

2018	Corporate €m	FI €m	Sovereign €m	Total €m
Loans by geography	241	253	1	495
- Netherlands	*—*	*34*	*—*	*34*
- Other Europe	*158*	*—*	*—*	*158*
- RoW	*83*	*219*	*1*	*303*
Loans by asset quality (1)	241	253	1	495
- AQ1-AQ4	*—*	*246*	*1*	*247*
- AQ5-AQ8	*201*	*1*	*—*	*202*
- AQ10	*40*	*6*	*—*	*46*
Loans by stage	241	253	1	495
- Stage 1	*132*	*246*	*1*	*379*
- Stage 2	*69*	*1*	*—*	*70*
- Stage 3	*40*	*6*	*—*	*46*
Weighted average life * - ECL measurement (years)	2	2	2	2
Weighted average 12 months PDs *				
- IFRS 9 (%)	*4.3*	*0.1*	*—*	*0.8*
- Basel (%)	*6.0*	*0.1*	*0.2*	*2.2*
ECL provisions by geography	34	3	—	37
- Netherlands	*—*	*3*	*—*	*3*
- Other Europe	*20*	*—*	*—*	*20*
- RoW	*14*	*—*	*—*	*14*
ECL provisions by stage	34	3	—	37
- Stage 2	*4*	*—*	*—*	*4*
- Stage 3	*30*	*3*	*—*	*33*
ECL provisions coverage (%)	14.1	1.2	—	7.5
- Stage 2 (%)	*5.8*	*—*	*—*	*5.7*
- Stage 3 (%)	*74.3*	*50.0*	*—*	*71.7*
ECL charge - Third party	4	—	—	4
ECL loss rate (%)	1.66	—	—	0.81
Amounts written-off	—	23	—	23
Other financial assets by asset quality (1)	256	—	336	592
- AQ1-AQ4	*—*	*—*	*336*	*336*
- AQ5-AQ8	*256*	*—*	*—*	*256*
Off-balance sheet	—	1,553	278	1,831
- Loan commitments	*—*	*476*	*278*	*754*
- Financial guarantees	*—*	*1,077*	*—*	*1,077*
Off-balance sheet by asset quality (1)	—	1,553	278	1,831
- AQ1-AQ4	*—*	*1,542*	*278*	*1,820*
- AQ5-AQ8	*—*	*11*	*—*	*11*

* Not within audit scope.

Note:
(1) AQ bandings are based on Basel PDs.

Key point

- Asset quality – Most on and off-balance sheet exposure was in the AQ1-AQ4 bands, which was equivalent to an indicative investment-grade rating of BBB- or better.

Credit risk – Banking activities continued

Sector and geographical regional analyses

The following table analyses gross loans to customers (excluding reverse repos) and the related debt management measures and ratios by sector and geography (by location of office).

2017	Gross loans €m	REIL €m	Provisions €m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment releases €m
Central and local government	1	—	—	—	—	—	—
Financial institution	13	6	3	46	50	23	—
Corporate	116	39	34	34	87	29	(4)
Latent	—	—	—	—	—	—	(2)
Total	130	45	37	35	82	29	(6)
Of which:							
- Netherlands	113	40	32	35	80	28	(4)
- Overseas	17	5	5	29	100	29	(2)
Total	130	45	37	35	82	29	(6)

Flow statement (audited)

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

- The flow statement captures the changes in ECL as well as the changes in related financial assets used in determining ECL. Exposures 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 as they relate to balances at central banks.
- Financial assets presented in the flow statement include treasury liquidity portfolios, comprising balances at central banks and debt securities, as well as loans. Both modelled and non-modelled portfolios are included.
- Stage transfers (for example, exposures moving from Stage 1 to Stage 2) are a key feature of the ECL movements, with the net re-measurement cost of transitioning to a worse stage being a primary driver of income statement charges 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.
- Amounts written-off – represent the gross asset written-down against accounts with ECL, including the net asset write-down for debt sale activity.
- The impact of model changes during 2018 were not material at total level or in the portfolios disclosed below.
- Inter-Group movements were a feature of the ECL flows during 2018, but net to zero at a RBS Group-wide level.

	Stage 1		Stage 2		Stage 3		Total	
	Financial assets €m	ECL €m	Financial assets €m	ECL €m	Financial assets €m	ECL €m	Financial assets €m	ECL €m
At 1 January 2018	708.5	0.5	487.7	0.6	92.5	55.0	1,288.7	56.1
Currency translation and other adjustments	5.4	—	1.1	—	1.0	0.8	7.5	0.8
Inter-Group movements	(233.9)	(0.2)	(0.1)	—	—	—	(234.0)	(0.2)
Transfers from Stage 1 to Stage 2	(8.6)	—	8.6	—	—	—	—	—
Transfers from Stage 2 to Stage 1	4.6	0.2	(4.6)	(0.2)	—	—	—	—
Transfers to Stage 3	—	—	(0.5)	—	0.5	—	—	—
Net re-measurement of ECL on stage transfer		(0.2)		0.4		0.2		0.4
Changes in risk parameters (model inputs)		(0.2)		2.9		(0.5)		2.2
Other changes in net exposure	165.1	—	(424.3)	0.1	(25.0)	(0.1)	(284.2)	—
Income statement (releases)/charges		(0.4)		3.4		(0.4)		2.6
Amounts written-off	—	—	—	—	(22.7)	(22.7)	(22.7)	(22.7)
At 31 December 2018	641.1	0.1	67.9	3.8	46.3	32.7	755.3	36.6
Net carrying amount	641.0		64.2		13.5		718.7	

Key points

- The overall ECL reduction was mainly driven by business-as-usual write-offs in Stage 3.
- The main driver of the movement in financial assets related to inter-Group movements. Other changes in net exposure reflected business run down.

Capital and risk management

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. The 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: – The 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.
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. PD models reflect losses that would arise through-the-cycle; this represents a long run average view of default levels.
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. Revolving products: the date of the last substantive credit review (typically annual) or, if later, the date facility became available to the customer. 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.

Capital and risk management

Market risk

The Group is exposed to traded market risk through its trading activities and to non-traded market risk as a result of its banking activities. It manages its traded and non-traded market risk exposures separately. Each type of market risk is discussed separately. The traded market risk section begins below. The non-traded market risk section begins on page 29.

Traded market risk

Definition

Traded market risk is the risk arising from changes in fair value on positions, assets, liabilities or commitments in trading portfolios as a result of fluctuations in market prices.

Sources of risk

From a market risk perspective, activities are focused on: rates; currencies; securitised products; and traded credit.

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

The key categories of traded market risk are interest rate risk, credit spread risk and foreign currency price risk.

Trading activities may also give rise to counterparty credit risk. For further detail, refer to page 18 of the Credit risk section.

Risk governance

Responsibility for identifying, measuring, monitoring and controlling market risk arising from trading activities lies with the relevant trading business. At 31 December 2018, oversight is provided by the RBS Group's Market Risk function. During 2019, this role will be assumed by the Group.

The Group's traded market risk positions are reported monthly to the Risk and Control Committee (RCC) and subsequently to the Managing and Supervisory Boards.

Market risk policy statements, approved at the RBS Group level, set out the governance and risk management framework.

Risk appetite

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

Quantitative appetite is expressed in terms of exposure limits.

The limit framework at the RBS Group level comprises value-at-risk (VaR) and stressed value-at-risk (SVaR). More details on these are provided on the following pages.

The limit framework at trading unit level also comprises additional metrics that are specific to the market risk exposures within its scope. These additional metrics aim to control various risk dimensions such as product type, exposure size, aged inventory, currency and tenor.

For each trading business, a document known as a dealing authority compiles details of all applicable limits and trading restrictions.

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

The Group's risk appetite is aligned with that of the RBS Group. A comprehensive structure and controls are in place aimed at ensuring that this appetite is not exceeded. The Group aims to mitigate market risk, to the extent possible, by way of hedging transactions with the RBS Group.

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 by the relevant business and the Market Risk function and implemented.

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

Risk controls

For information on risk controls, refer to page 12.

Risk monitoring and mitigation

Traded market risk is identified and assessed by gathering, analysing, monitoring and reporting market risk information at desk, business and Group-wide levels. Industry expertise, continued system developments and techniques such as stress testing are also used to enhance the effectiveness of the identification and assessment of all material market risks.

Traded market risk exposures are monitored against limits and analysed daily by market risk reporting and control functions. A daily report summarising the position of exposures against limits at desk, business and Group levels is provided to senior business and market risk managers.

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

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

Business profit and loss performance is monitored automatically through loss triggers which, if breached, require a remedial action plan to be agreed between the RBS Group's Market Risk function and the business. The loss triggers are set using both a fall-from-peak approach and an absolute loss level.

Risk measurement

The RBS Group uses a comprehensive set of methodologies and techniques to measure traded market risk. At the Group level, these chiefly comprise VaR and SVaR. In addition, stress testing is used to identify any vulnerabilities and potential losses in excess of VaR and SVaR. The incremental risk charge is not material at the Group level.

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

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

Value-at-risk

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

For internal risk management purposes, VaR assumes a time horizon of one trading day and a confidence level of 99%.

The RBS Group's internal VaR model is based on a historical simulation, utilising market data from the previous 500 days on an equally weighted basis.

At the Group level, at 31 December 2018, the VaR model used 401 observations of historical market data exponentially weighted with a weighted average history of six months. From March 2019, the Group model uses the same approach as the RBS Group model.

It captures the potential impact of: interest rate risk; credit spread risk; and foreign currency price risk.

Testing of the performance and adequacy of the VaR model is performed on a regular basis through the following processes:

- Back-testing – Internal and regulatory back-testing is conducted on a daily basis. VaR model back-testing counts the number of days when a loss exceeds the corresponding daily VaR estimate, measured at a 99% confidence level.
- Ongoing model validation – VaR model performance is assessed both regularly and on an ad-hoc basis if market conditions or portfolio profile change significantly.
- Model Risk Management review – As part of the model lifecycle, all risk models (including the VaR model) are independently reviewed to ensure that the model is still fit for purpose given current market conditions and portfolio profile (refer to page 13).

Capital and risk management

Traded market risk continued

1–day 99% traded internal VaR

The table below analyses the internal VaR for the Group's trading portfolios segregated by type of market risk exposure.

	2018				2017			
	Average €m	Maximum €m	Minimum €m	Period end €m	Average €m	Maximum €m	Minimum €m	Period end €m
Interest rate	0.1	0.3	—	—	0.7	2.5	0.1	0.1
Credit spread	0.9	1.5	0.4	0.4	2.0	2.5	1.5	1.5
Currency	0.4	1.8	—	0.1	0.5	3.2	0.2	0.7
Equity	—	0.1	—	—	—	—	—	—
Diversification (1)	(0.3)			(0.1)	(0.8)			(0.5)
Total	1.1	2.8	0.4	0.4	2.4	4.7	1.6	1.8

Note:

(1) The Group benefits from diversification, which reflects the risk reduction achieved by allocating investments across various financial instrument types, industry counterparties, currencies and regions. The extent of diversification benefit depends on the correlation between the assets and risk factors in the portfolio at a particular time.

Key point

- The decrease in traded VaR on an average basis was mainly driven by market data updates in the Credit business.

SVaR

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

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

This is in contrast with VaR, which was based on a rolling 401-day historical data set at 31 December 2018. A time horizon of ten trading days is assumed with a confidence level of 99%.

The internal traded SVaR model captures all trading book positions.

Model validation

The RBS Group uses a variety of models to manage and measure market risk. These include pricing models (used for valuation of positions) and risk models (for risk measurement and capital calculation purposes). They are developed and signed off in NatWest Markets Plc, with material models subject to independent review by Model Risk Management (refer to page 13).

Pricing models

Pricing models are developed by a dedicated first-line team, in conjunction with the trading desk. They are used to value positions for which prices are not directly observable and for the risk management of the portfolio.

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

These committees comprise representatives of the trading, finance, market risk, model development and model review functions. Approval requires review and authorisation by these stakeholders as well as Model Risk Management.

The review process includes the following steps:

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

Risk models

All model changes are approved through model governance committees in NatWest Markets Plc. Changes to existing models are subject to Model Risk Management review. The RBS Group follows regulatory guidance for assessing the materiality of extensions and changes for the internal model approach for market risk.

In addition to Model Risk Management's independent oversight – provides additional assurance that the RBS Group holds appropriate capital for the market risk to which it is exposed – the model testing team monitors the model performance for market risk through back-testing and other processes.

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.

Sources of risk

The key sources of non-traded market risk for the Group are interest rate risk and foreign exchange risk.

Interest rate risk

Non-traded interest rate risk (NTIRR) in the Group mainly arises from gap risk and basis risk. These sensitivities can give rise to volatility in net interest income as interest rates vary.

Foreign exchange risk

Non-traded foreign exchange risk exposures arise 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 the euro; and
- *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.

Risk governance

Responsibility for identifying, measuring, monitoring and controlling the market risk arising from non-trading activities lies with Treasury. At 31 December 2018, oversight is provided by the RBS Group's Treasury Risk function. During 2019, this role will be assumed by the Group.

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.

Quantitative appetite is expressed in terms of exposure limits.

The limit framework at the RBS Group level comprises VaR, SVaR, sensitivity and stress limits, 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 RBS Group remains within its risk appetite, triggers at the RBS Group and lower levels have been set and are actively managed.

The Group's risk appetite is aligned with that of the RBS Group. A comprehensive structure and controls are in place aimed at ensuring that this appetite is not exceeded. The Group aims to mitigate market risk, to the extent possible, by way of hedging transactions with the RBS Group.

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

Risk controls

For information on risk controls, refer to page 12.

Risk monitoring and measurement

Non-traded market risk positions are reported monthly to the Group Asset & Liability Management Committee (ALCo) and subsequently to the Managing and Supervisory Boards.

Interest rate risk

The Group policy is to manage interest rate sensitivity in banking book portfolios within defined risk limits which are monitored and approved by the Group ALCo. Interest rate swaps are used to hedge some exposures externally.

Key measures used to evaluate non-traded interest rate risk (NTIRR) are subjected to approval granted by the ALCo. Limits on NTIRR are set according to the Non-Trading Interest Rate and Foreign Currency Risk Policy Statement and are subject to Group ALCo approval.

Capital and risk management

Non-traded market risk continued

NTIRR is measured using a version of the same VaR methodology that is used by the RBS Group. VaR metrics are based on interest rate repricing gap reports as at the reporting date. NTIRR one-day VaR at a 99% confidence level for the Group's retail and commercial banking activities was as follows.

	Average €m	Maximum €m	Minimum €m	Period end €m
2018	0.7	0.8	0.5	0.5
2017	1.1	1.8	0.9	0.9

Key point

- Average VaR declined year-on-year reflecting the reduction in the balance sheet.

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 the RBS Group Treasury to predefined risk appetite levels under delegated authority from the Group's ALCo.

The table below sets out the Group's structural foreign currency exposures:

2018	Net investments in foreign operations (1) €m	Net investment hedges €m	Structural foreign currency exposures €m
US dollar	166	(5)	161
Saudi Arabian riyal	1,314	(1,293)	21
Other non-euro	316	(51)	265
	1,796	(1,349)	447
2017			
US dollar	156	(15)	141
Saudi Arabian riyal	1,177	(1,178)	(1)
Other non-euro	11	(51)	(40)
	1,344	(1,244)	100

Note:
(1) Includes non-controlling interests.

Key points

- The increase in structural foreign currency exposures mainly reflected increased sterling reserves. This was driven by Madoff-related recoveries and preparations for the unwinding of a legacy business anticipated in 2019.
- The pre-tax sensitivity of the foreign exchange reserves to changes in exchange rates is proportional to the nominal exposure. Hence, at 31 December 2018, a 5% strengthening in all foreign currencies against the euro results in a €24 million increase in foreign exchange reserves before tax, while a 5% weakening in all foreign currencies against the euro results in a €21 million reduction. This compares to a €5 million sensitivity in both scenarios at 31 December 2017.

Capital and risk management

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 22 on the consolidated 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.

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 the 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.

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 the RBS Group. Examples of these include the Complaints Management Policy, Client Assets & Money Policy, and Product Lifecycle Policy, as well as policies relating to 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 the 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 Group 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, which is covered by Operational Risk.

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 March 2018, the Federal Reserve Board terminated a Cease & Desist Order originally imposed in July 2011 for financial crime compliance weaknesses identified across the RBS Group's US businesses and concerns about the level of oversight that the RBS Group Board of Directors had over large and complex US operations. The termination of the Order followed a multi-year programme of work to establish an enhanced governance and oversight framework, risk management programme and compliance programme.
- In October 2018, the Federal Reserve Board terminated a Cease & Desist Order originally imposed in December 2013. The Order, which related to the 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 in order 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.

Capital and risk management

Financial crime continued

Risk monitoring and measurement

Financial crime risks are identified and reported through continuous risk management and regular monthly reporting to the 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 could 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 – could be 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

- The Group continued work on embedding its operational risk practices, improving links between risk appetite and risk exposure and building a more robust control environment. The Group will adopt the enhanced Group Operational Risk framework.
- The Group has developed key deliverables ahead of the Brexit transition plan for 2019. This included a risk appetite statement and a business operating model for the Risk function.

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 approach and culture across the Group.

The operational risk function is responsible for the oversight of both execution of the operational risk management framework, and the effective management of operational risks across the Group.

In 2018 the Group reviewed and enhanced the Risk and Control Committee in preparation for the Brexit transition in 2019. This 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 risks the Group is willing to accept to achieve its strategic objectives and business plans.

The operational risk appetite statement encompasses the full range of operational risks faced by the Group functions. Reporting the risk appetite statement for the Group will be implemented in 2019.

Risk controls

The Control Environment Certification (CEC) process is a half yearly self-assessment by the Group's business units. It gives an assessment on the adequacy and effectiveness of the internal control environment in a consistent and comparable manner.

CEC covers material risks and the key controls that underpin them, including financial, operational and compliance controls, as well as supporting risk management frameworks. The CEC process for the Group will be implemented in 2019. The CEC process helps to ensure compliance with the RBS Group Policy Framework including internal control over financial reporting.

Risk monitoring and measurement

Risk and control assessments will be used across all business areas and support functions to identify and assess material operational and conduct risks and key controls. To support identification of risk concentrations, all risks and controls are mapped to a 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 will use 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. Refer to the Capital, liquidity and funding risk section for operational risk capital requirement figures. Scenario analysis will be 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.

Risk and control assessment, operational risk capital and scenario analysis will be implemented and optimised by the Group in line with the RBS Group Operational Risk framework in 2019.

Event and loss data management

The operational risk event and loss data management process ensures operational risk loss events are captured and recorded in line with 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 financial impacts 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 Netherlands 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. Risks outside of appetite will have remediation plans that are subject to governance and oversight. These are integral steps in the risk assessment methodology to determine 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 the Group's long-term ambitions to key internal and external stakeholders, or that it is not able to execute 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 the Group's 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 bank's ability to execute its chosen strategic business plan as intended and thus contribute to business risk.

Key developments in 2018

- The Group continued to implement its plan to be operationally ready to serve European Economic Area (EEA) customers, in the event that there is a loss of access to the EU Single Market. In relation to this plan, the Group obtained a declaration of no objection with its regulator, the DNB, and approval from the Court of Session in Scotland in February 2019 for an order under Part VII of the Financial Services and Markets Act 2000 for a Transfer Scheme (the Scheme) to replicate master trade documentation for non-UK European Economic Area (EEA) customers and the transfer of certain existing transactions of EEA customers from NWM Plc to the Group. The intention is to transfer the in-scope EEA component of business from UK entities to the Group, with the activities planned to transfer primarily relating to Markets and Corporate Lending portfolios for EEA customers currently served from NWM Plc and the ring-fenced bank. The Scheme is designed with two phases to provide flexibility in response to any political changes in relation to the UK leaving the European Union, such as any agreed transitional period. During a transitional period, the move of non-UK EEA customers to the Group may be more gradual and subject to further political developments. No debt securities issued by NWM Plc are included in the Scheme or expected to transfer.
- It is anticipated the profile of the Group will change significantly during 2019 to reflect this transfer of business activities and the continued wind-down of existing legacy positions, including Alawwal Bank.

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 franchise, with oversight by the Finance function. The franchise is responsible for delivery of its 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

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 the Group is willing to accept.

Risk controls

For information on risk controls, refer to page 12.

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. Financial performance is monitored relative to plans and reported on a regular basis by the Chief Financial Officer to the Executive Committee.

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 information on risk controls, refer to page 12.

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.

Corporate governance

Introduction

The Group adheres to high standards of corporate governance and its operations are guided by its code of conduct. During 2018, and as part of the preparatory work, the governance set up has been reviewed to ensure it is reflective of the new set up of the entity. As a result, during Q1 2019, changes to the composition of both the Managing and Supervisory Boards were made.

In order to achieve good corporate governance, the Group organises the business in a way that promotes first-class stewardship by the Managing Board and effective supervision by the Supervisory Board. Integrity, transparency and accountability are key elements of the Group's corporate governance and they are embedded in the Group's business as a whole. These key elements ensure that the controls and oversight necessary for effective risk management, compliance with regulations, and accurate and complete disclosure of information to the market, are effective.

The Supervisory Board of the Group has prepared its annual report which is included on pages 34 to 36 of this report. The report provides an overview of its activities during 2018.

Corporate governance in the Netherlands

Dutch Corporate Governance Code

The Group ensures proper corporate governance by focusing on the Dutch Banking Code (Code Banken) which contains specific corporate governance rules for banks. However the Group also adheres, where possible, with the Dutch Corporate Governance Code although this is not a required code for the Group.

The Dutch Banking Code (Code Banken)

The updated Code Banken came into force on 1 January 2015. It requires banks to either comply with the Code Banken or explain any deviation from it. The Code Banken is applicable to NWM N.V. (formerly RBS N.V., renamed in 2018) as it has a banking licence issued under the Dutch Financial Supervision Act and the Group operates in line with all requirements under the Code Banken. A further explanation on compliance with the updated Code Banken is provided on page 38 of this report.

Capital Requirements Directive IV (CRD IV)

On 1 January 2014, CRD IV came into force in the European Union. The Directive contains several Corporate Governance related requirements, which were implemented in Dutch law on 1 August 2014. It required banks that fall under the SSM Supervision by the ECB to set up separate Audit, Nomination and Remuneration Committees, for its Supervisory Board. The Group has been qualified as a less significant institution as at 1 January 2017 and does not fall under ECB supervision. However, given its importance, the Group has implemented this requirement by allocating specific responsibilities on the Nomination and Remuneration areas to the full Supervisory Board.

As part of the repurposing of the entity, a Risk & Audit Committee, which operates as a sub-committee of the Supervisory Board, has been set up.

European Banking Authority (EBA) guidelines on internal governance

The EBA has issued guidelines relating to internal governance arrangements of credit institutions. These take into account weaknesses identified in the financial crisis and build upon the Committee of European Banking Supervisors (CEBS) Guidelines. The EBA guidelines are implemented by the local competent authorities, which is the Dutch Central Bank. The Group adheres to the implemented guidelines.

Wet beloningsbeleid financiële ondernemingen

On 7 February 2015, the Wet beloningsbeleid financiële ondernemingen (Wbfo) came into force. With this new legislation, the Dutch government has introduced a broad set of rules to ensure that financial services companies carry out a sound remuneration policy and avoid payment of excessive variable remuneration. Headline measure is the 20% bonus cap. The Group fully adheres to these principles.

Further details of the remuneration policy can be found in the RBS Group's 2018 Annual Report & Accounts, available at www.rbs.com.

Approval of Annual Report

The Managing Board approved the Annual Report at its meeting on 18 April 2019. The Supervisory Board approved the Annual Report at its meeting on 18 April 2019. The Group has proposed to its Shareholders that it adopts the 2018 financial statements, as included in this Annual Report, and discharge the Managing Board and Supervisory Board in respect of their management and supervision respectively.

Boards

RBS Holdings N.V. and NWM N.V. are public limited liability companies incorporated under the laws of the Netherlands. Both companies have a two-tier system of corporate governance consisting of a Supervisory Board and a Managing Board. The day to day management of the companies is vested with the Managing Board supervised by the Supervisory Board. The members of the Managing Board and Supervisory Board of RBS Holdings N.V. and NWM N.V. are the same.

The report of the Supervisory Board

Dear Reader,

It is with great pleasure that I present the 2018 report of the Supervisory Board. This report provides an overview of the tasks and the activities of the Board during 2018.

In 2017, the RBS Group's NatWest Markets business (NatWest Markets) announced its plan to repurpose the Group's existing banking licence in the Netherlands. This proposed approach should minimise disruption to the business and allow it to continue to serve customers in the event of any loss of EU passporting after the UK's departure from the EU. NatWest Markets and NWM N.V. are working together to ensure the banking licence is maintained and the entity is made operationally ready. In parallel, work continues to decrease the NWM N.V. legacy assets and liabilities further.

The Supervisory Board had oversight of the execution of this strategy, working together with the Managing Board through both face to face meetings and conference calls. The Supervisory Board challenged the Managing Board on client focus, the timing and speed at which the further de-risking is taking place and the work that is taking place to ensure the banking licence is maintained and the entity is made operationally ready. The corporate strategy of the Group has been discussed during all the Supervisory Board meetings in 2018.

Succession planning for the Managing Board and senior management was another important subject addressed by the Supervisory Board through the execution of the integration activities. On 15 February, Marije Elkenbracht joined the Managing Board as Chief Risk Officer. The Managing Board was further expanded with a Chief Operating Officer, Angelique Slach on 25 March 2019.

The composition of the Supervisory Board was also updated. Both Robert Begbie and Chris Campbell left the Board on 4 March 2019. They leave with the sincere thanks of the Supervisory Board. On 3 March 2019, Richard Place and Annelies van der Pauw joined and Anne Snel joined the Board on 25 March 2019.

The tasks of the Supervisory Board

The main task of the Supervisory Board is to supervise the Managing Board, as well as the general affairs of RBS Holdings N.V. and the entities connected to it. Furthermore, it assists and advises management and supervises the corporate governance structure of RBS Holdings N.V..

In performing their duties, the members of the Supervisory Board are guided by the interests of RBSH Group and the businesses connected to it and shall take into account the relevant interests of RBSH Group's stakeholders. Certain powers are vested in the Supervisory Board, including the approval of certain resolutions by the Managing Board. A complete overview of the powers vested with the Supervisory Board can be found in the Rules governing the Supervisory Board's Principles and best Practices. These rules are also applicable to the Supervisory Board of NWM N.V. and include specific provisions on remuneration and nomination topics as prescribed by the implementation of CRD IV in the Netherlands.

Members of the Supervisory Board

The Supervisory Board is an independent corporate body. Members of the Supervisory Board are appointed at the General Meeting of Shareholders. For each vacant seat the Supervisory Board nominates one or more candidates.

The Chairman and Vice-Chairman of the Supervisory Board are appointed by the Supervisory Board from among its members.

The Supervisory Board confirms that its current composition has the necessary experience, expertise and independence to ensure that its members are able to properly execute their duties. All appointments were made in accordance with the Supervisory Board profile resulting in the current composition of the board. The Supervisory Board is of the opinion that the addition of a female Supervisory Board member would be beneficial to its functioning and would then align with the RBS Group policy on diversity and inclusion. Two of the three newly joined members are female.

Supervisory Board members are appointed for a term of four years and may be re-appointed after that term, with a maximum term of 12 years from the date of their first appointment. In addition, each member is required to resign at the first General Meeting of Shareholders after reaching the age of 70.

Candidates recommended for appointment or re-appointment to the Supervisory Board must meet the criteria of the membership profile, which are set out in the Rules Governing the Supervisory Board's Principles and Best Practices of RBS Holdings N.V., which are also applicable to the Supervisory Board of NWM N.V..

Newly appointed Supervisory Board members undertake an induction programme. New Supervisory Board members receive relevant documentation necessary for their role in RBSH Group and undertake a series of meetings with management of RBSH Group to gain insight and understanding of RBSH Group and its enterprises. The programme is tailor-made and is adjusted to the specific needs of each new Supervisory Board member.

In case of a (potential) conflict of interest of material significance between a member of the Supervisory Board and RBS Holdings N.V., the Chairman of the Supervisory Board shall be notified. If the Chairman of the Supervisory Board has a (potential) conflict of interest of material significance, the Vice-Chairman is notified. The Supervisory Board member concerned will not take part in the assessment by the Supervisory Board where a conflict of interest exists. During 2018, no conflicts of interest have arisen.

Details of the remuneration of the Supervisory Board can be found in Note 25 on the consolidated accounts.

Activities of the Supervisory Board

Risk and audit topics are discussed on a regular basis and a report with deliberations and findings is prepared for each regular meeting. A Risk & Audit Committee has now been set up which membership will have an independent member acting as the chair and another member of the Supervisory Board.

Specific nomination and remuneration topics are also discussed on a regular basis. The members of the Supervisory Board collectively have sufficient accounting and financial management expertise to understand the Group's business, financial statements and risk profile.

The Supervisory Board works alongside RBS Group Remuneration Committee to ensure the implementation of a restrained and long-term remuneration policy that is aligned with the organisation's strategy and risk appetite, whilst also catering for an evermore globalising industry. The Supervisory Board extensively discussed remuneration at one of its meetings, highlighting the focus that this topic continues to receive in the organisation. In addition, specific remuneration provisions have been included into the Rules of the Supervisory Board.

The Supervisory Board met on ten occasions during 2018, either in person or by conference call. On a few occasions, the members were asked to give their approval on matters via email.

The Chairman of the Supervisory Board and the Company Secretary prepared the agenda for the meetings of the Supervisory Board in close co-operation with the Chairman of the Managing Board.

Throughout 2018, the Supervisory Board received regular updates on the further de-risking of the RBSH Group. The financial performance of the Group was extensively discussed during a number of Supervisory Board meetings, which were attended by members of the Managing Board who presented the results. Also, relevant members discussed the findings of the internal and external auditors.

Comprehensive information provided by the Managing Board and reviewed by the Supervisory Board gave a clear picture of the Group's strategy, risks, results, capital and liquidity position.

All members of the Supervisory Board have complied with the requirement to attend meetings on a frequent basis.

Composition of the Supervisory Board

The members of the Supervisory Board as at 18 April 2019 are as follows:

		Date of first appointment	Date for re-election
Chris Marks (Chairman)	(47, British, male)	1 November 2017	1 November 2021
Maarten Klessens (Vice-Chairman)	(60, Dutch, male)	2 September 2015	2 September 2019
Annelies van der Pauw	(58, Dutch, female)	3 March 2019	3 March 2023
Richard Place	(54, British, male)	3 March 2019	3 March 2023
Anne Snel	(50, Irish, female)	25 March 2019	25 March 2023

Corporate governance

Chris Marks - Chairman of the Supervisory Board

Mr Marks joined the Executive Committee of the RBS Group in April 2015. He was appointed CEO of NatWest Markets (then known as Corporate and Institutional Banking) in February 2015, overseeing its refocus to be a smaller, safer business. On 1 November 2017, Mr Marks was appointed as Chairman of the Supervisory Board of NWM N.V..

Mr Marks has been with the RBS Group since 2010, when he joined Non-Core as Head of Markets and Co-Head of Non-Core Solutions. He oversaw large transactions including the de-risking of the exotic credit trading book, the removal of the majority of the RBS Group's primary monoline exposure and the sale of multiple corporate banking portfolios.

Mr Marks was then appointed Co-CEO of RBS Capital Resolution (RCR). RCR successfully ran down the RBS Group's most risky and capital intensive assets.

Prior to the RBS Group, Mr Marks was a managing director at Barclays Capital and also held roles at Kensington Group, Greenwich NatWest and Coopers & Lybrand.

Maarten Klessens - Vice-Chairman of the Supervisory Board and Chairman of the Risk & Audit Committee

Mr Klessens was appointed as an independent member of the Supervisory Board on 2 September 2015. Mr Klessens started his career in finance with ABN AMRO in 1986, in structured aircraft finance. In 1997 he was appointed corporate Executive Vice President for ABN AMRO and had subsequent responsibilities in wholesale product teams, client management and Group Risk. For 12 years he was a voting member of ABN AMRO's Group Risk Committee. From 2011 he was acting head of Global Country Risk for RBS Group and was responsible for country appetite setting and exposure management with special attention for the financial stress in the Eurozone periphery. He was senior advisor Benelux for StormHarbour Securities LLP, London in 2014-2015. In 2016 he joined the Supervisory Board of Bank of Africa Holding S.A. and the Supervisory Board of DHB Bank in the Netherlands.

Mr Klessens is chairing the board in The Netherlands of 'Future Hope', a NGO in Calcutta, and has been a member and chairman of the foundation 'Multiple Sclerosis Research' Netherlands.

Mr Klessens holds a postgraduate in Financial Economics of Tilburg University and a Master in Business Economics of Erasmus University Rotterdam and has had executive training at IMD, INSEAD and University of Michigan.

Annelies van der Pauw

Ms Van der Pauw is a partner of the international law firm Allen & Overy LLP (A&O) and located in Amsterdam and has chaired the Amsterdam corporate practice group since 2006. In her practice Ms Van der Pauw focuses on mergers and acquisitions (including private equity) and general corporate governance issues. Ms Van der Pauw also has extensive equity capital markets experience. Furthermore, Ms Van der Pauw is well connected in the Dutch community. In addition to a strong understanding of the legal environment in the Netherlands, Ms Van der Pauw is also the co-chair of the A&O global corporate responsibility programme and a member of the board of the global A&O Foundation. Ms Van der Pauw has been with A&O and its predecessors since 1987.

Richard Place

Mr Place is currently Chief Financial Officer of NatWest Markets and has held this position since 2015. Preceding this role he acted as RBS Chief Operating Officer and Chief Financial Officer APAC. He started his career with PWC and has held positions at Bankers Trust, Deutsche Bank, Lehman Brothers and Barclays Capital. He holds a Joint Honours Degree in Mathematics & Economics from Nottingham University

Anne Snel

Ms Snel is currently the Head of Risk and Compliance at DIF, a fund manager specialised in infrastructure investment. She has held senior risk roles at Rabobank including Head of Operational Risk and Head of Integrated Risk. She brings a strong understanding of risk and regulation and excellent relationships with both the DNB and European Central Bank, having previously worked in banking supervision at the DNB.

Through her last role at Rabobank, she established the Regulatory Oversight function at Rabobank and also the Supervisory Relations function in order to enhance the relationship with Dutch and European regulators. She also has many years of experience in wholesale banking and private equity with ABN AMRO Bank. Ms Snel is experienced in the local legal, regulatory and commercial environment. Her strong European regulatory experience provides her with a thorough understanding of banking and regulation across the continent.

The report of the Managing Board

The members of the Managing Board of RBS Holdings collectively manage RBS Holdings and are responsible for the general affairs of RBS Holdings business and general affairs of all its subsidiaries. The members are appointed by the General Meeting of Shareholders.

The Supervisory Board of RBS Holdings nominates one or more candidates for each vacant seat. If the Supervisory Board nominates two or more candidates for a vacant seat in the Managing Board, the nomination list is binding. The members of the Managing Board are accountable both collectively and individually for all decisions taken by the Managing Board.

The Chairman of the Managing Board leads the Managing Board in its overall management of RBSH Group to achieve its performance goals and ambitions. The Chairman of the Managing Board is the main point of liaison with the Supervisory Board. The Chief Financial Officer is responsible for the financial affairs of RBSH Group. Alongside their overall corporate responsibilities, the members of the Managing Board are responsible for the management of the control and support functions. The Managing Board has delegated certain tasks to a number of Managing Board committees which are described on page 38 of this report.

Composition of the Managing Board

The members of the Managing Board as at 18 April 2019 are as follows:

		Date of first appointment	Date for re-election
Harm Bots (Chairman)	(48, Dutch, male)	1 November 2017	1 November 2021
Cornelis Visscher	(53, Dutch, male)	18 July 2013	18 July 2021
Angelique Slach	(47, Dutch, female)	18 March 2019	18 March 2023
Marije Elkenbracht	(50, Dutch, female)	15 February 2019	15 February 2023

Corporate governance

Harm Bots
Chairman of the Managing Board
Harm was appointed as Head of Strategy for RBS NatWest Markets (formerly known as Corporate and Institutional Banking) and has served as a member of its Executive Committee since 2015. He was subsequently appointed as CEO and Chairman of the Managing Board of NWM N.V. on 1 November 2017. Harm has been leading the development and implementation of the Brexit plans for NatWest Markets, setting up the European licenced bank for the RBS Group. Prior to that, Harm has been developing and overseeing the implementation of the NatWest Markets strategy including a radical restructuring of its business model and managing towards a smaller resource base. He oversaw and delivered a number of large transformation programmes within the business to ensure strategic goals were met. Harm has been with the RBS Group since 2008, when he joined through the acquisition of ABN AMRO. He was appointed as Director in GBM Strategy in 2010. Prior to that, Harm held several senior customer-facing positions including roles in a number of countries in Asia. Harm joined ABN AMRO in 1999 as a Management Trainee. Harm holds a Masters degree in Finance and Economic Policy from the University of London SOAS).

Cornelis Visscher
Chief Financial Officer,
Mr Visscher graduated from the Vrije Universiteit in Amsterdam with a degree in Business Economics, specialised in Financial Accounting and Management Accounting. He started his career at ABN AMRO in 1988, where, after several functions in Divisional and Group Finance, he ultimately became responsible for the delivery of ABN AMRO's Group Management Information. Following the acquisition of (parts of) ABN AMRO by the RBS Group, Mr Visscher became the head of Group Consolidation, in which he was responsible for the split of the ABN AMRO accounts between the Consortium members. Furthermore, in 2011 Mr Visscher was seconded to Edinburgh where he became the Head of Financial Control for the Retail & Wealth, Corporate and Business Services Divisions of RBS Group. In this role, he was, amongst other things, responsible for the Offshore programme. As of 2013 he is the CFO for RBS Holdings N.V. and a member of the RBS Holdings Managing Board.

Angelique Slach
Chief Operating Officer
After finalising her Business and Economics studies, Ms Slach began her 21 year career at Rabobank's international division. Starting in Technology, she fulfilled many diverse front- and back-office roles within the international organisation. She gained vast experience working in Wholesale Banking and Capital Markets with her latest roles as Chief Operations Officer for Global Financial Markets, Global Head of Operations and Chief Innovation Officer for Trade and Commodity Finance.

Marije Elkenbracht
Chief Risk Officer
Ms Elkenbracht brings 22 years of experience in various risk and strategy roles in ABN AMRO and NIBC. Before joining NatWest Markets Ms Elkenbracht was Managing Director Risk Modelling at ABN AMRO and member of the Supervisory Board of the ABN AMRO Mortgage group. Prior to these roles, she held the position of Managing Director Market, ALM and Treasury Risk also at ABN AMRO. Ms Elkenbracht holds a Master's degree and a PhD in Mathematics from the University of Leiden

Information, induction and professional development
As part of the Code Banken, both the Managing Board and the Supervisory Board participate in a programme of Life Long Learning. The programme consists of a modular approach, addressing matters that are mentioned in the Code Banken, including relevant developments in the financial sector in general and the banking sector specifically, corporate governance in general, the duty of care towards clients, integrity, risk management, financial reporting and audits.

Subject matter experts are invited, both from within the Group and from outside the Group, to deliver education modules on the above mentioned matters.

Performance evaluation
The members of the Managing Board participate in the annual performance management process of RBS Group.

Managing Board committees
In order to provide effective oversight and leadership, the Managing Board has three sub-committees, the Risk & Control Committee (RCC), the Asset & Liability management Committee (ALCo) and the Disclosure Committee.

Risk & Control Committee (RCC)
The RCC oversees the risk framework within RBSH Group, monitors the actual risk profile and advises the Managing Board on these matters. Its scope is, amongst others, credit, market, operational and regulatory risk within the Group.

Asset & Liability management Committee (ALCo)
The Managing Board has delegated to the ALCo the responsibility for the management of capital, liquidity, interest rate risk and foreign exchange risk. This includes responsibility for reviewing, approving and allocating balance sheet, capital, liquidity and funding limits.

Disclosure Committee
The Disclosure Committee advises and assists the Managing Board in fulfilling its responsibilities for overseeing the accuracy and timeliness of public disclosures made by the Group. This inter alia includes advising the Managing Board on the disclosure of financial information.

Group structure
RBS Holdings submits the overview of its subsidiary structure with the Dutch Chamber of Commerce, which is publically accessible.

Code of conduct
The RBS Group's Code of Conduct (Our Code) lets everyone know what to expect of each other, what to do when unsure of a decision, and where to go for advice when needed. It is available at rbs.com>About us>Our values, or without charge, and upon request, by contacting Company Secretariat at the telephone number listed on page 81. In 2016 we incorporated five new standards of behaviour into Our Code: (1) You must act with integrity; (2) You must act with due skill, care and diligence; (3) You must be open and cooperative with the Financial Conduct Authority (FCA), the Prudential Regulatory Authority (PRA) and other regulators; (4) You must pay due regard to the interests of customers and treat them fairly; and (5) You must observe proper standards of market conduct. These new conduct rules are part of the changes our UK banking regulators, the PRA and FCA, are making to improve accountability across the financial sector as part of the Individual Accountability Regime. The rules themselves are new, but very much in keeping with the values and behaviours that we are already following across RBS Group and the Group.

Relations with shareholders
Rights of shareholders
Any resolution to amend the Articles of Association of RBS Holdings may only be passed by the General Meeting of Shareholders following a proposal by the Managing Board which has been approved by the Supervisory Board.

A copy of the proposed amendments shall be made available for inspection by the holders of shares of RBS Holdings at the offices of RBS Holdings and at the offices stated in the convocation to the meeting, from the day of convocation to the end of the Meeting. Each shareholder may obtain a full copy of the proposal free of charge.

Meetings of shareholders and convocation
The general meetings of shareholders shall be held in Amsterdam, or in The Hague, Rotterdam, Utrecht or Haarlemmermeer (Schiphol). The Annual General Meeting of Shareholders must be held within six months of the end of each financial year. In addition, general meetings of shareholders shall be held as frequently as deemed necessary by the Managing Board or the Supervisory Board and when required by law or by the Articles of Association.

General meetings of shareholders shall be convened by the Managing Board or the Supervisory Board, without prejudice to the provisions of Sections 110, 111 and 112 of Book 2 of the Netherlands Civil Code. Convocation shall take place not later than on the fifteenth day prior to the day of the meeting. Convocation shall state the items to be discussed or alternatively notice shall be given that such items may be inspected at the company's offices. Proposals to amend the Articles of Association or proposals relating to a reduction of the company's capital shall always be included in the actual convocation.

Employees

Our colleagues

As at 31 December 2018, the Group employed approximately 30 people (full-time equivalent basis, including temporary workers), within continuing operations. Details of related costs are included in Note 3 on the consolidated accounts.

Rewarding our colleagues

Our approach to performance management provides clarity for our colleagues about how their contribution links to our ambition. It recognises behaviour that supports our values and holds individuals to account for behaviour and performance that does not.

Employee consultation

RBS Group recognises employee representatives such as trade unions and work councils in a number of businesses and countries. There has been ongoing engagement and discussion with those bodies given the scale of change taking place across RBS Group. Management have continued to meet regularly with our European Employee Council to discuss developments and update on the progress of our strategic plans.

Inclusion

Building a more inclusive RBS Group is essential for our customers and colleagues. Our inclusion policy standard applies to all our colleagues globally and includes: the roll out of unconscious bias learning to create a solid platform for the wider inclusion agenda; working towards our goal of having at least 30% senior women in our top three leadership layers across each Franchise and Function by 2020 and to be fully gender balanced (50/50) by 2030; becoming a disability smart organisation; building an ethnically diverse RBS Group; an LGBT agenda which continues to deliver a better experience for our LGBT colleagues and customers.

The RBS Group has been recognised for our work on Equality, Diversity and Inclusion by our Platinum ranking from Opportunity Now (gender); our Gold ranking for Race for Opportunity (race); retaining a position in the Times Top 50 Employers for Women; becoming a Top Ten Global Employer in Stonewall's Global Equality Index (LGBT); Silver Status from The Business Disability Forum; and being rated a Top 10 Employer by Working Families. In 2017 RBS Group was proud to be named 'Diverse Company of the Year' at the National Diversity Awards and winning Workplace Adjustments Innovation of the Year at the Disability Smart Awards.

The Dutch Banking Code (Code Banken)

Introduction

The Code Banken was drawn up by the Netherlands Bankers' Association (NVB) and is mandatory for the Group as stated in Book 2 of the Civil Code as from 1 January 2010.

The Code Banken offers specific provisions, but underlying these provisions, its aim is to instil learning in the banking sector following the financial crisis. Drawing lessons and implementing change with the aim to restore trust among all our stakeholders, clients, staff, investors and society at large. RBS Group, including the Group, has undergone, and continues to undergo, profound change following the crisis and is committed to high standards of corporate governance, business integrity and professionalism in all its activities.

Corporate Governance codes and the global footprint of RBS Group

The Group's ultimate parent company is the Royal Bank of Scotland Group plc. When implementing the Code Banken, the Managing Board and Supervisory Board of the Group take into account the effects of similar codes of conduct implemented in the RBS Group with the aim to align all businesses within the wider RBS Group.

Compliance with the Code Banken

RBSH Group considers the Code Banken as an important yardstick for the way banks draw lessons from the crisis. The Group takes account of all relevant remuneration regulatory regimes, including the Code Banken and the requirements as included in the Dutch Financial Supervision Act, in designing and implementing its remuneration policy as well as the Group's corporate governance structure.

Supervisory Board

The required expertise and experience are well embedded in the Supervisory Board providing for an independent board with a diverse composition. The board consists of executives of RBS Group with broad banking experience in addition to three independent members. A clearly defined process for the engagement and recruitment of a Supervisory Board member has been established.

If a vacancy for a new member exists, a new member is sought based on an established supervisory board profile to ensure that the knowledge and expertise obtained when filling the vacancy is fully complementing the composition of the board. This profile is amended to reflect the specific requirements for the role.

If the position of Chairman of the Supervisory Board became vacant, a separate individual profile would be drawn up based on an established Chairman's profile to ensure alignment with the specific socio-economic and political culture and the social environment of the bank's main markets.

All Supervisory Board members have committed themselves to fulfil their responsibilities as board members to the best of their ability. Their attendance at meetings is recorded. The board furthermore operates according to a set of rules governing the Supervisory Board's principles and best practices. These have been agreed by all board members. The remuneration received by Supervisory Board members is not dependent on RBSH Group's results. A lifelong learning programme covering aspects as included in the Code Banken being amended to reflect the repurposed banking license.

Furthermore the functioning of the Supervisory Board, including its lifelong learning programme, was assessed in 2016 by an independent party. Their conclusion was that the Supervisory Board members discharge their roles and responsibilities in a satisfying way. The independent assessment is in accordance with the Code Banken which requires such independent assessment at least once every three years. As a result, the next assessment will take place over 2019.

In line with the requirement of the Code Banken, Supervisory Board members have each signed the Banker's Oath.

Managing Board

The composition of the Managing Board of RBSH Group ensures that all business areas and all control and support functions are well represented on the board. The board comprises a Chief Executive Officer (CEO), a Chief Financial Officer (CFO), a Chief Risk Officer (CRO) and a Chief Operating Officer (COO). To further clarify the specifics of each role on the board and to ensure adherence to agreements made on procedure and governance, a set of rules governing the Managing Board's principles and best practices has been agreed.

The Managing Board will continuously ensure a prudent risk appetite, based on the risk appetite framework approved by the Supervisory Board. The risk appetite framework shall be approved by the Supervisory Board at least once a year and is actively monitored during the year. Any material changes in the interim shall also require the Supervisory Board's approval. The Managing Board takes the interests of all stakeholders (e.g. employees, clients, shareholders) into account in their decision making. The Managing Board recognises that duty of care for clients is an important component of doing business.

In line with the requirement of the Code Banken, Managing Board members sign the Banker's Oath.

The principles in the Banker's Oath are incorporated into the RBS Group's code of conduct which is issued to all new employees joining the Group.

Risk Policy

The Managing Board has arranged Risk Management in an adequate manner in order to ensure the Managing Board is aware in good time of any material risks run by the bank and to enable the Managing Board to manage these risks properly. The Chief Risk Officer reports into the Chief Executive Officer.

The Managing Board, through its sub committees, the Risk & Control Committee (RCC) and the Asset & Liability Management Committee (ALCo), takes any decision that is of material significance to the risk profile, the capital position or the liquidity impact. The Supervisory Board reviews and discusses the risk profile of the Group during each of its meetings. This is based on a risk appetite statement which it reviews on a regular (i.e. a minimum of once a year) basis. More information on the Risk organisation of the Group can be found on pages 9 to 11 of this report.

Audit

To ensure the function's independence, the Head of RBS Holdings Internal Audit reports into the Chairman of the Managing Board and the Chairman of the Supervisory Board. RBS Holdings Internal Audit also reports its opinion and findings on the quality of the control framework, the system of governance and the risk management of the bank to the Supervisory Board on a bi-annual basis and provides the Supervisory Board with their audit review in the remaining quarters of the year.

RBS Holdings Internal Audit furthermore presents their annual audit plan to the Supervisory Board. The Managing Board shall ensure that a systemic audit is conducted of the risks managed in relation to the business activities of the bank. The external auditors are invited to share their findings and opinion concerning the quality and effectiveness of the system of governance, risk management and the banks' control procedures with the Supervisory Board on a quarterly basis. The external auditors present the annual audit plan to the Supervisory Board and both RBS Holdings Internal Audit and the external auditors take part in a tri-partite meeting with DNB (the Group's regulators in the Netherlands) to share their audit plans, analysis and findings at least once per annum. There is a clear escalation process by which the external auditors can raise, with management, any significant concerns.

Remuneration Policy

Set out below is an overview of the NWM N.V. Remuneration policy. NWM N.V. became an employing entity on 1 December 2017 therefore full disclosure of the remuneration of staff commenced from the 2018 performance year.

As NWM N.V. is an indirectly owned subsidiary of The Royal Bank of Scotland Group plc (RBSG), its Remuneration Policy is fully aligned to RBS Group's Remuneration Policy Principles with amendments only to comply with Dutch Remuneration Rules, as set down in regulation Book 1 of the FSA. It applies not only to employees of NWM N.V., but also anybody who is working on its behalf, including individuals employed by other RBS Group entities, agency staff, contractors and the NWM N.V. Supervisory Board. The Remuneration policy is compliant with CRD IV, UK and Dutch regulatory requirements.

The Group's Remuneration Policy is aligned to the business strategy, objectives, values, risk appetite and long-term interests, and in turn, that of RBSG and its shareholders. Our chosen performance metrics reflect the aims of delivering sustained performance against our objectives. The policy explicitly aligns remuneration with effective risk management and a range of measures are considered to assess risk performance and overall risk culture. The remuneration policy aims to reward workers for delivering sustained, long-term business performance provided this is achieved in a manner consistent with our values, within acceptable risk parameters and in line with regulatory requirements.

The NWM N.V. remuneration policy applies the same principles to all workers who work under the responsibility of NWM N.V., including Material Risk Takers (MRTs) (i.e. those employees who can have a material impact on NWM N.V.'s risk profile as identified at an NWM N.V. subsidiary level in accordance with Commission Delegated Regulation 604/2014). Some of these employees may not be classified as MRTs at a Group level (these are called Locally Identified Staff). From performance year 2019 onwards, all Locally Identified Staff will become MRTs for simplicity as they are subject to the same requirements as MRTs at Group level.

There is a clear distinction between the criteria for setting basic fixed remuneration and variable remuneration. Fixed pay is set to ensure that it reflects relevant professional experience and organisational responsibility as set out in the colleague's job description. The level of fixed pay should be sufficient so that inappropriate risk-taking is not encouraged. Variable pay must be linked to Group, business and individual performance, and appropriate account must be taken of risk factors associated with that performance to ensure that remuneration is consistent with, and promotes, effective risk management. The variable remuneration of all employees in the scope of the NWM N.V. remuneration policy must not exceed 20% of the fixed remuneration of the aggregated population, subject to certain exceptions. Performance related remuneration is typically based on a balanced scorecard approach which measures individual and business performance against both financial and non-financial measures with at least 50% of such measures being based on non-financial criteria. The variable remuneration component (annual bonus) is designed to reflect sustainable and risk-adjusted performance against financial and strategic measures. Control Functions are assessed independently of the business units they oversee, with the Supervisory Board oversight on their remuneration to ensure independence is maintained. Pay for performance is underpinned by a robust performance management process against set goals and behaviours to ensure variable pay does not reward for underperformance and poor behaviours.

A proportion of individual variable remuneration is deferred over a defined period and applies to MRTs and individuals who receive an award over £2,000. Deferral of annual bonus awards ranges from a three to seven year period during which time unvested awards remain at risk of forfeit (malus) or recover of awards after they have vested (clawback). For awards made in 2015 and onwards, any vested variable pay awarded to MRTs will be subject to clawback for seven years from the date of award. Awards made to all other individuals are subject to a clawback period of five years from the date RBSG or NWM N.V. becomes aware of information that should result in clawback. For awards made in respect of the 2016 performance year onwards, a five year deferral schedule for Risk Manager MRTs and FCA Designated Senior Managers and a seven year deferral schedule for PRA designated Senior Manager MRTs will apply. For awards made in respect of the 2017 performance year onwards, the retention period applied to deferred share awards will be 12 months. NWM N.V. does not allow variable pay, that would have otherwise been subject to deferral, to be taken in pension form. The use of any personal hedging strategies in respect of unvested awards is prohibited and this is confirmed in participant award documentation. NWM N.V. does not pay variable remuneration through vehicles or methods that facilitate the non-compliance with the requirements in CRD IV or EU Regulation No 575/2013.

The Group recognises that remuneration structures for the 2019 performance year need to comply with the remuneration requirements of CRD IV, including the cap which limits the maximum ratio of variable to fixed remuneration. The Group is operating within the 20% Bonus Cap under section 1.7 of the FSA, including the relevant concessions for employees working within the EEA. NWM N.V. may make payments to, and/or arrangements with, individuals to settle actual or potential claims relating to the termination of their employment. Such payments and arrangements will be based on the potential liability involved and will only be made to the extent NWM N.V. considers appropriate, taking into account the financial soundness and the conduct of the individual. In any event, those individuals whose remit encompasses the day-to-day policy of NWM N.V. are prohibited from receiving a severance payment that is more than 100% of their Fixed Pay on an annual basis.

Corporate governance

Management's report on internal control over financial reporting under the Dutch Corporate Governance Code

Although the Group is not obliged to adhere to the Corporate Governance Declaration for the purposes of Corporate Governance Degree (Besluit Corporate Governance), the Group's Managing Board has decided nevertheless to adhere to the best practice provision II.1.5 of the Dutch Corporate Governance Code and to substantiate the operation of the internal risk management and control system during the year under review, and to state its adequacy and effectiveness.

The Group's internal risk management and control system is a process, effected by the Managing Board, management, and other personnel, which is designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (i) effectiveness and efficiency of operations; (ii) reliability of financial reporting; and (iii) compliance with laws and regulations.

Different sections of this Annual Report 2018, including capital and risk management on pages 7 to 33, elaborate on the Group's identified risks, such as capital, liquidity and funding risk, credit risk, market risk, conduct risk, operational risk, business risk and reputational risk.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or because the degree of compliance with policies or procedures may deteriorate.

Based on its assessment, management has concluded that, as of 31 December 2018, the Group's internal control over financial reporting is effective.

Managing Board
Amsterdam, 18 April 2019

Management's report on the 2018 Annual Report and Accounts for purposes of Section 5:25 sub 2 Financial Supervision Act

The Managing Board certifies that, to the best of their knowledge:

- the financial statements give a true and fair view, in all material respects, of the assets, liabilities, financial position and loss of the Group and its consolidated entities; and
- the Annual Report gives a true and fair view, in all material respects, of the Group and its consolidated entities as at 31 December 2018 and their state of affairs during 2018; and the Annual Report describes the material risks that the Group is facing.

Managing Board
Amsterdam, 18 April 2019

Financial statements

Consolidated income statement for the year ended 31 December 2018

	Note	2018 €m	2017 €m
Interest receivable		26	25
Interest payable		(35)	(26)
Net interest income	1	(9)	(1)
Fees and commissions receivable		3	19
Fees and commissions payable		(73)	(2)
Income from trading activities		138	(156)
Foreign exchange gains and losses related to net investment hedges reclassified to income following disposals of foreign operations (1)		(19)	(163)
Other operating income		395	242
Non-interest income	2	444	(60)
Total income		435	(61)
Staff costs		(7)	(5)
Premises and equipment		(5)	(1)
Other administrative expenses		(10)	(51)
Operating expenses	3	(22)	(57)
Profit/(loss) before impairment (losses)/releases		413	(118)
Impairment (losses)/releases	12	(4)	3
Operating profit/(loss) before tax		409	(115)
Tax (charge)/credit	6	(138)	24
Profit/(loss) from continuing operations		271	(91)
Loss from discontinued operations, net of tax		—	(1)
Profit/(loss) for the year		271	(92)
Attributable to:			
Controlling interests (2)		271	(92)

Notes:
(1) Reclassified foreign exchange losses are recognised on the repatriation of the proceeds of disposals. Such income includes losses in respect of disposals in prior periods.
(2) The appropriation of net profits pursuant to articles 37.2 and 37.3 of the Articles of Association includes the release from reserves of all profits/(losses) attributable to controlling interests.

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

	2018 €m	2017 €m
Profit/(loss) for the year	271	(92)
Items that do not qualify for reclassification		
Gain/(loss) on fair value of credit in financial liabilities designated at fair value through profit or loss due to own credit risk	89	(65)
	89	(65)
Items that do qualify for reclassification		
FVOCI financial assets (1)	(6)	4
Cash flow hedges	—	1
Currency translation	24	78
	18	83
Other comprehensive income after tax	107	18
Total comprehensive income/(loss) for the year	378	(74)
Attributable to:		
Controlling interests	378	(74)

Note:
(1) Refer to Note 26 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.

The accompanying notes on pages 51 to 74, the accounting policies on pages 46 to 50 and the audited sections of the Financial review: Capital and risk management on pages 7 to 33 form an integral part of these financial statements.

Consolidated balance sheet as at 31 December 2018

	Note	2018 €m	2017 €m
Assets			
Cash and balances at central banks	9	336	68
Derivatives	8	656	761
Loans to banks - amortised cost	9	392	352
Loans to customers - amortised cost	9	67	80
Amounts due from holding company and fellow subsidiaries	9	1,961	2,796
Other financial assets	14	402	531
Interest in associates	13	2	1,214
Assets of disposal groups	13	1,317	—
Other assets	15	158	274
Total assets		5,291	6,076
Liabilities			
Bank deposits	9	44	55
Customer deposits	9	61	58
Amounts due to holding company and fellow subsidiaries	9	417	1,073
Derivatives	8	364	549
Other financial liabilities	16	6	50
Subordinated liabilities	18	746	993
Other liabilities	17	420	414
Total liabilities		2,058	3,192
Total equity		3,233	2,884
Total liabilities and equity		5,291	6,076

The accompanying notes on pages 51 to 74, the accounting policies on pages 46 to 50 and the audited sections of the Financial review: Capital and risk management on pages 7 to 33 form an integral part of these financial statements.

Consolidated statement of changes in equity for the year ended 31 December 2018

	2018 €m	2017 €m
Share capital and share premium account (1)		
At 1 January	1,995	2,063
Distribution (2)	—	(68)
At 31 December	1,995	1,995
Fair value through other comprehensive income		
At 1 January	4	—
Unrealised (losses)/gains	(8)	3
Realised losses	2	1
At 31 December	(2)	4
Cash flow hedging reserve		
At 1 January	—	(1)
Amount recognised in equity	—	1
At 31 December	—	—
Foreign exchange reserve		
At 1 January	(42)	(120)
Gains/(losses) arising during the year	5	(85)
Reclassification of foreign currency losses included in the income statement	19	163
At 31 December	(18)	(42)
Retained earnings		
At 1 January	927	1,103
Implementation of IFRS 9 on 1 January 2018 (3)	(29)	—
Profit/(loss) attributable to controlling interests		
- continuing operations	271	(91)
- discontinued operations	—	(1)
Changes in fair value of credit in financial liabilities designated at fair value through profit or loss	89	(65)
Disposal of business	—	3
Distribution (4)	—	(22)
At 31 December	1,258	927
Equity attributable to controlling interests	3,233	2,884

Notes:
(1) Includes Ordinary share capital of €50,000 (2017 - €50,000) – refer to Note 19 for further details.
(2) 2017 includes N-share capital repatriation and reallocation of €68 million.
(3) Refer to Note 26 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.
(4) 2017 includes N share capital repatriation and reallocation of €22 million.

The accompanying notes on pages 51 to 74 the accounting policies on pages 46 to 50 and the audited sections of the Financial review: Capital and risk management on pages 7 to 33 form an integral part of these financial statements.

Consolidated cash flow statement for the year ended 31 December 2018

	Note	2018 €m	2017 €m
Operating activities			
Operating profit/(loss) before tax from continuing operations		409	(115)
Loss before tax from discontinued operations		—	(1)
Adjustments for:			
Interest on subordinated liabilities		19	24
Impairment releases on loans to banks and customers		(23)	—
Profit on sale of subsidiaries and associates		—	(3)
Loss on sale of securities		2	—
Defined benefit pension schemes		—	1
Provisions: expenditure in excess of charges		(7)	(24)
Loss on redemption of own debt		—	7
Elimination of foreign exchange differences		42	232
Other non-cash items		(44)	(418)
Net cash inflow from operating activities		398	(297)
Decrease in loans to banks and customers		1,115	12
Decrease in securities		88	54
Decrease/(increase) in other assets		29	(42)
(Increase)/decrease in derivative assets and liabilities		(80)	125
Decrease in deposits by banks and customers		(668)	(434)
Decrease in debt securities in issue		(27)	(28)
(Decrease)/increase in other liabilities		(99)	160
Decrease in settlement balances		(9)	(29)
Changes in operating assets and liabilities		349	(182)
Income taxes paid		(3)	(44)
Net cash flows from operating activities (1)		744	(523)
Investing activities			
Sale and maturity of securities		307	296
Purchase of securities		(266)	(202)
Net divestment of business interests		—	372
Other investment		(2)	—
Net cash flows from investing activities		39	466
Financing activities			
Maturity of subordinated liabilities		(191)	(378)
Distribution		—	(90)
Interest on subordinated liabilities		(22)	(19)
Net cash flows from financing activities	23	(213)	(487)
Effects of exchange rate changes on cash and cash equivalents		8	(50)
Net increase/(decrease) in cash and cash equivalents		578	(594)
Cash and cash equivalents at 1 January		422	1,016
Cash and cash equivalents at 31 December	24	1,000	422

Note:
(1) Includes interest received of €25 million (2017 - €21 million) and interest paid of €41 million (2017 - €21million).

The accompanying notes on pages 51 to 74, the accounting policies on pages 46 to 50 and the audited sections of the Financial review: Capital and risk management on pages 7 to 33 form an integral part of these financial statements.

Accounting policies

1. Corporate information

RBS Holdings N.V. (the company) is a public limited liability company, incorporated under Dutch law on 30 May 1990 and registered at Gustav Mahlerlaan 350, 1082 ME Amsterdam, the Netherlands. RBSH Group provides financial services principally in Europe and Asia.

The company is wholly owned by RFS Holdings B.V., itself 97.7% owned by The Royal Bank of Scotland Group plc (RBSG). RBSG is incorporated in the UK and registered at 36 St. Andrew Square, Edinburgh, Scotland. RBSG is the ultimate parent company of RBS Holdings N.V.. The consolidated financial statements of RBS Holdings N.V. are included in the consolidated financial statements of RBS Group. The consolidated financial statements of the Group incorporate financial information of the company, its controlled entities and interest in associates and joint ventures. The consolidated financial statements were signed and authorised for issue by the Managing Board on 18 April 2019 and by the Supervisory Board on 18 April 2019. The right to request an amendment of the financial statements is embedded in the Netherlands Civil Code. Interested parties have the right to ask the Enterprise Chamber of the Amsterdam Court of Appeal for an amendment of the financial statements.

2. Presentation of accounts

As announced on 19 April 2011, RBS Group is committed to providing the necessary support to ensure that the Group continues to meet its commitments.

The Managing Board, having made such enquiries as they considered appropriate, including: a review of the Group's activity; the plan to repurpose the banking licence in the Netherlands for EU passporting; and forecasts, projections and other relevant evidence regarding the continuing availability of sufficient resources from the RBS Group; have prepared the financial statements on a going concern basis. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and interpretations as issued by the IFRS Interpretations Committee (IFRIC) of the IASB and IFRS as adopted by the European Union (EU) (together IFRS). With the exception of investment property and certain financial instruments as described in Accounting policies 11 and 19, the accounts are presented on an historical cost basis.

Adoption of IFRS 9

Refer to Note 26 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.

3. Basis of consolidation

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

Changes in the Group's interest in a subsidiary that do not result in the Group ceasing to control that subsidiary are accounted for as equity transactions. All intergroup balances, transactions, income and expenses are eliminated on consolidation. The consolidated accounts are prepared under uniform accounting policies.

4. Revenue recognition

Interest income or expense on financial instruments that are measured at amortised cost and fair value through comprehensive income is 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. Assets and liabilities of disposal groups classified as held for sale and non-current assets classified as held for sale are shown separately on the face of the balance sheet.

The results of discontinued operations, comprising the post-tax profit or loss of discontinued operations and the post-tax gain or loss recognised either on measurement to fair value less costs to sell or on disposal of the discontinued operation, are shown as a single amount on the face of the income statement. 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 the Group or by RBSG shares. Variable compensation 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 drawback criteria. Contributions to defined contribution pension schemes are recognised in profit or loss when payable. For defined benefit schemes, the defined benefit obligation is measured on an actuarial basis and scheme assets are measured at their fair value. The difference between scheme assets and scheme liabilities is recognised in the balance sheet.

The charge to profit or loss for defined benefit pension costs comprises:

- the current service cost,
- interest on the net defined benefit liability or asset.

- past service cost and
- any gains or losses on settlement.

Actuarial gains and losses are recognised in other comprehensive income in full in the period in which they arise.

7. Foreign currencies

The Group's consolidated financial statements are presented in euros 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 19).

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 fair value through OCI, 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 euro at foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into euro 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.

8. 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.
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. 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.

9. 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.

10. Tax

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

11. Financial instruments

On initial recognition, financial instruments are measured at fair value. Subsequently they are measured 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 Group's approach to determining the fair value of financial instruments measured at fair value is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments. Further details are given in Note 10 on the accounts.

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.

12. 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. Financial assets are presented gross of allowances except where the asset has been wholly or partially written off.

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 frame from initial impairment to write off for collectively-assessed portfolios is five years.

13. 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 11. Amortisation is calculated so as to recognise fees receivable in profit or loss over the period of the guarantee.

14. Loan commitments

Provision is made for expected credit loss on 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.

15. 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.

16. 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.

17. Netting

Accounting policies

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.

18. 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.

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

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

20. Associates and joint ventures

An associate is an entity over which the Group has significant influence. A joint venture is one which it controls jointly with other parties. Investment in associates and interest in joint ventures are recognised using the equity method. They are stated initially at cost, including attributable goodwill, and subsequently adjusted for post-acquisition changes in the Group's share of net assets.

21. Cash and cash equivalents

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

Critical accounting policies and key sources of estimation uncertainty and judgements

The reported results of the Group are sensitive to the accounting policies, assumptions, estimates and judgements that underlie the preparation of its financial statements. Dutch 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
Fair value: financial instruments	10

Accounting developments

International Financial Reporting Standards (IFRS)

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 opening balance sheet of the Group at 1 January 2019 will be adjusted to create a right of use asset of approximately €3 million. A lease liability will also be recognised of €3 million. 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 consolidated accounts

1 Net interest income

	2018 €m	2017 €m
Loans to customers - amortised cost	8	4
Loans to banks - amortised cost	4	5
Amounts due from ultimate holding company	10	11
Other financial assets	4	5
Interest receivable (1)	26	25
Balances with banks	—	1
Customer deposits	14	1
Subordinated liabilities	19	24
Internal funding of trading businesses	2	—
Interest payable (1)	35	26
Net interest income	(9)	(1)

Note:
(1) Negative interest on Loans to banks – amortised cost is classed as interest payable and on Customer deposits is classed as interest receivable.

2 Non-interest income

	2018 €m	2017 €m
Brokerage and other	3	19
Fees and commissions receivable	3	19
Termination fee (1)	(70)	—
Other fees and commissions payable	(3)	(2)
Fees and commissions payable	(73)	(2)
Foreign exchange	(33)	(69)
Interest rate	153	(80)
Credit	4	(9)
Equities and other	14	2
Income from trading activities	138	(156)
Foreign exchange gains and losses related to net investment hedges reclassified to income following disposals of foreign operations (2)	(19)	(163)
Changes in the fair value of financial assets designated at fair value through profit or loss	(2)	70
Loss on sale of securities	(2)	(1)
Profit on sale of subsidiaries and associates	2	4
Share of profits of associated entities	78	101
Release of IBNER reserve	54	40
Other income (3)	265	28
Other operating income	395	242
Non-interest income	444	(60)

Notes:
(1) €70 million termination fee relates to termination costs on the closure of a deal.
(2) Foreign exchange losses of €19 million (2017 - €163 million) following the repatriation of the proceeds from the disposal of foreign operations, representing the cumulative exchange movement recorded in equity during the lifetime of those foreign operations that were the subject of a net investment hedge.
(3) 2018 includes insurance recoveries of €248 million.

3 Operating expenses

	2018 €m	2017 €m
Staff costs	7	5
Premises and equipment	5	1
Other administrative expenses	10	51
Operating expenses	22	57

There were 30 people employed (full time equivalent rounded to the nearest ten) in continuing operations at 31 December 2018 (2017 - 20); on the same basis there were no people employed in discontinued operations (2017 - nil). The average number of persons employed in continuing operations during the year was 30 (2017 - 20) and in discontinued operations was nil (2017 - 40).

Notes on the consolidated accounts

4 Segmental analysis

In 2015 the progress made by the restructuring programme enabled the Managing Board, as chief operating decision maker, to streamline reporting to a single reportable segment.

Geographical segments

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

2018	Netherlands €m	UK €m	RoW €m	Total €m
Net interest income	(16)	—	7	(9)
Net fees and commissions	(1)	(69)	—	(70)
Income from trading activities	(33)	171	—	138
Other operating income (1)	1	240	135	376
Total income	(49)	342	142	435
Operating (loss)/profit before tax	(75)	341	143	409
Total assets	2,340	668	2,283	5,291
Total liabilities	1,128	440	490	2,058
Net assets attributable to equity owners and non-controlling interests	1,212	228	1,793	3,233
Contingent liabilities and commitments	1,931	14	—	1,945
2017				
Net interest income	(18)	—	17	(1)
Net fees and commissions	(1)	19	(1)	17
Income from trading activities	(53)	(99)	(4)	(156)
Other operating income (1)	(72)	—	151	79
Total income	(144)	(80)	163	(61)
Operating (loss)/profit before tax	(182)	(79)	146	(115)
Total assets	3,049	555	2,472	6,076
Total liabilities	1,797	558	837	3,192
Net assets/(liabilities) attributable to equity owners and non-controlling interests	1,252	(3)	1,635	2,884
Contingent liabilities and commitments	5,478	72	—	5,550

Note:
(1) Includes foreign exchange gains and losses related to net investment hedges reclassified to income following disposals of foreign operations.

5 Auditor's remuneration

Amounts charged to the income statement relating to the Group's auditors for statutory audit and other services are set out below. All audit-related and other services are approved by the Group Supervisory Board and are subject to strict controls to ensure external auditor's independence is unaffected by the provision of other services. The Committee recognises that for certain assignments the auditors are best placed to perform the work economically. For other work the Group selects the supplier best placed to meet its requirements. The Group's auditors are free to tender for such work in competition with other firms where the work is permissible under audit independence rules.

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

Ernst & Young LLP	2018 €m	2017 €m
Fees for the audit of the Group's annual accounts	0.8	1.5
Audit related services (1)	0.7	0.7
Total audit and audit-related services	1.5	2.2
Total	1.5	2.2

Note:
(1) Fees incurred in relation to regulatory audits

Ernst & Young Accountants LLP provided audit and audit-related services amounting to €0.4 million (2017 - €0.75 million). The amount paid to Ernst & Young LLP in 2018 in respect of audit and audit-related services was €1.1 million (2017 - €1.3 million). The remaining amounts relate to services provided by other EY Member Firms.

Notes on the consolidated accounts

6 Tax

	2018 €m	2017 €m
Current tax		
(Charge)/credit for the year	(90)	17
(Under)/over provision in respect of prior periods	(27)	9
	(117)	26
Deferred tax		
Charge for the year	(48)	(2)
Over provision in respect of prior periods	27	—
Tax (charge)/credit for the year	(138)	24

The actual tax (charge)/credit differs from the expected tax (charge)/credit computed by applying the statutory tax rate of the Netherlands of 25% as follows:

	2018 €m	2017 €m
Expected tax (charge)/credit	(102)	29
Non-taxable items (including recycling of foreign exchange reserve)	19	6
Foreign profits taxed at other rates	8	4
Losses in year not recognised	(45)	(24)
Losses brought forward and utilised	1	8
Increase in carrying value of deferred tax liability in respect of associates	(19)	—
Adjustments in respect of prior years (1)	—	9
Other	—	(8)
Actual tax (charge)/credit	(138)	24

Note:
(1) Prior period tax adjustments include tax provision movements, adjustments to reflect submitted tax computations in the Netherlands and overseas, recovery of previously written-off current tax assets and changes in the valuation of deferred tax assets previously recognised.

	2018 €m	2017 €m
Deferred tax liability	44	22
Net deferred tax liability	44	22

	Revaluations/ deferred gains €m	Other €m	Total €m
At 1 January 2017	10	11	21
Transfers to and from disposal groups	(1)	—	(1)
Charge to income statement	—	2	2
At 1 January 2018	9	13	22
Charge to income statement	19	2	21
Currency translation and other adjustments	1	—	1
At 31 December 2018	29	15	44

Note:
(1) In jurisdictions where doubt exists over the availability of future taxable profits, deferred tax assets of €864 million (2017 - €1,793 million) have not been recognised in respect of tax losses carried forward of €3,456 million (2017 - €7,171 million). Of these losses, nil will expire within one year, €493 million within five years and €1,115 million thereafter. The balance of tax losses carried forward has no time limit.

7 Dividends

NWM N.V. did not make a distribution in 2018 (2017 - €90 million).

Notes on the consolidated accounts

8 Derivatives

Companies in the Group transact derivatives as principal either as a trading activity or to manage balance sheet foreign exchange, interest rate and credit risk.

The following table shows the notional amounts and fair values of the Group's derivatives.

	2018			2017		
	Notional amounts €m	Assets €m	Liabilities €m	Notional amounts €m	Assets €m	Liabilities €m
Exchange rate contracts	1,946	60	78	2,129	72	62
Interest rate swaps	5,039	596	282	4,866	662	482
Equity and commodity contracts	—	—	4	52	27	5
		656	364		761	549

Refer to Note 9 for amounts due to/from holding company and fellow 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 ticket financial instruments are fair value hedged and qualifying for hedge accounting. The majority of the Group's fair value hedges involve interest rate swaps hedging the interest rate risk in recognised financial assets and financial liabilities. The Group hedges its net investments in foreign operations with currency borrowings and forward foreign exchange contracts.

For fair value hedge relationships of interest rate risk, the hedged items are typically large corporate fixed-rate loans, and fixed-rate medium-term notes.

The initial and ongoing hedge effectiveness of fair value hedge relationships is assessed on a cumulative basis by comparing movements in the fair value of the hedged item attributable to the hedged risk with changes in the fair value of the hedging interest rate swap over a time period management feels appropriate.

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 above are derivatives held for hedging purposes as follows:

	2018			2017	
	Notional €m	Assets €m	Liabilities €m	Assets €m	Liabilities €m
Fair value hedging - Interest rate contracts	—	—	—	2	—
Net investment hedging - exchange rate contracts	1,376	3	22	12	3

The following table shows the period in which the hedging contract ends:

	0-3 months	3-12 months	Total
Exchange rate risk (€bn)	1,029	347	1,376
Principal currency hedges			
Average SAR - € rate	4.38	4.41	4.39

Hedge ineffectiveness recognised in other operating income comprised:

	2018 €m	2017 €m
Fair value hedging		
Gains on the hedged items attributable to the hedged risk	2	16
Losses on the hedging instruments	(2)	(14)
Fair value ineffectiveness	—	2

Notes on the consolidated accounts

9 Financial instruments - classification

The following tables analyse financial assets and liabilities in accordance with the categories of financial instruments on an IFRS 9 basis at 31 December 2018 and on an 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.

	MFVTPL (1) €m	DFV (2) €m	FVOCI (3) €m	Amortised cost €m	Other assets €m	Total €m
Assets						
Cash and balances at central banks	—	—	—	336		336
Derivatives (5)	656					656
Loans to banks - amortised cost				392		392
Loans to customers - amortised cost				67		67
Amounts due from holding company and fellow subsidiaries (4,5)	—	—	—	1,960	1	1,961
Other financial assets	20	—	382	—		402
Interest in associates					2	2
Assets of disposal groups					1,317	1,317
Other assets					158	158
31 December 2018	676	—	382	2,755	1,478	5,291

	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	—	—	—	68		68
Derivatives (5)	761					761
Loans to banks - amortised cost				352		352
Loans to customers - amortised cost				80		80
Amounts due from holding company and fellow subsidiaries (4,5)	—	—	—	2,771	25	2,796
Other financial assets	18	95	414	4		531
Interest in associates					1,214	1,214
Other assets					274	274
31 December 2017	779	95	414	3,275	1,513	6,076

	Held-for-trading €m	DFV (2) €m	Amortised cost €m	Other liabilities €m	Total €m
Liabilities					
Bank deposits			44		44
Customer deposits			61		61
Amounts due to holding company and fellow subsidiaries (5)	3	—	414		417
Derivatives (5)	364				364
Other financial liabilities	6	—	—		6
Subordinated liabilities (6)	—	493	253		746
Other liabilities				420	420
31 December 2018	373	493	772	420	2,058
Bank deposits			55		55
Customer deposits			58		58
Amounts due to holding company and fellow subsidiaries (5)	3	—	1,070		1,073
Derivatives (5)	549				549
Other financial liabilities	10	27	13		50
Subordinated liabilities (6)	—	592	401		993
Other liabilities				414	414
31 December 2017	562	619	1,597	414	3,192

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 reverse repurchase agreements of €1,143 million (2017 - €899 million) that are not settled within three months.
(5) Includes the following intergroup balances:
  a. Loans to banks - amortised cost of €1,827 million (2017 - €2,643 million).
  b. Loans to customers - amortised cost of €133 million (2017 - €128 million).
  c. Derivative assets of €436 million (2017 - €489 million).
  d. Bank deposits of €418 million (2017 - €1,073 million).
  e. Derivative liabilities of €281 million (2017 - €360 million).
(6) The cumulative own credit adjustment, representing a reduction of the subordinated liability value, was €196 million (2017 - €107 million) as subordinated RBS bond spreads widened during the year.

Amounts relating to continuing operations included in the consolidated income statement:

	2018 €m	2017 €m
Gains/(losses) on financial assets/liabilities designated as at fair value through profit or loss	2	(68)
Losses on disposal or settlement of loans and receivables	—	(1)

The tables below present information on financial assets and liabilities that are offset in the balance sheet under IFRS or subject to enforceable master netting agreements together with financial collateral received or given.

		Potential to offset not recognised by IFRS				
2018	Instruments which can be offset - at carrying value €m	Effect of master netting and similar agreements €m	Cash collateral €m	Net amount after the effect of netting arrangements and related collateral €m	Instruments outside netting arrangements €m	Balance sheet total €m
Derivative assets	254	—	(3)	251	402	656
Derivative liabilities	277	—	(3)	274	87	364
Net position	(23)	—	—	(23)	315	292
2017						
Derivative assets	697	(74)	(4)	619	64	761
Derivative liabilities	496	(74)	(4)	418	53	549
Net position	201	—	—	201	11	212

10 Financial instruments – valuation

Critical accounting policy: Fair value - financial instruments

In accordance with Accounting policies 11 and 19, 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.

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10 Financial instruments: carried at fair value - valuation hierarchy

The following tables show financial instruments carried at fair value on the balance sheet by valuation hierarchy.

	2018			2017		
	Level 1 €m	Level 2 €m	Level 3 €m	Level 1 €m	Level 2 €m	Level 3 €m
Assets						
Derivatives	—	514	142	—	736	25
Other financial assets						
Loans	—	9	—	—	13	—
Securities	155	234	4	21	488	5
Total financial assets held at fair value	155	757	146	21	1,237	30
Liabilities						
Amounts due to holding company and fellow subsidiaries	—	3	—	—	3	—
Derivatives	—	212	152	—	409	140
Other financial liabilities						
Deposits	—	6	—	—	10	—
Debt securities in issue	—	—	—	—	27	—
Subordinated liabilities	—	493	—	—	592	—
Total financial liabilities held at fair value	—	714	152	—	1,041	140

Notes:
(1) Transfers between levels are deemed to have occurred at the beginning of the quarter in which the instruments were transferred. Level 1 securities have increased as a result of transfers from level 2. This is due to improved market liquidity in certain portfolios.
(2) For an analysis of derivatives by type of contract – refer to Note 8
(3) The determination of an instruments 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 swap could be in level 2 or level 3 depending on whether the reference counterparty's obligations are liquid or illiquid.
(4) Level 2: valued using techniques based significantly on observable market data. Instruments in this category are valued using:
  a. quoted prices for similar instruments or identical instruments in markets which are not considered to be active; or
  b. valuation techniques where all the inputs that have a significant effect on the valuations are directly or indirectly based on observable market data.
(5) Level 3: instruments in this category have been valued using a valuation technique where at least one input which could have a significant effect on the instrument's valuation, is not based on observable market data. Where inputs can be observed from market data without undue cost and effort, the observed input is used. Otherwise, the Group determines a reasonable level for the input.

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, certain money market securities, 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

The Group 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.

Commodity prices - many commodities are actively traded in spot and forward contracts and futures on exchanges in London, New York and other commercial centres.

Notes on the consolidated accounts

10 Financial instruments – valuation continued

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, the Group considers the value of the prepayment option.

Recovery rates/loss given default - these are used as an input to valuation models and reserves for asset-backed securities and other credit products as an indicator of severity of losses on default. Recovery rates are primarily sourced from market data providers or inferred from observable credit spreads.

Valuation Control

The Group's control environment for the determination of the fair value of financial instruments includes formalised protocols for the review and validation of fair values independent of the businesses entering into the transactions.

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 month, 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 Model Risk team. The Group's Valuation Committee is made up of valuation specialists and senior business representatives from various functions and oversees pricing, reserving and valuations issues. The committee meets monthly to review and ratify any methodology changes. The Executive Valuation Committee meets quarterly to address key material and subjective valuation issues, to review items escalated by Valuation Committees and to discuss other relevant matters including prudential valuation.

Initial classification of a financial instrument is carried out by the Product Control team following the principles in IFRS 13. They base their judgment on information gathered during the IPV process for instruments which include the sourcing of independent prices and model inputs. The quality and completeness of the information gathered in the IPV process gives an indication as to the liquidity and valuation uncertainty of an instrument.

These initial classifications are 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.

The Group uses consensus prices for the IPV of some instruments. The consensus service encompasses the equity, interest rate, currency, commodity, credit, property, fund and bond markets, providing comprehensive matrices of vanilla prices and a wide selection of exotic products. The Group contributes to consensus pricing services where there is a significant interest either from a positional point of view or to test models for future business use. Data sourced from consensus pricing services are used for a combination of control processes including direct price testing, evidence of observability and model testing. In practice this means that the Group submits prices for all material positions for which a service is available.

Data from consensus services are subject to the same level of quality review as other inputs used for IPV process.

In order to determine a reliable fair value, where appropriate, management applies valuation adjustments to the pricing information gathered from the above sources. The sources of independent data are reviewed for quality and are applied in the IPV processes using a formalised input quality hierarchy. These adjustments reflect the Group's assessment of factors that market participants would consider in setting a price.

Where unobservable inputs are used, the Group may determine a range of possible valuations derived from differing stress scenarios to determine the sensitivity associated with the valuation. When establishing the fair value of a financial instrument using a valuation technique, the Group considers adjustments to the modelled price which market participants would make when pricing that instrument. Such adjustments include the credit quality of the counterparty and adjustments to compensate for model limitations.

Valuation reserves

When valuing financial instruments in the trading book, adjustments are made to mid-market valuations to cover bid-offer spread, liquidity and credit risk.

	2018 €m	2017 €m
Funding – FVA	—	2
Credit – CVA	103	3
Product and deal specific	3	214
	106	219

Total valuation reserves for the Group at 31 December 2018 were €106 million (2017 - €219 million) with the decrease during the year driven by trade close-out activity. The CVA component of the valuation reserves was €103 million (2017 - €3 million) with the increase during the year driven by a reclassification of product and deal specific valuation reserves to CVA.

Funding valuation adjustment (FVA)

FVA represents an estimate of the adjustment that a market participant would make to incorporate funding costs and benefits that arise in relation to derivative exposures. FVA is calculated as a portfolio level adjustment.

Funding levels are applied to estimated potential future exposures. For uncollateralised derivatives, the modelling of the exposure is consistent with the approach used in the calculation of CVA, and the counterparty contingent nature of the exposure is reflected in the calculation. For collateralised derivatives, the exposure reflects initial margin posting requirements.

Credit valuation adjustments (CVA)

CVA represents an estimate of the adjustment to fair value that a market participant would make to incorporate the counterparty credit risk inherent in derivative exposures.

CVA is actively managed by a credit and market risk hedging process, and therefore movements in CVA are partially offset by trading revenue on the hedges.

The CVA is calculated on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the credit risk.

Collateral held under a credit support agreement is factored into the CVA calculation. In such cases where the Group holds collateral against counterparty exposures, CVA is held to the extent that residual risk remains.

10 Financial instruments – valuation continued

Bid-offer

Fair value positions are adjusted to bid (long positions) or offer (short positions) levels, by marking individual cash positions directly to bid or offer or by taking bid-offer reserves calculated on a portfolio basis for derivatives exposures. The bid-offer approach is based on current market spreads and standard market bucketing of risk.

Bid-offer spreads vary by maturity and risk type to reflect different spreads in the market. For positions where there is no observable quote, the bid-offer spreads are widened in comparison to proxies to reflect reduced liquidity or observability. Bid-offer methodologies may also incorporate liquidity triggers whereby wider spreads are applied to risks above pre-defined thresholds.

As permitted by IFRS 13, netting is applied on a portfolio basis to reflect the value at which the Group believes it could exit the portfolio, rather than the sum of exit costs for each of the portfolio's individual trades. This is applied where the asset and liability positions are managed as a portfolio for risk and reporting purposes.

The discount rates applied to derivative cash flows in determining fair value reflect any underlying collateral agreements. Collateralised derivatives are generally discounted at the relevant OIS-related rates at an individual trade level. Reserves are held to the extent that the discount rates applied do not reflect all of the terms of the collateral agreements.

Product and deal specific

On initial recognition of financial assets and liabilities valued using valuation techniques incorporating information other than observable market data, any difference between the transaction price and that derived from the valuation technique is deferred. Such amounts are recognised in profit or loss over the life of the transaction; when market data becomes observable; or when the transaction matures or is closed out as appropriate.

Where system generated valuations do not accurately recover market prices, manuals valuation adjustments are applied either at a position or portfolio level. Manual adjustments are subject to the scrutiny of independent control teams and are subject to monthly review by senior management.

Own Credit

The Group takes into account the effect of its own credit standing when valuing financial liabilities recorded at fair value in accordance with IFRS. Own credit spread adjustments are made when valuing issued debt held at fair value, including issued structured notes, and derivatives. An own credit adjustment is applied to positions where it is believed that counterparties would consider the Group's creditworthiness when pricing trades.

Level 3

The following table shows the movement in level 3 assets and liabilities in the year.

	2018			2017			
	Trading assets (2) €m	Total assets €m	Total liabilities €m	Trading assets (2) €m	Other financial assets (3) €m	Total assets €m	Total liabilities €m
At 1 January	30	30	140	343	58	401	444
Amount recorded in the income statement (1)	(59)	(59)	(121)	(137)	—	(137)	(50)
Level 3 transfers in	250	250	151	67	—	67	48
Level 3 transfers out	—	—	—	(204)	—	(204)	(306)
Purchases	1	1	—	—	—	—	16
Settlements	(75)	(75)	(16)	—	—	—	—
Sales	—	—	—	(32)	(58)	(90)	—
Foreign exchange and other	(1)	(1)	(2)	(7)	—	(7)	(12)
At 31 December	146	146	152	30	—	30	140
Amounts recorded in the income statement in respect of balances held at year end - unrealised	(54)	(54)	(116)	(151)	—	(151)	(122)

Notes:
(1) There were €62 million net losses on trading assets and liabilities (2017 - €87 million HFT) recorded in income from trading activities. Net losses on other instruments of nil (2017 - nil) were recorded in other operating income and interest income as appropriate.
(2) Trading assets comprise assets held at fair value in trading portfolios.
(3) Other financial assets comprise fair value through other comprehensive income (2017 – available-for-sale), designated at fair value through profit or loss and other fair value through profit or loss.

Notes on the consolidated accounts

10 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.

2018	Items where fair value approximates carrying value €m	Carrying value €m	Fair value €m	Fair value hierarchy level Level 2 €m	Level 3 €m
Financial assets					
Cash and balances at central banks	336				
Loans to banks		392	392	45	347
Loans to customers		67	64	1	63
Amounts due from holding company and fellow subsidiaries		1,960	2,011	1,333	678
Financial liabilities					
Bank deposits	44				
Customer deposits		61	70	17	53
Amounts due to holding company and fellow subsidiaries	382	32	32	—	32
Subordinated liabilities		253	314	314	—
2017					
Financial assets					
Cash and balances at central banks	68				
Loans to banks		352	352	44	308
Loans to customers		80	45	—	45
Amounts due from holding company and fellow subsidiaries		2,771	2,837	1,099	1,738
Other financial assets - settlement balances	4				
Financial liabilities					
Bank deposits	55				
Customer deposits	3	55	64	18	46
Amounts due to holding company and fellow subsidiaries	375	695	695	—	695
Other financial liabilities - settlement balances	13				
Subordinated liabilities		401	466	466	—

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Quoted market values are used where available; otherwise, fair values have been estimated based on discounted expected future cash flows and other valuation techniques. These techniques involve uncertainties and require assumptions and judgments covering prepayments, credit risk and discount rates. Furthermore there is a wide range of potential valuation techniques. Changes in these assumptions would significantly affect estimated fair values. The fair values reported would not necessarily be realised in an immediate sale or settlement.

The assumptions and methodologies underlying the calculation of fair values of financial instruments at the balance sheet date are as follows:

Short-term financial instruments

For certain short-term financial instruments: cash and balances at central banks, items in the course of collection from other banks, settlement balances, items in the course of transmission to other banks, demand deposits and notes in circulation, fair value approximates to carrying value.

Loans and advances to banks and customers

In estimating the fair value of loans and advances to banks and customers measured at amortised cost, the Group’s loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans. Two principal methods are used to estimate fair value:

(a) Contractual cash flows are discounted using a market discount rate that incorporates the current spread for the borrower or where this is not observable, the spread for borrowers of a similar credit standing. This method is used for the majority of portfolios where most 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 order to reflect the homogeneous nature of these portfolios.

Debt securities

The majority of debt securities are valued using quoted prices in active markets or using quoted prices for similar assets in active markets.

Fair values are determined using discounted cash flow valuation techniques.

Deposits by banks and customer accounts

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

Debt securities in issue and subordinated liabilities

Fair values are determined using quoted prices for similar liabilities where available or by reference to valuation techniques and adjusting for own credit spreads where appropriate.

11 Financial instruments - maturity analysis

Remaining maturity

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

	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	336	—	336	68	—	68
Derivatives	81	575	656	39	722	761
Loans to banks - amortised cost	392	—	392	352	—	352
Loans to customers - amortised cost	—	67	67	2	78	80
Amounts due from holding company and fellow subsidiaries (1)	1,827	133	1,960	2,643	128	2,771
Other financial assets	55	347	402	215	316	531
Liabilities						
Bank deposits	44	—	44	55	—	55
Customer deposits	—	61	61	5	53	58
Amounts due to holding company and fellow subsidiaries	417	—	417	1,057	16	1,073
Derivatives	39	325	364	9	540	549
Other financial liabilities	6	—	6	48	2	50
Subordinated liabilities	240	506	746	172	821	993

Note:
(1) Amounts due from holding company and fellow subsidiaries relates to non-financial instruments of €1 million (2017 - €25 million) have been excluded from the table.

On balance sheet liabilities

The tables below show the timing of cash outflows to settle financial liabilities, prepared on the following basis:

Financial liabilities are included at the earliest date on which the counterparty can require repayment regardless of whether or not such early repayment results in a penalty. If repayment is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the liability is included at the earliest possible date that the conditions could be fulfilled without considering the probability of the conditions being met. For example, if a structured note automatically prepays when an equity index exceeds a certain level, the cash outflow will be included in the less than three months' period whatever the level of the index at the year end. The settlement date of debt securities issued by certain securitisation vehicles consolidated by the Group depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date.

Liabilities with a contractual maturity of greater than 20 years - The principal amounts of financial liabilities that are repayable after 20 years or where the counterparty has no right to repayment of the principal, are excluded from the table along with interest payments after 20 years.

Held-for-trading liabilities - held-for-trading liabilities of €0.4 billion (2017 - €0.6 billion) have been excluded from the tables below.

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	44	—	—	—	—	—
Customer deposits	1	5	59	1	3	6
Amounts due to holding company and fellow subsidiaries	414	—	—	—	—	—
Derivatives held for hedging	9	5	—	—	—	—
Subordinated liabilities	13	262	85	193	149	276
	481	272	144	194	152	282
Guarantees and commitments notional amount						
Guarantees (1)	1,456	—	—	—	—	—
Commitments (2)	14	—	—	—	—	—
	1,470	—	—	—	—	—

Notes on the consolidated accounts

11 Financial instruments - maturity analysis continued

2017	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	53	2	—	—	—	—
Customer deposits	3	1	57	1	3	6
Amounts due to holding company and fellow subsidiaries	728	325	13	3	—	—
Derivatives held for hedging	4	1	—	—	—	—
Subordinated liabilities	4	43	463	84	280	281
Other financial liabilities	38	—	2	—	—	—
	830	372	535	88	283	287
Guarantees and commitments notional amount						
Guarantees (1)	4,453	—	—	—	—	—
Commitments (2)	78	—	—	—	—	—
	4,531	—	—	—	—	—

Notes:
(1) The Group is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Group expects most guarantees it provides to expire unused.
(2) The Group has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Group does not expect all facilities to be drawn, and some may lapse before drawdown.

12 Loan impairment provisions

The table below summarises loans and related credit impairment measurements on an IFRS 9 basis at 31 December 2018 and 1 January 2018.

	31 December 2018 €m	1 January 2018 €m
Loans - amortised cost		
- Stage 1	379	256
- Stage 2	70	176
- Stage 3	46	33
- Inter-Group	1,961	2,646
Total	2,456	3,111
ECL provisions		
- Stage 2	4	1
- Stage 3	33	32
Total	37	33
ECL provisions coverage (1)		
- Stage 2 %	5.7	0.3
- Stage 3 %	71.7	97.5
Total	7.5	7.0
Other financial assets - Gross exposure	592	600
Other financial assets - ECL provision	1	23
ECL charge (2)		
- Third party	4	
Impairment losses		
- ECL loss rate (%) - third party	0.8	
- Amounts written off	23	

Notes:
(1) ECL provisions coverage is ECL provisions divided by loans - amortised cost.
(2) ECL charge balances in the above table include €0.8 million charge relating to other financial assets at FVOCI; and a €0.2 million release relating to contingent liabilities.

Notes on the consolidated accounts

12 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.

Notes on the consolidated accounts

13 Interest in associates

The Company has a 40% interest in the equity of Alawwal Bank which is incorporated and operates in the Kingdom of Saudi Arabia. On 25 April 2017 Alawwal Bank announced the start of merger discussions with Saudi British Bank (SABB). A 40% stake in its associate, Alawwal Bank, is the last significant shared asset of the RFS Holding Consortium. On 4 October 2018, they announced that terms had been agreed and that they anticipate being able to complete the transaction in H1 2019. Under the current terms of the transaction, the current interest in associate would be replaced by a 10.8% investment in the newly merged entity which would no longer qualify to be accounted for as an associate and the intention is for it to be distributed to the consortium members.

The Group accounted for its interest in Alawwal Bank as an associate up to 31 December 2018. The Group did not expect the interest in the new merged company to meet the significant influence criteria. Accordingly, it's interest in Alawwal Bank was reclassified and measured as a held for sale asset. The Interest in associate in relation to Alawwal Bank is classified as a disposal group and measured at its carrying value at 31 December 2018.

At 31 December 2018 Alawwal Bank was held at carrying value, €1,317 million (2017 - €1,212 million) which was lower than the estimated fair value less cost to sell.

The following table shows summary income statement and balance sheet information for Alawwal Bank translated into euro.

Alawwal Bank	2018 €m	2017 €m
Total income	806	878
Total expenses	(551)	(563)
Profit before tax	255	315
Share of profit after tax	78	101
Cash and balances at central banks	1,138	3,365
Loans to banks - amortised cost	260	470
Loans to customers - amortised cost	13,447	14,149
Debt securities and equity shares	3,740	3,758
Other assets	509	462
Total assets	19,094	22,204
Deposits by banks	357	744
Customer deposits	15,031	17,403
Other liabilities	480	1,033
Total liabilities	15,868	19,180

In addition to the share of profit after tax recorded in other income in 2018 of €78 million, reserves increased by €59 million in relation to foreign exchange movements, and reduced by €32 million in relation to Alawwal Bank's adoption of IFRS 9 on 1 January 2018. Refer to Note 26 for further information on the adoption of IFRS 9.

14 Other financial assets

	Debt securities						
2018	Other central and local government €m	Other debt €m	Total €m	Equity shares (1) €m	Other loans €m	Settlement balances €m	Total €m
Mandatory fair value through profit or loss	—	4	4	7	9	—	20
Fair value through other comprehensive income	14	238	252	130	—	—	382
Total	14	242	256	137	9	—	402
2017							
Held for trading	—	—	—	5	13	—	18
Designated as at fair value through profit or loss	—	—	—	95	—	—	95
Available-for-sale	21	259	280	134	—	—	414
Loans and receivables	—	—	—	—	—	4	4
Total	21	259	280	234	13	4	531

Note:
(1) Equity shares classified as fair value through other comprehensive income include €49 million in Credit Suisse Equity Funds and €34 million in UBS Equity Funds. During 2018 no dividend income was received in relation to these investments.

15 Other assets

	2018 €m	2017 €m
Prepayments and deferred expenses	—	62
Current tax	1	30
Property, plant and equipment	23	21
Other assets (1)	134	161
	158	274

Note:
(1) Includes insurance assets.

Notes on the consolidated accounts

16 Other financial liabilities

	2018 €m	2017 €m
Bank deposits - held for trading	3	4
Customer deposits - held for trading	3	6
Debt securities in issue - designated at fair value through profit or loss	—	27
Settlement balances	—	13
Total	6	50

17 Other liabilities

	2018 €m	2017 €m
Current taxation	89	5
Accruals	4	6
Insurance reserves	126	200
Other liabilities (1)	201	203
	420	414

Note:
(1) Includes insurance liabilities.

Alcover AG (Alcover) is consolidated by NWM N.V.; Alcover's insurance business is in run-off. Claims reserves represent the risk-adjusted cash outflows required to settle outstanding claims as they develop. These reserves are established on the basis of an external actuarial valuation and reflect historical claims experience.

In 2018, the reduction in insurance reserves was attributable to exposures that had expired without settlement. No material settlements were paid.

Included in other liabilities are provisions for liabilities and charges of €9 million (2017 - €13 million), of which litigation provisions are €7 million (2017 - €13 million) and restructuring provisions are nil (2017 - nil). Arising out of its normal business operations, the Group is party to legal proceedings in the Netherlands, United Kingdom, the United States of America and other jurisdictions. Litigation provisions at 31 December 2018 related to numerous proceedings; no individual provision is material. Detailed descriptions of the Group's legal proceedings and discussion of the associated uncertainties are given in Note 22.

18 Subordinated liabilities

	2018 €m	2017 €m
Dated loan capital	746	993

NWM N.V. has now resumed payments on all discretionary non-equity capital instruments following the end of the European Commission ban in 2013. Future coupons and dividends on hybrid capital instruments will only be paid subject to, and in accordance with, the terms of the relevant instruments.

Maturities and redemptions in the period (values as at date of transaction)	Capital treatment	2018 €m	2017 €m
US$500 million 4.65% subordinated notes June 2018	Tier 2	188	—
US$25 million floating rate notes December 2019 (Partial redemption)	Tier 2	3	—
€15 million floating rate notes 2020 (Partial redemption)	Tier 2	—	2
€250 million 4.70% notes 2019 (Partial redemption)	Tier 2	—	91
US$500 million 4.65% notes 2018 (Partial redemption)	Tier 2	—	278
		191	371

Note:
(1) There were no issuances in 2018 or 2017.

Subordinated liabilities held at 31 December:

Dated loan capital	Capital treatment	2018 €m	2017 €m
€250 million floating rate notes 2019	Tier 2	164	170
€170 million floating rate notes 2041	Tier 2	245	339
€15 million floating rate notes 2020	Tier 2	13	13
US$25 million floating rate notes 2019	Tier 2	12	15
US$72 million 5.98% notes 2019	Tier 2	60	56
US$500 million 4.65% notes 2018	Tier 2	—	159
US$136 million 7.75% notes 2023	Tier 2	119	114
US$150 million 7.13% notes 2093	Tier 2	133	127
		746	993

Note:
(1) Since the introduction of CRDIV and CRR, all Tier 2 subordinated debt issuances are eligible for grandfathering only and therefore subject to transitional rules.

Notes on the consolidated accounts

19 Share capital and reserves

The company's share capital at 31 December 2018 and 2017 consisted of 89,287 issued and fully paid ordinary shares of €0.56 each. The Company's authorised share capital amounts to €224,000. It comprises 400,000 ordinary shares, each with a nominal value of €0.56.

All issued ordinary shares have been fully paid. Each ordinary share entitles the holder to cast one vote. Subject to certain exceptions provided for by law or in the articles of association, resolutions are passed by an absolute majority of the votes cast. When shares are issued, each holder of shares shall have pre-emptive right, in proportion to the aggregate amount of their shares, except in the case of an issue of shares for a consideration other than in cash.

In the event of the dissolution and liquidation of RBS Holdings N.V., the assets remaining after payment of all debts will be distributed to the holders of ordinary shares on a pro-rata basis.

Share premium reserve

In 2017 there was N-share capital repatriation and reallocation of €68 million. There was no repatriation or reallocation in 2018.

As a part of the Dutch Scheme one share was issued against the share premium account.

Ordinary shares carry certain pre-emption rights and rank equally in voting, dividend and liquidation rights.

Dutch law prescribes that only the freely distributable reserves of the company are taken into account for the purpose of making distributions and in determining the permissible applications of the share premium account. The Group optimises capital efficiency by maintaining reserves in subsidiaries, including regulated entities. The remittance of reserves to the company or the redemption of capital by regulated entities may be subject to maintaining the capital resources required by the relevant regulator.

20 Structured entities and asset transfers

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.

Unconsolidated structured entities

The Group's interests in unconsolidated structured entities are analysed below.

	2018		2017		
	Asset backed securitisation vehicles €m	Total €m	Asset backed securitisation vehicles €m	Investment funds and other €m	Total €m
Trading assets and derivatives					
Trading assets	9	9	10	4	14
Derivative assets	—	—	1	—	1
Derivative liabilities	(3)	(3)	(4)	—	(4)
Total	6	6	7	4	11
Non-trading assets					
Loans to customers	5	5	8	—	8
Maximum exposure	11	11	15	4	19

Notes:
(1) Income from interests in unconsolidated structured entities includes interest receivable, changes in fair value, and other income less impairments that may be required.
(2) A sponsored entity is a structured entity, established by the Group where the Group provides liquidity and/or credit enhancements or provides ongoing services to the entity. The Group can act as sponsor for its own or for customers' transactions.

Notes on the consolidated accounts

20 Structured entities and asset transfers continued

Transfers that do not qualify for derecognition

Asset transfers

Under IFRS9 financial asset is transferred if the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. Following a transfer the financial asset will be derecognised; not derecognised and retained in full on the Group's balance sheet; continue to be recognised on the balance sheet to the extent of the Group's continuing involvement.

Securities repurchase agreements and lending transactions

The Group enters into securities repurchase agreements and securities lending transactions under which it transfers securities in accordance with normal market practice.

Generally, the agreements require additional collateral to be provided if the value of the securities falls below a predetermined level. Under standard terms for repurchase transactions in the UK and US markets, the recipient of collateral has an unrestricted right to sell or repledge it, subject to returning equivalent securities on settlement of the transaction.

Securities sold under such repurchase transactions are not derecognised if the Group retains substantially all the risks and rewards of ownership. Securities received as collateral under reverse repurchase agreements were €1.1 billion (2017 - €0.9 billion) of which €0.1 billion (2017 - €0.1 billion) had been sold or repledged as collateral of the Group's own transactions.

Assets pledged as collateral

The Group pledges collateral with its counterparties in respect of derivative liabilities.

There were €3 million of assets pledged against liabilities in 2018 (2017 - €4 million) and €3 million of liabilities secured by assets (2017 - €4 million).

21 Capital resources

The Group's regulatory capital resources were as follows:

Composition of regulatory capital	2018 €m	2017 €m
Tier 1		
Controlling interests	3,233	2,884
Adjustment for:		
- Goodwill and other intangible assets	—	(3)
- Other regulatory adjustments (1)	(471)	(111)
Core Tier 1 and Total Tier 1 capital	2,762	2,770
Tier 2		
Subordinated debt	234	238
Less deductions from Tier 2 capital	(131)	(125)
Total Tier 2 capital	103	113
Total regulatory capital	2,865	2,883

Note:
(1) Includes reversal of own credit risk of €196 million (2017 - €106 million) plus the elimination of the profit that has not been approved yet.

It is the Group's policy to maintain an appropriate 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 Group has regard to the supervisory requirements of DNB. DNB uses Capital Ratios as a measure of capital adequacy in the Dutch banking sector, comparing a bank's capital resources with its risk-weighted assets (RWAs) (the assets and off-balance sheet exposures are weighted to reflect the inherent credit and other risks). The Group has complied with its capital requirements during the year.

A number of subsidiaries and sub-groups within the Group are subject to various individual regulatory capital requirements in the Netherlands and overseas. Furthermore, the payment of dividends by subsidiaries and the ability of members of the Group to lend money to other members of the 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 consolidated accounts

22 Memorandum items

Contingent liabilities and commitments

The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December 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.

	Less than 5 years €m	Over 5 years €m	2018 €m	2017 €m
Contingent liabilities and commitments (1)				
Guarantees and assets pledged as collateral security	379	1,077	1,456	4,453
Other contingent liabilities	—	475	475	1,019
Standby facilities, credit lines and other commitments	14	—	14	78
	393	1,552	1,945	5,550

Note:
(1) Related parties balance included within contingent liabilities and commitments as at 31 December 2018 is €379 million (2017 - €674 million).

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 non-performance by the other party and where all counterclaims, collateral or security proves valueless, is represented by the contractual nominal amount of these instruments included in the table 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 obligations to third parties 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.

Also included within guarantees and assets pledged as collateral security as at 31 December 2018 is €1.1 billion (2017 - €3.8 billion) which relates to the Group's obligations over liabilities held within the Dutch State acquired businesses included in the new ABN AMRO Bank N.V.. On the division of an entity by demerger, Dutch law establishes a cross liability between surviving entities in respect of the creditors at the time of the demerger. The Group's cross liability is limited by law to the lower of its equity and the eligible debts of ABN AMRO Bank N.V. on 6 February 2010. The likelihood of cross liability crystallising is considered remote.

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.

Contractual obligations for future expenditure not provided in the accounts

Unprovided contractual obligations for future expenditure, primarily relating to property leases, amounted to €3 million at 31 December 2018 (2017 - €3 million).

Notes on the consolidated accounts

22 Memorandum items continued

Litigation, investigations and reviews

NatWest Markets N.V. and certain members of RBS Group are party to legal proceedings and the subject of investigation and other regulatory and governmental action in the Netherlands, the United Kingdom (UK), the European Union (EU), the United States (US) and other jurisdictions.

RBSH Group recognises a provision for a liability in relation to these matters when it is probable that an outflow of economic benefits will be required to settle an obligation resulting from past events, and a reliable estimate can be made of the amount of the obligation. While the outcome of these matters is inherently uncertain, the directors believe that, based on the information available to them, appropriate provisions have been made in respect of the matters as at 31 December 2018.

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 RBSH 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. RBSH Group cannot predict if, how, or when such claims will be resolved or what the eventual settlement, damages, fine, penalty or other relief, if any, may be, particularly for claims that are at an early stage in their development or where claimants seek substantial or indeterminate damages.

In respect of certain matters described below, we have established a provision. RBSH Group generally does not disclose information about the establishment or existence of a provision for a particular matter where disclosure of the information can be expected to prejudice seriously RBSH Group's position in the matter.

There are situations where RBSH 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 RBSH Group believes it has credible defences and should prevail on the merits. There are also situations where it may be in the interests of members of RBSH Group to settle adverse claims, including involving significant amounts, on a commercial basis in order to facilitate the achievement of a wider commercial or strategic objective. 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 RBSH Group has recognised. Where (and as far as) liability cannot be reasonably estimated, no provision has been recognised.

Other than those discussed below, no member of RBSH Group is or has been involved in governmental, legal or regulatory proceedings (including those which are pending or threatened) that are expected to be material individually or in aggregate.

RBS Group is involved in ongoing litigation, investigations and reviews that are not described below but are described on pages 313 to 325 in RBS Group's Annual Report & Accounts 2018. RBS Group expects that in future periods, additional provisions, settlement amounts and customer redress payments will be necessary, in amounts that are expected to be substantial in some instances. While RBSH Group may not be directly involved in such RBS Group matters, any final adverse outcome of those matters may also have an adverse effect on RBSH Group.

Litigation

Madoff

NatWest Markets N.V. is a defendant in two actions filed by Irving Picard, as trustee for the bankruptcy estates of Bernard L. Madoff and Bernard L. Madoff Investment Securities LLC, in bankruptcy court in New York. In both cases, the trustee alleges that certain transfers received by NatWest Markets N.V. amounted to fraudulent conveyances that should be clawed back for the benefit of the Madoff estate.

In the primary action, filed in December 2010, the trustee originally sought to recover US$75.8 million in redemptions that Nat West Markets N.V. allegedly received from certain Madoff feeder funds and US$162.1 million that NWM N.V. allegedly received from certain swap counterparties. In August 2018, the trustee voluntarily dismissed a portion of this claim (relating to US$74.6 million received from certain swap counterparties) without prejudice to-refiling at a later date. Otherwise this action remains pending before the bankruptcy court, where it will in due course be the subject of a motion to dismiss. In the second action, filed in October 2011, the trustee seeks to recover an additional US$21.8 million. In November 2016, the bankruptcy court dismissed this case on international comity grounds, and that decision was appealed. On 25 February 2019, the United States Court of Appeals for the Second Circuit reversed the bankruptcy court's decision. The case will now return to the bankruptcy court for further proceedings.

Australian Bank Bill Swap Reference Rate (BBSW)

In August 2017, a class action complaint was filed in the United States District Court for the Southern District of New York against certain RBS Group companies (including NatWest Markets N.V.) and a number of other financial institutions. The complaint alleges that the defendants conspired to manipulate the BBSW and asserts claims under the U.S. antitrust laws, the Commodity Exchange Act, RICO (Racketeer Influenced and Corrupt Organizations Act), and the common law. On 26 November 2018, the court dismissed all claims against RBS Group companies for lack of personal jurisdiction, but plaintiffs have filed an amended complaint, which will be the subject of a further motion to dismiss.

Fondazione Monte dei Paschi di Siena

A claim for €285.9 million was brought by Fondazione Monte dei Paschi di Siena (FMPS) in July 2014 against former directors and 13 syndicate banks, including NatWest Markets N.V., in connection with an Italian law-governed term facility agreement for €600 million dated 4 June 2011. The claim is a civil action based on a non-contractual liability arising from the alleged breach of the by-laws of FMPS which set a 20 per cent limit for its debt to equity ratio (the Ratio). The lenders are alleged to have aided and abetted the former directors of FMPS to breach the Ratio. It is alleged that as sophisticated financial institutions, each lender should have known FMPS's financial situation, including its debt to equity ratio, and that putting the facility in place would cause it to breach the Ratio. NatWest Markets N.V. will defend the claim, which has been transferred to the Florence courts. A hearing is anticipated to take place in June 2019.

Notes on the consolidated accounts

22 Memorandum items continued

Anti-Terrorism Act litigation against NatWest Markets N.V.

NatWest Markets N.V. and certain other financial institutions, are defendants in several actions pending in the United States District Courts for the Eastern and Southern Districts of New York, filed by a number of US nationals (or their estates, survivors, or heirs), most of whom are or were US military personnel, who were killed or injured in attacks in Iraq between 2003 and 2011.

The attacks at issue in the cases were allegedly perpetrated by Hezbollah and certain Iraqi terror cells allegedly funded by the Islamic Republic of Iran. According to the plaintiffs' allegations, the defendants are liable for damages arising from the attacks because they allegedly conspired with Iran and certain Iranian banks to assist Iran in transferring money to Hezbollah and the Iraqi terror cells, in violation of the US Anti-Terrorism Act, by agreeing to engage in 'stripping' of transactions initiated by the Iranian banks so that the Iranian nexus to the transactions would not be detected. The first of these actions was filed in the United States District Court for the Eastern District of New York in November 2014. On 27 July 2018, the magistrate judge in that case issued a report to the district court recommending that the district court deny the defendants' pending motion to dismiss. NatWest Markets N.V. has requested that the district court grant the motion to dismiss notwithstanding the magistrate's recommendation. In the second of these actions, filed in the United States District Court for the Southern District of New York in November 2017, the court dismissed the complaint in its entirety on 28 March 2019, subject to re-pleading or appeal. The other actions that have been filed have not yet been subjected to motions to dismiss.

Interest rate swap claim by Ville d'Aubagne

Ville d'Aubagne, a French local authority, filed a claim in April 2013 against NatWest Markets N.V. and NatWest Markets Plc in respect of two structured interest rates swaps, which were entered into between Ville d'Aubagne and RBS N.V. (now NatWest Markets N.V.), and novated to RBS plc (now NatWest Markets Plc) in 2009.

In the same year, they were terminated early and a rescheduling agreement was entered into under which payments were rescheduled over 28 years. Ville d'Aubagne sought retroactive cancellation of the swaps and the rescheduling agreement. The amount claimed was approximately €65 million (which was subject to fluctuations in market value from time to time). The bank was successful in its defence of the claim, winning at first instance in November 2015. An appeal of that decision was dismissed by the French Court of Appeal in January 2018. Ville d'Aubagne has appealed to the French Supreme Court.

Investigations and reviews

RBSH Group's financial condition can be affected by the actions of various governmental and regulatory authorities in the Netherlands, the UK, the EU, the US and elsewhere. RBS Group has engaged, and will continue to engage, in discussions with relevant governmental and regulatory authorities, including in the Netherlands, the UK, the EU, the US and elsewhere, on an ongoing and regular basis, and in response to informal and formal inquiries or investigations, regarding operational, systems and control evaluations and issues including those related to compliance with applicable laws and regulations, including consumer protection, business conduct, competition/anti-trust, anti-bribery, anti-money laundering and sanctions regimes.

The NatWest Markets business in particular has been providing, and continues to provide, information regarding a variety of matters, including, for example, the setting of benchmark rates and related derivatives trading, conduct in the foreign exchange market, and various issues relating to the issuance, underwriting, and sales and trading of fixed income securities, including structured products and government securities, some of which have resulted, and others of which may result, in investigations or proceedings.

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 RBSH Group, remediation of systems and controls, public or private censure, restriction of RBSH Group's business activities and/or fines. Any of the events or circumstances mentioned in this paragraph could have a material adverse effect on RBSH Group, its business, authorisations and licences, reputation, results of operations or the price of securities issued by it.

Notes on the consolidated accounts

23 Analysis of changes in financing during the year

	Share capital and share premium		Subordinated liabilities	
	2018 €m	2017 €m	2018 €m	2017 €m
At 1 January	1,995	2,063	993	1,438
Redemption of subordinated liabilities	—	—	(191)	(378)
Distribution	—	(68)	—	—
Net cash outflow from financing	—	(68)	(191)	(378)
Foreign exchange	—	—	49	(79)
Other adjustments (including own credit adjustments)	—	—	(105)	12
At 31 December	1,995	1,995	746	993

24 Analysis of cash and cash equivalents

	2018 €m	2017 €m
At 1 January		
- cash	68	773
- cash equivalents	354	243
	422	1,016
Net cash outflow	578	(594)
At 31 December	1,000	422
Comprising:		
Cash and balances at central banks	336	68
Loans to banks - amortised cost (1)	664	354
Cash and cash equivalents	1,000	422

Note:
(1) Cash collateral posted with bank counterparties in respect of derivative liabilities is nil (2017 - nil).

The Group had mandatory reserve deposits with central banks of €6 million (2017 - €55 million).

Notes on the consolidated accounts

25 Remuneration of the Managing Board and Supervisory Board

Remuneration of the Managing Board

The Managing Board during the year comprised the following members:
(1) H. Bots.
(2) C. Visscher.

All members of the Managing Board also performed roles in their respective fields elsewhere within RBS Group. As a consequence the following table only summarises total remuneration of the members of the Managing Board paid by RBS Holdings in respect of their functions in RBS Holdings.

As a result of the repurposing of NWM N.V.'s banking licence, the Managing Board members have spent more of their time on N.V. matters.

Members receive pension benefits through their employment in RBS Group.

The remuneration of the Managing Board is presented in aggregate in the table below. RBSG and its subsidiaries adhere to relevant statutory requirements and RBS Group discloses individual remuneration of RBS Group executive directors, compliant with the UK PRA Remuneration Code.

	2018 €000	2017 €000
Salaries and short-term benefits	621	361
Pensions	101	29
Profit sharing and bonus payments	131	72
Total	853	462

Notes:
(1) There are no loans from the Group to the Managing Board members.
(2) The vesting of long-term incentive awards in the form of shares in RBS Group will normally be subject to the satisfaction of financial and non-financial performance conditions. The performance conditions will be set by the RBS Group Performance and Remuneration Committee for each award. In addition, awards will only vest to the extent the Committee is satisfied that the vesting outcome reflects underlying financial results and if conduct and risk management during the performance period has been effective.

Remuneration of the Supervisory Board

The Supervisory Board during the year comprised the following members:
(1) C. Marks.
(2) C. Campbell.
(3) M. Klessens.
(4) R. Begbie.

The Supervisory Board included members employed elsewhere within RBS Group. The Supervisory Board members from RBS Group were not remunerated for time spent on matters relating to RBS Holdings N.V..

The table below provides information on the remuneration of the Supervisory Board in aggregate. Members of the Supervisory Board are not entitled to emoluments in the form of RBSG shares or options on RBSG shares.

	2018 €000	2017 €000
Remuneration (1)	80	80

Note:
(1) There are no loans from the Group to the Supervisory Board members.

Notes on the consolidated accounts

26 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 year is 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.

There was no change to the classification of Loans to customers and banks as a result of IFRS 9.

The net decrease to loan impairments under IAS 39 was €3 million under the expected credit loss requirements of IFRS 9.

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, and expected credit are as follows:

	31 December 2017 (IAS 39) €m	New Presentation €m	31 December 2017 re-presented €m	IFRS 9 impact Expected credit losses €m	Other €m	1 January 2018 (IFRS 9) €m
Assets						
Cash and balances at central banks	68	—	68	—	—	68
Derivatives		761	761	—	—	761
Loans and advances to banks	2,998	(2,998)	—			
Loans to banks - amortised cost		352	352	—	—	352
Loans and advances to customers	93	(93)	—			
Loans to customers - amortised cost		80	80	3	—	83
Amounts due from ultimate holding company	125	2,671	2,796	—	—	2,796
Debt securities and equity shares	514	(514)	—			
Other financial assets		531	531	—	—	531
Interest in associates	1,214	—	1,214	—	(32)	1,182
Settlement balances	4	(4)	—			
Derivatives	761	(761)	—			
Other assets	299	(25)	274	—	—	274
Total assets	6,076	—	6,076	3	(32)	6,047
Liabilities						
Deposits by banks	1,132	(1,132)	—			
Bank deposits	—	55	55	—	—	55
Customer accounts	64	(64)	—			
Customer deposits	—	58	58	—	—	58
Amounts due to holding company and fellow subsidiaries	—	1,073	1,073	—	—	1,073
Debt securities in issue	27	(27)	—			
Settlement balances	13	(13)	—			
Derivatives	549	—	549	—	—	549
Other financial liabilities	—	50	50	—	—	50
Subordinated liabilities	993	—	993	—	—	993
Other liabilities	414	—	414	—	—	414
Total liabilities	3,192	—	3,192	—	—	3,192
Total equity	2,884	—	2,884	3	(32)	2,855
Total liabilities and equity	6,076	—	6,076	3	(32)	6,047

The table below reflects the impact of IFRS 9 on total equity:

	€m
At 31 December - under IAS 39	2,884
Adjustments as result of implementation of IFRS 9:	
Reduction in interest in associates	(32)
Expected credit losses (1)	3
At 1 January 2018 - under IFRS on transition to IFRS 9	2,855

Note:
(1) Includes a net release of €3 million in relation to amortised cost financial assets.

Notes on the consolidated accounts

27 Related parties

The Group has a related party relationship with associates, joint ventures, key management and shareholders The UK Government through HM Treasury is the ultimate controlling party of The Royal Bank of Scotland Group plc ('RBS Group') which in turn owns 97.72% of RFS Holdings B.V., the immediate parent company of the Group.

Parties are considered to be related if one party has the ability to control or exercise significant influence over the other party in making financial or operational decisions. The Group enters into a number of banking transactions with related parties in the normal course of business. These transactions, which include loans, deposits and foreign currency transactions, have taken place on an arm's length basis. These transactions are carried out on commercial terms and at market rates. Employees are offered preferential terms for certain banking products. No allowances for loan losses have been recognised in respect of loans to related parties in 2018 and 2017.

Balances with Consortium Members

A substantial part of the business activities of NWM N.V. (previously RBS N.V, renamed in 2018) was successfully transferred to NWM Plc (previously RBS plc, renamed in 2018) by the end of 2013 following an announcement in April 2011 by the Boards of RBSG, NWM Plc, RBS Holdings and NWM N.V.. The Group entered into two agreements with NWM Plc under which it bought credit protection over the exposures held by the Group that were subject to RBS Group's Asset Protection Scheme agreement with HM Treasury.

These agreements cover 100% of losses on these assets. RBS Group exited the APS effective 18 October 2012. The Group agreements are not impacted by RBS Group's exit from APS and as a result, there has been no change to these agreements although with effect from 1 January 2013, the Managing Board of RBS Holdings N.V. agreed with NWM Plc to reduce the number of covered assets. The assets covered under the agreement at 31 December 2018 was €0.2 billion (2017 - €0.2 billion). The prepaid fee for the financial guarantee contract was fully amortised at 31 December 2017.

Financial assets and liabilities positions held-for-trading with RBS Group include positions of which risks have been transferred to NWM Plc. The assets and liabilities cannot be offset under IFRS, however master netting agreements are in place that reduce the credit risk in the assets.

Balances with associates

Pursuant to an agreement dated 22 July 2016 with an associate, a certain proportion of any proceeds of sale of NWM N.V.'s investment in that associate, up to a maximum of approximately €256 million, is payable to that associate.

On 25 April 2017 Alawwal Bank announced the start of merger discussions with Saudi British Bank (SABB). A 40% stake in its associate, Alawwal Bank, is the last significant shared asset of the RFS Holding Consortium. On 4 October 2018, they announced that terms had been agreed and that they anticipate being able to complete the transaction in H1 2019. Under the current terms of the transaction, the current interest in associate would be replaced by a 10.8% investment in the newly merged entity.

Balances with the Dutch State and UK Government

Transactions conducted directly with the Dutch State and UK Government are limited to normal banking transactions, taxation and other administrative relationships with the exception of the mandatory convertible securities and guarantee of the Dutch State. In addition the Group participates in the Dutch State treasuries market and utilises the liquidity support made available to all banks regulated by DNB.

There may be other significant transactions with entities under the common control of or subject to significant influence by the Dutch and/or the UK Government.

These would include, amongst others, loans, deposits, guarantees, fee based relationships, or equity holdings. Disclosure is made of any significant transactions with these entities.

At 31 December 2018 there were no transactions outstanding with directors or key management (for the Group this comprises the members of the Managing and Supervisory Boards).
Refer to Note 25 for further details of remuneration of the Managing and Supervisory Boards.

	2018 €m	2017 €m
Assets		
Balances at central banks	336	66

28 Post balance sheet events

In Q1 2019 a UK Banking Business Transfer Scheme under Part VII of the Financial Services and Markets Act 2000 (FMSA) was completed. Master documentation was moved or replicated and open trading positions transferred from NatWest Markets Plc and National Westminster Bank Plc to NWM N.V.. The FSMA first order was granted by the UK Court on the 6 December 2018 and the Final Court sanction hearing was received on 22 February 2019. The FSMA scheme was split into two phases:

- Phase 1 – 28 February 2019 – master document was replicated in relation to approximately 15,000 NWM N.V. clients, and
- Phase 2 – 25 March 2019 – in scope non-UK EEA customer transactions were transferred, including approximately 10,000 trades relating to 3,000 clients, or third party assets of approximately €6.2 billion and third party liabilities of approximately €6.6 billion at the date of transfer.

Following the completion of phase 2, the Group is the RBS Group's NatWest Markets business's continuing presence in Europe regardless of the outcome of Brexit, and EEA customers are served from its offices in Europe.

Other than this, there have been no 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.

Company Financial Statements RBS Holdings N.V. (Parent Company)

Accounting policies

The company financial statements of RBS Holdings N.V. have been prepared in accordance with the requirements in Title 9 Book 2 of the Dutch Civil Code. RBSH Group prepares its consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as issued by the IASB and IFRS as adopted by the EU. The accounting policies applied in the company financial statements are the same as those applied in the consolidated financial statements on pages 46 to 50. The Group applies the exemption as included in the section 2:362 paragraph 8 of the Netherlands Civil Code.

Interests in associates are valued at the company's share of their consolidated net asset value determined on the basis of IFRS as endorsed by the EU and adopted by the company.

Participating interests in RBSH Group companies

At the date of signing this report, RBS Holdings has one participation and is the sole shareholder of NWM N.V.. RBS Holdings guarantees all assets and liabilities of NWM N.V..

Basis of preparation

The financial statements are presented in euros, which is the presentation currency of the company. The income statement has been drawn up in accordance with Section 402, Book 2 of the Netherlands Civil Code.

Company income statement for the year ended 31 December 2018

	2018 €m	2017 €m
Net profit/(loss) for the year	271	(92)

Company balance sheet as at 31 December 2018 (before appropriation of result)

	Note	2018 €m	2017 €m
Assets			
Participating interests in group companies	A	3,233	2,884
Total assets		3,233	2,884
Equity	B		
Share premium		1,995	1,995
Retained earnings		1,234	992
Net income/(losses) not recognised in the income statement		4	(103)
Total equity		3,233	2,884
Total equity and liabilities		3,233	2,884

The notes to the company balance sheet on pages 76 to 77 are an integral part of these financial statements.

Company Financial Statements RBS Holdings N.V. (Parent Company)

Company statement of changes in equity for the year ended 31 December 2018

	2018 €m	2017 €m
Share capital and share premium (1)		
At 1 January	1,995	2,063
Distribution	—	(68)
At 31 December	1,995	1,995
Group undertakings reserve		
At 1 January	(103)	(121)
Comprehensive income for the year (net of tax)	107	18
At 31 December	4	(103)
Retained earnings		
At 1 January	992	1,103
Implementation of IFRS 9 on 1 January 2018 (2)	(29)	—
Profit/(loss) attributable to controlling interests	271	(92)
Distribution	—	(22)
Other changes	—	3
At 31 December	1,234	992
Equity attributable to controlling interests at 31 December	3,233	2,884

Notes:
(1) Includes ordinary share capital of €50,000 (2016 - €50,000; 2015 - €50,000). Refer to Note 19 on the consolidated accounts for further details.
(2) Refer to Note 26 on the consolidated accounts 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.

A. Participating interests in group companies

	2018 €m	2017 €m
At 1 January	2,884	3,045
Net profit/(loss) for the year	271	(92)
Distribution	—	(90)
Special component of equity	(6)	5
Currency translation differences	24	78
Other movements	60	(62)
At 31 December	3,233	2,884

The parent company's principal subsidiary undertakings and participating interests are shown below. As at 31 December 2018, RBS Holdings had one direct wholly owned subsidiary, NWM N.V. incorporated and operating in the Netherlands.

	Country of incorporation	Group interest
RBS Hollandsche N.V., Rotterdam	The Netherlands	100%
Alawwal Bank, Riyadh (1)	Saudi Arabia	40%

Note:
(1) Participating interest that is not 100% consolidated but is accounted for under the equity method.

All subsidiaries and participating interests operate principally in their country of incorporation.

The list of participating interests for which statements of liability have been issued, has been filed with the Chamber of Commerce in Amsterdam.

Some of RBSH Group's subsidiaries and participating investments are regulated entities and therefore their ability to transfer funds to RBSH Group is subject to regulatory approvals.

Company Financial Statements RBS Holdings N.V. (Parent Company)

B. Shareholders' equity

Share capital
There were 89,287 ordinary shares of €0.56 each in issue as at 31 December 2018 and 2017.

Reserves

	2018 €m	2017 €m
Share premium account	1,995	1,995
Non-distributable reserve shares	11	11
Non-distributable profit participations	1,156	1,110
Group undertakings reserve	4	(103)
Other reserves	67	(129)
Total reserves	3,233	2,884

€1,170 million (2017 - €1,126 million) is not distributable out of total reserves.

C. Remuneration of the Managing Board and Supervisory Board
Refer to Note 25 on the consolidated accounts for further details.

D. Related parties
Refer to Note 27 on the consolidated accounts for further details.

E. Post balance sheet events
In Q1 2019 a UK Banking Business Transfer Scheme under Part VII of the Financial Services and Markets Act 2000 (FMSA) was completed. Master documentation was moved or replicated and open trading positions transferred from NatWest Markets Plc and National Westminster Bank Plc to NWM N.V.. The FSMA first order was granted by the UK Court on the 6 December 2018 and the Final Court sanction hearing was received on 22 February 2019. The FSMA scheme was split into two phases:

- Phase 1 – 28 February 2019 – master document was replicated in relation to approximately 15,000 NWM N.V. clients, and
- Phase 2 – 25 March 2019 – in scope non-UK EEA customer transactions were transferred, including approximately 10,000 trades relating to 3,000 clients, or third party assets of approximately €6.2 billion and third party liabilities of approximately €6.6 billion at the date of transfer.

Following the completion of phase 2, the Group is the RBS Group's NatWest Markets business's continuing presence in Europe regardless of the outcome of Brexit, and EEA customers are served from its offices in Europe.

Other than this, there have been no 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.

Guarantees
RBS Holdings N.V. guarantees all liabilities of NWM N.V. under article 403 of section 2 of Dutch Civil Code.

Amsterdam, 18 April 2019

Supervisory Board	Managing Board
Chris Marks	Harm Bots
Maarten Klessens	Cornelis Visscher
Annelies van der Pauw	Angelique Slach
Richard Place	Marije Elkenbracht
Anne Snel	

Other information

Independent auditor's report

To: the shareholders and Supervisory Board of RBS Holdings N.V.

Report on the audit of the 2018 financial statements included in the Annual Report and Accounts

Our opinion

We have audited the 2018 financial statements of RBS Holdings N.V. (or the Company), based in Amsterdam. The financial statements include the consolidated financial statements and the company financial statements.

In our opinion:

- The accompanying consolidated financial statements give a true and fair view of the financial position of RBS Holdings N.V. as at 31 December 2018, and of its result and its cash flows for 2018 in accordance with International Financial Reporting Standards as adopted by the European Union (EU-IFRS) and with Part 9 of Book 2 of the Dutch Civil Code.
- The accompanying company financial statements give a true and fair view of the financial position of RBS Holdings N.V. as at 31 December 2018, and of its result for 2018 in accordance with Part 9 of Book 2 of the Dutch Civil Code.

The consolidated financial statements comprise:

- The consolidated balance sheet as at 31 December 2018.
- The following statements for 2018: the consolidated income statement, the consolidated statements of comprehensive income, changes in shareholder's equity and the consolidated cash flow statement.
- The notes comprising a summary of the significant accounting policies and other explanatory information.

The company financial statements comprise:

- The company balance sheet as at 31 December 2018.
- The following statements for 2018: the company income statement and changes in equity.
- The notes comprising a summary of the accounting policies and other explanatory information.

Basis for our opinion

We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. Our responsibilities under those standards are further described in the "Our responsibilities for the audit of the financial statements" section of our report.

We are independent of RBS Holding N.V. in accordance with the Wet toezicht accountantsorganisaties (Wta, Audit firms supervision act), the Verordening inzake de onafhankelijkheid van accountants bij assurance-opdrachten (ViO, Code of Ethics for Professional Accountants, a regulation with respect to independence) and other relevant independence regulations in the Netherlands. Furthermore we have complied with the Verordening gedrags- en beroepsregels accountants (VGBA, Dutch Code of Ethics).

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

Report on other information included in the Annual Report and Accounts

In addition to the financial statements and our auditor's report thereon, the Annual Report and Accounts contains other information that consists of:

- Financial review (the Managing Board's report).
- Other information pursuant to Part 9 of Book 2 of the Dutch Civil Code.
- Additional information.

Based on the following procedures performed, we conclude that the other information:

- Is consistent with the financial statements and does not contain material misstatements.
- Contains the information as required by Part 9 of Book 2 of the Dutch Civil Code.

We have read the other information. Based on our knowledge and understanding obtained through our audit of the financial statements or otherwise, we have considered whether the other information contains material misstatements. By performing these procedures, we comply with the requirements of Part 9 of Book 2 of the Dutch Civil Code and the Dutch Standard 720. The scope of the procedures performed is less than the scope of those performed in our audit of the financial statements.

Management is responsible for the preparation of the other information, including the managing board's report in accordance with Part 9 of Book 2 of the Dutch Civil Code and other information pursuant to Part 9 of Book 2 of the Dutch Civil Code.

Other information

Description of responsibilities for the financial statements

Responsibilities of the Managing Board for the financial statements

The Managing Board is responsible for the preparation and fair presentation of the financial statements in accordance with EU-IFRS and Part 9 of Book 2 of the Dutch Civil Code. Furthermore, the Managing Board is responsible for such internal control as the Managing Board determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

As part of the preparation of the financial statements, the Managing Board is responsible for assessing the company's ability to continue as a going concern. Based on the financial reporting frameworks mentioned, the Managing Board should prepare the financial statements using the going concern basis of accounting unless the Managing Board either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so. The Managing Board should disclose events and circumstances that may cast significant doubt on the company's ability to continue as a going concern in the financial statements.

Our responsibilities for the audit of the financial statements

Our objective is to plan and perform the audit assignment in a manner that allows us to obtain sufficient and appropriate audit evidence for our opinion.

Our audit has been performed with a high, but not absolute, level of assurance, which means we may not have detected all material errors and fraud.

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. The materiality affects the nature, timing and extent of our audit procedures and the evaluation of the effect of identified misstatements on our opinion.

We have exercised professional judgment and have maintained professional scepticism throughout the audit, in accordance with Dutch Standards on Auditing, ethical requirements and independence requirements. Our audit included, for example:

- Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
- Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control.
- Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Managing Board.
- Concluding on the appropriateness of the Managing Board's use of the going concern basis of accounting, and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause a company to cease to continue as a going concern.
- Evaluating the overall presentation, structure and content of the financial statements, including the disclosures.
- Evaluating whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because we are ultimately responsible for the opinion, we are also responsible for directing, supervising and performing the group audit. In this respect we have determined the nature and extent of the audit procedures to be carried out for group entities. Decisive were the size and/or the risk profile of the group entities or operations. On this basis, we selected group entities for which an audit or review had to be carried out on the complete set of financial information or specific items.

We communicate with the Managing Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant findings in internal control that we identify during our audit.

Amsterdam, 18 April 2019
Ernst & Young Accountants LLP

Signed by P.J.A.J Nijssen

Other information

Articles of association

The description set out below is a summary of the material information relating to the Company's share capital, including summaries of certain provisions of the Articles of Association and applicable Dutch law in effect at the relevant date. The Articles of Association of RBS Holdings N.V. were last amended by a notarial deed executed by Mr B.J. Kuck, civil law notary in Amsterdam on 5 April 2013, under register entry number 33220369.

As stated in the Articles of Association the object of the Company is:

- The participation in, collaboration with and financing, administration and management of other enterprises and companies and the performance of all acts, activities and services which are related or may be conducive thereto.
- The engagement in banking and stockbroking activities, the management of third party assets, acting as trustee, administrator, executor of wills and executive director, non-executive director or liquidator of companies or other organisations, the provision of insurances and the performance of all other acts and activities which are related or may be conducive thereto, all in the broadest possible sense.
- The fostering of the direct and indirect interests of all those who are involved in any way in the Company and the safeguarding of the continuity of the Company and its affiliated enterprise(s).

Profit appropriation

Profit is appropriated in accordance with article 37 of the articles of association. The main stipulations with respect to shares currently in issue are as follow:

The Managing Board may decide to make appropriations to reserves, subject to the approval of the Supervisory Board (article 37.2.a.).

The allocation of the amount remaining after these appropriations shall be determined by the General Meeting of Shareholders. The Managing Board, subject to the approval of the Supervisory Board, shall make a proposal to that effect. A proposal to pay a dividend shall be dealt with as a separate agenda item at the General Meeting of Shareholders (article 37.2.a.).

RBS Holdings' policy on reserves and dividends shall be determined and can be amended by the Supervisory Board, upon the proposal of the Managing Board. The adoption of and each subsequent amendment to the policy on reserves and dividends shall be discussed and accounted for at the General Meeting of Shareholders under a separate agenda item (article 37.2.b.).

Subject to approval of the Supervisory Board, the Managing Board may make the dividend or interim dividend on the shares payable, at the discretion of the holders, either in cash or, provided it is authorised to issue shares, partly or wholly in shares in the Company's capital or in a combination thereof, such combination to be determined by the Managing Board (article 37.3.).

Subject to the approval of the Supervisory Board, the Managing Board shall be authorised, in so far as such is permitted by the profit as evidenced by an interim balance sheet drawn up with due observance of the provisions of Section 105, Subsection 4 of Book 2 of the Netherlands Civil Code, to make payable an interim dividend on the shares once or more frequently in the course of any financial year and prior to the approval of the Annual Accounts by the General Meeting of Shareholders (article 37.4.).

Subject to the approval of the Supervisory Board, the Managing Board may decide on a distribution charged against reserves in cash or, if the Board is authorised to issue shares, in the form of shares (article 37.5.).

In February 2019 the Supervisory Board approved a distribution of €28 million to the N-share.

Proposed profit appropriation

Appropriation of net profit pursuant to articles 37.2 and 37.3 of the articles of association:

	2018 €m	2017 €m
Release from reserves	271	(92)

Other information

Shares and voting rights
The company's share capital at 31 December 2018 and 2017 consisted of 89,287 issued and fully paid ordinary shares of €0.56 each. The Company's authorised share capital amounts to €224,000. It comprises 400,000 ordinary shares, each with a nominal value of €0.56.

When shares are issued, each holder of shares shall have pre-emptive right, in proportion to the aggregate amount of their shares, except in the case of an issue of shares for a consideration other than in cash or an issue of shares to employees of the company or of a group company (art.9).

In the event of the dissolution and liquidation of the Company, the assets remaining after payment of all debts will be distributed to the shareholders of ordinary shares on a pro-rata basis (art 39.3).

Relations with shareholders

Rights of shareholders
Any resolution to amend the Articles of Association or dissolve RBS Holdings may only be passed by the General Meeting of Shareholders following a proposal by the Managing Board which has been approved by the Supervisory Board. A copy of the proposal containing the literal text of the proposed amendments shall be made available for inspection by the holders of shares of RBS Holdings at the offices of RBS Holdings and at the offices stated in the convocation to the meeting, from the day of convocation to the end of the Meeting. Each Shareholder may obtain a full copy of the proposal free of charge.

Meetings of shareholders and convocation
General meetings of shareholders shall be held in Amsterdam, or in The Hague, Rotterdam, Utrecht or Haarlemmermeer (Schiphol). Annual General Meeting of Shareholders must be held within six months of the end of each financial year. In addition, General meetings of shareholders shall be held as frequently as deemed necessary by the Managing Board or the Supervisory Board and when required by law or by the Articles of Association. General meetings of shareholders shall be convened by the Managing Board or the Supervisory Board, without prejudice to the provisions of Sections 110, 111 and 112 of Book 2 of the Netherlands Civil Code. Convocation shall take place not later than on the fifteenth day prior to the day of the meeting. Convocation shall state the items to be discussed or alternatively notice shall be given that such items may be inspected at the company's offices.

Proposals to amend the Articles of Association or proposals relating to a reduction of the company's capital shall always be included in the actual convocation.

Incorporation and registration
RBS Holdings N.V. is the parent company of the RBS Holdings N.V. consolidated group of companies. RBS Holdings is a public limited liability company, incorporated under Dutch law on 30 May 1990, and registered at Gustav Mahlerlaan 350, 1082 ME Amsterdam, the Netherlands and is entered in the Trade Register of the Amsterdam Chamber of Commerce under no. 33220369.

Code of conduct
The code of conduct applies to everyone who works for the Group.

It promotes honest and ethical conduct, including the handling of actual or apparent conflicts of interest between personal and professional relationships. The Group recognises that personal conduct, business integrity and the Group's security are crucial, and the code of conduct serves to inform those who work for us of the Group's expectations of their behaviour and practices.

The code of conduct is available on the RBS Group's website www.rbs.com and will be provided to any person without charge, upon request, by contacting Company Secretariat on the telephone number listed below.

Important addresses

Company Secretariat
Claude Debussylaan 94
1082 MD Amsterdam
The Netherlands
Telephone: + 31 20 464 26 99

Investor Relations
280 Bishopsgate
London EC2M 4RB
Telephone: +44 (0)207 672 1758
Facsimile: +44 (0)207 672 1801
Email: investor.relations@rbs.com

Registered office
Claude Debussylaan 94
1082 MD Amsterdam
The Netherlands

Website
https://www.natwestmarkets.com/natwest-markets/about-us/board-and-governance/natwest-markets-n-v-.html

Additional information

Major shareholders
On 17 October 2007, RFS Holdings B.V. (RFS Holdings), a company incorporated by RBS Group, Fortis and Santander, acquired 85.6% of RBS Holdings N.V.. Through subsequent purchases, RFS Holdings increased its stake in RBSH Group to 99.3% as at 31 December 2007. RFS Holdings started squeeze-out proceedings in order to acquire the remainder of the shares in RBSH Group from minority shareholders and this procedure was completed on 22 September 2008. As a result RFS Holdings is from that date the sole shareholder of RBS Holdings N.V.. RFS Holdings is controlled by The Royal Bank of Scotland Group plc, which is incorporated in the UK and registered at 36 St. Andrew Square, Edinburgh, Scotland and The Royal Bank of Scotland Group plc is the ultimate parent company of RBSH Group Holdings N.V..

On 3 October 2008, the Dutch State fully acquired all Fortis' businesses in the Netherlands, including the Fortis share in RFS Holdings. On 24 December 2008, the Dutch State purchased from Fortis Bank Nederland (Holding) N.V. its investment in RFS Holdings, to become a direct shareholder in RFS Holdings. On 31 December 2010, RBS Group increased its shareholding in RFS Holdings to 97.72%. As of that date, the Dutch State has a 1.25% shareholding and Santander has a 1.03% shareholding. On 7 November 2012 the Dutch State transferred its investment to Stichting Administratiekantoor Beheer Financiële Instellingen.

Stock exchange listings
None of the shares in the Group are listed.

Issued share capital
The issued share capital of NWM N.V. consists of 89,287 ordinary shares with a nominal value of €0.56 each.

Dividends
The Group's policy is to pay dividends on ordinary shares taking account the capital position and prospects. For further information on the payment of dividends, refer to Note 7 on the consolidated accounts.

Off-balance sheet arrangements
RBSH Group has no off-balance sheet arrangements that have or are reasonably likely to have an adverse effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

For further information on off-balance sheet commitments and contingent liabilities see Note 22 on the consolidated accounts.