

Company Registered Number: R0000733

ULSTER BANK LIMITED
ANNUAL REPORT AND ACCOUNTS
31 December 2017

Financial review

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Board of directors and secretary

Chairman

Howard Davies

[Nominations \(Chairman\)](#)

Executive directors

Ross McEwan, Chief Executive Officer

[Executive \(Chairman\)](#)

Ewen Stevenson, Chief Finance Officer

[Executive](#)

Independent non-executive directors

Frank Dangeard

[Risk, Technology](#)

Alison Davis

[Technology \(Chairman\), Remuneration, Sustainable Banking](#)

Morten Friis

[Audit, Risk](#)

Robert Gillespie

[Remuneration \(Chairman\), Nominations, Sustainable Banking](#)

Penny Hughes

[Sustainable Banking \(Chairman\), Nominations, Risk](#)

Yasmin Jetha

[Sustainable Banking, Technology](#)

Brendan Nelson

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

Baroness Noakes

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

Mike Rogers

[Remuneration, Sustainable Banking](#)

Mark Seligman

[Senior Independent Director, Nominations, Remuneration](#)

Lena Wilson

Chief Governance Officer and Board Counsel

Aileen Taylor (Company Secretary)

Audit

Executive

Nominations

Remuneration

Risk

Sustainable Banking

Technology

member of the Group Audit Committee

member of the Executive Committee

member of the Group Nominations and Governance Committee

member of the Group Performance and Remuneration Committee

member of the Board Risk Committee

member of the Sustainable Banking Committee

member of the Technology and Innovation Committee

Auditors

Ernst & Young

Chartered Accountants and Statutory Auditor

Ernst & Young Building

Harcourt Centre

Harcourt Street

Dublin 2 D02 YA40

Registered office

11-16 Donegall Square East

Belfast BT1 5UB

Head office

11-16 Donegall Square East

Belfast BT1 5UB

Ulster Bank Limited

Registered in Northern Ireland No. R0000733

Presentation of information

In the report and accounts, and unless specified otherwise, the term 'the Bank' or 'UBL' means Ulster Bank Limited, 'NatWest' means National Westminster Bank Plc, 'NatWest Holdings' means NatWest Holdings Limited, 'RBS plc' means The Royal Bank of Scotland plc, 'RBSG' or 'the ultimate holding company' means The Royal Bank of Scotland Group plc and 'the Group' or 'RBS Group' means the ultimate holding company and its subsidiaries.

The directors of the Bank present their strategic and directors' reports, together with audited financial statements of the Bank for the financial year ended 31 December 2017. The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union (EU).

Principal activities

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

Business review

The Bank's core ambition is to be number one for customer service, trust and advocacy in its market by 2020.

On 1 January 2017, as part of the response of RBS Group to ring fencing legislation and to deliver a simplified group structure, the Bank sold its investment in Ulster Bank (Ireland) Holdings Unlimited Company to NatWest Holdings Limited, a fellow subsidiary of RBSG. As a result the Bank no longer consolidates the Republic of Ireland operations of the RBS Group operating under the Ulster Bank brand. These financial statements present the results and financial position of Ulster Bank Limited as a standalone company.

In 2017 through the 'Help for What Matters' initiative the Bank continued to play an active and leading role in supporting personal and business customers across Northern Ireland in achieving their ambitions. In PBB the 'Help for the movers' campaign contributed to new mortgage lending of £183 million, representing a 14.4% increase year on year. In CPB the use of business reviews to identify customer needs and increased contact strategy contributed to a 15% increase in new lending year on year.

During the year the Bank launched market leading online savings offers and enhanced rates on branch and private deposit accounts, available to existing and new customers, that attracted over £2 billion of additional deposits which are being utilised to support RBS Group lending across the UK.

In 2017 the Bank announced further changes to the way that it interacts with its customers that were reflective of the changing trends in customer behaviours. The announced closure of 20 branches in Northern Ireland was offset by a four-fold increase in the number of Community Bankers. The Community Bankers engage with and support customers to understand the different options that are available to help them to meet their banking needs, including digital channels and via the Post Office. A relaunched Mobile Bank or "bank on wheels", that is Wi-Fi enabled and houses enhanced safety features for a more secure banking service, will regularly serve 17 communities across Northern Ireland.

The Bank also continued to invest significantly in its digital proposition, in particular enhancing and optimising its mobile capabilities. A number of new features were introduced to the app in 2017, including the ability to make international payments and manage multiple business accounts through one login. Customers can now, in addition to using their debit card, make purchases using their credit card with Apple Pay and Android Pay enabled devices. Customers with the iPhone X are able to log into the app using the Face-ID function and all customers can utilise the 'Message us' function to chat to an adviser on a 24/7 basis.

During 2017 the Bank registered a further 17,000 customers for mobile banking and the "Get Cash" feature that enables customers to withdraw cash from any Ulster Bank, NatWest, Tesco or Easycash ATM without the use of their bank card was used over 113,000 times.

The Bank maintained its support for businesses in Northern Ireland during 2017 through continued support of the Entrepreneurial Spark initiative along with the launch of the Boost programme. The Entrepreneurial Spark hub provides facilities to 80 entrepreneurs enabling them to work in a collaborative environment, providing business enablement and networking opportunities and support via a pool of specialised mentors. Figures released in early 2017 reflected that the businesses in the hub in Belfast had generated 231 jobs, £5.3 million of investment and a collective turnover of £12 million. The Bank launched the Boost program in June 2017 and supported events throughout Northern Ireland, giving local business leaders and entrepreneurs the opportunity to hear from expert speakers and gain insights and tips into relevant and topical issues, including cyber security.

Business review continued

The Bank continued with its strong corporate social responsibility (CSR) agenda and holds "CORE (NI)" status, an accreditation awarded by Business in the Community NI, recognising the Bank's commitment to integrating corporate responsibility into the way it does business. The Bank was also recognised as the "Best Age Friendly Business in NI" at awards hosted by the Belfast Chamber of Trade and Commerce. The Bank raised over £150,000 for its charity partners in Northern Ireland through its "One Week In June" initiatives. MoneySense, the Bank's financial education programme for primary and secondary level students, has enjoyed continued success with multiple workshops held across the region, presented by volunteer staff from the Bank. The programme now also includes resources for parents and carers to use at home.

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

	2017	2016
Net interest margin	1.23%	1.21%
Cost:income ratio ⁽¹⁾	81%	94%
CET1 ratio	16.2%	13.1%
Digitally active customers - growth ⁽²⁾	21%	6%

Notes:

(1) The cost:income ratio has been adjusted to eliminate one-off income transactions relating to UBL's investment in disposed subsidiaries.

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

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

Financial performance

The Bank's financial performance is presented in the income statement on page 15.

The Bank reported a total profit after tax for the financial year ended 31 December 2017 of £39 million (2016 - £336 million loss). The 2016 loss was impacted by significant one-off transactions, primarily the impairment of the Bank's investment in its Republic of Ireland operations, partially offset by a dividend received from those operations.

Net interest income

Net interest income increased by 3% to £134 million as the impact of actions taken on deposits pricing in the first quarter was partially offset by a reduction in interest on free funds. The additional interest payable on customer accounts arising from the deposit rate offers in the second half of 2017 was offset by interest receivable on placement of the funds raised with other Group subsidiaries with no overall impact on net interest income.

Non-interest income

Non-interest income moved from a £247 million expense in 2016 to £100 million income mainly due to the significant one-off transactions in 2016 noted above. There was also an increase in trading income in 2017, impacted by the updating of the Bank's interest rate swap profile subsequent to the sale of the Republic of Ireland operations.

Operating expenses

Operating expenses decreased by £26 million primarily due to a reduction in charges for services provided to the Bank by other RBS Group companies, a reduced impact from conduct charges and a continuing focus by the Bank on reducing the underlying cost base.

Impairment gain

The impairment gain reduced to £6 million from £14 million in 2016. Albeit reduced in 2017, the gain in both years was driven by improved residential and commercial property market conditions increasing collateral values and proactive debt management.

Tax

The Bank incurred a tax charge in 2017 of £22 million (2016 - £28 million). The 2017 charge is generated on the taxable profits of the business. The 2016 charge was primarily generated by a decrease in the deferred tax asset in respect of losses as a result of amended UK loss restriction rules from April 2017.

Return on assets

At the year end the total assets of the Bank were £11,987 million (2016 - £15,615 million). Return on total assets for 2017 was 0.5% (2016 - (2.0%)).

Capital ratios

The Bank's capital position remained strong during 2017. Its CET 1 ratio increased from 13.1% at 31 December 2016 to 16.2% at 31 December 2017 and remains above the regulatory minimum.

During 2017 the Bank executed a staged restructure of its capital base subsequent to the sale of the Republic of Ireland operations. The directors declared and paid a £3,900 million dividend on completion of the sale in January. In July a £60 million Additional Tier 1 loan replaced £658 million of Euro denominated preference share capital which was converted to distributable reserves. A further £681 million dividend was paid to the Bank's shareholder. In December 2017 the Bank redeemed £100 million of Sterling and €860 million of Euro denominated subordinated debt to re-align the Tier 2 capital position.

Outlook

The Bank remains vulnerable to changes and uncertainty in the external economic and political environment, which have intensified in the past year. Scenarios identified as having a potentially material negative impact on the Bank include: the impact of the UK's exit from the EU ("Brexit"); continued political uncertainty in Northern Ireland; a UK recession including significant falls in house prices; global financial market volatility linked to advanced economy interest rate increases or decreases; a protracted period of low interest rates in the UK; vulnerabilities in emerging market economies resulting in contagion in the local market; a Eurozone crisis; and major geopolitical instability.

The Bank will continue to focus on cost reduction but intends to increase focus and pace on digitisation which may necessitate increased investment and innovation spend.

With the introduction of IFRS 9 impairments are expected to be more volatile and the directors remain mindful of potential downside risks, particularly from single name and sector driven events. The consensus view on Brexit suggests a weaker Northern Ireland economy in the short to medium term. With the current high level of household debt and real wage compression any increases in unemployment and interest rates present a threat to retail impairment rates. In wholesale portfolios any further softening of regional GDP growth would be expected to impact credit losses negatively.

The Bank continues to maintain a long term CET1 target of 13% and is cognisant of a range of variables that are likely to impact over the coming years. These include:

- RWA inflation as a result of Bank of England mortgage floors and Basel 3 amendments; and
- expected increased and pro-cyclical impairment volatility as a result of IFRS 9.

Accounting policies

The reported results of the Bank are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its accounts. Details of the Bank's critical accounting policies and key sources of estimation uncertainty are included in the accounting policies on pages 25 to 26.

Risk management

The Bank has established a framework for managing risk, which is continually evolving as the Bank's business activities change in response to market, credit, product, regulatory and other developments. The major risks associated with the Bank's businesses and the Bank's policies for managing each of these risks and its exposure thereto are detailed in note 18 to the accounts. The principal risk associated with the Bank's business is credit risk.

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

Employees

Engaging our colleagues

The Bank values the input of its employees and actively seeks opportunities to engage with staff at all levels and invites them to contribute to on-going dialogue and activities to make the Bank a better organisation for our customers and staff. The annual survey of employee opinions, known as Our View, provides valuable data to decision makers across the Bank in support of improving employee engagement and satisfaction. We track our progress through pulse surveys utilising questions common across the financial services industry to enable comparison against our peers. In addition we run an annual Working Together Survey where a representative sample provides feedback on the services provided by our support functions.

Community engagement

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

The Bank is represented on the European Employee Council which facilitates dialogue amongst employee representatives in the European Economic Area.

Employment of people with disabilities

The Bank's policy is that people with disabilities are considered for employment and subsequent training, career development and promotion based on merit. If members of staff become disabled, it is the Bank's policy, wherever possible, to retain them in their existing jobs or to re-deploy them in suitable alternative duties.

Strategic report

Inclusion

The Bank values and promotes diversity in all areas of recruitment and employment. Building a working environment where all our employees can develop to their full potential is important to us irrespective of their age, belief, disability, ethnic or national origin, gender, gender identity, marital or civil partnership status, political opinion, race, religion or sexual orientation. We work hard to avoid limiting potential through bias, prejudice or discrimination. We need a diverse mix of uniquely talented individuals to deliver great service to our diverse customer base. Key principles of our Diversity and Inclusion Policy include that we attract, motivate and retain the best talent. We base the employment relationship on the principles of fairness, respect and inclusion. We comply with local laws on equality and Our Code, the Bank's code of conduct, to build and develop an inclusive workforce in order to understand and respond to our diverse customer base.

Safety, health and wellbeing

The Bank recognises that people are key to the success of its business. The Bank's vision is for its employees, peers and communities to recognise that the Bank's pride and performance in safety, health and wellbeing adds value to them and to the Bank's business. Industry leading expertise, innovative tools, products and services and a practical approach to implementation are combined to ensure improved performance continues to be delivered.

The Bank promotes flexible working for its employees. We support managers and individuals to facilitate flexible working. Employees are able to avail of a range of flexible working options including regular or occasional working from home, working variable hours or working part time.

Opportunities to improve the efficiency and effectiveness of safety, health and wellbeing management policies and services were monitored and, where relevant, implemented. In 2017 we have focused on improving wellbeing for our employees through the introduction of the Virgin Pulse Challenge, Employee Health Checks and improved Wellbeing support materials for line managers and employees.

By order of the Board:

Aileen Taylor
Company Secretary

22 February 2018

Ulster Bank Limited is registered in Northern Ireland No.
R0000733

Report of the directors

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

Board of directors

On 28 July 2017 the directors of the ultimate holding company were appointed to the board of the Bank. In order to align board membership with that of the ultimate holding company the directors who had been in place immediately prior to 28 July 2017 resigned on that date.

The Board is the main decision-making forum for the Bank. It has overall responsibility for management of the business and affairs of the Bank, the establishment of the Bank strategy and the allocation and raising of capital, and is accountable to shareholders for financial and operational performance. The Board considers strategic issues and ensures the Bank manages risk effectively through approving and monitoring the Bank's risk appetite, considering Bank stress scenarios and agreed mitigants and identifying longer term strategic threats to the Bank's business operations. The Board's terms of reference includes key aspects of the Bank's affairs reserved for the Board's decision and are reviewed at least annually.

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

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

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

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

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

The Group Performance and Remuneration Committee comprises at least three independent non-executive directors and has oversight of the Bank's policy on remuneration. It also considers senior executive remuneration and makes recommendations to the Board on remuneration of executive directors.

The Group Nominations and Governance Committee comprises five independent non-executive directors and is chaired by the Chairman of the Group. It assists the Board in the selection and appointment of directors. It reviews the structure, size and composition of the Board, and membership and chairmanship of Board committees. The Committee also has responsibility for monitoring the Bank's governance arrangements in order to ensure best corporate governance standards and practices are upheld.

The Technology and Innovation Committee comprises of independent non-executive directors. Recognising the strategic importance of technology and innovation to RBS's business, the Board established a new Board Committee in August 2017. The Technology and Innovation Committee is responsible for assisting the Board in overseeing and monitoring execution of our strategic direction in relation to technology and innovation.

The Sustainable Banking Committee comprises of independent non-executive directors. It is responsible for overseeing and challenging how management is addressing sustainability and reputation issues relating to all stakeholder groups, except where such issues have already been dealt with by other Board committees.

The Executive Committee comprises the Group's most senior executives and supports the Chief Executive Officer in managing the Bank's business. It reviews strategic issues and initiatives, monitors financial performance and capital allocations, and considers risk strategy, policy and risk management.

Report of the directors

Directors and secretaries

The names of the current members of the Board of Directors are shown on page 1. From 1 January 2017 to date the following changes have taken place:

	Appointed	Resigned
Directors		
Frank Dangeard	28 July 2017	-
Howard Davies	28 July 2017	-
Alison Davis	28 July 2017	-
Morten Friis	28 July 2017	-
Robert Gillespie	28 July 2017	-
Penny Hughes	28 July 2017	-
Yasmin Jetha	28 July 2017	-
Ross McEwan	28 July 2017	-
Brendan Nelson	28 July 2017	-
Baroness Noakes	28 July 2017	-
Mike Rogers	28 July 2017	-
Mark Seligman	28 July 2017	-
Ewen Stevenson	28 July 2017	-
Lena Wilson	1 January 2018	-
Christopher Campbell	-	28 July 2017
Sandy Crombie	28 July 2017	1 January 2018
Ellvena Graham	-	30 June 2017
John Hughes	28 July 2017	1 September 2017
Michael Larkin	-	28 July 2017
Leslie Matheson	-	28 July 2017
Des O'Shea	-	28 July 2017
Rosemary Quinlan	-	28 July 2017
Company Secretary		
Aileen Taylor	28 July 2017	-
Sheryl Anderson	-	28 July 2017

In accordance with the Articles of Association, the directors are not required to retire by rotation.

Share capital

Details of the ordinary share capital at 31 December 2017 are shown in note 15 on the accounts.

Directors' indemnities

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

In terms of section 236 of the Companies Act, Qualifying Pension Scheme Indemnity Provisions have been issued to all trustees of the Bank's pension scheme.

Political donations

During 2017, no political donations were made nor any political expenditure incurred (2016 - nil).

Dividends

The directors do not recommend the payment of a final dividend on ordinary shares (2016 - nil). During 2017 the directors approved and paid interim dividends of £4,581 million (2016 - £1,273 million).

Post balance sheet events

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

Country-by-Country Reporting

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

Report of the directors

Going concern

The directors, having considered the Bank's business activities and financial position discussed in the business review (pages 2 to 3), its liquidity and funding profile and the risk factors set out in note 18 and having made such enquiries as they considered appropriate, have prepared the financial statements on a going concern basis. They considered the financial statements of the Group for the year ended 31 December 2017, approved on 22 February 2018, which were prepared on a going concern basis.

Directors' disclosure to auditors

Each of the directors at the date of approval of this report confirms that:

- (a) so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- (b) the director has taken all steps he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

By order of the Board:

Aileen Taylor
Company Secretary

22 February 2018

Ulster Bank Limited is registered in Northern Ireland No.
R0000733

Statement of directors' responsibilities

This statement should be read in conjunction with the responsibilities of the auditor set out in their report on page 14.

The directors are responsible for the preparation of the Annual Report and Accounts. As permitted by the Companies Act 2006 the directors have elected to prepare accounts, for each financial year in accordance with International Financial Reporting Standards as adopted by the European Union. They are responsible for preparing accounts that present fairly the financial position, financial performance and cash flows of the company. In preparing those accounts, the directors are required to:

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

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

The directors confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company; and
- the strategic report and report of the directors includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal risks and uncertainties that they face.

By order of the Board:

Howard Davies
Chairman

Ross McEwan
Chief Executive Officer

Ewen Stevenson
Chief Financial Officer

22 February 2018

Board of directors

Chairman

Howard Davies

Executive directors

Ross McEwan

Ewen Stevenson

Non-executive directors

Frank Dangeard

Alison Davis

Morten Friis

Robert Gillespie

Penny Hughes

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Brendan Nelson

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Mike Rogers

Mark Seligman

Lena Wilson

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

Opinion

We have audited the financial statements of Ulster Bank Limited ('the Company') for the year ended 31 December 2017, which comprise the Income Statement, Statement of Comprehensive Income, Balance Sheet, Statement of Changes in Equity, Cash flow Statement, summary of significant accounting policies and the related notes 1 to 29 (excluding those marked as 'unaudited'). The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

In our opinion, the financial statements:

- give a true and fair view of the company's affairs as at 31 December 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

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

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

Use of our report

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

Conclusions relating to going concern

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

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

Overview of our audit approach

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

Key audit matters

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

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

Risk	Our response to the risk
<p>Impairment provision on loans and advances to customers</p> <p>As at 31 December 2017, gross loans and advances to customers amounted to £3,855m (2016: £3,882m) and the related impairment provision amounted to £119m (2016: £168m). The basis of the impairment provision policy is presented within 'Critical accounting policies and key sources of estimation uncertainty' note (iii) and further analysed in Note 7 to the financial statements.</p> <p>The Company exercises significant judgement, using subjective assumptions, when determining both the timing and the amounts of the impairment provision for loans and advances. As retail and commercial loans and advances form a significant portion of the Company's assets, and due to the significance of judgement used in estimating both the specific and collective provisions, this is considered to be a key area of audit focus.</p> <p>We have focused on the following critical judgements and estimates which could give rise to material misstatement or are potentially subject to management bias:</p> <ul style="list-style-type: none"> • The completeness and timing of recognition of loss events. • The measurement of individually assessed provisions, which is dependent on the valuation of collateral, the timing of cash flows and realisations. • The measurement of modelled provisions, which is dependent upon key assumptions relating to probability of default and recovery rates. <p>Refer to the Critical accounting policies and key sources of estimation uncertainty (page 25); and Note 7 of the Financial Statements (page 38).</p>	<p>Impairment provisions recognised in respect of retail and commercial lending are determined by management using discounted cash flow assessments and modelling techniques that utilise customer data, historical loan performance, expected future performance and a variety of market assumptions. We focused on the assumptions underlying the calculation of modelled provisions and the discounted cash flow assessments.</p> <p>In obtaining sufficient audit evidence we:</p> <ul style="list-style-type: none"> • Reviewed design and operating effectiveness of key controls around the end-to-end process of initiation, classification and performance monitoring, assessment and approval of impairment provisions, governance and model validation, with consideration given to susceptibility of controls to management override. • Verified key data inputs employed by modelling tools and impairment calculations. • Reviewed impairment methodology to establish model parameters and utilised our credit risk specialists to test the assumptions and calculations of modelled provisions. • For a risk based sample of performing commercial loans, we performed file reviews to assess whether any IAS 39 loss indicators were present and test classifications of facilities. • For non-performing loans, we tested a sample of the bank's loan reviews. With the support of our valuation specialists, we assessed the measurement of the provisions by testing the valuation of collateral where relevant. We examined other cash flow assumptions where the level of provision is not dependent on collateral values. We also assessed the reasonableness of the timing of estimated cash flows. • Evaluated and challenged key assumptions adopted by management. • Assessed the appropriateness and presentation of disclosures with relevant accounting standards. <p>Our planned audit procedures were completed without material exception.</p>
<p>Recoverability of deferred tax assets</p> <p>The Company has deferred tax assets of £10m (2016: £11m), of which £14m (2016: £14m) arises from tax losses carried forward.</p> <p>As set out within 'Critical accounting policies and key sources of estimation uncertainty' note (ii), the recognition and carrying value of deferred tax assets requires management judgement and estimation in assessing the probability and sufficiency of future taxable profits from which deductible temporary differences and unutilised tax losses can be offset.</p> <p>In light of the inherent uncertainty and significant amount of judgement and estimation required by management, we have considered future forecasts supporting the recognition of deferred tax assets to be an area of audit focus.</p> <p>Refer to the Critical accounting policies and key sources of estimation uncertainty (page 25); and Note 13 of the Financial Statements (page 41).</p>	<p>In the performance of our audit procedures, focus was placed on assessing the key judgement inputs and assumptions underlying the profit projections such as macro-economic assumptions, business growth rates, cost reduction and restructuring initiatives.</p> <p>In obtaining sufficient audit evidence we:</p> <ul style="list-style-type: none"> • Tested the design and operating effectiveness of the Company's key controls around the preparation and review of budgets and forecasts supporting deferred tax assessment and profitability projections, including appropriate governance procedures and management challenge. • Reviewed and challenged inputs and assumptions embedded in forecasts, considering whether the overall forecasts are reasonable and achievable based on performance, our understanding of the business and the economic environment. • Assessed the reasonableness of deferred tax assets recognised in the context of the actual results, management profit projections and the Company's strategic plans. • Evaluated how previous management forecasts compared to actual results to assess the accuracy of the forecasting process. <p>Our planned audit procedures were completed without material exception.</p>

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

Risk	Our response to the risk
<p>IT systems and controls</p> <p>Our audit procedures have a focus on IT systems and controls due to the pervasive nature and complexity of the IT environment, the large volume of transactions processed in numerous locations daily and the reliance on automated and IT dependent manual controls.</p> <p>Key areas of audit focus included the changeover to a new General Ledger system during the year, user access management, developer access to the production environment and changes to the IT environment. The effectiveness of these areas is key to ensuring IT dependent and application based controls are operating effectively.</p>	<p>We tested the design and operating effectiveness of the Company's IT controls over the information systems that support critical business processes relevant to financial reporting.</p> <p>In obtaining sufficient audit evidence we:</p> <ul style="list-style-type: none"> • Tested IT general controls (logical access, changes management and aspects of IT operational controls). This included testing that requests for access to systems were appropriately reviewed and authorised. • Tested the Company's periodic review of access rights. • Inspected requests of changes to systems for appropriate approval and authorisation and the assessment of segregation of duties between developers and those with the ability to promote changes to production. • Reviewed and assessed the control environment relating to various interfaces, configuration and other application layer controls identified as key to our audit. <p>Our planned audit procedures were completed without material exception.</p>

An overview of the scope of our audit

Tailoring the scope

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

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

Our application of materiality

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

Materiality

Materiality is the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Company to be £9.7m (2016: £49.7m), which is 2% (2016: 1%) of Equity. We believe that Equity provides us with the most appropriate basis for materiality having considered the expectation of the users of the financial statements and the overall business environment.

Performance materiality

Performance materiality is the threshold for application of materiality at the individual account or balance level. Performance materiality is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Company's overall control environment, our judgement was that performance materiality was 75% (2016: 50%) of our planning materiality, namely £7.3m (2016: £24.8m). We have set performance materiality at this level having considered our prior year experience of the risk of misstatements, both corrected and uncorrected.

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

Reporting threshold

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

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.5m (2016: £2.5m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. Our reporting threshold amount is designated at an amount below which misstatements would not be accumulated because we expect that the accumulation of such amounts clearly would not have a material effect on the financial statements.

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

Other information

The directors are responsible for the other information. Other information comprises the information included in the Annual Report other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

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

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

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

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

Matters on which we are required to report by exception

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

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

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

Responsibilities of directors

As explained more fully in the statement directors' responsibilities set out on page 9, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditor's responsibilities for the audit of the financial statements

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

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

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Company and have a direct impact on the preparation of the financial statements.
- We assessed the susceptibility of the financial statements to material misstatement, including how fraud might occur by holding discussions with senior management, including the Deputy Chief Financial Officer, Group General Counsel, Head of Internal Audit and Audit Committee Chairman. We also reviewed the fraud-related policies and mandates of different governance forums assessing fraud.
- As part of our audit procedures, we were aware of the risk of fraud, especially in the areas of estimation and those we assessed as having the risk of management override.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved inquiring of key management, reviewing the key policies and reports on the aforementioned regulatory frameworks as well as reviewing the correspondence exchanged with the Regulators.

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

Other matters we are required to address

- We were appointed by the company to audit the financial statements for the year ending 31 December 2016 and subsequent financial periods. The current period of total uninterrupted engagement including previous renewals and reappointments of the firm is 2 years.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the company and we remain independent of the company in conducting the audit.
- The audit opinion is consistent with the additional report to the audit committee.

Martina Keane
for and on behalf of
Ernst & Young Chartered Accountants and Statutory Auditor

Office: Dublin

Date: 22/02/2018

Income statement for the year ended 31 December 2017

	Note	2017 £m	2016 £m
Interest receivable		168	178
Interest payable		(34)	(48)
Net interest income	1	134	130
Fees and commission receivable		50	56
Fees and commission payable		(9)	(7)
Income from trading activities		13	(9)
Other operating income		46	(287)
Non-interest income	2	100	(247)
Total income		234	(117)
Operating expenses	3	(179)	(205)
Operating profit/(loss) before impairment		55	(322)
Impairment gain	7	6	14
Operating profit/(loss) before tax		61	(308)
Tax charge	5	(22)	(28)
Profit/(loss) for the year		39	(336)
Attributable to:			
Ordinary shareholders		39	(336)
		39	(336)

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

Statement of comprehensive income for the year ended 31 December 2017

	2017	2016
	£m	£m
Profit/(loss) for the year	39	(336)
Items that will not be reclassified subsequently to profit or loss:		
Actuarial losses on defined benefit plans and other movements	(7)	(48)
Tax	1	13
Other comprehensive loss after tax	(6)	(35)
Total comprehensive income/(loss) for the year	<u>33</u>	<u>(371)</u>
Attributable to:		
Ordinary shareholders	33	(371)
	<u>33</u>	<u>(371)</u>

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

Balance sheet as at 31 December 2017

	Note	2017 £m	2016 £m
Assets			
Cash and balances at central banks	6	1,032	1,012
Loans and advances to banks	6	7,149	5,935
Loans and advances to customers	6	3,736	3,714
Derivatives	8	9	7
Property, plant and equipment	10	45	43
Prepayments, accrued income and other assets	11	6	10
Deferred taxation	13	10	11
Assets held for sale	6	-	4,883
Total assets		11,987	15,615
Liabilities			
Deposits by banks	6	2,675	3,099
Customer accounts	6	7,841	5,765
Derivatives	8	18	35
Provisions, accruals and other liabilities	12	845	801
Current tax	6	15	-
Subordinated liabilities	14	107	939
Total liabilities		11,501	10,639
Equity			
Owners' equity	15,16	314	455
Reserves		172	4,521
Total equity	6	486	4,976
Total liabilities and equity		11,987	15,615

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

The accounts were approved by the Board of Directors on 22 February 2018 and signed on its behalf by:

Howard Davies
Chairman

Ross McEwan
Chief Executive Officer

Ewen Stevenson
Chief Financial Officer

Ulster Bank Limited is registered in Northern Ireland No. R0000733

Statement of changes in equity for the year ended 31 December 2017

	2017	2016
	£m	£m
Called up share capital		
At 1 January	455	1,521
Reduction of ordinary share capital	-	(1,066)
Conversion of preference share capital to retained earnings	(201)	-
At 31 December	254	455
Paid-in equity		
At 1 January	-	-
Additional Tier 1 loan (note 16)	60	-
At 31 December	60	-
Share premium account		
At 1 January	457	891
Reduction of ordinary share capital	-	(434)
Conversion of preference share capital to retained earnings	(457)	-
At 31 December	-	457
Retained earnings		
At 1 January	4,064	4,208
Actuarial losses on defined benefit plans and other movements	(7)	(48)
Tax	1	13
Conversion of preference share capital to retained earnings	658	-
Reduction of ordinary share capital	-	1,500
Profit/(loss) attributable to ordinary shareholders	39	(336)
Paid-in equity coupon payments	(2)	-
Dividends paid	(4,581)	(1,273)
At 31 December	172	4,064
Owners' equity at 31 December	486	4,976
Total comprehensive income recognised in the statement of changes in equity is attributable as follows:		
Ordinary shareholders	33	(371)
	33	(371)

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

Cash flow statement for the year ended 31 December 2017

	Note	2017 £m	2016 £m
Cash flows from operating activities			
Operating profit/(loss) before tax		61	(308)
Adjustments for:			
Dividends received		(14)	(1,271)
Depreciation, amortisation and impairment of property, plant and equipment		3	3
Interest on subordinated liabilities		4	5
Charge for defined benefit pension schemes		13	10
Cash contribution to defined benefit pension schemes		(20)	(42)
Impairment recoveries		(6)	(14)
Loans and advances written-off net of recoveries		(42)	(384)
Impairment loss on investments in Group undertakings		-	1,549
Elimination of foreign exchange differences		19	62
Other non-cash items		5	13
Net cash flows from/(used in) trading activities		23	(377)
Changes in operating assets and liabilities		2,077	849
Net cash flows from operating activities before tax		2,100	472
Income taxes paid		(5)	(4)
Net cash flows from operating activities	20	2,095	468
Cash flows from investing activities			
Purchase of property, plant and equipment		(5)	(4)
Sale of property, plant and equipment		-	2
Sale of investment in Group undertakings		4,883	-
Dividends received		14	1,271
Net cash flows from investing activities		4,892	1,269
Cash flows from financing activities			
Issue of Additional Tier 1 loan		60	-
Repayment of debt securities in issue		-	(1)
Repayment of subordinated loans		(857)	-
Interest on subordinated liabilities		(4)	(5)
Paid-in equity coupon payments		(2)	-
Dividends paid		(4,581)	(1,273)
Net cash flows used in financing activities		(5,384)	(1,279)
Effect of exchange rate changes on cash and cash equivalents		6	57
Net increase in cash and cash equivalents		1,609	515
Cash and cash equivalents 1 January	23	4,411	3,896
Cash and cash equivalents 31 December	23	6,020	4,411

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

Accounting policies

1. Presentation of accounts

The accounts are prepared on a going concern basis and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the IFRS Interpretations Committee of the IASB as adopted by the European Union (EU) (together IFRS).

The company is incorporated in the UK and registered in Northern Ireland. Its accounts are presented in accordance with the Companies Act 2006. With the exception of certain financial instruments as described in accounting policies 12 and 14 the accounts are presented on a historical cost basis.

The Bank adopted two revisions to IFRSs effective 1 January 2017:

In January 2016, the IASB amended IAS 7 'Cash Flow Statements' to require disclosure of the movements in financing liabilities.

In January 2016, the IASB amended IAS 12 'Income Taxes' to clarify the recognition of deferred tax assets in respect of unrealised losses.

Neither of these amendments has had a material effect on the Bank's financial statements.

2. Basis of consolidation

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

3. Revenue recognition

Interest income on financial assets that are classified as loans and receivables and interest expense on financial liabilities other than those measured at fair value are determined using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees payable or receivable that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows.

Financial assets and financial liabilities held for trading or designated as at fair value through profit or loss are recorded at fair value. Changes in fair value are recognised in profit or loss.

Fees in respect of services are recognised as the right to consideration accrues through the provision of the service to the customer. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable. The application of this policy to significant fee types is outlined below.

Payment services - this comprises income received for payment services including cheques cashed, direct debits, Clearing House Automated Payments (the UK electronic settlement system) and BACS payments (the automated clearing house that processes direct debits and direct credits). These are generally charged on a per transaction basis. The income is earned when the payment or transaction occurs. Charges for payment services are usually debited to the customer's account monthly or quarterly in arrears. Income is accrued at period end for services provided but not yet charged.

Credit and debit card fees - fees from card business include:

- Interchange received: as issuer, the Bank receives a fee (interchange) each time a cardholder purchases goods and services. The Bank also receives interchange fees from other card issuers for providing cash advances through its branch and automated teller machine networks. These fees are accrued once the transaction has taken place.
- Periodic fees payable by a credit card or debit card holders are deferred and taken to profit or loss over the period of the service.

Lending (credit facilities) - commitment and utilisation fees are determined as a percentage of the outstanding facility. If it is unlikely that a specific lending arrangement will be entered into, such fees are taken to profit or loss over the life of the facility, otherwise they are deferred and included in the effective interest rate on the loan.

Brokerage fees - in respect of securities, foreign exchange, futures or options transactions entered into on behalf of a customer are recognised as income on execution of a significant act.

Trade finance - income from the provision of trade finance is recognised over the term of the finance unless specifically related to a significant act, in which case income is recognised when the act is executed.

Accounting policies

4. Assets held for sale and discontinued operations

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

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

5. Employee benefits

Short-term employee benefits, such as salaries, paid absences, and other benefits are accounted for on an accruals basis over the period in which the employees provide the related services. Employees may receive variable compensation satisfied by cash or by debt instruments or shares issued by RBSG. Variable compensation that is settled in cash or debt instruments is charged to profit or loss over the period from the start of the year to which the variable compensation relates to the expected settlement date taking account of forfeiture and claw back criteria.

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

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

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

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

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

6. Property, plant and equipment

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, these are accounted for separately.

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

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

Freehold buildings	50 years
Long leasehold property (leases with more than 50 years to run)	50 years
Short leaseholds	unexpired period of lease
Property adaptation costs	10 to 15 years
Computer equipment	up to 5 years
Other equipment	4 to 15 years

The residual value and useful life of property, plant and equipment are reviewed at each balance sheet date and updated for any changes to previous estimates.

7. Impairment of non-financial assets

At each balance sheet date, the Bank assesses whether there is any indication that its non-financial assets are impaired. If any such indication exists, the Bank estimates the recoverable amount of the asset and the impairment loss if any.

If an asset does not generate cash flows that are independent from those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The recoverable amount of an asset or cash-generating unit is the higher of its fair value less cost to sell and its value in use.

Value in use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash-generating unit that have not been taken into account in estimating future cash flows. If the recoverable amount of a tangible asset is less than its carrying value, an impairment loss is recognised immediately in profit or loss and the carrying value of the asset reduced by the amount of the loss.

Accounting policies

A reversal of an impairment loss on non-financial assets can be recognised when an increase in service potential arises provided the increased carrying value is not greater than it would have been had no impairment loss been recognised. Impairment losses on goodwill are not reversed.

8. Foreign currencies

The Bank's accounts are presented in Sterling which is the functional currency of the company.

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.

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.

9. Leases

As lessee

The Bank'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 Bank.

10. Provisions

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

If the Bank 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 Bank's contractual obligations exceed the expected economic benefits. When the Bank 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.

11. Tax

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

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

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

12. Financial assets

On initial recognition, financial assets are classified into held-to-maturity investments; held-for-trading; designated as at fair value through profit or loss; loans and receivables; or available-for-sale financial assets. Regular way purchases of financial assets classified as loans and receivables are recognised on the settlement date; all other regular way transactions in financial assets are recognised on the trade date.

Held-for-trading - a financial asset is classified as held-for trading if it is acquired principally for sale in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial assets are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Income from trading activities includes gains and losses on held-for trading financial assets as they arise.

Loans and receivables - non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables, except those that are classified as available-for-sale or as held-for trading, or designated as at fair value through profit or loss. Loans and receivables are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see accounting policy 3) less any impairment losses.

Accounting policies

Reclassifications - held-for-trading and available-for-sale financial assets that meet the definition of loans and receivables (non-derivative financial assets with fixed or determinable payments that are not quoted in an active market) may be reclassified to loans and receivables if the Bank has the intention and ability to hold the financial asset for the foreseeable future or until maturity. The Bank typically regards the foreseeable future for this purpose as twelve months from the date of reclassification.

Additionally, held-for-trading financial assets that do not meet the definition of loans and receivables may, in rare circumstances, be transferred to available-for-sale financial assets or to held-to-maturity investments. Reclassifications are made at fair value. This fair value becomes the asset's new cost or amortised cost as appropriate. Gains and losses recognised up to the date of reclassification are not reversed.

Fair value - the Bank'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 6 on the accounts.

13. Impairment of financial assets

The Bank assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as loans and receivables is impaired. A financial asset or group of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows.

Loans and receivables - if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables has been incurred, the Bank measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition. For collateralised loans and receivables, estimated future cash flows include cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable. Where, in the course of the orderly realisation of a loan, it is exchanged for equity shares or property, the exchange is accounted for as the sale of the loan and the acquisition of equity securities or investment property.

Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant. In making collective impairment assessments, financial assets are grouped into portfolios on the basis of similar risk characteristics. Future cash flows from these portfolios are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics.

Historical loss experience is adjusted, on the basis of observable data, to reflect current conditions not affecting the period of historical experience. Impairment losses are recognised in profit or loss and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses. If, in a subsequent period, the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance.

Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

Impaired loans and receivables are written off, i.e. the impairment provision is applied in writing down the loan's carrying value partially or in full, when the Bank concludes that there is no longer any realistic prospect of recovery of part or all of the loan. For loans that are individually assessed for impairment, the timing of 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.

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

14. Financial liabilities

Financial liabilities are recognised initially at fair value and classified into held-for-trading; designated as at fair value through profit or loss; or amortised cost. Issues of financial liabilities measured at amortised cost are recognised on settlement date; all other regular way transactions in financial liabilities are recognised on trade date.

Held-for-trading - a financial liability is classified as held-for trading if it is incurred principally for repurchase in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial liabilities are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Gains and losses are recognised in profit or loss as they arise.

Designated as at fair value through profit or loss - financial liabilities may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both that the Bank manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

Accounting policies

Financial liabilities that the Bank designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Income from trading activities includes gains and losses on held-for-trading financial liabilities as they arise.

Amortised cost - all other financial liabilities are measured at amortised cost using the effective interest method (see accounting policy 3).

Fair value - the Bank'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 6 on the accounts.

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 Bank 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 Bank 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 Bank assesses whether or not it has retained control of the asset. If the Bank has retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement; if the Bank 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 Bank, the Bank 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. Netting

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

17. Capital instruments

The Bank 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 Bank after the deduction of liabilities.

18. Derivatives and hedging

Derivative financial instruments are initially recognised, and subsequently measured, at fair value. The Bank's approach to determining the fair value of financial instruments is set out in the section of critical accounting policies and key sources of estimation uncertainty entitled Fair value – financial instruments; further details are given in note 6 on the accounts.

A derivative embedded in a contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract; unless the entire contract is measured at fair value with changes in fair value recognised in profit or loss.

Gains and losses arising from changes in the fair value of derivatives that are not the hedging instrument in a qualifying hedge are recognised as they arise in profit or loss. Gains and losses are recorded in Income from trading activities except for gains and losses on those derivatives that are managed together with financial instruments designated at fair value; these gains and losses are included in other operating income.

The Bank enters into hedge relationships in respect of changes in the fair value of a recognised asset or liability or unrecognised firm commitment (fair value hedges).

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 Bank revokes the designation of a hedge relationship.

Accounting policies

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.

19. 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.

20. Shares in subsidiaries

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

21. Critical accounting policies and key sources of estimation uncertainty

The reported results of the Bank are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law and IFRS require the directors, in preparing the Bank's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent.

In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's 'Conceptual Framework for Financial Reporting'.

The judgements and assumptions involved in the Bank's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Bank would affect its reported results.

(i) Provisions for liabilities

Provisions are liabilities of uncertain timing or amount, and are recognised when there is a present obligation as a result of a past event, the outflow of economic benefit is probable and the outflow can be estimated reliably. Judgement is involved in determining whether an obligation exists, and in estimating the probability, timing and amount of any outflows. Where the Bank can look to another party such as an insurer to pay some or all of the expenditure required to settle a provision, any reimbursement is recognised when, and only when, it is virtually certain that it will be received.

Before the existence of a present obligation as the result of a past event can be confirmed, numerous facts may need to be established, involving extensive and time-consuming discovery, and novel or unsettled legal questions addressed. Once it is determined there is an obligation, assessing the probability of economic outflows and estimating the amount of any liability can be very difficult. In many proceedings, it is not possible to determine whether any loss is probable or to estimate the amount of any loss. Furthermore, for an individual matter, there can be a wide range of possible outcomes and often it is not practicable to quantify a range of such outcomes. The Bank's outstanding litigation is periodically assessed in consultation with external professional advisers, where appropriate, to determine the likelihood of the Bank incurring a liability. A detailed description of the Bank's material legal proceedings and a discussion of the nature of the associated uncertainties are given in note 19 on the accounts.

(ii) Deferred tax

The Bank makes provision for deferred tax on temporary differences where tax recognition occurs at a different time from accounting recognition.

The Bank has recognised deferred tax assets in respect of losses and temporary differences. Deferred tax assets are recognised in respect of unused tax losses and other temporary differences to the extent that it is probable that there will be future taxable profits against which the losses and other temporary differences can be utilised. The Bank has considered the carrying value of the deferred tax asset as at 31 December 2017 and concluded that it is recoverable based on future projections. Deferred tax assets of £14 million were recognised as at 31 December 2017 (2016 - £14 million) in respect of losses.

Deferred tax assets of £15 million (2016 - £15 million) have not been recognised in respect of tax losses where the availability of future taxable profits is uncertain. Further details about the Bank's deferred tax assets are given in note 13 on the accounts.

(iii) Loan impairment provisions

The Bank's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans classified as loans and receivables and carried at amortised cost in accordance with accounting policy 13.

A loan is impaired when there is objective evidence that events since the loan was granted have affected expected cash flows from the loan. Such objective evidence, indicative that a borrower's financial condition has deteriorated, can include for loans that are individually assessed: the non-payment of interest or principal; debt renegotiation; probable bankruptcy or liquidation; significant reduction in the value of any security; breach of limits or covenants; and deteriorating trading performance and, for collectively assessed portfolios: the borrowers' payment status and observable data about relevant macroeconomic measures.

Accounting policies

The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate. There are two components to the Bank's loan impairment provisions: individual and collective.

Individual component - all impaired loans that exceed specific thresholds are individually assessed for impairment. Individually assessed loans principally comprise the Bank's portfolio of commercial loans to medium and large businesses. Impairment losses are recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held. These estimates take into account the customer's debt capacity and financial flexibility; the level and quality of its earnings; the amount and sources of cash flows; the industry in which the counterparty operates; and the realisable value of any security held. Estimating the quantum and timing of future recoveries involves significant judgement. The size of receipts will depend on the future performance of the borrower and the value of security, both of which will be affected by future economic conditions. Additionally, collateral may not be readily marketable. The actual amount of future cash flows and the date they are received may differ from these estimates and consequently actual losses incurred may differ from those recognised in these financial statements.

Collective component - this is made up of two elements: loan impairment provisions for impaired loans that are below individual assessment thresholds (collectively assessed provisions) and for loan losses that have been incurred but have not been separately identified at the balance sheet date (latent loss provisions). Collectively assessed provisions are established on a portfolio basis using a present value methodology taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates and the related average life. These portfolios include mortgages, credit card receivables and other personal lending. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions.

These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends. Latent loss provisions are held against estimated impairment losses in the performing portfolio that have yet to be identified as at the balance sheet date. To assess the latent loss within its portfolios, the Bank has developed methodologies to estimate the time that an asset can remain impaired within a performing portfolio before it is identified and reported as such.

22. Accounting developments International Financial Reporting Standards

A number of IFRSs and amendments to IFRS were in issue at 31 December 2017 that would affect RBS Group from 1 January 2018 or later.

Effective 1 January 2018 - IFRS 9

In July 2014, the IASB published IFRS 9 'Financial Instruments' with an effective date of 1 January 2018. IFRS 9 replaces the current financial instruments standard IAS 39 'Financial Instruments: Recognition and Measurement', setting out new accounting requirements in a number of areas.

The principle features of IFRS 9 are as follows:

Classification and measurement

Financial assets - There are three classifications for financial assets in IFRS 9.

- **Amortised cost** - financial assets with terms that give rise to interest and principal cash flows only and which are held in a business model whose objective is to hold financial assets to collect their cash flow are measured at amortised cost.
- **Fair value through other comprehensive income** - financial assets with terms that give rise to interest and principal cash flows only and which are held in a business model whose objective is achieved by holding financial assets to collect their cash flow and selling them are measured at fair value through other comprehensive income.
- **Fair value through profit and loss** - other financial assets are measured at fair value through profit and loss.

At initial recognition, any financial asset may be irrevocably designated as measured at fair value through profit or loss if such designation eliminates a measurement or recognition inconsistency.

The measurement basis of the majority of the Bank's financial assets will be unchanged on application of IFRS 9.

Financial liabilities - since early adopting in 2016 the IFRS 9 accounting for fair value attributable to own credit risk there are no further material changes on accounting for financial liabilities on adoption of IFRS 9.

Hedge accounting

IFRS 9's hedge accounting requirements are designed to align accounting more closely to the risk management framework; permit a greater variety of hedging instruments; and remove or simplify some of the rule-based requirements in IAS 39. The elements of hedge accounting: fair value, cash flow and net investment hedges are retained. The Bank accounting policy choice is to continue with the IAS 39 hedge accounting framework.

Accounting policies

Credit impairment

IFRS 9's credit impairment requirements apply to financial assets measured at amortised cost, to those measured at fair value through other comprehensive income, to lease receivables and to certain loan commitments and financial guarantee contracts. On initial recognition a loss allowance is established at an amount equal to 12-month expected credit losses (ECL) that is the portion of life-time expected losses resulting from default events that are possible within the next 12 months. Where a significant increase in credit risk since initial recognition is identified, the loss allowance increases so as to recognise all expected default events over the expected life of the asset. The Bank expects that financial assets where there is objective evidence of impairment under IAS 39 will be credit impaired under IFRS 9, and carry loss allowances based on all expected default events.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted: determined by evaluating at the balance sheet date for each customer or loan portfolio a range of possible outcomes using reasonable and supportable information about past events, current conditions, forecasts of future events and economic conditions. The estimation of ECL also takes into account the discount of future cash flows. Recognition and measurement of credit impairments under IFRS 9 are more forward-looking than under IAS 39.

An RBS Group-wide programme has implemented the necessary changes in the modelling of credit loss parameters, and the underlying credit management and financial processes. The result is an increase in overall credit impairment provisions when compared with the current basis of measurement under IAS 39.

Recognition and derecognition

The material in IAS 39 setting out the criteria for the recognition and derecognition of financial instruments have been included unamended in IFRS 9.

Transition

The classification and measurement and impairment requirements will be applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods.

In summary, on 1 January 2018:

- The change in impairment methodology will lead to a £4.9 million pre-tax reduction in equity.
- The net tax impact is a £1 million increase in equity.
- This results in a £3.9 million net post tax reduction in equity.

There will be no restatement of accounts prior to 2018.

The Bank has opted to early adopt the IFRS 9 amendment on negative compensation with effect from 1 January 2018; this is expected to be endorsed for use in the EU in early 2018.

Effective 1 January 2018 – other standards

IFRS 15 'Revenue from Contracts with Customers' was issued in May 2014. It will replace IAS 11 'Construction Contracts', IAS 18 'Revenue' and several Interpretations. Contracts are bundled or unbundled into distinct performance obligations with revenue recognised as the obligations are met.

The Bank has also adopted IFRS 15 'Revenue from Contracts with Customers' from 1 January 2018; it is not expected to have a material impact on shareholders' equity.

IFRS 2 'Share-based Payment' was amended in June 2016 to clarify the accounting for net settlement of tax in respect of share-based payments and the calculation of the cost of modified awards and those with vesting conditions that are not market conditions.

IFRIC Interpretation 22 'Foreign Currency Transaction and Advance Consideration' was issued in December 2016 clarifying the date of a foreign exchange transaction to be used on initial recognition of a related asset or other item.

IAS 40 'Investment Property' was amended in December 2016 to clarify that transfers into or out of the investment property classification may only occur on a change of use or the property ceasing to meet the definition of an investment property. The effective date is 1 January 2018.

Effective after 2018

IFRS 16 'Leases' was issued in January 2016 to replace IAS 17 'Leases'. There are no substantial changes to the accounting for leases by lessors. For lessees: accounting for finance leases will remain substantially the same; operating leases will be brought on balance sheet through the recognition of assets representing the contractual rights of use and liabilities will be recognised for the contractual payments. The effective date is 1 January 2019.

IFRS 17 'Insurance Contracts' was issued in May 2017 to replace IFRS 4 and to establish a comprehensive standard for acceptors of insurance policies. The effective date is 1 January 2021.

IFRIC Interpretation 23 'Uncertainty over income tax treatments' was issued in June 2017 to clarify how to apply judgement in assessing the tax position of the reporting entity. The effective date is 1 January 2019.

In October 2017, the IASB amended IAS 28 'Investments in Associates and Joint Ventures' to require long term, non-equity interests in these investments to be tested for impairment first in accordance with IFRS 9 and then in accordance with IAS 28. The effective date of the amendment is 1 January 2019.

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

Notes to the accounts

1. Net interest income

	2017	2016
	£m	£m
Loans and advances to customers	123	123
Loans and advances to banks	45	55
Interest receivable	168	178
Customer accounts	(16)	(16)
Deposits by banks	(14)	(27)
Subordinated liabilities	(4)	(5)
Interest payable	(34)	(48)
Net interest income	134	130

Included within net interest income is £1 million (2016 - £2 million) of interest on impaired loans.

2. Non-interest income

	2017	2016
	£m	£m
Fees and commission receivable		
Payment services	17	21
Credit and debit card fees	15	14
Lending (credit facilities)	16	15
Brokerage	1	1
Trade finance	-	1
Other	1	4
	50	56
Fees and commission payable	(9)	(7)
Income from trading activities⁽¹⁾:		
Foreign exchange	3	-
Interest rate	10	(9)
	13	(9)
Other operating income:		
Income on services provided to other RBS Group companies	50	49
Loss on disposal or settlement of loans and receivables	(18)	(2)
Other income ⁽²⁾	14	(334)
	46	(287)
Non-interest income	100	(247)

Notes:

(1) The analysis of trading income is based on how the business is organised and the underlying risks managed. Foreign exchange includes income from spot foreign exchange contracts and currency swaps.

(2) Other income in 2017 represents dividends from subsidiary companies. Other income in 2016 primarily represents a £1,271m dividend from the Bank's former subsidiary, Ulster Bank Ireland Holdings Unlimited Company, offset by an impairment of investment in group undertakings in respect of the same entity (note 9).

Notes to the accounts

3. Operating expenses

	2017	2016
	£m	£m
Wages, salaries and other staff costs	61	70
Social security costs	7	7
Pension costs:		
- defined benefit schemes (see note 4)	13	10
- defined contribution schemes (see note 4)	1	1
Restructure costs	6	2
Staff costs	88	90
Premises and equipment	21	16
Administration	67	96
Other expenses	88	112
Property, plant and equipment depreciation (see note 10)	3	3
Operating expenses	179	205

The average number of persons employed by the Bank during the year, excluding temporary staff, was 1,969 (2016 - 2,216). The average number of temporary employees during 2017 was 170 (2016 - 78). The number of persons employed by the Bank at 31 December, excluding temporary staff, was as follows:

	2017	2016
	Number	Number
PBB	774	822
CPB	75	103
Other	1,001	1,133
	1,850	2,058

Other represents central functions comprising Treasury, Customer Debt Solutions, Finance, Risk, Legal and Human Resources which support the PBB and CPB divisions and other RBS Group subsidiaries.

Included within Other are 602 staff members (2016 - 722) whose roles involve the provision of services exclusively to other companies in RBS Group including attributable central costs at an arm's length transfer pricing mark up. The staff costs of these employees are recharged to the companies they provide services to.

	2017	2016
	£'000	£'000
Auditors' remuneration		
Audit of the Bank's annual accounts	385	210
Assurance services	-	36
	385	246

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

Auditors' remuneration is disclosed exclusive of VAT.

Notes to the accounts

4. Pensions

Defined contribution schemes

The Bank contributes to a small number of RBS Group Pension Schemes, the costs of which are accounted for as defined contributions. The Bank made contributions of £1 million to its defined contribution schemes in 2017 (2016 - £1 million).

Defined benefit scheme

The Bank sponsors the Ulster Bank Pension Scheme (UBPS), which operates under UK trust law and is managed and administered on behalf of its members in accordance with the terms of the trust deed, the scheme rules and UK legislation (principally the Pension Schemes Act 1993, the Pensions Act 1995 and the Pensions Act 2004). Under UK legislation a defined benefit pension scheme is required to meet the statutory funding objective of having sufficient and appropriate assets to cover its liabilities.

The UBPS corporate trustee is Ulster Bank Pension Trustees Limited (UBPTL) a wholly owned subsidiary of the Bank. UBPTL is the legal owner of the scheme assets which are held separately from the assets of the Bank. The board of UBPTL comprises 3 trustee directors nominated by members selected from eligible active staff and pensioner members who apply and 6 appointed by the Bank. The board is responsible for operating the scheme in line with its formal rules and pensions law. It has a duty to act in the best interests of all scheme members, including pensioners and those who are no longer employed by the Bank, but who still have benefits in the scheme.

Pension fund trustees are required to: prepare a statement of funding principles; obtain regular actuarial valuations and reports; put in place a recovery plan addressing any funding shortfall; and send regular summary funding statements to members of the scheme.

The scheme was closed to new entrants in 2009, when a new defined contribution scheme was launched.

Employees make contributions at varying levels depending on when they joined the scheme. In addition, employees may make voluntary contributions to secure additional benefits on a money-purchase basis.

Pension risk is the risk to the Bank arising from its contractual or other liabilities to, or with respect to, its pension scheme, whether established for its employees, for those of a related company or otherwise. For further details on pension risk refer to note 18.

Investment strategy

The assets of the UBPS are invested in a diversified portfolio of quoted equities, government and corporate fixed-interest and index-linked bonds, and other assets including real estate and hedge funds.

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

Major classes of plan assets as a percentage of total plan assets	2017	2016
Quoted assets		
Quoted equities	7%	22%
Index-linked bonds	30%	33%
Government fixed interest bonds	3%	-
Corporate and other bonds	23%	21%
Unquoted assets		
Private equity	1%	1%
Hedge funds	3%	3%
Real estate	3%	5%
Derivatives	10%	10%
Cash and other assets	20%	5%

Amounts in the financial statements

The Bank recognises the net pension scheme surplus or deficit as an asset or liability. In doing so, the funded status is adjusted to reflect any surplus that the Bank may not be able to access, as well as any minimum funding requirement to pay in additional contributions.

	2017 £m	2016 £m
Amounts recognised on the balance sheet		
Fund assets at fair value	1,191	1,162
Present value of fund liabilities	(896)	(884)
Funded status	295	278
Asset ceiling/minimum funding	(295)	(278)
Retirement benefit asset	-	-

	2017 £m	2016 £m
Amounts recognised in the income statement		
Operating expenses	13	10

Notes to the accounts

4. Pensions continued

	Fair value of plan assets	Present value of defined benefit obligations	Asset ceiling/ minimum funding ⁽¹⁾	Net pension surplus
	£m	£m	£m	£m
Changes in value of net pension asset				
At 1 January 2017	1,162	(884)	(278)	-
<i>Income statement:</i>				
Net interest cost	31	(23)	-	8
Current service cost	-	(12)	-	(12)
Past service cost	-	(1)	-	(1)
Interest on the asset ceiling	-	-	(8)	(8)
	31	(36)	(8)	(13)
<i>Statement of comprehensive income:</i>				
Return on plan assets above recognised interest income	9	-	-	9
Experience gains and losses	-	(1)	-	(1)
Effect of changes in actuarial financial assumptions	-	(17)	-	(17)
Effect of changes in actuarial demographic assumptions	-	11	-	11
Loss resulting from changes in amounts not recognised due to effect of asset ceiling amounts recognised in net interest income	-	-	(17)	(17)
Gain resulting from changes in additional liability due to minimum funding requirements excluding amounts recognised in net interest income	-	-	8	8
	9	(7)	(9)	(7)
Contributions by employer	20	-	-	20
Contributions by plan participants	1	(1)	-	-
Benefits paid	(32)	32	-	-
At 31 December 2017	1,191	(896)	(295)	-

	Fair value of plan assets	Present value of defined benefit obligations	Asset ceiling/ minimum funding ⁽¹⁾	Net pension surplus
	£m	£m	£m	£m
Changes in value of net pension asset				
At 1 January 2016	911	(755)	(140)	16
<i>Income statement:</i>				
Net interest cost	36	(30)	-	6
Current service cost	-	(10)	-	(10)
Past service cost	-	(1)	-	(1)
Interest on the asset ceiling	-	-	(5)	(5)
	36	(41)	(5)	(10)
<i>Statement of comprehensive income:</i>				
Return on plan assets above recognised interest income	200	-	-	200
Experience gains and losses	-	42	-	42
Effect of changes in actuarial financial assumptions	-	(184)	-	(184)
Effect of changes in actuarial demographic assumptions	-	27	-	27
Loss resulting from changes in amounts not recognised due to effect of asset ceiling excluding amounts recognised in net interest income	-	-	(243)	(243)
Gain resulting from changes in additional liability due to minimum funding requirements excluding amounts recognised in net interest income	-	-	110	110
	200	(115)	(133)	(48)
Contributions by employer	42	-	-	42
Contributions by plan participants	1	(1)	-	-
Benefits paid	(28)	28	-	-
At 31 December 2016	1,162	(884)	(278)	-

Note:

(1) In recognising the net surplus or deficit of a pension scheme, the funded status of the scheme is adjusted to reflect any minimum funding requirement imposed on the sponsor and any ceiling on the amount that the sponsor has a right to recover from the scheme.

Notes to the accounts

4. Pensions continued

Funding and contributions by the Bank

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

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

The Bank expects to contribute £11 million to its defined benefit pension scheme in 2018.

Assumptions

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

An interim valuation of the Bank's scheme was prepared to 31 December 2017 by the scheme actuary using the following assumptions:

Principal actuarial assumptions at 31 December	2017	2016
Discount rate	2.55%	2.70%
Rate of increase in salaries	1.75%-3.10%	1.75%-3.20%
Rate of increase in pensions in payment	0.00%-2.20%	0.00%-2.25%
Inflation assumption	2.10%	2.20%
Post-retirement mortality assumptions	2017	2016
Longevity for current pensioners currently aged 70 (years)		
Males	19.5	19.6
Females	20.8	21.0
Longevity for future pensioners currently aged 63 (years)		
Males	25.9	26.1
Females	27.4	27.8

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

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

	(Decrease)/increase in pension cost for the year		(Decrease)/increase in obligation at 31 December	
	2017 £m	2016 £m	2017 £m	2016 £m
0.25% increase in the discount rate	(2.9)	(2.5)	(43)	(44)
0.25% increase in inflation	1.3	1.4	26	29
0.25% additional rate of increase in pensions in payment	1.0	1.3	22	21
0.25% additional rate of increase in deferred pensions	0.3	0.3	10	10
0.25% additional rate of increase in salaries	0.5	0.5	3	6
Longevity increase of 1 year	0.8	0.9	20	19

The average duration of the Bank's defined benefit obligation is 21 years (2016 - 21 years).

Notes to the accounts

4. Pensions continued

The experience history of the scheme is shown below:

	2017	2016	2015	2014	2013
	£m	£m	£m	£m	£m
History of defined benefit schemes					
Fair value of plan assets	1,191	1,162	911	889	731
Present value of defined benefit obligations	896	884	755	770	654
Net surplus	295	278	156	119	77
Experience (losses)/gains on plan liabilities	(1)	42	8	6	7
Experience gains/(losses) on plan assets	9	200	(33)	99	28
Actual return on pension scheme assets	40	236	1	132	58

5. Taxation

	2017	2016
	£m	£m
Current taxation:		
<i>United Kingdom corporation tax at 19.25% (2016 - 20%)</i>		
Charge for the year	(14)	(1)
Under provision in respect of prior periods	(6)	-
Total current taxation	(20)	(1)
Deferred taxation:		
Charge for the year	(1)	(12)
(Under)/over provision in respect of prior periods	(1)	2
Reduction in the carrying value of deferred tax asset in respect of losses	-	(17)
Total deferred taxation	(2)	(27)
Tax charge for the year	(22)	(28)

The actual tax charge differs from the expected tax charge/(credit) computed by applying the standard rate of UK Corporation Tax of 19.25% (2016 - 20%) as follows:

	2017	2016
	£m	£m
Operating profit/(loss) before tax	61	(308)
Expected tax (charge)/credit	(12)	62
<i>Factors affecting the charge for the year:</i>		
Non-deductible items	(4)	(326)
Non-taxable income	3	254
Surcharge on banking companies ⁽¹⁾	(5)	-
UK tax rate change impact	-	(3)
Losses brought forward and utilised	3	-
Reduction in the carrying value of deferred tax asset in respect of losses	-	(17)
Adjustments to tax charge in respect of prior periods	(7)	2
Actual tax charge for the year	(22)	(28)

Note:

(1) The main rate of UK Corporation Tax reduced from 20% to 19% on 1 April 2017 and will reduce to 17% from 1 April 2020. Under the Finance (No 2) Act 2015, tax losses carried forward at 31 December 2017 are given credit in future periods at the main rate of UK corporation tax rate, excluding the Banking Surcharge rate (8%) introduced by the Act. Deferred tax assets and liabilities at 31 December 2017 take into account the reduced rates in respect of tax losses and non-banking temporary differences and where appropriate, the banking surcharge inclusive rate in respect of other banking temporary differences. As this is a banking company, the Banking Surcharge rate of 8% is applied from 1 January 2016.

Notes to the accounts

6. Financial instruments - classification

The following tables analyse the financial assets and financial liabilities of the Bank in accordance with the categories of financial instruments as defined by IAS 39. Assets and liabilities outside the scope of IAS 39 are shown within non financial assets/liabilities.

	Held-for-trading	Designated as at fair value through profit or loss	Loans and receivables	Amortised cost	Non financial assets / liabilities	Total
	£m	£m	£m	£m	£m	£m
2017						
Assets						
Cash and balances at central banks	-	-	1,032	-	-	1,032
Loans and advances to banks ⁽¹⁾	-	-	7,149	-	-	7,149
Loans and advances to customers	-	-	3,736	-	-	3,736
Derivatives	9	-	-	-	-	9
Property, plant and equipment	-	-	-	-	45	45
Prepayments, accrued income and other assets	-	-	-	-	6	6
Deferred taxation	-	-	-	-	10	10
	9	-	11,917	-	61	11,987
Liabilities						
Deposits by banks ⁽²⁾	-	-	-	2,675	-	2,675
Customer accounts ⁽³⁾	-	36	-	7,805	-	7,841
Derivatives	18	-	-	-	-	18
Provisions, accruals and other liabilities	-	-	-	803	42	845
Current tax	-	-	-	-	15	15
Subordinated liabilities	-	-	-	107	-	107
	18	36	-	11,390	57	11,501
Equity						486
						11,987

	Held-for-trading	Designated as at fair value through profit or loss	Loans and receivables	Amortised cost	Non financial assets / liabilities	Total
	£m	£m	£m	£m	£m	£m
2016						
Assets						
Cash and balances at central banks	-	-	1,012	-	-	1,012
Loans and advances to banks ⁽¹⁾	-	-	5,935	-	-	5,935
Loans and advances to customers	-	-	3,714	-	-	3,714
Derivatives	7	-	-	-	-	7
Property, plant and equipment	-	-	-	-	43	43
Prepayments, accrued income and other assets	-	-	-	-	10	10
Deferred taxation	-	-	-	-	11	11
Assets held for sale	-	-	-	-	4,883	4,883
	7	-	10,661	-	4,947	15,615
Liabilities						
Deposits by banks ⁽²⁾	-	-	-	3,099	-	3,099
Customer accounts ⁽³⁾	-	121	-	5,644	-	5,765
Derivatives	35	-	-	-	-	35
Provisions, accruals and other liabilities	-	-	-	752	49	801
Subordinated liabilities	-	-	-	939	-	939
	35	121	-	10,434	49	10,639
Equity						4,976
						15,615

Notes:

- (1) Includes items in the course of collection from other banks of £41 million (2016 - £37 million).
- (2) Includes items in the course of transmission to other banks of £16 million (2016 - £15 million).
- (3) The carrying amount of other customer accounts designated as at fair value through profit or loss is £1 million lower (2016 - £3 million) than the principal amount.
- (4) There are no financial instruments that are subject to IAS 32 (on balance sheet) netting arrangements or subject to enforceable master netting instruments or similar agreements that are not set off in accordance with IAS 32.

Notes to the accounts

6. Financial instruments - valuation

Valuation of financial instruments carried at fair value

Control environment

The Bank places reliance on NatWest Markets independent price verification (IPV) process and the Bank eliminates its market risk on its trading book portfolios by entering into back to back positions with RBS plc.

Common valuation policies, procedures, frameworks and models apply across the Bank. Therefore, for the most part, discussions on these aspects below reflect those in the Bank as relevant for businesses in the Bank.

The Bank's control environment for the determination of the fair value of financial instruments includes formalised protocols for the review and validation of fair values independent of the businesses entering into the transactions. There are specific controls to ensure consistent pricing policies and procedures, incorporating disciplined price verification. The Bank ensures that appropriate attention is given to bespoke transactions, structured products, illiquid products and other instruments which are difficult to price.

Independent price verification

IPV is a key element of the control environment. Valuations are first performed by the business which entered into the transaction. Such valuations may be directly from available prices, or may be derived using a model and variable model inputs. These valuations are reviewed, and if necessary amended, by a team independent of those trading the financial instruments, in the light of available pricing evidence.

IPV differences are classified according to the quality of independent market observables into IPV quality bands linked to the fair value hierarchy principles, as laid out in IFRS 13 'Fair Value Measurement'. These differences are classified into fair value levels 1, 2 and 3 (with the valuation uncertainty risk increasing as the levels rise from 1 to 3) and then further classified into high, medium, low and indicative depending on the quality of the independent data available to validate the prices. Valuations are revised if they are outside agreed thresholds.

Governance framework

IPV takes place at least each month end date, for exposures in the trading book and at least quarterly for exposures in the banking book. The IPV control includes formalised reporting and escalation of any valuation differences in breach of established thresholds. The Pricing Unit determines IPV policy, monitors adherence to that policy and performs additional independent reviews of highly subjective valuation issues.

Valuation hierarchy

Initial classification of a financial instrument is carried out by the Product Control team following the principles in IFRS 13. They base their judgement on information gathered during the IPV process for instruments which include the sourcing of independent prices and model inputs.

The quality and completeness of the information gathered in the IPV process gives an indication as to the liquidity and valuation uncertainty of an instrument.

These initial classifications are reviewed and challenged by the Pricing Unit and are also subject to senior management review. Particular attention is paid to instruments crossing from one level to another, new instrument classes or products, instruments that are generating significant profit and loss and instruments where valuation uncertainty is high.

Valuation techniques

The Bank derives fair value of its instruments differently depending on whether the instrument is a non-modelled or a modelled product.

Non-modelled products

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

Modelled products

Modelled products valued using a pricing model range in complexity from comparatively vanilla products such as interest rate swaps and options (e.g. interest rate caps and floors) through to more complex derivatives. The valuation of modelled products requires an appropriate model and inputs into this model. Sometimes models are also used to derive inputs (e.g. to construct volatility surfaces). The Group uses a number of modelling methodologies.

Inputs to valuation models

Values between and beyond available data points are obtained by interpolation and extrapolation. When utilising valuation techniques, the fair value can be significantly affected by the choice of valuation model and by underlying assumptions concerning factors such as the amounts and timing of cash flows, discount rates and credit risk. The principal inputs to these valuation techniques are as follows:

- Bond prices - quoted prices are generally available for government bonds, certain corporate securities and some mortgage-related products.
- 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 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.
- Prepayment rates - the fair value of a financial instrument that can be prepaid by the issuer or borrower differs from that of an instrument that cannot be prepaid. In valuing prepayable instruments that are not quoted in active markets, the Group considers the value of the prepayment option.

Notes to the accounts

6. Financial instruments - valuation continued

- 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

Valuation of financial instruments in the banking books are made to the mid-price.

The following tables show the financial instruments carried at fair value by valuation method:

	2017				2016			
	Level 1 ⁽¹⁾	Level 2 ⁽²⁾	Level 3 ⁽³⁾	Total	Level 1 ⁽¹⁾	Level 2 ⁽²⁾	Level 3 ⁽³⁾	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Assets								
Derivatives	-	9	-	9	-	7	-	7
Total	-	9	-	9	-	7	-	7
Liabilities								
Customer accounts	-	36	-	36	-	121	-	121
Derivatives	-	18	-	18	-	35	-	35
Total	-	54	-	54	-	156	-	156

Notes:

(1) Level 1: valued using unadjusted quoted prices in active markets for identical financial instruments. This category includes listed equity shares and government securities.

(2) Level 2: valued using techniques based significantly on observable market data. Instruments in this category are valued using:

- quoted prices for similar instruments or identical instruments in markets which are not considered to be active; or
- valuation techniques where all the inputs that have a significant effect on the valuation are directly or indirectly based on observable market data.

Level 2 instruments included non-G10 government securities, most government agency securities, certain mortgage products, most bank loans, repos and reverse repos, less liquid listed equities, and most OTC derivatives.

The type of instruments that trade in markets that are not considered to be active, but are based on quoted market prices, broker dealer quotations or alternative pricing sources with reasonable levels of price transparency and those instruments valued using techniques include most government agency securities, investment-grade corporate bonds, certain mortgage products, certain bank and bridge loans, repos and reverse repos, less liquid equities, state and municipal obligations, most physical commodities, investment contracts issued by the Bank's life assurance businesses and certain money market securities and loan commitments and most OTC derivatives.

(3) Level 3: instruments in this category have been valued using a valuation technique where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data.

Level 3 instruments primarily include cash instruments which trade infrequently, certain mortgage loans, unlisted equity shares, asset-backed products and less liquid debt securities, and OTC derivatives where valuation depends upon unobservable inputs. No gain or loss is recognised on the initial recognition of a financial instrument valued using a technique incorporating significant unobservable data.

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

	2017	2017	2016	2016
	Carrying value	Fair value	Carrying value	Fair value
	£m	£m	£m	£m
Financial assets				
Cash and balances at central banks	1,032	1,032	1,012	1,012
Loans and advances to banks	7,149	7,149	5,935	5,935
Loans and advances to customers	3,736	3,712	3,714	3,675
Financial liabilities				
Deposits by banks	2,675	2,675	3,099	3,099
Customer accounts	7,805	7,805	5,644	5,644
Notes in circulation ⁽¹⁾	803	803	752	752
Subordinated liabilities	107	97	939	843

Note:

(1) Included in accruals and other liabilities.

Notes to the accounts

6. Financial instruments - valuation continued

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

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

Short-term financial instruments

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

Financial instruments - maturity analysis

Remaining maturity

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

	2017			2016		
	Less than 12 months £m	More than 12 months £m	Total £m	Less than 12 months £m	More than 12 months £m	Total £m
Assets						
Cash and balances at central banks	1,032	-	1,032	1,012	-	1,012
Loans and advances to banks	5,261	1,888	7,149	3,941	1,994	5,935
Loans and advances to customers	953	2,783	3,736	1,003	2,711	3,714
Derivatives	4	5	9	5	2	7
Liabilities						
Deposits by banks	2,350	325	2,675	2,654	445	3,099
Customer accounts	7,831	10	7,841	5,728	37	5,765
Derivatives	6	12	18	9	26	35
Subordinated liabilities	-	107	107	343	596	939

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 Bank's loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans. The principal method used to estimate fair value in the Bank is to discount expected cash flows at the current offer rate for the same or similar products.

Deposits by banks and customer accounts

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

Subordinated liabilities

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

Notes to the accounts

7. Financial assets - impairments

The following tables show the movement in the provision for impairment losses on loans and advances:

	Collective component			2017 £m	2016 £m
	Individual component £m	Collectively assessed £m	Latent £m		
At 1 January	29	123	16	168	568
Amounts written-off ⁽¹⁾	(15)	(31)	-	(46)	(396)
Recoveries of amounts previously written-off	3	1	-	4	12
Release to the income statement	(3)	-	(3)	(6)	(14)
Unwind of discount (recognised in interest income)	-	(1)	-	(1)	(2)
At 31 December ⁽²⁾	14	92	13	119	168

Notes:

(1) 2016 movement includes amounts relating to impairments previously recognised on assets included in sale transactions. Amounts written-off do not include any loans and advances to banks.

(2) Impairment provisions as at 31 December 2017 and 31 December 2016 do not include any balances held against loans and advances to banks.

Loan impairment

The Bank considers financial assets to be impaired when there is no longer a reasonable prospect of receiving the contractual cash flows in accordance with the contract and the net present value of any security is less than the outstanding amount.

The following tables analyse impaired financial assets:

	2017			2016		
	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m
Impaired financial assets						
Loans and advances to customers	138	(106)	32	191	(152)	39
- of which are individually assessed	14	(14)	-	29	(29)	-
					2017 £m	2016 £m

Gross income not recognised at balance sheet date but which would have been recognised under the original terms of impaired loans

15 34

The following tables show loans and advances to customers that were past due at the balance sheet date but not considered impaired:

	Past due 1–29 days £m	Past due 30–59 days £m	Past due 60–89 days £m	Past due more than 90 days £m	Total £m
	2017	50	14	8	3
2016	49	12	8	3	72

Notes to the accounts

8. Derivatives

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

	2017			2016		
	Notional amounts £m	Assets £m	Liabilities £m	Notional amounts £m	Assets £m	Liabilities £m
Over-the-counter derivatives						
Foreign exchange contracts:						
Spot, forwards and futures	240	3	3	259	5	4
Interest rate contracts:						
Interest rate swaps	3,360	6	15	2,428	2	31
	3,600	9	18	2,687	7	35

9. Shares in subsidiaries

Shares in subsidiaries are carried at cost less impairment. Movements during the year were as follows:

	2017 £m	2016 £m
At 1 January	-	6,432
Impairment loss	-	(1,549)
Transfer to assets held for disposal	-	(4,883)
At 31 December	-	-

On 1 January 2017 the Bank sold its shareholding in Ulster Bank Ireland Holdings Unlimited Company, an intermediate parent company of Ulster Bank Ireland Designated Activity Company (UBIDAC) for consideration equal to the valuation determined and UBIDAC is therefore no longer a principal related undertaking of the Bank.

Full information on all subsidiaries is included in note 27. At the balance sheet date the carrying value of the Bank's shares in subsidiary undertakings was £400,113.

Notes to the accounts

10. Property, plant and equipment

2017	Freehold land and buildings £m	Leases of 50 years or more unexpired £m	Leases of 50 years or less unexpired £m	Computer and other equipment £m	Total £m
Cost or valuation:					
At 1 January	36	21	9	51	117
Additions	3	-	-	2	5
Disposals	(1)	(1)	-	-	(2)
At 31 December	<u>38</u>	<u>20</u>	<u>9</u>	<u>53</u>	<u>120</u>
Accumulated impairment, depreciation and amortisation:					
At 1 January	15	5	7	47	74
Disposals	(1)	(1)	-	-	(2)
Depreciation charge for the year	1	-	1	1	3
At 31 December	<u>15</u>	<u>4</u>	<u>8</u>	<u>48</u>	<u>75</u>
Carrying amount at 31 December 2017	<u>23</u>	<u>16</u>	<u>1</u>	<u>5</u>	<u>45</u>

2016

Cost or valuation:					
At 1 January	36	20	8	51	115
Additions	1	1	1	1	4
Disposals	(1)	-	-	(1)	(2)
At 31 December	<u>36</u>	<u>21</u>	<u>9</u>	<u>51</u>	<u>117</u>
Accumulated impairment, depreciation and amortisation:					
At 1 January	14	5	6	46	71
Disposals	-	-	-	-	-
Depreciation charge for the year	1	-	1	1	3
At 31 December	<u>15</u>	<u>5</u>	<u>7</u>	<u>47</u>	<u>74</u>
Carrying amount at 31 December 2016	<u>21</u>	<u>16</u>	<u>2</u>	<u>4</u>	<u>43</u>

There was no profit on disposal of freehold land and buildings during the year (2016 - nil).

11. Prepayments, accrued income and other assets

	2017 £m	2016 £m
Prepayments	2	3
Accrued income	2	3
Current tax	-	2
Other assets	2	2
	<u>6</u>	<u>10</u>

Notes to the accounts

12. Provisions, accruals and other liabilities

	2017 £m	2016 £m
Notes in circulation	803	752
Accruals	13	18
Deferred income	2	-
Provisions for liabilities and charges	25	26
Other liabilities	2	5
	845	801

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

	Property £m	Payment protection insurance £m	Global Restructuring Group (GRG) £m	Other £m	Total £m
Provisions at 1 January 2016	5	12	-	6	23
Transfer from accruals	-	-	-	6	6
Charge to income statement	1	-	6	2	9
Utilised in the year	(1)	(3)	-	(1)	(5)
Release to income statement	(2)	-	-	(5)	(7)
Provisions at 31 December 2016	3	9	6	8	26
Transfer from accruals	-	-	-	2	2
Charge to income statement	4	-	-	5	9
Utilised in the year	-	(1)	(2)	(5)	(8)
Release to income statement	(1)	-	-	(3)	(4)
Provisions at 31 December 2017	6	8	4	7	25

Property provisions

The property provisions principally comprise provisions for onerous lease contracts. The timing for such payments is uncertain. Provision is made for future rentals payable in respect of vacant leasehold property and for any shortfall where leased property is sub-let at a rental lower than the lease rentals payable by the Bank.

Payment protection insurance (PPI)

The PPI provision was established to reflect future costs as estimated using current experience of PPI complaints received. The eventual cost is dependent upon complaint volumes, uphold rates and average redress costs. Assumptions relating to these are inherently uncertain and the ultimate financial impact may be different from the amount provided. The remaining provision of £8 million represents expected costs at current utilisation rates.

Global Restructuring Group (GRG)

The Bank holds a provision in respect of the FCA review of the treatment of SME customers, relating to the automatic refund of complex fees for SME customers that were in GRG between 2008 and 2013, additional redress costs arising from a new complaints process and the associated operational costs. Background information in relation to the FCA review of SME customers is given in note 19.

13. Deferred taxation

The following is the deferred tax asset recognised by the Company, and the movements thereon:

	Pension £m	Accelerated capital allowances £m	Deferred gains £m	Tax losses £m	Total £m
At 1 January 2016	(5)	6	(7)	31	25
Charge to income statement	(8)	(2)	-	(17)	(27)
Credit to other comprehensive income	13	-	-	-	13
At 1 January 2017	-	4	(7)	14	11
Charge to income statement	(1)	(1)	-	-	(2)
Credit to other comprehensive income	1	-	-	-	1
At 31 December 2017	-	3	(7)	14	10

Notes to the accounts

13. Deferred taxation *continued*

A deferred tax asset of £14 million (2016 - £14 million) has been recognised in respect of £82 million (2016 - £78 million) of total tax losses of £173 million (2016 - £168 million) carried forward at 31 December 2017. These losses arose principally from significant impairment losses reflecting weak economic conditions in Northern Ireland. The economy continues to improve and, based on current business forecasts, the losses on which a deferred tax asset has been recognised will be utilised against future taxable profits of the company by the end of 2024. Under UK tax legislation, tax losses do not expire and can be carried forward indefinitely.

In periods from April 2015, the Finance Act 2015 limits the offset of losses carried forward by UK banks to 50% of profits. Furthermore, in periods from April 2016, the Finance Act 2016 further limits the offset of losses carried forward by UK banks to 25% of profits. The main rate of UK Corporation Tax reduced from 20% to 19% from 1 April 2017 and to 17% from 1 April 2020. Under the Finance (No 2) Act 2015, tax losses carried forward at 31 December 2015 are given credit in future periods at the main rate of UK corporation tax, excluding the banking surcharge rate (8%) introduced by the Act. Deferred tax assets and liabilities at 31 December 2017 take into account the reduced rates in respect of tax losses and where appropriate, the banking surcharge inclusive rate in respect of other banking temporary differences.

14. Subordinated liabilities

	2017 £m	2016 £m
Dated loan capital	-	836
Undated loan capital	107	103
	<u>107</u>	<u>939</u>
	2017 £m	2016 £m
Dated loan capital:		
£100 million floating rate loan capital repayable 2019		
- held by RBS (3 month LIBOR plus 0.5%)	-	100
€400 million floating rate loan capital repayable 2017		
- held by RBS (3 month EURIBOR plus 1%)	-	343
€180 million floating rate loan capital repayable 2020		
- held by RBS (3 month EURIBOR plus 0.4%)	-	154
€280 million floating rate loan capital repayable 2022		
- held by RBS (3 month EURIBOR plus 0.35%)	-	239
	<u>-</u>	<u>836</u>
	2017 £m	2016 £m
Undated loan capital:		
€120 million perpetual floating rate notes		
- held by RBS (3 month EURIBOR plus 0.35%)	107	103
	<u>107</u>	<u>103</u>
Total	<u>107</u>	<u>939</u>

As discussed in the strategic report the Bank redeemed subordinate liabilities in 2017 as part of a capital restructure post the sale of its former Republic of Ireland based subsidiaries on 1 January 2017.

Claims in respect of the Bank's loan capital are subordinate to the claims of other creditors. None of the loan capital is secured.

Undated loan capital

The €120 million loan notes are held by RBS and are repayable at the option of the Bank, only with prior consent of the Prudential Regulatory Authority (PRA).

Notes to the accounts

15. Share capital

	Allotted, called up and fully paid		Authorised	
	2017 £m	2016 £m	2017 £m	2016 £m
<i>Equity shares:</i>				
Ordinary shares of £1	254	254	2,000	2,000
<i>Equity preference shares:</i>				
Non-cumulative redeemable preference shares of €1 each	-	201	444	365
Total share capital	254	455	2,444	2,365

	Allotted, called up and fully paid		Authorised	
	2017 Millions	2016 Millions	2017 Millions	2016 Millions
Number of shares				
<i>Equity shares:</i>				
Ordinary shares of £1	254	254	2,000	2,000
<i>Equity preference shares:</i>				
Non-cumulative redeemable preference shares of €1 each	-	309	500	500
Total share capital	254	563	2,500	2,500

On 11 July 2017 the Bank carried out a capital reduction under Section 641(1)(a) of the Companies Act 2006. The issued share capital of the Bank was reduced by cancelling and extinguishing the 309 million issued non-cumulative preference shares of €1 each and the £201 million by which the share capital was reduced was credited to retained earnings. The Bank's share premium account was cancelled and a further £457 million was credited to retained earnings.

16. Other equity

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

	2017 £m	2016 £m
Additional Tier 1 loan		
£60 million 7.4% perpetual loan repayable from July 2022	60	-
	60	-

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

17. Leases

Minimum amounts payable under non-cancellable leases:

	2017				2016			
	Within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Total £m	Within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Total £m
<i>Operating lease obligations:</i>								
Premises	2	5	95	102	2	3	86	91
							2017 £m	2016 £m
Amounts recognised in income statement								
Operating lease expense – minimum rentals payable							3	3

18. Risk management

Institutional risk management framework (unaudited)

Presentation of information

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

Risk management approach

RBS Group operates an integrated risk management approach, centred around the embedding of a strong risk culture. Each element of the risk management framework functions both individually and as part of a larger continuum designed to support the business in achieving its strategic objectives.

The framework ensures the tools and capability are in place to support risk management and decision-making across the organisation.

Measurement, evaluation and transparency are 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 RBS Group is exposed to.

Essential to this is the ability to scan both the medium- and long-term horizon for risks that could affect RBS Group's ability to achieve its strategic objectives. Stress testing is used to quantify, evaluate and understand the potential impact that changes to risks may have on the financial strength of RBS Group, including its capital position.

Effective governance – underpinned by our three lines of defence model – is important to ensure that decision-making is robust and that the right information is given to the right people at the right time. In turn, this ensures that the appropriate action is taken in response to emerging or evolving risks.

While the RBS Group strategy is informed and shaped by an understanding of the risk landscape, the elements of the framework facilitate an effective control environment and a strong risk identification capability – so that the risks arising as a result of running the business and delivering the strategy can be ascertained and evaluated within the context of the appetite set by the RBS Group Board.

Having the right capability, people and infrastructure is key. At RBS Group, the Risk, Conduct & Restructuring function continually strives to improve the way risk is managed, not only in responding to threats but also in enhancing policies and governance to ensure the right decisions are being taken by the right people at the right time.

This is supported by a strong emphasis on systems, training and development, particularly with a view to responding effectively to threats, both taking action to address those that have already crystallised and mitigating those that have yet to do so.

At RBS Group there is a strong focus on evolving and enhancing the risk management approach. In 2017, there was an emphasis on enhancing both the risk culture and risk appetite elements of the framework – as well as the interconnectivity between framework components – in advance of the structural reform required by the UK's ring-fencing requirements.

RBS faces a wide range of risks in the course of its day-to-day business and in the pursuit of its strategic goals. Identifying these risks and understanding how they affect not only the Bank but also its customers informs risk appetite and risk management practice. To achieve consistent, long-term performance, RBS defines acceptable levels of risk. Risk appetite, which is supported by a robust set of principles, policies and practices, defines the levels of tolerance for a variety of risks and is a key element of RBS's risk management culture and framework.

All employees share ownership of the way risk is managed. Franchises, support functions and risk professionals work together to make sure business activities and policies are consistent with risk appetite; following the three lines of defence model. RBS Group constantly monitors its risk profile against its defined risk appetite and limits, taking action when required to balance risk and return. Governance includes regular and transparent risk reporting as well as discussion at senior management committees, which informs management strategies across the organisation.

Risk culture

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

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

18. Risk management *continued*

Institutional risk management framework (unaudited) *continued*

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

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

To embed and strengthen the required risk culture, a number of RBS Group-wide activities were undertaken in 2017. These included ethical scenario training, mandatory Group Policy Learning, and RBS Group-wide Managing Our Performance meetings designed to enhance risk culture at a team and individual employee level. To support a consistent tone from the top, senior management regularly communicate the importance of the required risk behaviours, linking them to the achievement of good customer outcomes.

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

Risk culture behaviour assessment is incorporated into performance assessment and compensation processes for enhanced governance staff. In Q1 2017 an objective aligned to RBS Group's risk culture target was set for the Executive Committee. Activity against that objective over the year was integral to performance reviews.

A risk culture measurement and reporting framework has been developed, enabling RBS Group to benchmark both internally and externally. The purpose of the framework is to assess progress in embedding RBS Group's target risk culture where risk is simply part of the way we work and think. In 2017 external validation indicated that good progress had been made against that objective demonstrating that the continued focus and actions are moving RBS Group towards its target risk culture.

Risk-based key performance indicators

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

Training

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

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

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

Code of Conduct

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

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

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

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

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

Notes to the accounts

18. Risk management continued

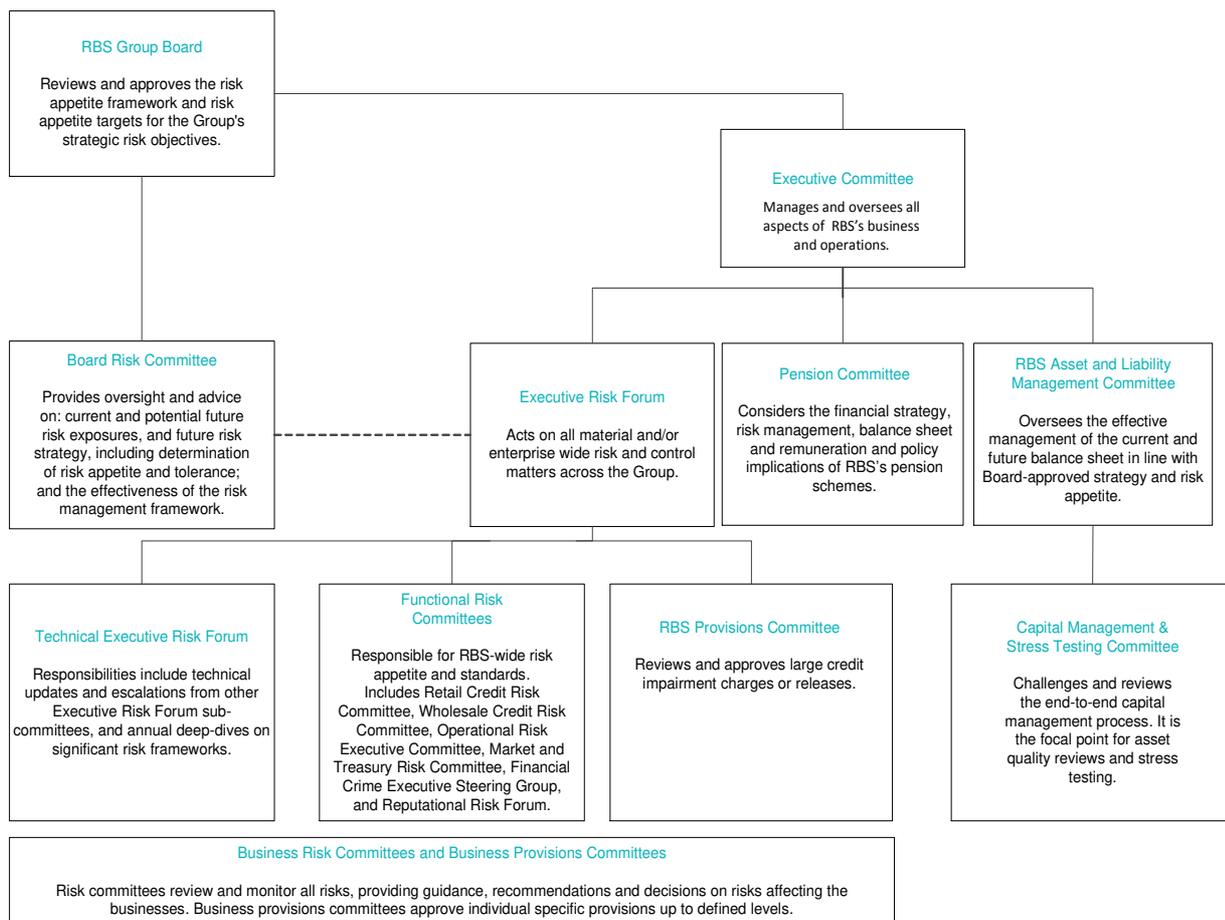
Institutional risk management framework (unaudited) continued

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

The Group Performance & Remuneration Committee also considers risk performance and conduct when determining overall bonus pools. Such pay decisions aim to reinforce the need for all employees to demonstrate good behaviours.

Risk governance Committee structure

The diagram illustrates the risk committee structure in 2017 and the main purposes of each committee.

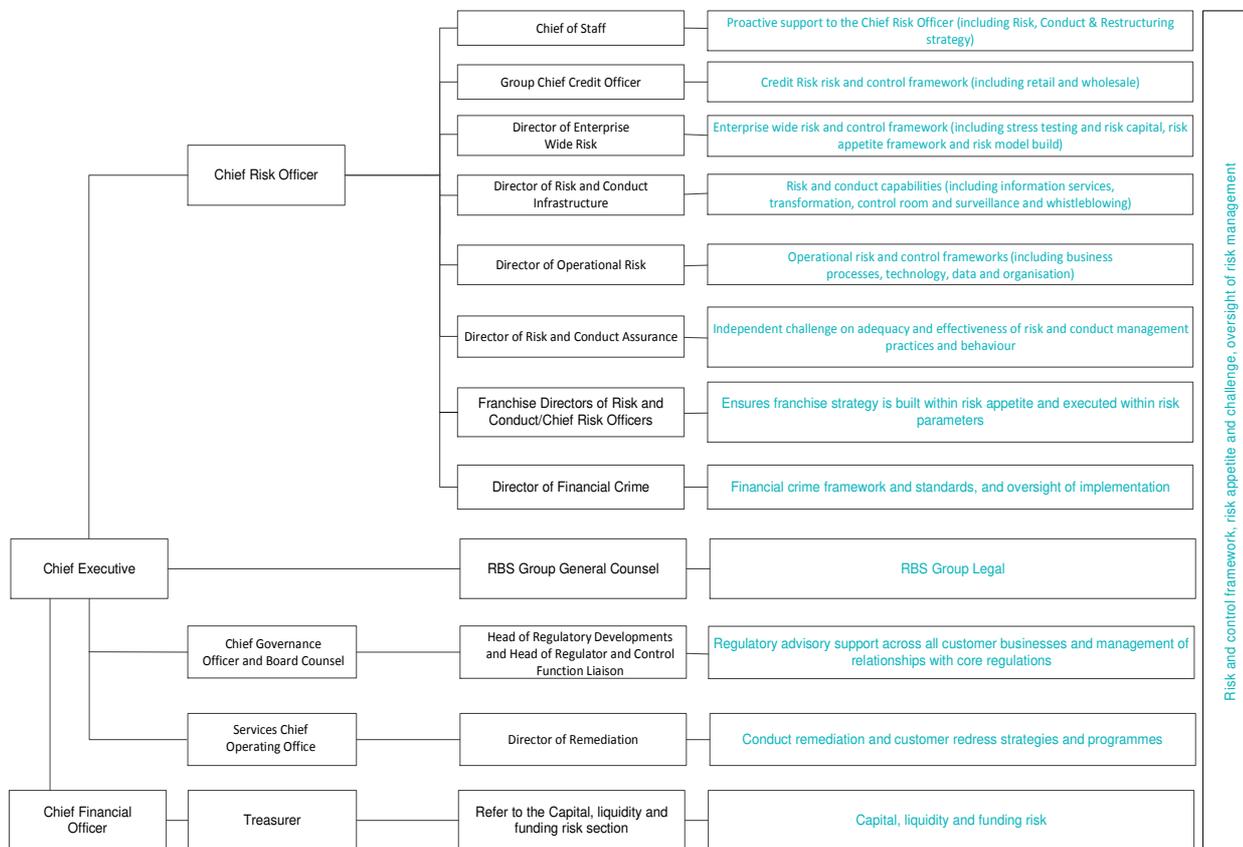


18. Risk management continued

Institutional risk management framework (unaudited) continued

Risk management structure

The diagram illustrates RBS Group's risk management structure in 2017 and key risk management responsibilities.



Notes:

(1) RBS Group risk management framework

In 2017, the RBS Group Chief Risk Officer (CRO) led Risk, Conduct & Restructuring. The CRO reported directly to the Chief Executive and had a dotted reporting line to the Board Risk Committee – as well as a right of access – to the chairman of the Board Risk Committee.

Risk, Conduct & Restructuring was a function independent of the franchises, structured by risk discipline to facilitate the effective management of risk.

Risk, Conduct & Restructuring was organised into seven functional areas: Chief of Staff; Credit Risk; Enterprise-Wide Risk; Risk & Conduct Infrastructure; Operational Risk; Risk & Conduct Assurance; and Financial Crime. There were also directors of Risk & Conduct/Chief Risk Officers for each of the Group's franchises and for Services.

Risk committees in the customer businesses and key functional risk committees oversaw risk exposures arising from management and business activities and focused on ensuring that they were adequately monitored and controlled.

(2) Regulatory Affairs

In 2017, Regulatory Affairs was responsible for providing leadership of RBS's relationships with its regulators. Regulatory Affairs is part of Corporate Governance & Regulatory Affairs. Remediation & Complaints reports to the Services Chief Operating Officer.

18. Risk management continued

Institutional risk management framework (unaudited) continued

Three lines of defence

The Bank uses the three lines of defence model to articulate accountabilities and responsibilities for managing risk across the organisation. The three lines of defence model is adopted across the industry to support the embedding of effective risk management and is expressed through a set of principles as outlined below:

First line of defence – management and supervision

The first line of defence includes customer franchises, Technology and Services as well as support and control 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 appropriate controls are in place to mitigate risk, balancing control, customer service and competitive advantage.
- Ensuring that the culture of the business supports balanced risk decisions and compliance with policy, laws and regulations.
- Ensuring the business has effective mechanisms for identifying, reporting and managing risk and controls.

Second line of defence – oversight and control

The second line of defence includes Risk, Conduct & Restructuring, Legal, and the Financial Control element of the Bank's Finance function. Responsibilities include:

- Working with the businesses and functions to develop risk and control policies, limits and tools for the business to use in order to discharge its responsibilities.
- Overseeing and challenging the management of risks and controls.
- Leading the articulation, design and development of risk culture and appetite.
- Analysing the aggregate risk profile and ensuring that risks are being managed within risk appetite.
- Providing expert advice to the business on risk management.
- Providing senior executives with relevant management information and reports and escalating concerns where appropriate.

Third line of defence – Internal Audit

Responsibilities include:

- Providing assurance to the Group Audit Committee that the main business risks have been identified and effective controls are in place to manage these 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 FCA, PRA and other key jurisdictional regulators on specific risks and control.

Risk management process

Within a robust risk environment, the risk management process begins with the risk appetite statement, and is underpinned by strong reviewing, monitoring and reporting.

Risk appetite statements inform our risk policies and limits. The next stage of a strong risk management process is risk identification of key vulnerabilities, followed up by risk measurement. This in turn leads to effective risk treatment and appropriate risk mitigation.

Risk appetite

Risk capacity defines the maximum level of risk the Bank 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 Bank's ultimate capacity to absorb losses.

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

Risk appetite framework

The risk appetite framework bolsters effective risk management by promoting sound risk-taking 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:

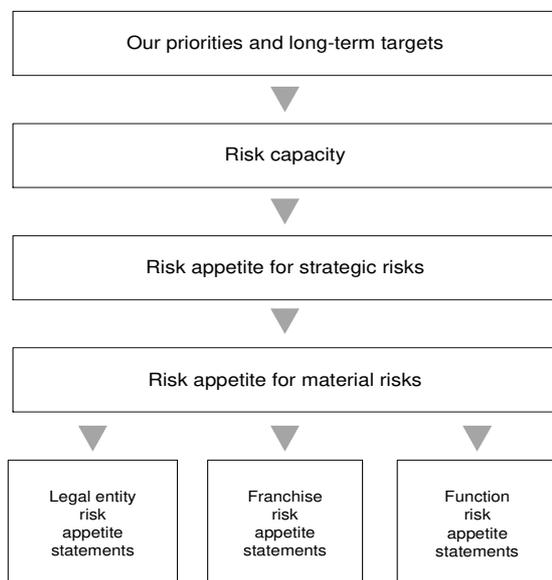
- Assessing the adequacy of the framework when compared to internal and external expectations.
- Ensuring the framework remains effective as a strong control environment for risk appetite.
- Assessing the level of embedding of risk appetite across the organisation.

The Board approves the risk appetite framework annually.

18. Risk management continued

Institutional risk management framework (unaudited) continued

Establishing risk appetite



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

Risk appetite is communicated across RBS 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 a RBS Group-wide level for all strategic risks and material risks, and at a 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 risk appetite remains appropriate given the levels of risk expected in the future.

The Board sets risk appetite for our most material risks to help ensure the Bank is well placed to meet its priorities and long-term targets even under challenging economic environments. It is the basis on which the Bank remains safe and sound while implementing its strategic business objectives.

The Bank's risk profile is frequently reviewed and monitored to ensure it remains in appetite and that management focus is concentrated on all strategic risks, material risks and emerging risk issues. Effective processes are in place to report risk profile relative to risk appetite to the Board and senior management.

Risk control frameworks and limits

Risk control frameworks and their associated limits are an integral part of the risk appetite framework and a key part of embedding risk appetite in day-to-day risk management decisions. The risk control frameworks manage risk by expressing a clear tolerance for material risk types that is aligned to business activities.

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

Risk identification and measurement

Risk identification and measurement within the risk management process comprise:

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

RBS Group has developed a risk directory which contains details of all the financial and non-financial risks that the Bank faces each day. It provides a common risk language to ensure consistent terminology is used across the RBS Group. The risk directory is subject to annual review. This ensures that the directory 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. The Board Risk Committee, Asset & Liability Management Committee (ALCo) and Executive Risk Forum (ERF) provide governance and oversight. Functions performed by ALCo may be performed under delegated authority by PBB ALCo.

Information about regulatory developments and discussions is communicated to each customer-facing business and function. This helps identify and execute any required mitigating changes to strategy or to business models.

18. Risk management continued

Institutional risk management framework (unaudited) continued

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

Top 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. The Board Risk Committee, ALCo and ERF provide governance and oversight.

Risk & Conduct Assurance

Risk & Conduct Assurance is an independent second line of defence function which provides assurance to both internal and external stakeholders including the Board, senior management, risk functions, franchises, Internal Audit and regulators.

The function has three main elements – assurance, model risk and risk culture. Risk & Conduct Assurance teams perform quality assurance on targeted credit, market, financial crime and conduct risk activities. They also review selected key controls and manage model risk governance and validation activities. In addition, the Head of Risk & Conduct Assurance also oversees the delivery of work to embed and strengthen RBS Group's desired risk culture.

Assurance

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 (PD)/Loss Given Default (LGD) classifications, the quality of risk management practices, policy compliance and adherence to risk appetite. This can include testing the Bank's credit portfolios and market risk exposures to assist in early identification of emerging risks, as well as undertaking targeted reviews to examine specific concerns raised either by these teams or by their stakeholders.

The adequacy and effectiveness of selected key controls owned and operated by the Risk function are also tested (with a particular focus on credit risk and market risk controls). The team's remit includes selected controls within the scope of Section 404 of the US Sarbanes-Oxley Act 2002 as well as selected controls supporting risk data aggregation and reporting.

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 of conduct policies is predominantly focused on the Risk, Conduct & Restructuring (RCR) owned conduct policies. Targeted work is also carried out to assist RBS Group in meeting its promises to customers as well as its regulatory requirements.

The Risk & Conduct Assurance Committee ensures a consistent and fair approach to all aspects of the team's 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 Bank uses a variety of models as part of its risk management process and activities. Key examples include the use of model outputs to support risk assessments in the credit approval process, ongoing credit risk management, monitoring and reporting, as well as the calculation of risk-weighted assets. Other examples include the use of models to measure market risk exposures and calculate associated capital requirements, as well as for the valuation of positions. The models used for stress-testing purposes also play a key role in ensuring the bank holds sufficient capital, even in stressed market scenarios.

Model Risk Governance

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

Model Risk Management

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

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

18. Risk management continued

Institutional risk management framework (unaudited) continued

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 Bank's model or risk committees consider whether a model can be approved for use. Models used for regulatory reporting may additionally require regulatory approval before implementation.

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

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

Risks arising from business activity

The Bank serves UK customers through retail and commercial banking activities.

The Bank's strategic aim is to be a bank that its customers – and all other stakeholders – can trust. By delivering only services that meet the needs of its customers, the Bank aims to achieve an appropriate return. Accordingly, the Bank is simplifying its services as well as the processes it uses to deliver them, thereby providing customers with better value. RBS Group's ambition is to become the number one bank in the UK for customer service, trust and advocacy by 2020 and the Bank shares this ambition in respect of the Northern Ireland market.

The Bank's main sources of earnings are interest income from lending and fee income from transactional and other services. Given increased competition and the UK's low interest rate environment, net interest margin has been under pressure. The Bank is reducing costs through rationalisation, integration and simplification.

The Bank continues to resolve legacy issues related to historical misconduct and unsustainable strategic decision-making. To prevent the recurrence of similar issues in the future, the Bank aims to underpin its business model with a strong risk culture that promotes appropriate risk awareness and judgements about risk-taking.

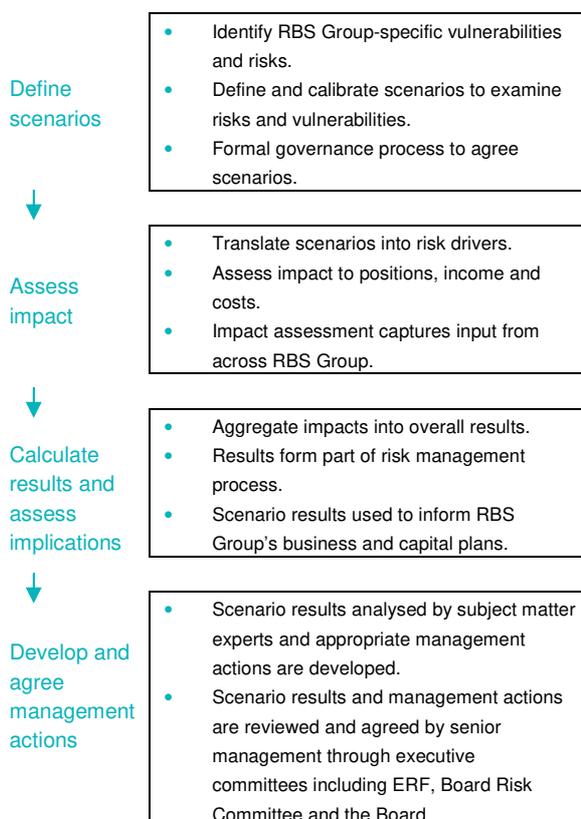
Stress testing: capital management

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

Stress testing includes:

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

The process for stress testing consists of four broad stages:



18. Risk management continued

Institutional risk management framework (unaudited) continued

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



Specific areas that involve capital management include:

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

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

Capital sufficiency: going concern forward-looking view

Going concern capital requirements are examined on a forward-looking basis – including as part of its annual budgeting process – by assessing the resilience of capital adequacy and leverage ratios under hypothetical future states.

A range of future states are examined. In particular:

- Capital requirements are assessed based on a forecast of future business performance given expectations of economic and market conditions over the forecast period.
- Capital requirements are assessed based on a forecast of future business performance under adverse economic and market conditions over the forecast period. A range of scenarios of different severity may be examined.

The examination of capital requirements under normal economic and market conditions enables the Bank to demonstrate how the projected business performance allows it to meet all internal and regulatory capital requirements as they arise over the plan horizon.

Internal assessment of capital adequacy

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

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

Capital allocation

The RBS Group has mechanisms to allocate capital across its legal entities and businesses that aim to optimise the utilisation of capital resources taking into account applicable regulatory requirements, strategic and business objectives and risk appetite.

The framework for allocating capital is approved by ALCo.

Governance

Capital management is subject to substantial review and governance. Formal approval of capital management policies is either by ALCo or the Board on the recommendation of the Board Risk Committee.

The Board approves the capital plans, as well as the results of the stress tests relating to those capital plans.

Stress testing: recovery and resolution planning

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

Notes to the accounts

18. Risk management continued

Institutional risk management framework (unaudited) continued

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

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

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

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

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

Liquidity risk monitoring and contingency planning

In implementing the liquidity risk management framework, a suite of tools are used to monitor, limit and stress test the risks in the balance sheet. Set limits control the amount and composition of funding sources, asset and liability mismatches and funding concentrations, in addition to the level of liquidity risk.

Liquidity risks are reviewed at significant legal entity and business levels daily, with performance reported to the ALCo at least monthly. Any breach of internal metric limits will set in motion a series of actions and escalations outlined under the RBS Recovery Plan, which covers all legal entities in the RBS Group. The plan sets out credible recovery options that could be implemented in the event of a severe stress to restore the business to a stable and sustainable position, focussing on addressing the bank's capital and liquidity position.

Stress testing: liquidity risk management

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

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

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

Stress testing in Market Risk

Non-traded market risk

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

Scenario analysis based on hypothetical adverse scenarios are performed on non-traded exposures as part of the industry-wide Bank of England and European Banking Authority stress exercises. In addition, RBS Group produce its own internal scenario analysis as part of the financial planning cycles.

18. Risk management continued

Institutional risk management framework (unaudited) continued

Non-traded market risk exposures are capitalised through ICAAP, the process covers the following risk types: gap risk, basis risk, credit spread risk, pipeline risk, structural foreign exchange risk, prepayment risk and accounting volatility risk. ICAAP is completed with a combination of value and earnings measures. Total non-traded market risk capital requirement is determined by adding the different charges for each sub risk type. ICAAP methodology captures at least ten years of historical volatility and are produced with 99% confidence level. Methodologies are reviewed by Model Risk and results approved by the Capital Management & Stress Testing Committee.

Capital, liquidity and funding risk

Definitions

Capital consists of reserves and instruments issued that are available 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 RBS Group risk appetite and supporting its strategic goals.

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

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

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

The risks are dependent on factors such as:

- maturity profile;
- composition of sources and uses of funding;
- the quality and size of the liquidity portfolio;
- wholesale market conditions; and
- deposit or and investor behaviour.

Sources

The determination of what instruments and financial resources are eligible to be counted as capital is laid down by applicable regulation. Capital is categorised by applicable regulation under two tiers (Tier 1 and Tier 2) according to the ability to absorb losses, degree of permanency and the ranking of absorbing losses. There are three broad categories of capital across these two tiers:

- **CET1 capital** - CET1 capital must be perpetual and capable of unrestricted and immediate use to cover risks or losses as soon as these occur. This includes ordinary shares issued and retained earnings.
- **Additional Tier 1 (AT1) capital** - This is the second type of loss absorbing capital and must be capable of absorbing losses on a going concern basis. These instruments are either written down or converted into CET1 capital when a pre-specified CET1 ratio is reached.
- **Tier 2 capital** - Tier 2 capital is the Bank's supplementary capital and provides loss absorption on a gone concern basis. Tier 2 capital absorbs losses after Tier 1 capital.

RBS Group maintains a prudent approach to the definition of liquidity resources. Liquidity resources are divided into primary and secondary liquidity as follows:

- Primary liquid assets include cash and balances at central banks.
- Secondary liquid assets are eligible as collateral for local central bank liquidity facilities. These assets include whole loans that are retained on balance sheet and pre-positioned with a central bank so that they may be converted into additional sources of liquidity at very short notice.

Managing capital requirements: regulated entities

In line with paragraph 135 of IAS 1 'Presentation of Financial Statements', UBL manages capital having regard to regulatory requirements. Regulatory capital is monitored and reported on an individual regulated legal entity basis, which is the CRR transitional basis.

Notes to the accounts

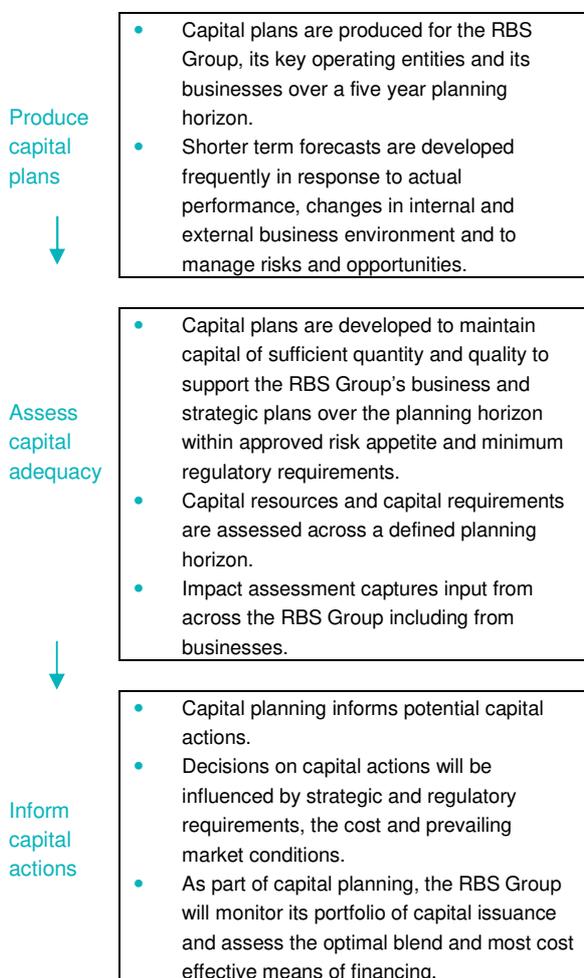
18. Risk management continued

Capital, liquidity and funding risk continued

Capital management (unaudited)

Capital management is the process by which the Bank ensures it has sufficient capital and other loss absorbing instruments to operate effectively including meeting minimum regulatory requirements, operating within Board approved risk appetite, maintaining credit ratings and supporting strategic goals.

Capital management is critical in supporting the bank entities' businesses and is also considered at Group level. It is enacted through an RBS Group-wide an end to end framework. Capital planning is integrated into the RBS Group's wider annual budgeting process and is assessed and updated at least monthly. This is summarised below.



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

Liquidity and funding management follows a similar process to that outlined for capital above.

Minimum capital requirements (unaudited)

Capital adequacy ratios

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

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

Notes:

- The countercyclical capital buffer (CCyB) applied to UK designated assets is set by the Financial Policy Committee (FPC). The UK CCyB may be set between 0% and 2.5% and is linked to the state of the UK economy. The Bank of England's Financial Policy Committee (FPC) increased the UK CCyB from 0.0% to 0.5%, with effect from June 2018; subsequently in November 2017 the FPC announced a further increase to 1.0% effective November 2018. Foreign exposures may be subject to different CCyBs depending on the CCyB rate set in the jurisdiction of the foreign exposure.
- The minimum requirements do not include any capital that the bank entities may be required to hold as a result of the Pillar 2 assessment for RBS Group.

Leverage ratio

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

Liquidity portfolio management (unaudited)

The Bank is part of the UK Defined Liquidity Group (UK DLG) with risk management of liquidity requirements integrated into the risk management function of the RBS Group. The size of the portfolio is determined by referencing the Group's liquidity risk appetite. The Group retains a prudent approach to setting the composition of the liquidity portfolio, which is subject to internal policies and limits over quality of counterparty, maturity mix and currency mix.

The Bank manages funding risk through a comprehensive framework which measures and monitors the funding risk on the balance sheet.

The asset and liability types broadly match. Customer deposits provide more funding than customer loans utilise; interbank lending and funding largely nets off and derivative assets are broadly netted against derivative liabilities.

Notes to the accounts

18. Risk management continued

Capital, liquidity and funding risk continued

Contractual maturity

The tables below analyse the contractual undiscounted cash flows receivable and payable including future receipts and payments of interest on the balance sheet items by contractual maturity. The balances in the tables below do not agree directly to the Bank balance sheet as the tables include all cash flows relating to principal and future coupon payments presented on an undiscounted basis.

The contractual maturity of balance sheet assets and liabilities reflect the maturity transformation role banks perform, lending long-term but obtaining funding predominantly through short-term liabilities such as customer deposits. In practice, the behavioural profiles of many liabilities exhibit greater stability and longer maturity than the contractual maturity. This is particularly true of many types of retail and corporate deposits which, despite being repayable on demand or at short notice, have demonstrated very stable characteristics even in periods of acute stress. In analysis to assess and manage asset and liability maturity gaps the Bank determines the expected customer behaviour through qualitative and quantitative techniques, incorporating observed customer behaviours over long periods of time. This analysis is subject to governance through ALCo.

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	>20 years £m
Assets by contractual maturity							
Cash and balances at central banks	1,032	-	-	-	-	-	-
Loans and advances to banks	5,048	213	1,187	701	-	-	-
Total maturing assets	6,080	213	1,187	701	-	-	-
Loans and advances to customers	632	391	794	625	1,023	893	250
Total assets	6,712	604	1,981	1,326	1,023	893	250
Liabilities by contractual maturity							
Deposits by banks	2,230	120	310	-	15	-	-
Subordinated liabilities	-	-	1	1	3	5	107
Other liabilities	803	-	-	-	-	-	-
Total maturing liabilities	3,033	120	311	1	18	5	107
Customer accounts	7,681	121	39	-	-	-	-
Total liabilities	10,714	241	350	1	18	5	107
Maturity gap	(4,002)	363	1,631	1,325	1,005	888	143
Cumulative maturity gap	(4,002)	(3,639)	(2,008)	(683)	322	1,210	1,353
Guarantees and commitments notional amount							
Guarantees ⁽¹⁾	22	-	-	-	-	-	-
Commitments ⁽²⁾	893	-	-	-	-	-	-
	915	-	-	-	-	-	-

Notes:

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

Notes to the accounts

18. Risk management continued

Capital, liquidity and funding risk continued

	0–3 months £m	3–12 months £m	1–3 years £m	3–5 years £m	5–10 years £m	10–20 years £m	>20 years £m
2016							
Assets by contractual maturity							
Cash and balances at central banks	1,012	-	-	-	-	-	-
Loans and advances to banks	3,541	400	766	851	377	-	-
Total maturing assets	4,553	400	766	851	377	-	-
Loans and advances to customers	696	410	788	569	965	1,004	254
Total assets	5,249	810	1,554	1,420	1,342	1,004	254
Liabilities by contractual maturity							
Deposits by banks	2,404	250	390	40	15	-	-
Subordinated liabilities	1	346	103	155	242	5	102
Other liabilities	752	-	-	-	-	-	-
Total maturing liabilities	3,157	596	493	195	257	5	102
Customer accounts	5,465	230	70	-	-	-	-
Total liabilities	8,622	826	563	195	257	5	102
Maturity gap	(3,373)	(16)	991	1,225	1,085	999	152
Cumulative maturity gap	(3,373)	(3,389)	(2,398)	(1,173)	(88)	911	1,063
Guarantees and commitments notional amount							
Guarantees ⁽¹⁾	22	-	-	-	-	-	-
Commitments ⁽²⁾	968	-	-	-	-	-	-
	990	-	-	-	-	-	-

For notes relating to this table refer to page 56.

Other contractual cash obligations

	0–3 months £m	3–12 months £m	1–3 years £m	3–5 years £m	5–10 years £m	10–20 years £m	>20 years £m
2017							
Operating leases	-	2	3	2	4	7	84
Contractual obligations to purchase goods or services	1	1	1	-	-	-	-
	1	3	4	2	4	7	84
2016							
Operating leases	-	2	2	1	1	1	84
Contractual obligations to purchase goods or services	-	1	2	-	-	-	-
	-	3	4	1	1	1	84

Financial assets have been reflected in the time band of the latest date on which they could be repaid unless earlier repayment can be demanded by the Bank; 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 the repayment of a financial asset or liability is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the asset is included in the latest date on which it can repay regardless of early repayment whereas the liability is included at the earliest possible date that the conditions could be fulfilled without considering the probability of the conditions being met.

Notes to the accounts

18. Risk management continued

Credit risk

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

Sources of credit risk (unaudited)

The principal sources of credit risk for the Bank are lending, off-balance sheet products and derivatives. The Bank is also exposed to settlement risk through foreign exchange, trade finance and payments activities.

Credit risk management function (unaudited)

Risk governance

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

- Approving credit limits for customers.
- Defining concentration risk and implementing the credit risk control framework.
- Oversight of the first line of defence to ensure that credit risk remains within the risk appetite set by the Board.
- Developing and monitoring compliance with credit risk policies.
- Conducting Group-wide assessments of provision adequacy.

The GCCO has overall responsibility for the credit risk function and chairs the Wholesale Credit Risk Committee, as well as co-chairing the Retail Credit Risk Committee. These committees have authority for risk appetite (within the appetite set by the Board), strategy, frameworks and policy as well as oversight of the Group's credit profile. The Group's Provisions Committee has authority over provisions adequacy and approves proposals from business provisions committees in accordance with approval thresholds. The Group's Provisions Committee is chaired either by the GCCO or the Head of Provisions & Restructuring Credit.

Controls

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

Risk appetite (unaudited)

The Group's approach to lending is governed by comprehensive credit risk appetite frameworks. The frameworks are closely monitored and actions are taken to adapt lending criteria as appropriate. Credit risk appetite aligns to the strategic risk appetite set by the Board, which includes capital adequacy, earnings volatility, funding and liquidity, and stakeholder confidence. The credit risk appetite frameworks have been designed to reflect factors (e.g. 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 policies and transaction acceptance standards that set out the risk parameters within which franchises must operate.

For Wholesale the four formal frameworks used, and their basis for classification, are detailed in the following table.

Framework	Basis for classification	
	Size	Other
Single name concentration	Net exposure or loss given default for a given probability of default	
Sector	Exposure ⁽¹⁾	Risk – based on economic capital and other qualitative factors
Country	Exposure ⁽¹⁾	
Product and asset class	Exposure – net/gross dependent on type of risk and limit definition.	Risk – based on heightened risk characteristics

Note:

(1) Potential exposure as defined on page 59.

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

Risk identification and measurement (unaudited)

Credit stewardship

Risks are identified through relationship management and 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 measurement

The Group uses current exposure and potential exposure as its measures of credit risk exposure. Unless otherwise stated, current exposure and potential exposure are reported:

- Net of collateral – cash and gold collateral for all product types as well as financial collateral for derivative and securities financing products.
- Net of provisions – credit valuation adjustments for derivative and securities financing products; individual, collective and latent provisions across all other product types.

Exposures backed by guarantees are allocated to the guarantor rather than the direct obligor. This does not affect the current or potential exposure amount, but does affect allocations to obligors, sectors, country and product and asset classes.

Notes to the accounts

18. Risk management continued

Credit risk continued

The following table summarises the differences between current exposure and potential exposure across product types.

Product	Current exposure	Potential exposure ^(1,2)
Lending	Drawn balances	Legally committed limits
Derivatives and securities financing	Measured using the mark-to-market value after the effect of enforceable netting agreements and net of legally enforceable financial collateral. ⁽³⁾	Measured using scaled credit limit utilisation, which takes into account mark-to-market movements, any collateral held and expected market movements over a specified horizon. ⁽³⁾
Contingent obligations	Issued amount of the guarantee or letter of credit	Legally committed amount

Notes:

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

(2) Potential exposure cannot be less than current exposure.

(3) Current exposure and potential exposure for exchange-traded derivatives are defined as exposure at default

Risk models (unaudited)

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 PD, LGD or exposure at default (EAD). The economic capital model is used for credit risk appetite setting.

Asset quality - (unaudited)

Internal reporting and oversight of risk assets is principally differentiated by credit grades. Customers are assigned credit grades based on various credit grading models that reflect the key drivers of default for each customer type. All credit grades across the Bank map to both a Bank level asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures, used for internal management reporting across portfolios. Accordingly, measures of risk exposure may be readily aggregated and reported at increasing levels of granularity depending on stakeholder or business need.

Performing loans are defined as AQ1-AQ9 (where the PD is less than 100%) and non-performing loans as AQ10 (where the PD is 100%). The PD models used to assign a credit grade for the purposes of credit risk management assess the probability of a customer failing to honour its credit obligations over a one-year time period.

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

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

Notes to the accounts

18. Risk management continued

Credit risk continued

Asset quality – (unaudited) continued

The following table provides an analysis of the credit quality of third party financial assets by probability of default.

	Cash and balances at central banks	Loans and advances to banks	Loans and advances to customers	Derivatives	Commitments	Contingent liabilities
	£m	£m	£m	£m	£m	£m
2017						
AQ1	1,032	7,121	25	8	38	-
AQ2	-	-	14	-	-	-
AQ3	-	6	35	-	45	13
AQ4	-	20	1,157	1	293	13
AQ5	-	2	1,465	-	316	14
AQ6	-	-	474	-	119	7
AQ7	-	-	345	-	66	18
AQ8	-	-	90	-	9	-
AQ9	-	-	37	-	1	2
AQ10	-	-	-	-	6	3
Accruing past due	-	-	75	-	-	-
Non-accrual	-	-	138	-	-	-
Impairment provisions	-	-	(119)	-	-	-
Total	1,032	7,149	3,736	9	893	70

	Cash and balances at central banks	Loans and advances to banks	Loans and advances to customers	Derivatives	Commitments	Contingent liabilities
	£m	£m	£m	£m	£m	£m
2016						
AQ1	1,012	5,930	61	6	61	-
AQ2	-	-	-	-	2	-
AQ3	-	3	50	-	7	-
AQ4	-	2	886	-	207	29
AQ5	-	-	1,444	1	418	17
AQ6	-	-	633	-	127	5
AQ7	-	-	357	-	113	16
AQ8	-	-	157	-	21	2
AQ9	-	-	31	-	2	-
AQ10	-	-	-	-	10	5
Accruing past due	-	-	72	-	-	-
Non-accrual	-	-	191	-	-	-
Impairment provisions	-	-	(168)	-	-	-
Total	1,012	5,935	3,714	7	968	74

Notes to the accounts

18. Risk management continued

Credit risk continued

Risk mitigation (unaudited)

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. To mitigate credit risk arising from Personal mortgage lending, collateral is taken in the form of residential property.

The key sectors where the Group provides asset-backed lending are commercial real estate and residential mortgages. Valuation methodologies are detailed below.

Commercial real estate valuations

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

Residential mortgages

The Group takes collateral in the form of residential property to mitigate the credit risk arising from mortgages. The Group values residential property during the loan underwriting process by appraising properties individually. The Group updates residential property values quarterly using the relevant residential property index namely:

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

Risk assessment and monitoring (unaudited)

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

Wholesale

Wholesale customers – including corporates, banks and other financial institutions – are grouped by industry sectors and geography as well as by product/asset class and are managed on an individual basis.

A credit assessment is carried out before credit facilities are made available to customers. The assessment process is dependent on the complexity of the transaction.

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

For all other transactions credit is only granted to customers following joint approval by an approver from the business and the credit risk function. Credit risk management is organised in terms of the complexity of the assessment rather than aligned to franchises. The joint business and credit approvers act within a delegated approval authority under the Wholesale Credit Authorities Framework (CAF) approved by the Executive Risk Forum. The level of delegated authority held by approvers is dependent on their experience and expertise. Only a small number of senior executives hold the highest authority provided under the CAF.

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

Transaction Acceptance Standards (TAS) provide detailed transactional lending and risk acceptance metrics and structuring guidance. TAS are one of the tools used to manage risk appetite at the customer/transaction level and are supplementary to the Credit Policy.

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

Credit relationships are reviewed, and credit grades (PD and LGD) 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.

Personal

Personal customers are served through a lending approach that entails making a large number of small-value loans. To ensure that these lending decisions are made consistently, the Group analyses credit information, including the historical debt servicing behaviour of customers with respect to both the Group and their other lenders. The Group then sets its lending rules accordingly, developing different rules for different products.

18. Risk management continued

Credit risk continued

The process is then largely automated, with customers receiving a credit score that reflects a comparison of their credit profile with the rule set. However, for relatively high-value, complex personal loans, including some residential mortgage lending, specialist credit managers make the final lending decisions.

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

Wholesale (unaudited)

Early problem identification

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

Risk of Credit Loss framework

The framework focuses on Wholesale customers whose credit profiles have deteriorated since origination. Expert judgement is applied by experienced credit risk officers to classify cases into categories that reflect progressively deteriorating credit risk to the Bank. There are two classifications which apply to non-defaulted customers within the framework - Heightened Monitoring and Risk of Credit Loss. The framework also applies to those customers that have met the Bank's default criteria.

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

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

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

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

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

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

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

Restructuring

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

18. Risk management continued

Credit risk continued

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.

Personal (unaudited)

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

Collections

The Collections function takes over management of a customer when the customer exceeds an agreed limit or misses a regular monthly payment. Once in Collections the customer will be supported by skilled debt management staff who will endeavour to provide the customer with solutions based on current circumstances and, where appropriate, any known future changes to their financial position. Solutions include short-term account restructuring, refinance loans and forbearance which can include interest suspension and breathing space. In the event that an affordable/sustainable agreement with a customer cannot be reached, the debt will transition into Recoveries.

Recoveries

The Recoveries function will issue a notice of intention to default to the customer and, subsequently, a formal demand, while also registering the account with the credit reference agencies where appropriate. Following this, the customer's debt may then be placed with a third-party debt collection agency, or alternatively a solicitor, in order to agree an affordable repayment plan with the customer.

Forbearance

Forbearance across the Bank takes place when a concession is made on the contractual terms of a loan/debt in response to a customer's financial difficulties. Concessions granted where there is no evidence of financial difficulty, or where any changes to terms and conditions are within current risk appetite, or reflect improving credit market conditions for the customer, are not considered forbearance.

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

Loans/debt may be forborne more than once, generally where a temporary concession has been granted and circumstances warrant another temporary or permanent revision of the loan's terms.

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

Types of forbearance

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

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

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

Monitoring of forbearance

In the Wholesale portfolio, all customers are assigned a PD and related facilities an LGD. These are re-assessed prior to finalising any forbearance arrangement in light of the loan's amended terms.

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

For Personal portfolios, forborne loans are separated into a distinct population and reported on a regular basis until they exit the forborne population.

Notes to the accounts

18. Risk management continued

Credit risk continued

Provisioning for Wholesale forbearance

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

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

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

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

For performing loans, credit metrics are an integral part of the latent provision methodology, and an extended emergence period for forborne loans is applied.

The transfer of wholesale loans from impaired to performing status follows assessment by relationship managers and credit. When no further losses are anticipated and the customer is expected to meet the loan's revised terms, any provision is written off and the balance of the loan returned to performing status. This course of action is not dependent on a specified time period and follows the credit risk manager's assessment.

The arrears information on mortgages in forbearance and related provisions are shown in the table below:

<i>Arrears status and provisions</i>	2017		2016	
	Balance £m	Provisions £m	Balance £m	Provisions £m
No missed payments	14.7	0.1	23.0	0.1
1-3 months in arrears	5.2	0.2	8.5	0.5
>3 months in arrears	20.7	8.4	25.8	9.7
Total	40.6	8.7	57.3	10.3

Provisioning for Personal forbearance

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

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

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

For the latent calculation, an extended emergence period is applied to account for the impact of forbearance within the portfolio. Additionally for portfolios with material forbearance, forborne loans form a separate risk pool and use a different PD model. The separate risk pool applies for the duration of the forbearance arrangement and with exit from forbearance segmentation dependent on meeting applicable probationary periods and performance criteria.

For non-performing loans, there is no difference in treatment.

Notes to the accounts

18. Risk management continued

Credit risk continued

The incidence of the main types of personal forbearance on the balance sheet as at 31 December 2017 is analysed below.

	2017 £m	2016 £m
Interest only	9.2	16.5
Term extensions – capital repayment & interest only	1.7	1.8
Payment concession/holidays	28.6	36.3
Capitalisation of arrears	1.1	2.7
Total	40.6	57.3

At the balance sheet date 1.8% (2016 - 2.6%) of the Bank's retail mortgages were in forbearance.

Personal exposures

The table below details residential mortgages three months or more in arrears (by volume):

Personal	2017 %	2016 %
Mortgages	3.0	3.0

The table below shows the distribution of residential mortgages by LTV (indexed). LTV is based upon gross loan amounts and, whilst including defaulted loans, does not take account of provisions made.

Residential mortgages – distribution by average LTV ⁽¹⁾	2017 %	2016 %
<=50%	28.4	23.9
>50% and <=80%	42.3	37.2
>80% and <=100%	18.2	23.7
>100% and <=150%	9.5	12.2
>150%	1.6	3.0
Total portfolio average LTV at 31 December	68.1	75.0
Average LTV on new originations during the year	68.6	70.9

Note:

(1) The above table uses unweighted LTV averages calculated by value.

The tables below show period-end weighted LTVs for the Bank's residential mortgage portfolio.

LTV ratio value ⁽¹⁾	<=50% £m	50<=80% £m	80<=100% £m	100<=150% £m	>150% £m	Total £m	Weighted Average LTV %
2017							
AQ1-AQ8	611	916	385	190	24	2,126	67
AQ9	4	7	7	4	3	25	85
Accruing past due - non-accrual	15	18	12	17	9	71	90
Total	630	941	404	211	36	2,222	68
2016							
AQ1-AQ8	520	801	511	243	53	2,128	74
AQ9	4	8	7	7	3	29	95
Accruing past due - non-accrual	10	19	12	23	14	78	102
Total	534	828	530	273	70	2,235	75

Note:

(1) LTV is calculated on a current exposure basis, gross of provisions.

Notes to the accounts

18. Risk management continued

Credit risk continued

Impairment, provisioning and write-offs

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

Impairment

A financial asset is impaired if there is objective evidence that the amount, or timing, of future cash flows has been adversely affected. Refer to accounting policy 13 on page 23 for details of the quantification of impairment losses.

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

Provisioning

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

The Group uses one of the following three methods to quantify the provision required: individual, where the quantification method is on a case-by-case assessment of future cash flows; collective, a quantitative review of the relevant portfolio; and latent, where PD, LGD, drawn balance and emergence period are considered in the calculation.

Sensitivity of impairments to assumptions

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

In addition, for secured lending, key assumptions relate to the valuation of the security and collateral held, as well as the timing and cost of asset disposals based on underlying market depth and liquidity. Assessments are made by relationship managers on a case-by-case basis for individually-assessed provisions and are validated by credit teams. Impairments less than £1 million are approved by credit officers under their delegated authority. For individual impairments greater than £1 million, oversight is provided by the RBS Group Provisions Committee.

Write-offs

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

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

Notes to the accounts

18. Risk management continued

Credit risk continued

Sector and geographical concentration

Credit risk assets by industry and geography

Industry analysis plays an important part in assessing the potential for concentration risk in the loan portfolio. Particular attention is given to industry sectors where the Bank believes there is a high degree of risk or potential for volatility in the future. The tables below analyse credit risk assets by industry sector. All balances were transacted from a UK office.

2017	Gross loans and advances to banks and customers £m	Derivatives £m	Total £m	Netting and offset ⁽¹⁾ £m
UK				
Central and local government	15	-	15	15
Manufacturing	274	-	274	22
Construction	52	-	52	11
Finance	7,171	8	7,179	1
Service industries and business activities	488	1	489	68
Agriculture, forestry and fishing	233	-	233	1
Property	340	-	340	-
Individuals				
Home mortgages	2,222	-	2,222	-
Other	204	-	204	-
Interest accruals	5	-	5	-
	11,004	9	11,013	118

2016	Gross loans and advances to banks and customers £m	Derivatives £m	Total £m	Netting and offset ⁽¹⁾ £m
UK				
Central and local government	13	-	13	-
Manufacturing	263	1	264	5
Construction	50	-	50	9
Finance	6,029	5	6,034	-
Service industries and business activities	464	1	465	31
Agriculture, forestry and fishing	237	-	237	48
Property	330	-	330	7
Individuals				
Home mortgages	2,236	-	2,236	-
Other	190	-	190	1
Interest accruals	5	-	5	-
	9,817	7	9,824	101

Note:

(1) This column shows the amount by which the Bank's credit risk exposures is reduced through arrangements, such as master netting agreements, which give the Bank a right to set-off the financial asset against a financial liability due to the same counterparty.

18. Risk management continued

Market risk

The Bank's exposure to traded market risk is not material. Non-traded market risk is discussed below.

Pension-related activities also give rise to market risk. Refer to page 70 for more information on risk related to pensions.

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.

Disclosures in this section are presented on an overall Group basis, reflecting the way the Group manages the risk or the basis on which it reports the risk measure to the regulator.

Sources of risk (unaudited)

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

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

Interest rate risk

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

NTIRR comprises three primary risk factors: gap risk, basis risk and option risk.

Foreign exchange risk

Non-traded foreign exchange risk exposures for the Bank arise principally as a result of customer transactions and profits and losses that are in a currency other than Sterling.

The directors do not consider foreign exchange risk to be material to the Bank.

Risk governance (unaudited)

Responsibility for identifying, measuring, monitoring and controlling the market risk arising from non-trading activities lies with the relevant business, with second-line-of-defence oversight provided by the Non-Traded Market Risk function, which reports into the Director of Enterprise Wide Risk.

Risk positions are reported monthly to the RBS Group's ERF and quarterly to the Board Risk Committee, as well as to ALCo (monthly in the case of interest rate risk and quarterly in the case of foreign exchange risk).

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

Risk appetite (unaudited)

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

These limits are cascaded further down the organisation as required, as approved by the Technical Executive Risk Forum in the case of the Board risk measures and by ALCo in the case of the key risk measures.

The limit framework at RBS Group level comprises value-at-risk (VaR), stressed value-at-risk (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 Bank remains within its risk appetite, triggers at have been set such that if exposures exceed a specified level, action plans are developed by the front office, Market Risk and Finance.

Risk assessment, monitoring and mitigation (unaudited)

Interest rate risk

Non-traded interest rate risk (NTIRR) factors are grouped into the following categories:

- **Gap risk** – which arises from the timing of rate changes in non-trading book instruments. The extent of gap risk depends on whether changes to the term structure of interest rates occur consistently across the yield curve (parallel risk) or differentially by period (non-parallel risk).
- **Basis risk** – which captures the impact of relative changes in interest rates for financial instruments that have similar tenors but are priced using different interest rate indices, or on the same interest rate indices but with different tenors.
- **Option risk** – which arises from option derivative positions or from optional elements embedded in assets, liabilities and/or off-balance sheet items, where the Group or its customer can alter the level and timing of their cash flows. Option risk can be further characterised into automatic option risk and behavioural option risk. One example of behavioural option risk is pipeline risk. This is the risk of loss arising from personal customers owning an option to draw down a loan (typically a mortgage loan) at a committed rate. Changes in interest rates can result in greater or fewer customers than anticipated taking up the committed offer. The risk depends on customer behaviour as the option will not automatically be exercised.

Notes to the accounts

18. Risk management continued

Market risk continued

Due to the long-term nature of many retail and commercial portfolios and their varied interest rate repricing characteristics and maturities, it is likely that net interest income will vary from period to period, even if interest rates remain the same. New business originated in any period will alter the Bank's interest rate sensitivity if the resulting portfolio differs from portfolios originated in prior periods, depending on the extent to which exposure has been hedged.

In order to manage exposures within these limits, the Bank aggregates its interest rate positions and hedges them externally with RBS plc.

Risk measurement

The market risk exposures that arise as a result of the Bank's retail and commercial banking activities are measured using a combination of value-based metrics (VaR and sensitivities) and earnings-based metrics, as explained in greater detail for each of the key non-traded risk exposure types disclosed in this section.

Interest rate risk

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

The RBS Group uses both approaches to quantify the Bank's interest rate risk: VaR as its value-based approach and sensitivity of net interest income (NII) as its earnings-based approach.

Total VaR

The total VaR for the Bank's dealing is presented in the table below:

	31 December 2017	Maximum	Minimum	Average
	£m	£m	£m	£m
Value-at-Risk	0.4	0.4	0.1	0.3
	31 December 2016	Maximum	Minimum	Average
	£m	£m	£m	£m
Value-at-Risk	0.5	0.7	0.1	0.4

Interest Rate VaR

The Interest Rate VaR limit is a sub limit of the Total VaR limit and is monitored daily.

Interest Rate VaR is presented in the table below:

	31 December 2017	Maximum	Minimum	Average
	£m	£m	£m	£m
Value-at-Risk	0.4	0.4	0.1	0.3
	31 December 2016	Maximum	Minimum	Average
	£m	£m	£m	£m
Value-at-Risk	0.5	0.7	0.1	0.4

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

NII sensitivity is calculated and monitored at RBS Group level

Value-at-risk

The standard VaR metrics - which assume a time horizon of one trading day and a confidence level of 99% - are based on interest rate repricing gaps at the reporting date. Daily rate moves are modelled using observations over the last 500 business days. These incorporate customer products plus associated funding and hedging transactions as well as non-financial assets and liabilities such as property, plant and equipment, capital and reserves. Behavioural assumptions are applied as appropriate.

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

18. Risk management continued

Pension risk (unaudited)

Definition

Pension obligation risk is the risk to the Bank caused by its contractual or other liabilities to, or with respect to, its pension scheme, whether established for its employees or for those of a related company.

Source of pension risk

The Bank is exposed to risk from its defined benefit pension scheme to the extent that the assets of the scheme do not fully match the timing and amount of the schemes' liabilities.

Pension scheme liabilities vary with changes to long-term interest rates, inflation, pensionable salaries and the longevity of scheme members as well as changes in legislation. Ultimate responsibility for the Bank's pension scheme is separate from Bank management. The Bank is exposed to the risk that the market value of the scheme's assets, together with future returns and any additional future contributions could be considered insufficient to meet the liabilities as they fall due. In such circumstances, the Bank could be obliged, or may choose, to make additional contributions to the scheme or be required to hold additional capital to mitigate such risk.

Risk governance

The UBPS scheme operates under a trust deed under which the corporate trustee is a wholly owned subsidiary of the Bank. The trustee board comprises six directors selected by the Bank and three directors nominated by members.

Risk appetite

Risk appetite and investment policy are agreed by the trustees with quantitative and qualitative input from the scheme actuary and investment advisers. The trustees also consult with the Bank to obtain its view on the appropriate level of risk within the pension funds. The Bank independently monitors risk within its pension funds as part of the ICAAP.

The trustee board is solely responsible for the investment of the scheme's assets which are held separately from the assets of the Bank. The Bank and the trustee board must agree on the investment principles and the funding plan. An Investment Review Committee is in place for the scheme, comprising Bank and Trustee representatives, which have specific responsibility for scheme investment matters.

The scheme is invested in diversified portfolios of quoted and private equity, government and corporate fixed-interest and index-linked bonds, and other assets including property, derivatives and hedge funds.

In November 2009 the scheme was closed to new employees.

Risk controls

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

Risk identification and measurement

Pension risk reports are submitted to the Executive Risk Forum and the Board Risk Committee quarterly in the RBS Risk & Conduct Management Report. This includes an assessment of the overall deficit or surplus position, estimated capital requirements, and an assessment of the associated assets and liabilities.

Reputational risk (unaudited)

Definition

Reputational risk is the risk to the Bank'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; activities of customers and the sectors and countries in which they operate; provision of products and transactions; as well as operations and infrastructure.

Governance

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

Risk appetite

RBS Group manages and articulates its appetite for reputational risk through the implementation of a qualitative reputational risk appetite statement and a committee-based governance framework. This has improved the identification, assessment and management of customers, transactions, products and issues that present a material reputational risk, resulting in a greater awareness and focus on the importance of this risk. Moreover, RBS Group has seen a rise in the number of cases being referred to franchise and group-wide reputational risk fora as a result of increased awareness of the framework as well as training on reputational risk.

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. Lessons learned from committee meetings have also improved the way cases and issues are debated and decisions made.

Notes to the accounts

18. Risk management continued

Reputational risk (unaudited)

The most material threats to RBS Group's reputation continued to originate from historical and more recent conduct issues.

Conduct risk (unaudited)

Definition

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

Sources of conduct risk

Conduct risk exists across all stages of the Bank's relationships with its customers, from the development of its business strategies, through governance arrangements, to post-sales processes – and arises from a variety of activities. These include product design, marketing and sales, complaint handling, staff training, and handling of confidential Inside Information. Conduct risk also arises if the Bank does not take effective action to prevent fraud, bribery and money laundering.

Governance

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

Key elements of the governance structure are set out below:

- The Risk, Conduct & Restructuring Executive Committee considers emerging material risks and issues, and implements Board and Executive Committee risk management policy decisions.
- The Financial Crime Executive Steering Group (accountable to the Executive Risk Forum) ensures that the customer businesses and the Services function fulfil strategic objectives by identifying and managing their financial crime risks effectively.

Controls

Under the policy framework, there are 18 conduct policies. These are designed to provide both high-level direction and stipulate RBS Group-wide requirements. The policies provide the necessary clarity to staff on their conduct obligations.

Risk assessments are used to identify material conduct risks and inform key controls across all business areas. The risk assessment process is designed to confirm risks are effectively managed and prioritised. The process also ensures controls are tested.

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

Risk appetite

The conduct risk appetite framework was established in 2015 and has embedded across RBS Group.

The Conduct risk appetite framework and the Conduct Performance Assessment, which forms part of it, facilitate a consistent approach across RBS Group for assessing conduct risk.

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

The Conduct Performance Assessment was run in Q1 and Q3 2017, reporting on risk exposures and the operating effectiveness of controls across the businesses. In Q4 2017, the Conduct Performance Assessment was discontinued in advance of the roll-out of a new approach providing a real-time quantitative view, supported by qualitative assessment.

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

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

The Group Audit Committee is provided with a whistleblowing report twice a year. The report comments on the operational effectiveness of our whistleblowing framework, internally branded as 'Speak Up', and any trends emerging from completed investigations. It details cases by internal reporting categories based on the RBS Group definition of whistleblowing included in the Speak Up policy.

The Speak Up policy encompasses both the legislative definition contained within the Public Interest Disclosure Act 1998 and the regulatory definition within FCA and PRA regulations and guidance. It extends these to include conduct or behaviour which does not meet the expected standards documented in Our Code.

18. Risk management continued

Operational risk (unaudited)

Definition

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

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

Sources of operational risk

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

Risk governance

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

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

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

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

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

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

The aggregation of operational risk appetite allows RBS Group to monitor and report on its material risk exposures against predetermined limits. This drives management intervention and action at defined points, such as the breach of an early warning trigger.

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

Risk controls

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

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

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

18. Risk management continued

Operational risk (unaudited) continued

Risk identification and measurement

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

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

During 2017, work continued to increase the coverage of the enhanced end-to-end risk and control assessment methodology. This approach, which strengthens understanding of the risk profile of key products and services, is used to identify and quantify the most material operational risks. Subject matter experts and key stakeholders are engaged from across RBS Group to underpin management action in line with RBS Group's financial and non-financial appetite statement.

The results of the risk and control assessments support RBS Group's on-going journey to build on, and enhance, its control environment.

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

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

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

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

Event and loss data management

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

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

All losses and recoveries associated with an operational risk event are reported against their financial accounting date. A single event can result in multiple losses (or recoveries) that may take time to crystallise. Losses and recoveries with a financial accounting date in 2017 may relate to events that occurred, or were identified in, prior years.

Risk mitigation

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

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

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

Business risk (unaudited)

Definition

Business risk is the risk that RBS Group makes inappropriate business or strategic choices or that RBS Group is not able to execute its chosen strategy in line with its budget.

Sources of risk

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

Notes to the accounts

18. Risk management continued

Business risk (unaudited) continued

Governance

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

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

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

19. 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 2017. Although the Bank is exposed to credit risk in the event of non-performance of the obligations undertaken by customers, the amounts shown do not, and are not intended to, provide any indication of the Bank's expectation of future losses.

	2017 £m	2016 £m
Contingent liabilities:		
Guarantees and assets pledged as collateral security	22	22
Other contingent liabilities	48	52
	<u>70</u>	<u>74</u>
Commitments:		
Documentary credits and other short-term trade related transactions	2	2
Commitments to lend	883	958
Other commitments	8	8
	<u>893</u>	<u>968</u>

Banking commitments and contingent obligations, which have been entered into on behalf of customers and for which there are corresponding obligations from customers, are not included in assets and liabilities. The Bank's maximum exposure to credit loss, in the event of non-performance by the other party and where all counterclaims, collateral or security proves valueless, is represented by the contractual nominal amount of these instruments included in the table. These commitments and contingent obligations are subject to the Bank's normal credit approval processes.

Risk identification

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

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

Risk mitigation

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

Contingent liabilities

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

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

Notes to the accounts

19. Memorandum items continued

Contingent liabilities and commitments continued

Commitments

Commitments to lend - under a loan commitment the Bank 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 Bank to a named beneficiary against presentation of specified documents, forward asset purchases, forward deposits placed and undrawn note issuance and revolving underwriting facilities and other short-term trade related transactions.

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

	2017 £m	2016 £m
Property, plant and equipment		
Contracts to purchase goods or services	3	3
	<u>3</u>	<u>3</u>

Litigation and investigations

The Bank is involved in litigation, investigations and reviews. Other than as set out below, the litigation involves claims against the Bank which arise in the ordinary course of business. No material adverse effect on the net assets of the Bank is expected to arise from the ultimate resolution of these claims. The material investigation and review involving the Bank is described below.

FCA review of RBS's treatment of SMEs

In November 2013, a report by Lawrence Tomlinson, entrepreneur in residence at the UK Government's Department for Business Innovation and Skills, was published (Tomlinson Report). The Tomlinson Report was critical of RBS Group's treatment of SME's.

The Tomlinson Report was passed to the PRA and FCA. Shortly thereafter, the FCA announced that an independent Skilled Person would be appointed under section 166 of the Financial Services and Markets Act to review the allegations in the Tomlinson Report. On 17 January 2014, a Skilled Person was appointed. The Skilled Person's review was focused on the Group's UK small and medium sized business customers with credit exposures of up to £20 million whose relationship was managed within the Global Restructuring Group or within similar units within the Group's Corporate Banking Division that were focused on customers in financial difficulties. In the period 2008 to 2013 the Group was one of the leading providers of credit to the UK SME sector.

Separately, in November 2013, RBS Group instructed the law firm Clifford Chance to conduct an independent review of the principal allegation made in the Tomlinson Report: RBS Group was alleged to be culpable of systematic and institutional behaviour in artificially distressing otherwise viable businesses and, through that, putting businesses into insolvency. Clifford Chance published its report on 17 April 2014 and, while it made certain recommendations to enhance customer experience and transparency of pricing, it concluded that there was no evidence to support the principal allegation.

The Skilled Person review focussed on the allegations made in the Tomlinson Report and certain observations made by Sir Andrew Large in his 2013 Independent Lending Review, and was broader in scope than the reviews undertaken by Clifford Chance which is referred to above. The Skilled Person delivered the draft findings from its review to the FCA in March 2016. RBS was then given the opportunity to consider and respond to those draft findings before the Skilled Person delivered its final report to the FCA during September 2016.

In November 2016, the FCA published an update on its review. In response, RBS Group announced steps that will impact SME customers in the UK and the Republic of Ireland that were in GRG between 2008 and 2013. These steps were (i) an automatic refund of certain complex fees; and (ii) a new complaints process, overseen by an Independent Third Party. These steps have been developed with the involvement of the FCA which agreed that they were appropriate for RBS Group to take.

The Bank estimates the costs associated with the new complaints review process and the automatic refund of complex fees to be approximately £6 million, which was recognised as a provision in 2016. This includes operational costs together with the cost of refunded complex fees and the additional estimated redress costs arising from the complaints process.

On 23 October 2017, the FCA published an interim report incorporating a summary of the Skilled Person's report which stated that, further to the general investigation announced in November 2016, the FCA had decided to carry out a more focused investigation. The FCA published its final summary of the Skilled Person's report on 28 November 2017. The UK House of Commons Treasury Select Committee, seeking to rely on Parliamentary powers, published the full version of the Skilled Person's report on 20 February 2018.

Notes to the accounts

19. Memorandum items continued

The Financial Services Compensation Scheme

The Financial Services Compensation Scheme ("FSCS"), the UK's statutory fund of last resort for customers of authorised financial services firms, pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the industry. In relation to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year (which runs from 1 April to 31 March), subject to annual maxima set by the FCA. In addition, the FSCS has the power to raise levies on a firm that has ceased to participate in the scheme and is in the process of ceasing to be authorised for the costs that it would have been liable to pay had the FSCS made a levy in the financial year it ceased to be a participant in the scheme.

FSCS has now repaid the loans taken out from HM Treasury for the Icesave, Kaupthing Singer & Friedlander, Dunfermline Building Society, Heritable Bank and London Scottish defaults through a combination of recoveries and levies.

The only loan outstanding is for Bradford & Bingley (B&B). The interest forecast on the loan for the 2017/18 year currently stands at £61 million offset by recoveries of £37 million. (2016/17 - £306 million of which only £202 million was invoiced). There is nothing expected in 2017/18 for capital repayments. HM treasury are exploring sales of the remaining B&B mortgages with a view to repaying the FSCS debt owed by B&B allowing FSCS to repay the loan by the end of 2017/18.

The Bank has accrued £0.2 million for its share of estimated FSCS levies for the 2017/18 scheme year.

Capital Support Deed

The Bank, together with other members of RBS, is party to a capital support deed ("CSD"). Under the terms of the CSD, the Bank may be required, if compatible with its legal obligations, to make distributions on, or repurchase or redeem, its ordinary shares. The amount of this obligation is limited to the Bank's capital resources in excess of the capital and financial resources needed to meet its regulatory requirements. The Bank may also be obliged to make onward distribution to its ordinary shareholders of dividends or other capital distributions received from subsidiaries that are party to the CSD. The CSD also provides that, in certain circumstances, funding received by the Bank from other parties to the CSD becomes immediately repayable, such repayment being limited to the Bank's available resources.

20. Net cash flow from operating activities

	2017	2016
	£m	£m
Net cash flows from/(used in) trading activities	23	(377)
Decrease in loans and advances to banks and customers	402	1,790
(Increase)/decrease in other assets	(12)	11
Increase in derivative assets	(2)	(4)
Changes in operating assets	388	1,797
Increase/(decrease) in deposits by banks and customers	1,652	(999)
Increase in other liabilities	54	51
Decrease in derivative liabilities	(17)	-
Changes in operating liabilities	1,689	(948)
Total taxes paid	(5)	(4)
Net cash flows from operating activities	2,095	468

Notes to the accounts

21. Interest received and paid

	2017	2016
	£m	£m
Interest received	167	178
Interest paid	(37)	(49)
	<u>130</u>	<u>129</u>

22. Analysis of changes in financing during the year

	Share capital, share premium and paid-in equity		Subordinated liabilities		Debt securities in issue	
	2017	2016	2017	2016	2017	2016
	£m	£m	£m	£m	£m	£m
At 1 January	912	2,412	939	820	-	1
Net cash flows from financing	-	-	(857)	-	-	(1)
Issue of Additional Tier 1 loan	60	-	-	-	-	-
Currency translation and other adjustments	-	-	25	119	-	-
Conversion of preference share capital to retained earnings	(658)	-	-	-	-	-
Ordinary share capital reduction	-	(1,500)	-	-	-	-
At 31 December	<u>314</u>	<u>912</u>	<u>107</u>	<u>939</u>	<u>-</u>	<u>-</u>

23. Analysis of cash and cash equivalents

	2017	2016
	£m	£m
At 1 January		
Cash	1,027	618
Cash equivalents	3,384	3,278
	4,411	3,896
Net cash inflow	1,603	458
Effect of exchange rate changes on cash and cash equivalents	6	57
At 31 December	<u>6,020</u>	<u>4,411</u>
Comprising:		
Cash and balances at central banks	1,032	1,012
Loans and advances to banks	4,988	3,399
Cash and cash equivalents	<u>6,020</u>	<u>4,411</u>

24. Segmental analysis

The Bank operates entirely in the UK and is managed by class of business and reports on a segmental basis as follows:

The PBB division provides loan and deposit products through a network of branches and direct channels to customers.

The CPB division provides services to commercial and corporate customers.

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

Notes to the accounts

24. Segmental analysis continued

Segmental information by class of business is set out below:

Class of business

	Total income			Operating expenses before depreciation	Depreciation and amortisation	Impairment (loss)/gain	Operating profit/(loss) before tax
	Net interest income	Non-interest income	Total				
2017	£m	£m	£m	£m	£m	£m	£m
PBB	99	77	176	(74)	-	(1)	101
CPB	35	10	45	(10)	-	7	42
Other	-	13	13	(92)	(3)	-	(82)
Total	134	100	234	(176)	(3)	6	61

Class of business

	Total income			Operating expenses before depreciation	Depreciation and amortisation	Impairment gain	Operating profit/(loss) before tax
	Net interest income	Non-interest income	Total				
2016	£m	£m	£m	£m	£m	£m	£m
PBB	97	34	131	(89)	-	1	43
CPB	33	3	36	(16)	-	13	33
Other	-	(284)	(284)	(97)	(3)	-	(384)
Total	130	(247)	(117)	(202)	(3)	14	(308)

Class of business

	2017		2016	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
PBB	3,722	6,996	3,732	4,880
CPB	1,108	1,686	982	1,653
Other	7,157	2,819	6,018	4,106
Held for sale	-	-	4,883	-
Total	11,987	11,501	15,615	10,639

25. Directors' and key management remuneration

As noted in the report of the directors the composition of the Board changed fundamentally on 28 July 2017.

Up to 28 July 2017 the executive directors of the Bank were Leslie Matheson and Michael Larkin, who are employed by RBS plc and are remunerated by RBS plc for their services to RBS Group as a whole but are not directors of RBS plc. The Bank did not remunerate the executive directors nor could their remuneration be apportioned in respect of their services to the Bank. The directors' emoluments in the table below represents the emoluments of the non-executive directors for the period up to 28 July 2017 and comparative data for the full year ended 31 December 2016.

	2017	2016
	£	£
Emoluments for the provision of directors' services	108,444	247,666

From 28 July 2017 the directors of the Bank are also directors of the ultimate holding company and are remunerated for their services to RBS Group as a whole. The remuneration of the directors is disclosed in the Report and Accounts of RBS Group. Comparatives are not presented as these directors were not directors of the Bank during 2016.

Notes to the accounts

25. Directors' and key management remuneration *continued*

	2017
	£'000
Directors' remuneration	1,747
Non-executive directors emoluments	1,747
Chairman and executive directors emoluments	5,299
- contributions and allowances in respect of money purchase schemes	7,046
	<hr/>
Amounts receivable under long-term incentive plans and share options plans	1,225
	<hr/> 8,271

No directors accrued benefits under defined benefit schemes or money purchase schemes during 2017 and 2016.

The executive directors may participate in the company's long-term incentive plans, executive share option and sharesave schemes and details of their interests in the company's shares arising from their participation are given in the Directors' remuneration report in the Report and Accounts of RBS Group. Details of the remuneration received by each director is also given in the Directors' remuneration report in the Report and Accounts of RBS Group.

Compensation of key management

The aggregate remuneration of directors and other members of key management during the year, borne by the RBS Group, was as follows:

	2017	2016
	£'000	£'000
Short term benefits	19,019	20,350
Post employment benefits	434	471
Share-based benefits	3,558	2,606
	<hr/>	<hr/>
	23,011	23,427

Key management comprises members of the RBS Group Executive Committee.

26. Transactions with directors

As at 31 December 2017, the amounts outstanding in relation to transactions, arrangements and agreements, as defined in UK legislation, were £34 (2016 - £383) in respect of loans to any persons who were directors of the Bank at any time during the financial period.

Notes to the accounts

27. Related parties

The Bank's immediate parent company is National Westminster Bank Plc, which is incorporated in Great Britain and registered in England.

The Bank's ultimate holding company, and the parent of the largest group into which the Bank is consolidated, is The Royal Bank of Scotland Group plc which is incorporated in Great Britain and registered in Scotland. Copies of the accounts for The Royal Bank of Scotland Group plc can be obtained from Corporate Governance and Regulatory Affairs, The Royal Bank of Scotland Group plc, Gogarburn, Edinburgh, EH12 1HQ, or at www.rbs.com.

The smallest subgroup into which the Bank is consolidated is its parent company National Westminster Bank Plc. Copies of the consolidated accounts for NatWest can be obtained from Corporate Governance and Regulatory Affairs, The Royal Bank of Scotland Group plc, Gogarburn, Edinburgh, EH12 1HQ, or at www.rbs.com.

UK Government

The UK Government through HM Treasury is the ultimate controlling party of RBSG. Its shareholding is managed by UK Financial Investments Limited, a company it wholly owns and as a result, the UK Government and UK Government controlled bodies are related parties of the Bank.

Related undertakings

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

- Ulster Bank Commercial Services (NI) Limited
- Ulster Bank Pension Trustees Limited
- West Register (Northern Ireland) Property Limited (in liquidation)
- WR (NI) Property Investments Limited (in liquidation)
- WR (NI) Property Realisations Limited (in liquidation)

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

(a) Directors and key management

The aggregate transactions between the Bank and its directors, key management, their close families and companies which they control were:

	Number of directors	Number of key management	Connected parties	Transaction £
Transactions during the year				
Loans made during the year:				
- at a commercial rate	-	-	-	-
Balances outstanding at the end of the year				
Loans:				
- at a commercial rate	1	1	-	1,319
- at a preferential rate	-	1	-	16,817
Customer accounts:				
- savings	1	1	3	655,150

Notes to the accounts

27. Related parties continued

(b) Related party transactions

	2017	2016
	£m	£m
Assets		
Loans and advances:		
Parent companies	7,095	5,888
Other related parties, including fellow subsidiaries	(4)	68
	<u>7,091</u>	<u>5,956</u>
Derivatives:		
Other RBSG subsidiaries	8	5
	<u>7,099</u>	<u>5,961</u>
Liabilities		
Deposits:		
Parent companies	2,654	3,083
Key management	1	1
Other related parties, including fellow subsidiaries	19	39
	<u>2,674</u>	<u>3,123</u>
Subordinated loans:		
Parent companies	107	939
	<u>107</u>	<u>939</u>
Derivatives:		
Other RBSG subsidiaries	18	34
	<u>2,799</u>	<u>4,096</u>

28. Post balance sheet events

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

29. Capital resources (unaudited)

The Bank operates in the United Kingdom and is subject to regulatory oversight in this jurisdiction. The Bank is regulated by the PRA and the FCA in the United Kingdom. Capital resources disclosures are provided separately in respect of licensed institution.

The Capital Requirements Directive (CRD IV) and the Capital Requirements Regulation (CRR) are being implemented on a phased basis from 1 January 2014, with full implementation from 1 January 2019. The capital resources disclosures for 2017 below reflect the transition arrangements of the legislation together with the PRA guidance as implemented in the UK by PRA policy statement PS7/13 (PRA transitional rules).

Notes to the accounts

29. Capital resources (unaudited) continued

	Unaudited ⁽¹⁾ 2017 £m	Unaudited ⁽¹⁾ 2016 £m
<i>Shareholders' equity (excluding non-controlling interests)</i>		
Shareholders' equity	486	4,976
Paid-in equity	(60)	-
Preference shares - equity	-	(659)
	426	4,317
<i>Regulatory adjustments and deductions</i>		
Deferred tax assets	(10)	(14)
Instruments of financial sector entities where the institution has a significant investment	-	(2,989)
Excess of expected losses over provisions	(12)	(14)
Other adjustments for regulatory purposes	(40)	-
	(62)	(3,017)
Core 1 Tier capital	364	1,300
<i>Other Tier 1 capital</i>		
Eligible AT1	60	-
Qualifying Tier 1 capital and related share premium subject to phase out from AT1 capital	-	576
	60	576
<i>Tier 1 deductions</i>		
Instruments of financial sector entities where the institution has a significant investment	-	(62)
Total Tier 1 capital	424	1,814
<i>Qualifying Tier 2 capital</i>		
Qualifying items and related share premium	107	583
	107	583
<i>Tier 2 deductions</i>		
Instruments of financial sector entities where the institution has a significant investment	-	(309)
Other adjustments for regulatory purposes	-	62
	-	(247)
Total Tier 2 capital	107	336
Total regulatory capital	531	2,150
Key capital ratios		
	%	%
CET1	16.2	13.1
Tier 1	18.9	18.2
Total capital	23.7	21.6
Risk weighted assets by risk		
	£m	£m
Credit risk	1,960	9,633
Counterparty risk	7	5
Market risk	-	7
Operational risk	277	298
Total risk weighted assets	2,244	9,943

Note:

(1) The capital metrics included in the above table have not been audited for the financial years ended 31 December 2017 and 31 December 2016.

Capital management

The objectives of the Bank's capital management framework are to at all times comply with the regulatory capital requirements and to ensure that the Bank has sufficient capital to cover the current and future risk inherent in its business and to support its future development. Capital planning is a key part of the Group Capital Management Framework. The annual strategic planning process drives the levels of required capital to support growth plans and meet regulatory requirements. A base capital plan over a 5 year timeframe is produced as part of the integrated strategic planning process and is monitored on a monthly basis. The Bank's current and future capital requirements are captured as part of the annual ICAAP, which is subject to supervisory review and evaluation.