Company Registered Number: R0000733

ULSTER BANK LIMITED

REPORT OF THE DIRECTORS AND FINANCIAL STATEMENTS

31 December 2016

ULSTER BANK LIMITED

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ULSTER BANK LIMITED

BOARD OF DIRECTORS AND SECRETARY

DIRECTORS:	C Campbell (Chairman) E Graham M Larkin L Matheson D O'Shea R Quinlan
REGISTERED OFFICE:	11-16 Donegall Square East Belfast BT1 5UB
SECRETARY:	S Anderson
AUDITORS:	Ernst & Young Chartered Accountants and Statutory Auditor Ernst & Young Building Harcourt Centre Harcourt Street Dublin 2 D02 YA40

STRATEGIC REPORT

The directors of Ulster Bank Limited (“the Bank”) present their report, together with audited financial statements of the Bank and its subsidiaries (together "the Group" or “Ulster Bank Group”) for the year ended 31 December 2016. The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union (EU).

ACTIVITIES AND BUSINESS REVIEW

Principal activities

The Group, operating under the Ulster Bank brand, provides a comprehensive range of financial services through its retail and commercial banking divisions. The retail banking divisions provide loan and deposit products through the Group’s network of branches and direct channels, including the internet, mobile and telephony. The commercial banking divisions provide services to business and corporate customers, including small and medium enterprises. For the year ended 31 December 2016 the Group consisted of operations located in both Northern Ireland and the Republic of Ireland. On 1 January 2017 the Group divested its Republic of Ireland operations, principally Ulster Bank Ireland Designated Activity Company (“UBIDAC”), as outlined below. Therefore in the next reporting period the Group will consist only of Northern Ireland operations, principally Ulster Bank Limited.

Business review

The Group’s core ambition is to become the number one bank for customer service, trust and advocacy by 2020. In June 2016, subsequent to the UK vote to leave the European Union, the Royal Bank of Scotland (“RBS”) emphasised the continued strategic importance of the Group in its commitment to serve businesses and customers in the UK, Ireland and the rest of Europe.

On 30 September 2016, RBS issued a market communication outlining its plans to meet the requirements of the UK Financial Services (Banking Reform) Act 2013, designed to promote financial stability in the UK banking sector and reduce the severity of any potential future financial crisis, specifically implementing a ring-fence. The ring-fence, to be established by 1 January 2019, will separate core banking activities and services from higher risk activities. In December 2016 as part of the planned implementation and to simplify the RBS group structure, the directors, in conjunction with RBS, agreed that NatWest Holdings Limited, the holding company for the ring-fenced bank entities, would acquire the Group’s Republic of Ireland operations, including UBIDAC, on 1 January 2017. All trading companies in the Ulster Bank Group will be positioned inside the ring-fence.

This reorganisation establishes a more simplified Group by aligning the legal entity structure with the existing management structure. Consequently, going forward it allows the Group’s executive management team to dedicate their focus on serving local customers and strengthening its market leading position in Northern Ireland, whilst continuing to realise the benefits of being part of a leading UK retail bank.

The timing of this acquisition on 1 January 2017 means that these financial statements present the entire Group’s performance for 2016 whilst disclosing the Republic of Ireland operations as discontinued operations in the income statement and as a disposal group on the balance sheet. The remainder of the business review focuses on the performance of the entire Group for 2016. The financial performance section discusses continuing and discontinued operations separately.

In November 2016, the directors approved the payment of a dividend of £1.3bn to the bank’s parent, National Westminster Bank Plc. This significant milestone reflected the continued strength of the Group’s capital position.

In February 2016 the Group launched its ‘Help for what matters’ campaign, a comprehensive brand recharge signalling the Group’s ambitions for the future based on developing lasting relationships with new and existing customers.

In retail banking the ‘Help for the movers’ element of the campaign contributed to new mortgage lending of £1.1bn, an increase of 38% from 2015 at constant exchange rates. In Northern Ireland an increase in lending of 15% was driven largely by strong uptake of the Group’s fixed rate propositions. In the Republic of Ireland an increase in lending of 48% was supported by a successful re-entry into the mortgage broker market and the use of new innovative technologies including the introduction of a secure video chat app for use by mobile mortgage managers to complement their ability to meet customers outside branches and normal business hours.

The offer period for the Group’s lowest ever personal loan rate in Northern Ireland, launched in January 2016, was extended until June 2016 due to strong demand. The Group introduced a fee-free ‘Foundation’ current account across the island of Ireland. The proposition encourages customers not eligible for other current accounts to more tightly manage their finances and simultaneously improve their credit rating.

Commercial banking continued to support and make more credit available to existing and new customers. New lending activity was particularly strong in the SME division and in commercial real estate where the Group is supporting the recovery in the property markets with the provision of finance across a number of sectors including residential development, student accommodation and investment property. In January 2016 the Group commenced a partnership with the Strategic Banking Corporation of Ireland to provide £64m in new lower-cost funding to independent SME’s and agri-businesses. The farming sector endured both price and weather volatility during 2016. In recognition of these issues, the Group provided additional measures to support dairy farmers, who were experiencing cash-flow difficulties.

Business review (continued)

The Group's asset financing business performed strongly driven largely by the provision of hire purchase and lease finance for business assets, as well as a successful re-entry to the car market supporting vehicle dealers with stocking finance.

The Group continued to invest heavily in developing the channels though which its customers can interact with the business, with a particular focus on enhancing and optimising online and mobile capabilities. During 2016 58% of the Group's customer base were 'digitally active', this included a 23% increase in mobile app users, reflecting the continued strengthening of the Group's digital proposition. Customers in both Northern Ireland and the Republic of Ireland can now access the app using multiple devices, manage and create standing orders and customers using enabled Android devices can now utilise the Android Fingerprint technology to log into the app. In addition, customers in Northern Ireland can also make purchases through Android Pay, complementing the existing Apple Pay feature. The Group, in conjunction with RBS and the Royal National Institute for the Blind, developed functionality within the mobile app making it accessible and usable by blind and partially sighted customers.

The innovative 'Get Cash' feature that enables customers in the Republic of Ireland to withdraw cash from any Ulster Bank ATM and customers in Northern Ireland to withdraw cash from any Ulster Bank, NatWest, Tesco or Easycash ATM without the use of their bank card was used over 163,000 times in 2016. The complementary 'Near Me' feature allows customers to use their smart phone to locate their nearest Ulster Bank ATM. The number of the Group's customers opting for online statements via Anytime Banking has risen to 47% in both Northern Ireland and the Republic of Ireland.

The Group maintained its focus on innovation and development during 2016. The partnership with Dogpatch Labs in Dublin entered its second year with the Group facilitating a second Hackathon in the CHQ building, bringing together members of the external technology community to design, code and pitch ideas on banking innovations throughout the weekend-long event. The Group remained a key supporter of the Accenture & Enterprise Ireland Fintech Innovation Lab. In February 2016 it hosted an 'Innovation Showcase' at its Central Park offices with six Fintech companies presenting their propositions to a cross-section of the Group's staff. In March 2016 the world's largest free business accelerator hub was opened in Belfast under the Group's Entrepreneurial Spark initiative. The hub houses 80 entrepreneurs enabling them to work in a collaborative environment, providing business enablement and networking opportunities and support via a pool of specialised mentors.

The Group continued to make significant progress in dealing with legacy issues in 2016. The Problem Debt Management division continued to oversee the de-leveraging of impaired debt in order to strengthen the Group's balance sheet. In December 2016, as part of Project Oyster, the Group completed the sale of £1.7bn of distressed loans.

On 22 December 2015, UBIDAC received a letter from the Central Bank of Ireland (CBI) requesting that UBIDAC conduct a review into its mortgage loan books to assess instances of contractual and regulatory non-compliance that may have adversely impacted a number of its tracker mortgage customers. The Group is in the process of completing this in-depth review and has begun to write to impacted customers. A charge of £168m (2015: £4m) has been recognised to cover potential remediation and project costs.

In November 2016, the Group confirmed it had agreed a settlement with the CBI of £2.7m relating to Anti-Money Laundering ("AML") compliance failings. The Group had proactively engaged the CBI in the identification of these issues and dedicated significant resources to remediation and developing a stronger AML framework.

The Group continued with its strong corporate social responsibility (CSR) agenda and was awarded the Business Working Responsibly Mark, the highest level of CSR accreditation in Ireland. The Group raised £369,000 for its charity partners on the island of Ireland through its "One Week In June" initiatives. Customers in the Republic of Ireland were able to donate via Ulster Bank ATMs or Anytime Banking to Concern's appeal for Haiti following the impact of Hurricane Matthew. In February 2016 the Group began partnering with Young Social Innovators, encouraging staff to volunteer to support and mentor young people in their community. MoneySense, the Group's financial education programme, has enjoyed continued success with a re-designed website launched in February and a growing number of the Group's staff volunteering.

The Group has established a set of key performance indicators (KPIs) to track its performance towards its objectives. As a result of the sale of the Group's Republic of Ireland operations on 1 January 2017 the KPIs have been rebased to reflect only continuing operations:

	Target	**2016**	2015
Net interest margin	>2.15%	**1.28%**	1.22%
Cost:income ratio	<60%	**108%**	110%
Digitally active customers*	>65%	**58%**	53%

* 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 net interest margin and the cost:income ratio are discussed further in the financial performance section of this report.

Business review (continued)

Financial performance

The Group's financial performance is presented in the Consolidated Income Statement on page 13.

The Group reported a total profit after tax for the financial year ended 31 December 2016 of £50m (2015: £837m) driven primarily by a profit on discontinued operations, net of tax of £63m (2015: £834m). The significant reduction in total profit after tax in 2016 was predominately driven by a £592m reduction in the impairment gain and the recognition of a £168m provision for the tracker mortgage review. Continuing operations reported an after tax loss of £13m (2015: £3m profit) with the movement in the year primarily as a result of a £28m reduction in the impairment gain.

Net interest income from continuing operations decreased by 8% to £130m due to reduced income on free funds and the impact of the Bank of England base rate cut of 0.25% in August 2016. Other contributory factors were the further reduction in the loan book from asset sales and continued loan amortisation. These were partially offset by pricing actions taken on retail and commercial deposits.

Non-interest income from continuing operations increased from £27m in 2015 to £46m, mainly due to a decrease in the loss recognised on portfolio sales, offset by reduced trading income as a result of reduced volumes on foreign exchange contracts and the impact of fluctuation in foreign exchange rates.

Operating expenses from continuing operations decreased by £1m in the current year. The Group continued to focus on reducing the cost base with a decrease in staff costs resulting from a reduction in headcount. These positive results were negated by the impact of one-off costs incurred in 2016 associated with the FCA's review into the treatment of SME customers in the bank's former Global Restructuring Group and an increase in the Group's property and technology costs.

Included within operating expenses is £46m (2015: £38m) of staff and overhead costs which are incurred by the Bank in providing services to UBIDAC. Although these costs are recharged to UBIDAC on an arms-length basis they are required to be reflected within continuing operations in the Consolidated Income Statement, driving the reported loss. Further details and adjusted profits for continuing and discontinued operations are shown in Note 18.

The impairment gain from continuing operations reduced to £27m from £55m in 2015. Albeit reduced in 2016, the gain in both years was driven by improved residential and commercial property market conditions increasing collateral values, the release of PDM provisions due to asset sales and proactive debt management.

The Group incurred a tax charge on continuing operations in 2016 of £25m (2015: £29m). 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 2016.

Profit from discontinued operations decreased by £771m from £834m in 2015 to £63m. This was driven by a decrease in the impairment gain (£564m) and an increase in operating expenses (£229m) primarily relating to £168m of project and remediation cost on the tracker mortgage examination. Increased property and technology costs also contributed to the year on year reduction in profit from discontinued operations, offset by the benefit of the devaluation in Sterling relative to the Euro following the UK referendum decision on EU membership in June 2016.

At the year end the total assets of the Group were £36,474m (2015: £33,990m). Return on total assets for 2016 was 0.1% (2015: 2.3%).

The Bank's capital position remained strong during 2016. Its CET 1 ratio decreased from 17.5% at 31 December 2015 to 13.1% at 31 December 2016 as a result of planned activities, including the payment of a £1.3bn dividend to its parent National Westminster Bank Plc and the revaluation of the Bank's investment in subsidiaries. The CET 1 ratio remains significantly above the regulatory minimum.

On 21 December 2016, the Bank carried out a capital reduction under Section 641 (1)(a) of the Companies Act 2006. The issued ordinary shares of £1 were reduced from £1,320m to £254m and an amount of £1,066m was transferred to retained earnings. In the same transaction the Bank's share premium account on ordinary shares was cancelled and a further £434m was transferred to retained earnings.

Business review (continued)

Outlook

The directors note that economic data trends for Northern Ireland, the Group's core market going forward, continue to be positive. The Composite Economic Index, produced by the Northern Ireland Statistics and Research Agency, indicated the economy grew by 1.6% in 2016 driven by a 2.3% growth in the private sector. The unemployment rate fell by 0.3% year on year, with the number of people in employment increasing by 0.5%. The Office of National Statistics reported an annual increase of 5.4% in average house prices in Northern Ireland to November 2016, an improvement on the 4.6% increase in 2015. However, depreciation in sterling coupled with a rise in global commodity prices has fuelled a return of inflationary pressures contributing to the UK Consumer Price Index rising to 1.6%, its highest level since July 2014 but still significantly below the 3.3% average during the post-recessionary period from 2010-2013.

The Group remains vulnerable to multiple macroeconomic risks including a sustained low interest rate environment, continued low growth rates in the Eurozone, uncertainty around the impact of the UK's exit from the European Union (EU), geopolitical uncertainty and a challenging international trade environment.

The directors, while cognisant of the macroeconomic risks outlined above, believe that the largely positive economic indicators, the continued focus on cost control, the benefits of closer integration with RBS, its strong competitive position and resolution of legacy issues along with the significant investment in the Ulster Bank brand through the 'Help for what matters' campaign should lead to a sustainable financial performance.

Accounting policies

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of the Group's critical accounting policies and key sources of estimation uncertainty are included in the Accounting policies on pages 25 to 28.

Risk management

The major risks associated with the Group's businesses are credit, market, liquidity, regulatory, reputational, conduct and operational risk, with the principal risk associated with the Group's business being credit risk. The Group has established a comprehensive framework for managing these risks, which is continually evolving as the Group's business activities change in response to market, credit, product, regulatory and other developments. The Group is also exposed to risks from its defined benefit pension schemes. The Group's policies for managing each of these risks and its exposure thereto are detailed in Note 25 to the financial statements.

The Group'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.

Staff involvement

The Group 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 Ulster Bank a better bank for our customers and staff. The annual survey of employee opinions, known as Our View, provides valuable data to decision makers across the Group in support of improving employee engagement and satisfaction. We track our progress through pulse surveys and ask questions used by other organisations so we can compare ourselves against our financial peers. In addition we run an annual Working Together Survey where a representative sample provides feedback on the services provided by our support functions.

Our community programmes focus on delivering genuine benefits that make a difference to people's lives throughout Ireland. We invest in programmes that are most relevant for us as a financial institution – in particular promoting financial education. Employees across the Group continue to widely support, both financially and through volunteering, many community and other worthy causes. Such giving is encouraged by the Group through its use of payroll giving and staff charity funds which support worthy causes at local, national and international level. Whilst our community programme and activities run throughout the year every June we have 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 Group promotes flexible working for its employees. We support businesses, 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.

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

Employment of people with disabilities

The Group'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 Group's policy, wherever possible, to retain them in their existing jobs or to re-deploy them in suitable alternative duties.

Inclusion

The Group 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 to build and develop an inclusive workforce in order to understand and respond to our diverse customer base.

Safety, health and wellbeing

The Group recognises that people are key to the success of its business. The Group's vision is for its employees, peers and communities to recognise that the Group's pride and performance in safety, health and wellbeing adds value to them and to the Group'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.

During 2016, the Group continued to focus on compliance, governance and managing risk across both jurisdictions in which it operates. Opportunities to improve the efficiency and effectiveness of safety, health and wellbeing management policies and services were monitored and, where relevant, implemented. In 2016 we have focused on improving wellbeing for our employees through the introduction of the Global Corporate Challenge, Employee Health Checks and improved Wellbeing support materials for line managers and employees.

By order of the Board:

Sheryl Anderson
Secretary
11-16 Donegall Square East
Belfast
BT1 5UB

16 February 2017

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 Group, staff involvement and employment of people with disabilities.

Board of directors

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

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

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

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

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

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

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

Directors and secretaries

The names of the current members of the Board of Directors are shown on page 1 and brief biographical details are shown on page 108. From 1 January 2016 to date the following changes have taken place:

	Appointed	Resigned
Directors		
E Graham	18 February 2016	-
C Mills	-	27 February 2016
B Rosewell	-	30 June 2016
N Hamilton	-	30 September 2016
Secretary		
R Bergin	-	31 January 2016

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

Directors' indemnities

In terms of Section 236 of the Companies Act 2006, all directors have been granted Qualifying Third Party Indemnity Provisions by RBS Group.

Political donations

During the year the Group made no political donations in the UK or EU (2015: £nil).

Investments in Group undertakings

The investments in Group undertakings are shown in Note 13. All of these undertakings are included in the Group's consolidated financial statements and all have an accounting reference date of 31 December.

Dividends

The directors do not recommend the payment of a final dividend on ordinary shares (2015: £nil). In November 2016 the directors approved and paid an interim dividend of £1.3bn.

Post balance sheet events

On 1 January 2017, the Bank sold Ulster Bank (Ireland) Holdings Unlimited Company ("UBIH") and its subsidiaries, comprising the Group's Republic of Ireland operations, to NatWest Holdings Limited, a fellow subsidiary of RBS Group for consideration of £4.9bn. On completion of the transaction the Group realised a consolidated loss on disposal of £0.4bn representing the differential between the consideration received and the net asset value of the legal entities disposed of.

Consequently, UBIH and its subsidiaries are classified as a disposal group in these financial statements at 31 December 2016 and its assets and liabilities presented in aggregate in accordance with IFRS 5.

The directors proposed a dividend of £3.9bn in December 2016 which was paid during January 2017.

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 sustainability website:
www.rbs.com/sustainability/sustainability-downloads.html.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position, including potential risks and uncertainties, are set out in the Business review on pages 2 to 5.

The Bank's liquidity position is considered to be a constituent part of the UK Defined Liquidity Group (DLG). At 31 December 2016, the Group had excess funding and placed c. £2.6bn with The Royal Bank of Scotland plc ("RBS plc"). Access to liquidity from RBS Group and market sources is expected to remain available in sufficient quantity throughout 2017. The Bank also has a Discount Window Facility with the Bank of England which can be used for liquidity, if required.

The Bank's capital position remained strong during 2016. Its CET 1 ratio decreased from 17.5% at 31 December 2015 to 13.1% at 31 December 2016 as a result of planned activities, including the payment of a £1.3bn dividend to its parent National Westminster Bank Plc and the revaluation of the bank's investment in subsidiaries, principally UBIDAC. However, the CET 1 ratio remains significantly above the regulatory minimum.

The financial position of the Group, its cash flows, liquidity position, capital and funding sources are set out in the financial statements. Notes 9, 25 and 35 to the financial statements include the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to market, credit and liquidity risks.

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

REPORT OF THE DIRECTORS

Directors' disclosure to auditors

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

(a) so far as the director is aware, there is no relevant audit information of which the Bank's auditors are unaware; and

(b) the director has taken all 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 Bank's auditors are aware of that information.

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

By order of the Board:

Sheryl Anderson
Secretary
11-16 Donegall Square East
Belfast
BT1 5UB

16 February 2017

Ulster Bank Limited is registered in Northern Ireland No. R0000733

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the financial statements in accordance with applicable laws and regulation. Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare Group and Bank financial statements in accordance with IFRS as adopted by the EU. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Bank and of the profit or loss for that period. In preparing these financial statements, the directors are required to:

- properly select and apply accounting policies;

- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;

- provide additional disclosures when compliance with the specific requirements in IFRS are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Bank's financial position and financial performance; and

- make an assessment of the Group and Bank's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Bank and enable them to ensure that the financial statements comply with the Companies Act 2006. They are responsible for safeguarding the assets of the Group and Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors confirm that these financial statements comply with the aforementioned requirements.

By order of the Board:

Sheryl Anderson
Secretary
11-16 Donegall Square East
Belfast
BT1 5UB

16 February 2017

Ulster Bank Limited is registered in Northern Ireland No. R0000733

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF ULSTER BANK LIMITED

We have audited the financial statements of Ulster Bank Limited for the year ended 31 December 2016 which comprise the Consolidated Income Statements, Consolidated Statement of Comprehensive Income, the Group and Parent Company Balance Sheets, the Group and Parent Company Statements of Changes in Equity, the Group and Parent Company Cash Flow Statements, and the related notes 1 to 34 (unless stated otherwise). 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 parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 10, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Strategic Report and the Report of the Directors to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Continued /…

Opinion on financial statements
In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2016 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion 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.
    - the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements;

Matters on which we are required to report by exception

In light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have identified no material misstatements in the Strategic Report or Directors' Report.

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

- adequate accounting records have not been kept by the parent company; or
- the parent company 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.

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

16 February 2017

Notes:

1. The maintenance and integrity of the RBS plc and Ulster Bank Group web sites is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

CONSOLIDATED INCOME STATEMENT *for the year ended 31 December 2016*

		Group	
		2016	2015
	Note	**£m**	£m
Interest receivable		**179**	195
Interest payable		**(49)**	(53)
Net interest income	2	**130**	142
Fees and commission receivable		**56**	53
Fees and commission payable		**(7)**	(7)
Income from trading activities		**-**	7
Other operating income		**(3)**	(26)
Non-interest income	3	**46**	27
Total income		**176**	169
Operating expenses excluding costs of servicing discontinued operations		**(145)**	(154)
Costs incurred in servicing discontinued operations	18	**(46)**	(38)
Operating expenses	4	**(191)**	(192)
Operating profit before impairment excluding costs of servicing discontinued operations		**31**	15
Costs incurred in servicing discontinued operations	18	**(46)**	(38)
Operating loss before impairment		**(15)**	(23)
Impairment gain	10	**27**	55
Operating profit before tax excluding costs of servicing discontinued operations		**58**	70
Costs incurred in servicing discontinued operations	18	**(46)**	(38)
Operating profit before tax		**12**	32
Tax charge	7	**(25)**	(29)
Profit from continuing operations excluding costs of servicing discontinued operations		**33**	41
Costs incurred in servicing discontinued operations	18	**(46)**	(38)
(Loss)/profit from continuing operations	18	**(13)**	3
Profit from discontinued operations, net of tax	18	**63**	834
Profit for the year		**50**	837
Profit attributable to:			
Ordinary shareholders		**50**	837
		50	837

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

The financial statements were approved by the Board of Directors on 16 February 2017 and signed on its behalf by:

Christopher Campbell	Leslie Matheson	Michael Larkin
Chairman	Chief Executive Officer	Chief Financial Officer

Ulster Bank Limited is registered in Northern Ireland No. R0000733

ULSTER BANK LIMITED

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME *for the year ended 31 December 2016*

	Group	
	2016	2015
	£m	£m
Profit for the year	**50**	837
Items that will not be reclassified subsequently to profit or loss:		
Actuarial gains on defined benefit plans and other movements	**45**	148
Tax	**13**	5
Items that will be reclassified subsequently to profit or loss:		
Fair value gains on available-for-sale financial assets	**3**	-
Exchange differences on translation of foreign operations	**917**	(278)
Other comprehensive income/(loss) after tax	**978**	(125)
Total comprehensive income for the year	**1,028**	712
Attributable to:		
Non-controlling interests	**72**	(27)
Ordinary shareholders	**956**	739
	1,028	712

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

ULSTER BANK LIMITED

BALANCE SHEETS *as at 31 December 2016*

		Group		Bank	
		2016	2015	**2016**	2015
	Note	**£m**	£m	**£m**	£m
Assets					
Cash and balances at central banks	9	**1,012**	868	**1,012**	616
Loans and advances to banks	9	**5,402**	9,485	**5,935**	7,119
Loans and advances to customers	9	**3,696**	20,643	**3,714**	3,801
Debt securities	9,11	**-**	1,889	**-**	-
Equity shares	9,12	**-**	5	**-**	-
Investments in Group undertakings	9,13	**-**	-	**-**	6,432
Derivatives	9,16	**5**	627	**7**	3
Property, plant and equipment	9,15	**43**	126	**43**	44
Prepayments, accrued income and other assets	9,17	**8**	95	**10**	31
Retirement benefit assets	5,9	**-**	16	**-**	16
Deferred taxation	9,20	**11**	236	**11**	25
Assets of disposal groups	9,18	**26,297**	-	**4,883**	-
Total assets		**36,474**	33,990	**15,615**	18,087
Liabilities					
Deposits by banks	9	**3,065**	4,785	**3,099**	4,003
Customer accounts	9	**5,727**	18,977	**5,765**	5,860
Debt securities in issue	9	**-**	1,473	**-**	1
Derivatives	9,16	**4**	477	**35**	35
Provisions, accruals and other liabilities	9,19	**803**	921	**801**	748
Retirement benefit liabilities	5,9	**-**	285	**-**	-
Deferred taxation	9,20	**-**	3	**-**	-
Subordinated liabilities	9,21	**939**	960	**939**	820
Liabilities of disposal groups	9,18	**20,072**	-	**-**	-
Total liabilities		**30,610**	27,881	**10,639**	11,467
Equity					
Non-controlling interests		**507**	435	**-**	-
Shareholders' equity:					
Called up share capital	22	**455**	1,521	**455**	1,521
Reserves		**4,902**	4,153	**4,521**	5,099
Total equity	9	**5,864**	6,109	**4,976**	6,620
Total liabilities and equity		**36,474**	33,990	**15,615**	18,087

The accompanying notes form an integral part of these financial statements. As detailed in Note 8 the Bank's loss after tax for the year ended 31 December 2016 was £336m (2015: £1,793m profit).

The financial statements were approved by the Board of Directors on 16 February 2017 and signed on its behalf by:

Christopher Campbell Chairman	Leslie Matheson Chief Executive Officer	Michael Larkin Chief Financial Officer

Ulster Bank Limited is registered in Northern Ireland No. R0000733

STATEMENTS OF CHANGES IN EQUITY *for the year ended 31 December 2016*

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Called up share capital				
At 1 January	**1,521**	1,521	**1,521**	1,521
Reduction of capital (Note 22)	**(1,066)**	-	**(1,066)**	-
At 31 December	**455**	1,521	**455**	1,521
Share premium account				
At 1 January	**891**	891	**891**	891
Reduction of capital (Note 22)	**(434)**	-	**(434)**	-
At 31 December	**457**	891	**457**	891
Available-for-sale reserve				
At 1 January	**-**	-	**-**	-
Unrealised gains	**3**	-	**-**	-
At 31 December	**3**	-	**-**	-
Foreign exchange reserve				
At 1 January	**(489)**	(238)	**-**	-
Exchange differences on translation of foreign operations	**845**	(251)	**-**	-
Transfer to retained earnings	**4**	-	**-**	-
At 31 December	**360**	(489)	**-**	-
Retained earnings				
At 1 January	**3,751**	2,761	**4,208**	2,426
Actuarial gains/(losses) on defined benefit plans and other movements	**45**	148	**(48)**	(16)
Tax	**13**	5	**13**	5
Transfer from foreign exchange reserve	**(4)**	-	**-**	-
Reduction of capital (Note 22)	**1,500**	-	**1,500**	-
(Loss)/profit attributable to ordinary shareholders:				
- from continuing operations	**(13)**	3	**(336)**	1,793
- from discontinued operations	**63**	834	**-**	-
Ordinary dividends paid	**(1,273)**	-	**(1,273)**	-
At 31 December	**4,082**	3,751	**4,064**	4,208
Shareholders' equity at 31 December	**5,357**	5,674	**4,976**	6,620
Non-controlling interests				
At 1 January	**435**	482	**-**	-
Decrease in loan classed as equity	**-**	(20)	**-**	-
Currency translation	**72**	(27)	**-**	-
At 31 December	**507**	435	**-**	-
Total equity at 31 December	**5,864**	6,109	**4,976**	6,620

Total comprehensive income recognised in the Statement of Changes in Equity is attributable as follows:

Non-controlling interests	**72**	(27)	**-**	-
Ordinary shareholders	**956**	739	**(371)**	1,782
	1,028	712	**(371)**	1,782

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

ULSTER BANK LIMITED

CASH FLOW STATEMENTS *for the year ended 31 December 2016*

		Group		Bank	
		2016	2015	**2016**	2015
	Note	**£m**	£m	**£m**	£m
Operating activities					
Operating profit/(loss) before tax from continuing operations		**12**	32	**(308)**	1,820
Profit before tax from discontinued operations	18	**60**	837	**-**	-
Adjustments for:					
Dividends received		**-**	-	**(1,271)**	(31)
Depreciation, amortisation and impairment of property, plant and equipment		**11**	13	**3**	4
Interest on subordinated liabilities		**9**	11	**5**	6
Charge for defined benefit pension schemes		**47**	62	**10**	13
Cash contribution to defined benefit pension schemes		**(121)**	(70)	**(42)**	(42)
Impairment gains on loans and advances and amounts written off		**(2,557)**	(7,138)	**(398)**	(1,635)
Impairment loss/(reversal) on investments in Group undertakings		**-**	-	**1,549**	(1,713)
Elimination of foreign exchange differences		**592**	(897)	**62**	(21)
Other non-cash items		**193**	(145)	**13**	10
Net cash flows used in trading activities	27	**(1,754)**	(7,295)	**(377)**	(1,589)
Changes in operating assets and liabilities		**4,251**	7,244	**849**	1,420
Net cash flows from/(used in) operating activities before tax		**2,497**	(51)	**472**	(169)
Income taxes paid		**(8)**	(78)	**(4)**	(66)
Net cash flows from/(used in) operating activities	27	**2,489**	(129)	**468**	(235)
Investing activities					
Sale and maturity of securities		**1,495**	2,004	**-**	5
Purchase of debt securities		**(1,339)**	(1,959)	**-**	-
Purchase of equity shares		**(1)**	(1)	**-**	-
Sale of equity shares		**1**	62	**-**	-
Purchase of property, plant and equipment		**(8)**	(6)	**(4)**	(1)
Sale of property, plant and equipment		**25**	171	**2**	-
Dividends received		**-**	-	**1,271**	31
Net cash flows from investing activities		**173**	271	**1,269**	35
Financing activities					
Repayment of debt securities in issue		**(538)**	(127)	**(1)**	(9)
Repayment of subordinated loans		**-**	(20)	**-**	(20)
Interest on subordinated liabilities		**(9)**	(11)	**(5)**	(6)
Dividends paid		**(1,273)**	-	**(1,273)**	-
Net cash flows used in financing activities		**(1,820)**	(158)	**(1,279)**	(35)
Effect of exchange rate changes on cash and cash equivalents		**794**	(184)	**57**	(22)
Net increase/(decrease) in cash and cash equivalents		**1,636**	(200)	**515**	(257)
Cash and cash equivalents 1 January	30	**6,997**	7,197	**3,896**	4,153
Cash and cash equivalents 31 December	30	**8,633**	6,997	**4,411**	3,896

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

1. Accounting policies

a) Presentation of financial statements

The consolidated financial statements are prepared on a going concern basis and in accordance with IFRS issued by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB, as adopted by the EU. The Group and Bank's financial statements are presented in accordance with the Companies Act 2006.

The Bank is incorporated and registered in Northern Ireland. The Group and Bank's financial statements are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: held-for-trading financial assets and financial liabilities, financial assets and financial liabilities that are designated at fair value through profit or loss, available-for-sale financial assets and investment property. Recognised financial assets and financial liabilities in fair value hedges are adjusted for changes in fair value in respect of the risk that is hedged.

b) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank (Ulster Bank Limited) and entities (including certain special purpose entities) that are controlled by the Bank (its subsidiaries). The Group controls another entity (a subsidiary) when it is exposed, or has rights, to variable returns from its involvement with that entity and has the ability to affect those returns through its power over the other entity; power generally arises from holding a majority of voting rights.

There are a number of entities in which the Group holds less than half the voting rights which are consolidated when the substance of the relationship between the Group and the entity indicates that the entity is controlled by the Group. Such entities are deemed to be controlled by the Group when relationships with such entities give rise to benefits that are in substance no different from those that would arise were the entity a subsidiary.

On acquisition of a subsidiary, its identifiable assets and liabilities are included in the consolidated financial statements at their fair value. Any excess of the cost (the fair value of assets given, liabilities incurred or assumed and equity instruments issued by the Group plus any directly attributable costs) of an acquisition over the fair value of the net assets acquired is recognised as goodwill. The interest of non-controlling shareholders is stated at their share of the fair value of the subsidiary.

A subsidiary is included in the consolidated financial statements from the date control passes until the Group ceases to control them through a sale or significant change in circumstances. Changes in interest that do not result in a loss of control are recognised in equity. Total comprehensive income of subsidiaries is attributed to the owners of the Group and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

All intra-group balances, transactions, income and expenses are eliminated on consolidation. The consolidated financial statements are prepared using uniform accounting policies.

c) Assets and liabilities held for sale and discontinued operations

A non-current asset or a disposal group is classified as held for sale if the Group will recover its carrying amount principally through a sale transaction rather than through continuing use. A disposal group is a collection of assets and the liabilities directly associated with them that are intended to be transferred in a single transaction.

A non-current asset or disposal group classified as held for sale is measured at the lower of its carrying amount and fair value less costs to sell. If the asset or disposal group is acquired as part of a business combination it is initially measured at fair value less costs to sell. Assets and liabilities of disposal groups classified as held for sale and non-current assets classified as held for sale are shown separately on the face of the balance sheet. An analysis of the major classes of assets and liabilities classified as held for sale is presented in Note 18.

A discontinued operation is a cash generating unit or a group of cash generating units that either has been disposed of, or is classified as held for sale, and (a) represents a separate major line of business or geographical area of operations, (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or (c) is a subsidiary acquired exclusively with a view to resale. The financial performance of discontinued operations, comprising the post-tax profit or loss of discontinued operations, are shown as a single amount on the face of the income statement. An analysis of this amount is presented in Note 18.

1. Accounting policies (continued)

d) Revenue recognition

Interest income and expense on financial assets that are classified as loans and receivables or available-for-sale and interest expense on financial liabilities other than those at fair value through profit or loss is 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. Where negative effective interest rates apply to financial assets the related interest expense is shown as a separate item in interest payable.

Financial assets and financial liabilities held-for-trading or designated as at fair value through profit or loss are recorded at fair value. Changes in fair value are recognised through profit or loss together with dividends and interest receivable and payable.

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 income comprises income received for payment services including cheques cashed and direct debits. 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 charged.

Card related services: fees from credit card business include:

- Interchange received: as issuer, the Group receives a fee (interchange) each time a cardholder purchases goods and services. The Group also receives interchange fees from other card issuers for providing cash advances through its branch and automated teller machine networks. These fees are accrued once the transaction has taken place; and
- Periodic fees payable by credit card holders: these 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 in to, 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 advance.

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, causing income to be recognised when the act is executed.

Investment management fees: fees charged for managing investments are recognised as revenue as the services are provided. Incremental costs that are directly attributable to securing an investment management contract are deferred and charged as an expense as the related revenue is recognised.

Fees and commissions payable: fees and commissions are payable in respect of services provided by third party intermediaries. These are charged through profit or loss over the life of the underlying product.

e) Pensions and other post-retirement benefits

The Group provides post-retirement benefits in the form of pensions to eligible employees.

For defined benefit schemes, scheme liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate that reflects the current rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities. Scheme assets are measured at their fair value. Past service costs are recognised immediately to the extent that benefits have vested; otherwise they are amortised over the period until the benefits become vested.

1. Accounting policies (continued)

e) Pensions and other post-retirement benefits (continued)

Any surplus or deficit of scheme assets over liabilities adjusted for unrecognised actuarial gains and losses and past services costs is recognised on the balance sheet as an asset (surplus) or liability (deficit). In 2015, the Group voluntarily changed its accounting policy for the recognition of surpluses in its defined benefit pension schemes: in particular, the policy for determining whether or not it has an unconditional right to a refund of surpluses in its employee pension funds. Where the Group has a right to a refund, this is not deemed unconditional if pension fund trustees can use a scheme surplus to enhance benefits for plan members. As a result of this change, a minimum funding requirement to cover an existing shortfall in a scheme may give rise to an additional liability and surpluses may not be recognised in full as a defined benefit asset is limited to the present value of any economic benefits available to the Group in the form of refunds from the plan or reduced contributions to it. The revised accounting policy, by taking account of the powers of pension trustees in assessing the economic benefit available as a refund, provides more relevant information about the effect on the Group's financial position of its defined benefit pension schemes.

Contributions to defined contribution pension schemes are recognised in the income statement when payable.

f) Intangible assets and goodwill

Intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses.

g) Property, plant and equipment

Items of property, plant and equipment (except investment properties – see accounting policy i) are stated at cost less accumulated depreciation (see below) and accumulated impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they 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. Estimated useful lives are as follows:

Freehold and long leasehold buildings	50 years
Short leaseholds	unexpired period of the lease
Property adaptation costs	10 to 15 years
Computer equipment	up to 5 years
Other equipment	4 to 15 years

The residual value and useful life of property, plant and equipment are reviewed at each balance sheet date with the effect of any changes in estimate accounted for on a prospective basis.

h) Impairment of non-financial assets

At each reporting date, the Group assesses whether there is any indication that the value of its non-financial assets is impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss, if any. The recoverable amount of an asset 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 risk specific to the asset or cash-generating unit that have not been reflected in the estimation of future cash flows. If the recoverable amount of a non-financial asset is less than its carrying value, an impairment loss is recognised immediately in profit or loss and the carrying value of the asset reduced by the amount of the loss. A reversal of an impairment loss on non-financial assets is recognised as it arises provided the increased carrying value does not exceed that which it would have been had no impairment loss been recognised.

i) Investment properties

Investment property, which is property held to earn rentals and/or for capital appreciation (including property under construction for such purposes), is measured initially at its cost, including transaction costs. Subsequent to initial recognition, investment property is measured at fair value. Fair value is based on current prices for similar properties in the same location and condition using internal valuation models based on yield comparables and any available recent market transactions taking cognisance of the principles of the Royal Institute of Chartered Surveyors (RICS) valuation methodology. Any gain or loss arising from a change in fair value is recognised in profit or loss.

Rental income from investment property is recognised on a straight line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income.

1. Accounting policies (continued)

j) Foreign currencies

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

Group entities record transactions in foreign currencies in their functional currency - the currency of the primary economic environment in which they operate - at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the foreign exchange rates ruling at the balance sheet date. Foreign exchange differences arising on the settlement of foreign currency transactions and from the translation of monetary assets and liabilities are reported in income from trading activities except for differences arising on hedges of net investments in foreign operations.

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

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

k) Leases

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

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

Rental income from operating leases is credited to the income statement on a receivable basis over the term of the lease. Operating lease assets are included within property, plant and equipment and depreciated over their useful lives (see accounting policy g). Operating lease rentals receivable are included in other operating income.

As lessee
Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease.

l) Provisions and contingent liabilities

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

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

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

m) Taxation

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.

1. Accounting policies (continued)

m) Taxation (continued)

Current tax is income tax payable or recoverable in respect of the taxable profit or loss for the year arising in income or in 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 liability in a transaction (other than a business combination) that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is calculated using tax rates expected to apply in the periods when the assets will be realised or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, at the balance sheet date.

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

n) Financial assets

On initial recognition financial assets, as defined by IAS 39 'Financial Instruments: Recognition and Measurement' (IAS 39), are classified into held-for-trading; designated as at fair value through profit or loss; loans and receivables or available-for-sale. Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date; all other regular way purchases are recognised on 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. Gains and losses on held-for-trading financial assets are recognised in profit or loss as they arise.

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

Financial assets that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss and are subsequently measured at fair value. Gains and losses on financial assets that are designated as at fair value through profit or loss are recognised in profit or loss as they arise.

Loans and receivables - non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables, except those that are classified as available-for-sale, 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 d) less any impairment losses.

Available-for-sale - financial assets that are not classified as held-for-trading; designated as at fair value through profit or loss; or loans and receivables are classified as available-for-sale. Financial assets can be designated as available-for-sale on initial recognition. Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Unquoted equity investments whose fair value cannot be measured reliably are carried at cost and classified as available-for-sale financial assets. Impairment losses and exchange differences resulting from retranslating the amortised cost of monetary available-for-sale financial assets denominated in a foreign currency are recognised in profit or loss together with interest calculated using the effective interest method (see accounting policy d). Other changes in the fair value of available-for-sale financial assets and any related tax are reported in a separate component of shareholders' equity until disposal, when the cumulative gain or loss is recognised in profit or loss.

Fair value - the Group's approach to determining the fair value of financial instruments measured at fair value is set out in the section of critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 9.

1. Accounting policies (continued)

o) Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as available-for-sale or loans and receivables is impaired. Loans (including lendings under revolving facilities) with an impairment provision must be reported as an impaired loan. This includes loans granted forbearance where there is an economic loss and therefore an impairment provision.

Financial assets carried at amortised cost - if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the original 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 properties, the exchange is accounted for as the sale of the loan and the acquisition of equity securities or investment properties. Where the Group's interest in equity shares following the exchange is such that the Group controls an entity, that entity is consolidated.

Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant. In making collective assessment of impairment, 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 current 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 original effective rate of interest at which estimated future cash flows were discounted in measuring impairment.

Impaired loans and receivables are written off, i.e. the impairment provision is applied in writing down the loan's carrying value partially or in full, when the Group concludes that there is no longer any realistic prospect of recovery of part or all of the loan. For portfolios that are collectively assessed for impairment, the timing of write off principally reflects historic recovery experience for each portfolio. 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 will be prompted by bankruptcy, insolvency, restructuring 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. Further details are given in Note 25.

Financial assets carried at fair value - when a significant or prolonged decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in equity and there is objective evidence that the asset is impaired, or if there is a decline in estimated future cashflows or a decline in underlying collateral, any cumulative loss is removed from equity and recognised in profit or loss. The loss is measured as the difference between the acquisition cost of the financial asset and its current fair value. Impairment losses on available-for-sale equity instruments are not reversed through profit or loss, but those on available-for-sale debt instruments are reversed if there is an increase in fair value that is objectively related to a subsequent event.

p) Financial liabilities

On initial recognition financial liabilities, as defined by IAS 39, are recognised at fair value and classified into held-for-trading; designated as at fair value through profit or loss; or amortised cost.

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

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

1. Accounting policies (continued)

p) Financial liabilities (continued)

Financial liabilities that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Gains and losses on financial liabilities that are designated as at fair value through profit or loss are recognised in profit or loss as they arise.

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

Fair value - the Group's approach to determining the fair value of financial instruments measured at fair value is set out in the section of critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 9.

q) Derecognition

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

A financial liability is removed from the balance sheet when the obligation is discharged, or cancelled, or expires. On the redemption or settlement of debt securities (including subordinated liabilities) issued by the Group, the Group derecognises the debt instrument and records a gain or loss being the difference between the debt's carrying amount and the cost of redemption or settlement. The same treatment applies where the debt is exchanged for a new debt issue that has terms substantially different from those of the existing debt. The assessment of whether the terms of the new debt instrument are substantially different takes into account qualitative and quantitative characteristics including a comparison of the discounted present value of the cash flows under the new terms with the discounted present value of the remaining cash flows of the original debt issue.

r) Sale and repurchase transactions

Securities subject to a sale and repurchase agreement under which substantially all the risks and rewards of ownership are retained by the Group continue to be shown on the balance sheet and the sale proceeds recorded as a deposit. Securities acquired in reverse sale and repurchase transactions under which the Group is not exposed to substantially all the risks and rewards of ownership are not recognised on the balance sheet and the consideration is recorded in Loans and advances to banks or Loans and advances to customers as appropriate.

Securities borrowing and lending transactions are usually secured by cash or securities advanced by the borrower. Borrowed securities are not recognised on the balance sheet or lent securities derecognised. Cash collateral received or given is treated as a loan or deposit; collateral in the form of securities is not recognised. However, where securities borrowed are transferred to third parties, a liability for the obligation to return the securities to the stock lending counterparty is recorded.

s) Netting

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

t) Capital instruments

The Group classifies a financial instrument that it issues as a financial asset, financial liability or an equity instrument in accordance with the substance of the contractual arrangement. An instrument is classified 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. An instrument is classified as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities.

1. Accounting policies (continued)

u) Derivatives and hedging

Derivative financial instruments are initially recognised, and subsequently measured, at fair value. Derivative fair values are determined from quoted prices in active markets where available. Where there is no active market for an instrument, fair value is derived from prices for the derivative's components using appropriate pricing or valuation models. Credit valuation adjustments are made when valuing derivative financial assets to incorporate counterparty credit risk. Valuation adjustments are made when fair valuing financial liabilities to reflect the Group's own credit standing.

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.

The Group 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).

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.

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 attributable to the hedged risk, consistent with the documented risk management strategy, hedge accounting is discontinued. Hedge accounting is also discontinued if the Group revokes the designation of a hedged relationship.

v) Share-based payments

RBS Group awards options over shares to its employees and employees of subsidiary companies (including the Group) under various share option schemes. IFRS 2 'Share-based Payment' is applied by RBS Group to grants made under these schemes. The cost of employee services received in exchange for an award of shares or share options granted is measured by reference to the fair value of the shares or share options on the date the award is granted. The fair value of options granted is estimated using valuation techniques which incorporate exercise price, term, risk-free interest rates, the current share price and its expected volatility. The cost is expensed on a straight-line basis over the vesting period. RBS Group includes the cost of these awards in determining any recharges of employee costs it makes to subsidiaries. The Group recognises the cost based on these recharges.

w) Cash and cash equivalents

In the Cash Flow Statements, cash and cash equivalents comprise cash and demand deposits with banks 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.

x) Investments in Group undertakings

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

y) Critical accounting policies and key sources of estimation uncertainty

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law and IFRS require the directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', requires management to develop and apply an accounting policy that results in relevant and reliable information in light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's Conceptual Framework.

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

1. Accounting policies (continued)

y) Critical accounting policies and key sources of estimation uncertainty (continued)

Loan impairment provisions

The Group's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans classified as loans and receivables and carried at amortised cost. Loans (including lendings under revolving facilities) with an impairment provision must be reported as an impaired loan. This includes loans granted forbearance where there is an economic loss and therefore an impairment provision.

There are three components to the Group's loan impairment provisions: individual, collective and latent.

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

Collective component - impaired loans that are below individual assessment thresholds are collectively assessed. 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 personal advances including mortgages, smaller commercial loans and credit card receivables. 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 component – latent loss provisions are held against estimated impairment losses in the performing portfolio that have yet to be identified as at the balance sheet date. To assess the latent loss within its portfolios, the Group has developed methodologies to estimate the time that an asset can remain impaired within a performing portfolio before it is identified and reported as such.

The impact of changes to the Group’s credit models during the year are discussed in Note 25.

Non performing loans

Loans are considered to be non-performing if they are categorised as Risk Elements in Lending (REiL) or potential problem loans.

REiL comprises impaired loans and accruing loans past due 90 days or more. Accruing loans past due 90 days or more comprise loans past due 90 days where no impairment loss is expected. An asset is past due when any amount of interest, principal or fee has not been paid at the date it was due.

Potential problem loans are loans for which an impairment event has taken place but no impairment loss is expected. This category is used for advances which have met a pre-defined trigger for an impairment assessment and that assessment has determined that the future expected cash flows are greater than the carrying value of the asset.

1. Accounting policies (continued)

y) Critical accounting policies and key sources of estimation uncertainty (continued)

Forbearance

The forbearance policies are the main response to managing mortgage customers in financial difficulty and are deployed through the Group's forbearance initiative. Forbearance is applied to secured retail products where relief is offered through the renegotiation of the original contract, although on terms not generally available on a commercial basis. This may include offering contract revision by various means including reduced repayment, interest only arrangements, payment moratorium and/or term extension; these forbearance arrangements are subject to heightened monitoring.

Deferred tax

The Group makes provision for deferred tax on short-term and other temporary differences where tax recognition occurs at a different time from accounting recognition. Tax assets are recognised in respect of unused tax losses to the extent that it is probable that there will be future taxable profits against which the losses can be utilised. Judgement is required to determine the amount of deferred tax assets that can be recognised, based on the likely timing and level of future taxable profits.

Pensions

The assets of defined benefit schemes are measured at their fair value at the balance sheet date.

Scheme liabilities are measured using the projected unit method, which takes account of projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. These cash flows are discounted at an interest rate based on the yields of high-quality corporate bonds of appropriate duration, with high-quality almost universally understood to mean AA-rated. The choice of discount rate is a source of estimation uncertainty, due to a lack of appropriate Euro-denominated AA-rated bonds of equivalent duration to the pension schemes' liabilities. The approach used is to fit a yield curve to an appropriate dataset of AA bonds, and derive the discount rate from that curve. To increase the number of reference bonds available at the end of the reporting period, equivalent AA yields were extrapolated for longer dated A and AAA rated bonds by applying a credit spread adjustment to their actual yields. These were then included in the dataset used to create the yield curve.

In determining the value of scheme liabilities, financial and demographic assumptions are made as to price inflation, pension increases, earnings growth and employee life expectancy. A range of assumptions could be adopted in valuing the schemes' liabilities. Different assumptions could significantly alter the amount of the surplus or deficit recognised in the balance sheet and the pension cost charged to the income statement. The assumptions adopted for the Group's pension schemes are set out in Note 5 to the financial statements together with sensitivities of the balance sheet and income statement to changes in those assumptions.

A net surplus is limited to the present value of any economic benefits available to the Group in the form of refunds from the plan or reduced contributions to it.

Fair value – financial instruments

Financial instruments classified as held-for-trading or designated as at fair value through profit or loss and financial assets classified as available-for-sale are recognised in the financial statements at fair value. All derivatives are measured at fair value. On the balance sheet, financial assets carried at fair value are included within debt securities, equity shares and derivatives as appropriate. Financial liabilities carried at fair value are included within deposits by banks, customer accounts and derivatives. Derivative assets and derivative liabilities are shown separately on the face of the balance sheets. The carrying value of a financial asset or a financial liability carried at cost or amortised cost that is the hedged item in a qualifying hedge relationship is adjusted by the gain or loss attributable to the hedged risk.

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. Fair values are determined by reference to observable market prices where available and reliable. Where representative market prices for an instrument are not available or are unreliable because of poor liquidity, the fair value is derived from prices for its components using appropriate pricing or valuation models that are based on independently sourced market parameters, including interest rate yield curves, option volatilities and currency rates.

1. Accounting policies (continued)

y) Critical accounting policies and key sources of estimation uncertainty (continued)

Fair value – financial instruments (continued)

Financial assets carried at fair value include debt securities issued by governments and companies, reverse repurchase agreements (reverse repos), loans and advances, equity shares of companies or corporations, both listed and unlisted, and derivatives. Financial liabilities carried at fair value include customer deposits, repurchase agreements (repos), debt securities in issue and derivatives. Fair value for a substantial proportion of these instruments is based on observable market prices or derived from observable market parameters. Where observable prices are not available, fair value is based on appropriate valuation techniques or management estimates.

The Group's derivative products include swaps, forwards, futures and options. Exchange traded instruments are valued using quoted prices. The fair value of over-the-counter instruments is derived from pricing models which take account of contract terms, including maturity, as well as quoted market parameters such as interest rates and volatilities. Values established from pricing models are adjusted for credit risk, liquidity risk and future operational costs.

The fair value of substantially all securities positions carried at fair value is determined directly from quoted prices. Fair value for a net open position in a financial instrument in an active market is the number of units of the instrument held times the closing market price. In determining the fair value of derivative financial instruments gross long and short positions measured at current mid market prices are adjusted by bid-offer reserves calculated on a portfolio basis. Credit valuation adjustments are made when valuing derivative financial assets to incorporate counterparty credit risk. Valuation adjustments are made when fair valuing financial liabilities to reflect the Group's own credit standing. Where the market for a financial instrument is not active, fair value is established using a valuation technique. These valuation techniques involve a degree of estimation, the extent of which depends on the instrument's complexity and the availability of market-based data

More details about the Group's valuation methodologies of the fair value of financial instruments valued using techniques where at least one significant input is unobservable are given in Note 9.

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 Group can look to another party such as an insurer to pay some or all of the expenditure required to settle a provision, any reimbursement is recognised when, and only when, it is virtually certain that it will be received. The provisions are management's best estimate of the anticipated costs of redress and related administration expenses.

z) Accounting developments

International Financial Reporting Standards

A number of IFRSs and amendments to IFRS were in issue at 31 December 2016 that would affect the Group from 1 January 2017 or later.

Effective for 2017

In January 2016, the IASB amended IAS 7 'Cash Flow Statements' to require disclosure of the movements in financing liabilities. The amendment is effective from 1 January 2017.

In January 2016, the IASB amended IAS 12 'Income taxes' to clarify the recognition of deferred tax assets in respect of unrealised losses. The amendment is effective from 1 January 2017.

Neither of these amendments is expected to have a material effect on the Group's financial statements.

1. Accounting policies (continued)

z) Accounting developments (continued)

Effective after 2017 - IFRS 9

In July 2014, the IASB published IFRS 9 'Financial Instruments' with an effective date of 1 January 2018. IFRS 9 replaces the current financial instruments standard IAS 39, setting out new accounting requirements in a number of areas. The Group is continuing its assessment of the standard's effect on its financial statements.

The principle features of IFRS 9 are as follows:

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

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

Amortised cost - Financial assets with terms that give rise to interest and principal cash flows only and which are held in a business model whose objective is to hold financial assets to collect their cash flow are measured at amortised cost.

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

Fair value through profit and loss - Other financial assets are measured at fair value through profit and loss.

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

The Group continues to evaluate the overall effect, but expects that the measurement basis of the majority of the Group's financial assets will be unchanged on application of IFRS 9.

Financial liabilities - IFRS 9's requirements on the classification and measurement of financial liabilities are largely unchanged from those in IAS 39. However, there is a change to the treatment of changes in the fair value attributable to own credit risk of financial liabilities designated as at fair value through profit or loss which are recognised in other comprehensive income and not in profit or loss as required by IAS 39.

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

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

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

A programme has been established to implement the necessary changes in the modelling of credit loss parameters, and the underlying credit management and financial processes; this programme is led jointly by Risk and Finance. The inclusion of loss allowances on all financial assets will tend to result in an increase in overall credit impairment provisions when compared with the current basis of measurement under IAS 39.

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

1. Accounting policies (continued)

z) Accounting developments (continued)

The table below sets out the descriptions used for credit impairment under IFRS 9, and their equivalent usage under IAS 39 and existing regulatory reporting.

Attribute	IFRS 9	IAS 39	Regulatory
Default / credit impairment	To determine the risk of a default occurring, management intends to apply a default definition that is consistent with the Basel/Regulatory definition of default. Assets that are defaulted will be shown as credit impaired. The Group intends to use 90 days past due as a consistent measure for default across all product classes.	Default aligned to loss events, by classing all financial assets for which an impairment event has taken place as nonperforming. Nonperforming assets are defined as those that have a 100% probability of default and an internal asset quality grade of AQ10 (see page 75 for definition). Impaired financial assets are those for which there is objective evidence that the amount or timing of future cash flows have been adversely impacted since initial recognition.	A default shall be considered to have occurred with regard to a particular financial asset when either or both of the following have taken place: - The Group considers that the customer is unlikely to pay its credit obligations without recourse by the institution to actions such as realising security; - the customer is past due more than 90 days. For retail exposures, the definition of default may be applied at the level of an individual credit facility rather than in relation to the total obligations of a borrower.
Probability of default (PD)	PD is the likelihood of default assessed on the prevailing economic conditions at the reporting date (point in time), adjusted to take into account estimates of future economic conditions that are likely to impact the risk of default; it will not equate to a long run average.	Regulatory PDs are used in the latent provision calculation.	The likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon. PD models reflect losses that would arise through-the-cycle; this represents a long run average view of default levels.
Significant increase in credit risk	A framework is being established that incorporates both quantitative and qualitative measures and is aligned to the Group's current risk management framework. Decisions in relation to credit deterioration will be management decisions, subject to approval by governing bodies such as the Group Provisions Committee. The staging assessment requires a definition of when a significant increase in credit risk has occurred; this moves the loss calculation for financial assets from a 12 month horizon to a lifetime horizon. Management propose to establish an approach that is primarily informed by the increase in lifetime probability of default, with additional qualitative measures to account for assets where PD does not move, but a high risk factor is determined, these include the Risk of Credit Loss framework and binary triggers (examples includes the use of payday lending, forbearance and 30 days past due). In most cases, management expect an asset that has demonstrated a doubling of its lifetime probability of default would be considered to have a significant increase in credit risk. IFRS 9 includes an option that permits assets that are 'low risk' to be excluded from this assessment; the Group does not intend to apply this option.	Not applicable	Not applicable

1. Accounting policies (continued)

z) Accounting developments (continued)

Attribute	IFRS 9	IAS 39	Regulatory
Forward-looking and multiple scenarios	The evaluation of future cash flows, the risk of default and impairment loss should take into account expectations of economic changes that are reasonable. More than one outcome should be considered to ensure that the resulting estimation of impairment is not biased towards a particular expectation of economic growth. Management have developed the default modelling capability for IFRS 9 to simulate multiple economic forecasts as part of the model outcomes for PD, LGD and exposure.	Financial asset carrying values based upon the expectation of future cash flows.	Follows financial accounting.
Loss given default (LGD)	LGD is a current assessment of the amount that will be recovered in the event of default, taking account of future conditions. It may occasionally equate to the regulatory view.	Regulatory LGD values are used for calculating collective and latent provisions.	An estimate of the amount that will not be recovered in the event of default, plus the cost of debt collection activities and the delay in cash recovery. LGD is a downturn based metric, representing a prudent view of recovery in adverse economic conditions.
Exposure at default (EAD)	EAD represents expected balance sheet exposure at default. It differs from the regulatory method as follows: - it includes the effect of amortisation; - it caps exposure at the contractual limit.	EAD is assessed as the current drawn balance plus future committed drawdowns.	EAD models provide estimates of credit facility utilisation at the time of a customer default, recognising that customers may make further drawings on unused credit facilities prior to default or that exposures may increase due to market movements. EAD cannot be lower than the reported balance sheet, but can be reduced by a legally enforceable netting agreement.
Date of initial recognition (DOIR)	The reference date used to assess a significant increase in credit risk is as follows: *Term lending:* the date the facility became available to the customer. *Wholesale revolving products*: the date of the last substantive credit review (typically annual) or, if later, the date facility became available to the customer. *Retail Cards*: the account opening date or, if later, the date the card was subject to a regular 3-year review or the date of any subsequent limit increases. *Current Accounts/Overdrafts*: the account opening date or, if later, the date of initial granting of overdraft facility or of limit increases.	Not applicable for impairment but defined as the date when the entity becomes a party to the contractual provisions of the instrument.	Generally follows financial accounting.

1. Accounting policies (continued)

z) Accounting developments (continued)

Attribute	IFRS 9	IAS 39	Regulatory
Modification	A modification occurs when the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in derecognition. A modification requires immediate recognition in the income statement of any impact on the carrying value and EIR. Examples of modification events include forbearance and distressed restructuring. The financial impact is recognised in the income statement as an impairment release/(loss).	Modification is not separately defined but accounting impact arises as an EIR adjustment on changes that are not derecognition or impairment events.	Not applicable

The following table summarises the treatment of asset classification under IAS 39 and IFRS 9.

Assets	**IFRS 9**			**IAS 39**		
	AC(1)	**FVTPL(2)**	**FVOCI(3)**	**AC(1)**	**FVTPL(2)**	**FVOCI(3)**
Cash and balances at central banks						
Non held for trading	x			x		
Loans and advances to banks						
Held for trading		x			x	
Non held for trading	x			x		
Loans and advances to customers						
Held for trading		x			x	
Non held for trading	x	x	x	x	x	
Debt securities						
Held for trading		x			x	
Non held for trading:						
Held to maturity	x			x		
Available-for-sale		x	x			x
Other	x	x		x	x	
Equity shares						
Held for trading		x			x	
Non held for trading		x	x		x	x
Settlement balances						
Non held for trading	x			x		
Derivatives						
Held for trading		x			x	

(1) Amortised cost
(2) Fair value through profit and loss
(3) Fair value other comprehensive income

Effective after 2017 – other standards

IFRS 15 'Revenue from Contracts with Customers' was issued in May 2014. It will replace IAS 11 'Construction Contracts', IAS 18 'Revenue' and several Interpretations. Contracts are bundled or unbundled into distinct performance obligations with revenue recognised as the obligations are met. It is effective from 1 January 2018.

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

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

2. Net interest income

	Group	
	2016	2015
	£m	£m
Loans and advances to customers	**125**	136
Loans and advances to banks	**54**	59
Interest receivable	**179**	195
Customer accounts	**(16)**	(20)
Deposits by banks	**(28)**	(27)
Subordinated liabilities	**(5)**	(6)
Interest payable	**(49)**	(53)
Net interest income	**130**	142

Included within net interest income is £2m (2015: £3m) of interest on impaired loans.

3. Non-interest income

	Group	
	2016	2015
	£m	£m
Fees and commission receivable	**56**	53
Fees and commission payable	**(7)**	(7)
Income from trading activities(1):		
Foreign exchange	**-**	7
Other operating income:		
Loss on disposal or settlement of loans and receivables	**(2)**	(33)
Other income	**(1)**	7
Non-interest income	**46**	27

(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.

4. Operating expenses

	Group	
	2016	2015
	£m	£m
Wages, salaries and other staff costs	**70**	76
Social security costs	**7**	6
Pension costs:		
- defined benefit schemes (see Note 5)	**10**	13
- defined contribution schemes (see Note 5)	**1**	1
Restructure costs	**2**	2
Staff costs	**90**	98
Premises and equipment	**16**	17
Administration	**82**	73
Other expenses	**98**	90
Property, plant and equipment depreciation (see Note 15)	**3**	4
Operating expenses	**191**	192

Included within operating expenses is £46m (2015: £38m) of staff and overhead costs which are incurred by the Bank in providing services to UBIDAC. Although these costs are recharged to UBIDAC on an arms-length basis they are required to be reflected within continuing operations in the Consolidated Income Statement. Further details are shown in Note 18.

4. Operating expenses (continued)

The average number of persons employed by the Group during the year, excluding temporary staff, was 2,064 (2015: 2,160). The average number of temporary employees during 2016 was 78 (2015: 132). The number of persons employed by the Group at 31 December, excluding temporary staff, was as follows:

	Group	
	2016	2015
Employee numbers	**Number**	Number
PBB	**741**	910
CPB	**101**	174
Other	**1,071**	1,062
	1,913	2,146
Discontinued operations	**2,493**	2,730
	4,406	4,876

Other is central functions comprising Group and corporate functions such as treasury, problem debt management, finance, risk, legal and human resources which support the PBB and CPB divisions. In 2015, other also comprised RBS Capital Resolution.

Included within other are 91 staff members (2015: 109) whose roles involve the provision of services exclusively to other companies in RBS Group. The staff costs of these employees are recharged to the companies they provide services to.

	Group	
	2016	2015
Auditors' remuneration	**£'000**	£'000
Audit of the Bank's individual and Group accounts	**1,169**	815
Assurance services	**187**	163
	1,356	978

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 and reimbursement of expenses.

Bank levy

The UK bank levy rate decreased during 2016 and the blended rate charged was 0.18% on chargeable liabilities in excess of £20 billion (2015: 0.1967%). Levy costs in respect of the Bank will be borne by RBS plc for 2016.

5. Pension costs

Pension risk is the risk to the Group arising from its contractual or other liabilities to, or with respect to, its pension schemes, whether established for its employees, for those of a related company or otherwise.

The Group is exposed to risk from its defined benefit pension schemes to the extent that the assets of the schemes 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 Group's pension schemes is separate from the Group management. The Group is exposed to the risk that the market value of the schemes' 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 Group could be obliged, or may choose, to make additional contributions to the schemes or be required to hold additional capital to mitigate such risk.

During the year, the Group operated four defined benefit pension schemes, the assets of which are independent of the Group's finances. Three of these schemes; Ulster Bank Pension Scheme (Republic of Ireland), First Active Pension Scheme and Lombard Ireland Limited Non Contributory Pension & Death Benefit Plan were transferred to the disposal group at year end. All subsequent current year disclosures regarding governance and assumptions relate to the pension scheme included in continuing operations, the Ulster Bank Pension Scheme.

5. Pension costs (continued)

The Ulster Bank Pension Scheme operates under UK trust law and is managed and administered on behalf of its members in accordance with the terms of the trust deed, the scheme rules and UK legislation (principally the Pension Schemes Act 1993, the Pensions Act 1995 and the Pensions Act 2004). Under UK legislation a defined benefit pension scheme is required to meet the statutory funding objective of having sufficient and appropriate assets to cover its liabilities. Pension fund trustees are required to: prepare a statement of funding principles; obtain regular actuarial valuations and reports; put in place a recovery plan addressing any funding shortfall; and send regular summary funding statements to members of the scheme.

The Ulster Bank Pension Scheme corporate trustee is Ulster Bank Pension Trustees Limited (“UBPTL”) a wholly owned subsidiary of Ulster Bank Limited. UBPTL is the legal owner of the scheme assets which are held separately from the assets of the Group. 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 Group. The board is responsible for operating the scheme in line with its formal rules and pensions law. It has a duty to act in the best interests of all scheme members, including pensioners and those who are no longer employed by the Group, but who still have benefits in the scheme.

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 which scheme they are a member of and when they joined the scheme. In addition, employees may make voluntary contributions to secure additional benefits on a money-purchase basis.

The Group independently monitors risk within its pension funds as part of the Internal Capital Adequacy Assessment Process. The RBS Pension Committee, acting as a sub-committee of the RBS Asset and Liability Committee (“ALCO”), formulates the RBS view of pension risk. A sub-committee of the RBS Pension Committee has responsibility for oversight of the Ulster Bank Pension Scheme as a material RBS pension scheme; considering mechanisms that could potentially be used for managing risk within the schemes as well as financial strategy, and also reviews actuarial assumptions from a sponsor perspective as appropriate.

The Group also contributes to a small number of RBS Group Pension Schemes, the costs of which are accounted for as defined contributions. The Group made contributions of £1m to its defined contribution schemes in 2016 (2015: £1m). The Bank made contributions of £1m to its defined contribution schemes in 2016 (2015: £1m).

Interim valuations of the Group’s schemes were prepared to 31 December 2016 by independent actuaries, using the following assumptions:

	Group	
Principal actuarial assumptions at 31 December (weighted average)	**2016**	2015
Discount rate	**2.70%**	2.60% - 3.90%
Rate of increase in salaries	**1.75%-3.20%**	1.30% - 2.75%
Rate of increase in pensions in payment	**0.00%-2.25%**	0.88% - 2.00%
Inflation assumption	**2.20%**	1.75% - 3.00%

Discount rate

The yield curves are constructed by reference to yields on 'AA' corporate bonds from which a single discount rate is derived based on a cash flow profile similar in structure and duration to the pension obligations. Significant judgement is required when setting the criteria for bonds to be included in the population from which the yield curve is derived. The criteria include issuance size, quality of pricing and the exclusion of outliers. Judgement is also required in determining the shape of the yield curve at long durations: a constant credit spread relative to gilts is assumed.

	Group	
Major classes of plan assets as a percentage of total plan assets	**2016**	2015
Quoted assets		
Quoted equities	**22%**	34%
Index-linked bonds	**33%**	17%
Government fixed interest bonds	**-**	2%
Corporate and other bonds	**21%**	29%
Unquoted assets		
Private equity	**1%**	-
Corporate and other bonds	-	1%
Hedge funds	**3%**	3%
Real estate	**5%**	4%
Derivatives	**10%**	4%
Cash and other assets	**5%**	6%

5. Pension costs (continued)

	Bank	
Principal actuarial assumptions at 31 December	**2016**	2015
Discount rate	**2.70%**	3.90%
Rate of increase in salaries	**1.75%-3.20%**	1.75%-3.00%
Rate of increase in pensions in payment	**0.00%-2.25%**	1.00%-2.00%
Inflation assumption	**2.20%**	2.00%-3.00%

	Bank	
Major classes of plan assets as a percentage of total plan assets	**2016**	2015
Quoted assets		
Quoted equities	**22%**	28%
Index-linked bonds	**33%**	32%
Corporate and other bonds	**21%**	23%
Unquoted assets		
Private equity	**1%**	-
Corporate and other bonds	**-**	1%
Hedge funds	**3%**	3%
Real estate	**5%**	4%
Derivatives	**10%**	4%
Cash and other assets	**5%**	5%

	Group	
Post–retirement mortality assumptions (Main scheme)	**2016**	2015
Longevity at age 70 for current pensioners (years)		
Males	**19.6**	17.2
Females	**21.0**	18.8
Longevity at age 63 for future pensioners (years)		
Males	**26.1**	23.7
Females	**27.8**	25.5

	Bank	
Post–retirement mortality assumptions (Main scheme)	**2016**	2015
Longevity at age 70 for current pensioners (years)		
Males	**19.6**	19.8
Females	**21.0**	20.6
Longevity at age 63 for future pensioners (years)		
Males	**26.1**	26.6
Females	**27.8**	27.5

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

5. Pension costs (continued)

Group (all schemes)

Changes in value of net pension liability	**Recoverable amount of plan assets £m**	**Present value of defined benefit obligations £m**	**Net pension liability £m**
At 1 January 2016	1,555	(1,824)	**(269)**
Currency translation and other adjustments	146	(186)	**(40)**
Income statement:			
Return on plan assets above recognised interest income	62	-	**62**
Interest cost	-	(68)	**(68)**
Current service cost	-	(30)	**(30)**
Expenses	-	(2)	**(2)**
Past service cost	-	(4)	**(4)**
Interest on asset ceiling	(5)	-	**(5)**
	57	(104)	**(47)**
Statement of comprehensive income:			
Actuarial gains and losses due to experience gains and losses	266	81	**347**
Actuarial gains and losses due to changes in financial assumptions	-	(235)	**(235)**
Actuarial gains and losses due to changes in demographic assumptions	-	66	**66**
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**
	133	(88)	**45**
Inter group transfers	95	(114)	**(19)**
Contributions by employer	121	-	**121**
Contributions by plan participants	2	(2)	**-**
Benefits paid	(65)	65	**-**
Transfer to disposal groups	(1,160)	1,369	**209**
At 31 December 2016	**884**	**(884)**	**-**

5. Pension costs (continued)

Group (all schemes)

Changes in value of net pension liability	Recoverable amount of plan assets £m	Present value of defined benefit obligations £m	Net pension liability £m
At 1 January 2015	1,601	(2,056)	(455)
Currency translation and other adjustments	(47)	77	30
Income statement:			
Return on plan assets above recognised interest income	48	-	48
Interest cost	-	(55)	(55)
Current service cost	-	(41)	(41)
Contributions by other scheme members	-	3	3
Past service gain	-	(13)	(13)
Interest on asset ceiling	(4)	-	(4)
	44	(106)	(62)
Statement of comprehensive income:			
Actuarial gains and losses due to experience gains and losses	(52)	19	(33)
Actuarial gains and losses due to changes in financial assumptions	-	150	150
Actuarial gains and losses due to changes in demographic assumptions	-	51	51
Loss resulting from changes in amounts not recognised due to effect of asset ceiling excluding amounts recognised in net interest income	(35)	-	(35)
Gain resulting from changes in additional liability due to minimum funding requirements excluding amounts recognised in net interest income	15	-	15
	(72)	220	148
Contributions by employer	70	-	70
Contributions by other scheme members	3	(3)	-
Contributions by plan participants	3	(3)	-
Benefits paid	(47)	47	-
At 31 December 2015	1,555	(1,824)	(269)

The irrecoverable surplus of £278m at 31 December 2016 (2015: £35m) due to the effect of asset ceiling and the additional liability due to minimum funding requirements of £nil at 31 December 2016 (2015: £105m) have reduced the fair value of plan assets of £1,162m at 31 December 2016 (2015: £1,695m) to their recoverable amount.

Net pension deficit comprises	**2016 £m**	2015 £m
Net assets of schemes in surplus	**-**	16
Net liabilities of schemes in deficit	**-**	(285)
	-	(269)

The Income Statement charge comprises:	**2016 £m**	2015 £m
Continuing operations	**(10)**	(13)
Discontinued operations	**(37)**	(49)
	(47)	(62)

Of the expense for the year, £10m (2015: £13m) has been included in the Income Statement within staff costs (see Note 4). Actuarial gains of £45m (2015: £148m) have been recognised in the Statement of Comprehensive Income.

The Group expects to contribute £22m to its defined benefit pension scheme in 2017.

The average duration of the Group's defined benefit obligation is 21 years (2015: 23 years weighted average duration).

5. Pension costs (continued)

Bank **Changes in value of net pension asset**	**Recoverable amount of plan assets** **£m**	**Present value of defined benefit obligations** **£m**	**Net pension asset** **£m**
At 1 January 2016	771	(755)	**16**
Income statement:			
Return on plan assets above recognised interest income	36	-	**36**
Interest cost	-	(30)	**(30)**
Current service cost	-	(10)	**(10)**
Past service cost	-	(1)	**(1)**
Interest on the asset ceiling	(5)	-	**(5)**
	31	(41)	**(10)**
Statement of comprehensive income:			
Actuarial gains and losses due to experience gains and losses	200	42	**242**
Actuarial gains and losses due to changes in financial assumptions	-	(184)	**(184)**
Actuarial gains and losses due to changes in demographic assumptions	-	27	**27**
Loss resulting from changes in amounts not recognised due to effect of asset ceiling 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**
	67	(115)	**(48)**
Contributions by employer	42	-	**42**
Contributions by plan participants	1	(1)	**-**
Benefits paid	(28)	28	**-**
At 31 December 2016	884	(884)	**-**

Bank Changes in value of net pension asset	Recoverable amount of plan assets £m	Present value of defined benefit obligations £m	Net pension asset £m
At 1 January 2015	773	(770)	3
Income statement:			
Return on plan assets above recognised interest income	34	-	34
Interest cost	-	(28)	(28)
Current service cost	-	(12)	(12)
Past service cost	-	(3)	(3)
Interest on the asset ceiling	(4)	-	(4)
	30	(43)	(13)
Statement of comprehensive income:			
Actuarial gains and losses due to experience gains and losses	(33)	8	(25)
Actuarial gains and losses due to changes in financial assumptions	-	24	24
Actuarial gains and losses due to changes in demographic assumptions	-	5	5
Loss resulting from changes in amounts not recognised due to effect of asset ceiling excluding amounts recognised in net interest income	(35)	-	(35)
Gain resulting from changes in additional liability due to minimum funding requirements excluding amounts recognised in net interest income	15	-	15
	(53)	37	(16)
Contributions by employer	42	-	42
Contributions by plan participants	1	(1)	-
Benefits paid	(22)	22	-
At 31 December 2015	771	(755)	16

5. Pension costs (continued)

The irrecoverable surplus of £278m at 31 December 2016 (2015: £35m) due to the effect of asset ceiling and the additional liability due to minimum funding requirements of £nil at 31 December 2016 (2015: £105m) have reduced the fair value of plan assets of £1,162m at 31 December 2016 (2015: £912m) to their recoverable amount.

Of the expense for the year, £10m (2015: £14m) has been included in the Income Statement within staff costs.

The Bank expects to contribute £22m to its defined benefit pension scheme in 2017.

The average duration of the Bank's defined benefit obligation is 21 years (2015: 23 years).

History of defined benefit schemes (Group)	**2016 £m**	2015 £m	2014 £m	2013 £m	2012 £m
Present value of defined benefit obligations	**(884)**	(1,824)	(2,056)	(1,616)	(1,511)
Recoverable amount of plan assets	**884**	1,555	1,601	1,356	1,280
Net deficit	**-**	(269)	(455)	(260)	(231)
Experience gains on plan liabilities	**81**	19	15	53	31
Experience gains/(losses) on plan assets	**266**	(52)	205	20	55
Actual return on pension scheme assets	**328**	(4)	267	79	117

History of defined benefit schemes (Bank)	**2016 £m**	2015 £m	2014 £m	2013 £m	2012 £m
Present value of defined benefit obligations	**(884)**	(755)	(770)	(654)	(616)
Recoverable amount of plan assets	**884**	771	773	626	598
Net surplus/(deficit)	**-**	16	3	(28)	(18)
Experience gains on plan liabilities	**42**	8	6	7	28
Experience gains/(losses) on plan assets	**200**	(33)	99	28	22
Actual return on pension scheme assets	**236**	1	132	58	50

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:

	Group			
	(Decrease)/increase in pension cost for the year		(Decrease)/increase in obligation at 31 December	
	2016 £m	2015 £m	**2016 £m**	2015 £m
0.25% increase in the discount rate	**(2.5)**	(3)	**(44)**	(92)
0.25% increase in inflation	**1.4**	2	**29**	57
0.25% additional rate of increase in pensions in payment	**1.3**	2	**21**	57
0.25% additional rate of increase in deferred pensions	**0.3**	1	**10**	18
0.25% additional rate of increase in salaries	**0.5**	2	**6**	20
Longevity increase of 1 year	**0.9**	2	**19**	49

	Bank			
	(Decrease)/increase in pension cost for the year		(Decrease)/increase in obligation at 31 December	
	2016 £m	2015 £m	**2016 £m**	2015 £m
0.25% increase in the discount rate	**(2.5)**	(0.4)	**(44)**	(33)
0.25% increase in inflation	**1.4**	0.3	**29**	24
0.25% additional rate of increase in pensions in payment	**1.3**	0.2	**21**	23
0.25% additional rate of increase in deferred pensions	**0.3**	-	**10**	6
0.25% additional rate of increase in salaries	**0.5**	0.1	**6**	4
Longevity increase of 1 year	**0.9**	0.1	**19**	17

6. Emoluments of directors

	2016 £	2015 £
Emoluments for the provision of directors' services	**489,499**	2,288,168

The executive directors of the Bank, Leslie Matheson and Michael Larkin, are employed by RBS plc and are remunerated by RBS plc for their services to RBS Group as a whole. The Bank does not remunerate directors nor can remuneration from elsewhere in RBS Group be apportioned in respect of their services to the Bank.

No retirement benefits are accruing to directors under either the Bank's defined contribution or defined benefit schemes at year end (2015: £nil).

During the year there were no emoluments in respect of compensation payments for loss of office (2015: £nil).

During the year the highest paid director received emoluments of £97,000 (2015: £1,032,582). The highest paid director did not exercise any share options during the year.

The executive directors may also participate in the RBS executive share option and Sharesave schemes.

7. Taxation

	Group	
	2016	2015
Current taxation:	**£m**	£m
United Kingdom corporation tax at 20% (2015: 20.25%)		
Charge for the year	**(1)**	(5)
Under provision in respect of prior periods[1]	**-**	(49)
Total current taxation	**(1)**	(54)
Deferred taxation:		
Charge for the year	**(12)**	(16)
Over provision in respect of prior periods[2]	**5**	41
Reduction in the carrying value of deferred tax asset in respect of losses	**(17)**	-
Total deferred taxation	**(24)**	25
Tax charge for the year	**(25)**	(29)

The actual tax charge differs from the expected tax charge computed by applying the standard rate of UK Corporation Tax of 20% (2015: 20.25%) as follows:

	2016	2015
	£m	£m
Operating profit before tax	**12**	32
Expected tax charge	**(2)**	(6)
Factors affecting the charge for the year:		
Non-deductible items	**(8)**	(14)
UK tax rate change impact	**(3)**	(1)
Reduction in the carrying value of deferred tax asset in respect of losses	**(17)**	-
Adjustments to tax charge in respect of prior periods	**5**	(8)
Actual tax charge for the year	**(25)**	(29)

(1) The current tax movement arises from the finalisation of prior year tax computations and finalisation of loss utilisation within the Group in 2015 resulting in tax losses being carried forward in UBL. No similar adjustment arises in 2016.

(2) The deferred tax movement arises mainly from the recognition of a deferred tax asset in 2015 in respect of tax losses carried forward in UBL. The balance relates to movement on standard timing adjustments in respect of pensions and capital allowances.

8. Profit dealt with in the financial statements of the Bank

In accordance with the exemption contained within Section 408(3) of the Companies Act 2006 the primary financial statements of the Bank do not include an Income Statement or Statement of Comprehensive Income. The Bank's loss after tax for the year ended 31 December 2016 was £336m (2015: £1,793m profit) driven by the impact of impairment of investments in Group undertakings partially offset by dividend income.

9. Financial instruments - classification

The following tables analyse the financial assets and financial liabilities of the Group and 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.

	Group						
	Held-for-trading	Designated as at fair value through profit or loss	Available-for-sale	Loans and receivables	Other financial liabilities	Non financial assets / liabilities	Total
2016	£m	£m	£m	£m	£m	£m	£m
Assets							
Cash and balances at central banks[1]	-	-	-	1,012	-	-	1,012
Loans and advances to banks[2]	-	-	-	5,402	-	-	5,402
Loans and advances to customers[3]	-	-	-	3,696	-	-	3,696
Derivatives	5	-	-	-	-	-	5
Property, plant and equipment	-	-	-	-	-	43	43
Prepayments, accrued income and other assets	-	-	-	-	-	8	8
Deferred taxation	-	-	-	-	-	11	11
Assets of disposal groups	848	-	2,009	23,100	-	340	26,297
	853	-	2,009	33,210	-	402	36,474
Liabilities							
Deposits by banks[4]	-	-	-	-	3,065	-	3,065
Customer accounts[5]	-	121	-	-	5,606	-	5,727
Derivatives	4	-	-	-	-	-	4
Provisions, accruals and other liabilities[6]	-	-	-	-	752	51	803
Subordinated liabilities	-	-	-	-	939	-	939
Liabilities of disposal groups	781	932	-	-	17,848	511	20,072
	785	1,053	-	-	28,210	562	30,610
Equity							5,864
							36,474

For notes relating to this table refer to page 43.

9. Financial instruments - classification (continued)

	Group						
	Held-for-trading	Designated as at fair value through profit or loss	Available-for-sale	Loans and receivables	Other financial liabilities	Non financial assets / liabilities	Total
2015	£m	£m	£m	£m	£m	£m	£m
Assets							
Cash and balances at central banks(1)	-	-	-	868	-	-	868
Loans and advances to banks(2)	-	-	-	9,485	-	-	9,485
Loans and advances to customers(3)	-	-	-	20,643	-	-	20,643
Debt securities	-	-	1,889	-	-	-	1,889
Equity shares	-	-	5	-	-	-	5
Derivatives	627	-	-	-	-	-	627
Property, plant and equipment	-	-	-	-	-	126	126
Prepayments, accrued income and other assets	-	-	-	-	-	95	95
Retirement benefit assets	-	-	-	-	-	16	16
Deferred taxation	-	-	-	-	-	236	236
	627	-	1,894	30,996	-	473	33,990
Liabilities							
Deposits by banks(4)	31	-	-	-	4,754	-	4,785
Customer accounts(5)	-	1,156	-	-	17,821	-	18,977
Debt securities in issue(7)	-	-	-	-	1,473	-	1,473
Derivatives	477	-	-	-	-	-	477
Provisions, accruals and other liabilities(6)	-	-	-	-	687	234	921
Retirement benefit liabilities	-	-	-	-	-	285	285
Deferred taxation	-	-	-	-	-	3	3
Subordinated liabilities	-	-	-	-	960	-	960
	508	1,156	-	-	25,695	522	27,881
Equity							6,109
							33,990

(1) Cash and balances at central banks includes Bank of England notes held in respect of notes in circulation in Northern Ireland.
(2) This includes items in the course of collection from other banks of £37m (2015: £74m).
(3) The Group has advances secured on residential properties subject to non-recourse funding. Under IAS 39, these securitised mortgages qualify for full recognition on the balance sheet. As at 31 December 2016 £nil (2015: £7,395m) is included in loans and advances to customers. There are no gross loans subject to IAS 32 (on balance sheet) netting arrangements included within loans and advances to customers (2015: £nil). No netting has taken place in any of the years under review therefore the net effective balance sheet value is equal to the gross amount.
(4) This includes items in the course of transmission to other banks of £15m (2015: £21m). No netting has taken place therefore the net effective balance sheet value is equal to the gross amount.
(5) The carrying amount of other customer accounts designated as at fair value through profit or loss is £3m lower (2015: £51m higher) than the principal amount. No amounts have been recognised (2015: £nil) in the profit or loss for changes in credit risk associated with these liabilities.
(6) Includes notes in circulation of £752m (2015: £687m).
(7) Comprises bonds and medium term notes of £1,472m and certificates of deposit and other commercial paper of £1m. The medium term notes are issued by limited recourse entities that are controlled by the Group and are collateralised on residential mortgages held by the Group. Further information on securitisations is provided in Note 24.

9. Financial instruments - classification (continued)

	Bank					
2016	Held-for-trading £m	Designated as at fair value through profit or loss £m	Loans and receivables £m	Other financial liabilities £m	Non financial assets / liabilities £m	Total £m
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 disposal	-	-	-	-	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

For notes relating to this table refer to page 45.

9. Financial instruments - classification (continued)

	Bank					
2015	Held-for-trading £m	Designated as at fair value through profit or loss £m	Loans and receivables £m	Other financial liabilities £m	Non financial assets / liabilities £m	Total £m
Assets						
Cash and balances at central banks	-	-	616	-	-	616
Loans and advances to banks [(1)]	-	-	7,119	-	-	7,119
Loans and advances to customers	-	-	3,801	-	-	3,801
Investments in Group undertakings	-	-	-	-	6,432	6,432
Derivatives	3	-	-	-	-	3
Property, plant and equipment	-	-	-	-	44	44
Prepayments, accrued income and other assets	-	-	-	-	31	31
Retirement benefit assets	-	-	-	-	16	16
Deferred taxation	-	-	-	-	25	25
	3	-	11,536	-	6,548	18,087
Liabilities						
Deposits by banks [(2)]	-	-	-	4,003	-	4,003
Customer accounts [(3)]	-	159	-	5,701	-	5,860
Debt securities in issue	-	-	-	1	-	1
Derivatives	35	-	-	-	-	35
Provisions, accruals and other liabilities	-	-	-	687	61	748
Subordinated liabilities	-	-	-	820	-	820
	35	159	-	11,212	61	11,467
Equity						6,620
						18,087

(1) Includes items in the course of collection from other banks of £37m (2015: £44m).
(2) Includes items in the course of transmission to other banks of £15m (2015: £21m).
(3) The carrying amount of other customer accounts designated as at fair value through profit or loss is £3m lower (2015: £8m) than the principal amount.

9. Financial instruments – valuation

Valuation of financial instruments carried at fair value

Control environment
The Group places reliance on NatWest Markets independent price verification (IPV) process and the Group eliminates its market risk on its trading book portfolios by entering into back to back positions with its ultimate parent company, The Royal Bank of Scotland plc.
The Group's control environment for the determination of the fair value of financial instruments includes formalised protocols for the review and validation of fair values independent of the businesses entering into the transactions. There are specific controls to ensure consistent pricing policies and procedures, incorporating disciplined price verification. The Group ensures that appropriate attention is given to structured products, illiquid products and other instruments which are difficult to price.

Common valuation policies, procedures, frameworks and models apply across the Group.

Independent price verification (IPV)
IPV is a key element of the control environment. Valuations may be directly from available prices, or may be derived using a model and variable model inputs. These valuations are reviewed, and if necessary amended, by a team independent of those trading the financial instruments, in the light of available pricing evidence.

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

Governance framework
IPV takes place at least each month end date, for exposures in the regulatory trading book and at least quarterly for exposures in the regulatory banking book. The IPV control includes formalised reporting and escalation of any valuation differences in breach of established thresholds. The Pricing Unit determines IPV policy, monitors adherence to that policy and performs additional independent reviews of highly subjective valuation issues. The quality and completeness of the information gathered in the IPV process gives an indication as to the liquidity and valuation uncertainty of an instrument.

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

Valuation techniques
The Group derives the 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.

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

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

Bond prices - quoted prices are generally available for government bonds, certain corporate securities and some mortgage-related products.

Credit spreads - where available, these are derived from prices of credit default swaps or other credit based instruments, such as debt securities. For others, credit spreads are obtained from pricing services.

9. Financial instruments – valuation (continued)

Inputs to valuation models (continued)

Interest rates - these are principally benchmark interest rates such as the London Interbank Offered Rate (LIBOR), European Interbank Offered Rate (EURIBOR), 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.

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

Prepayment rates - the fair value of a financial instrument that can be prepaid by the issuer or borrower differs from that of an instrument that cannot be prepaid. In valuing prepayable instruments that are not quoted in active markets, the Group considers the value of the prepayment option.

Counterparty credit spreads - adjustments are made to market prices (or parameters) when the creditworthiness of the counterparty differs from that of the assumed counterparty in the market price (or parameters).

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 reserves

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

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

Credit valuation adjustments

Credit Valuation Adjustments (CVA) represents an estimate of the adjustment to fair value that a market participant would make to incorporate the counterparty credit risk inherent in derivative exposures. CVA reserve at 31 December 2016 was £2m (2015: £22m).

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

Where a positive exposure exists to a counterparty that is considered to be close to default, the CVA is calculated by applying expected losses to the current level of exposure. Otherwise, expected losses are applied to estimated potential future positive exposures which are modelled to reflect the volatility of the market factors which drive the exposures and the correlation between those factors.

Expected losses are determined from market implied probabilities of default and internally assessed recovery levels. The probability of default is calculated with reference to observable credit spreads and observable recovery levels. For counterparties where observable data do not exist, the probability of default is determined from the credit spreads and recovery levels of similarly rated entities.

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

Debt valuation adjustments

The fair value of the Group's derivative financial liabilities is adjusted to reflect the Group's own credit risk through debt valuation adjustments. Expected gains are applied to estimated potential future negative exposures, the modelling of which is consistent with the approach used in the calculation of CVA.

9. Financial instruments - valuation (continued)

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

	Group			
	2016			
	Level 1 (1)	**Level 2 (2)**	**Level 3 (3)**	**Total**
	£m	**£m**	**£m**	**£m**
Assets				
Derivatives	**-**	**5**	**-**	**5**
Total	**-**	**5**	**-**	**5**
Liabilities				
Customer accounts	**-**	**121**	**-**	**121**
Derivatives	**-**	**4**	**-**	**4**
Total	**-**	**125**	**-**	**125**

	Group			
	2015			
	Level 1 (1)	Level 2 (2)	Level 3 (3)	Total
	£m	£m	£m	£m
Assets				
Debt securities	1,889	-	-	1,889
Equity shares	-	-	5	5
Derivatives	-	414	213	627
Total	1,889	414	218	2,521
Liabilities				
Deposits by banks	-	31	-	31
Customer accounts	-	1,156	-	1,156
Derivatives	-	213	264	477
Total	-	1,400	264	1,664

For notes relating to these tables refer to page 49.

9. Financial instruments - valuation (continued)

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

	Bank			
	2016			
	Level 1 (1)	**Level 2 (2)**	**Level 3 (3)**	**Total**
	£m	**£m**	**£m**	**£m**
Assets				
Derivatives	**-**	**7**	**-**	**7**
Total	**-**	**7**	**-**	**7**
Liabilities				
Customer accounts	**-**	**121**	**-**	**121**
Derivatives	**-**	**35**	**-**	**35**
Total	**-**	**156**	**-**	**156**

	Bank			
	2015			
	Level 1 (1)	Level 2 (2)	Level 3 (3)	Total
	£m	£m	£m	£m
Assets				
Derivatives	-	3	-	3
Total	-	3	-	3
Liabilities				
Customer accounts	-	159	-	159
Derivatives	-	35	-	35
Total	-	194	-	194

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

(2) Valued using techniques based significantly on observable market data. Instruments in this category are valued using:
  a) quoted prices for similar instruments or identical instruments in markets which are not considered to be active: or
  b) valuation techniques where all the inputs that have a significant effect on the valuation are directly or indirectly based on observable market data.

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 Group's life assurance businesses and certain money market securities and loan commitments and most OTC derivatives.

(3) Instruments in this category have been valued using a valuation technique where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data. Where inputs can be observed from market data without undue cost and effort, the observed input is used. Otherwise, the Group determines a reasonable level for the input.

Financial instruments included within Level 3 of the fair value hierarchy primarily consist of cash instruments which trade infrequently, certain syndicated and commercial mortgage loans, unlisted equity shares, certain residual interests in securitisations, super senior tranches of high grade and mezzanine collateralised debt obligations (CDOs), and other mortgage-based products and less liquid debt securities, certain structured debt securities in issue and OTC derivatives where valuation depends upon unobservable inputs such as certain credit and exotic derivatives. No gain or loss is recognised on the initial recognition of a financial instrument valued using a technique incorporating significant unobservable data.

9. Financial instruments – valuation (continued)

Level 3 portfolio movement tables

	Group					
	Equity shares		**Derivative assets**		**Derivative liabilities**	
	2016	2015	**2016**	2015	**2016**	2015
	£m	£m	**£m**	£m	**£m**	£m
At 1 January	**5**	26	**213**	95	**(264)**	(183)
Additions	**-**	1	**-**	-	**-**	-
Disposals	**-**	(22)	**-**	-	**-**	-
Credit/(charge) to income statement	**-**	-	**154**	118	**(228)**	(81)
Transfer to disposal group	**(5)**	-	**(367)**	-	**492**	-
At 31 December	**-**	5	**-**	213	**-**	(264)

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 and none (2015: £1,803m) of the loans and advances to banks carried at amortised cost have been determined using procedures consistent with the requirements of level 2 valuation methodologies, as set out above. The fair value of these loans and advances to banks equal carrying value. All other balances have been fair valued using procedures that fall within level 3 of the fair value methodologies.

	Group			
	2016	**2016**	2015	2015
	Carrying value	**Fair value**	Carrying value	Fair value
	£m	**£m**	£m	£m
Financial assets				
Cash and balances at central banks	**1,012**	**1,012**	868	868
Loans and advances to banks	**5,402**	**5,402**	9,485	9,485
Loans and advances to customers	**3,696**	**3,643**	20,643	18,741
Financial liabilities				
Deposits by banks	**3,065**	**3,065**	4,754	4,754
Customer accounts	**5,606**	**5,606**	17,821	17,835
Debt securities in issue	**-**	**-**	1,473	1,248
Provisions, accruals and other liabilities	**752**	**752**	687	687
Subordinated liabilities	**939**	**843**	960	845

9. Financial instruments - valuation (continued)

	Bank			
	2016	**2016**	2015	2015
	Carrying value	**Fair value**	Carrying value	Fair value
	£m	**£m**	£m	£m
Financial assets				
Cash and balances at central banks	**1,012**	**1,012**	616	616
Loans and advances to banks	**5,935**	**5,935**	7,119	7,119
Loans and advances to customers	**3,714**	**3,675**	3,801	3,710
Financial liabilities				
Deposits by banks	**3,099**	**3,099**	4,003	4,003
Customer accounts	**5,644**	**5,644**	5,701	5,703
Debt securities in issue	**-**	**-**	1	1
Provisions, accruals and other liabilities	**752**	**752**	687	687
Subordinated liabilities	**939**	**843**	820	713

Fair value calculation

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

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

Short-term financial instruments and loans and advances to banks

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

Loans and advances to customers

In estimating the fair value of loans and advances to customers measured at amortised cost, the Group's loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans. The principal method used to estimate fair value in the Group is to discount expected cash flows at the current offer rate for the same or similar products.

For certain portfolios where there are very few or no recent transactions bespoke approaches are utilised.

Deposits by banks and customer accounts

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

Debt securities in issue and subordinated liabilities

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

9. Financial instruments - maturity analysis

Remaining maturity

	Group		
2016	**Less than 12 months £m**	**More than 12 months £m**	**Total £m**
Assets			
Cash and balances at central banks	**1,012**	**-**	**1,012**
Loans and advances to banks	**3,849**	**1,553**	**5,402**
Loans and advances to customers	**989**	**2,707**	**3,696**
Derivatives	**5**	**-**	**5**
Liabilities			
Deposits by banks	**2,620**	**445**	**3,065**
Customer accounts	**5,690**	**37**	**5,727**
Derivatives	**4**	**-**	**4**
Provisions, accruals and other liabilities	**752**	**-**	**752**
Subordinated liabilities	**343**	**596**	**939**

	Group		
2015	Less than 12 months £m	More than 12 months £m	Total £m
Assets			
Cash and balances at central banks	868	-	868
Loans and advances to banks	6,659	2,826	9,485
Loans and advances to customers	4,356	16,287	20,643
Debt securities	1,331	558	1,889
Equity shares	-	5	5
Derivatives	71	556	627
Liabilities			
Deposits by banks	4,499	286	4,785
Customer accounts	17,874	1,103	18,977
Debt securities in issue	1	1,472	1,473
Derivatives	31	446	477
Provisions, accruals and other liabilities	687	-	687
Subordinated liabilities	-	960	960

9. Financial instruments - maturity analysis (continued)

Remaining maturity

	Bank		
	Less than 12 months	**More than 12 months**	**Total**
2016	**£m**	**£m**	**£m**
Assets			
Cash and balances at central banks	**1,012**	**-**	**1,012**
Loans and advances to banks	**3,941**	**1,994**	**5,935**
Loans and advances to customers	**1,003**	**2,711**	**3,714**
Derivatives	**5**	**2**	**7**
Liabilities			
Deposits by banks	**2,654**	**445**	**3,099**
Customer accounts	**5,728**	**37**	**5,765**
Derivatives	**9**	**26**	**35**
Provisions, accruals and other liabilities	**752**	**-**	**752**
Subordinated liabilities	**343**	**596**	**939**

	Bank		
	Less than 12 months	More than 12 months	Total
2015	£m	£m	£m
Assets			
Cash and balances at central banks	616	-	616
Loans and advances to banks	3,957	3,162	7,119
Loans and advances to customers	1,135	2,666	3,801
Derivatives	2	1	3
Liabilities			
Deposits by banks	3,728	275	4,003
Customer accounts	5,722	138	5,860
Debt securities in issue	1	-	1
Derivatives	16	19	35
Provisions, accruals and other liabilities	687	-	687
Subordinated liabilities	-	820	820

10. Financial assets - impairments

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

	Group				
	Individually assessed	**Collectively assessed**	**Latent**	**2016**	2015
	£m	**£m**	**£m**	**£m**	£m
At 1 January	**1,414**	**1,928**	**269**	**3,611**	11,326
Currency translation and other adjustments	**94**	**215**	**31**	**340**	(529)
Amounts written-off (1)	**(1,431)**	**(1,022)**	**-**	**(2,453)**	(6,453)
Recoveries of amounts previously written-off	**27**	**8**	**-**	**35**	46
Release/(charge) to the income statement					
- from continuing operations	**(11)**	**(13)**	**(3)**	**(27)**	(55)
- from discontinued operations	**(7)**	**98**	**(203)**	**(112)**	(676)
Unwind of discount (recognised in interest income)					
- from continuing operations	**-**	**(2)**	**-**	**(2)**	(3)
- from discontinued operations	**(1)**	**(36)**	**-**	**(37)**	(45)
Transfer to disposal group	**(69)**	**(1,053)**	**(78)**	**(1,200)**	-
At 31 December (2)	**16**	**123**	**16**	**155**	3,611

	Bank				
	Individually assessed	**Collectively assessed**	**Latent**	**2016**	2015
	£m	**£m**	**£m**	**£m**	£m
At 1 January	**255**	**295**	**18**	**568**	2,206
Amounts written-off (1)	**(237)**	**(159)**	**-**	**(396)**	(1,602)
Recoveries of amounts previously written-off	**9**	**3**	**-**	**12**	22
Release/(charge) to the income statement	**2**	**(14)**	**(2)**	**(14)**	(55)
Unwind of discount (recognised in interest income)	**-**	**(2)**	**-**	**(2)**	(3)
At 31 December (2)	**29**	**123**	**16**	**168**	568

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

(2) Impairment provisions as at 31 December 2016 and 31 December 2015 do not include any balances held against loans and advances to banks.

Loan impairment

The Group 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 show analysis of impaired financial assets:

	2016			2015		
	Gross carrying value	**Provision**	**Net book value**	Gross carrying value	Provision	Net book value
Group	**£m**	**£m**	**£m**	£m	£m	£m
Impaired financial assets						
Loans and advances to customers	**178**	**(139)**	**39**	5,369	(3,342)	2,027
- of which are individually assessed	**16**	**(16)**	**-**	1,570	(1,414)	156

10. Financial assets – impairments (continued)

	2016			2015		
Bank	**Gross carrying value £m**	**Provision £m**	**Net book value £m**	Gross carrying value £m	Provision £m	Net book value £m
Impaired financial assets						
Loans and advances to customers	**191**	**(152)**	**39**	624	(550)	74
- of which are individually assessed	**29**	**(29)**	**-**	252	(255)	(3)

The net book value of the individually assessed impaired loans in the Bank was less than zero in 2015 as a result of provisions held against probable future cash outflows relating to off balance sheet commitments.

	Group		**Bank**	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Gross income not recognised at balance sheet date but which would have been recognised under the original terms of non–accrual and restructured loans:				
United Kingdom	**34**	130	**34**	95
Republic of Ireland	**-**	492	**-**	-
	34	622	**34**	95

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

Group	**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**
2016	**49**	**12**	**8**	**3**	**72**
2015	556	250	271	24	1,101

Bank	**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**
2016	**49**	**12**	**8**	**3**	**72**
2015	39	14	7	4	64

11. Debt securities

	Group		
2016	**Other central and local government £m**	**Mortgage backed securities £m**	**Total £m**
Available-for-sale	**-**	**-**	**-**
2015			
Available-for-sale	1,889	-	1,889

There were no gross unrealised gains or losses at the balance sheet date for either of the years under review.

12. Equity shares

	Group	
	2016	2015
	Unlisted	Unlisted
	£m	£m
Available-for-sale	**-**	5

13. Investments in Group undertakings

Investments in Group undertakings are carried at cost less impairment. Movements during the year were as follows:

	Bank	
	2016	2015
	£m	£m
At 1 January	**6,432**	4,719
Impairment (loss)/reversal	**(1,549)**	1,713
Transfer to assets held for disposal	**(4,883)**	-
At 31 December	**-**	6,432

The principal related undertaking of the Bank, during the year, is shown below. Its capital consists of unlisted ordinary shares. It was wholly owned by the Bank through intermediate holding companies throughout the year.

Undertaking	Nature of business	Country of incorporation
Ulster Bank Ireland Designated Activity Company	Banking services, corporate and investment banking, foreign exchange services	Republic of Ireland(1)

(1) Ulster Bank Ireland Designated Activity Company and its subsidiaries also operate in the UK.

During the year the Bank received a dividend of £1,273m from its subsidiary, UBIDAC, via its intermediate holding companies. This, combined with a change in the valuation inputs and movements in the sterling/euro exchange rate, led to the impairment charge in the valuation of UBIDAC. The recoverable amount of UBIDAC was determined on a value-in-use basis utilising a discount rate of 10.6% (2015: 9.7%). On 1 January 2017 the Bank sold its shareholding in the intermediate parent companies of UBIDAC for consideration equal to the valuation determined and UBIDAC is therefore no longer a principal related undertaking of the Bank. Consequently, the Bank's investment in UBIH is held for disposal.

Full information on all related undertakings is included in Note 33. The financial performance of these companies is included in the Group's consolidated financial statements and all have an accounting reference date of 31 December.

14. Intangible assets

Intangible assets comprising goodwill and other acquired intangibles were fully impaired as at 31 December 2016 and 31 December 2015.

15. Property, plant and equipment

	Group					
2016	**Investment properties £m**	**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 2016	22	85	30	54	97	**288**
Currency translation and other adjustments	1	8	2	8	7	**26**
Additions	-	3	1	2	2	**8**
Disposals	(23)	(5)	-	(1)	(1)	**(30)**
Transfer to disposal group	-	(55)	(12)	(54)	(54)	**(175)**
At 31 December 2016	**-**	**36**	**21**	**9**	**51**	**117**
Accumulated impairment, depreciation and amortisation:						
At 1 January 2016	-	37	14	31	80	**162**
Currency translation and other adjustments	-	3	1	4	6	**14**
Disposals	-	(4)	-	-	(1)	**(5)**
Impairments	-	2	-	-	-	**2**
Depreciation charge for the year						
- from continuing operations	-	1	-	-	2	**3**
- from discontinued operations	-	-	-	4	2	**6**
Transfer to disposal group	-	(24)	(10)	(32)	(42)	**(108)**
At 31 December 2016	**-**	**15**	**5**	**7**	**47**	**74**
Carrying amount at 31 December 2016	**-**	**21**	**16**	**2**	**4**	**43**

	Group					
2015	Investment properties £m	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 2015	135	92	31	78	111	447
Currency translation and other adjustments	(8)	(6)	(1)	(4)	(4)	(23)
Additions	-	3	1	1	1	6
Disposals	(157)	(4)	(1)	(21)	(11)	(194)
Revaluation	52	-	-	-	-	52
At 31 December 2015	22	85	30	54	97	288
Accumulated impairment, depreciation and amortisation:						
At 1 January 2015	-	42	14	39	86	181
Currency translation and other adjustments	-	(4)	(1)	(2)	(2)	(9)
Disposals	-	(4)	-	(11)	(8)	(23)
Depreciation charge for the year						
- from continuing operations	-	1	1	-	2	4
- from discontinued operations	-	2	-	5	2	9
At 31 December 2015	-	37	14	31	80	162
Carrying amount at 31 December 2015	22	48	16	23	17	126

15. Property, plant and equipment (continued)

There was no profit on disposal of freehold land and buildings during the year (2015: £nil).

Rental income from investment properties was £nil (2015: £8m). No direct operating expenses were incurred in relation to income generating investment properties (2015: £4m). No direct operating expenses were incurred for investment properties not generating income (2015: £nil).

Investment properties were valued using techniques based on observable market data. This methodology falls within level 2 of the valuation methods set out in Note 9.

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

	Bank				
2015	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 2015	37	21	10	55	123
Additions	1	-	-	-	1
Disposals	(2)	(1)	(2)	(4)	(9)
At 31 December 2015	36	20	8	51	115
Accumulated impairment, depreciation and amortisation:					
At 1 January 2015	14	6	7	49	76
Disposals	(2)	(1)	(2)	(4)	(9)
Depreciation charge for the year	2	-	1	1	4
At 31 December 2015	14	5	6	46	71
Carrying amount at 31 December 2015	22	15	2	5	44

There was no profit on disposal of freehold land and buildings during the year (2015: £nil).

16. Derivatives

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

	Group					
	2016			2015		
	Notional amounts	**Assets**	**Liabilities**	Notional amounts	Assets	Liabilities
	£m	**£m**	**£m**	£m	£m	£m
Over-the counter derivatives						
Foreign exchange contracts:						
Spot, forwards and futures	**259**	**5**	**4**	2,889	31	29
Currency swaps	**-**	**-**	**-**	1,290	51	101
Interest rate contracts:						
Interest rate swaps	**-**	**-**	**-**	32,015	452	347
Options purchased	**-**	**-**	**-**	77	-	-
Options written	**-**	**-**	**-**	73	-	-
Equity and commodity contracts	**-**	**-**	**-**	960	93	-
	259	**5**	**4**	37,304	627	477

	Bank					
	2016			2015		
	Notional amounts	**Assets**	**Liabilities**	Notional amounts	Assets	Liabilities
	£m	**£m**	**£m**	£m	£m	£m
Over-the-counter derivatives						
Foreign exchange contracts:						
Spot, forwards and futures	**259**	**5**	**4**	392	2	3
Interest rate contracts:						
Interest rate swaps	**2,428**	**2**	**31**	2,135	1	32
	2,687	**7**	**35**	2,527	3	35

17. Prepayments, accrued income and other assets

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Prepayments	**3**	7	**3**	3
Accrued income	**3**	8	**3**	2
Other assets	**2**	80	**4**	26
	8	95	**10**	31

18. Discontinued operations and assets and liabilities of disposal groups

On 1 January 2017, the Bank sold Ulster Bank (Ireland) Holdings Unlimited Company ("UBIH") and its subsidiaries comprising the Group's Republic of Ireland operations to NatWest Holdings Limited. Accordingly UBIH and its subsidiaries have been classified as a disposal group at 31 December 2016 and presented as a discontinued operation.

(a) Profit from discontinued operations, net of tax

	Group	
	2016	2015
	£m	£m
Interest receivable	**484**	481
Interest payable	**(73)**	(126)
Net interest income	**411**	355
Other income	**123**	163
Total income	**534**	518
Operating expenses	**(586)**	(357)
Operating (loss)/profit before impairment	**(52)**	161
Impairment gain	**112**	676
Operating profit before tax	**60**	837
Tax credit/(charge)	**3**	(3)
Profit from discontinued operations, net of tax	**63**	834

Other comprehensive income for discontinued operations includes actuarial gains on defined benefit plans of £93m (2015: £164m) and fair value gains on available-for-sale financial assets of £3m (2015: £nil).

(b) Cash flows attributable to discontinued operations

	Group	
	2016	2015
	£m	£m
Net cash flows from operating activities	**2,144**	335
Net cash flows (used in)/from investing activities	**167**	199
Net cash used in financing activities	**(1,802)**	(262)
Effects of exchange rate changes on cash and cash equivalents	**612**	(215)
Net increase in cash and cash equivalents	**1,121**	57

18. Discontinued operations and assets and liabilities of disposal groups (continued)

(c) Assets and liabilities of disposal groups

	Group 2016 £m	Bank 2016 £m
Assets of disposal groups		
Cash and balances at central banks	249	-
Loans and advances to banks	3,923	-
Loans and advances to customers	18,928	-
Debt securities	2,004	-
Equity shares	5	-
Investments in Group undertakings	-	4,883
Derivatives	848	-
Property, plant and equipment	67	-
Prepayments, accrued income and other assets	22	-
Deferred taxation	251	-
	26,297	4,883
Liabilities of disposal groups		
Deposits by banks	1,342	-
Customer accounts	16,121	-
Debt securities in issue	1,179	-
Derivatives	757	-
Provisions, accruals and other liabilities	302	-
Retirement benefit liabilities	209	-
Subordinated liabilities	162	-
	20,072	-

18. Discontinued operations and assets and liabilities of disposal groups (continued)

(d) Intercompany recharges

Included within operating expenses in the consolidated income statement is £46m (2015: £38m) of staff and overhead costs incurred by the Bank in providing services to UBIDAC. These services were recharged to UBIDAC on an arms' length basis and these recharges are reflected as income in the individual financial statements of the Bank and as operating expenses in the individual financial statements of UBIDAC.

In accordance with IFRS 10 'Consolidated Financial Statements' the cost recharges in the Bank's income and UBIDAC's operating expenses eliminate in the consolidated income statement of the Group and only the overall cost to the Group of providing the services remain within consolidated operating expenses. Applying the requirements of IFRS 5 'Non-Current Assets Held for Sale and Discontinued Operations' to the consolidated income statement results in these costs being classified within continuing operations even though they represent costs of servicing the discontinued operations. Therefore as presented under IFRS 10 and IFRS 5 the loss/profit from continuing operations and profit from discontinued operations do not reflect the go-forward operations of either the Bank or the disposal group.

To assist the reader in better understanding the results of the underlying operations of the Bank and the disposal group the costs of servicing discontinued operations have been extracted and presented separately within continuing operations in the consolidated income statement.

Similarly profit from discontinued operations includes £12m (2015: £9m) of staff and overhead costs incurred by the disposal group in providing services to the Bank. The table below summarises both adjustments and the impact on the results of both continuing and discontinued operations:

	2016	2015
	£m	£m
(Loss)/profit from continuing operations		
As presented in consolidated income statement	**(13)**	3
Costs incurred by continuing operations in servicing discontinued operations	**46**	38
Costs incurred by discontinued operations in servicing continuing operations	**(12)**	(9)
Adjusted profit from continuing operations	**21**	32
Profit from discontinued operations		
As presented in consolidated income statement	**63**	834
Costs incurred by discontinued operations in servicing continuing operations	**12**	9
Costs incurred by continuing operations in servicing discontinued operations	**(46)**	(38)
Adjusted profit from discontinued operations	**29**	805
Profit for the year	**50**	837

19. Provisions, accruals and other liabilities

	Group		**Bank**	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Notes in circulation	**752**	687	**752**	687
Accruals	**19**	120	**18**	30
Deferred income	**-**	6	**-**	-
Provisions for liabilities and charges	**26**	66	**26**	23
Other liabilities	**6**	42	**5**	8
	803	921	**801**	748

19. Provisions, accruals and other liabilities (continued)

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

	Group						
	Property	Interest rate hedge products	Payment protection insurance	Tracker mortgage examination	Global restructuring group	Other	Total
	£m	£m	£m	£m	£m	£m	£m
Provision as at 1 January 2015	47	33	19	-	-	2	101
Charge to income statement							
- from continuing operations	3	-	-	-	-	8	11
- from discontinued operations	13	-	-	-	-	5	18
Utilised in the year	(31)	(4)	(6)	-	-	(1)	(42)
Exchange movements	(3)	(2)	-	-	-	-	(5)
Release to income statement							
- from continuing operations	(1)	-	1	-	-	-	-
- from discontinued operations	(1)	(13)	(2)	-	-	(1)	(17)
Provision at 31 December 2015	27	14	12	-	-	13	66
Transfer from accruals	-	-	-	4	-	14	18
Charge to income statement							
- from continuing operations	1	-	-	-	6	2	9
- from discontinued operations	2	-	-	168	9	11	190
Utilised in the year	(5)	(5)	(3)	(18)	-	(4)	(35)
Exchange movements	5	2	-	9	-	-	16
Release to income statement							
- from continuing operations	(2)	-	-	-	-	(5)	(7)
- from discontinued operations	(16)	(10)	-	-	-	(2)	(28)
Transfer to disposal group	(9)	(1)	-	(163)	(9)	(21)	(203)
Provisions at 31 December 2016	**3**	**-**	**9**	**-**	**6**	**8**	**26**

	Bank				
	Property	Payment protection insurance	Global restructuring group	Other	Total
	£m	£m	£m	£m	£m
Provisions at 1 January 2015	5	17	-	-	22
Charge to income statement	3	-	-	6	9
Utilised in the year	(2)	(5)	-	-	(7)
Release to income statement	(1)	-	-	-	(1)
Provisions at 31 December 2015	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**

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 Group.

Interest rate hedge products

In 2013, the CBI requested that UBIDAC, along with a number of other Irish banks, carry out a review of interest rate hedging products sold in the Republic of Ireland in the period 2001 to 2012. Potential redress for the Republic of Ireland customer base was established as part of an RBS Group initiative. During 2016, detailed legal reviews and specific case settlements, coupled with revised anticipated requirements for the remaining sophisticated population, resulted in a £10m reduction in the provision. A £1m provision remains in the disposal group to cover redress payments and legal costs for a small number of outstanding cases.

19. Provisions, accruals and other liabilities (continued)

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 £9m represents expected costs at current utilisation rates.

Tracker mortgage examination
In 2015 UBIDAC, along with other Irish banks, received a letter from the Central Bank of Ireland (CBI) requesting that it conduct a review to assess instances of contractual and regulatory non-compliance that may have adversely impacted its portfolio of tracker mortgage customers. £4m was booked as an accrual at 31 December 2015 based on expected costs of carrying out the review at that point in time. In 2016 the accrual was transferred from accruals and incorporated within the overall provision with a further £168m recognised to cover customer remediation and other project costs. As this provision is held by UBIDAC it is part of the liabilities that constitute the disposal group at the balance sheet date.

Global restructuring group (GRG)
The Group established a provision of £15m (£6m in continuing operations, £9m in disposal group; 2015: £nil) 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 26.

20. Deferred taxation

Provision for deferred taxation has been made as follows:

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Deferred tax asset	**11**	236	**11**	25
Deferred tax liability	**-**	(3)	**-**	-
Net deferred tax asset	**11**	233	**11**	25

	Group						
	Pension	Accelerated capital allowances	Deferred gains	Fair value on financial instruments	Other	Tax losses	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 January 2015	1	-	(5)	-	(3)	223	216
(Charge)/credit to income statement							
- from continuing operations	(9)	5	(2)	-	-	31	25
Credit/(charge) to other comprehensive income							
- from continuing operations	5	-	-	(1)	-	-	4
Other							
- from discontinued operations	-	-	-	-	-	(12)	(12)
At 1 January 2016	(3)	5	(7)	(1)	(3)	242	233
(Charge)/credit to income statement							
- from continuing operations	(8)	(2)	-	-	3	(17)	(24)
- from discontinued operations	-	-	-	-	-	5	5
Credit to other comprehensive income							
- from continuing operations	13	-	-	-	-	-	13
Other							
- from discontinued operations	-	-	-	-	-	35	35
Transfer to disposal group	(2)	1	-	1	-	(251)	(251)
At 31 December 2016	**-**	**4**	**(7)**	**-**	**-**	**14**	**11**

20. Deferred taxation (continued)

	Bank				
	Pension	Accelerated capital allowances	Deferred gains	Tax losses	Total
	£m	£m	£m	£m	£m
At 1 January 2015	(1)	2	(5)	-	(4)
(Charge)/credit to income statement	(9)	4	(2)	31	24
Credit to other comprehensive income	5	-	-	-	5
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 31 December 2016	**-**	**4**	**(7)**	**14**	**11**

A deferred tax asset of £14m (2015: £31m) has been recognised in respect of £78m (2015: £170m) of total tax losses of £168m (2015: £170m) carried forward at 31 December 2016. 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 2022. Under UK tax legislation, tax losses do not expire and can be carried forward indefinitely.

Deferred tax liabilities of £123m (2015: £138m) have not been recognised in respect of retained earnings of overseas subsidiaries and held-over gains on the incorporation of overseas branches. Retained earnings of overseas subsidiaries are expected to be reinvested indefinitely or remitted to the UK free from further taxation. No taxation is expected to arise in the foreseeable future in respect of held-over gains. With effect from the 1 January 2017, the overseas subsidiaries and held-over gains have transferred to NatWest Holdings Limited.

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 will reduce from 20% to 19% from 1 April 2017 and to 17% from 1 April 2020. Under the Finance (No 2) Act 2015, tax losses carried forward at 31 December 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 2016 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.

21. Subordinated liabilities

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Dated loan capital	**836**	805	**836**	732
Undated loan capital	**103**	155	**103**	88
	939	960	**939**	820

21. Subordinated liabilities (continued)

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Dated loan capital:				
£100m floating rate loan capital repayable 2019				
- held by RBS (3 month LIBOR plus 0.5%)	**100**	100	**100**	100
€400m floating rate loan capital repayable 2017				
- held by RBS (3 month EURIBOR plus 1%)	**343**	294	**343**	294
€180m floating rate loan capital repayable 2020				
- held by RBS (3 month EURIBOR plus 0.4%)	**154**	132	**154**	132
€280m floating rate loan capital repayable 2022				
- held by RBS (3 month EURIBOR plus 0.35%)	**239**	279	**239**	206
	836	805	**836**	732
Undated loan capital:				
€120m perpetual floating rate notes				
- held by RBS (3 month EURIBOR plus 0.35%)	**103**	88	**103**	88
€32m 11.375% perpetual tier two capital	**-**	41	**-**	-
£12m 11.75% perpetual tier two capital	**-**	24	**-**	-
£1.3m floating rate perpetual tier two capital	**-**	2	**-**	-
	103	155	**103**	88
Total	**939**	960	**939**	820

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

Dated loan capital
Interest on the Sterling denominated dated loan capital held by the Group's ultimate holding company is payable quarterly at a margin over London Interbank Offer Rates (LIBOR). Interest on Euro denominated loan capital is payable quarterly at a margin over Euro Interbank Offer Rates (EURIBOR).

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

The subordinated perpetual bonds were issued by First Active Limited, in the Republic of Ireland, at par on conversion of First National Building Society to a public limited company pursuant to Section 107 of the Building Societies Act, 1989 to replace the issued fixed and floating rate permanent interest bearing shares of the society. The issuance of the bonds transferred to UBIDAC when First Active Limited transferred its banking business in February 2010. The claims of the holders of the bonds are subordinate to the claims of all creditors of UBIDAC.

22. Share capital

	Group and Bank			
	Allotted, called up and fully paid		Authorised	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Equity shares:				
Ordinary shares of £1	**254**	1,320	**2,000**	2,000
Equity preference shares:				
Non-cumulative redeemable preference shares of €1 each	**201**	201	**365**	346
Total share capital	**455**	1,521	**2,365**	2,346

	Allotted, called up and fully paid		Authorised	
	2016	2015	**2016**	2015
Number of shares	**Millions**	Millions	**Millions**	Millions
Equity shares:				
Ordinary shares of £1	**254**	1,320	**2,000**	2,000
Equity preference shares:				
Non-cumulative redeemable preference shares of €1 each	**309**	309	**500**	500
Total share capital	**563**	1,629	**2,500**	2,500

On 21 December 2016, the Bank carried out a capital reduction under Section 641 (1)(a) of the Companies Act 2006. The issued ordinary shares of £1 were reduced from £1,320m to £254m and an amount of £1,066m was transferred to retained earnings. In the same transaction the Bank's share premium account on ordinary shares was cancelled and a further £434m was transferred to retained earnings.

The non-cumulative redeemable preference shares entitle the holders thereof to receive periodic non-cumulative cash dividends, at the discretion of the directors, at a specified floating rate payable out of distributable profits of the Bank. In a winding-up the holders of the preference shares have the right to repayment in priority to the holders of any other class of shares in the capital of the Bank. Any surplus assets available after repayment of the preference shares will be distributable to the holders of the £1 ordinary shares.

The non-cumulative redeemable preference shares do not confer on the holder a right to attend or vote at general meetings of the Bank unless the business of the meeting includes the consideration of a resolution for winding up of the Bank, reducing its share capital or varying any of the special rights attached to the preference shares.

Subject to the provisions of company law and to the consent of the Financial Conduct Authority (FCA), the Bank shall have the right to redeem the preference shares at any time by notice to the holders provided that no such notice may be issued in respect of any preference share prior to the day following the fifth anniversary of the date of its allotment.

23. Leases

The Group purchases plant and equipment, renting them to customers under lease arrangements that, depending on their terms, qualify as either operating or finance leases.

The Group provides asset finance to its customers through acting as a lessor. Amounts receivable under finance lease and hire purchase agreements:

	Group					
	2016			2015		
	Gross amounts	**Present value adjustments**	**Present value**	Gross amounts	Present value adjustments	Present value
Year in which receipt will occur:	**£m**	**£m**	**£m**	£m	£m	£m
Within 1 year	**18**	**(1)**	**17**	81	(6)	75
After 1 year but within 5 years	**20**	**(1)**	**19**	87	(7)	80
After 5 years	**1**	**-**	**1**	1	-	1
	39	**(2)**	**37**	169	(13)	156

23. Leases (continued)

Minimum amounts payable under non–cancellable leases:

	Group							
	2016				2015			
Year in which payment will occur:	**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
Operating lease obligations:								
Premises	**2**	**3**	**86**	**91**	16	42	113	171
Equipment	**-**	**-**	**-**	**-**	1	-	-	1
	2	**3**	**86**	**91**	17	42	113	172

	Bank							
	2016				2015			
Year in which payment will occur:	**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
Operating lease obligations:								
Premises	**2**	**3**	**86**	**91**	2	2	87	91

	Group		Bank	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Amounts recognised in income statement				
Operating lease expense – minimum payments				
- continuing operations	**3**	14	**3**	3
- discontinued operations	**11**	11	**-**	-

24. Collateral and securitisations

Securities repurchase agreements and lending transactions

The Group enters into securities repurchase agreements and securities lending transactions under which it receives or transfers collateral in accordance with normal market practice. Generally, the agreements require additional collateral to be provided if the value of the securities fall below a predetermined level.

Under standard terms for repurchase transactions in the United Kingdom and Republic of Ireland, the recipient of collateral has an unrestricted right to sell or repledge it, subject to returning equivalent securities on settlement of the transaction.

There were no securities transferred under repurchase transactions included within debt securities on the balance sheet in either of the years under review. There were no securities received as collateral under reverse repurchase agreements in either of the years under review.

Other collateral given

	Group	
	2016	2015
Group assets charged as security for liabilities	**£m**	£m
Loans and advances to customers	**8,558**	7,395

	Group	
	2016	2015
Liabilities secured by charges on assets	**£m**	£m
Debt securities in issue[1]	**4,646**	5,544
Derivatives	**24**	31
	4,670	5,575

[1] £3,467m of the debt securities in issue are held by the Group (2015: £4,072m).

During the financial year all of the debt securities in issue by Celtic Residential Irish Mortgage Securitisation No. 12 DAC ("Celtic 12"), a limited recourse entity controlled by the Group and included in the consolidated financial statements on that basis, were redeemed at par by that entity. At 31 December 2015 the value of the debt securities issue by Celtic 12 was £788m, £469m of these were held by the Group and consolidated in the Group financial statements.

The amounts provided as collateral relate to assets and liabilities held for disposal.

Securitisations and other asset transfers

The Group undertakes securitisations to fund specific portfolios of assets. In a securitisation, assets, or interests in a pool of assets, are transferred generally to a special purpose entity (SPE) which then issues liabilities to third party investors. SPEs are vehicles established for a specific, limited purpose, usually do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions.

It is primarily the extent of risks and rewards assumed that determines whether these entities are consolidated in the Group's financial statements. The table below sets out the asset categories together with the carrying amounts of the assets and associated liabilities for those securitisations where substantially all the risks and rewards of the asset have been retained by the Group and continue to be presented in its balance sheet.

	2016		2015	
	Assets	**Liabilities**	Assets	Liabilities
	£m	**£m**	£m	£m
Residential mortgages	**8,558**	**1,179**	7,395	1,472

The assets and liabilities held in SPEs relate to assets and liabilities of disposal groups.

25. Risk management

On 1 January 2017, the Group sold Ulster Bank (Ireland) Holdings Unlimited Company ("UBIH") and its subsidiaries comprising the Group's Republic of Ireland operations to NatWest Holdings Limited. Accordingly UBIH and its subsidiaries have been classified as a disposal group at 31 December 2016. Consequently, all current year disclosures relate to the continuing operations (Northern Ireland operations, principally the Bank).

Business model and associated risks

The Group aims to become a bank that its customers' and all other stakeholders can trust. It is doing so by focusing on Personal & Business Banking ("PBB") and Commercial & Private Banking ("CPB"). By delivering only services that meet the customers' needs in these segments, it aims to achieve an appropriate return. To support delivery, a major programme is underway to transform and enhance the ways in which the Group operates.

PBB provides traditional retail banking products including current and savings accounts, mortgages and credit cards to individual, mass-affluent and small business customers. CPB provides commercial, corporate and high-net-worth customers with loan products and investment services.

The main sources of earnings are interest income from lending and fee income from transactional and other services. In 2016, greater competition and lower interest rates have put pressure on financial targets. In response, the Group continues to focus on customer service and satisfaction while reducing costs through rationalisation and simplification.

In the past year the Group has further reduced exposures to legacy issues, deleveraged the balance sheet and significantly improved the risk profile of the bank. Moreover, the Group must respond to new and impending regulation, such as adapting to the UK Financial Services (Banking Reform) Act, which requires core banking services including deposit-taking to be ring-fenced by 2019.

These major strategic and regulatory change programmes mean that the Group must manage the associated execution risk in coming years. If not effectively managed, this could represent a significant burden on management and may threaten strategic objectives. The volume of change could also affect the Group's ability to retain the talent and skills it requires and, until target operating models are achieved, organisational complexity, particularly in IT systems, will contribute to increased levels of operational risk.

Increased focus on key strengths is intended to deliver financial robustness and stronger risk management, but also raises product concentration risks. These risks must be managed effectively in increasingly competitive and fast-changing target markets while navigating industry-wide risks such as those related to cybercrime.

The Group continues to resolve issues related to historical misconduct and unsustainable strategic decision-making. To prevent the recurrence of similar issues, the Group aims to underpin its business model with a strong risk culture across its businesses. This culture promotes appropriate risk awareness and judgements about risk-taking. Through its business model, the Group will continue to be exposed to credit, market, operational and liquidity risks, but also a range of other risk types including pension, reputational conduct and regulatory. These, and the business model related risks outlined here, are considered further in the following sections. Capital and risk management are conducted on an overall basis within RBS Group such that common policies, procedures, frameworks and models apply across RBS Group. Therefore, for the most part, discussions on these aspects reflect those in RBS Group as relevant for the businesses and operations in the Group.

Governance structure

The risk governance structure of the Group and the main purposes of each of the committees are indicated below:

Board
Sets and owns the Group's risk appetite, which is cascaded across the business.

Group Audit Committee
Reviews systems and standards of internal control

Board Risk Committee
Provides oversight and advice on current and potential exposure, risk strategy and tolerance

Executive committees
Consider emerging issues material to both the Group's strategy and risk exposures.

25. Risk management (continued)

Three lines of defence

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

First line of defence - management and supervision
The first line of defence includes customer franchises, Technology and Operations and support functions such as Human Resources, Communications and some areas of 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 that the business has effective mechanisms for identifying, reporting and managing risk and controls.

Second line of defence - oversight and control
The second line of defence includes Risk Management and Conduct & Regulatory Affairs, Legal and the financial control aspects of Finance. Responsibilities include:

- Working with the businesses and functions to develop the risk and control policies, limits and tools for the business to use 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 to the desired level (risk appetite).
- Providing expert advice to the business on risk management.
- Providing senior executives with relevant management information and reports and escalating concerns where appropriate.
- Undertaking risk assurance.

Third line of defence - Internal Audit
Responsibilities include:

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

Risk culture and appetite

Risk culture
A strong risk culture is essential if the Group is to achieve its ambition to build a truly customer-focused bank. The Group has measured and benchmarked its risk culture across all functions and businesses. It has set a risk culture target, making risk simply part of the way that employees work and think. Such a culture must be built on strong risk capabilities, with robust risk practices and appropriate risk behaviours embedded across the organisation.

25. Risk management (continued)

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

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

To embed and strengthen the required risk culture behaviours, a number of Group-wide activities have been undertaken. To support a consistent tone from the top, senior management frequently communicate the importance of the required risk behaviours through various channels, linking them to the achievement of good customer outcomes.

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

In addition to embedding risk culture behaviours into performance management, in 2016 an objective aligned to the Group's risk culture target was set for the Executive Committees and made integral to performance reviews. The Group's policies require that risk behaviour assessment is incorporated into performance assessment and compensation processes for enhanced governance staff.

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

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

Training
Enabling employees to have the capabilities and confidence to manage risk is core to the Group's learning strategy. The 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 the 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 these values is the Code of Conduct. The Code provides guidance on expected behaviour and sets out the standards of conduct that support the values. It explains the effect of decisions that are taken and describes the principles that must be followed.

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

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

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

25. Risk management (continued)

Risk culture (continued)

Code of Conduct (continued)
Each of the five questions is a prompt to think about how the situation fits with the Group's values. It ensures that employees can think through decisions that do not have a clear answer, and guides their judgements. If conduct falls short of the Group's required standards, the accountability review process is used to assess how this should be reflected in pay outcomes for those individuals concerned.

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

Risk appetite
Understanding and managing risk is essential in order to keep the Group safe and secure and embed a strong risk culture. Risk appetite is the way the Group expresses the level of risk it is willing to accept in order to achieve its strategic objectives and business plans. Risk appetite seeks to ensure the Group strikes an optimal balance between building a sustainable business and creating long-term value for customers and stakeholders.

Risk appetite is set for material risks and cascaded and embedded across the Group. Risk appetite informs, guides and empowers the divisions, functions and legal entities to execute their strategies within manageable limits.

Risk appetite framework
The risk appetite framework outlines the standards to which the Group holds itself accountable for establishing, governing, reporting and embedding risk appetite. It provides a structured approach to risk-taking within agreed boundaries. The Board reviews and approves the risk appetite framework annually. The Group embraces taking risk as part of the way we work and think and our risk appetite framework is intended to:

- Ensure the Group is safe and secure.
- Contribute towards the achievement of our strategic plans.
- Ensure risks are comprehensively understood and effectively controlled.
- Avoid activities that are inconsistent with the Group's values, code of conduct and policies.

Strategic risk appetite
The Board has set out four strategic risk appetite objectives. These are aligned with the strategic plan and provide the boundaries within which risk appetite for all other material risks are set. The strategic risk appetite objectives are to:

- Maintain capital adequacy: to ensure there are sufficient capital resources to meet regulatory requirements and cover potential unexpected losses.
- Deliver stable earnings growth: to ensure that the strategy for growth considers the longer-term risks versus rewards. Risk appetite is set so that the Group remains profitable under severe stress.
- Ensure stable and efficient access to funding and liquidity: there must be sufficient funding to meet obligations, taking account of the constraint that some forms of funding may not be available when they are most needed.
- Maintain stakeholder confidence: to ensure that the Group is respected and valued by stakeholders, as well as trusted to attain its strategic objectives.

To establish and maintain an appropriate culture and operational controls. Strategic risk appetite objectives provide the link between the overall business strategy and the frameworks, limits and tolerances used to set risk appetite and manage risk in the business on a day-to-day basis.

Risk appetite measures
Risk appetite is set in a manner that:

- Is aligned to the Group's goals: risks are managed in support of business and financial objectives.
- Is meaningful to the business: risk appetite is expressed as a qualitative statement of appetite supported, where possible, by quantitative risk limits and triggers. Risk appetite is communicated to each division, function and legal entity in a meaningful and clear way.
- Allows risks to be effectively controlled: risk control frameworks set detailed tolerances and limits for managing risks, such as credit risk and market risk, on a day-to-day basis.
- Considers performance under stress: the establishment and monitoring of risk appetite considers potential risk exposures and vulnerabilities under plausible stress conditions.
- Facilitates robust monitoring: effective processes allow frequent reporting of risk profile against agreed risk appetite to senior management and the Board.

25. 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
The principal sources of credit risk for the Group are as follows:

Lending -The Group offers a number of lending products where it has an irrevocable obligation to provide credit facilities to a customer. Security can be obtained to mitigate the risk of loss in the form of physical collateral (such as commercial real estate assets and residential housing), or financial collateral (such as cash or bonds). Exposures arising from leasing activities are also included.

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

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

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

Credit risk management function
As is standard practice in the industry, credit risk management activities are organised along two separate lines, wholesale and personal, reflecting the distinction between business types and consequent drivers of credit risk. Wholesale focuses on activities with institutional, corporate and SME customers. Personal covers personal customers, small businesses as well as personal lending activities in private banking. Nonetheless, many activities remain common to both business lines. The following discussion refers to both wholesale and personal, with some specific additional comments relating to each individual business line.

Risk measurement and models
The Group uses the output of credit risk models in the credit approval process - as well as for ongoing credit risk assessment, monitoring and reporting - to inform credit risk appetite decisions. These models are divided into different categories:

<table>
<tr><th>Model</th><th>Calculation method</th><th>Wholesale</th><th>Personal</th></tr>
<tr><td>PD model</td><td>Individual counterparty</td><td>Each customer is assigned a probability of default (“PD”) rating and corresponding grade. PD is calculated using a combination of quantitative inputs, such as recent financial performance, and qualitative inputs such as management performance and sector outlook.</td><td>Each customer account is scored and models are used to assign a PD rating. Inputs vary across portfolios and include both internal account and customer level data, as well as data from credit bureaus. This score is used to support automated credit decision-making through the use of a statistically-derived scorecard.</td></tr>
<tr><td>LGD model</td><td>Individual counterparty</td><td colspan="2">Loss given default (“LGD”) models estimate the amount that would not be recovered in the event of a customer default. 'When estimating LGD, the Group’s models assess both borrower and facility characteristics, as well as any credit risk mitigants. The cost of collections and a time-discount factor for the delay in cash recovery are also incorporated.</td></tr>
<tr><td>EAD model</td><td>Individual counterparty</td><td colspan="2">Exposure at default (“EAD”) models provide estimates of credit facility utilisation at the time of a customer default, recognising that customers may make further drawings on unused credit facilities prior to default or that exposures may increase due to market movements. Regulatory requirements stipulate that EAD must always be equal to, or higher, than current utilisation, though exposures can be reduced by a legally enforceable netting agreement.</td></tr>
</table>

25. Risk management – credit risk (continued)

Risk measurement and models (continued)

During 2016, the Group made two key amendments to the underlying assessment of loan loss provisions:
- LGD rate methodology was revised to align methodology with Basel II LGDs. This resulted in a £0.7m charge to the income statement; and
- Property price indices were revised to utilise new UK House Price Index for Northern Ireland resulting in a £0.5m charge to the income statement.

The following table analyses the sensitivity of the Income Statement to key inputs to the credit risk models.

Metric	Sensitivity	2016 £m
Retail Probability of Default	1% movement in Good Book (across all segments)	4.1
Wholesale Probability of Default	1% movement	1.3
Probability of Default - Combined	**1% movement**	**5.4**
Wholesale Loss Given Default	1% movement	0.7
Retail Loss Given Default	1% movement	0.8
Loss Given Default - Combined	**1% movement**	**1.5**
Retail Emergence Period	1 month increase	0.4
Wholesale Emergence Period	1 month increase	0.2
Emergence Period - Combined	**1 month increase**	**0.6**

Models are regularly revised to reflect changes in the economic environment, regulatory environment, portfolio changes or changes in business strategy. Capital models, used to estimate risk weighted assets (“RWA”) and capital, are subject to enhanced internal scrutiny followed by submission to the Group's regulators for approval.

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 Group map to both a Group 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

25. Risk management – credit risk (continued)

Risk measurement and models (continued)

Asset quality - unaudited (continued)
The following table provides an analysis of the credit quality of third party financial assets by probability of default.

	Group					
2016	**Cash and balances at central banks £m**	**Loans and advances to banks £m**	**Loans and advances to customers £m**	**Derivatives £m**	**Commitments £m**	**Contingent liabilities £m**
AQ1	1,012	5,397	8	4	61	-
AQ2	-	-	-	-	2	-
AQ3	-	3	50	-	7	-
AQ4	-	2	888	-	207	29
AQ5	-	-	1,456	1	418	17
AQ6	-	-	636	-	127	5
AQ7	-	-	375	-	113	16
AQ8	-	-	157	-	21	2
AQ9	-	-	31	-	2	-
AQ10	-	-	-	-	10	5
Accruing past due	-	-	72	-	-	-
Non–accrual	-	-	178	-	-	-
Impairment provisions	-	-	(155)	-	-	-
Total	**1,012**	**5,402**	**3,696**	**5**	**968**	**74**

	Group					
2015	Cash and balances at central banks £m	Loans and advances to banks £m	Loans and advances to customers £m	Derivatives £m	Commitments £m	Contingent liabilities £m
AQ1	868	7,515	68	541	84	-
AQ2	-	305	3	30	97	-
AQ3	-	1,662	248	27	323	96
AQ4	-	2	2,366	22	883	75
AQ5	-	1	5,705	3	878	33
AQ6	-	-	6,007	1	540	69
AQ7	-	-	1,134	1	265	31
AQ8	-	-	511	-	51	3
AQ9	-	-	1,742	-	8	2
AQ10	-	-	-	2	54	27
Accruing past due	-	-	1,101	-	-	-
Non–accrual	-	-	5,369	-	-	-
Impairment provisions	-	-	(3,611)	-	-	-
Total	868	9,485	20,643	627	3,183	336

25. Risk management – credit risk (continued)

Risk measurement and models (continued)

Asset quality - unaudited (continued)

	Bank					
2016	**Cash and balances at central banks £m**	**Loans and advances to banks £m**	**Loans and advances to customers £m**	**Derivatives £m**	**Commitments £m**	**Contingent liabilities £m**
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**

	Bank					
2015	Cash and balances at central banks £m	Loans and advances to banks £m	Loans and advances to customers £m	Derivatives £m	Commitments £m	Contingent liabilities £m
AQ1	616	7,116	90	2	40	-
AQ2	-	-	30	-	36	-
AQ3	-	2	26	-	1,107	11
AQ4	-	1	1,035	-	186	7
AQ5	-	-	1,375	-	298	17
AQ6	-	-	453	-	167	13
AQ7	-	-	380	1	100	14
AQ8	-	-	142	-	19	1
AQ9	-	-	150	-	2	-
AQ10	-	-	-	-	9	6
Accruing past due	-	-	64	-	-	-
Non-accrual	-	-	624	-	-	-
Impairment provisions	-	-	(568)	-	-	-
Total	616	7,119	3,801	3	1,964	69

Risk appetite

Risk appetite across all risk types is set using specific quantitative targets under stress, including earnings volatility and capital adequacy. The credit risk appetite frameworks have been designed to reflect factors that influence the ability to meet those targets. Tools such as stress testing and economic capital are used to measure credit risk volatility and develop links between the credit risk appetite frameworks and risk appetite targets. The frameworks are supported by a suite of policies and transaction acceptance standards that set out the risk parameters within which franchises must operate.

25. Risk management - credit risk (continued)

Risk mitigation

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

When seeking to mitigate risk, at a minimum the Group considers the following:

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

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

Within its secured portfolios, the Group has recourse to various types of collateral and other credit enhancements to mitigate credit risk and reduce the loss to the Group arising from the failure of a customer to meet its obligations. These include: cash deposits; charges over residential and commercial property, debt securities and equity shares; and third-party guarantees. The existence of collateral may affect the pricing of a facility and its regulatory capital requirement.

When a collateralised financial asset becomes impaired, the impairment charge directly reflects the realisable value of collateral and any other credit enhancements.
For further information, refer to the sub-sections on Wholesale credit risk management and Personal credit risk management.

Risk assessment and monitoring

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 any 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.

Provision method	**Customer type**	**Quantification method**	**Key factors considered**
Individual	Impaired, individually significant	Case-by-case assessment of future cash flows	• Customer and guarantor performance. • Future value of collateral. • Future economic conditions based on factors available at the time.
Collective	Impaired but not individually significant, grouped into homogenous portfolios	Quantitative review of relevant portfolio	• Level of arrears. • Value of security. • Historical and projected cash recovery trends. • Current economic conditions. • Operational processes. • Latest cash collection profile.
Latent	Not impaired	PD% x LGD% x Drawn Balance x Emergence Period The emergence period is the period between the occurrence of an impairment event and a loan being identified and reported as impaired.	• For wholesale and retail customers PD, LGD, Drawn balance and Emergence Period • Portfolio-level emergence periods are based on products or businesses with similar homogenous characteristics. Emergence periods range from 120 to 365 days.

25. Risk management - credit risk (continued)

Wholesale credit risk management

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

A summary of the frameworks is set out below.

Concentration framework	Single name (SNC)	Sector	Product and asset class
Risk addressed	Concentration on a single borrower or borrower group.	Concentration in a single sector or across sectors that are susceptible to similar stress events.	Concentration on certain products or asset classes.
Basis for classification	Size or LGD - based on net customer exposure for a given probability of default.	Size - based on exposure; and Risk - based on economic capital and other qualitative factors.	Size - based on exposure to a product or asset class; and Risk – based on heightened risk characteristics of a product.
Limit types	Customer exposure and LGD limits relative to PD.	Bank-wide and franchise sector and sub-sector exposure limits.	Bank-wide and franchise product/asset class exposure limits and sub-limits.

Risk assessment
Credit is only granted to customers following joint approval by an approver from the business and the credit risk function.

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

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

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

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

- The amount, terms, tenor, structure, conditions, purpose and appropriateness of all credit facilities.
- Compliance with relevant credit policies and transaction acceptance standards.
- The customer's ability to meet obligations, based on an analysis of financial information.
- A review of payment and covenant compliance history.
- The customer's risk profile, including sector, sensitivity to economic and market developments and management capability.
- Legal capacity of the customer to engage in the transaction.
- Credit risk mitigation including requirements for valuation and revaluation. The customer's credit grade and the loss given default estimate for the facilities, including any expected changes.
- The requirement for the provision of financial information, covenants and/or monitoring formulae to monitor the customer's financial performance.
- Refinancing risk - the risk of loss arising from the failure of a customer to settle an obligation on expiry of a facility through the drawdown of another credit facility provided by the Group or by another lender.
- Consideration of other risks such as environmental, social and ethical, regulatory and reputational risks.
- The portfolio impact of the transaction, including the impact on any credit risk concentration limits or agreed business franchise risk appetite.

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

25. Risk management - credit risk (continued)

Wholesale credit risk management (continued)

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

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

Problem debt management

Early problem identification
Early warning indicators ("EWIs") are in place 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
In early 2016, the Risk of Credit Loss framework replaced the Group's previous Watchlist process for managing problem debts. The new framework focuses on wholesale customers whose credit profiles have deteriorated since origination. Expert judgement is applied by experienced credit risk officers to classify cases into categories that reflect progressively deteriorating credit risk to the bank. There are two classifications which apply to non-defaulted customers within the framework - Heightened Monitoring and Risk of Credit Loss. The framework also applies to those customers that have met the bank's default criteria (AQ10 exposures).

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

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

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

Agreed customer management strategies are regularly monitored by both the business and credit teams. The largest Risk of Credit Loss exposures 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 sector appetite, the credit quality of the customer, the market environment and the loan structure and security.

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. 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.

25. Risk management – credit risk (continued)

Wholesale credit risk management (continued)

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

The aim of forbearance is to restore the customer to financial health while minimising risk to RBS. 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.

The levels of wholesale forbearance in the Group are not material and are therefore not reported.

Wholesale exposures
The type of collateral taken by the Group's commercial and corporate businesses and the manner in which it is taken will vary according to the activity and assets of the customer.

- *Physical assets* - These include business assets such as stock, plant and machinery, vehicles, ships and aircraft. In general, physical assets qualify as collateral only if they can be unambiguously identified, located or traced, and segregated from uncharged assets. Assets are valued on a number of bases according to the type of security that is granted.
- *Real estate* - The Group takes collateral in the form of real estate, which includes residential and commercial properties. The loan amount will typically exceed the market value of the collateral at origination date. The market value is defined as the estimated amount for which the asset could be sold in an arm's length transaction by a willing seller to a willing buyer.
- *Receivables* - When taking a charge over receivables, the Group assesses their nature and quality and the borrower's management and collection processes. The value of the receivables offered as collateral will typically be adjusted to exclude receivables that are past their due dates.

The security charges may be floating or fixed, with the type of security likely to impact: (i) the credit decision; and (ii) the potential loss upon default. In the case of a general charge such as a mortgage debenture, balance sheet information may be used as a proxy for market value if the information is deemed reliable.

The Group does not recognise certain asset classes as collateral: for example, short leasehold property and equity shares of the borrowing company. Collateral whose value is correlated to that of the obligor is assessed on a case-by-case basis and, where necessary, over-collateralisation may be required.

The existence of collateral has an impact on provisioning. Where the Group no longer expects to recover the principal and interest due on a loan in full or in accordance with the original terms and conditions it is assessed for impairment. If exposures are secured, the current net realisable value of the collateral will be taken into account when assessing the need for a provision. No impairment provision is recognised in cases where all amounts due are expected to be settled in full on realisation of the security.

	2016		2015	
	Loans	**Provisions**	Loans	Provisions
Non-performing corporate loans (excluding commercial real estate)	**£m**	**£m**	£m	£m
Secured	**43**	**42**	195	190
Unsecured	**-**	**-**	-	-

The reduction in non-performing balances has been driven by asset sales during the year.

Personal credit risk management

Risk assessment
Personal lending 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. 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.

25. Risk management – credit risk (continued)

Personal credit risk management (continued)

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

The property price indices were revised in 2016 to utilise new UK House Price Index for Northern Ireland.

Problem debt management
Personal customers in financial difficulty are managed through either collections or recoveries functions. Further details of these are set out below:

Personal collections and recoveries
There are collections and recoveries functions in each of the consumer businesses. Their role is to provide support and assistance to customers who are currently experiencing difficulties meeting their financial obligations. Where possible, the aim of the collections and recoveries teams is to return the customer to a satisfactory position by working with them to restructure their finances. If this is not possible, the team has the objective of reducing the loss to the Group.

Personal forbearance
Within the Group’s retail businesses forbearance generally occurs when the business grants a permanent or temporary concession to a customer. Forbearance is granted following an assessment of the customer’s individual circumstances and ability to pay.

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

Types of retail forbearance
Forbearance options include, but are not limited to the measures outlined below:

- Payment concessions - a temporary reduction in, or elimination of, the periodic (usually monthly) loan repayment is agreed with the customer. At the end of the concessionary period, forborne principal and accrued interest outstanding is scheduled for repayment over an agreed period.
- Capitalisation of arrears - the arrears are repaid over the remaining term of the mortgage and the customer returns to an up-to-date position.
- Term extensions - the maturity date of the loan is extended.
- Interest only conversions - the customer converts from principal and interest repayment to interest only repayment on a temporary or permanent basis.

For unsecured portfolios, forbearance treatments entail reduced or deferred payments. Arrangements to facilitate the repayment of overdraft excesses or loan arrears can be agreed dependent on affordability. Where repayment arrangements are not affordable debt consolidation loans can be provided to customers in collections. Definitions are based on those used within the FCA forbearance guidelines. For a proportion of mortgages, more than one forbearance type applies.

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

	2016		2015	
Arrears status and provisions	**Balance £m**	**Provisions £m**	Balance £m	Provisions £m
No missed payments	**23.0**	**0.1**	33.1	0.5
1-3 months in arrears	**8.5**	**0.5**	6.9	0.5
>3 months in arrears	**25.8**	**9.7**	30.3	8.1
Total	**57.3**	**10.3**	70.3	9.1

The incidence of the main types of personal forbearance on the balance sheet as at 31 December 2016 is analysed below.

	2016 £m	2015 £m
Interest only	**16.5**	21.8
Term extensions – capital repayment & interest only	**1.8**	2.4
Payment concession/holidays	**36.3**	42.9
Capitalisation of arrears	**2.7**	3.2
Total	**57.3**	70.3

At the balance sheet date 2.6% (2015: 3.2%) of the Group's retail mortgages were in forbearance.

25. Risk management – credit risk (continued)

Personal credit risk management (continued)

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

Impairments for forbearance
The methodology used for provisioning and impairments for forborne loans will differ depending on whether the loans are performing or non-performing. For the performing loans, an extended emergence period is applied to account for the impact of forbearance within the portfolio. For non-performing loans, there is no difference in treatment.

Recoveries
Once a loan has been identified as impaired it is managed by recoveries teams in the relevant businesses. The teams seek to minimise the Group's loss while treating customers fairly. Where an acceptable repayment arrangement cannot be agreed with the customer litigation may be considered. No repossession procedures are initiated until at least six months following the emergence of arrears.

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

	Group	
	2016	2015
Personal	**%**	%
Mortgages	**3.0**	3.3

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.

	Group	
	2016	2015
Residential mortgages – distribution by average LTV [(1)]	**%**	%
<=50%	**23.9**	23.7
>50% and <=60%	**11.0**	9.8
>60% and <=70%	**11.8**	10.4
>70% and <=80%	**14.4**	14.4
>80% and <=90%	**17.0**	15.6
>90% and <=100%	**6.7**	10.3
>100%	**15.2**	15.8
Total portfolio average LTV at 31 December	**74.9**	73.9
Average LTV on new originations during the year	**75.2**	74.6

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

25. Risk management – credit risk (continued)

Personal credit risk management (continued)

The tables below show period-end weighted LTVs for the Group's residential mortgage portfolio split between performing and non-performing.

Non-performing residential mortgages average LTV by exposure	2016 £m	2015 £m
<70%	21.4	23.9
>70% and <=90%	12.7	16.7
>90% and <=110%	12.2	19.1
>110% and <=130%	10.7	13.7
>130%	20.4	17.3
Total	77.4	90.7
Total portfolio average by LTV	102%	94%

Performing residential mortgages average LTV by exposure	2016 £m	2015 £m
<70%	1,020	955
>70% and <=90%	687	651
>90% and <=110%	213	306
>110% and <=130%	115	134
>130%	124	88
Total	2,159	2,134
Total portfolio average by LTV	74.0%	73.0%

The increase in >130% average LTV by exposure is due to the utilisation of new UK House Price Index for Northern Ireland.

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 Group 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 and geographical region (based on location of transaction office) and sector:

	Group			
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	6
Construction	50	-	50	9
Finance	5,430	3	5,433	-
Service industries and business activities	464	1	465	31
Agriculture, forestry and fishing	237	-	237	48
Property	329	-	329	7
Individuals				
Home mortgages	2,236	-	2,236	-
Other	226	-	226	1
Interest accruals	5	-	5	-
	9,253	**5**	**9,258**	**102**

For notes relating to this table refer to page 85.

25. Risk management – credit risk (continued)

Sector and geographical concentrations (continued)

Credit risk assets by industry and geography (continued)

	Group				
	Gross loans and advances to banks and customers	Debt securities and equity shares	Derivatives	Total	Netting and offset (1)
2015	£m	£m	£m	£m	£m
UK					
Central and local government	14	-	-	14	-
Manufacturing	323	-	-	323	6
Construction	144	-	-	144	25
Finance	7,561	-	2	7,563	-
Service industries and business activities	589	-	1	590	36
Agriculture, forestry and fishing	248	-	-	248	34
Property	865	-	-	865	5
Individuals					
Home mortgages	2,223	-	-	2,223	-
Other	281	-	-	281	-
Interest accruals	6	-	-	6	-
Total UK	12,254	-	3	12,257	106
Republic of Ireland					
Central and local government	31	1,894	-	1,925	-
Manufacturing	520	-	3	523	6
Construction	350	-	2	352	18
Finance	2,087	-	562	2,649	-
Service industries and business activities	2,542	-	47	2,589	61
Agriculture, forestry and fishing	459	-	-	459	16
Property	1,388	-	1	1,389	2
Individuals					
Home mortgages	13,770	-	-	13,770	-
Other	321	-	9	330	-
Interest accruals	17	-	-	17	-
Total Republic of Ireland	21,485	1,894	624	24,003	103
Total					
Central and local government	45	1,894	-	1,939	-
Manufacturing	843	-	3	846	12
Construction	494	-	2	496	43
Finance	9,648	-	564	10,212	-
Service industries and business activities	3,131	-	48	3,179	97
Agriculture, forestry and fishing	707	-	-	707	50
Property	2,253	-	1	2,254	7
Individuals					
Home mortgages	15,993	-	-	15,993	-
Other	602	-	9	611	-
Interest accruals	23	-	-	23	-
	33,739	1,894	627	36,260	209

(1) This column shows the amount by which the Group's credit risk exposures is reduced through arrangements, such as master netting agreements, which give the Group a legal right to set-off the financial asset against a financial liability due to the same counterparty. In addition, the Group holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade receivables; and guarantees of lending from parties other than the borrower. The Group obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

25. Risk management – credit risk (continued)

Sector and geographical concentrations (continued)

Credit risk assets by industry and geography (continued)

	Bank			
	Gross loans and advances to banks and customers	**Derivatives**	**Total**	**Netting and offset [1]**
2016	**£m**	**£m**	**£m**	**£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**

	Bank			
	Gross loans and advances to banks and customers	Derivatives	Total	Netting and offset[1]
2015	£m	£m	£m	£m
UK				
Central and local government	14	-	14	-
Manufacturing	316	-	316	6
Construction	104	-	104	24
Finance	7,233	2	7,235	-
Service industries and business activities	507	1	508	35
Agriculture, forestry and fishing	248	-	248	34
Property	618	-	618	5
Individuals				
Home mortgages	2,223	-	2,223	-
Other	219	-	219	-
Interest accruals	6	-	6	-
	11,488	3	11,491	104

(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 legal right to set-off the financial asset against a financial liability due to the same counterparty. In addition, the Bank holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade receivables; and guarantees of lending from parties other than the borrower. The Bank obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

25. Risk management (continued)

Market risk

Market risk is defined as the risk of loss as a result of adverse changes in market factors. The risk factors include interest rates, foreign currency and equity prices together with related parameters such as market volatilities.

The principal market risks to which the Group is exposed are interest rate and foreign exchange risks. The Group manages market risk within its trading and non-trading portfolios through a comprehensive market risk management framework. This framework includes limits based on, but not limited to Value at Risk ("VaR"), scenario analysis, position and sensitivity analysis. The Group in conjunction with RBS Market Risk and Treasury annually agree sub limits based on the Group's approved market risk appetite.

Risk appetite is expressed in the form of a combination of VaR, sensitivity and scenario limits. VaR is a technique that produces estimates of the potential change in the market value of a portfolio over a specified time horizon at given confidence levels. For internal risk management purposes, the Group's VaR model assumes a time horizon of one trading day and confidence level of 99% and calculates VaR using historical simulation based on the previous 500 trading days of market data. The model calculates both general market risk (the risk due to movement in general market benchmarks) and idiosyncratic market risk (the risk due to movements in the value of securities by reference to specific issuers). The Group VaR should be interpreted in light of the limitations of the methodology used as follows:

- Historical simulation VaR may not provide the best estimate of future market movements. It can only provide a prediction of the future based on events that occurred in the time series horizon. Therefore, events that are more severe than those in the historical data series cannot be predicted;
- VaR that uses a 99% confidence level does not reflect the extent of potential losses beyond that percentile;
- VaR that uses a one-day time horizon will not fully capture the profit or loss implications of positions that cannot be liquidated or hedged within one day; and
- The Group computes the VaR of trading portfolios and non-trading Treasury money market and liquid asset portfolios at the close of business. Treasury structural interest rate risk VaR is computed monthly.

These limitations mean that the Group cannot guarantee that losses will not exceed the VaR. A 'Risks not in VaR' framework has been developed to address those market risks not adequately captured by the market standard VaR methodology. Where risks are not included in the model, various non-VaR controls (for example, position monitoring, sensitivity limits, triggers or stress limits) are in place.

(i) Trading portfolios
The Group eliminates its market risk in these portfolios by entering into back-to-back positions with The Royal Bank of Scotland plc.

(ii) Non-trading
The principal market risks arising from the Group's non-trading activities are interest rate risk and foreign exchange risk. Non-trading risk is managed by Treasury, and arises from mismatches between the repricing of assets and liabilities in its wholesale markets, retail business and commercial bank.

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

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

	31 December 2015	Maximum	Minimum	Average
	£m	£m	£m	£m
Value-at-Risk	0.3	0.4	0.1	0.3

25. Risk management - market risk (continued)

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 2016	**Maximum**	**Minimum**	**Average**
	£m	**£m**	**£m**	**£m**
Value-at-Risk	**0.5**	**0.7**	**0.1**	**0.4**

	31 December 2015	Maximum	Minimum	Average
	£m	£m	£m	£m
Value-at-Risk	0.3	0.4	0.1	0.3

Treasury interest rate risk

The Group's portfolio of non-trading financial instruments principally comprises retail and commercial banking loans and deposits, debt securities issued, capital and hedging instruments.

Non-trading interest rate risk is calculated either on the basis of contractual maturity or by establishing the repricing behaviour of each asset, liability and off-balance sheet product. For many products, the actual interest rate repricing characteristics differ from the contractual repricing. In most cases, the repricing maturity is determined by the market interest rate that most closely fits the historical behaviour of the product interest rate. For example with non-interest bearing current accounts, the repricing maturity is determined by the stability of the portfolio. The repricing maturities used are approved by ALCO at least annually. Key conventions are reviewed annually by ALCO. Short-term exposures are reviewed in terms of net interest income sensitivity over 12 months to a 1% parallel movement in interest rates. Risk is managed through arm's length cash transactions, bonds and derivatives, principally interest rate swaps.

A static maturity gap report is produced as at the month-end, in each functional currency based on the behaviouralised repricing or contractual maturity for each product. It is Group policy to include in the gap report non-financial assets and liabilities, mainly property, plant and equipment and the Group's capital and reserves, spread over medium and longer term maturities. This report also includes hedge transactions, principally derivatives.

Any residual non-trading interest rate exposures are controlled by limiting repricing mismatches in the balance sheets. Potential exposures to interest rate movements in the medium to long term are measured and controlled using a version of the same VaR methodology that is used for the Group's trading portfolios but without discount factors. Net accrual income exposures are measured and controlled in terms of sensitivity over time to movements in interest rates.

Risk is managed within VaR limits approved by ALCO through the execution of cash and derivative instruments. Execution of the hedging is carried out by the Group's Treasury function. The residual risk position is reported to ALCO on a monthly basis.

Principal amounts only are included. Average balances are used for products where this is considered to provide a more accurate representation of the exposure. A separate ladder is produced for each material currency.

Option risk in the non-trading businesses principally occurs in certain fixed rate assets and liabilities. It arises where businesses undertake to provide funding to, or to accept deposits from, customers at a future date at a pre-determined fixed interest rate. Derivatives are used to manage the risk of interest rate movements from the date a commitment is made to a customer to the date the transaction closes. Option risk also arises where customers can repay fixed rate loans or withdraw fixed rate deposits prior to their maturity. In managing this risk, historic early repayment rates are taken into account.

The Group generally seeks to protect itself from early repayment risk through the imposition of contract breakage fees.

Foreign exchange risk

Foreign exchange risk in the banking book represents exposures to changes in the values of current holdings and future cash flows denominated in other currencies. Hedging instruments used to mitigate these risks include foreign currency options, currency swaps, futures, forwards and deposits. Foreign exchange risk results from the Group's investments in overseas subsidiaries, associates and branches in three principal forms:

- Structural foreign currency exposures that arise from net investment in overseas subsidiaries, associates and branches;
- Transactional/commercial foreign currency exposures that arise from mismatches in the currency balance sheet; and
- Foreign currency profit streams.

25. Risk management - market risk (continued)

Foreign exchange risk (continued)

The Group does not maintain material non-trading open currency positions other than the structural foreign currency translation exposures that arose from its investments in foreign subsidiaries and associated undertakings and their related currency funding. The Group's policy in relation to structural positions was to match fund the structural foreign currency exposure arising from net asset value, including goodwill, in foreign subsidiaries, equity accounted investments and branches, except where doing so would materially increase the sensitivity of either the Group's or the subsidiaries regulatory capital ratios to currency movements. The policy requires structural foreign exchange positions to be reviewed regularly by ALCO.

Foreign exchange differences arising on the translation of foreign operations are recognised directly in equity.

The table below sets out the Group's structural foreign currency exposures as at 31 December:

	2016					
	Net assets of overseas investment	**Minority interest**	**Net investments**	**Currency borrowings**	**Economic hedges**	**Structural foreign currency exposures**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Euro	**5,205**	**(1)**	**5,204**	**(429)**	**(1,329)**	**3,446**

	2015					
	Net assets of overseas investment	Minority interest	Net investments	Currency borrowings	Economic hedges	Structural foreign currency exposures
	£m	£m	£m	£m	£m	£m
Euro	5,502	(1)	5,501	(305)	(1,202)	3,994

At 31 December 2016, a 5% strengthening of foreign currencies would have resulted in a structural foreign currency gain of £172m in equity (2015: £215m) and a 5% weakening of foreign currencies would have resulted in a structural foreign currency loss of £172m in equity (2015: £215m).

Changes in foreign exchange rates affect the Group's earnings and equity through differences on the retranslation of the net assets and related funding of overseas subsidiaries from the local functional currency to Sterling. Gains or losses on foreign currency investments in subsidiary and associated undertakings are recognised in reserves. In 2016, exchange gains of £917m (2015: exchange losses of £278m) have been taken directly to reserves.

On 1 January 2017, the Group sold UBIH and its subsidiaries. Consequently, whilst not entirely eliminating structural foreign exchange risk, the Group no longer holds a structural foreign currency exposure on its investments in foreign subsidiaries and associated undertakings.

Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its financial obligations, including financing wholesale maturities or customer deposit withdrawals as and when they fall due. Liquidity risk is highly dependent on company specific characteristics such as the maturity profile and composition of the Group's asset and liabilities, the quality and marketable value of its liquidity buffer and broader market factors, such as wholesale market conditions alongside depositor and investor behaviour.

Policy, framework and governance
The Group has in place a comprehensive set of policies to manage liquidity risk that reflect best market practice and complies with prevailing regulatory strictures.

These policies are designed to address three broad issues which ensure that:

- the Group maintains adequate liquidity resources to meet liabilities as and when they fall due;
- the Group maintains an adequate liquidity buffer appropriate to the business activities of the Group and their risk profile; and
- the Group has in place robust strategies, policies, systems and procedures for identifying, measuring, monitoring and managing liquidity risk.

25. Risk management – liquidity risk (continued)

Policy, framework and governance (continued)
At their simplest, these policies determine the sources of liquidity risk and the steps the Group can take when these risks exceed certain tolerances. These include, not only, when and how to use the Group's liquidity buffer but also what other adjustments to the Group's balance sheet could be undertaken to manage these risks back within Group appetite. These policies are reviewed at least annually, or more frequently if the Group's own liquidity position changes, or if market conditions and/or regulatory rules warrant further amendment or refinement.

Guided by ALCO, the Bank's Board of directors are responsible for defining and approving the Group's liquidity policy and high level, risk appetite setting acceptable parameters and risk limits that align with the overall RBS standard and risk appetite. The Group's liquidity buffer is managed by Treasury which monitors and controls the Group's funding and liquidity position.

Regulatory oversight
The Group operates in the United Kingdom and is subject to regulatory oversight in that jurisdiction. The Group's lead regulators are the Prudential Regulatory Authority ("PRA") and the Financial Conduct Authority ("FCA"). The PRA is the consolidated supervisor of RBS Group and is responsible for promoting the safety and soundness of systemically important financial institutions in the UK. The FCA provides regulatory oversight over the Group's liquidity management. In June 2010 liquidity rules were introduced to provide a standardised approach for all UK banks. At an RBS Group level, the rules focus on the UK Defined Liquidity Group (a subset comprising the RBS Group's five UK banks: RBS, NatWest, Ulster Bank Limited, Coutts & Co plc and Adam & Co plc) and cover adequacy of liquidity resources, controls, stress testing and the Individual Liquidity Adequacy Assessment ("ILAA"). The ILAA informs the RBS Group Board and the FCA of the assessment and quantification of the Group's liquidity risks and their mitigation, and how much current and future liquidity is required.

Liquidity measurement and monitoring
Liquidity risk is measured and assessed on a daily basis at RBS Group level in compliance with regulatory requirements. The Group uses a set of internal metrics and analysis to assess liquidity risk including Liquidity Coverage Ratio, Net Stable Funding Ratio, Additional Liquidity Monitoring Metrics. Maturity Mismatch Cash Flow, Stressed Outflows, Loan to Deposit Ratio and Asset Encumbrance. In addition to risk limits covering these metrics, deposit concentration and Foreign Exchange Mismatch limits are set by ALCO and monitored via daily reporting. Liquidity risk performance reports are reviewed by ALCO. Any breach or material deterioration of these metrics will set in motion a series of actions and escalations that could lead to activation of the Recovery Plan. The Group maintains a Recovery Plan, which forms the basis of analysis and management actions to be undertaken in a liquidity stress scenario

The Group's liquidity risk framework is subject to internal oversight, challenge and governance both at Board level and via Risk and Internal Audit control functions. The Group is also subject to regulatory review and challenge.

Stress testing
Stress testing is used to help inform a broader understanding of liquidity risk as well as to model specific liquidity risk events; for example the secession of a country from the European Union or withdrawal from the Eurozone.

The Group actively monitors a range of market and firm specific indicators on an ongoing basis which are designed to act as early warning indicators that liquidity stresses are emerging. Some of these indicators will be based upon actual performance of the business against pre-agreed limits, for example customer deposit outflows. Others will be based around general or specific market movements.

Stress tests can therefore be run on an ad hoc basis in response to the emergence of one of these risks.

Scenarios include assumptions about significant changes in key funding sources, external credit ratings, contingent uses of funding and political and economic conditions or events in particular countries. Stress scenarios are applied to both on-balance sheet instruments and off-balance sheet activities to provide a comprehensive view of potential cash flows.

In determining the adequacy of the Group's liquidity resources the Group focuses on the stressed outflows that it could anticipate experiencing as a result of any stress scenario occurring. These outflows are measured as occurring over certain time periods which extend from any given day, out to two weeks or to as long as three months. The Group is expected to be able to withstand these stressed outflows through its own resources (principally the use of the liquidity buffer) over these time horizons without having to revert to extraordinary central bank or government assistance.

Stress tests are augmented from time to time to reflect firm specific or emerging market risks that could have a material impact on the Group's liquidity position.

The results of stress testing are an active part of balance sheet management and strategy and also inform allocation, target and limit discussions. In short, limits in the business-as-usual environment are bounded by capacity to satisfy the Group's liquidity needs in the stress environments.

25. Risk management – liquidity risk (continued)

Balance sheet composition

The Group's balance sheet composition is a function of product offerings and diverse markets served. The structural composition of the balance sheet is enhanced as needed through active management of both asset and liability portfolios. The objective of these activities is to optimise liquidity transformation in normal business environments, while ensuring adequate coverage of all cash requirements under extreme stress conditions.

The Group also accesses professional markets funding by way of public and private debt issuances on an unsecured and secured basis. These debt issuance programmes are spread across multiple currencies and maturities, to appeal to a broad range of investor types and preferences around the world. This market-based funding supplements the Group's structural liquidity needs and, in some cases, achieves certain capital objectives.

The Group is part of RBS Group and a contingency funding support agreement is in place.

Contractual maturity

The tables below analyse the contractual undiscounted cash flows receivable and payable up to a period of twenty years 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 Group or Bank balance sheet as the tables include all cash flows relating to principal and future coupon payments presented on an undiscounted basis.

	Group					
2016	**0–3 months £m**	**3–12 months £m**	**1–3 years £m**	**3–5 years £m**	**5–10 years £m**	**10–20 years £m**
Assets by contractual maturity						
Cash and balances at central banks	1,012	-	-	-	-	-
Loans and advances to banks	3,449	400	732	821	-	-
Total maturing assets	4,461	400	732	821	-	-
Loans and advances to customers	627	410	788	569	965	1,004
Total assets	**5,088**	**810**	**1,520**	**1,390**	**965**	**1,004**
Liabilities by contractual maturity						
Deposits by banks	2,370	250	390	40	15	-
Subordinated liabilities	1	346	103	155	242	5
Other liabilities	752	-	-	-	-	-
Total maturing liabilities	3,123	596	493	195	257	5
Customer accounts	5,427	230	70	-	-	-
Total liabilities	**8,550**	**826**	**563**	**195**	**257**	**5**
Maturity gap	**(3,462)**	**(16)**	**957**	**1,195**	**708**	**999**
Cumulative maturity gap	**(3,462)**	**(3,478)**	**(2,521)**	**(1,326)**	**(618)**	**381**

25. Risk management – liquidity risk (continued)

Contractual maturity (continued)

	Group					
2015	0–3 months £m	3–12 months £m	1–3 years £m	3–5 years £m	5–10 years £m	10–20 years £m
Assets by contractual maturity						
Cash and balances at central banks	868	-	-	-	-	-
Loans and advances to banks	6,114	546	1,697	1,127	-	-
Debt securities	387	955	577	-	-	-
Total maturing assets	7,369	1,501	2,274	1,127	-	-
Loans and advances to customers	2,268	1,500	3,701	3,483	5,808	6,446
Total assets	9,637	3,001	5,975	4,610	5,808	6,446
Liabilities by contractual maturity						
Deposits by banks	3,525	926	100	175	-	-
Debt securities in issue	30	84	198	167	315	357
Subordinated liabilities	3	7	310	245	304	74
Other liabilities	687	-	-	-	-	-
Total maturing liabilities	4,245	1,017	608	587	619	431
Customer accounts	16,026	1,928	905	127	-	-
Total liabilities	20,271	2,945	1,513	714	619	431
Maturity gap	(10,634)	56	4,462	3,896	5,189	6,015
Cumulative maturity gap	(10,634)	(10,578)	(6,116)	(2,220)	2,969	8,984

	Bank					
2016	**0–3 months £m**	**3–12 months £m**	**1–3 years £m**	**3–5 years £m**	**5–10 years £m**	**10–20 years £m**
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
Total assets	**5,249**	**810**	**1,554**	**1,420**	**1,342**	**1,004**
Liabilities by contractual maturity						
Deposits by banks	2,404	250	390	40	15	-
Debt securities in issue	-	-	-	-	-	-
Subordinated liabilities	1	346	103	155	242	5
Other liabilities	752	-	-	-	-	-
Total maturing liabilities	3,157	596	493	195	257	5
Customer accounts	5,465	230	70	-	-	-
Total liabilities	**8,622**	**826**	**563**	**195**	**257**	**5**
Maturity gap	**(3,373)**	**(16)**	**991**	**1,225**	**1,085**	**999**
Cumulative maturity gap	**(3,373)**	**(3,389)**	**(2,398)**	**(1,173)**	**(88)**	**911**

25. Risk management – liquidity risk (continued)

Contractual maturity (continued)

	Bank					
2015	0–3 months £m	3–12 months £m	1–3 years £m	3–5 years £m	5–10 years £m	10–20 years £m
Assets by contractual maturity						
Cash and balances at central banks	616	-	-	-	-	-
Loans and advances to banks	3,459	554	1,697	1,127	331	-
Total maturing assets	4,075	554	1,697	1,127	331	-
Loans and advances to customers	711	316	754	711	1,093	1,063
Total assets	4,786	870	2,451	1,838	1,424	1,063
Liabilities by contractual maturity						
Deposits by banks	3,553	175	100	175	-	-
Debt securities in issue	1	-	-	-	-	-
Subordinated liabilities	1	4	302	236	210	6
Other liabilities	687	-	-	-	-	-
Total maturing liabilities	4,242	179	402	411	210	6
Customer accounts	5,505	290	55	10	2	-
Total liabilities	9,747	469	457	421	212	6
Maturity gap	(4,961)	401	1,994	1,417	1,212	1,057
Cumulative maturity gap	(4,961)	(4,560)	(2,566)	(1,149)	63	1,120

The contractual maturity of balance sheet assets and liabilities reflects 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 Group 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.

Other contractual cash obligations

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

	Group					
2015	0–3 months £m	3–12 months £m	1–3 years £m	3–5 years £m	5–10 years £m	10–20 years £m
Operating leases	5	12	27	15	17	10
Contractual obligations to purchase goods or services	-	2	5	5	-	-
	5	14	32	20	17	10

25. Risk management - liquidity risk (continued)

Other contractual cash obligations (continued)

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

	Bank					
2015	0–3 months £m	3–12 months £m	1–3 years £m	3–5 years £m	5–10 years £m	10–20 years £m
Operating leases	1	1	1	1	1	1
Contractual obligations to purchase goods or services	-	1	2	2	-	-
	1	2	3	3	1	1

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 Group; 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. For example, if a structured note is automatically prepaid when an equity index exceeds a certain level, the cash outflow will be included in the less than three months period whatever the level of the index at the year end. The settlement date of debt securities in issue issued by certain securitisation vehicles consolidated by the Group depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date. As the repayment of assets and liabilities are linked, the repayment of assets in securitisations are shown on the earliest date that the asset can be prepaid as this is the basis used for liabilities.

The principal amounts of financial assets and liabilities that are repayable after 20 years or where the counterparty has no right to repayment of the principal are excluded from the table as are interest payments after 20 years.

Conduct and Regulatory risk

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

Sources of risk

Conduct and regulatory risk exists across all stages of the Group's relationships with its customers, from the development of its business strategies, through governance arrangements, to post-sales processes. The activities through which conduct risk may arise are diverse and include product design, marketing and sales, complaint handling, staff training, and handling of confidential Inside Information. Conduct risk also exists if the Group does not take effective action to prevent fraud, bribery and money laundering. Regulatory risk arises from the regulatory, business or operating environment and from the Group's response to it.

Governance

Conduct & Regulatory Affairs ("C&RA") is responsible for defining appropriate standards of conduct and driving adherence to them, designing the framework for managing conduct and regulatory risk, and overseeing remediation activity. The Board and its senior committees receive updates on conduct risk exposures and action plans through regular reporting.

25. Risk management (continued)

Conduct and Regulatory risk (continued)

Controls and assurance
Risk assessments are used to identify material conduct risks and implement key controls across all business areas. The risk assessment process is designed to confirm that risks are effectively managed and prioritised, as well as ensure controls are tested. Scenario analysis is used to assess the impact of extreme but plausible conduct risks including financial crime.

Risk appetite
The conduct risk appetite framework has now been embedded and the Conduct Performance Assessment, which forms part of it, facilitates a consistent approach across the Bank for assessing conduct and regulatory risk. Risk Appetite Statements articulate the levels of risk which must not be exceeded. Where areas are operating outside of appetite, the problems are addressed through agreed risk mitigation plans.

Risk monitoring and measurement
C&RA reports on the most material conduct matters including conduct risk exposures and action plans to the appropriate committees, including the Board, the Group Audit Committee and Board Risk Committee.

Reputational risk

Reputational risk is the risk of brand damage and/or financial loss due to a failure to meet stakeholders' expectations of the Group's conduct and performance. Stakeholders include customers, investors, rating agencies, employees, suppliers, government, politicians, regulators, special interest groups, consumer groups, media and the general public. Brand damage can be detrimental to the business in a number of ways, including an inability to build or sustain business relationships, low staff morale or reduced access to funding sources.

The Group has put the focus on serving customers well at the heart of its strategic objectives that, combined with a safe and sound Group, will build a culture and reputation in line with our stakeholder expectations. There are still legacy issues to work through, but dealing with them in an open and direct manner is a necessary part of the ability to move forward.

Risk management and mitigation

The Board has ultimate responsibility for managing the Group's reputation, though all parts of the Group have responsibility for any reputational impact arising from their operations. The Board's oversight of reputational risk is reinforced by an RBS-wide Reputational Risk policy framework comprising reputational risk committees in franchises designed to opine on cases and issues that present a heightened reputational risk. These are supported by a senior RBS-wide Reputational Risk Forum which opines on cases that represent a material reputational risk to the whole organisation. The framework has improved the identification, assessment and management of customers and issues that present a reputational risk, resulting in a greater awareness and focus on the importance of managing this risk. Reputational risk is further mitigated through ongoing training to ensure early identification, assessment and escalation of material issues.

Operational risk

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

The Group aims to drive the design, development, delivery and awareness of an integrated framework for the management of operational risk. The aim is to ensure the risks facing the Group are managed proactively and comprehensively in a manner that shapes and supports the effective delivery of the Group's strategy. Strategies to manage operational risk include avoidance, transfer, acceptance and mitigation by controls.

The Group's policy framework provides the direction for delivering effective operational risk management and ensures the consistent identification, assessment, management, monitoring and reporting of operational risk across the Group.

Operational risk appetite, policy and frameworks are tabled regularly at the Executive Risk Committee to satisfy oversight responsibilities and, as appropriate, to other senior committees.

25. Risk management (continued)

Pension risk

Pension risk is the risk to the Group arising from its contractual or other liabilities to, or with respect to, its pension schemes, whether established for its employees or for those of a related company.

The Group is exposed to risk from its defined benefit pension schemes to the extent that the assets of the schemes 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 Group's pension schemes is separate from Group management. The Group is exposed to the risk that the market value of the schemes' 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 Group could be obliged, or may choose, to make additional contributions to the schemes or be required to hold additional capital to mitigate such risk.

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

Risk appetite and investment policy are agreed by the trustees with quantitative and qualitative input from the scheme actuaries and investment advisers. The trustees also consult with the Group to obtain its view on the appropriate level of risk within the pension funds. The Group independently monitors risk within its pension funds as part of the Internal Capital Adequacy Assessment Process.

The trustee board is solely responsible for the investment of the schemes' assets which are held separately from the assets of the Group. The Group and the trustee board must agree on the investment principles and the funding plan. Investment Review Committees are in place for each of the schemes, 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.

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.

26. Memorandum items

Contingent liabilities and commitments

The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December 2016. Although the Group is exposed to credit risk in the event of non-performance of the obligations undertaken by customers, the amounts shown do not, and are not intended to, provide any indication of the Group's expectation of future losses.

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Contingent liabilities:				
Guarantees and assets pledged as collateral security	**22**	133	**22**	26
Other contingent liabilities	**52**	203	**52**	43
	74	336	**74**	69
Commitments:				
Documentary credits and other short-term trade related transactions	**2**	4	**2**	1
Commitments to lend:				
- less than one year	**694**	1,469	**694**	687
- one year and over	**264**	1,637	**264**	1,270
Other commitments	**8**	73	**8**	6
	968	3,183	**968**	1,964

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

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

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

Commitments
Commitments to lend - under a loan commitment the Group agrees to make funds available to a customer in the future. Loan commitments, which are usually for a specified term may be unconditionally cancellable or may persist, provided all conditions in the loan facility are satisfied or waived. Commitments to lend include commercial standby facilities and credit lines, liquidity facilities to commercial paper conduits and unutilised overdraft facilities.

Other commitments - these include documentary credits, which are commercial letters of credit providing for payment by the Group to a named beneficiary against presentation of specified documents, forward asset purchases, forward deposits placed and undrawn note issuance and revolving underwriting facilities, documentary credits and other short-term trade related transactions.

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

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Property, plant and equipment				
Other capital expenditure	**-**	1	**-**	1
Contracts to purchase goods or services	**3**	12	**3**	4
	3	13	**3**	5

26. Memorandum items (continued)

Litigation and investigations

The Group is involved in litigation, investigations and reviews in the United Kingdom and the Republic of Ireland. Other than as set out below, the litigation involves claims by and against Group companies which arise in the ordinary course of business. No material adverse effect on the net assets of the Group is expected to arise from the ultimate resolution of these claims. The material litigation, investigations and reviews involving the Group are described below. These matters could, individually or in the aggregate, have a material adverse effect on the Group's consolidated net assets, operating results or cash flows in any particular period.

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's treatment of SMEs.

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

Separately, in November 2013, RBS instructed the law firm Clifford Chance to conduct an independent review of the principal allegation made in the Tomlinson Report: RBS 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.

A separate independent review of the principal allegation, led by Mason Hayes & Curran, Solicitors, was conducted in the Republic of Ireland. The report was published in December 2014 and found no evidence to support the principal allegation.

The Skilled Person review 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 and Mason, Hayes & Curran which are referred to above. The Skilled Person delivered the draft findings from its review to the FCA in March 2016. 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.

On 8 November 2016, the FCA published an update on its review. In response, RBS announced steps that will impact SME customers in the UK and the Republic of Ireland that were in GRG between 2008 and 2013. These steps are (i) an automatic refund of certain complex fees; and (ii) a new complaints process, overseen by an Independent Third Party. These steps have been developed with the involvement of the FCA which agreed that they are appropriate for RBS to take.

The Group estimates the costs associated with the new complaints review process and the automatic refund of complex fees to be approximately £15m (continuing operations: £6m, disposal group: £9m), which has been recognised as a provision at 31 December 2016. This includes operational costs together with the cost of refunded complex fees and the additional estimated redress costs arising from the new complaints process.

The FCA has announced that its review will continue. RBS and the Group continue to cooperate fully with the review.

CBI tracker mortgage review

The CBI has written to Irish banks requiring lenders to conduct a complete review of their mortgage loan books (including redeemed or sold loans as required) to assess compliance with both contractual and regulatory requirements relating to tracker mortgages and in situations where customer detriment is identified from the review, provide appropriate redress and compensation in order to ensure fair outcomes for customers. The request for a review was received by UBIDAC in a formal letter from the CBI on 22 December 2015. The review requires a detailed plan to be submitted followed by the completion of monthly data templates. In addition UBIDAC is required to submit a final report that details the methodology used in conducting the review and includes assurance and sign off by an independent party on all aspects of the work carried out. The report must detail any findings on customer detriment and the proposals in respect of redress and compensation where relevant. UBIDAC has booked a provision of £168m during the year based on the expected costs incurred in carrying out the review.

Separately, on 15 April 2016, the CBI notified UBIDAC that it was also commencing an investigation under its Administrative Sanctions Procedure into suspected breaches of the Consumer Protection Code 2006 during the period 4 August 2006 to 30 June 2008 in relation to certain customers who switched from tracker mortgages to fixed rate mortgages.

26. Memorandum items (continued)

Litigation and investigations (continued)

Anti-money laundering ("AML") remediation

UBIDAC was engaged with the CBI in relation to a long-running AML remediation project. A settlement meeting was held with the CBI and a fine of £2.7m has been paid in November 2016.

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, Heritable Bank and London Scottish defaults through a combination of recoveries and levies. On 14 January 2016, FSCS received £236m as a final distribution for Icesave payout. FSCS used £165m of these proceeds to make a third interim payment relating to resolution costs for Dunfermline Building Society. The total Dunfermline liability is expected to be capped at £578 million (less interest on interim payments), but 3 interim payments have now been made to HM Treasury totalling £500 million. The final settlement date is still uncertain. The latest estimate of the final bill for Dunfermline is £46m, and is currently expected to be paid from cash balances and other recoveries. This would mean that no further levy would be raised for Dunfermline costs.

The only loan outstanding is for Bradford & Bingley (B&B). The interest forecast on the loan for the 2016/17 year currently stands at £353 million (2015/16: £337m). There total capital element levied on the industry in 2015/16 scheme was £352million. There is nothing expected in 2016/17 for capital repayments. HM treasury are exploring sales of the 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 Group has accrued £1.03m for its share of estimated FSCS levies for the 2016/17 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.

27. Net cash flow from operating activities

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Net cash flows used in trading activities	**(1,754)**	(7,295)	**(377)**	(1,589)
Decrease in loans and advances to banks and customers	**1,655**	10,926	**1,790**	1,729
Decrease in debt securities	**22**	96	**-**	1
Decrease/(increase) in other assets	**19**	(25)	**11**	(13)
(Increase)/decrease in derivative assets	**(226)**	30	**(4)**	2
Changes in operating assets	**1,470**	11,027	**1,797**	1,719
Increase/(decrease) in deposits by banks and customers	**2,493**	(3,598)	**(999)**	(274)
Increase/(decrease) in other liabilities	**4**	(53)	**51**	(12)
Increase/(decrease) in derivative liabilities	**284**	(132)	**-**	(13)
Changes in operating liabilities	**2,781**	(3,783)	**(948)**	(299)
Total taxes paid	**(8)**	(78)	**(4)**	(66)
Net cash flows from/(used in) operating activities	**2,489**	(129)	**468**	(235)

28. Interest received and paid

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Interest received	**698**	688	**178**	197
Interest paid	**(134)**	(209)	**(49)**	(61)
	564	479	**129**	136

29. Analysis of changes in financing during the year

	Group					
	Share capital and share premium		Subordinated liabilities		Debt securities In issue	
	2016	2015	**2016**	2015	**2016**	2015
	£m	£m	**£m**	£m	**£m**	£m
At 1 January	**2,412**	2,412	**960**	1,031	**1,473**	1,707
Net cash flows from financing	**-**	-	**-**	(20)	**(538)**	(127)
Currency translation and other adjustments	**-**	-	**141**	(51)	**244**	(107)
Capital reduction	**(1,500)**	-	**-**	-	**-**	-
At 31 December	**912**	2,412	**1,101**	960	**1,179**	1,473

	Bank					
	Share capital and share premium		Subordinated liabilities		Debt securities In issue	
	2016	2015	**2016**	2015	**2016**	2015
	£m	£m	**£m**	£m	**£m**	£m
At 1 January	**2,412**	2,412	**820**	883	**1**	10
Net cash flows from financing	**-**	-	**-**	(20)	**(1)**	(9)
Currency translation and other adjustments	**-**	-	**119**	(43)	**-**	-
Capital reduction	**(1,500)**	-	**-**	-		
At 31 December	**912**	2,412	**939**	820	**-**	1

30. Analysis of cash and cash equivalents

	Group		Bank	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
At 1 January				
Cash	**1,209**	1,305	**618**	648
Cash equivalents	**5,788**	5,892	**3,278**	3,505
	6,997	7,197	**3,896**	4,153
Net cash inflow/(outflow)	**842**	(16)	**458**	(235)
Effect of exchange rate changes on cash and cash equivalents	**794**	(184)	**57**	(22)
At 31 December	**8,633**	6,997	**4,411**	3,896
Comprising:				
Cash and balances at central banks	**1,012**	868	**1,012**	616
Debt securities	**-**	129	**-**	-
Loans and advances to banks	**3,399**	6,000	**3,399**	3,280
Assets in disposal group	**4,222**	**-**	**-**	**-**

31. Divisional analysis

On 1 January 2017, the Group sold UBIH and its subsidiaries comprising the Group's Republic of Ireland operations to NatWest Holdings Limited. Accordingly UBIH has been classified as a disposal group at 31 December 2016 and presented as discontinued operations. Consequently, the continuing Group now operates entirely in the UK and is managed by class of business and reports on a divisional 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 with an additional remit for private customers.

Other is central functions comprising Group and corporate functions such as treasury, problem debt management, finance, risk, legal and human resources which support the PBB and CPB divisions. In 2015, other also comprised RBS Capital Resolution.

Divisional information by class of business is set out below:

Class of business

	Total income						
	Net interest income	**Non-interest income**	**Total**	**Operating expenses before depreciation**	**Depreciation and amortisation**	**Impairment gain**	**Operating profit/(loss) before tax**
2016	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
PBB	97	43	140	(41)	-	1	100
CPB	33	3	36	(16)	-	26	46
Other	-	-	-	(131)	(3)	-	(134)
Total	**130**	**46**	**176**	**(188)**	**(3)**	**27**	**12**

Class of business

	Total income						
	Net interest income	Non-interest income	Total	Operating expenses before depreciation	Depreciation and amortisation	Impairment gain/(loss)	Operating profit/(loss) before tax
2015	£m	£m	£m	£m	£m	£m	£m
PBB	111	33	144	(62)	-	(9)	73
CPB	38	13	51	(21)	-	10	40
Other	(7)	(19)	(26)	(105)	(4)	54	(81)
Total	142	27	169	(188)	(4)	55	32

31. Divisional analysis (continued)

Class of business	**2016**		2015	
	Assets	**Liabilities**	Assets	Liabilities
	£m	**£m**	£m	£m
PBB	**3,714**	**4,108**	3,555	3,786
CPB	**1,247**	**1,647**	1,396	2,087
Other	**5,216**	**4,783**	6,260	4,984
Held for Disposal	**26,297**	**20,072**	22,779	17,024
Total	**36,474**	**30,610**	33,990	27,881

32. Transactions with directors

At 31 December 2016, the amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions in the Group, as defined in UK legislation, were £416,645 (2015: £392,555) in respect of loans to any persons who were directors at any time during the financial period.

33. Related parties

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

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 Secretariat, 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 has as its parent company National Westminster Bank Plc, a company incorporated in Great Britain. Copies of the accounts for this subgroup can be obtained from Corporate Governance and Secretariat, 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 The Royal Bank of Scotland Group plc. 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 Group.

Related undertakings

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

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

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

33. Related parties (continued)

The following are the active related undertakings incorporated in the Republic of Ireland which are 100% owned by the Group (except where indicated) and fully consolidated for accounting purposes. The registered office for all of the below undertakings is Ulster Bank Group Centre, Georges Quay, Dublin 2, DO2 VR98.

- Easycash (Ireland) Limited
- First Active Holdings Limited
- First Active Insurances Services Limited
- First Active Investments No. 4 Limited
- First Active Limited (formerly First Active plc)
- First Active Treasury Limited (formerly First Active Treasury plc)
- Hume Street Nominees Limited
- Norgay Property Limited
- The RBS Group Ireland Retirement Savings Trustee Limited
- Ulster Bank (Ireland) Holdings Unlimited Company (89.52% owned)
- Ulster Bank Commercial Services Limited (90.91% owned)
- Ulster Bank Dublin Trust Company Unlimited Company
- Ulster Bank Holdings (ROI) Limited
- Ulster Bank Ireland Designated Activity Company
- Ulster Bank Pension Trustees (RI) Limited
- Ulster Bank Wealth Unlimited Company
- Walter Property Limited
- West Register (Republic of Ireland) Property Limited

The following are the active related undertakings incorporated in the Republic of Ireland where the Group ownership is less than 100% and fully consolidated for accounting purposes. The registered office for all of the below undertakings is 70 Sir John Rogerson's Quay, Dublin 2, DO2 R296.

- Qulpic Limited
- Zrko Limited

The following are the related undertakings incorporated in the Republic of Ireland that are not active. The registered office for all of the below undertakings is 24-26 City Quay, Dublin 2, DO2 NY19.

- First Active Investments No. 3 Limited
- First Active Nominees Limited
- Meritvale Limited
- Ulster Bank Group Treasury Limited
- Ulster Bank Investment Funds Limited
- Ulster International Finance Limited
- UB SIG (ROI) Limited

The Drive4Growth Company Limited is an active related undertaking incorporated in the Republic of Ireland where the Group ownership is less than 100% and not consolidated for accounting purposes. The registered office is Unit 6, Riverside Grove, Riverstick, Co. Cork, P43 W221.

(a) Directors and key management

The aggregate transactions between the Group 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	-	1	1	67,984
Balances outstanding at the end of the year				
Loans:				
- at a commercial rate	2	9	6	1,470,540
- at a preferential rate	-	4	-	353,229
Customer accounts:				
- Savings	4	12	30	3,384,180

33. Related parties (continued)

(b) Related party transactions

	Group		Bank	
	2016	2015	**2016**	2015
Assets	**£m**	£m	**£m**	£m
Loans and advances:				
Parent companies	**5,356**	7,132	**5,888**	6,737
Key management	**2**	1	**-**	-
Other related parties, including fellow subsidiaries	**1**	25	**74**	96
	5,359	7,158	**5,962**	6,833
Derivatives:				
Parent companies	**-**	531	**5**	2
Assets held for disposal:				
Parent companies	**2,260**	-	**-**	-
Other related parties, including fellow subsidiaries	**11**	-	**-**	-
	2,271	-	**-**	-
Total assets	**7,630**	7,689	**5,967**	6,835
Liabilities				
Deposits:				
Parent companies	**3,049**	3,998	**3,083**	3,982
Key management	**3**	2	**1**	1
Other related parties, including fellow subsidiaries	**8**	61	**46**	46
	3,060	4,061	**3,130**	4,029
Subordinated loans:				
Parent companies	**939**	893	**939**	820
Derivatives:				
Parent companies	**-**	410	**34**	34
Liabilities held for disposal:				
Parent companies	**754**	-	**-**	-
Other related parties, including fellow subsidiaries	**1**	-	**-**	-
	755	-	**-**	-
Total liabilities	**4,754**	5,364	**4,103**	4,883

(c) Compensation of key management

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

	Group	
	2016	2015
	£	£
Short term benefits	**3,593,694**	4,397,786
Termination benefit	**236,452**	300,000
Long term benefits	**508,830**	599,987
Share-based benefits	**202,808**	492,077
Post employment benefits	**123,797**	96,231
	4,665,581	5,886,081

34. Post balance sheet events

On 1 January 2017, the Bank sold Ulster Bank (Ireland) Holdings Unlimited Company (“UBIH”) and its subsidiaries, comprising the Group’s Republic of Ireland operations, to NatWest Holdings Limited, a fellow subsidiary of RBS Group for consideration of £4.9bn. On completion of the transaction the Group realised a consolidated loss on disposal of £0.4bn representing the differential between the consideration received and the net asset value of the legal entities disposed of.

Consequently, UBIH and its subsidiaries are classified as a disposal group in these financial statements at 31 December 2016 and its assets and liabilities presented in aggregate in accordance with IFRS 5.

The directors proposed a dividend of £3.9bn in December 2016 which was paid during January 2017.

35. Capital resources - unaudited

The Group operates in both the United Kingdom and the Republic of Ireland and is subject to regulatory oversight in both jurisdictions. The Bank is regulated by the PRA and the FCA in the United Kingdom and UBIDAC is regulated by the CBI and the ECB in the Republic of Ireland under the Single Supervisory Mechanism. Capital resources disclosures are provided separately in respect of each licensed institution.

Ulster Bank Limited
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 2016 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).

	Bank	
	Unaudited [1]	Unaudited [1]
	2016	2015
	£m	£m
Shareholders' equity (excluding non-controlling interests)		
Shareholders' equity	**4,976**	6,620
Preference shares - equity	**(659)**	(659)
	4,317	5,961
Regulatory adjustments and deductions		
Defined benefit pension fund adjustment	**-**	(16)
Deferred tax assets	**(14)**	(31)
Instruments of financial sector entities where the institution has a significant investment	**(2,989)**	(3,269)
Excess of expected losses over provisions	**(14)**	(13)
	(3,017)	(3,329)
Core 1 tier capital	**1,300**	2,632
Other tier 1 capital		
Qualifying Tier 1 capital and related share premium subject to phase out from AT1 capital	**576**	659
Tier 1 deductions		
Instruments of financial sector entities where the institution has a significant investment	**(62)**	(68)
Total tier 1 capital	**1,814**	3,223
Qualifying tier 2 capital		
Qualifying items and related share premium	**583**	607
	583	607
Tier 2 deductions		
Instruments of financial sector entities where the institution has a significant investment	**(309)**	(227)
Other adjustments for regulatory purposes	**62**	68
	(247)	(159)
Total tier 2 capital	**336**	448
Total regulatory capital	**2,150**	3,671
Key capital ratios	**%**	%
CET1	**13.1**	17.5
Tier 1	**18.2**	21.5
Total capital	**21.6**	24.5
Risk weighted assets by risk	**£m**	£m
Credit risk	**9,633**	14,661
Counterparty risk	**5**	2
Market risk	**7**	2
Operational risk	**298**	343
Total risk weighted assets	**9,943**	15,008

[1] The capital metrics included in the above table have not been audited for the financial years ended 31 December 2016 and 31 December 2015.

35. Capital resources - unaudited (continued)

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 RBS Internal Capital Adequacy Assessment Process ("ICAAP"), which is subject to supervisory review and evaluation.

UBIDAC

The Capital Requirements Regulation ("CRR") and Capital Requirements Directive (CRD IV - which was enacted in Irish law by S.I. No. 158 of 2014 and S.I. No. 159 of 2014) requirements are being implemented on a phased basis from 1 January 2014, with full implementation from 1 January 2019. The capital resources disclosures for 2016 below reflect the transition arrangements of the legislation together with the CBI guidance (Implementation of Competent Authority Discretions and Options in CRD IV and CRR) on the application of transitional rules in Ireland.

	UBIDAC	
	Unaudited[(1)]	Unaudited[(1)]
	2016	2015
	€m	€m
Shareholders' equity (excluding non-controlling interests)	**6,487**	7,835
Non-controlling interests		
Non-controlling interests per balance sheet	**1**	1
Adjustments to non-controlling interests for regulatory purposes	**(1)**	(1)
	-	-
Regulatory adjustments and deductions		
Own credit	**(3)**	-
Defined benefit pension fund adjustment	**71**	193
Deferred tax assets	**(59)**	(28)
Qualifying deductions exceeding AT1 capital	**(39)**	(9)
Other adjustments for regulatory purposes	**(79)**	(230)
Excess of expected losses over provisions	**(116)**	(12)
	(225)	(86)
Core tier 1 capital	**6,262**	7,749
Deductions		
Excess of expected losses over impairment provisions	**(39)**	(9)
Qualifying deductions exceeding AT1 capital	**39**	9
Total tier 1 capital	**6,262**	7,749
Qualifying tier 2 capital		
Qualifying items and related share premium	**649**	670
Tier 2 deductions		
Excess of expected losses over impairment provisions	**(39)**	(9)
Total tier 2 capital	**610**	661
Total regulatory capital	**6,872**	8,410
Key capital ratios	**%**	%
Tier 1	**29.8**	29.6
Total capital	**32.7**	32.1

(1) For note relating to this table refer to page 107.

35. Capital resources (unaudited) (continued)

	UBIDAC	
	Unaudited[1]	Unaudited[1]
	2016	2015
Risk weighted assets by risk	**€m**	€m
Credit risk	**18,987**	24,143
Counterparty risk	**589**	470
Market risk	**14**	10
Operational risk	**1,419**	1,563
Total risk weighted assets	**21,009**	26,186

[1]The capital metrics included in the above table have not been audited for the financial years ended 31 December 2016 and 31 December 2015.

In the management of capital resources, UBIDAC is governed by the Ulster Bank Ireland Group and RBS policies which are to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business.

In carrying out these policies UBIDAC has regard to and has complied with the capital supervisory requirements of the ECB and CBI throughout the financial year.

ULSTER BANK LIMITED

DIRECTORS AND EXECUTIVES

Chairman

Christopher Campbell (58)

Mr Campbell joined RBS Group in August 2005 as Deputy General Counsel and Director, Group Legal and became Group General Counsel in May 2010. Prior to joining RBS Group, he was a partner for 18 years in Scotland's largest law firm, Dundas & Wilson, and was Managing Partner from 1996 until he joined RBS Group in 2005. In his role as Group General Counsel, Mr Campbell had overall responsibility for advising the RBS Group Board and Executive Committee and for the provision of legal support to all of RBS's businesses globally. Mr Campbell retired as Group Counsel as of 31 December 2014. Mr Campbell was appointed as Chairman of Ulster Bank Limited in October 2015 and is also a Non Executive Director with RBS N.V. and Scottish Equitable Policyholders Trust Limited.

EXECUTIVE DIRECTORS

Chief Executive Officer

Leslie Matheson (57)

Mr Matheson was appointed CEO Personal and Business Banking in February 2014. He joined RBS in 2010 as Managing Director of Products and added responsibility for Marketing in 2011. Prior to joining RBS, Les served as Group Executive at St George Bank, part of the Westpac Group. Before becoming Head of the Retail Bank at St George, Mr Matheson held a series of senior roles at Citibank where he spent 11 years. These included Head of Wealth Management and Marketing for Asia Pacific, General Manager for the Retail Business in Japan, CEO for Citibank Australia and finally Group CEO of Consumer Business for Central Asia. Mr Matheson began his career at Procter & Gamble following the completion of his Bachelor of Commerce at the University of Edinburgh in 1982 where he achieved Honours in Marketing. Mr Matheson is a former Deputy Chairman of the Australian Bankers' Association, a former Board member of Visa Europe and past member of the Edinburgh University Court.

Chief Financial Officer

Michael Larkin (47)

Mr Larkin joined RBS from GE Capital in 2001. He initially joined the Group Financial Planning & Analysis team focusing on reviewing the performance of Ulster Bank and Wealth Management. Over the years he looked after the majority of the divisions in the Group, then in 2007 moved to Retail to be the FD for the mortgage business. His role expanded taking on additional products and in 2010 was promoted to Head of Products for Retail Finance. He began his current role as Finance Director for Personal & Business Banking in April 2014.

NON-EXECUTIVE DIRECTORS

Ellvena Graham (53)

Ms Graham was appointed as a Non-Executive Director to the Board of Ulster Bank in February 2016. Ms Graham is also the Chairman of Electricity Supply Board (ESB), one of the major state-owned utilities in Ireland and also Chairman of the Economic Advisory Group (EAG) in Northern Ireland and the Chairman of Belfast Waterfront & Ulster Hall Ltd. Ms Graham has over 30 years experience in Banking, most recently at Executive Management level within Ulster Bank where she was Head of Ulster Bank in Northern Ireland & MD of SME Banking across the island of Ireland. Ms Graham has global experience within the wider RBS Group, having managed large scale Operations in EMEA for Royal Bank of Scotland. Ms Graham was a Board member of Barretstown, a charity helping children with serious illnesses, up until June 2012.

Des O'Shea (60)

Mr O'Shea was appointed to the Board of Ulster Bank Limited and Ulster Bank Ireland Designated Activity Company in November 2012. He is Chair of the Audit Committee and a member of the Risk and Nominations Committees in both banks. He is also a Non Executive Director of Byblos Bank SAL and Pepper Australia Pty Limited. Mr O'Shea has over 35 years experience in financial services and has worked in a number of global institutions. In November 2011 he retired from GE Capital after 14 years having held a variety of senior roles.

Rosemary Quinlan (47)

Ms Quinlan is an Independent Non-Executive director and has been a Board director since 2006. She has over 26 years experience in Financial Services and has worked with a number of global banks in the UK, the USA, the Netherlands and Ireland. Ms. Quinlan has been a member of the Board of Ulster Bank Limited since 2013 and is the Chair of the Risk Committee and a member of the Audit Committee. Rosemary has been a member of the Board of Ulster Bank Ireland DAC since 2013 and is the Chair of the Risk Committee, Chair of the Remuneration and Performance Committee and a member of the Audit Committee. Ms Quinlan sits on the Boards of RSA Insurance Ireland DAC, Prudential International Assurance Plc and Dodge & Cox Funds Worldwide Plc. Ms Quinlan is a Certified Bank Director, has completed the Chartered Director Programme in Ireland and is a member of the Institute of Directors and the Institute of Banking in Ireland.

ULSTER BANK LIMITED

AUDIT COMMITTEE
Des O'Shea, Chairman
Rosemary Quinlan

BOARD RISK COMMITTEE
Rosemary Quinlan, Chairman
Des O'Shea
Ellvena Graham

GROUP NOMINATIONS COMMITTEE
Christopher Campbell, Chairman
Any two other non-executive directors

DIVISIONAL HEADS

L Matheson	Chief Executive Officer
M Larkin	Chief Finance Officer
G Bulkeley	Chief Risk Officer
R Donnan	Regional Managing Director Corporate & Commercial NI and Head of Northern Ireland
D Lowe	Chief Administrative Officer
L Burns	Head of Human Resources

COMPANY SECRETARY
S Anderson

HEAD OFFICE
11-16 Donegall Square East, Belfast, BT1 5UB