SEI INVESTMENTS CO
Form 4
April 13, 2005

FORM 4

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL
OMB Number: 3235-0287
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(Print or Type Responses)

1. Name and Address of Reporting Person *
LIEB RICHARD
(Last) (First) (Middle)
ONE FREEDOM VALLEY DRIVE
(Street)
OAKS, PA 19456
(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
SEI INVESTMENTS CO [SEIC]

3. Date of Earliest Transaction (Month/Day/Year)
04/12/2005

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer
(Check all applicable)
__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	04/11/2005		G	V	3,000	D	$ 0 (1)	458,000	D	
Common Stock								75,000	I	By the Richard B. Lieb Two Year Annuity Trust (2)
Common Stock								45,000	I	By the Richard B. Lieb Four Year

Annuity Trust (2)

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
LIEB RICHARD ONE FREEDOM VALLEY DRIVE OAKS, PA 19456	X			

Signatures

Jill B. Geisenheimer (Attorney-in-fact)	04/13/2005
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Not applicable - Gift Transfer

(2) The Richard B. Lieb Two Year Annuity Trust and The Richard B. Lieb Four Year Annuity Trust are Grantor Retained Annuity Trusts (GRATs).

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.

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Explanation of Responses:

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Explanation of Responses:

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Explanation of Responses:

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Explanation of Responses:

264

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86

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323

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4

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354

Explanation of Responses:

2015

UK PBB

8

1

9

Explanation of Responses:

18

123

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Explanation of Responses:

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Explanation of Responses:

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Explanation of Responses:

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Explanation of Responses:

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Explanation of Responses:

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Explanation of Responses:

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Total

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14

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38

254

(86)

(130)

38

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92

130

308

340

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346

Explanation of Responses:

Notes:

(1) NatWest Markets

(2) Capital Resolution

Key points

- The net customer funding surplus has decreased by £7 billion during 2016 to £31 billion, driven by loan growth in addition to deposit rundown in Capital Resolution, partially offset by underlying deposit growth.

- Customer deposits and customer loans are broadly matched from a behavioural perspective.

- The net funding surplus in 2016 is concentrated in the longer dated buckets, reflecting the stable characteristics of customer deposits and lending that is behaviourally shorter dated.

*unaudited

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Business review Capital and risk management

Liquidity and funding risk continued

Contractual maturity

The following table shows the residual maturity of financial instruments, based on contractual date of maturity. Held-for-trading (HFT) assets and liabilities have been excluded from the maturity analysis in view of their short-term nature and are shown in total in the table below. Hedging derivatives are included within the relevant maturity bands.

	Other than held-for-trading										
2016	Less than 1 month	1-3 months	3-6 months	6 months -1 year	Subtotal	1-3 years	3-5 years	More than 5 years	Total excluding HFT	HFT	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	74,250	—	—	—	74,250	—	—	—	74,250	—	74,250
Bank reverse repos	1,543	197	—	—	1,740	—	—	—	1,740	11,120	12,860
Customer reverse repos	338	1,362	641	—	2,341	—	—	—	2,341	26,586	28,927
Loans to banks	9,521	237	655	38	10,451	46	—	1	10,498	6,780	17,278
Loans to customers	33,832	8,042	9,314	18,876	70,064	52,954	42,690	139,811	305,519	17,504	323,023
Personal	4,341	2,476	3,332	6,513	16,662	20,212	17,050	111,628	165,552	340	165,892
Corporate	25,112	4,859	4,475	7,243	41,689	28,338	24,222	26,148	120,397	3,702	124,099
Financial institutions (excluding banks)	4,379	707	1,507	5,120	11,713	4,404	1,418	2,035	19,570	13,462	33,032
Debt securities	1,911	2,279	3,016	3,138	10,344	10,103	7,356	20,215	48,018	24,504	72,522
Equity shares	—	—	—	—	—	—	—	537	537	166	703
Settlement balances	5,526	—	—	—	5,526	—	—	—	5,526	—	5,526
Derivatives	455	—	—	1,178	1,633	2,319	531	306	4,789	242,192	246,981

Total financial assets											
excluding disposal groups	127,376	12,117	13,626	23,230	176,349	65,422	50,577	160,870	453,218	328,852	782,070
Disposal groups	13	—	—	—	13	—	—	—	13	—	13
Total financial assets	127,389	12,117	13,626	23,230	176,362	65,422	50,577	160,870	453,231	328,852	782,083
Bank repos	917	197	—	—	1,114	—	—	—	1,114	4,125	5,239
Customer repos	3,910	—	—	—	3,910	—	—	—	3,910	23,186	27,096
Deposits by banks	5,632	462	31	2	6,127	1,284	5,000	150	12,561	20,756	33,317
Customer accounts	324,109	5,785	3,665	4,485	338,044	2,846	167	37	341,094	12,778	353,872
Personal	155,417	2,971	1,689	2,881	162,958	1,877		—	—	164,835	—	164,835
Corporate	119,156	1,759	1,493	758	123,166	769	98	34	124,067	2,008	126,075
Financial institutions											
(excluding banks)	49,536	1,055	483	846	51,920	200	69	3	52,192	10,770	62,962
Debt securities in issue	1,061	1,040	2,170	1,987	6,258	5,586	4,808	8,979	25,631	1,614	27,245
Settlement balances	3,645	—	—	—	3,645	—	—	—	3,645	—	3,645
Short positions	—	—	—	—	—	—	—	—	—	22,077	22,077
Derivatives	—	205	405	—	610	1,329	584	1,534	4,057	232,418	236,475
Subordinated liabilities	684	162	115	101	1,062	2,814	483	15,060	19,419	—	19,419
Other liabilities	2,028	—	—	—	2,028	—	—	—	2,028	—	2,028
Total financial liabilities	341,986	7,851	6,386	6,575	362,798	13,859	11,042	25,760	413,459	316,954	730,413

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Business review Capital and risk management

Liquidity and funding risk continued											
	Other than held-for-trading										
2015	Less than 1 month	1-3 months	3-6 months	6 months -1 year	Subtotal	1-3 years	3-5 years	More than 5 years	Total excluding HFT	HFT	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	79,939	—	—	—	79,939	—	—	—	79,939	—	79,939
Bank reverse repos	535	748	—	—	1,283	—	—	—	1,283	11,069	12,352
Customer reverse repos	26	—	—	—	26	—	—	—	26	27,532	27,558
Loans to banks	7,425	217	17	27	7,686	—	21	1	7,708	11,295	19,003
Loans to customers	34,439	8,039	8,501	17,243	68,222	50,822	41,151	130,219	290,414	17,559	307,973
Personal	5,875	2,575	3,277	5,805	17,532	19,113	15,640	99,778	152,063	35	152,098
Corporate	23,976	4,932	4,072	7,699	40,679	26,460	24,046	28,126	119,311	4,644	123,955
Financial institutions (excluding banks)	4,588	532	1,152	3,739	10,011	5,249	1,465	2,315	19,040	12,880	31,920
Debt securities	3,246	2,766	5,662	2,866	14,540	7,199	6,932	17,988	46,659	35,857	82,516
Equity shares	—	—	—	—	—	—	—	725	725	660	1,385
Settlement balances	4,116	—	—	—	4,116	—	—	—	4,116	—	4,116
Derivatives	484	—	—	1,106	1,590	1,571	433	231	3,825	258,719	262,544
Total financial assets	130,210	11,770	14,180	21,242	177,402	59,592	48,537	149,164	434,695	362,691	797,386

Bank repos	609	—	—	—	609	—	—	—	609	9,657	10,266
Customer repos	1,542	—	—	—	1,542	—	—	—	1,542	25,570	27,112
Deposits by banks	6,023	536	30	739	7,328	—	—	265	7,593	20,469	28,062
Customer accounts	315,641	5,101	4,023	4,455	329,220	4,372	427	61	334,080	11,911	345,991
Personal	145,786	3,131	1,826	3,323	154,066	3,199	13	—	157,278	—	157,278
Corporate	126,306	1,314	1,689	830	130,139	786	364	57	131,346	1,503	132,849
Financial institutions											
(excluding banks)	43,549	656	508	302	45,015	387	50	4	45,456	10,408	55,864
Debt securities in issue	442	3,410	1,523	2,727	8,102	5,666	7,513	5,986	27,267	3,883	31,150
Settlement balances	3,397	—	—	—	3,397	—	—	—	3,397	—	3,397
Short positions	—	—	—	—	—	—	—	—	—	20,809	20,809
Derivatives	—	144	291	—	435	605	413	1,150	2,603	252,130	254,733
Subordinated liabilities	4	162	88	69	323	2,801	317	16,406	19,847	—	19,847
Other liabilities	1,886	—	—	—	1,886	—	—	—	1,886	—	1,886
Total financial liabilities	329,544	9,353	5,955	7,990	352,842	13,444	8,670	23,868	398,824	344,429	743,253

Business review Capital and risk management

Liquidity and funding risk continued

Encumbrance

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

RBS categorises its assets into three broad groups; assets that are:

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

Balance sheet encumbrance										
	Encumbered as a result of transactions with counterparties other than central banks				Pre-positioned & encumbered assets held at central banks	Unencumbered assets not pre-positioned with central banks				
2016	Covered bonds & securitisations (1) £bn	Derivatives £bn	Repos & similar (2) £bn	Total (3) £bn	(4) £bn	Readily available (5) £bn	Other available (6) £bn	Cannot be used (7) £bn	Total £bn	Total £bn
Cash and balances at central banks	—	—	4.0	4.0	—	70.2	0.1	—	70.3	74.3

Loans and advances												
- banks	1.2	6.7	0.7	8.6		—	8.1	0.5	0.1	8.7		17.3
- residential mortgages												
- UK	10.1	—	—	10.1		97.9	19.8	9.5	—	29.3		137.3
- Irish	7.1	—	—	7.1		1.5	5.7	—	0.1	5.8		14.4
- US	0.3	—	—	0.3		—	—	—	—	—		0.3
- credit cards	—	—	—	—		—	4.0	0.3	—	4.3		4.3
- personal loans	—	—	—	—		—	6.2	3.3	—	9.5		9.5
- other	0.1	17.0	—	17.1		6.1	5.9	105.6	22.5	134.0		157.2
Reverse repos	—	—	—	—		—	—	—	41.8	41.8		41.8
Debt securities	—	2.8	35.4	38.2		—	33.2	0.8	0.3	34.3		72.5
Equity shares	—	—	0.1	0.1		—	0.3	0.2	0.1	0.6		0.7
Settlement balances	—	—	—	—		—	—	—	5.5	5.5		5.5
Derivatives	—	—	—	—		—	—	—	247.0	247.0		247.0
Intangible assets	—	—	—	—		—	—	—	6.5	6.5		6.5
PP&E	—	—	—	—		—	—	3.1	1.5	4.6		4.6
Deferred tax	—	—	—	—		—	—	—	1.8	1.8		1.8
Other assets	—	—	—	—		—	—	—	3.7	3.7		3.7
	18.8	26.5	40.2	85.5		105.5	153.4	123.4	330.9	607.7		798.7

For the notes to this table refer to the following page.

Liquidity and funding risk continued

2015	Encumbered as a result of transactions with counterparties other than central banks				Pre-positioned & encumbered assets held at central banks	Unencumbered assets not pre-positioned with central banks				
	Covered bonds & securitisation (1) £bn	Derivatives £bn	Repos & similar (2) £bn	Total £bn	(4) £bn	Readily available (5) £bn	Other available (6) £bn	Cannot be used (7) £bn	Total £bn	Total £bn
Cash and balances at central banks	—	—	2.5	2.5	—	77.3	0.1	—	77.4	79.9
Loans and advances										
- banks	1.5	11.0	0.4	12.9	—	4.3	1.3	0.5	6.1	19.0
- residential mortgages										
- UK	15.2	—	—	15.2	81.3	18.6	8.4	—	27.0	123.5
- Irish	7.4	—	—	7.4	1.2	4.0	—	0.1	4.1	12.7
- credit cards	—	—	—	—	—	4.4	0.2	—	4.6	4.6
- personal loans	—	—	—	—	—	6.0	5.1	—	11.1	11.1
- other	0.8	17.2	0.4	18.4	8.3	8.9	98.4	22.1	129.4	156.1
Reverse repos	—	—	—	—	—	—	—	39.9	39.9	39.9
Debt securities	—	2.9	31.9	34.8	—	47.2	0.5	—	47.7	82.5
Equity shares	—	—	—	—	—	0.8	0.2	0.4	1.4	1.4
Settlement balances	—	—	—	—	—	—	—	4.1	4.1	4.1
Derivatives	—	—	—	—	—	—	—	262.5	262.5	262.5
Intangible assets	—	—	—	—	—	—	—	6.5	6.5	6.5
PP&E	—	—	0.3	0.3	—	—	3.1	1.1	4.2	4.5

Deferred tax	—	—	—	—		—	—	—	2.6	2.6		2.6
Other assets	—	—	—	—		—	—	—	4.5	4.5		4.5
	24.9	31.1	35.5	91.5		90.8	171.5	117.3	344.3	633.1		815.4

Notes:

(1) Covered bonds and securitisations include securitisations, conduits and covered bonds.

(2) Repos and other secured deposits, cash, coin and nostro balance held with the Bank of England as collateral against deposits and notes in circulation are included here rather than within those positioned at the central bank as they are part of normal banking operations.

(3) Total assets encumbered as a result of transactions with counterparties other than central banks are those that have been pledged to provide security and are therefore not available to secure funding or to meet other collateral needs.

(4) Assets pre-positioned at the central banks include loans provided as security as part of funding schemes and those encumbered under such schemes.

(5) Readily available for encumbrance: including assets that have been enabled for use with central banks but not pre-positioned; cash and high quality debt securities that form part of RBS's liquidity portfolio and unencumbered debt securities.

(6) Other assets that are capable of being encumbered are those assets on the balance sheet that are available for funding and collateral purposes but are not readily realisable in their current form. These assets include loans that could be prepositioned with central banks but have not been subject to internal and external documentation review and diligence work.

(7) Cannot be used includes:

(a) Derivatives, reverse repurchase agreements and trading related settlement balances.

(b) Non-financial assets such as intangibles, prepayments and deferred tax.

(c) Loans that cannot be pre-positioned with central banks based on criteria set by the central banks, including those relating to date of origination and level of documentation.

(d) Non-recourse invoice financing balances and certain shipping loans whose terms and structure prohibit their use as collateral.

(8) In accordance with market practice, RBS employs securities recognised on the balance sheet, and securities received under reverse repo transactions as collateral for repos. Secured derivative liabilities reflect net positions that are collateralised by balance sheet assets.

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Explanation of Responses:

Business review **Capital and risk management**

Business risk*

Definition and sources of risk

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

Key developments in 2016

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

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

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

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

Business risk is reported, assessed and challenged at every

governance level within the organisation. Each franchise monitors its financial performance relative to plans and reports this on a regular basis to the finance directors of each franchise.

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

RBS continued to reduce its business risk profile by implementing its strategic plan to shift the business mix towards the UK and retail and commercial banking segments, with higher risk activities in NatWest Markets and Capital Resolution curtailed through disposals and run-downs.

RBS also continued with its simplification and cost reduction programmes.

Market conditions have become more volatile following the EU referendum result, and RBS has been closely monitoring and assessing the operating environment and its impact on business risk.

*unaudited

Reputational risk*

Definition and sources of risk

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

Key developments in 2016

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

RBS articulated its appetite for reputational risk through the implementation of a qualitative reputational risk appetite statement and framework. This has improved the identification, assessment and management of customers and issues that present a material reputational risk, resulting in a greater awareness and focus on the importance of this risk and an increase in the number of cases brought to franchise and RBS-wide Reputational Risk fora.

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

The most material threats to RBS's reputation continued to originate from historical and more recent conduct issues. As a result, RBS has been the subject of investigations and reviews by a number of its regulators, some of which have resulted in fines and public censure. Refer to the Litigation, investigations and reviews section of Note 31 on the consolidated accounts on page 459.

*unaudited

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Explanation of Responses:

Conduct and regulatory risk*

Definition

Conduct and regulatory risk is the risk that the behaviour of RBS 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. All the disclosures in this section are unaudited.

Sources of risk

Conduct and regulatory risk exists across all stages of RBS's relationships with its customers, from the development of its business strategies, to post-sales processes. The activities through which conduct risk may arise are varied and include product design, marketing and sales, complaint handling, staff training, and handling of confidential Insider Information. Conduct risk also exists if RBS does not take effective action to prevent fraud, bribery and money laundering. Regulatory risk arises from the regulatory, business or operating environment and from RBS's response to it. As set out in the Litigation, investigations and reviews section in Note 30 on the consolidated accounts, RBS and certain members of staff are party to legal proceedings and are subject to investigation and other regulatory action in the UK, the US and other jurisdictions.

Key regulatory and conduct developments in 2016

RBS continued to remediate historical conduct issues, while also focusing its customer-facing businesses and support functions around the needs of its customers including the delivery of a number of regulatory change programmes. Conduct and litigation costs were £5.9 billion in 2016 compared with £3.6 billion in 2015.

- The remediation of PPI continued, with the FCA due to update on policy during the first quarter of 2017. Provisioning was increased by £601 million principally to cover the potential pushing back of the time bar.

- On 8 November, RBS announced it would be taking two steps in relation to the FCA's S166 review into GRG, firstly to implement a complaints process with independent third-party oversight for all customers in scope and secondly to provide an automatic refund of complex fees paid by in-scope SME customers. The FCA review is ongoing and the final report findings are awaited.

- RBS made a provision for the industry-wide review by the Central Bank of Ireland on the treatment of customers who were sold mortgages with a tracker interest rate or with a tracker interest rate entitlement.

- Following the outcome of the FCA's thematic review on Packaged Bank Accounts, NatWest was required to provide an attestation that it is compliant with FCA rules.

- The application of the revised Markets in Financial Instruments Directive and Regulation (MiFID II/MiFIR) was delayed by a year to January 2018, while UK and EU regulators published several consultations on its implementation.

- The Market Abuse Regime took effect from July 2016.

- The UK's Senior Managers and Certification regime was successfully implemented.

- Work continues on the UK's ring-fencing requirements.

*unaudited

Conduct and regulatory risk* continued

The Conduct Risk Appetite Framework was established in 2015 and continues to be embedded across RBS.

The Conduct Risk Appetite Framework is divided into seven pillars, ensuring that conduct risk exposures are understood and managed in accordance with agreed risk appetite. The Conduct Risk Appetite Framework requires regular and consistent assessment through periodic Conduct Performance Assessment, reporting of risk exposures and the operating effectiveness of controls, across the businesses.

Product profitability and

pricing structures are fair

and transparent

Other activities undertaken to address regulatory risk included:

- Migration to simpler, principle-based policies with accountable executives identified and roles, accountabilities and responsibilities defined;
- Roll-out of RBS-wide policies, processes and strategic systems to identify and manage conflicts of interest better;
- Enhancement of the RBS-wide surveillance programme; and
- Significant investment in anti-money laundering controls, governance and training.

*unaudited

Conduct and regulatory risk* continued

Governance

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

Key elements of the governance structure are set out below:

- The Conduct & Regulatory Affairs (C&RA) Executive Committee considers emerging material risks and issues, and implements Board and Executive Committee risk management policy decisions;

- The Financial Crime Accountable Executive Committee (accountable to the Executive Risk Forum) ensures that the customer businesses and the Services function fulfil strategic objectives by identifying and managing their financial crime risks effectively; and

- The Mandatory Change Advisory Committee, reports to the Bank-Wide Investment Committee, acting as the reception committee for reviewing externally mandated changes that may affect RBS. It also recommends appropriate responses, including change implementation activities. In doing so, it determines which businesses or functions own individual risks; and commissions and reviews impact assessments from customer businesses and functions.

Plans to merge parts of the C&RA function with Risk management were announced in December 2016 to take effect from 1 January 2017. The change is designed to take advantage of synergies across the risk, conduct and regulatory agendas. Regulatory Affairs will move to Corporate Governance & Secretariat, and Remediation and Complaints will move to Services' Chief Operating Office.

Controls and assurance

Under the Policy framework, there are 19 conduct risk policies. Each policy is designed to provide both high-level direction and RBS-wide requirements. The policies ensure RBS meets its regulatory obligations. They also provide the necessary clarity to staff on their conduct obligations.

RBS's Regulatory Affairs department separately oversees regulatory developments, interactions with regulators and regulatory approvals for individuals.

Assurance and monitoring activities are essential to measure the extent to which RBS manages its delivery of specific customer outcomes.

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. The scenarios assess the exposures that could significantly affect RBS's financial performance or reputation and are an important component in the operational risk framework and capital model.

*unaudited

Conduct and regulatory risk* continued

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 RBS for assessing conduct and regulatory risk.

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

Risk monitoring and measurement

The Board and senior RBS committees receive updates on conduct risk exposures and action plans through monthly reporting. The reporting is intended to be focused, forward-looking and action-oriented.

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

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

The Group Audit Committee is provided with a whistleblowing report on a biannual basis. It details cases by internal reporting categories based on the RBS definition of whistleblowing, which is contained within RBS's Speak Up policy.

The policy encompasses both the legislative definition contained within the Public Interest Disclosure Act 1998 and the regulatory definition within FCA and PRA regulations and guidance. It extends these to include conduct or behaviour which does not meet the expected bank standards documented in Our Code. The whistleblowing report identifies underlying trends and highlights the outcomes of investigations.

Each business within RBS has enhanced its use of management information by linking it to the risk appetite statement. This is required to help ensure appropriate customer outcomes are delivered and that the management information is compliant with the Basel Committee on Banking Supervision's principles for effective risk data aggregation and risk reporting.

Risk mitigation

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

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

*unaudited

Operational risk*

Definition

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

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

All the disclosures in this section are unaudited.

Sources of risk

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

Key developments in 2016

During 2016, RBS's operational risk management framework was enhanced with improved links between risk appetite and risk exposures. This underpins an appropriate risk-based approach to operational risk management.

The year also saw a continued focus on the risks arising from the execution of major projects, including the Transformation programme, the restructuring of NatWest Markets (formerly CIB), preparations for the implementation of the Independent Commission on Banking's ring-fencing proposals, the planned divestment of Williams & Glyn, and the impact on RBS's control environment due to cost reduction measures. These are essential to the achievement of RBS's strategic objectives and, accordingly, Operational Risk continued to oversee these, ensuring the associated risks were assessed and understood with mitigating activity in place wherever possible.

There was also a continued strong focus on RBS's enhanced risk and control assessment methodology. This approach enhances understanding of the risk profile for the most critical products and services. As a core aspect of the Controls Transformation Programme, the new approach, building on design in 2015, continued to be rolled out and embedded across the organisation. A significant number of assessments were carried out during 2016 in order to identify and quantify the most material risks to key products and services. Refer to page 278 for further details.

*unaudited

Operational risk* continued

The external fraud threat environment across the industry continued to escalate in 2016, with this trend predicted to continue. RBS has put in place a collective bank-wide response plan to the increased threat. This aligns fraud prevention programmes across the bank with the objective of mitigating the customer and financial impacts of external fraud. The plan successfully delivered key strategic programmes in 2016 that enhanced RBS's fraud prevention and detection capabilities, enabling it to limit the impact of fraudulent activity on its customers. As a result RBS recorded an increase in its fraud detection rates in the second half of 2016. RBS is also supporting an industry-led education initiative in 2017-2018 which will offer advice to help the public protect themselves from preventable financial fraud. The initiative is led by Financial Fraud Action UK Ltd and is being delivered in conjunction with the Home Office, law enforcement and other banks.

The information and cyber security risk facing RBS continues to change in line with the constantly evolving threat environment in which it operates. Internal security improvement programmes continue to progress RBS-wide, developing new, and strengthening existing controls to protect RBS and its customers. RBS continuously develops and utilises pro-active threat management and intelligence processes to understand, manage and mitigate credible threats.

Throughout 2016 RBS has decommissioned a number of internet-facing websites thus reducing the attack surface visible to external parties such as hackers and fraudsters. Improvements have also been made to access controls for RBS systems. Internal training programmes continue to ensure all employees are fully aware of the constant threats facing RBS and remain vigilant to unauthorised attempts by internal or external parties to access systems and data.

Risk governance

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

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

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

*unaudited

Operational risk* continued

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

Controls and assurance

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

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

The CEC process helps to ensure compliance with the RBS Policy Framework, Sarbanes-Oxley 404 requirements concerning internal control over financial reporting (as referenced in the Compliance report section on page 150), and certain requirements of the UK Corporate Governance Code.

Risk appetite

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

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

business risk committees, the OREC, ERF and BRC.

The aggregation of operational risk appetite drives measurement of how effectively RBS is managing its material risks across the core components of the operational risk management framework. It provides for an aggregate view of risk appetite, risk and control profile, loss and event data management and control environment.

*unaudited

Operational risk* continued

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

Risk identification and assessment

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

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

During 2016, work continued on rolling out and embedding the enhanced end-to-end risk and control assessment methodology originally developed in 2015. This approach, which strengthens understanding of the risk profile of key products and services, is used to identify and quantify the most material operational risks. Subject matter experts and key stakeholders are engaged from across RBS to underpin management action in line with RBS's financial and non-financial appetite statement. Assessments were carried out on a number of critical products and services during 2016. The results of these assessments support RBS's on-going journey to build on, and enhance, its control environment.

Risk mitigation

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

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

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

Risk monitoring

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

*unaudited

Operational risk* continued

Risk measurement

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

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

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

Refer to the Capital risk section for operational risk capital requirement figures.

Event and loss data management

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

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

All losses and recoveries associated with an operational risk event are reported against their financial accounting date. A single event can result in multiple losses (or recoveries) that may take time to crystallise. Losses and recoveries with a financial accounting date in 2016 may relate to events that occurred, or were identified in, prior years.

*unaudited

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Explanation of Responses:

Business review **Capital and risk management**

Operational risk* continued

Percentage and value of events

At 31 December 2016, events aligned to the ‘clients, products and business practices’ event category accounted for 99% of RBS’s operational risk losses (compared to 98% in 2015).These losses primarily resulted from new conduct-related provisions in respect of RBS's issuance and underwriting of residential mortgage-backed securities (RMBS), the majority settlement of the 2008 shareholder litigation, the automatic refund of complex fees paid by SME customers in RBS's Global Restructuring Group and further increased provisions relating to Payment Protection Insurance, together with other regulatory settlements.

A small number of operational risk events contributed a high percentage of the total losses. In 2016, around 1% of the events contributed 97% of the losses. This was in line with 2015.

	Value of events				Volume of events (1)	
	£m		Proportion		Proportion	
	2016	2015	2016	2015	2016	2015
Fraud	51	40	1%	1%	79%	78%
Clients, products and business practices	6,282	3,449	99%	98%	13%	14%
Execution, delivery and process management	15	23	—	1%	8%	7%
Employment practices and workplace safety	1	15	—	—	—	1%
	6,349	3,527	100%	100%	100%	100%

Note:

(1) The calculation in the above table is based on the volume and value of events where the associated loss is more than or equal to £10,000.

*unaudited

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Explanation of Responses:

Pension risk*

Definition

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

Sources of risk

RBS has exposure to pension risk through its defined benefit schemes worldwide. The five largest schemes, which represent around 97% of RBS's pension liabilities are: the Main Section of The Royal Bank of Scotland Group Pension Fund (the Main scheme), the AA Section of The Royal Bank of Scotland Group Pension Fund, the Ulster Bank Pension Scheme, the Ulster Bank Pension Scheme (Republic of Ireland), and the Royal Bank of Scotland International Pension Trust. The Main scheme is the principal source of pension risk. Further detail on the Group's pension obligations can be found in Note 4 on the consolidated accounts.

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

Prior to 6 April 1997 individuals who contracted out of the UK State Second Pension were entitled to a Guaranteed Minimum Pension (GMP). Men accrued GMP at different rates to women. The Government intends that GMP should be equalised but until the mechanism is defined, pension funds are uncertain of their obligations. In the meantime, no allowance is made for GMP equalisation in the IAS 19 defined benefit obligations and risk disclosures.

Key developments in 2016

As part of the 31 December 2015 triennial valuation, RBS made a single £4.2 billion payment to the RBS Group Pension Fund in March 2016, instead of a series of annual contributions up to 2023, removing an element of pension risk. RBS and the trustee also agreed that the next valuation of the RBS Group Pension Fund will take place as at 31 December 2018, giving certainty to pension funding commitments until at least 2020.

*unaudited

Pension risk* continued

Throughout 2016, various pension risk stress-testing initiatives were undertaken, focused both on internally defined scenarios and on scenarios to meet integrated Bank of England and European Banking Authority stress-testing requirements. For more information on stress testing, refer to the following page.

Governance

The Main scheme operates under a trust deed. The corporate trustee, RBS Pension Trustee Limited, is a wholly owned subsidiary of National Westminster Bank Plc. The trustee board comprises six directors selected by RBS and four directors nominated by members. The trustee is supported by RBS Investment Executive Ltd (RIEL), which specialises in pension investment strategy.

The Pension Committee (PC) chaired by the RBS Chief Risk Officer, acts as a sub-committee of the RBS Asset and Liability Committee (ALCo) and formulates RBS's view of pension risk. The PC considers mechanisms that could potentially be used for managing risk within the funds as well as financial strategy. It also reviews actuarial assumptions from a sponsor perspective as appropriate. The PC is a key component of RBS's approach to managing pension risk and it reviews and monitors risk management, asset strategy and financing issues on behalf of RBS. The PC also serves as a formal link between RBS, RIEL and the trustee.

For further information on Risk governance, refer to page 224.

Risk appetite

Investment policy for the schemes is defined by the trustee with input from RIEL and other specialist advisers employed by the trustee. While the trustee is responsible for the management of the scheme assets, it consults with RBS on material changes to the Main scheme's risk appetite and investment policy.

RBS maintains an independent view of the risk inherent in pension funds, with an associated risk appetite, and has defined metrics against which risk is measured. In addition to the scrutiny provided by the PC, RBS undertakes regular pension risk monitoring and reporting to the Board and the BRC on the material pension schemes that RBS has an obligation to support.

Risk mitigation

The trustee has taken measures to mitigate inflation and interest rate risks, both by investing in suitable financial assets and by entering into inflation and interest rate swaps. The Main scheme also uses derivatives to manage the allocation of the portfolio to different asset classes and to manage risk within asset classes. The assets of the Main scheme, which represented around 89% of RBS's pension plan assets at 31 December 2016, are invested in a diversified portfolio. This includes quoted and private equity, government and corporate fixed interest and index-linked bonds, property and other alternative assets.

*unaudited

Pension risk* continued

Risk monitoring and measurement

Pension risk reports are submitted quarterly in the RBS Risk and Conduct Report. The report includes a measurement of the overall deficit or surplus position, estimated capital requirements, and an assessment of the associated assets and liabilities.

RBS also undertakes stress tests and scenario analyses on its material defined benefit pension schemes each year as part of its risk measurement framework. These stress tests are also used to satisfy the requests of regulatory bodies such as the Bank of England. The stress testing framework includes pension risk capital calculations for the purposes of the ICAAP as well as additional stress tests for a number of internal management purposes.

Pension stress tests take the form of both stochastic and deterministic stresses over time horizons ranging from instantaneous to five years in duration. They are designed to examine the behaviour of the pension schemes' assets and liabilities under a range of financial and demographic shocks. The results of the stress tests and their consequential impact on RBS's balance sheet, income statement and capital position are incorporated into the overall RBS-wide stress test results.

*unaudited

Pension risk* continued

The table below shows the sensitivity of the Main scheme's assets and liabilities (measured according to IAS 19 'Employee Benefits'). It includes changes in interest rates and equity values at the year-end, taking account of the current asset allocation and hedging arrangements. Asset sensitivity to changes in nominal yields increased over the year as swap yields fell at longer durations.

	Change in value of assets	Change in value of liabilities	Change in net pension obligations
2016	£m	£m	£m
Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields	1,048	502	546
Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields	1,485	1,552	(67)
Fall in AA credit spreads of 0.25% at all durations with no change in nominal or real swap yields			
or other credit spreads	9	2,074	(2,065)
Fall in equity values of 10%	(905)	—	(905)
2015			
Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields	874	363	511
Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields	1,029	1,104	(75)
Fall in AA credit spreads of 0.25% at all durations with no change in nominal or real swap yields			
or other credit spreads	7	1,526	(1,519)
Fall in equity values of 10%	(667)	—	(667)

The chart below shows the pension liability cash flow profile, allowing for expected indexation of future payments. The majority of expected cash flows (80%) are anticipated within the next 40 years. The profile will vary depending on the assumptions made regarding inflation expectations and mortality.

Explanation of Responses:

*unaudited

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Credit risk: management basis

Definition

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.

The following disclosures in this section are audited:

- Risk assessment and monitoring
- Portfolio overview - geography
- Wholesale credit risk management
  - Risk mitigation
  - Problem debt management - Forbearance
  - Key credit portfolios - Commercial Real Estate LTV distribution
- Personal credit risk management
  - Problem debt management - Forbearance
  - Overview of personal portfolios - Forbearance, mortgage balances, and LTV distribution.

Sources of credit risk*

The principal sources of credit risk for RBS are as follows:

Lending - RBS offers a number of lending products that involve an obligation to provide credit facilities to customers. To mitigate the risk of loss, security may be obtained in the form of physical collateral (such as commercial real estate assets and residential property) or financial collateral (such as cash and bonds). Exposures arising from leasing activities are also included.

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

Derivatives and securities financing - RBS 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 and netting are used along with the additional legal rights provided under the terms of over-the-counter contracts.

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

Other activities - RBS is exposed to settlement risk through its activities in foreign exchange, trade finance and payments.

Key developments in 2016*

Credit quality - The portfolio was reduced due to strategic disposals and the ongoing run-off of assets in Capital Resolution, although this was offset by the depreciation of the value of sterling relative to most major currencies. Asset quality remained stable against a backdrop of challenging economic conditions in the Shipping and Natural Resources sectors.

*unaudited

Credit risk: management basis continued

UK personal lending - The increase in the UK Personal portfolio was driven by significant mortgage lending activity. Underwriting standards are constantly monitored to ensure that they remain adequate in the current market environment and were not weakened to sustain the growth observed during the period. The UK unsecured lending portfolio remained stable during the year with no material changes to asset quality.

Shipping - RBS is winding down its shipping portfolio and has also disposed of assets during the year. RBS continues to witness difficult market conditions which are affecting vessel values and contributing to high levels of forbearance and impairments.

Natural Resources - The Oil & Gas sector continued to be affected by low oil prices which are predominantly due to over- supply. Exposures to the Oil & Gas sector were further reduced during 2016 and credit quality remained strong with the majority of the portfolio investment grade. The prolonged challenging market conditions did however result in a limited number of customers experiencing financial stress during the year, which resulted in impairments in the sector. For further information, refer to the Key credit portfolios section on page 308.

Credit risk measurement .RBS has changed its measure of credit risk exposure from Credit Risk Assets (CRA) to Current Exposure (CE) and Potential Exposure (PE). This change is discussed further on page 289.

Risk of Credit Loss - A new framework for managing problem debts in the wholesale portfolio was introduced during the year. The framework is discussed in detail on page 302.

IFRS 9 - The new IFRS 9 accounting requirement for loan impairments will draw extensively on the bank’s risk models and measures in the calculation of expected credit loss required by the standard. A cross-functional programme involving teams in Finance, Risk and Services is delivering the additional capabilities in terms of models, systems and operational processes.

Credit risk management function*

Governance

The activities of the RBS credit risk management function, which is led by the Group Chief Credit Officer (GCCO), include:

- Approving credit for customers;
- Ensuring that credit risk is within the risk appetite set by the Board;
- Managing concentration risk and credit risk control frameworks;
- Developing and ensuring compliance with credit risk policies; and
- Conducting RBS-wide assessments of provision adequacy.

*unaudited

Credit risk: management basis continued

The key elements of the credit risk management function are set out below.

Element	Managed by	Description
Leadership	GCCO	The GCCO has overall responsibility for the credit risk function. The GCCO chairs the Credit Risk Committee and, with the CRO, co-chairs the RBS Provisions Committee.
Governance	Credit Risk Committees	The Wholesale Credit Risk Committee and the Retail Credit Risk Committee have authority for risk appetite (within appetite set by the board), strategy, frameworks and policy as well as oversight of RBS's credit profile.
	Provisions Committee (1,2)	The Provisions Committee has authority over provisions adequacy and to approve recommendations from business provisions committees in accordance with approval thresholds.
Risk appetite	Concentration frameworks - Wholesale ° Single name ° Sector ° Country ° Product and asset class - Personal credit risk appetite framework Reputational and environmental, social and ethical frameworks	Wholesale frameworks are maintained to ensure that the risk of an outsized loss due to concentration to a particular borrower, sector, product type or country remains within appetite. The credit frameworks are aligned to the RBS risk appetite framework. RBS uses a product and asset class framework to control credit risk for its Personal businesses. The framework sets limits that measure and control the quality of both existing and new business for each relevant franchise or segment.

	Credit policy	
Controls and risk assurance	Risk Assurance	Credit policy standards are in place for both Wholesale and Personal portfolios and are expressed as a set of mandatory controls. Assurance activities, as defined by the RBS credit policy, are undertaken by the independent Risk Assurance function.
Credit stewardship	Credit assessment standards Credit risk mitigation and collateral Credit documentation Regular portfolio/customer review Problem debt identification and management	Credit risk stewardship takes place throughout the customer relationship, from initial credit approval and on a continuous basis thereafter. The methodology applied for assessing and monitoring credit risk varies between customer types and segments.
Customers	Segmentation	Customers are managed differently reflecting different customer types and risks. Wholesale customers - including corporates, banks and other financial institutions - are grouped by industry sectors and geography as well as by product/asset class and are managed on an individual basis. Personal customers - usually in UK PBB and Ulster Bank RoI as well as personal lending activities in Private Banking - are grouped into portfolios of similar risk and managed on a portfolio basis.

Notes:

(1) Authority is delegated by the Executive Risk Forum.

(2) For further information on the RBS provisioning and impairment practices refer to page 390.

*unaudited

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Explanation of Responses:

Credit risk: management basis continued

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. For further information on the specific frameworks for Wholesale and Personal refer to page 299 and 318 respectively.

Risk measurements and models*

RBS has changed its measure of credit risk exposure from Credit Risk Assets (CRA) to Current Exposure (CE) and Potential Exposure (PE). In these credit risk disclosures the measure used, unless otherwise stated, is Current Exposure. 2015 comparatives have been restated in Current Exposure. The table below summarises the differences between CRA, Current Exposure and Potential Exposure:

	CRA	Current Exposure	Potential Exposure (1)
Lending exposure Comprises cash balances at central banks as well as loans and advances to banks and customers.	Drawn balances (gross of impairment provisions)	Drawn balances	Legally committed limits (2)
		Measured net of individual, collective and latent provisions unless otherwise stated.	
Counterparty exposure	Measured using the mark-to-market value of derivatives after the effect of enforceable netting agreements and regulator-approved models but before the effect of collateral. Calculations are gross of credit valuation adjustments (CVAs).	Measured using the mark-to-market value of derivatives after the effect of enforceable netting agreements and net of legally enforceable financial collateral. (3)	Measured using scaled credit limit utilisation, which takes into account mark-to-market movements, any collateral held and expected market movements over a specified horizon. (2,3)
		Current and Potential Exposures are measured net of CVA unless otherwise stated.	
Contingent obligations	Drawn balances	Drawn balances	Legally committed amount (2)

Primarily letters of credit and guarantees.			
Exclusions	• Trading book bonds • Equity securities • Settlement risk • Intra-group credit exposures • Securities financing transactions (repos) • Banking book debt securities	• Trading book bonds • Equity securities • Settlement risk • Suretyships • Intra-group credit exposures	
Other		• Net of cash and gold collateral. • Current Exposure and Potential Exposure are reported against the guarantor of a transaction to reflect the transfer of risk.	

Notes:

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

(2) Cannot be less than Current Exposure.
(3) Current Exposure and Potential Exposure for exchange-traded derivatives are defined as exposure at default (EAD).

*unaudited

Credit risk: management basis continued

Comparing the Current Exposure measure to the previous CRA measure, the following changes are noted:

- Exposures to the Sovereign sector are higher. This is primarily due to the inclusion of government bond exposure held in the banking book and managed in Treasury and Capital Resolution. The increased current exposure value, compared to CRA, is also a result of risk transfer related to guarantees (pledged by sovereign customers) for obligors active in other sectors.

- In the Banks & Other Financial Institutions sector, the netting of financial collateral reduced the Current Exposure value compared to CRA. Risk transfer also reduced current exposure compared to CRA.

- Outside these sectors, the impact of risk transfer is less material. However, the impact of netting impairment provisions means that for most other wholesale sectors Current Exposure is less than CRA.

Risk models

RBS 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:

Model	Calculation method	Wholesale	Personal
PD model	Individual counterparty/account	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.	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.
LGD model	Individual counterparty/facility/product	Loss given default (LGD) models estimate the amount that would not be recovered in the event of a customer default. When estimating LGD, RBS'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.	
EAD model	Individual counterparty/facility/product	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. EAD estimates for committed and uncommitted facilities are based on historic data on limit utilisation. The estimates are also gross of provisions, as well as cash and gold collateral, and as a result can be higher or lower than Potential Exposure. In accordance with regulatory requirements, EAD for Lending Exposures must always be equal to, or higher, than the drawn balance sheet amount, though it can be reduced by a legally enforceable netting agreement.
EC model	Portfolio level	The credit economic capital (EC) model is a framework that allows for the calculation of portfolio credit loss distributions and associated metrics over a given risk horizon for a variety of business purposes. The model takes into account migration risk (the risk that credit assets will deteriorate in credit quality across multiple years), factor correlation (the assumption that groups of obligors share a common factor) and contagion risk (for example, the risk that the weakening of the sovereign's credit worthiness has a significant impact on the creditworthiness of a business operating in that country).

*unaudited

Credit risk: management basis continued

Impact of credit model changes

RBS reviews and updates models on an ongoing basis in order to reflect the effects of more recent data, changes to products and portfolios, and new regulatory requirements. The PD models for banks, local authorities, housing associations, property, housebuilders and mortgages were recalibrated during the year. This resulted in some downwards ratings migrations across internal asset quality bands.

Model changes affect year-on-year comparisons of risk measures in certain disclosures. Where meaningful, in commentary RBS has differentiated between instances where movements in risk measures reflect the impact of model changes and those where such movements reflect changes in the size of underlying credit portfolios or their credit quality.

For more information on model governance and review refer to the Models used in Risk section on page 229.

Asset quality*

Credit grades are assigned at legal entity level for wholesale customers.

All credit grades map to both an RBS-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 aggregated and reported at differing levels of detail depending on stakeholder or business requirements. Performing loans are defined as AQ1-AQ9 (where the PD is less than 100%) and non-performing loans as AQ10 (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 (mid-point)	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

*unaudited

Credit risk: management basis continued

Risk mitigation*

Risk mitigation techniques, as set out in RBS's credit policies, are used in the management of credit portfolios across RBS, 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 RBS 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. RBS 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.

For further information refer to the sub-sections on Wholesale credit risk management and Personal credit risk management.

Counterparty credit risk

RBS mitigates counterparty credit risk arising from both derivatives transactions and repurchase agreements through the use of market standard documentation, enabling netting, and through collateralisation.

Amounts owed by RBS to a counterparty are netted against amounts the counterparty owes the bank, in accordance with relevant regulatory and internal policies. However, generally, this is only done if a netting agreement is in place. A legal opinion, to the effect that the agreement is enforceable in the relevant jurisdictions, is also required.

Collateral may consist of either cash or securities. Additional collateral may be called should the net value of the obligations to RBS rise or should the value of the collateral itself fall. The majority of agreements are subject to daily collateral calls with collateral valued using RBS's internal valuation methodologies.

RBS restricts counterparty credit exposures by setting limits that take into account the potential adverse movement of an exposure after adjusting for the impact of netting and collateral (where applicable).

Risk assessment and monitoring

Practices for credit stewardship - including credit assessment, approval and monitoring as well as the identification and management of problem debts - differ between the Wholesale and Personal portfolios. For further information refer to the relevant sub-sections on page 299 and 318. A key aspect of credit risk stewardship is ensuring that, when signs of impairment are identified, appropriate impairment provisions are recognised.

*unaudited

Credit risk: management basis continued

Impairment, provisioning and write-offs

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

Impairment

A financial asset is impaired if there is objective evidence that the amount, or timing, of future cash flows has been adversely affected. Refer to accounting policies on page 390 for details regarding the quantification of impairment losses.

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

Provisioning

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

Provision method	Asset 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, by Retail products and Wholesale businesses	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 EAD x Emergence Period	• For Wholesale customers PD, LGD and EAD values are used. • For Personal, calculations are performed at portfolio level by product (e.g. mortgages, credit cards or unsecured loans). • Portfolio-level emergence periods are based on products or businesses with similar homogenous characteristics. Emergence periods range from 120 to 365 days.

Note:

(1) Refer to pages 336 to 341 for an analysis of impaired loans, related provisions and impairments. Refer to page 390 for details of accounting policies. For details on collateral, refer to the Counterparty credit risk section on page 292 as well as the Wholesale and Personal risk mitigation sections on pages 299 and 318.

Credit risk: management basis continued

Sensitivity of impairments to assumptions

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

In addition, for secured lending, key assumptions relate to the valuation of the security and collateral held, as well as the timing and cost of asset disposals based on underlying market depth and liquidity. Assessments are made by relationship managers on a case-by-case basis for individually-assessed provisions and are validated by credit teams. The Restructuring Credit team will ultimately recommend or approve any provisions that may be required under their delegated authority. For individual impairments greater than £1 million, oversight is provided by the RBS Provisions Committee.

Available-for-sale portfolios

Available-for-sale portfolios are also regularly reviewed for evidence of impairment, including: default or delinquency in interest or principal payments; significant financial difficulty of the issuer or obligor; and increased likelihood that the issuer will enter bankruptcy or other financial reorganisation.

Determining whether evidence of impairment exists requires the exercise of management judgement. It should be noted that the following factors are not, of themselves, evidence of impairment, but may be evidence of impairment when considered with other factors:

- Disappearance of an active market because an entity's financial instruments are no longer publicly traded.
- A downgrade of an entity's credit rating.
- A decline in the fair value of a financial asset below its cost or amortised cost.

Write-offs

Impaired loans and receivables are written-off when there is no longer any realistic prospect of recovery of part, or the entire loan. For loans that are individually assessed for impairment, the timing of write-off is determined on a case-by-case basis. Such loans are reviewed regularly and write-offs may be prompted by bankruptcy, insolvency, forbearance and similar events. For details of the typical time frames, from initial impairment to write off, for collectively assessed portfolios refer to the accounting policies section on page 390.

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

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Business review **Capital and risk management**

Credit risk: management basis continued

Portfolio overview - asset quality*

The table below summarises Current and Potential Exposure, net of provisions and after risk transfer, by sector and asset quality.

		Wholesale (1)						
		Banks and			Natural			
	Personal	other FIs	Sovereigns (2)	Property	resources	Transport	Other	Total
2016	£m	£m	£m	£m	£m	£m	£m	£m
AQ1-AQ4	111,899	42,903	118,049	19,087	8,708	5,452	15,874	321,972
AQ5-AQ8	47,992	4,392	135	21,728	3,357	9,077	38,178	124,859
AQ9	2,622	32	4	149	33	52	357	3,249
AQ10	3,693	355	—	1,387	302	1,004	772	7,513
Total	166,206	47,682	118,188	42,351	12,400	15,585	55,181	457,593
Potential Exposure	172,607	84,300	119,056	54,734	25,425	23,690	81,442	561,254
Risk of Credit Loss (3)	—	1	4	93	2	386	370	856
Flow into forbearance (4)	834	5	1	637	531	755	1,309	4,072
Forbearance stock (5)	5,284	63	1	787	785	836	1,805	9,561
Provisions	2,192	58	1	696	237	469	802	4,455
- Individual and collective	*1,966*	*52*	*—*	*659*	*226*	*454*	*698*	*4,055*
- Latent	*226*	*6*	*1*	*37*	*11*	*15*	*104*	*400*

2015**								
AQ1-AQ4	96,830	41,254	123,410	21,062	8,773	7,960	17,054	316,343
AQ5-AQ8	49,684	4,214	183	18,233	2,733	10,924	36,613	122,584
AQ9	2,840	35	—	279	127	55	297	3,633
AQ10	3,765	769	1	2,284	149	396	888	8,252
Total	153,119	46,272	123,594	41,858	11,782	19,335	54,852	450,812
Potential Exposure	159,837	82,434	125,048	53,955	24,565	26,795	81,823	554,457

Watch Red	—	20	73	529	348	145	858	1,973
Flow into forbearance (4)	1,829	85	—	1,035	643	205	1,207	5,004
Forbearance stock (5)	7,143	181	—	1,549	734	275	1,728	11,610
Provisions	3,003	73	1	2,282	133	300	1,347	7,139
- *Individual and collective*	*2,613*	*60*	*—*	*2,232*	*124*	*276*	*1,250*	*6,555*
- *Latent*	*390*	*13*	*1*	*50*	*9*	*24*	*97*	*584*

Notes:

(1) Includes SME customers managed in UK PBB Business Banking who are assigned a sector under the Bank's sector concentration framework.

(2) Includes exposure to central governments, central banks and sub-sovereigns such as local authorities.

(3) Excludes Private Banking, Lombard and Invoice Finance exposures which are not material in context of the Risk of Credit Loss portfolio.

(4) Completed during the year.

(5) Forbearance stock: Wholesale forbearance stock represents loans that have been subject to a forbearance event in the two years up to the reported date. Personal forbearance stock is aligned to the European Banking Authority definition for forbearance reporting (refer to individual Personal section on page 319 for further details).

*unaudited

**restated - refer to page 289 for further details

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Credit risk: management basis continued

Key points

The following key portfolios are either designated high-oversight sectors under the sector framework or constitute a material proportion of Current Exposure and are discussed in more detail below.

Commercial Real Estate (CRE) (in Property) - refer to page 308;

Oil & Gas (in Natural Resources) - refer to page 312;

Mining & Metals (in Natural Resources) - refer to page 315;

Shipping - refer to page 316; and

Personal, including mortgages - refer to page 321.

- RBS's credit risk exposure has been affected by the significant appreciation of both the euro and US dollar against sterling. This was relevant to exposures in Ireland, Western Europe and the US and is discussed in further detail on page 297.

- The increase in credit risk exposure in the personal sector was predominantly driven by growth in UK mortgage lending. This portfolio is managed on a specific risk appetite framework and the growth observed the year was within risk appetite. For further information refer to page 321.

- The Wholesale portfolio decreased by 8% (£25.1 billion) on a constant currency basis (foreign exchange impact of £18.8 billion). This was predominately due to a reduction in the sovereign sector, driven by liquidity management activities, and in the transport sector in line with the exit strategy for the shipping sector.

- The quality of the Personal portfolio improved with AQ1-AQ4 making up 67% of personal lending against 63% in 2015. For the Wholesale portfolio AQ1-AQ4 made up 72% of the portfolio (2015 - 74%).

- The Risk of Credit Loss framework was fully implemented in April 2016. Exposure classified as Risk of Credit Loss decreased during 2016 due to customers who defaulted during the year and are shown in AQ10.

- For Wholesale, the flow into forbearance remained stable and continued to reflect the challenging conditions in certain sectors, notably Transport. 45% (2015 - 29%) of the total forbearance granted related to non-performing loans. Provision coverage of non-performing forborne loans was 27% (2015 - 43%). Refer to the Wholesale Forbearance section (page 304) for further details.

- The reduction in defaulted exposures during the year was primarily due to specific portfolio disposals, including in the Republic of Ireland of small and medium enterprise-related exposures and buy-to-let mortgages, during the fourth quarter of 2016. This was partly offset by higher defaulted assets in Capital Resolution's Shipping portfolio.

- Credit impairment charges increased during 2016. In particular large individual charges were incurred in the Shipping, Oil & Gas and Mining & Metals sectors. Challenging economic conditions resulted in reduced global demand, oversupply and consequently volatile commodity prices, which adversely affected the shipping market and vessel values. Credit impairment releases were lower in 2016 with less asset disposal activity.

- In Personal, including mortgages, the flow into defaults was broadly stable year-on-year. Cash repayments and recoveries on previously defaulted debt remained strong.

*unaudited

**restated - refer to page 289 for further details

Business review Capital and risk management

Credit risk: management basis continued

Portfolio overview - geography

The table below summarises both Current and Potential Exposure, net of provisions and after risk transfer by geographic region, as well as providing further detail for selected country risk exposure.

		Wholesale (1)						Current	Potential
	Personal	Banks and other FI	Sovereigns (2)	Property	Natural resources	Transport	Other	Exposure total	Exposure total
2016	£m	£m	£m	£m	£m	£m	£m	£m	£m
UK	148,882	19,393	69,390	38,001	8,357	9,324	45,515	338,862	391,370
RoI (3)	15,079	433	2,387	950	443	206	2,966	22,464	23,771
Other Western Europe	528	9,978	36,603	2,332	2,406	1,760	3,602	57,209	86,659
US	329	11,116	7,338	350	610	488	2,159	22,390	38,177
RoW (4)	1,388	6,762	2,470	718	584	3,807	939	16,668	21,277
Total	166,206	47,682	118,188	42,351	12,400	15,585	55,181	457,593	561,254
Of which:									
Southern Europe									
Spain	63	52	7	845	487	25	341	1,820	3,250
Italy	27	477	67	70	113	176	30	960	2,568
Portugal	6	90	8	13	148	2	1	268	439
Cyprus	9	—	—	—	—	—	—	9	10
Greece	13	—	—	5	—	—	12	30	30
Southern Europe total	118	619	82	933	748	203	384	3,087	6,297
Eurozone other (5)									
Germany	70	1,789	26,107	74	137	223	1,057	29,457	34,761
RoI (3)	15,079	433	2,387	950	443	206	2,966	22,464	23,771
Netherlands	32	2,399	4,740	235	230	118	563	8,317	12,217
France	69	1,835	3,170	288	563	611	578	7,114	15,299
Belgium	21	1,067	869	44	48	178	17	2,244	2,905

Luxembourg	9	703	28	490	1	41	274	1,546		2,736
Other (6)	14	365	674	47	22	72	261	1,455		2,383
Eurozone other total	15,294	8,591	37,975	2,128	1,444	1,449	5,716	72,597		94,072
Eurozone total	15,412	9,210	38,057	3,061	2,192	1,652	6,100	75,684		100,369
Japan (7)	25	467	1,008	—	—	—	146	1,646		2,613
India (7)	14	169	499	1	25	1	77	786		810
2015**										
UK	136,024	21,187	60,068	37,328	7,386	9,524	43,262	314,779		365,407
RoI (3)	13,440	433	1,624	692	436	218	2,542	19,385		20,661
Other Western Europe	548	9,481	33,942	2,408	2,144	2,567	4,334	55,424		84,143
US	301	8,121	21,819	622	864	911	2,386	35,024		54,120
RoW (4)	2,806	7,050	6,141	808	952	6,115	2,328	26,200		30,126
Total	153,119	46,272	123,594	41,858	11,782	19,335	54,852	450,812		554,457
Southern Europe										
Spain	79	58	6	671	526	75	326	1,741		2,960
Italy	27	428	52	62	175	67	59	870		2,271
Portugal	6	87	10	26	139	63	1	332		492
Cyprus	12	—	—	—	—	38	—	50		52
Greece	15	1	—	8	—	1	10	35		39
Southern Europe total	139	574	68	767	840	244	396	3,028		5,814
Eurozone other (5)										
Germany	63	1,533	23,801	91	150	800	1,073	27,511		32,574
RoI (3)	13,440	433	1,624	692	436	218	2,542	19,385		20,661
Netherlands	30	1,966	4,176	451	94	138	1,126	7,981		12,247
France	76	2,309	2,402	357	447	827	679	7,097		15,982
Belgium	22	702	537	158	44	138	61	1,662		2,427
Luxembourg	6	625	21	346	32	41	106	1,177		1,917
Other (6)	14	382	609	55	84	34	123	1,301		2,022
Eurozone other total	13,651	7,950	33,170	2,150	1,287	2,196	5,710	66,114		87,830
Eurozone total	13,790	8,524	33,238	2,917	2,127	2,440	6,106	69,142		93,644

Japan (7)	31	249	1,417	2	—	3	112	1,814		2,639
India (7)	11	227	824	1	92	43	436	1,634		1,733
**restated - refer to page 289 for further details. 2015 data is unaudited.										

Credit risk: management basis continued

Notes:

(1) Includes SME customers managed in UK PBB Business Banking who are assigned a sector under RBS's sector concentration framework.

(2) Includes exposures to central governments, central banks and sub-sovereigns such as local authorities.

(3) RoI: Republic of Ireland.

(4) Comprises Asia Pacific, Central and Eastern Europe, the Middle East, Central Asia and Africa. RoW also includes supranationals such as the World Bank and exposure relating to ocean-going vessels which cannot be meaningfully assigned to specific countries from a country risk perspective.

(5) Countries where current exposure is greater than £1 billion.

(6) Finland, Austria, Malta, Slovakia, Estonia, Lithuania, Latvia and Slovenia.

(7) Non-eurozone countries displayed in the table are those that are A+ or worse and with current exposure greater than £1 billion.

Key points*

- Country Risk exposure was significantly affected by foreign exchange movements (£10.4 billion) during the year. On a constant currency basis, eurozone exposure decreased by £3.9 billion.

- Sovereign exposure to the US and RoW decreased. This is in line with RBS strategy to reduce activity in the US as well as reductions in RoW, which were partly due to reduced exposure in the shipping sector and other Capital Resolution disposals.

- The proportion of RBS's exposure to the UK is now 74% (70% - 2015).

*unaudited

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Explanation of Responses:

Credit risk: management basis continued

Wholesale credit risk management

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

Wholesale credit risk framework*

A summary of the frameworks is set out below.

Concentration framework	Single name concentration (SNC)	Sector	Product and asset class	Country
Risk addressed	Concentration on a single borrower or borrower group.	Concentration in a single sector or across sectors susceptible to similar stress events.	Concentration on certain products or asset classes.	Concentration on a particular country.
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.	Size - based on exposure to a particular country.
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.	Bank-wide country limits.
Controls within the framework	Elevated approval requirements, mandatory controls and procedures, monitoring and reporting, the requirement for regular reviews and for plans to address any exposures in excess of limit.			
Exposure measure (net/gross)	Both net and gross of "eligible" mitigants. To be eligible under the framework, mitigants must be legally	Gross exposure to a sector/sub-sector. Where PE is used it is net of eligible collateral and	Net/gross - dependent on type of risk and limit definition. Where PE is used it is net of	Net of provisions and risk transfer.

	enforceable, structurally effective and of appropriate maturity.	provisions.	eligible collateral and provisions.	
Recent developments	The aggregate SNC exposure remained outside RBS long term risk appetite. Whilst the number of SNC excesses increased by 17.1%, the value of the SNC excesses decreased by 9.1% during the year. The top ten SNC excesses comprised 87.7% of total SNC excesses.	Risk appetite has remained broadly stable across all sectors, allowing for growth in our core franchises in accordance with our strategy. CRE limits have remained broadly flat, allowing for a limited amount of targeted growth within the sector and there has been some notable growth in certain of our non-Bank FI sectors where a more targeted growth strategy has been in place.	The product and asset class framework was enhanced during the year to encompass all products and asset classes where there is a specific identified credit risk which needs to be managed at the product and asset class level rather than at customer or sector level.	Risk appetite limits were reduced for exit countries taking account of the revised risk appetite and international strategy.

*unaudited

Business review **Capital and risk management**

Credit risk: management basis continued

Risk assessment*

Before credit facilities are made available to customers a credit assessment is undertaken. The assessment process is the same for all customers. However, in RBS credit risk management is organised in terms of the complexity of the assessment rather than aligned to franchises. Capital Resolution is not managed separately but is shown in tables to aid understanding of the size of the exit portfolio. 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. TAS are one of the tools used to control risk appetite at the customer/transaction level. The introduction of sector-specific TAS followed the introduction of general sector TAS in November 2015, providing full sector coverage. TAS are supplementary to the 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 RBS or by another lender;

- Consideration of other risks such as environmental, social and ethical, regulatory and reputational risks; and

- The portfolio impact of the transaction, including the impact on any credit risk concentration limits or agreed business franchise risk appetite.

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

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.

*unaudited

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Credit risk: management basis continued

Risk mitigation

RBS 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 - Refer to CRE section on page 308.

- Other physical assets - Including stock, plant, equipment, machinery, vehicles, ships and aircraft. Such assets are suitable collateral only if RBS can identify, locate, and segregate them from other assets on which it does not have a claim. RBS 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 RBS's counterparties by their own customers. RBS values them after taking into account the quality of its counterparty's receivable management processes and excluding any that are past due.

- Financial collateral - Refer to Counterparty credit risk section on page 292.

All collateral is assessed case by case to ensure that it will retain its value independently of the provider. RBS monitors the value of the collateral and, if there is a shortfall, will seek additional collateral.

Credit risk: management basis continued

Key sectors where RBS provides asset-backed lending are commercial real estate and shipping. Valuation methodologies are detailed below.

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

Shipping valuations - Vessel valuations are obtained using several different independent sources. Valuations are usually undertaken on a desktop basis, assuming a willing buyer and willing seller. Most vessels are valued on a charter-free basis, but in certain circumstances the valuations take account of longer term committed charter income. Valuations are normally performed on a quarterly basis. From time to time, particularly for facilities showing increased signs of financial stress, a more formal valuation or specialist advice will be obtained.

Problem debt management

*Early problem identification**

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

*Risk of Credit Loss Framework**

The Risk of Credit Loss framework, which was fully implemented in April 2016, has replaced RBS'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. All customers that have been granted forbearance are managed under this framework. 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).

*unaudited

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Credit risk: management basis continued

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 in RBS and in each business are regularly reviewed by a Risk of Credit Loss Committee. The committee members are experienced credit, business and Restructuring specialists. The purpose of the committee is to review and challenge the strategies undertaken for those customers who pose the largest risk of credit loss to the bank.

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

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

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

*unaudited

Credit risk: management basis continued

Restructuring*

For the Wholesale problem debt portfolio, customer relationships are managed by the Restructuring team (this excludes customers managed by PBB). The factor common to all customers with Restructuring involvement is that RBS's exposure is outside risk appetite. The purpose of Restructuring is to protect the bank's capital. Where practicable, Restructuring do this by working with corporate and commercial customers to support their turnaround and recovery strategies and enable them to return to mainstream banking. Restructuring will always aim to recover capital in a fair and efficient manner.

Specialists in Restructuring work with customers experiencing financial difficulties, and showing signs of financial stress, with the aim of restoring their business to financial health whenever practicable. The objective is to find a mutually acceptable solution, including restructuring of existing facilities, repayment or refinancing.

An assessment of the viability of the business, as well as the ability of management to deal with the causes of financial difficulty, is carried out by specialists in Restructuring, focusing on both financial and operational issues. Following the assessment, options which may include forbearance and/or restructuring of facilities are developed. Credit risk decisions, including reviewing and approving any restructuring solutions in relation to these customers, are made by a dedicated Restructuring Credit team, which is part of the credit risk management function.

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

Forbearance

Forbearance takes place when a concession is made on the contractual terms of a loan 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, RBS applies

minimum standards when assessing, recording, monitoring and reporting forbearance.

*unaudited

Credit risk: management basis continued

Types of wholesale forbearance

The type of forbearance offered is tailored to the customer's individual circumstances. For wholesale customers forbearance may involve the following types of concessions:

- Covenant waiver

A recalibration of covenants or a covenant amendment may be used to cure a potential or actual covenant breach. In return for this relief, RBS may seek to obtain a return commensurate with the risk that it is required to take. The increased return for the increased risk can be structured flexibly to take into account the customer's circumstances. For example it may be structured as either increased margin on a cash or payment-in-kind basis, deferred-return instruments or both. While RBS considers these types of concessions qualitatively different from other forms of forbearance, they constitute a significant proportion of UK Wholesale forborne loans and are therefore included in these disclosures.

- Amendment to margin

Contractual margin may be amended to assist the customer's day-to-day liquidity to help sustain its business as a going concern. This would normally be a short-term solution. RBS would seek a return commensurate to the risk that it is required to take.

- Payment concessions and loan rescheduling (including extensions in contractual maturity)

May be granted to improve the customer's liquidity or in the expectation that the customer's liquidity will recover when market conditions improve. In addition, they may be granted if the customer will benefit from access to alternative sources of liquidity, such as an issue of equity capital. These options have been used in CRE transactions, particularly during periods where a shortage of market liquidity has ruled out immediate refinancing and made short-term collateral sales unattractive.

- Debt forgiveness/debt for equity swap

May be granted where the customer's business condition or economic environment is such that it cannot meet obligations and where other forms of forbearance are unlikely to succeed. Debt forgiveness can be used for stressed corporate transactions and is typically structured on the basis of projected cash flows from operational activities, rather than underlying tangible asset values. Provided that the underlying business model, strategy and debt level are viable, maintaining the business as a going concern is the preferred option, rather than realising the value of the underlying assets.

Loans may be forborne more than once, generally where a temporary concession has been granted and circumstances warrant another temporary or permanent revision of the loan's terms. All customers are assigned a PD and related facilities an LGD. These are re-assessed prior to finalising any forbearance arrangement in light of the loan's amended terms and any revised grading is incorporated in the calculation

of the impairment loss provisions for RBS’s wholesale exposures.

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Credit risk: management basis continued

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

- Enforcement of security or otherwise taking control of assets - Where RBS holds collateral or other security interest and is entitled to enforce its rights, it may enforce its security or otherwise take control of the assets. The preferred strategy is to consider other possible options prior to exercising these rights.

- Insolvency - Where there is no suitable forbearance option or the business is no longer sustainable, insolvency will be considered. Insolvency may be the only option that ensures that the assets of the business are properly and efficiently distributed to relevant creditors.

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

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

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

For performing loans, credit metrics are an integral part of the latent provision methodology and therefore the impact of covenant concessions will be reflected in the latent provision. For non-performing loans, covenant concessions will be considered in determining the overall provision for these loans.

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

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

Business review **Capital and risk management**

Credit risk: management basis continued

Flow into forbearance

The table below shows the value of loans (excluding loans where RBS has initiated recovery procedures) where forbearance was completed during the year, by sector and types. This includes only the forborne facility Current Exposure net of provisions and after risk transfer. No exit criteria are currently applied.

	2016					2015**			
Wholesale forbearance during the year by sector	Performing	Non-performing	Total	Provision coverage (1)		Performing	Non-performing	Total	Provision coverage (1)
	£m	£m	£m	%		£m	£m	£m	%
Property	330	307	637	25		474	561	1,035	45
Natural resources	365	166	531	36		610	33	643	36
Transport	141	614	755	25		147	58	205	29
Retail and leisure	424	87	511	22		269	99	368	32
Services	201	225	426	33		451	105	556	44
Other	324	54	378	8		297	71	368	46
Total	1,785	1,453	3,238	27		2,248	927	3,175	43

Note:

(1) Provision coverage reflects impairment provision as a percentage of non-performing loans gross of provisions.

Forbearance arrangements

The table below shows the main types of Wholesale renegotiations. This includes only the forborne facility Current Exposure net of provisions and after risk transfer.

Wholesale renegotiations during the year by type (1)	2016	2015**
	£m	£m
Payment concessions	1,751	2,091
Non-payment concessions	1,487	1,084
Total	3,238	3,175

Note:

(1) Previously reported forbearance types are classified as non-payment (covenant concessions, release of security) and payment (payment concessions and loan rescheduling, forgiveness of all or part of the outstanding debt, variation in margin, standstill agreements).

**Restated - refer to page 289 for further details. 2015 data is unaudited.

Key points

- The levels of completed forbearance in 2016 remained stable. Year-on-year comparisons of the level of forbearance within the various sectors may be impacted by individual material cases during a given year.

- Loans totalling £1.4 billion were granted approval for forbearance but had not yet reached legal completion at 31 December 2016 (2015 - £1.4 billion). These exposures are referred to as “in process” and are not included in the tables above. 61% (£0.9 billion) of these “in process” exposures related to non-performing customers and 39% (£0.5 billion) related to performing loans. The principal types of arrangements offered were payment concessions and loan rescheduling.

- Forbearance in the Transport sector has increased in 2016 driven by the Shipping sector (£0.7 billion). A number of Shipping facilities which were forborne in 2016 were included in a portfolio sale during Q4. (Refer to page 316 for further information).

- The decrease in exposure in the Natural Resources sector is reflective of forbearance being granted to defaulted customers with provisions in the Oil & Gas sector given the sector’s challenges (refer to page 312 for further information). As the exposure measure is net of provisions, this reduced forborne exposure is not reported in the table above. On a gross basis, the level of forbearance granted to customers in the Natural Resources sector was consistent with 2015.

- Forbearance for performing Retail & Leisure customers increased driven by a limited number of covenant waivers for individually material cases, while the volume of customers receiving forbearance decreased.

- £1.6 billion of the facilities granted forbearance in 2016 were managed by Restructuring Credit. This equated to 48% of loans managed by Restructuring Credit (excluding loans to customers where recovery procedures have commenced).

- The value of loans forborne during 2015 and 2016 and still outstanding at 31 December 2016 was £4.3 billion (2015 - £4.5 billion), of which £1.0 billion related to arrangements completed during 2015 (2015 - £1.3 billion completed in 2014).

- By value, 77% (£1.7 billion) of the performing loans granted forbearance in 2015 (£2.2 billion) remained performing at 31 December 2016.

- Provisions for non-performing loans disclosed above are for the most part individually assessed. As a result, material provisions and associated fluctuations in coverage levels can impact direct comparison across periods. Provision coverage decreased in 2016, which is reflective of the proportion of the 2015 forborne portfolio relating to Exit portfolios where the strategy resulted in high levels of provisions. Provision coverage for non-performing "in process" loans was 29%. Additional provisions charged in 2016 and relating to loans forborne during 2015 totalled £160 million. Provision coverage of these loans at 31 December 2016 was 50%.

- The data presented above include loans forborne during 2015 and 2014. Until April 2014 a reporting threshold was in place which ranged from nil to £3 million after which no thresholds were in use. A number of immaterial portfolios have forbearance assessed under a portfolio approach.

Business review Capital and risk management

Credit risk: management basis continued

Key credit portfolios

Commercial Real Estate

The CRE sector relates to lending activity for the development of, and investment in, commercial and residential properties.

A dedicated portfolio controls team is responsible for reviewing portfolio strategy, credit risk appetite and policies, as well as oversight of valuations and environmental frameworks. The sector is reviewed regularly at senior executive committees. Reviews include portfolio credit quality, capital consumption and control frameworks.

The majority of CRE lending applications are reviewed by specialist CRE transactional credit teams, including a dedicated development team. Lending guidelines and policy are informed by lessons learned from the 2008 financial crisis.

New business is monitored and controlled against agreed underwriting standards. Sub-sector and asset class limits are used to restrict exposure to emerging risks when appropriate. This activity is reviewed and monitored on a regular basis.

CRE lending exposure by geography and property type on a Current Exposure basis net of provisions and after risk transfer*

	Investment				Development			Overall
	Commercial	Residential	Total		Commercial	Residential	Total	total
By geography (1)	£m	£m	£m		£m	£m	£m	£m
2016								
UK	16,773	3,762	20,535		367	3,127	3,494	24,029
RoI	459	70	529		49	133	182	711
Other Western Europe	739	34	773		13	39	52	825
US	154	1	155		—	4	4	159
RoW	25	2	27		2	1	3	30
Total	18,150	3,869	22,019		431	3,304	3,735	25,754

Of which: Capital Resolution	953	46	999		1	74	75	1,074
Williams & Glyn	2,050	668	2,718		32	633	665	3,383
2015**								
UK	15,825	4,173	19,998		613	3,251	3,864	23,862
RoI	342	95	437		24	80	104	541
Other Western Europe	597	8	605		15	1	16	621
US	241	1	242		—	—	—	242
RoW	211	12	223		5	13	18	241
Total	17,216	4,289	21,505		657	3,345	4,002	25,507
Of which: Capital Resolution	1,318	47	1,365		50	104	154	1,519
Williams & Glyn	2,080	644	2,724		82	483	565	3,289

Note:

(1) Geography is based on country of collateral risk.

*unaudited

**restated - refer to page 289 for further details

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Credit risk: management basis continued

CRE lending exposure by sub-sector based on current exposure net of provisions and after risk transfer*

By sub-sector	UK	RoI	Other Western Europe	US	RoW	Total
	£m	£m	£m	£m	£m	£m
2016						
Residential	6,889	204	73	4	3	7,173
Office	3,322	155	518	41	15	4,051
Retail	4,970	50	56	—	2	5,078
Industrial	2,696	33	65	1	—	2,795
Mixed/other	6,152	269	113	113	10	6,657
Total	24,029	711	825	159	30	25,754
2015						
Residential	7,424	175	9	1	25	7,634
Office	2,938	76	398	85	62	3,559
Retail	4,497	93	85	19	22	4,716
Industrial	2,600	36	39	—	7	2,682
Mixed/other	6,403	161	90	137	125	6,916
Total	23,862	541	621	242	241	25,507

A breakdown of the Commercial Banking UK investment portfolio for 2016 by UK region is set out below.

UK region (1)	Proportion
Greater London	29%
Portfolio (2)	22%
Midlands	13%
South East	12%
North	11%
Scotland	7%
Rest of the UK (3)	6%

Notes:

(1) Based on management estimates using the postcode of the security. Percentages are based on current exposure gross of provisions.

(2) Includes lending secured against property portfolios comprising numerous properties across multiple UK locations.

(3) Includes Northern Ireland.

Key points

- A slowdown in the UK commercial property investment market, which began in the third quarter of 2015, continued after the EU referendum result in June 2016. As a result, capital values were down by approximately 3% on average in the second half of 2016. Despite a minor recovery in the final months of 2016, forecasts suggest that values will remain under pressure during 2017. However, the sector continues to attract equity flows given its attractive yields.

- With the outlook for UK commercial property more uncertain, underwriting standards have been tightened across all commercial property investment portfolios to mitigate potential declines in property values.

- Lending to the CRE sector in the UK increased during the year as a result of CPB and PBB having appetite to support activity in the sector.

- The increase in exposure in RoI and Western Europe was primarily due to foreign exchange movements.

*unaudited

Business review **Capital and risk management**

Credit risk: management basis continued

CRE exposure by LTV band

The table below provides a breakdown of the CRE portfolio by LTV band.

	2016			2015**		
	AQ1-AQ9	AQ10	Total	AQ1-AQ9	AQ10	Total
	£m	£m	£m	£m	£m	£m
<= 50%	10,695	53	10,748	9,896	72	9,968
> 50% and <= 70%	6,508	120	6,628	5,964	116	6,080
> 70% and <= 80%	474	67	541	685	125	810
> 80% and <= 90%	299	57	356	353	376	729
> 90% and <= 100%	130	41	171	143	150	293
> 100% and <= 110%	74	24	98	149	75	224
> 110% and <= 130%	136	357	493	221	122	343
> 130% and <= 150%	82	28	110	44	65	109
> 150%	108	61	169	253	199	452
Total with LTVs	18,506	808	19,314	17,708	1,300	19,008
Total portfolio average LTV (1)	48%	113%	51%	52%	167%	63%
Minimal security	1	—	1	2	4	6
Other	2,357	349	2,706	2,253	238	2,491
Development (2)	3,553	180	3,733	3,641	361	4,002
	24,417	1,337	25,754	23,604	1,903	25,507

Notes:

(1) Weighted average by Current Exposure gross of provisions
(2) Relates to the development of commercial and residential properties. LTV is not a meaningful measure for this type of lending activity.

Key points

- The reduction in overall portfolio average is primarily the result of repayments, asset sales and write-offs of legacy non-performing assets from Ulster Bank RoI, CPB and NatWest Markets. Remaining exposures with LTVs greater than 100% are legacy transactions.

- The exposure in Other relates mainly to lending to large corporate entities. It is not asset-backed but lent against corporate balance sheets.

- Interest payable on outstanding loans was covered 3.7x in Commercial Banking and 1.1x in Capital Resolution (2015 - 3.4x and 1.6x respectively).

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Business review Capital and risk management

Credit risk: management basis continued

A breakdown of CRE portfolio lending, gross of provision and after risk transfer, risk elements in lending (REIL) and provisions is provided below.

	Total			Commercial Banking			Capital Resolution	
CRE loans, REIL and provisions	2016	2015*		2016	2015*		2016	2015*
	£m	£m		£m	£m		£m	£m
Lending (gross of provisions)	26,265	27,561		18,296	18,178		1,193	2,842
Of which REIL	1,407	3,560		731	1,050		497	1,951
Provisions	511	2,054		263	305		119	1,323
REIL as a % of gross loans to customers	5.4%	12.9%		4.0%	5.8%		41.7%	68.6%
Provisions as a % of REIL	36%	58%		36%	29%		24%	68%

Asset quality*

A breakdown of asset quality of the CRE portfolio measured on a Current Exposure basis, net of provisions and after risk transfer, is set out below.**

Note:

(1) There is little variation between CE and PE figures for the CRE portfolio as facilities tend to be fully drawn.

Key point

- The growth in AQ6 band is the result of the introduction of a more conservative calibration of certain commercial real estate asset quality models, rather than deterioration of underlying asset quality.

*unaudited

**restated - refer to page 289 for further details

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Explanation of Responses:

Credit risk: management basis continued

Natural Resources*

Exposure to the Natural Resources sector, measured on both a Current Exposure (CE) and Potential Exposure (PE) basis, net of provisions and after risk transfer, is summarised below.

	2016					2015**			
		Of which:		Of which:			Of which:		Of which:
		Capital		Capital			Capital		Capital
	CE	Resolution	PE	Resolution		CE	Resolution	PE	Resolution
	£m	£m	£m	£m		£m	£m	£m	£m
Oil and gas	2,911	159	5,286	191		3,544	1,539	6,798	2,117
Mining and metals	623	32	1,887	126		729	237	1,823	391
Electricity	3,430	797	9,076	1,087		2,851	1,128	7,683	1,773
Water and waste	5,436	3,386	9,176	6,041		4,657	1,648	8,261	3,039
	12,400	4,374	25,425	7,445		11,781	4,552	24,565	7,320
Commodity traders	631	1	992	1		900	444	1,320	452
Of which: Natural resources	*568*	—	*744*	—		*521*	*212*	*752*	*212*

Key points

- Oil & Gas - CE and PE decreased during the year by 27% and 32% (£1.1 billion and £2.5 billion) respectively on a constant currency basis, with foreign exchange impact of £0.5 billion (CE) and £1.0 billion (PE). This portfolio remains subject to active risk management (see below).

- Mining & Metals - CE and PE decreased during the year by 23% and 10% (£0.2 billion and £0.2 billion) on a constant currency basis, with foreign exchange impact of £0.1 billion (CE) and £0.3 billion (PE). There was some deterioration in asset quality due to challenging market conditions and this portfolio remains subject to active risk management (see below).

- Electricity - CE and PE increased during the year by 9% and 5% (£0.3 billion and £0.4 billion) on a constant currency basis, with foreign exchange impact of £0.3 billion (CE) and £1.0 billion (PE). This was mainly due to refined classification of exposure in the natural resources sector which lead to a transfer of regulated utility exposure from Oil and Gas to Electricity and an increase in Project Finance exposure as part of the RBS growth strategy.

- Water & Waste - CE and PE increased during the year by 16% and 10% (£0.7 billion and £0.8 billion) on a constant currency basis, with foreign exchange impact of £0.1 billion (CE) and £0.1 billion (PE). These increases are predominately due to mark-to-market movements in long-dated inflation linked swaps driven by changes in long-term inflation outlook.

Oil & Gas*

Exposure to the Oil & Gas sector, split by sub-sector and geography, measured on a Potential Exposure basis, net of provisions and after risk transfer, is summarised below.

			Other			
			Western			
	UK	RoI	Europe	US	RoW (1)	Total
2016	£m	£m	£m	£m	£m	£m
Producers (including international oil companies)	664	—	1,087	2	236	1,989
Oilfield service providers	701	9	630	68	5	1,413
Other wholesale and trading activities	489	43	542	46	280	1,400
Refineries	27	—	—	285	3	315
Pipelines	33	4	121	1	10	169
	1,914	56	2,380	402	534	5,286
Of which:						
National oil companies	—	—	16	—	76	92
International oil companies	450	—	821	155	14	1,440
Exploration and production	302	—	154	2	141	599
2015**						
Producers (including international oil companies)	1,177	51	1,028	275	256	2,787
Oilfield service providers	700	10	678	279	51	1,718
Other wholesale and trading activities	450	76	475	45	432	1,478
Refineries	21	2	—	327	18	368
Pipelines	98	—	310	31	8	447
	2,446	139	2,491	957	765	6,798
Of which:						
National oil companies	—	—	21	—	70	91
International oil companies	654	—	868	273	10	1,805
Exploration and production	338	—	38	130	118	624

Note:

(1) Comprises Asia Pacific, Central and Eastern Europe, the Middle East, Central Asia and Africa.

*unaudited

**restated - refer to page 289 for further details

Credit risk: management basis continued

Asset quality

A breakdown of asset quality for the oil and gas portfolio, measured on both a Current Exposure and Potential Exposure basis, net of provisions and after risk transfer, is summarised below.**

*unaudited

*restated – refer to page 289 for further details

Explanation of Responses:

Credit risk: management basis continued

Key points

- Oil prices dipped below $30 per barrel at the start of the year but ended the year above $50 per barrel following positive announcements from OPEC and Non-OPEC producers around implementing production cuts of 1.8 million barrels a day. However, there is considerable market uncertainty around future oil prices and the outlook for the sector remains challenging.

- The portfolio reduced by £1.5 billion during the year or 22% (32% or £2.5 billion on a constant currency basis). Regulated gas distribution companies are no longer reported under the Oil and Gas sector and this reclassification reduced sector exposure by £724 million. The other reductions are attributable to the continued run-off of the US and APAC portfolios and active risk management in all regions.

- The risk management strategy during the year remained to focus the portfolio towards investment grade customers with robust credit profiles and strong liquidity to manage through the extended downturn. At 31 December 2016, 71% (2015 - 76%) of the portfolio exposure was investment grade (AQ1-AQ4 or equivalent to BBB- and above).

- The sub-sector in which a customer operates is a primary consideration for assessing credit risk. Customers involved in exploration and production (E&P) are most immediately exposed to low oil prices and these companies have introduced capital spending reductions and tight cost controls to conserve cash. In turn, this has impacted oilfield service providers, with E&P companies buying fewer products and services from the oilfield service providers, and demanding lower prices for those they do purchase.

- The other principal components of exposure to producers are International Oil Companies (IOCs) and National Oil Companies (NOCs). IOCs and NOCs are less vulnerable to the oil price decline due to scale, diversification and, in the case of NOCs, implicit support from governments. At 31 December 2016, 29% of the portfolio exposure was to IOCs and NOCS combined (2015 - 28%).

- Committed lending exposure included legal commitments to syndicated bank facilities and bilateral facilities with tenors up to five years. These committed facilities are for general corporate purposes - including funding operating needs and capital expenditures - and are available as long as counterparties comply with the terms of the credit agreement. Contingent obligations relate to guarantees, letters of credit and suretyships provided to customers. RBS had no high-yield bond or loan underwriting positions at 31 December 2016 (2015 - Nil).

- The number of forbearance events was consistent with 2015. In 2016 there was an increase in payment concessions granted compared to 2015 which predominantly involved the relaxation of financial covenants to give customers more financial flexibility. Most forbearance involved customers in the E&P and oilfield services sub-sectors where earnings have been more immediately and materially affected by the downturn.

- The number and value of cases on the Risk of Credit Loss framework in the Oil & Gas sector decreased during the year. The framework exposure is predominantly classified as Heightened Monitoring and the sector continues to be monitored closely. At 31 December 2016, exposures classified as Risk of

Credit Loss totalled £2 million.

- The increase in AQ10 reflected ongoing challenging market conditions which resulted in a small number of customers experiencing financial stress during the year. AQ10 assets at 31 December 2016 totalled £181 million (2015 - £44 million).

*unaudited

**restated - refer to page 289 for further details

Business review Capital and risk management

Credit risk: management basis continued

Mining & Metals*

Exposure to the Mining & Metals sector, measured on a Potential Exposure basis, net of provisions and after risk transfer, is summarised below.

			Other			
			Western			
	UK	RoI	Europe	US	RoW (1)	Total
2016	£m	£m	£m	£m	£m	£m
Mining	118	36	129	—	566	849
Metals - production	120	1	340	—	2	463
- wholesale	184	3	382	6	—	575
	422	40	851	6	568	1,887
2015**						
Mining	31	1	7	105	447	591
Metals - production	308	1	361	13	40	723
- wholesale	164	2	309	34	—	509
	503	4	677	152	487	1,823

Note:

(1) Comprises Asia Pacific, Central and Eastern Europe, the Middle East, Central Asia and Africa .

Asset quality

A breakdown of asset quality for the Mining & Metals portfolio, measured on both a Current Exposure and Potential Exposure basis, net of provisions and after risk transfer, is summarised below.**

Key point

- The deterioration in asset quality reflected the challenging operating environment in 2016.

*unaudited

**restated - refer to page 289 for further details

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Business review **Capital and risk management**

Credit risk: management basis continued

Shipping*

Exposure to the Shipping sector, measured on both a Current Exposure and Potential Exposure basis net of provisions and after risk transfer, is summarised below.

	2016					2015**			
		Of which:		Of which:			Of which:		Of which:
	Current	Capital	Potential	Capital		Current	Capital	Potential	Capital
	Exposure	Resolution	Exposure	Resolution		Exposure	Resolution	Exposure	Resolution
	£m	£m	£m	£m		£m	£m	£m	£m
Shipping	4,553	3,854	5,173	4,005		6,776	6,162	7,301	6,309

Asset quality

A breakdown of asset quality for the Shipping sector, measured on both a Current Exposure and Potential Exposure basis, net of provisions and after risk transfer, is summarised below.**

*unaudited

**restated - refer to page 289 for further details

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Credit risk: management basis continued

Key points

- Shipping exposure was £4.6 billion on a Current Exposure basis (down 43% or £3.4 billion on a constant currency basis compared with 2015, with foreign exchange impact of £1.2 billion) and £5.2 billion on a Potential Exposure basis (down 40% or £3.4 billion on a constant currency basis compared with 2015, with foreign exchange impact of £1.3 billion).

- Most of the Shipping portfolio is managed in Capital Resolution and is related to exposure secured by ocean-going vessels. The remaining exposure outside Capital Resolution related principally to is within the Shipbuilding and Inland Water Transport sub-sectors. The reduction in exposure was mainly driven by asset sales and debt repayments in Capital Resolution, in line with RBS's strategy.

- Within Capital Resolution, Concentrations were as follows: Containers 34% (2015 - 21%), Dry Bulk 26% (2015 - 37%), Tankers at 18% (2015 - 23%). Other vessel types included liquid petroleum gas, natural gas and roll-on/roll-off vessels at 22% of exposure (2015 - 19%).

- Conditions remained depressed in the Dry Bulk market, notwithstanding a gradual improvement during the second half of the year. The Container market also saw a marked downturn in 2016 with a significant reduction in spot rates and vessel values and this is set to continue into 2017. Tanker rates also weakened in 2016 with a general deterioration in vessel values.

- The Capital Resolution portfolio LTV at 31 December 2016 was 102% (2015 - 85%), or 92% net of the provisions outlined below. The year-on-year increase in LTV is reflective of the market and vessel value movements outlined above. The LTV calculation includes vessel security only and does not incorporate any non-vessel security such as cash or guarantees.

- At 31 December 2016, exposures classified as Risk of Credit Loss totalled £363 million reflecting the prolonged market downturn in this sector.

- Provisions, excluding latent provisions, increased from £169 million to £386 million during 2016. Again, this was due to weak market conditions, and increasing LTV, which led to an increase in the portfolio's levels of default.

- At 31 December 2016, AQ10 exposure, net of provisions was £867 million (2015 - £210 million).

- There was an increase in the number of forbearance events, mainly involving the relaxation of minimum security covenants due to deteriorating asset prices. Total forbearance for this sector was £723 million.

*unaudited

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Explanation of Responses:

Credit risk: management basis continued

Personal credit risk management

This section sets out further detail on RBS's approach to credit risk management for its personal customers.

Risk appetite*

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

Personal credit risk assessment*

Personal lending entails making a large number of small-value loans. To ensure that these lending decisions are made consistently, RBS analyses credit information, including the historical debt servicing behaviour of customers with respect to both RBS and their other lenders. RBS 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.

Personal risk mitigation*

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

Region	Index used
UK	Halifax quarterly regional house price index
Northern Ireland	UK House Price Index (published by the Land Registry)
RoI	Central Statistics Office residential property price index

Problem debt management*

Personal customers in financial difficulty are managed through either collections or recoveries functions.

Collections*

Collections functions in each of RBS's personal businesses provide support to customers who cannot meet their obligations to RBS. Such customers may miss a payment on their loan, borrow more than their agreed limit, or ask for help. Dedicated support teams are also in place to identify and help customers who have not yet missed a payment but may be facing financial difficulty. The collections function uses a range of tools to initiate contact with such customers, establish the cause of their financial difficulty and support them where possible.

*unaudited

Credit risk: management basis continued

In the process, they may consider granting the customer forbearance.

Additionally, in the UK and Ireland support is provided to customers with unsecured loans who establish a repayment plan with RBS through a debt advice agency or a self-help tool. Such “breathing space” suspends collections activity for a 30-day period to allow time for the repayment plan to be put in place. Arrears continue to accrue for customer loans granted breathing space.

If collections strategies are unsuccessful the relationship is transferred to the recoveries team.

Forbearance

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

Customers who contact RBS 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.

The type of forbearance granted will differ based upon an assessment of the customer's circumstances. Forbearance is granted principally to customers with mortgages and less frequently to customers with unsecured loans. This includes instances where forbearance may be taken for customers with highly flexible mortgages.

Forbearance options include, but are not limited to:

- 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. Ulster Bank RoI also offers payment concessions in the form of discounted interest rates that involve the forgiveness of some interest.

- Capitalisation of arrears - The customer repays the arrears over the remaining term of the mortgage and returns to an up-to-date position.

- Term extensions - The loan's maturity date is extended.

- Interest only conversions - The loan converts from principal and interest repayment to interest only repayment. This is only available in Ulster Bank RoI and Ulster Bank North on a temporary basis. These forbearance concessions are no longer offered to customers in UK PBB, RBSI and Private Banking.

Types of forbearance offered in the unsecured portfolios vary by reportable segment.

*unaudited

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Credit risk: management basis continued

Monitoring of forbearance - Forborne loans are separated into a distinct population and reported on a regular basis until they exit the forborne population.

A loan is considered to have exited forbearance when it meets the criteria set out by the European Banking Authority (EBA) requirements for Financial Reporting. These include being classified as performing for two years since the last forbearance event, making regular repayments and the debtor being less than 30 days past due.

The act of granting of forbearance in itself 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.

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

Impairments for forbearance

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

For the latent calculation, an extended emergence period is applied to account for the impact of forbearance within the portfolio. Additionally for portfolios with material forbearance, forborne loans form a separate risk pool and use different PD model:

- UK PBB (excl. NI) and W&G: forborne mortgages form a separate risk pool for 24 months after the agreement of forbearance and the calculation uses the higher of the observed default rates or PD. On unsecured loans, separate risk pools are used for the duration of the forbearance treatment.
- Ulster Bank: forborne and previously forborne mortgages form a separate risk pool taking into account the term of the forbearance treatment and applicable probationary periods. The PD model used is calibrated separately for forborne loans, using information on the historic performance of loans subject to

similar arrangements.

For non-performing loans, there is no difference in treatment with the exception of Ulster Bank, where forborne loans which result in an economic loss to the group form a separate risk pool where specific LGDs are allocated using observed cohort performance.

Recoveries*

Once a loan has been identified as impaired it is managed by recoveries teams in the relevant businesses. The teams seek to minimise RBS's loss by maximising cash recovery while treating customers fairly.

Where an acceptable repayment arrangement cannot be agreed with the customer litigation may be considered. In the UK and Northern Ireland, no repossession procedures are initiated until at least six months following the emergence of arrears (in the Republic of Ireland, regulations prohibit taking legal action for an extended period). Additionally, certain forbearance options are made available to customers managed by the recoveries function.

*unaudited

Business review Capital and risk management

Credit risk: management basis continued

Overview of personal portfolio split by product type and segment on a Current Exposure basis net of provisions*

		Ulster	Private			
	UK PBB	Bank RoI	Banking	RBSI	W&G	Total
2016	£m	£m	£m	£m	£m	£m
Mortgages	117,040	14,396	7,168	2,637	10,856	152,097
Of which:						
Interest only variable rate	11,694	349	3,625	692	1,317	17,677
Interest only fixed rate	11,132	7	2,290	81	1,186	14,696
Mixed (capital and interest only)	5,316	75	—	23	687	6,101
Buy-to-let	16,678	1,777	770	881	1,427	21,533
Provisions	151	919	2	27	23	1,122
REIL	736	3,144	23	84	101	4,088
Other lending (1)	8,962	291	1,730	64	958	12,005
Provisions	834	48	18	1	113	1,014
REIL	860	50	61	5	117	1,093
Total lending	126,002	14,687	8,898	2,701	11,814	164,102
Mortgage LTV ratios (2)						
- Total portfolio	56%	76%	56%	57%	54%	58%
- New business	69%	74%	55%	66%	69%	68%
- Buy-to-let	56%	82%	54%	49%	55%	56%
- Performing	56%	72%	56%	56%	53%	57%
- Non-performing	60%	94%	68%	105%	56%	77%

2015**						
Mortgages	104,599	12,713	6,552	2,525	10,430	136,819
Of which:						

Interest only variable rate	13,252	407	3,025	730	1,388	18,802
Interest only fixed rate	9,112	6	2,431	49	1,076	12,674
Mixed (capital and interest only)	5,380	76	7	29	745	6,237
Buy-to-let	14,098	1,762	476	835	1,150	18,321
Provisions	180	1,062	4	18	26	1,290
REIL	878	2,550	19	63	123	3,633
Other lending (1)	8,795	233	3,458	62	958	13,506
Provisions	1,028	48	22	1	129	1,228
REIL	1,028	49	53	5	140	1,275
Total lending	113,394	12,946	10,010	2,587	11,388	150,325
Mortgage LTV ratios (2)						
- Total portfolio	56%	83%	54%	57%	54%	59%
- New business	69%	77%	57%	62%	68%	68%
- Buy-to-let	57%	95%	58%	51%	57%	60%
- Performing	56%	80%	54%	57%	54%	58%
- Non-performing	63%	106%	92%	96%	60%	83%

Notes:

(1) Excludes loans guaranteed by a company and commercial real estate lending to personal customers.

(2) Weighted by current exposure gross of provisions.

*unaudited

**restated - refer to page 289 for further details

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Business review Capital and risk management

Credit risk: management basis continued						
Overview of new mortgage lending on a Current Exposure basis net of provisions*						
		Ulster	Private			
	UK PBB	Bank RoI	Banking	RBSI	W&G	Total
2016	£m	£m	£m	£m	£m	£m
Gross new mortgage lending (1)	29,027	893	3,291	470	2,156	35,837
Of which:						
Owner occupied	25,086	876	2,819	300	1,833	30,914
Average LTV by weighted value	71%	74%	55%	69%	70%	70%
Buy-to-let	3,941	17	472	170	323	4,923
Average LTV by weighted value	62%	59%	54%	62%	62%	61%
(1) Excludes additional lending to existing customers.						
2015						
Gross new mortgage lending	22,713	553	2,383	258	1,728	27,635
Of which:						
Owner occupied	18,884	541	2,161	179	1,412	23,177
Average LTV by weighted value	71%	77%	54%	64%	69%	69%
Buy-to-let	3,829	12	222	79	316	4,458
Average LTV by weighted value	64%	65%	64%	57%	64%	64%

Forbearance stock and flow on a Current Exposure basis net of provisions						
2016						
Forbearance stock (1)	1,290	3,709	65	43	177	5,284
Forbearance stock: arrears						
Current	790	2,077	65	29	107	3,068
1-3 months in arrears	286	473	—	2	41	802
>3 months in arrears	214	1,159	—	12	29	1,414
Provisions against forbearance stock	51	790	—	1	8	850
Forbearance type:						
Long-term arrangements (2)	701	1,249	63	37	111	2,161

Short-term arrangements (3)	860	2,460	2	6	110	3,438
Forbearance flow	406	316	49	10	53	834
2015*						
Forbearance stock (1)	1,444	3,643	64	43	202	5,396
Forbearance stock: arrears						
Current	863	2,165	64	31	124	3,247
1-3 months in arrears	329	470	—	6	46	851
>3 months in arrears	252	1,008	—	6	32	1,298
Provisions against forbearance stock	59	884	—	1	8	952
Forbearance type:						
Long-term arrangements (2)	800	1,173	39	35	129	2,176
Short-term arrangements (3)	953	2,470	25	8	120	3,576
Forbearance flow	435	197	47	17	57	753

Notes:

(1) Q4 2016 forbearance calculation has moved to the FINREP EBA basis.

(2) Capitalisation term extensions, economic concessions.

(3) Payment concessions, amortising payments of outstanding balances, payment holidays and temporary interest arrangements.

*unaudited

Business review Capital and risk management

Credit risk: management basis continued

Mortgage LTV distribution by segment on a Current Exposure basis net of provisions

LTV ratio value (1)	<=50% £m	50% <=70% £m	70% <=80% £m	80% <=90% £m	90% <=100% £m	100% <=110% £m	110% <=130% £m	130% <=150% £m	>150% £m	Total with LTVs £m	Other £m	Total £m
2016												
UK PBB												
AQ1-AQ9	43,332	41,442	15,778	10,862	2,885	175	150	76	55	114,755	705	115,460
AQ10	548	637	182	113	51	15	7	3	5	1,561	19	1,580
	43,880	42,079	15,960	10,975	2,936	190	157	79	60	116,316	724	117,040
Of which: buy-to-let	5,645	8,196	2,290	360	105	27	20	14	6	16,663	15	16,678
Ulster Bank RoI												
AQ1-AQ9	3,079	2,897	1,649	1,411	1,144	1,056	1,205	119	22	12,582	—	12,582
AQ10	252	296	169	179	177	199	340	154	48	1,814	—	1,814
	3,331	3,193	1,818	1,590	1,321	1,255	1,545	273	70	14,396	—	14,396
Private Banking												
AQ1-AQ9	2,594	3,188	820	163	29	7	2	8	13	6,824	233	7,057
AQ10	25	49	12	8	1	5	2	—	—	102	9	111
	2,619	3,237	832	171	30	12	4	8	13	6,926	242	7,168
RBSI												
AQ1-AQ9	1,099	812	378	236	26	29	6	6	15	2,607	—	2,607
AQ10	(2)	11	3	4	4	3	2	—	5	30	—	30
	1,097	823	381	240	30	32	8	6	20	2,637	—	2,637
W&G												
AQ1-AQ9	4,565	3,754	1,280	867	178	6	—	—	—	10,650	10	10,660
AQ10	81	89	17	7	2	—	—	—	—	196	—	196
	4,646	3,843	1,297	874	180	6	—	—	—	10,846	10	10,856

2015**												
UK PBB												
AQ1-AQ9	38,430	38,645	14,372	7,985	2,646	255	174	90	18	102,615	251	102,866
AQ10	483	713	250	152	77	26	12	7	3	1,723	10	1,733
	38,913	39,358	14,622	8,137	2,723	281	186	97	21	104,338	261	104,599
Of which: buy-to-let	4,374	6,879	2,202	431	131	34	30	14	1	14,096	2	14,098
Ulster Bank RoI												
AQ1-AQ9	2,276	2,075	1,222	1,155	1,004	964	1,633	410	49	10,788	—	10,788
AQ10	226	258	153	163	179	178	385	264	119	1,925	—	1,925
	2,502	2,333	1,375	1,318	1,183	1,142	2,018	674	168	12,713	—	12,713
Private Banking												
AQ1-AQ9	2,431	2,846	707	147	30	15	1	12	20	6,209	323	6,532
AQ10	3	1	3	1	9	1	1	—	1	20	—	20
	2,434	2,847	710	148	39	16	2	12	21	6,229	323	6,552
RBSI												
AQ1-AQ9	985	873	339	190	40	27	19	2	14	2,489	—	2,489
AQ10	5	11	2	3	5	1	3	1	5	36	—	36
	990	884	341	193	45	28	22	3	19	2,525	—	2,525
W&G												
AQ1-AQ9	4,113	3,738	1,216	648	174	11	1	—	—	9,901	297	10,198
AQ10	71	100	27	18	8	1	—	—	—	225	7	232
	4,184	3,838	1,243	666	182	12	1	—	—	10,126	304	10,430

Note:

(1) LTV is calculated on a Current Exposure basis, gross of provisions.

**restated - refer to page 289 for further details. 2015 data is unaudited.

Explanation of Responses:

Business review Capital and risk management

Credit risk: management basis continued

Key points

UK PBB*

- The total portfolio increased by 11.9% from 31 December 2015. This was in line with the segment's growth strategy and within risk appetite. The portfolio is closely monitored and risk appetite is regularly reviewed to ensure it is appropriate for market conditions. Underwriting standards were not relaxed during the year.

- Other Personal lending remained stable during the year in the context of an upward trend in unsecured household debt in the wider UK market. Asset quality remained stable with no deterioration in the arrears rate from the prior year.

- Gross new mortgage lending amounted to £29.0 billion (excluding additional lending to existing customers) in 2016 with an average LTV by weighted value of 69% (2015 - 69%). Lending to owner-occupiers during this period was £25.1 billion (2015 - £18.9 billion) and had an average LTV by weighted value of 71% (2015 - 71%). Buy-to-let lending was £3.9 billion (2015 - £3.8 billion) with an average LTV by weighted value of 62% (2015 - 64%).

- Approximately 12% by value of owner-occupied mortgages were on interest-only terms with a bullet repayment and 5% were on a combination of interest-only and capital and interest. The remainder were capital and interest. 65% by value of the buy-to-let mortgages were on interest-only terms and 3% on a combination of interest only and capital and interest.

- Fixed interest rate products of varying time durations accounted for approximately 73% by value of the mortgage portfolio with 2% a combination of fixed and variable rates and the remainder variable rate. The proportion of the portfolio on fixed rate products rose due to the very high proportion of customers taking out fixed rate mortgages in 2016.

- Based on the Halifax House Price Index at September 2016, the portfolio average indexed LTV by volume was 50% (2015 - 49%) and 56% by weighted value of debt outstanding (2015 - 56%). The £2.2 billion of mortgages granted by Ulster Bank North were indexed against the UK house price index published by the Land Registry.

- The arrears rate (three or more repayments past due) fell from 0.8% (by volume) in December 2015 to 0.7% at 31 December 2016. The number of properties repossessed in 2016 was also lower at 519 compared with 727 in 2015.

- The flow of new forbearance was £406 million in 2016 compared with £435 million in 2015. The value of mortgages subject to forbearance decreased by 10.4% compared with 2015 to £1.3 billion (equivalent to 1.1% of the total mortgage book). This was mainly driven by benign market conditions.

- A release of provision on historically-impaired mortgages was the key driver in an overall provision release of £20.5 million for the year (2015 charge of £2.8 million). The value of underlying defaults was

slightly lower year-on-year.

*unaudited

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Business review **Capital and risk management**

Credit risk: management basis continued

The table below summarises UK mortgage exposure by region and LTV.

LTV ratio value	<=50%	50% <=70%	70% <=80%	80% <=90%	90% <=100%	100% <=110%	110% <=130%	130% <=150%	>150%	Total with LTVs	WA LTV (1)		Other	To
2016	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	%		£m	£
South East	12,793	11,521	3,371	1,734	320	4	8	1	—	29,752	53%		153	29,90
Greater London	12,624	7,108	1,715	675	228	1	2	1	—	22,354	48%		158	22,51
Scotland	2,931	3,521	1,684	1,316	553	42	4	—	—	10,051	61%		51	10,10
North West	2,713	3,728	1,836	1,682	342	13	4	2	—	10,320	62%		70	10,39
South West	3,535	4,116	1,499	853	97	5	3	5	—	10,113	56%		62	10,17
West Midlands	2,033	2,960	1,334	1,001	289	3	2	2	—	7,624	61%		47	7,67
Rest of the UK (2)	7,251	9,125	4,521	3,714	1,107	122	134	68	60	26,102	62%		183	26,28
Total	43,880	42,079	15,960	10,975	2,936	190	157	79	60	116,316	56%		724	117,04
2015														
South East	10,402	10,668	3,279	1,410	318	8	7	6	—	26,098	54%		45	26,14
Greater London	11,402	6,426	1,252	418	90	1	2	1	—	19,592	47%		68	19,66
Scotland	3,198	3,775	1,497	840	323	34	2	—	—	9,669	58%		25	9,69
North West	2,475	3,548	1,662	1,162	476	47	5	—	—	9,375	61%		31	9,40
South West	2,850	3,549	1,581	851	217	8	6	5	—	9,067	58%		23	9,09
West Midlands	1,728	2,601	1,301	737	324	17	2	3	—	6,713	61%		23	6,73
Rest of the UK (2)	6,858	8,791	4,050	2,719	975	166	162	82	21	23,824	62%		46	23,87
Total	38,913	39,358	14,622	8,137	2,723	281	186	97	21	104,338	56%		261	104,59

Notes:

(1) Weighted average.

(2) Includes Northern Ireland.

*unaudited

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Business review Capital and risk management

Credit risk: management basis continued								
The table below shows interest only mortgage portfolios (excluding mixed repayment mortgages) by type and by contractual year of maturity.								
	2017 (1)	2018-19	2020-24	2025-29	2030-34	2035-44	After 2044	Total
2016	£m	£m	£m	£m	£m	£m	£m	£m
Bullet principal repayment (2)	452	956	3,528	5,320	6,015	6,096	453	22,820
Conversion to amortising (2,3)	6	—	—	—	—	—	—	6
Total	458	956	3,528	5,320	6,015	6,096	453	22,826
	2016 (4)	2017-18	2019-23	2024-28	2029-33	2034-43	After 2043	Total
2015**	£m	£m	£m	£m	£m	£m	£m	£m
Bullet principal repayment (2)	461	1,028	3,413	5,006	6,362	5,743	348	22,361
Conversion to amortising (2,3)	3	—	—	—	—	—	—	3
Total	464	1,028	3,413	5,006	6,362	5,743	348	22,364

Notes:

(1) 2017 includes pre-2017 maturity exposure.

(2) Includes £0.1 billion (2015 - £0.1 billion) of repayment mortgages that have been granted interest-only concessions (forbearance).

(3) Maturity date relates to the expiry of the interest only period.

(4) 2016 includes pre-2016 maturity exposure.

*unaudited

Credit risk: management basis continued

Key points

Ulster Bank RoI *

- Excluding the impact of exchange rate movements of £2,174 million, the portfolio decreased by 2.9% (£433 million) from 31 December 2015 as a result of amortisation and portfolio sales (£588 million). The volume of new business has increased reflecting continuing market demand.

- Tracker-rate products accounted for approximately 64% of the portfolio, while variable rate totalled 21% and fixed rate 15%.

- The decrease in portfolio average indexed LTV reflected positive house price index trends over the last 12 months and the impacts of Central Bank of Ireland requirements for new lending.

- At 31 December 2016, 26% of total mortgage assets (£3.7 billion) were subject to a forbearance arrangement, an increase of 2% (£66 million) from 31 December 2015. Excluding the impact of exchange rate movements of £606 million, the value of mortgage assets subject to a forbearance arrangement decreased by £540 million (13%).

- The number of customers approaching Ulster Bank RoI for the first time in respect of forbearance assistance declined during 2016. The majority (69%) of forbearance arrangements were less than 90 days in arrears.

- A key driver of both reduced forbearance rates and longer average forbearance durations was the introduction of Ulster Bank RoI's sustainability policy in the fourth quarter of 2015. Under that policy customers are only eligible for forbearance as part of a sustainable solution. The use of forbearance is therefore more limited than previously, applying only to those customers who can be returned to a sustainable status through forbearance.

- The AQ10 population reduced to £1.8 billion. This was mainly the result of the disposal of a distressed portfolio. There was a very high provision coverage in relation to this portfolio and, as a result, the disposal also led to a reduction in provision coverage.

The table below shows interest only mortgage portfolios (excluding mixed repayment mortgages) by type and by contractual year of maturity.

	2017 (1)	2018-19	2020-24	2025-29	2030-34	2035-44		Total

							After 2044	
2016	£m	£m	£m	£m	£m	£m	£m	£m
Bullet principal repayment (2)	9	11	31	47	59	34	6	197
Conversion to amortising (2,3)	110	29	4	3	7	5	2	160
Total	119	40	35	50	66	39	8	357
	2016 (4)	2017-18	2019-23	2024-28	2029-33	2034-43	After 2043	Total
2015**	£m	£m	£m	£m	£m	£m	£m	£m
Bullet principal repayment (2)	6	13	25	41	63	25	5	178
Conversion to amortising (2,3)	118	104	5	3	3	1	1	235
Total	124	117	30	44	66	26	6	413

Notes:

(1) 2017 includes pre-2017 maturity exposure.

(2) Includes £0.2 billion (2015 - £0.3 billion) of repayment mortgages that have been granted interest only concessions (forbearance).

(3) Maturity date relates to the expiry of the interest only period.

(4) 2016 includes pre-2016 maturity exposure.

*unaudited

**restated - refer to page 289 for further details

Credit risk: management basis continued

Key points

Private Banking*

- The majority of the Private Banking personal lending portfolio related to mortgage lending. The net portfolio increase was £616 million (9.4%) from 31 December 2015, in line with the segment's growth strategy and risk appetite.

- Gross new mortgage lending amounted to £3.3 billion in 2016. Lending to owner-occupiers during the period was £2.8 billion (2015 - £2.2 billion) and had an average LTV by weighted value of 55% (2015 - 54%). Buy-to-let lending was £472 million (2015 - £222 million) with an average LTV by weighted value of 54% (2015 - 64%).

- Fixed interest rate products accounted for approximately 41% of the mortgage portfolio, with two-year term products accounting for 58% of all fixed deals.

- Approximately 82% of all mortgages were on interest-only terms; 82% of owner-occupied mortgages were interest-only with 90% of buy-to-let mortgages on interest-only terms.

- Provisions remained minimal during the period.

The table below shows interest only mortgage portfolios (excluding mixed repayment mortgages) by type and by contractual year of maturity.

	2017 (1)	2018-19	2020-24	2025-29	2030-34	2035-44	After 2044	Total
2016	£m	£m	£m	£m	£m	£m	£m	£m
Bullet principal repayment	1,399	1,081	1,452	1,111	453	415	3	5,914
	2016 (2)	2017-18	2019-23	2024-28	2029-33	2034-43	After 2043	Total
2015**	£m	£m	£m	£m	£m	£m	£m	£m
Bullet principal repayment	846	1,585	1,658	859	296	210	2	5,456

Notes:

(1) 2017 includes pre-2017 maturity exposure.

Explanation of Responses:

(2) 2016 includes pre-2016 maturity exposure.

*unaudited

**restated – refer to page 289 for further details

Explanation of Responses:

Credit risk: management basis continued

Key points

RBS International*

- The total portfolio increased by 4% from £2.6 billion to £2.7 billion from 31 December 2015 in line with the franchise's growth strategy and risk appetite.

- Gross new mortgage lending amounted to £470 million in 2016. Lending to owner-occupiers during this period was £300 million (2015 - £175 million) and had an average LTV by weighted value of 69% (2015 - 64%). Buy-to-let lending was £170 million (2015 - £79 million) with an average LTV by weighted value of 62% (2015 - 57%).

- The number of customers granted forbearance in 2016 decreased by 28%. A total of £37 million of forborne loans were subject to a long-term arrangement (term extensions and covenant breaches) at 31st December 2016 (2015 - £35 million). Short term forbearance comprises payment suspensions and reduced payments.

- The arrears rate increased from 0.75% in December 2015 to 0.78% at the end of December 2016.

- There was a provision impairment charge of £8.5 million for personal mortgages in 2016 (release of £1 million in 2015.

The table below shows interest only mortgage portfolios (excluding mixed repayment mortgages) by type and by contractual year of maturity.

	2017 (1)	2018-19	2020-24	2025-29	2030-34	2035-44	After 2044	Total
2016	£m	£m	£m	£m	£m	£m	£m	£m
Bullet principal repayment	117	98	107	170	128	59	94	773
	2016 (2)	2017-18	2019-23	2024-28	2029-33	2034-43	After 2043	Total
2015**	£m	£m	£m	£m	£m	£m	£m	£m
Bullet principal repayment	77	177	157	183	145	39	1	779

Notes:

(1) 2017 includes pre-2017 maturity exposure.

(2) 2016 includes pre-2016 maturity exposure.

*unaudited

**restated - refer to page 289 for further details

Explanation of Responses:

Business review **Capital and risk management**

Credit risk: management basis continued

Key points

Williams & Glyn*

- The total portfolio increased by 3.74% from 31 December 2015, driven by gross new mortgage lending amounting to £2.2 billion in 2016 but remained within risk appetite. Lending to owner-occupiers during this period was £1.8 billion (2015 - £1.4 billion) and had an average LTV by weighted value of 70% (2015 - 70%). Buy-to-let lending was £323 million (2015 - £316 million) with an average LTV by weighted value of 62% (2015 - 64%).

- Fixed interest rate products of varying time durations accounted for approximately 65% of the mortgage portfolio with 6% a combination of fixed and variable rates and the remainder variable rate.

- The flow of new forbearance remained low during the year, with exposure totalling £53 million (2015 - £57 million) granted forbearance in 2016. The value of mortgages subject to forbearance remain low, showing a decrease of 12% in 2016 to £0.18 billion (equivalent to 1.6% of the total mortgage portfolio) as a result of improved market conditions.

- There was a reduction of impairment provision balances for personal mortgages in 2016 to £23 million compared with £26 million in 2015. The provision release resulted from revised modelling assumptions reflecting current market conditions.

The table below shows interest only mortgage portfolios (excluding mixed repayment mortgages) by type and by contractual year of maturity.

	2017 (1)	2018-19	2020-24	2025-29	2030-34	2035-44	After 2044	Total
2016	£m	£m	£m	£m	£m	£m	£m	£m
Bullet principal repayment	66	136	451	702	626	486	37	2,504
	2016 (2)	2017-18	2019-23	2024-28	2029-33	2034-43	After 2043	Total
2015**	£m	£m	£m	£m	£m	£m	£m	£m
Bullet principal repayment	58	124	419	621	670	538	34	2,464

Notes:

Explanation of Responses:

(1) 2017 includes pre-2017 maturity exposure.

(2) 2016 includes pre-2016 maturity exposure.

*unaudited

**restated - refer to page 289 for further details

Explanation of Responses:

Business review **Capital and risk management**

Credit risk: management basis continued

Balance sheet to current exposure bridge*							
The table below provides a bridge between the balance sheet and the related components of Current Exposure (CE).							
	Balance sheet	Within the scope of market risk (1)	Disposal groups (2)	Netting and collateral (3)	Methodology differences and reclassifications (4)	Not within the scope of CE (5)	CE
2016	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Cash and balances at central banks	74.3	—	—	—	(0.6)	(4.2)	69.5
Reverse repurchase agreements and stock borrowing (6)	41.8	—	—	(39.4)	—	—	2.4
Loans and advances	340.3	(0.2)	—	(24.4)	(8.4)	(1.7)	305.6
Debt securities	72.5	(24.4)	—	—	0.4	—	48.5
Equity shares	0.7	(0.2)	—	—	(0.5)	—	—
Settlement balances	5.5	—	—	—	—	(5.5)	—
Derivatives	247.2	—	—	(226.8)	(1.4)	—	19.0
Other assets (7)	16.8	—	—	—	—	(15.5)	1.3
Total assets	799.1	(24.8)	—	(290.6)	(10.5)	(26.9)	446.3
Contingent obligations							11.3
							457.6
2015							
Cash and balances at central banks	79.4	—	0.5	—	(0.2)	(3.9)	75.8
Reverse repurchase agreements and stock borrowing (6)	39.8	—	—	(37.3)	—	—	2.5
Loans and advances	324.7	(0.3)	2.4	(28.9)	(8.3)	(1.5)	288.1
Debt securities	82.1	(35.7)	0.5	—	0.6	(0.3)	47.2
Equity shares	1.4	(0.7)	—	—	(0.7)	—	—
Settlement balances	4.1	—	—	—	—	(4.1)	—

Derivatives	262.5	—	—	(244.0)	2.2	—	20.7
Other assets (7)	21.4	—	(3.4)	—	(0.1)	(16.5)	1.4
Total assets	815.4	(36.7)	—	(310.2)	(6.5)	(26.3)	435.7
Contingent obligations							15.1
							450.8

Notes:

(1) The exposures in regulatory trading book businesses are subject to market risk and are hence excluded from current exposure.

(2) Amounts reclassified to balance sheet lines.

(3) Primarily includes:

- Reverse repos: reflects netting of collateral and cash legs.

- Loans and advances: cash collateral pledged with counterparties in relation to net derivative liability positions.

- Derivatives: impact of master netting arrangements.

(4) Primarily includes cash management pooling arrangements not allowed under IFRS for loans and advances.

- Settlement balances: exposure not included in current exposure measure

(5) Primarily includes cash in ATMs and branches; Other assets (see note below); and Settlement balances (not within the scope of current exposure).

(6) Balance sheet position shows reverse repurchase and stock borrowing position; current exposure position shows net reverse repurchase / stock borrowing and repurchase / stock lending position.

(7) Balance sheet position includes intangible assets, property, plant and equipment, deferred tax, prepayments and accrued income and assets of disposal groups.

*unaudited

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Credit risk: balance sheet analysis

Current and Potential Exposures presented in Credit risk: management basis are used by Risk Management for risk management and monitoring. However, they exclude certain exposures, primarily trading securities and take account of legal netting agreements that provide a right of legal set-off but do not meet the offset criteria in IFRS. The tables that follow are therefore provided to supplement the disclosures in the Credit risk: management basis section, to reconcile to the balance sheet. The tables in this section include balances relating to disposal groups, reflecting the total credit risk and losses faced by RBS. All the disclosures in this section are audited.

Financial assets

Exposure summary and credit mitigation

The following table analyses financial asset exposures, both gross and net of offset arrangements, as well as credit mitigation and enhancement.

2016	Gross exposure	IFRS offset (1)	Carrying value (2)	Balance sheet offset (3)	Collateral (4) Cash (5)	Securities (6)	Real estate and other Residential (7)	Commercial (7)	Credit enhancement (8)	Exposu post cre mitigati a enhanceme
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£
Cash and balances at central banks	74.3	—	74.3	—	—	—	—	—	—	74
Reverse repos	73.5	(31.7)	41.8	(1.1)	—	(40.7)	—	—	—	
Lending	340.9	(0.6)	340.3	(29.8)	(0.8)	(3.5)	(154.3)	(52.8)	(2.1)	97
Debt securities	72.5	—	72.5	—	—	—	—	—	—	72
Equity shares	0.7	—	0.7	—	—	—	—	—	—	0
Derivatives	298.1	(51.1)	247.0	(197.3)	(28.7)	(8.4)	—	—	(12.6)	
Settlement balances	7.0	(1.5)	5.5	—	—	—	—	—	—	5
Total	867.0	(84.9)	782.1	(228.2)	(29.5)	(52.6)	(154.3)	(52.8)	(14.7)	250
Short positions	(22.1)	—	(22.1)	—	—	—	—	—	—	(22
	844.9	(84.9)	760.0	(228.2)	(29.5)	(52.6)	(154.3)	(52.8)	(14.7)	227

Net of short positions										
2015										
Cash and balances at central banks	79.9	—	79.9	—	—	—	—	—	—	79
Reverse repos	74.3	(34.4)	39.9	(2.5)	—	(37.3)	—	—	—	0
Lending	330.0	(3.0)	327.0	(35.6)	(0.7)	(3.3)	(140.8)	(52.7)	(3.4)	90
Debt securities	82.5	—	82.5	—	—	—	—	—	—	82
Equity shares	1.4	—	1.4	—	—	—	—	—	—	1
Derivatives	386.3	(123.7)	262.6	(214.8)	(27.6)	(7.5)	—	—	(12.7)	
Settlement balances	5.3	(1.2)	4.1	—	—	—	—	—	—	4
Total	959.7	(162.3)	797.4	(252.9)	(28.3)	(48.1)	(140.8)	(52.7)	(16.1)	258
Short positions	(20.8)	—	(20.8)	—	—	—	—	—	—	(20
Net of short positions	938.9	(162.3)	776.6	(252.9)	(28.3)	(48.1)	(140.8)	(52.7)	(16.1)	237

Notes:

(1) Relates to offset arrangements that comply with IFRS criteria and transactions cleared through and novated to central clearing houses, primarily London Clearing House and US Government Securities Clearing Corporation. During 2016, changes in the legal contracts with LCH led to many derivatives cleared through that counterparty being settled to market each day rather than being collateralised as previously. This led to the derecognition of the associated assets and liabilities.

(2) The carrying value on the balance sheet represents the exposure to credit risk by class of financial instrument.

(3) The amount by which credit risk exposure is reduced through arrangements, such as master netting agreements and cash management pooling, which give RBS a legal right to set off the financial asset against a financial liability due to the same counterparty.

(4) RBS 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 debtors; and guarantees of lending from parties other than the borrower. RBS obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

(5) Includes cash collateral pledged by counterparties based on daily mark-to-market movements of net derivative positions with the counterparty.

(6) Represent the fair value of securities received from counterparties, mainly relating to reverse repo transactions as part of netting arrangements.

(7) Property valuations are capped at the loan value and reflect the application of haircuts in line with regulatory rules to indexed valuations. Commercial collateral includes ships and plant and equipment collateral.

(8) Comprises credit derivatives (bought protection) and guarantees against exposures.

Key points

- The majority of the £227.9 billion net exposure comprises cash and balances at central banks, unsecured commercial and personal bank lending and sovereign debt securities.

- Net exposure fell by £9.8 billion or 4% reflecting disposals and run-down within Ulster Bank RoI and Capital Resolution and lower held-for-trading bonds partially offset by higher unsecured lending.

- Lending increase of £6.5 billion primarily reflected growth in PBB and CPB.

Business review Capital and risk management

Credit risk: balance sheet analysis continued

Sector concentration

The following table analyses financial assets by industry sector.

							Other			
		Reverse		Securities			financial	Balance		Exposure
								sheet		post
		repos	Lending	Debt	Equity	Derivatives	assets	value	Offset	offset
2016		£m	£m	£m	£m	£m	£m	£m	£m	£m
Central and local government		219	6,091	58,472	—	2,508	63	67,353	(5,188)	62,165
Financial institutions	- banks	12,860	17,291	3,437	11	145,565	74,250	253,414	(149,941)	103,473
	- other (1)	28,407	33,083	9,738	619	87,965	5,290	165,102	(91,395)	73,707
Personal - mortgages		—	153,319	—	—	—	8	153,327	—	153,327
- unsecured		—	14,492	—	—	39	—	14,531	—	14,531
Property		—	34,756	148	54	1,140	13	36,111	(1,111)	35,000
Construction		—	4,247	—	—	105	35	4,387	(779)	3,608
Manufacturing		43	9,609	198	12	2,007	18	11,887	(1,083)	10,804
Finance leases and instalment credit		—	12,269	—	—	3	—	12,272	(3)	12,269
Retail, wholesale and repairs		—	12,823	7	—	662	2	13,494	(1,610)	11,884
Transport and storage		—	6,428	28	—	1,178	—	7,634	(971)	6,663
Health, education and leisure		—	11,526	17	—	685	11	12,239	(648)	11,591
Hotels and restaurants		—	6,079	6	—	50	—	6,135	(181)	5,954
Utilities		193	3,938	159	—	3,783	15	8,088	(1,603)	6,485
Other		65	18,818	394	88	1,291	71	20,727	(2,324)	18,403
Total gross of provisions		41,787	344,769	72,604	784	246,981	79,776	786,701	(256,837)	529,864
Provisions		—	(4,455)	(82)	(81)	—	—	(4,618)	n/a	(4,618)
Total		41,787	340,314	72,522	703	246,981	79,776	782,083	(256,837)	525,246
2015										
Central and local government		10	6,707	67,720	—	3,307	126	77,870	(6,346)	71,524

Financial institutions	- banks	12,352	19,004	2,378	52	169,517	79,939	283,242		(177,804)	105,438
	- other (1)	27,314	31,981	11,724	956	78,522	3,777	154,274		(84,992)	69,282
Personal - mortgages		—	137,601	—	—	—	—	137,601		—	137,601
- unsecured		—	16,654	—	—	45	—	16,699		—	16,699
Property		—	35,744	124	99	1,343	—	37,310		(1,084)	36,226
Construction		—	4,421	—	3	266	—	4,690		(932)	3,758
Manufacturing		184	9,861	128	160	1,947	94	12,374		(1,593)	10,781
Finance leases and instalment credit		—	11,443	1	—	10	—	11,454		(2)	11,452
Retail, wholesale and repairs		—	12,096	156	31	570	10	12,863		(1,329)	11,534
Transport and storage		—	8,909	87	2	1,494	—	10,492		(873)	9,619
Health, education and leisure		—	10,960	17	6	641	7	11,631		(690)	10,941
Hotels and restaurants		—	5,372	11	—	81	5	5,469		(232)	5,237
Utilities		—	3,463	53	19	3,284	—	6,819		(1,689)	5,130
Other		50	19,899	311	144	1,517	97	22,018		(2,957)	19,061
Total gross of provisions		39,910	334,115	82,710	1,472	262,544	84,055	804,806		(280,523)	524,283
Provisions		—	(7,139)	(194)	(87)	—	—	(7,420)		n/a	(7,420)
Total		39,910	326,976	82,516	1,385	262,544	84,055	797,386		(280,523)	516,863

Note:

(1) Includes loans made by consolidated conduits to asset owning companies.

For geographic concentrations refer to:

- Lending: Loans and related credit metrics and Credit risk management basis: Portfolio overview - asset quality
- Debt securities: Issuer and IFRS measurement and Credit risk - Country risk and Credit risk management basis: Portfolio overview - geography
- Derivatives: Summary and uncollaterised exposures
- Equity shares.

Explanation of Responses:

Business review **Capital and risk management**

Credit risk: balance sheet analysis continued

Asset quality

The asset quality analysis presented below is based on internal asset quality ratings which have ranges for the probability of default. Customers are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades across RBS map to both an asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across portfolios. Debt securities are analysed by external ratings and are therefore excluded from the following table and are set out on pages 342 to 344.

The table that follows details the relationship between internal asset quality (AQ) bands and external ratings published by Standard & Poor's (S&P), for illustrative purposes only. This relationship is established by observing S&P's default study statistics, notably the one year default rates for each S&P rating grade. A degree of judgement is required to relate the probability of default ranges associated with the master grading scale to these default rates given that, for example, the S&P published default rates do not increase uniformly by grade and the historical default rate is nil for the highest rating categories.

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

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

specialist corporate segments given that S&P does not typically assign ratings to such entities.

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Business review **Capital and risk management**

Credit risk: balance sheet analysis continued

													Impairment	
	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10	Past due	Impaired	provision	Total
2016	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Cash and balances at central banks	74.2	—	0.1	—	—	—	—	—	—	—	—	—	—	74.3
Banks														
- Reverse repos	4.7	—	—	6.4	0.6	0.4	0.4	—	0.4	—	—	—	—	12.9
- Derivative cash collateral	0.9	—	1.2	4.4	0.2	—	—	—	—	—	—	—	—	6.7
- Bank loans	6.1	—	2.7	1.2	0.3	0.1	—	—	0.1	—	—	—	—	10.5
- Total	11.7	—	3.9	12.0	1.1	0.5	0.4	—	0.5	—	—	—	—	30.1
Customers														
- Reverse repos	23.2	0.2	0.5	4.4	0.6	—	—	—	—	—	—	—	—	28.9
- Derivative cash collateral	8.1	0.4	1.0	7.3	0.2	—	—	—	—	—	—	—	—	17.0
- Customer loans	25.3	12.3	35.7	107.3	53.7	30.9	20.1	4.5	4.2	1.0	6.6	8.9	(4.5)	306.0
- Total	56.6	12.9	37.2	119.0	54.5	30.9	20.1	4.5	4.2	1.0	6.6	8.9	(4.5)	351.9
Settlement balances and														
other financial assets	3.8	0.2	0.2	0.9	0.1	—	0.2	—	—	0.1	—	—	—	5.5
Derivatives	38.2	1.4	25.9	168.7	9.4	1.1	2.3	—	—	—	—	—	—	247.0
Undrawn commitments	22.9	7.7	15.2	42.8	26.7	11.4	10.7	0.5	0.1	0.6	—	—	—	138.6
Contingent liabilities	0.7	0.4	1.0	7.1	1.5	0.7	0.4	0.1	—	0.1	—	—	—	12.0
Total	208.1	22.6	83.5	350.5	93.3	44.6	34.1	5.1	4.8	1.8	6.6	8.9	(4.5)	859.4
Total %	24.2%	2.6%	9.7%	40.8%	10.9%	5.2%	4.0%	0.6%	0.6%	0.2%	0.7%	1.0%	(0.5%)	100%

	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10	Past due	Impaired	provision	Total
2015	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Cash and balances at central banks	77.5	—	2.3	0.1	—	—	—	—	—	—	—	—	—	79.9
Banks														
- Reverse repos	1.6	0.6	3.5	4.8	1.3	0.4	0.2	—	—	—	—	—	—	12.4
- Derivative cash collateral	3.6	4.6	1.4	1.2	0.2	—	—	—	—	—	—	—	—	11.0
- Bank loans	2.5	0.6	3.4	0.7	0.3	0.1	0.1	—	0.2	—	0.1	—	—	8.0
- Total	7.7	5.8	8.3	6.7	1.8	0.5	0.3	—	0.2	—	0.1	—	—	31.4
Customers														
- Reverse repos	20.7	0.4	1.5	3.2	1.7	0.1	—	—	—	—	—	—	—	27.6
- Derivative cash collateral	9.2	1.1	3.6	3.0	0.2	0.1	—	—	—	—	—	—	—	17.2
- Customer loans	23.3	12.1	28.8	106.6	52.0	29.3	20.3	4.2	2.6	1.1	6.7	10.9	(7.1)	290.8
- Total	53.2	13.6	33.9	112.8	53.9	29.5	20.3	4.2	2.6	1.1	6.7	10.9	(7.1)	335.6
Settlement balances and														
other financial assets	2.3	0.1	0.1	0.6	—	—	—	—	—	—	1.0	—	—	4.1
Derivatives	41.5	65.7	89.1	57.8	6.2	1.1	0.8	—	0.2	0.1	—	—	—	262.5
Undrawn commitments	24.1	6.9	20.1	41.9	27.6	8.8	7.0	0.6	0.2	0.5	—	—	—	137.7
Contingent liabilities	0.9	1.3	1.8	8.3	1.9	0.6	0.9	0.1	0.1	0.1	—	—	—	16.0
Total	207.2	93.4	155.6	228.2	91.4	40.5	29.3	4.9	3.3	1.8	7.8	10.9	(7.1)	867.2
Total %	23.8%	10.8%	17.9%	26.3%	10.5%	4.7%	3.4%	0.6%	0.4%	0.2%	0.9%	1.3%	(0.8%)	100%

Business review Capital and risk management

Credit risk: balance sheet analysis continued

Loans, REIL and impairment provisions

Risk elements in lending (REIL) comprises impaired loans and accruing loans past due 90 days or more as to principal or interest. Impaired loans are all loans (including loans subject to forbearance) for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans. Accruing loans past due 90 days or more comprise loans past due 90 days where no impairment loss is expected.

Loans and related credit metrics

The tables below analyse gross loans and advances (excluding reverse repos) and related credit metrics by reportable segment.

	Gross loans to				Credit metrics				
2016	Banks	Customers	REIL	Provisions	REIL as a % of gross loans to customers	Provisions as a % of REIL	Provisions as a % of gross loans to customers	Impairment losses/ (releases)	Amounts written-off
	£m	£m	£m	£m	%	%	%	£m	£m
UK PBB	504	133,399	1,992	1,292	1.5	65	1.0	83	453
Ulster Bank RoI	2,418	20,130	3,513	1,200	17.5	34	6.0	(113)	2,057
Commercial Banking	582	101,824	1,946	845	1.9	43	0.8	206	577
Private Banking	111	12,188	105	31	0.9	30	0.3	(3)	3
RBS International	18	7,902	109	38	1.4	35	0.5	10	6
NatWest Markets	3,313	17,419	—	1	—	nm	—	—	—
Capital Resolution	4,558	13,569	2,264	802	16.7	35	5.9	312	509
W&G	—	20,791	380	245	1.8	64	1.2	42	68
Central items & other	5,787	256	1	1	0.4	100	0.4	—	22
Total	17,291	327,478	10,310	4,455	3.1	43	1.4	537	3,695

2015									
UK PBB	965	121,552	2,682	1,847	2.2	69	1.5	(6)	695
Ulster Bank RoI	1,971	18,584	3,503	1,911	18.8	55	10.3	(142)	168
Commercial Banking	665	92,002	1,911	749	2.1	39	0.8	69	263
Private Banking	54	11,230	115	37	1.0	32	0.3	13	7
RBS International	6	7,401	92	31	1.2	34	0.4	—	32
NatWest Markets	5,696	16,076	—	1	—	—	—	(7)	—
Capital Resolution	7,097	25,898	3,372	2,266	13.0	67	8.7	(794)	7,689
W&G	—	20,291	461	275	2.3	60	1.4	15	110
Central items & other	2,550	2,077	21	22	1.0	105	1.1	(1)	—
Total	19,004	315,111	12,157	7,139	3.9	59	2.3	(853)	8,964

Key points

- Customer loans increased by £12.4 billion (4%) mainly reflecting lending in UK PBB and Commercial Banking offset by disposals and wind downs in Capital Resolution.

- UK PBB: mortgage growth of £13.8 billion was the principal driver of the £11.4 billion gross lending increase in 2016.

- Commercial Banking: lending growth of £9.7 billion was across a variety of sectors supporting businesses in the UK and Western Europe.

- Ulster Bank RoI: customer lending increased by £1.5 billion reflecting new lending, invoice finance and foreign exchange movements, partially offset by portfolio sales and repayments.

- Private Banking: lending growth of £1.0 billion primarily mortgage lending.

- Capital Resolution: lending fell by £14.9 billion including wind downs and disposals of Markets (£5.2 billion), GTS (£2.4 billion) and Shipping (£1.8 billion).

- REIL and loan impairment provisions declined by £1.8 billion and £2.7 billion to £10.3 billion and £4.5 billion respectively. These reductions were predominantly driven by the portfolio sale of non-performing SME lending and buy-to-let mortgages in Ulster Bank RoI in Q4 2016 and related write-offs. These decreases were offset by the adverse impact of exchange rate movements of £1.0 billion in REIL and £0.5 billion in loan impairment provisions respectively.

- Net impairment charge of £537 million largely related to the Shipping portfolio within Capital Resolution.

- Amounts written off were significantly lower at £3.7 billion compared with £9.0 billion in 2015, primarily in commercial real estate (£1.5 billion in 2016 compared with £6.2 billion in 2015).

Explanation of Responses:

Business review **Capital and risk management**

Credit risk: management basis continued

Impairment charge and provisions

The tables below analyse the categories of loan impairment losses/(releases) and provisions by reportable segment.

	Impairment losses/(releases)				Impairment provision			
	Individual	Collective	Latent	Total	Individual	Collective	Latent	Total
2016	£m	£m	£m	£m	£m	£m	£m	£m
UK PBB	—	83	—	83	—	1,116	176	1,292
Ulster Bank RoI	(8)	99	(204)	(113)	69	1,053	78	1,200
Commercial Banking	196	3	7	206	479	278	88	845
Private Banking	2	—	(5)	(3)	27	—	4	31
RBS International	9	—	1	10	32	—	6	38
NatWest Markets	—	—	—	—	—	—	1	1
Capital Resolution	331	(2)	(17)	312	761	23	18	802
W&G	5	35	2	42	26	190	29	245
Central items & other	—	—	—	—	1	—	—	1
Total	535	218	(216)	537	1,395	2,660	400	4,455

2015								
UK PBB	—	73	(79)	(6)	1	1,665	181	1,847
Ulster Bank RoI	8	(126)	(24)	(142)	46	1,620	245	1,911
Commercial Banking	58	33	(22)	69	373	299	77	749
Private Banking	8	—	5	13	28	—	9	37
RBS International	1	—	(1)	—	27	—	4	31
NatWest Markets	—	—	(7)	(7)	—	—	1	1
Capital Resolution	(505)	(22)	(267)	(794)	2,173	52	41	2,266
W&G	20	8	(13)	15	24	225	26	275
Central items & other	—	(1)	—	(1)	22	—	—	22
Total	(410)	(35)	(408)	(853)	2,694	3,861	584	7,139

Credit risk: balance sheet analysis continued

Sector and geographical concentration

The tables below analyse gross loans and advances to banks and customers (excluding reverse repos) and related credit metrics by sector and geography based on the location of lending office. Ulster Bank RoI contributes a significant proportion of the European loan exposure. Refer to Business review on page 188.

				Credit metrics				
				REIL	Provisions	Provisions	Impairment	
	Gross			as a % of	as a %	as a % of	losses/	Amounts
	loans	REIL	Provisions	gross loans	of REIL	gross loans	(releases)	written-off
2016	£m	£m	£m	%	%	%	£m	£m
Central and local government	6,091	1	1	—	100	—	1	2
Finance	33,083	61	51	0.2	84	0.2	(2)	17
Personal - mortgages (1)	153,319	4,091	1,019	2.7	25	0.7	222	290
- unsecured	14,492	1,113	900	7.7	81	6.2	138	396
Property	34,756	1,370	489	3.9	36	1.4	(162)	1,485
Construction	4,247	264	137	6.2	52	3.2	8	153
of which: commercial real estate	*26,265*	*1,407*	*511*	*5.4*	*36*	*1.9*	*(184)*	*1,483*
Manufacturing	9,609	173	90	1.8	52	0.9	13	90
Finance leases and instalment credit	12,269	139	79	1.1	57	0.6	8	12
Retail, wholesale and repairs	12,823	283	182	2.2	64	1.4	39	169
Transport and storage	6,428	1,388	422	21.6	30	6.6	419	301
Health, education and leisure	11,526	381	129	3.3	34	1.1	8	75
Hotels and restaurants	6,079	211	107	3.5	51	1.8	13	116
Utilities	3,938	95	50	2.4	53	1.3	(20)	2
Other	18,818	740	399	3.9	54	2.1	68	587
Latent	—	—	400	—	—	—	(216)	—
Total	327,478	10,310	4,455	3.1	43	1.4	537	3,695
Of which:								
UK								

Personal - mortgages	137,427	943	143	0.7	15	0.1	(4)	3
- unsecured	14,198	1,060	853	7.5	80	6.0	132	362
Property and construction	37,942	1,543	537	4.1	35	1.4	(98)	676
of which: commercial real estate	*25,311*	*1,323*	*426*	*5.2*	*32*	*1.7*	*(102)*	*600*
Other	115,833	3,133	1,299	2.7	41	1.1	666	629
Latent	—	—	318	—	—	—	(12)	—
Total	305,400	6,679	3,150	2.2	47	1.0	684	1,670
Europe								
Personal - mortgages	15,548	3,144	872	20.2	28	5.6	226	287
- unsecured	265	52	46	19.6	88	17.4	5	11
Property and construction	1,055	85	84	8.1	99	8.0	(56)	933
of which: commercial real estate	*947*	*78*	*78*	*8.2*	100	*8.2*	*(83)*	*878*
Other	3,920	279	165	7.1	59	4.2	(156)	665
Latent	—	—	83	—	—	—	(204)	—
Total	20,788	3,560	1,250	17.1	35	6.0	(185)	1,896
Total banks	17,291	—	—	—	—	—	—	—

Note:

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

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Business review Capital and risk management

Credit risk: balance sheet analysis continued

				Credit metrics				
				REIL	Provisions	Provisions	Impairment	
	Gross			as a % of	as a %	as a % of	losses/	Amounts
	loans	REIL	Provisions	gross loans	of REIL	gross loans	(release)	written-off
2015	£m	£m	£m	%	%	%	£m	£m
Central and local government	6,707	1	1	—	100	—	—	—
Finance	31,981	87	61	0.3	70	0.2	(10)	165
Personal - mortgages (1)	137,601	3,637	1,006	2.6	28	0.7	(82)	171
- unsecured	16,654	1,331	1,151	8.0	86	6.9	122	513
Property	35,744	3,505	2,012	9.8	57	5.6	(557)	5,999
Construction	4,421	357	269	8.1	75	6.1	(14)	313
of which: commercial real estate	*27,630*	*3,560*	*2,054*	*12.9*	*58*	*7.4*	*(811)*	*6,151*
Manufacturing	9,861	263	154	2.7	59	1.6	—	154
Finance leases and instalment credit	11,443	107	79	0.9	74	0.7	(8)	37
Retail, wholesale and repairs	12,096	434	299	3.6	69	2.5	7	325
Transport and storage	8,909	563	258	6.3	46	2.9	115	370
Health, education and leisure	10,960	394	190	3.6	48	1.7	14	171
Hotels and restaurants	5,372	336	201	6.3	60	3.7	1	346
Utilities	3,463	131	63	3.8	48	1.8	8	27
Other	19,899	1,010	810	5.1	80	4.1	(37)	340
Latent	—	—	584	—	—	—	(408)	—
Total customers	315,111	12,156	7,138	3.9	59	2.3	(849)	8,931
Of which:								
UK								
Personal - mortgages	123,653	1,083	158	0.9	15	0.1	17	36
- unsecured	14,348	1,262	1,085	8.8	86	7.6	126	501
Property and construction	38,006	2,814	1,282	7.4	46	3.4	27	2,773
	25,676	*2,568*	*1,107*	*10.0*	*43*	*4.3*	*(121)*	*2,575*

of which: commercial real estate								
Other	110,193	2,198	1,182	2.0	54	1.1	125	800
Latent	—	—	330	—	—	—	(303)	—
Total	286,200	7,357	4,037	2.6	55	1.4	(8)	4,110
Europe								
Personal - mortgages	13,908	2,550	844	18.3	33	6.1	(101)	135
- unsecured	775	49	45	6.3	92	5.8	(5)	12
Property and construction	1,993	1,008	966	50.6	96	48.5	(593)	3,539
of which: commercial real estate	*1,628*	*974*	*935*	*59.8*	*96*	*57.4*	*(688)*	*3,576*
Other	7,148	1,011	864	14.1	85	12.1	(8)	1,014
Latent	—	—	255	—	—	—	(103)	—
Total	23,824	4,618	2,974	19.4	64	12.5	(810)	4,700
Total banks	19,004	1	1	—	100	—	(4)	33

Note:

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

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Credit risk: balance sheet analysis continued

Risk elements in lending

The tables below analyse REIL by segment.

	2016									2015
	UK PBB	Ulster Bank RoI	Commercial Banking	Private Banking	RBS International	Capital Resolution	W&G	Central items & other	Total	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January	2,682	3,503	1,911	115	92	3,372	461	21	12,157	28,219
Inter segment transfers	(187)	1,404	496	—	—	(1,685)	(28)	—	—	—
Currency translation and other adjustments	—	557	—	—	9	445	—	2	1,013	(860)
Additions	877	1,326	1,149	25	51	1,685	193	—	5,306	4,250
Transfers between REIL and potential problem loans	(155)	—	9	(6)	6	—	(20)	—	(166)	(222)
Transfer to performing book	(290)	(454)	(158)	—	(14)	(5)	(39)	—	(960)	(1,120)
Repayments and disposals	(482)	(766)	(884)	(26)	(29)	(1,039)	(119)	—	(3,345)	(8,966)
Amounts written-off	(453)	(2,057)	(577)	(3)	(6)	(509)	(68)	(22)	(3,695)	(9,144)
At 31 December	1,992	3,513	1,946	105	109	2,264	380	1	10,310	12,157

The table below analyses REIL between UK and overseas, based on the location of the lending office.

	2016			2015	
	Impaired loans	Accruing past due		Impaired loans	Accruing past due
	£m	£m		£m	£m
- UK	5,557	1,122		6,095	1,262
- overseas	3,308	323		4,775	25
Total	8,865	1,445		10,870	1,287

Notes:

(1) REIL are stated without giving effect to any security held that could reduce the eventual loss should it occur or to any provisions marked.

(2) For details on impairment methodology refer to Credit risk on page 293 and Accounting policy 15 Impairment of financial assets on page 390.

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Credit risk: balance sheet analysis continued

Provisions

The tables below analyse provisions by segment.

	2016										2
		Ulster							Central		
	UK	Bank	Commercial	Private	RBS	NatWest	Capital		items		
	PBB	RoI	Banking	Banking	International	Markets	Resolution	W&G	& other	Total	T
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	
At 1 January	1,847	1,911	749	37	31	1	2,266	275	22	7,139	18
Inter segment transfers	(173)	1,257	443	—	—	—	(1,527)	—	—	—	
Currency translation and other adjustments	—	215	8	—	3	—	253	—	1	480	(
Repayments and disposals	—	—	—	—	—	—	—	—	—	—	(
Amounts written-off	(453)	(2,057)	(577)	(3)	(6)	—	(511)	(68)	(22)	(3,697)	(9.
Recoveries of amounts previously written-off	28	24	28	1	—	—	27	1	—	109	
Charges/(releases) to income statement from continuing operations	83	(113)	206	(3)	10	—	312	42	—	537	(
Charges/(releases) to income statement from discontinued operations	—	—	—	—	—	—	—	—	—	—	
Unwind of discount	(40)	(37)	(12)	(1)	—	—	(18)	(5)	—	(113)	(
At 31 December	1,292	1,200	845	31	38	1	802	245	1	4,455	7

Past due analysis		
The table below shows loans and advances to customers that were past due at the balance sheet date but are not considered impaired.		
	2016	2015
	£m	£m
Past due 1-29 days	3,852	4,150
Past due 30-59 days	753	769
Past due 60-89 days	512	530
Past due 90 days or more	1,445	1,287
Total	6,562	6,736
Past due analysis by sector		
Personal	3,577	3,437
Property and construction	1,020	1,341
Financial institution	94	187
Other corporate	1,871	1,771
Total	6,562	6,736

Explanation of Responses:

Business review Capital and risk management

Credit risk: balance sheet analysis continued

Securities and available-for-sale reserves

Debt securities

The table below analyses debt securities by issuer and IFRS measurement classifications. The other financial institutions category includes US government sponsored agencies and securitisation entities, the latter principally relating to asset-backed securities (ABS). Ratings are based on the lowest of Standard & Poor's, Moody's and Fitch.

2016	Central and local government			Banks	Other financial institutions	Corporate	Total	Of which ABS
	UK	US	Other					
	£m	£m	£m	£m	£m	£m	£m	£m
Held-for-trading (HFT)	2,615	4,133	14,087	821	2,299	549	24,504	886
Designated as at fair value (DFV)	—	—	25	—	2	—	27	—
Available-for-sale (AFS)	10,581	6,953	15,678	1,852	4,072	118	39,254	2,263
Loans and receivables (LAR)	—	—	—	—	3,774	194	3,968	3,814
Held-to-maturity (HTM)	4,769	—	—	—	—	—	4,769	—
Total	17,965	11,086	29,790	2,673	10,147	861	72,522	6,963
Ratings								
AAA	—	—	11,478	1,610	6,024	36	19,148	3,993
AA to AA+	17,965	11,086	5,533	481	720	34	35,819	244
A to AA-	—	—	9,727	238	2,128	150	12,243	1,627
BBB- to A-	—	—	2,737	155	698	378	3,968	645
Non-investment grade	—	—	315	69	458	31	873	381
Unrated	—	—	—	120	119	232	471	73
Total	17,965	11,086	29,790	2,673	10,147	861	72,522	6,963
Available-for-sale								
AFS reserves (gross of tax)	79	(66)	190	5	144	(6)	346	46
Gross unrealised gains	768	56	504	8	93	2	1,431	75
Gross unrealised losses	(16)	(123)	(13)	(1)	(43)	(2)	(198)	(32)
Of which:								

less than 12 months	(16)	(123)	(13)	(1)	(11)	(2)	(166)			(1)
more than 12 months	—	—	—	—	(32)	—	(32)			(31)

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Business review Capital and risk management

Credit risk: balance sheet analysis continued								
	Central and local government				Other financial			Of which
	UK	US	Other	Banks	institutions	Corporate	Total	ABS
2015	£m	£m	£m	£m	£m	£m	£m	£m
Held-for-trading (HFT)	4,107	4,627	22,222	576	3,689	636	35,857	707
Designated as at fair value (DFV)	—	—	111	—	—	—	111	—
Available-for-sale (AFS)	9,124	10,359	12,259	1,801	5,599	108	39,250	2,501
Loans and receivables (LAR)	—	—	—	1	2,242	144	2,387	2,222
Held-to-maturity (HTM)	4,911	—	—	—	—	—	4,911	—
Total	18,142	14,986	34,592	2,378	11,530	888	82,516	5,430
Of which US agencies	—	—	—	—	806	—	806	—
Short positions (HFT)	(4,697)	(3,347)	(11,796)	(391)	(411)	(165)	(20,807)	—
Ratings								
AAA	—	—	11,696	1,696	5,234	3	18,629	3,366
AA to AA+	18,142	14,986	6,879	119	1,611	66	41,803	261
A to AA-	—	—	8,880	420	1,991	147	11,438	445
BBB- to A-	—	—	6,785	79	1,460	301	8,625	363
Non-investment grade	—	—	352	32	526	200	1,110	446
Unrated	—	—	—	32	708	171	911	549
Total	18,142	14,986	34,592	2,378	11,530	888	82,516	5,430
Available-for-sale								
AFS reserves (gross of tax)	12	(78)	90	4	114	4	146	60
Gross unrealised gains	383	104	270	6	110	7	880	90
Gross unrealised losses	(7)	(62)	(9)	(1)	(58)	(3)	(140)	(42)
Of which:								
less than 12 months	(7)	(58)	(9)	(1)	(30)	(3)	(108)	(14)
more than 12 months	—	(4)	—	—	(28)	—	(32)	(28)

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Business review Capital and risk management

Credit risk: balance sheet analysis continued

Asset-backed securities

The table below summarises the ratings of asset-backed securities on the balance sheet.

	RMBS (1)							
2016	Government sponsored or similar (2)	Prime	Non-conforming	Sub-prime	CMBS (1)	CDOs & CLOs	Other ABS	Total
	£m	£m	£m	£m	£m	£m	£m	£m
AAA	—	654	—	—	—	23	3,316	3,993
AA to AA+	—	52	155	—	—	3	34	244
A to AA-	—	460	2	—	22	33	1,110	1,627
BBB- to A-	—	84	—	—	470	21	70	645
Non-investment grade (3)	—	182	1	8	15	121	54	381
Unrated (4)	—	5	—	—	—	19	49	73
Total	—	1,437	158	8	507	220	4,633	6,963
2015								
AAA	—	266	749	2	—	78	2,271	3,366
AA to AA+	—	2	150	—	1	12	96	261
A to AA-	109	4	24	5	13	9	281	445
BBB- to A-	—	13	144	20	21	121	44	363
Non-investment grade (3)	—	23	25	143	24	169	62	446
Unrated (4)	—	10	—	1	470	24	44	549
Total	109	318	1,092	171	529	413	2,798	5,430

Notes:

(1) Residential mortgage-backed securities (RMBS) and commercial mortgaged-backed securities (CMBS) are securities that represent an interest in a portfolio of residential and commercial mortgages respectively. Repayments made on the underlying mortgages are used to make payments to holders of the mortgage-backed securities (MBS). The risk of the MBS will vary primarily depending on the quality and geographic region in which the underlying mortgage assets are located and the credit enhancement of the securitisation structure. Several tranches of notes are issued, each secured against the same portfolio of mortgages, but providing differing levels of seniority to match the risk appetite of investors. The most junior

(or equity) notes will suffer early capital and interest losses experienced by the referenced mortgage collateral, with each more senior note benefiting from the protection provided by the subordinated notes below. Additional credit enhancements may be provided to the holder of senior MBS notes.

The main categories of mortgages that serve as collateral to RMBS held by RBS are set out below and described in the Glossary on page 619. The US market has more established definitions of differing underlying mortgage quality and these are used as the basis for RBS's RMBS categorisation.

(2) Includes US agency and Dutch government guaranteed securities.

(3) Comprises HFT £282 million (2015 - £303 million), AFS £99 million (2015 - £106 million) and LAR nil (2015 - £37 million).

(4) Comprises HFT £25 million (2015 - £46 million), AFS nil (2015 - £28 million) and LAR £48 million (2015 - £475 million).

Business review Capital and risk management

Credit risk: balance sheet analysis continued

Equity shares

The table below analyses holdings of equity shares for eurozone countries and other countries with balances of more than £50 million by country, issuer and measurement classification. The HFT positions are used mainly for economic hedging of debt issuances and equity derivatives. The AFS balances are individually small holdings in unlisted companies, mainly acquired through debt for equity transactions in Restructuring.

	HFT				AFS/DFV (1)					
Countries	Banks	Other financial institutions (2)	Corporate	Total HFT	Banks	Other financial institutions (2)	Corporate	Total AFS/DFV	Total	AFS reserves
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
2016										
Luxembourg	—	91	—	91	—	—	—	—	91	—
Belgium	—	—	—	—	—	80	—	80	80	6
Netherlands	—	—	—	—	—	—	61	61	61	2
Other	—	8	11	19	—	5	3	8	27	—
Total eurozone	—	99	11	110	—	85	64	149	259	8
UK	10	32	11	53	—	284	9	293	346	(37)
US	—	1	—	1	—	53	2	55	56	12
Other	—	—	2	2	—	38	2	40	42	36
Total	10	132	24	166	—	460	77	537	703	19
2015										
Total	47	283	330	660	5	640	80	725	1,385	302

Notes:

(1) Designated as at fair value through profit or loss balances are £171 million (2015 - £147 million), of which £142 million are other financial institutions (2015 - £111 million) and

£29 million are corporate (2015 - £36 million).

(2) Includes government sponsored entities.

(3) HFT short positions of £3 million (2015 - £2 million) did not relate to non-periphery eurozone countries.

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Business review **Capital and risk management**

Credit risk: balance sheet analysis continued

Derivatives

Summary and net uncollateralised exposures

The table below analyses derivatives by type of contract. The master netting agreements and collateral shown below do not result in a net presentation on the balance sheet under IFRS.

	2016							2015		
	Notional									
	GBP	USD	Euro	Other	Total	Assets	Liabilities	Notional	Assets	Liabilities
	£bn	£bn	£bn	£bn	£bn	£m	£m	£bn	£m	£m
Interest rate	3,106	7,179	6,385	1,303	17,973	170,524	158,485	19,783	206,138	194,854
Exchange rate	418	1,969	856	1,208	4,451	75,442	77,148	3,702	54,938	58,243
Credit	—	22	20	—	42	682	557	67	909	840
Equity and commodity	4	7	12	2	25	333	285	18	559	796
Balance sheet	3,528	9,177	7,273	2,513	22,491	246,981	236,475	23,570	262,544	254,733
Counterparty mark-to-market netting						(197,288)	(197,288)		(214,800)	(214,800)
Cash collateral						(28,742)	(20,417)		(27,629)	(25,729)
Securities collateral						(8,435)	(11,048)		(7,535)	(8,213)
Net exposure						12,516	7,722		12,580	5,991
Banks (1)						830	1,061		1,011	1,311
Other financial institutions (2)						2,646	1,428		2,864	1,468
Corporate (3)						8,196	5,065		7,816	3,108
Government (4)						844	168		889	104
Net exposure						12,516	7,722		12,580	5,991
UK						7,329	2,300		6,270	1,199
Europe						3,300	2,485		4,069	2,408
US						757	1,738		639	714
RoW						1,130	1,199		1,602	1,670
Net exposure						12,516	7,722		12,580	5,991

Asset quality of uncollateralised derivative assets	2016		2015	
	£m		£m	

AQ1	1,415		2,335	
AQ2	582		829	
AQ3	2,870		3,421	
AQ4	4,908		3,923	
AQ5	1,028		1,260	
AQ6	449		275	
AQ7	1,222		226	
AQ8	25		39	
AQ9	4		177	
AQ10	13		95	
Net exposure	12,516		12,580	

Notes:

(1) Transactions with certain counterparties with whom RBS has netting arrangements but collateral is not posted on a daily basis; certain transactions with specific terms that may not fall within netting and collateral arrangements; derivative positions in certain jurisdictions for example China where the collateral agreements are not deemed to be legally enforceable.

(2) Transactions with securitisation vehicles and funds where collateral posting is contingent on RBS's external rating.

(3) Predominantly large corporate with whom RBS may have netting arrangements in place, but operational capability does not support collateral posting.

(4) Sovereigns and supranational entities with one way collateral agreements in their favour.

(5) The notional amount of interest rate derivatives include £9,724 billion (2015 - £11,555 billion) in respect of contracts cleared through central clearing counterparties. The associated derivatives assets and liabilities including variation margin reflect IFRS offset of £51 billion (2015 - £124 billion) and £51 billion (2015 - £118 billion) respectively.

Key point

- At Group level, derivative assets and liabilities reduced reflecting lower trading volumes of £34 billion, TriOptima tear-ups of £9 billion, partially offset by the impact of foreign exchange movements. Increases in trading activity in NatWest Markets of £15 billion was more than offset by disposals and run-off in Capital Resolution.

Credit risk: balance sheet analysis continued

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. The following table shows credit valuation adjustments (CVA) and other valuation reserves. CVA represents an estimate of the adjustment to fair value that a market participant would make to incorporate the risk inherent in derivative exposures. For details of CVA methodology, refer to Note 9 on the consolidated accounts: Financial instruments - valuation.

	2016	2015
	£m	£m
Funding valuation adjustments (FVA)	936	752
Credit valuation adjustments (CVA)	618	774
Bid-offer reserves	334	304
Product and deal specific	643	660
Valuation reserves	2,531	2,490
The table below analyses CVA relating to counterparties by rating and sector.		
	2016	2015
	£m	£m
Ratings		
AAA	4	37
AA to AA+	22	66
A to AA-	52	49
BBB- to A-	388	293
Non-investment grade and unrated	152	329
	618	774
Counterparty		
Banks	22	18
Other financial institutions	70	126
Corporate	337	470
Government	189	160
	618	774

Key points

- FVA reserves increased by £184 million during 2016, primarily driven by interest rates tightening with the movements in the first half of the year partially reversing in the second half of 2016.

- The decrease in CVA reserves of £156 million, was driven by credit spreads tightening together with trade close-outs and novations.

- The increase in bid-offer reserves of £30 million mainly reflected sterling weakening against all major currencies.

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Credit risk: balance sheet analysis continued

Derivatives: settlement basis and central counterparties

The table below analyses the derivative notional and fair value by trading and settlement method.

	Notional				Asset		Liability	
		Traded over the counter						
2016	Traded on recognised exchanges £bn	Settled by central counterparties £bn	Not settled by central counterparties £bn	Total £bn	Traded on recognised exchanges £m	Traded over the counter £m	Traded on recognised exchanges £m	Traded over the counter £m
Interest rate	2,849	9,724	5,400	17,973	—	170,524	—	158,485
Exchange rate	8	—	4,443	4,451	—	75,442	—	77,148
Credit	—	—	42	42	—	682	—	557
Equity and commodity	5	—	20	25	—	333	4	281
Total	2,862	9,724	9,905	22,491	—	246,981	4	236,471
2015								
Interest rate	2,761	11,585	5,437	19,783	—	206,138	2	194,852
Exchange rate	23	—	3,679	3,702	—	54,938	—	58,243
Credit	—	—	67	67	—	909	—	840
Equity and commodity	1	—	17	18	1	558	44	752
Total	2,785	11,585	9,200	23,570	1	262,543	46	254,687

Market risk

Definition

Market risk is the risk of losses arising from fluctuations in interest rates, credit spreads, foreign currency rates, equity prices, commodity prices and other factors, such as market-implied volatilities, that may lead to a reduction in earnings, economic value or both.

RBS is exposed to traded market risk through its trading activities and to non-traded market risk as a result of its banking activities. It manages its traded and non-traded market risk exposures separately, largely in line with the regulatory definitions of the trading and non-trading books.

The following disclosures in this section are audited:

- Traded market risk - Internal VaR
- Non-traded market risk:
  - Internal banking book VaR; and
  - Foreign exchange risk

Key developments in 2016*

Traded market risk:

- The year was characterised by higher market volatility. This was particularly notable during Q1 2016 - due to market concerns over the stability of the financial sector - and around key events, such as the UK referendum on EU membership in June and the US presidential election in November.
- NatWest Markets significantly reduced its traded market risk exposure in the run-up to these key events, reflecting market uncertainty. Value-at-Risk (VaR) fell as low as £11 million on 22 June, the day before the EU referendum, from £16 million at the start of that month. The focus of the risk reduction was in the Rates business.
- Market flows increased markedly following these events, supporting NatWest Markets' customer activity. Given the significant risk reduction achieved in recent years, notably in Capital Resolution, by year-end 2016 the Group's VaR profile was more reflective of NatWest Markets' areas of activity in line with its strategic focus.

- Total market risk RWAs fell 18% or £3.8 billion to £17.4 billion, driven by reductions under both the standardised approach and the internal model approach.

- The majority of the VaR back-testing exceptions by legal entity during the year were driven by the increased market volatility.

Non-traded market risk:

- The non-traded market risk appetite statement and metrics were revised in early 2016. The risk appetite metrics were enhanced to capture a combination of earnings-based and economic value-based metrics, as prescribed by regulatory guidelines. The appetite framework was also aligned to RBS's capital framework and directly supports the strategic risk objectives of maintaining capital adequacy and delivering stable earnings growth.

- Hedging activity aims to reduce RBS's sensitivity to potential adverse impacts of exchange rate and interest rate movements, in particular on its Common Equity Tier 1 ratio. Ahead of the EU referendum, the residual sensitivity of this ratio was low and no adverse impact from RBS's economic risk exposure resulted from the outcome of the vote. However, the sensitivity of interest income to a further downward shock in interest rates increased after the referendum as interest rates fell sharply, with the UK base rate cut from 0.5% to 0.25%. This reflected the limited ability of banks, including RBS, to pass on further rate cuts to customers that already receive low nominal returns on deposits. For more commentary on earnings sensitivity, refer to page 364.

*unaudited

Market risk continued

Sources of risk*

Traded market risk

The majority of traded market risk exposure arises in NatWest Markets and Capital Resolution.

The primary objective of RBS's trading activities is to provide a range of financing, risk management and investment services to its customers - including major corporations and financial institutions around the world. From a market risk perspective, the trading activities are focused on the following markets: currencies; rates; securitised products; and traded credit.

RBS undertakes transactions in financial instruments including debt securities, loans, deposits and equities, as well as securities financing and derivatives.

Some of these transactions involve trading or clearing financial instruments on an exchange, including interest rate swaps, futures and options. Holders of these instruments provide margin on a daily basis with cash or other security at the exchange.

Other products are not transacted on an exchange. Of these over-the-counter transactions, those with standard terms may be cleared through central counterparties, while those that are more complex are settled directly with the counterparty and may give rise to counterparty credit risk. For more information on the management of counterparty credit risk, refer to the Credit risk section on page 292.

Non-traded market risk

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

Non-traded market risk is largely managed in line with the following key categories: interest rate risk; credit spread risk; foreign exchange risk; equity risk; and accounting volatility risk.

*unaudited

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Explanation of Responses:

Market risk continued

Interest rate risk

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

NTIRR comprises three primary risk factors: gap risk, basis risk and option risk. For more information, refer to page 364.

Credit spread risk

Credit spread risk arises from the potential adverse economic impact of a move in the spread between bond yields and swap rates, where the bond portfolios are accounted at fair value in the non-trading book.

Foreign exchange risk

Non-traded foreign exchange risk exposures arise from two main sources:

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

Equity risk

Non-traded equity risk is the potential variation in income and reserves arising from changes in the values of non-trading book equity positions. Equity exposures may arise through strategic acquisitions, venture capital investments and certain restructuring arrangements.

Accounting volatility risk

Accounting volatility risk arises when a non-trading book exposure is accounted for at amortised cost but economically hedged by a derivative that is accounted for at fair value. Although this is not an economic risk, the difference in accounting between the exposure and the hedge creates volatility in the income statement.

Pension risk

Pension-related activities also give rise to market risk. Refer to page 282 for more information on risk related to pensions.

*unaudited

Market risk continued

Risk governance*

RBS manages the key categories of traded and non-traded market risk separately. Each category is discussed in dedicated sections below.

Responsibility for identifying, measuring, monitoring and controlling the market risk arising from trading or non-trading activities lies with the relevant trading or non-trading business, with second-line-of-defence oversight provided by the Market Risk function, headed by the Director of Market Risk.

Market risk positions are reported monthly to the Executive Risk Forum (ERF) and quarterly to the Board Risk Committee. In addition, traded market risk positions are reported monthly to the Treasury and Market Risk Committee and non-traded market risk positions are reported to the ALCo (monthly in the case of interest rate, credit spread and accounting volatility risks and quarterly in the case of foreign exchange and equity risks).

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

RBS's policy is to manage risk exposures within an appetite that is set by the ERF and, in the case of non-traded market risk, endorsed by the ALCo. This appetite is expressed in the form of exposure limits.

Risk appetite*

RBS's qualitative market risk appetite is set out in policy statements.

Its quantitative market risk appetite is expressed in terms of limits for the trading and non-trading activities that are consistent with business plans.

The Market Risk Committee cascades the limits further down the organisation as required. For each trading business, a document known as a dealing authority compiles details of all applicable limits and trading restrictions.

The limit framework at RBS level comprises VaR, stressed value-at-risk (SVaR) and sensitivity and stress limits (for more details on VaR and SVaR, refer to pages 354 to 359). The limit framework at trading unit level also comprises additional metrics that are specific to the market risk exposures within its scope. These additional metrics aim to control various risk dimensions such as product type, exposure size, aged inventory, currency and tenor.

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

To ensure approved limits are not breached and that RBS remains within its risk appetite, triggers at RBS and lower levels have been set such that if exposures exceed a specified level, action plans are developed by the front office, Market Risk and Finance.

For further information on risk appetite, refer to page 222.

*unaudited

Market risk continued

Risk controls and assurance

For information on risk controls and assurance, refer to page 228.

Traded market risk

Risk identification and assessment

Identification and assessment of traded market risk is achieved through gathering, analysing, monitoring and reporting market risk information by business line or at a consolidated level. Industry expertise, continued system developments and techniques such as stress testing are also used to enhance the effectiveness of the identification and assessment of all material market risks.

This is complemented by the New Product Risk Assessment process, which requires market risk teams to assess and quantify the market risk associated with all proposed new products.

Risk monitoring*

Traded market risk exposures are monitored against limits and analysed daily by market risk reporting and control functions. A daily report that summarises market risk exposures against the limits set by the ERF is sent to the Chief Risk Officer and market risk managers across the function.

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

Businesses' profit and loss performance is monitored automatically via loss triggers which, if breached, require a remedial action plan to be agreed with the Market Risk function. The loss triggers are set using both a fall-from-peak approach and an absolute loss level.

The Market Risk function also prepares daily risk reports that detail exposures against a more granular set of limits and triggers.

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

In addition, as noted under Risk governance above, regular updates on traded market risk positions are provided to the ERF, the Board Risk Committee, Treasury and the Market Risk Committee.

The reporting and updates facilitate frequent reviews and discussions of traded market risk exposures and related issues between the market risk functions, senior management and the front office.

*unaudited

Market risk continued

Risk measurement

RBS uses a comprehensive set of methodologies and techniques to measure traded market risk.

The main risk measurement methods are VaR, SVaR and the incremental risk charge. Risks that are not adequately captured by VaR or SVaR are captured by the Risks not in VaR (RNIV) framework to ensure that RBS is adequately capitalised for market risk. In addition, stress testing is used to identify any vulnerabilities and potential losses in excess of VaR and SVaR.

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

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

Value-at-risk*

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

For internal risk management purposes, VaR assumes a time horizon of one trading day and a confidence level of 99%. The VaR model is based on a historical simulation, utilising market data from the previous 500 days on an equally weighted basis.

The internal traded VaR model captures all trading book positions including those products approved by the regulator. For an explanation of the distinction between internal VaR and regulatory VaR, refer to page 361.

*unaudited

Market risk continued

The internal VaR model captures the potential impact of the following risk factors:

- General interest rate risk - which arises from the impact of changes in interest rates and volatilities on cash instruments and derivatives. This includes interest rate tenor basis risk and cross-currency basis risk.
- Specific interest rate risk - which arises from the impact of changes in the credit spreads of sovereign bonds, corporate bonds, securitised products and credit derivatives.
- Currency risk - which arises from the impact of changes in currency rates and volatilities.
- Equity risk - which arises from the impact of changes in equity prices, volatilities and dividend yields.
- Commodity risk - which arises from the impact of changes in commodity prices and volatilities.

When simulating potential movements in risk factors, a combination of absolute and relative returns is used, depending on the risk factor.

The following types of risk - which are components of the above-mentioned factors - are also considered:

- Basis risk - which is the risk that imperfect correlation between two instruments in a hedging strategy creates the potential for excess gains or losses, thus adding risk to the position;
- Prepayment risk - which is the risk associated with early unscheduled return of principal on a fixed rate security; and
- Inflation risk - which is the risk of a decrease in the value of instruments as a result of changes in inflation rates and associated volatilities.

VaR limitations*

Historical VaR and RBS’s implementation of this risk measurement methodology have a number of known limitations, as summarised below, and VaR should be interpreted in light of these. RBS’s approach is to supplement VaR with other risk metrics that address these limitations to ensure appropriate coverage of all material market risks.

Historical simulation VaR may not provide the best estimate of future market movements. It can only provide a forecast of portfolio losses based on events that occurred in the past. The RBS model uses the previous 500 days of data; this period represents a balance between model responsiveness to recent shocks and risk factor data coverage.

Market data time series are updated on a daily basis, with a ten-working-day time lag.

The use of a 99% confidence level VaR statistic does not provide information about losses beyond this level, usually referred to as 'tail' risks. These risks are more appropriately assessed using measures such as SVaR and stress testing.

Finally, where market data time series are not appropriate (due to poor quality or a lack of liquidity in the market), RBS uses proxy time series or excludes the risk factor from its VaR model and capitalises the risk through its RNIV framework.

1-Day 99% traded internal VaR 2016

*unaudited

Business review **Capital and risk management**

Market risk continued

The table below analyses 1-day 99% internal VaR for RBS's trading portfolios, segregated by type of market risk exposure.

	2016				2015			
	Average	Period end	Maximum	Minimum	Average	Period end	Maximum	Minimum
Traded VaR (1-day 99%)	£m	£m	£m	£m	£m	£m	£m	£m
General interest rate	12.5	16.9	22.3	7.8	14.5	12.8	29.8	9.5
Specific interest rate	9.5	9.7	13.7	5.8	10.1	7.1	16.4	6.5
Currency	4.6	5.4	14.3	1.0	4.9	5.0	8.9	1.9
Equity	0.5	1.9	2.1	0.2	1.6	0.8	6.1	0.4
Commodity	0.7	0.3	2.4	0.2	0.4	0.5	2.2	0.2
Diversification (1)		(10.4)				(9.1)		
Total	17.0	23.8	29.3	9.9	18.9	17.1	30.1	12.1

Note:

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

Key points

- On an average basis, total traded VaR decreased in 2016 by 10%. The reduction was mainly driven by lower risk positions during Q1 2016, with reduced market activity reflecting concerns over the stability of the financial sector. Stronger client flows later in the year, mainly in NatWest Markets' strategic Rates and Currencies businesses, resulted in a risk increase in the second half of 2016.

- On a period end basis, total traded VaR increased in 2016 by 39%. The increase was mainly driven by the Rates business.

- VaR fluctuated throughout 2016, reflecting developments in US and the eurozone and other macroeconomic factors. These included, but were not limited to, the US presidential elections, the EU referendum in the UK and central bank actions. However, total traded VaR was managed within risk appetite.

Explanation of Responses:

Market risk continued

*VaR validation**

In addition to being a key risk management measure used by Market Risk in its second-line-of-defence oversight of the risk arising from trading activities, VaR is also used as one of the components of RBS's market risk regulatory capital requirements (refer to page 361 for more information).

Therefore, VaR is subject not only to model management review and validation but also to regulation compliance, which includes (but is not restricted to) regulator-prescribed back-testing.

The performance and adequacy of the VaR model are tested on a regular basis through the following processes:

- Back-testing - Internal and regulatory back-testing is conducted on a daily basis.
- Ongoing model validation - VaR model performance is assessed both regularly and on an ad-hoc basis if market conditions or book constitution change significantly.
- RNIV framework - The RNIV framework ensures that all material risks outside the internal VaR models are captured by, if necessary, developing an RNIV calculation to manage the risk (refer to page 359).
- Model Risk Management review - As part of the model lifecycle, all risk models (including the VaR model) are independently reviewed to ensure that the model is still fit for purpose given current market conditions and book constitution (refer to page 228).

VaR back-testing*

The main approach employed to assess the ongoing performance of the VaR model is back-testing, which counts the number of days when a loss exceeds the corresponding daily VaR estimate, measured at a 99% confidence level.

Two types of profit and loss (P&L) are used in back-testing comparisons: Actual P&L and Hypothetical (Hypo) P&L.

The Actual P&L for a particular business day is the firm's actual P&L for that day in respect of the trading activities within the scope of the firm's regulatory VaR model, including any intraday activities, adjusted by stripping out fees and commissions, brokerage, and additions to and releases from reserves that are not directly related to market risk.

The Hypo P&L reflects the firm's Actual P&L excluding any intra-day activities.

A portfolio is said to produce a back-testing exception when the Actual or Hypo P&L exceeds the VaR level on a given day. Such an event may be caused by a large market movement or may highlight issues such as missing risk factors or inappropriate time series. Any such issues identified are analysed and addressed through taking appropriate remediation or development action. RBS monitors both Actual and Hypo back-testing exceptions.

The table below shows internal back-testing exceptions for a period of 250 days for 1-day 99% traded internal VaR vs. Actual and Hypo P&L for major NatWest Markets businesses.

	Back-testing exceptions	
Description	Actual	Hypo
Rates	2	4
Credit	3	4
Currencies	—	9
Securitised products	3	2

*unaudited

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Market risk continued

Key points

- Statistically RBS would expect to see back-testing exceptions 1% of the time over the 250-day period.

- The top-level businesses presented in the table above are subject to quarterly review by the PRA. For these businesses, exceptions were noted during the period and analysis conducted as explained below.

- The exceptions in the Rates business were driven by rates and volatility changes adversely affecting the desk.

- The exceptions in the Credit business were mainly driven by mark-downs and changes in credit default swap spreads.

- The exceptions in the Currencies business were mainly driven by the increased volatility connected with the large market movements in the run-up to and following the EU referendum. In addition, a small number of exceptions were driven in part by movements in the independent price verification reserve.

- The exceptions in the Securitised Products business were mainly due to mark-downs and tightening in credit default swap spreads.

*unaudited

Market risk continued

*Stressed VaR (SVaR)**

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

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

This is in contrast with VaR, which is based on a rolling 500-day historical data set. For the purposes of both internal risk management and regulatory SVaR calculation, a time horizon of ten trading days is assumed with a confidence level of 99%.

The internal traded SVaR model captures all trading book positions, including not only those products, locations and legal entities approved by the regulator.

*10-day 99% trading internal SVaR**

	2016	2015
	£m	£m
Total RBS	161	145

Key point

- Total traded SVaR was broadly unchanged in 2016 compared to 2015, although it fluctuated during the year.

*Risks not in VaR (RNIVs)**

The RNIV framework is used to identify and quantify market risks that are inadequately captured by the internal VaR and SVaR models.

The need for an RNIV calculation is typically identified in one of the following three circumstances: (i) as part of the New Product Risk Assessment process, when a risk manager determines that the associated risk is not adequately captured by the VaR model or system; (ii) when risks are mapped to time series that are deemed to be inadequate (for example, due to data quality problems or proxy series usage); or (iii) as a result of a recommendation made during the ongoing model validation or by Model Risk Management during its annual review of the VaR model.

RNIVs that are related specifically to instruments that have level 3 valuation hierarchy assumptions (refer to page 425) are mainly included in the following categories: proxied sensitivities or risk factors, higher-order sensitivity terms, and static pricing parameters.

RBS adopts two approaches for the quantification of RNIVs:

- A VaR/SVaR approach. Under this approach, two values are calculated: (i) the VaR RNIV; and (ii) the SVaR RNIV.
- A stress-scenario approach. Under this approach, an assessment of ten-day extreme, but plausible, market moves is used in combination with position sensitivities to give a stress-type loss number - the stress-based RNIV value.

*unaudited

Market risk continued

In each of these approaches, potential diversification benefits between RNIVs are ignored.

The RNIV calculations provide the additional capital required to capture the market risks not captured in the internal VaR model and are regularly reported to senior management and the regulator and discussed with them. The methodology used in the material RNIV calculations is internally reviewed by Model Risk Management. Where appropriate, risk managers set sensitivity limits to monitor specific risk factors. RNIV calculations form an integral part of RBS's ongoing model and data improvement efforts to capture all market risks in scope for model approval in VaR and SVaR.

*Stress testing**

RBS undertakes daily market risk stress testing to identify vulnerabilities and potential losses in excess of or not captured in VaR. The calculated stresses measure the impact of changes in risk factors on the fair values of the trading and available-for-sale portfolios.

RBS conducts historical, macroeconomic and vulnerability-based stress testing.

Historical stress testing is a measure that is used for internal management. Using the historical simulation framework employed for VaR, the current portfolio is stressed using historical data since 1 January 2005. The methodology simulates the impact of the 99.9 percentile loss that would be incurred by historical risk factor movements over the period, assuming variable holding periods specific to the risk factors and the businesses.

Historical stress tests form part of the market risk limit framework and their results are reported daily to senior management

Macroeconomic stress tests are carried out periodically as part of the firm-wide, cross-risk capital planning process. The scenario narratives are translated into risk factor shocks using historical events and insights by economists, risk managers and the front office. Market risk stress results are combined with those for other risks into the capital plan that is presented to the Board. The cross-risk capital planning process is conducted once a year, in September/October, with a planning horizon of five years. The scenario narratives cover both regulatory scenarios and macroeconomic scenarios identified by the firm.

Vulnerability-based stress testing begins with the analysis of a portfolio and expresses the key vulnerabilities of the portfolio in terms of plausible, so-called vulnerability scenarios under which the portfolio would suffer material losses. These scenarios can be historical, macroeconomic or forward-looking/hypothetical. Vulnerability-based stress testing is used for internal management information and is not subject to limits. However, the results for relevant scenarios are reported to senior management.

*unaudited

Market risk continued

*Economic capital**

The market risk economic capital framework uses models to calculate the market and default risk in the trading book which are aligned with other models that are used for limit setting and market risk management. The results are annualised to be consistent with the other economic capital models to permit consolidation of all risk types as part of the RBS-wide economic capital programme.

Market risk regulatory capital*

Regulatory treatment

The market risks subject to capital requirements under Pillar 1 are primarily interest rate, credit spread and equity risks in the trading book and foreign exchange and commodity risks in both the trading and non-trading books. Interest rate and equity risks are split between general and specific risks. General risks represent market risks due to a move in a market as a whole, such as a main index or yield curve, while specific risks represent market risks arising from events particular to an underlying issuer.

The aggregation approach taken for general and specific risks is as follows:

- General risks are aggregated at the simulation level, adding P&L forecasts generated by the VaR model before statistics such as VaR and SVaR are extracted.

- Specific equity risks are aggregated with general risks using the simulation-level approach.

- Specific interest rate risks have both a systematic component and an idiosyncratic component. The systematic component captures the risk in market movements of credit spreads (across sectors, geographic locations and ratings) while the idiosyncratic component captures the credit spread variability of the underlying entity. The systematic components of specific interest rate risks are aggregated at the simulation level, while the idiosyncratic components are calculated as a standalone charge.

RBS uses two broad methodologies to calculate its market risk capital charge: (i) the standardised or non-modelled approach, whereby regulator-prescribed rules are applied, and (ii) the internal model approach, where, subject to regulatory approval, a model such as VaR is used to calculate the capital charge.

VaR and SVaR capture general and specific risks using a single model but not risks arising from the impact of defaults and rating changes associated with traded credit products and their derivatives. For these risks, two product-dependent approaches are used:

- The incremental risk charge model captures risks arising from rating migration and default events for the more liquid traded credit instruments and their derivatives.

- Securitisation and re-securitisation risks in the trading book are treated with the non-trading book non-modelled capitalisation approach.

Regulatory VaR

The PRA renewed RBS's Internal Model Approach (IMA) permission with effect from 30 November 2016, incorporating changes to the legal entity coverage of the permission (removal of RBSSI) and minor revisions to its product and trading location coverage.

*unaudited

Market risk continued

The changes were requested by RBS, reflecting the continued simplification of its operations. RBS has IMA permission for the following material legal entities: RBS plc and NatWest Plc.

While internal VaR provides a measure of the economic risk, regulatory VaR is one of the measures of regulatory capital requirements by legal entity.

The calculation of regulatory VaR differs from that of the internal VaR as it takes into account only regulator-approved products, locations and legal entities. In addition, it is based on a directly modelled ten-day holding period, rather than a scaled one-day holding period, for market risk capital calculations.

The PRA approval covers general market risk in interest rate, foreign exchange, equity and commodity products and specific market risk in interest rate and equity products.

*Regulatory SVaR**

RBS's SVaR model has also been approved by the PRA for use in the capital requirement calculation. The distinction between regulatory SVaR and internal SVaR is the same as that between regulatory VaR and internal VaR.

Risks not in VaR

As discussed earlier, RBS has an established RNIV framework that ensures that the risks not captured in VaR are adequately covered by its capital. In line with regulatory guidelines for external reporting, VaR RNIV values are reported as a subset of the VaR-based regulatory capital charge, whereas SVaR RNIV and stress-based RNIV values are reported as subsets of the SVaR-based charge.

*Incremental risk charge (IRC)**

The IRC model quantifies the impact of rating migration and default events on the market value of instruments with embedded credit risk (in particular, bonds and credit default swaps) that are held in the trading book. It further captures basis risk between different instruments, maturities and reference entities. Following the internal ratings-based approach for credit risk, the IRC is calculated over a one-year capital

horizon with a 99.9% confidence level. The dependency of positions is modelled using a single-factor Gaussian copula.

The IRC is mainly driven by three-month credit rating transition, default and correlation parameters. The portfolio impact of correlated defaults and rating changes is assessed by observing changes in the market value of positions using stressed recovery rates and modelled credit spread changes. Revaluation matrices are used to capture any non-linear behaviour.

The transition matrix is estimated using Moody's history of issuer ratings.

The average liquidity horizon by position (weighted by materiality) at the year end was 3.2 months (2015 - 3.2 months). The horizon is determined based on issuer liquidity, position concentration, product type and maturity.

*unaudited

Market risk continued

Market risk RWAs and minimum capital requirements*

At 31 December 2016, total market risk RWAs were £17 billion (31 December 2015 - £21 billion). Minimum capital requirements, which represent 8% of RWAs, were £1.4 billion (31 December 2015 - £1.7 billion).

By regulatory approach, the internal model approach accounted for 80% of the total (2015 - 78%). By legal entity, RBS plc accounted for 90% of the total (2015 - 90%).

Model validation*

RBS uses a variety of models to manage and measure market risk. These include pricing models (used for valuation of positions) and risk models (for risk measurement and capital calculation purposes). They are developed in both RBS-level and lower-level functions and are subject to independent review and sign-off.

For general information on the independent model validation carried out by Model Risk Management (MRM), which applies also to market risk models (including VaR models), refer to page 229. Additional details relating to pricing and market risk models are presented below.

Pricing models

Pricing models are developed by a dedicated front office quantitative team, in conjunction with the trading desk. They are used for the valuation of positions for which prices are not directly observable and for the risk management of the portfolio.

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

These committees comprise representatives of the major stakeholders in the valuation process - trading, finance, market risk, model development and model review functions.

The review process comprises the following steps:

- The committees prioritise models for review by MRM, considering the materiality of the risk booked against the model and an assessment of the degree of model risk, that is the valuation uncertainty arising from the choice of modelling assumptions.

- MRM quantifies the model risk by comparing front office model outputs with those of alternative models independently developed by MRM.

- The sensitivities derived from the pricing models are validated.

- The conclusions of the review are used by MRM to inform risk limits and by Finance to inform model reserves.

*unaudited

Market risk continued

Risk models

All model changes are approved through model governance committees at franchise level. Changes to existing models are subject to MRM review and RBS follows regulatory guidance for assessing the materiality of extensions and changes to the internal model approach for market risk.

MRM's independent oversight provides additional assurance that RBS holds appropriate capital for the market risk to which it is exposed.

In addition to MRM's independent oversight, the model testing team monitors the model performance for market risk through back-testing, which is discussed in more detail on page 357, and other processes.

Non-traded market risk

As noted earlier, RBS largely manages the key categories of non-traded market risk separately. The categories are: interest rate risk; credit spread risk; foreign exchange risk; equity risk; and accounting volatility risk.

Risk assessment, monitoring and mitigation

Interest rate risk*

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

- Gap risk - which arises from the timing of rate changes in non-trading book instruments. The extent of gap risk depends on whether changes to the term structure of interest rates occur consistently across the yield curve (parallel risk) or differentially by period (non-parallel risk).

- Basis risk - which captures the impact of relative changes in interest rates for financial instruments that have similar tenors but are priced using different interest rate indices, or on the same interest rate indices but with different tenors.

- Option risk - which arises from option derivative positions or from optional elements embedded in assets, liabilities and/or off-balance sheet items, where RBS or its customer can alter the level and timing of their cash flows. Option risk can be further characterised into automatic option risk and behavioural option risk. One example of behavioural option risk is pipeline risk. This is the risk of loss arising from personal

customers owning an option to draw down a loan (typically a mortgage loan) at a committed rate. Changes in interest rates can result in greater or fewer customers than anticipated taking up the committed offer. The risk depends on customer behaviour as the option will not automatically be exercised.

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

*unaudited

Market risk continued

In order to manage exposures within these limits, RBS aggregates its interest rate positions and hedges them externally using cash and derivatives, primarily interest rate swaps.

This task is primarily carried out by RBS Treasury, to which all businesses except NatWest Markets transfer most of their NTIRR. The main exposures and limit utilisations are reported to the ALCo and the ERF monthly and to the Board Risk Committee quarterly.

Credit spread risk

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

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

Foreign exchange risk

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

*unaudited

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Explanation of Responses:

Market risk continued

Foreign exchange exposures arising from customer transactions are sold down by businesses on a regular basis in line with RBS policy.

Equity risk

Non-traded equity risk is the potential variation in the income and reserves arising from changes in non-trading book equity valuations. Any such risk is identified prior to any investments and then mitigated through a framework of controls.

Investments, acquisitions or disposals of a strategic nature are referred to RBS's Acquisitions and Disposals Committee (ADCo). Once approved by ADCo for execution, such transactions are referred for approval to the Board, the Executive Committee, the Chief Executive, the Chief Financial Officer or as otherwise required. Decisions to acquire or hold equity positions in the non-trading book that are not of a strategic nature, such as customer restructurings, are taken by authorised persons with delegated authority under the credit approval framework.

Accounting volatility risk

Accounting volatility can be mitigated through hedge accounting whereby RBS can mitigate the profit and loss impact of the derivatives by marking the exposure to market. However, volatility will remain in cases where accounting rules mean that hedge accounting is not an option. Accounting volatility is reported to the ALCo monthly and capitalised as part of the Internal Capital Adequacy Assessment Process.

Risk measurement

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

Following the approval of an enhanced non-traded market risk appetite framework in early 2016, VaR disclosures reflect a more complete economic risk measure for the banking book.

The following table presents 1-day internal banking book VaR at a 99% confidence level, analysed by type of risk.

	2016				2015 (1)*
	Average	Maximum	Minimum	Period end	Period end
	£m	£m	£m	£m	£m
Interest rate	10	19	5	18	19
Euro	3	4	2	4	4
Sterling	10	24	5	21	14
US dollar	3	5	2	2	5
Other	2	2	1	1	2
Credit spread	57	67	42	63	31
Structural FX rate	13	20	10	10	11
Pipeline risk	1	1	—	—	1
Diversification (2)	—	—	—	(19)	(29)
Total	57	72	41	72	33

Notes:

(1) Certain 2015 year end numbers have been restated for comparison purposes in light of the enhancement of the risk appetite framework in 2016.

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

Key points

- Total internal non-traded VaR rose from £33 million to £72 million on a period end basis, primarily driven by credit spread risk, which remains the largest contributor to the total VaR.

- The rise in credit spread VaR reflected the increase in the proportion of bonds held within Treasury's liquidity portfolio and the increased volatility in the market data captured in the VaR. (For more information on the liquidity bond portfolio, refer to the Liquidity and funding risk section.)

- Interest rate risk mainly arises from the structural hedges carried out by Treasury. It rose towards the end of the year as the equity structural hedging strategy was adjusted in anticipation of future conduct fines.

Explanation of Responses:

Market risk continued

Interest rate risk*

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

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

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

*Value-at-risk**

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

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

*unaudited

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Explanation of Responses:

Market risk continued

Sensitivity of net interest income*

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

The following table shows the sensitivity of net interest income, over the next 12 months, to an immediate upward or downward change of 25 and 100 basis points to all interest rates. All yield curves are expected to move in parallel with the exception that interest rates are assumed to floor at zero per cent or, for euro rates, at the current negative rate.

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

Multi-year forward projections would increase the negative impact of a downward change in rates or, conversely, the benefit of an immediate upward change in interest rates to current market rates. This is because, over time a greater proportion of maturing structural hedges will be reinvested at prevailing rates which may be higher or lower. Also, in the absence of dynamic assumptions relating to further management actions, the variance to the base case income forecast arising from margin compression or expansion on managed rate products will continue to accrue.

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

*unaudited

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Explanation of Responses:

Market risk continued					
	Euro	Sterling	US dollar	Other	Total
2016	£m	£m	£m	£m	£m
+ 25 basis point shift in yield curves	4	79	11	2	96
– 25 basis point shift in yield curves	(1)	(222)	(11)	(2)	(236)
+ 100 basis point shift in yield curves	9	436	42	13	500
– 100 basis point shift in yield curves	(2)	(337)	(30)	(9)	(378)
2015					
+ 25 basis point shift in yield curves	(6)	48	25	1	68
– 25 basis point shift in yield curves	(7)	(66)	(24)	1	(96)
+ 100 basis point shift in yield curves	(17)	385	94	7	469
– 100 basis point shift in yield curves	(7)	(345)	(79)	2	(429)

Key points

- Interest rate exposure remains asset-sensitive, so that rising interest rates will have a positive impact on net interest income.

- The largest change in net interest income sensitivity in 2016 related to the negative impact of a 0.25% fall in interest rates from the base case. Sensitivity increased from £96 million to £236 million, primarily due to lower customer deposit interest rates. When interest rates are already at very low levels, it is assumed that further interest rate cuts will not be passed through to customer depositors and, therefore, net interest income falls.

- Structural hedges reduce income sensitivity to interest rate shocks over a 12-month period because only a relatively small amount of the hedge matures and rolls forward at the lower rate. For example, one-fifth of a five-year hedging programme will mature over a 12-month period.

- Assumptions relating to customer pricing are kept under review and may vary at different levels of interest rates. As a result, the increase in sensitivity between 25 basis points and 100 basis points is not linear.

- Changes in pricing assumptions and increased hedging of customer deposits are the key actions in personal and commercial banking that may reduce interest rate sensitivity.

Structural hedging*

RBS has the benefit of a significant pool of stable, non and low interest bearing liabilities, principally comprising equity and money transmission accounts. These balances are usually hedged, either by investing directly in longer-term fixed rate assets or by the use of interest rate swaps, in order to provide a consistent and predictable revenue stream.

After hedging the net interest rate exposure of the bank externally, RBS Treasury allocates income to products or equity in structural hedges by reference to the relevant interest rate swap curve. Over time, the hedging programme has built up a portfolio that provides a basis for stable income attribution to the product and equity structural hedges.

*unaudited

Market risk continued

*Product structural hedging**

Product structural hedges are used to minimise the volatility on earnings related to specific products, primarily customer deposits. The balances are primarily hedged with medium-term interest rate swaps, so that reported income is less sensitive to movements in short-term interest rates. The size and term of the hedge are based on the stability of the underlying portfolio.

The table below shows the impact on net interest income associated with product hedges managed by RBS Treasury. These relate to the main UK banking businesses except Private Banking and RBS International. RBS Treasury allocates income to products or equity in structural hedges by reference to the relevant interest rate swap curve after hedging the net interest rate exposure of the bank externally. This internal allocation has been developed over time alongside the bank's external hedging programme and provides a basis for stable income attribution to the product and equity hedges.

Net interest income - impact of product structural hedging	2016 £m	2015 £m
UK Personal & Business Banking	346	373
Commercial Banking	235	256
Capital Resolution	10	21
Williams & Glyn	44	45
Total	635	695

Key points

- The incremental impact of product hedges on net interest income above 3-month LIBOR remained positive in 2016. The average size of the hedge increased from £72 billion in 2015 to £90 billion, split by business broadly in line with the proportion of income as shown above. The increase largely reflected growth in hedged product balances and increased hedging of rate-on sensitive customer deposits. During the year, interest rates remained at or close to historical low levels, as a result of which the average book yield (including 3-month LIBOR) fell from 1.48% to 1.20%. This reflects the impact of maturing hedges being reinvested at lower rates and new hedges added during the year at lower market rates.

- At 31 December 2016, the 5-year swap rate was 0.74% compared with 1.45% one year previously. The market rate matching the amortising structure of the hedge was 0.60%.

*unaudited

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Explanation of Responses:

Market risk continued

*Equity structural hedging**

Equity structural hedges are used to minimise the volatility on earnings arising from returns on equity. The hedges managed by Treasury relate mainly to the UK banking businesses (PBB and CPB) and contributed £0.6 billion to these businesses in 2016 (2015 - £0.7 billion), which is an incremental benefit relative to short-term wholesale cash rates. The average size of the hedge was £33 billion in 2016, lower than in 2015 (£41 billion), primarily reflecting the payment of £4.2 billion into the pension fund, an additional £3.1 billion provision for various investigations and litigation matters relating to RBS's issuance and underwriting of residential mortgage-backed securities (RMBS) and the £1.2 billion payment of the final Dividend Access Share (DAS) dividend.

The equity hedge also aims broadly to track a time series of medium-to-longer-term swap rates. Other factors, such as the impact of the sale of fixed-rate securities or additional hedging activity, are not captured in the equity yield. The average book yield (including 3-month LIBOR) rose from 2.3% to 2.4%.

At 31 December 2016, the 10-year swap rate was 1.1% compared with 1.9% one year previously. The market rate matching the amortising structure of the equity hedge was 0.9%.

*unaudited

Business review **Capital and risk management**

Sensitivity of available-for-sale and cashflow hedging reserves to interest rate movements*

The table below shows the estimated sensitivity of equity reserves to interest rate movements, on a pre-tax basis. The scenarios shown are simplified scenarios in which all rates across the yield curve have been moved up or down instantaneously by 25 basis points and 100 basis points and taxation effects have not been estimated. In this analysis, interest rates have not been floored at zero. Note that a movement in the AFS reserve would have an impact on CET1 capital but a movement in the cash flow hedge reserve would not be expected to do so. Volatility in both reserves affects tangible net asset value.

	+25 basis points	-25 basis points	+100 basis points	-100 basis points
2016	£m	£m	£m	£m
Available-for-sale reserve	(36)	35	(150)	135
Cashflow hedge reserve	(417)	422	(1,641)	1,714
Total	(453)	457	(1,791)	1,849
2015				
Available-for-sale reserve	(63)	63	(255)	255
Cashflow hedge reserve	(462)	467	(1,817)	1,896
Total	(525)	530	(2,072)	2,151

Key points

- The asymmetry in results between the upward and downward interest rate shocks reflects the changing sensitivity of derivative valuations to the same interest rate movement at different levels of interest rates (i.e. convexity).

- The reduction in the sensitivity of the available-for-sale reserve primarily results from the reduction of Capital Resolution exposures.

*unaudited

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Explanation of Responses:

Business review Capital and risk management

Market risk continued

Foreign exchange risk

The table below shows structural foreign currency exposures.

2016	Net investments in foreign operations	Non-controlling interests (NCI)	Net investments in foreign operations excluding NCI (1)	Net investment hedges	Structural foreign currency exposures pre-economic hedges	Economic hedges (2)	Residual structural foreign currency exposures
	£m	£m	£m	£m	£m	£m	£m
US dollar	(595)	—	(595)	(28)	(623)	—	(623)
Euro	6,085	(4)	6,089	(582)	5,507	(2,289)	3,218
Other non-sterling	3,366	761	2,605	(1,491)	1,114	(625)	489
Total	8,856	757	8,099	(2,101)	5,998	(2,914)	3,084
2015							
US dollar	1,172	—	1,172	(134)	1,038	(1,038)	—
Euro	6,562	(127)	6,435	(573)	5,862	(1,963)	3,899
Other non-sterling	3,599	(524)	3,075	(2,364)	711	—	711
Total	11,333	(651)	10,682	(3,071)	7,611	(3,001)	4,610

Notes:

(1) Non-controlling interests (NCI) represents the structural foreign exchange exposure not attributable to owners’ equity.

(2) Economic hedges mainly represent US dollar and euro preference shares in issue that are treated as equity under IFRS and do not qualify as hedges for accounting purposes. They provide an offset to structural foreign exchange exposures to the extent that there are net assets in overseas operations available.

Key points

- Structural foreign currency exposure at 31 December 2016 was £6 billion before and £3 billion after economic hedges, respectively, £1.6 billion and £1.5 billion lower than at 31 December 2015.

- The reduction in the residual structural foreign currency exposure was driven by provisions for RMBS and dividends received from EU subsidiaries. These reductions were partly offset by appreciation of the US dollar and the euro against sterling in 2016.

- Changes in foreign currency exchange rates affect equity in proportion to structural foreign currency exposure. For example, a 5% strengthening in foreign currencies against sterling would result in a gain of £0.3 billion in equity (2015 - a £0.5 billion gain). A 5% weakening in foreign currencies against sterling would result in a loss of £0.3 billion in equity (2015 - a £0.4 billion loss).

Equity risk

Equity positions are carried at fair value on the balance sheet based on available market prices where possible. In the event that market prices are not available, fair value is based on appropriate valuation techniques or management estimates.

The table below shows the balance sheet carrying value of non-traded book equity positions.

	2016	2015
	£m	£m
Exchange-traded equity	33	25
Private equity	357	534
Other	146	136
	536	695

The exposures may take the form of (i) equity shares listed on a recognised exchange, (ii) private equity shares defined as unlisted equity shares with no observable market parameters or (iii) other unlisted equity shares.

	2016	2015
	£m	£m
Net realised gains arising from disposals	295	60
Unrealised gains included in Tier 1 or Tier 2 capital	53	301

Note:

(1) Includes gains or losses on available-for-sale instruments only.

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Explanation of Responses:

Market risk continued

Structured credit portfolio

The structured credit portfolio is no longer material.

Calculation of regulatory capital*

RBS capitalises non-traded market risk as part of the Pillar 2A Internal Capital Adequacy Assessment Process (ICAAP). The approach combines both earnings based and economic value based methodologies, in accordance with regulatory guidelines. The calculation captures the principal sources of non-traded market risk – interest rate risk, credit spread risk, structural foreign exchange risk and accounting volatility risk.

Pillar 1 capital must be held for non-trading book foreign exchange exposures, as outlined under CRR Articles 455 and 92(3)c. Structural foreign exchange exposures are excluded from the calculations as outlined under CRR Article 352(2); such exposures are considered under Pillar 2A.

Non-traded equity risk is captured in credit risk RWAs.

The capital calculations under ICAAP are also used for economic capital purposes.

Linkage to balance sheet*

The table below analyses RBS's balance sheet by trading and non-trading business.

	2016				2015			
	Total	Trading business (1)	Non-trading business (2)		Total	Trading business (1)	Non-trading business (2)	
	£bn	£bn	£bn		£bn	£bn	£bn	Primary risk factor
Assets								
Cash and balances at central banks	74.3	0.1	74.2		79.9	—	79.9	Interest rate
	17.3	6.9	10.4		19.0	11.2	7.8	Interest rate

Net loans and advances to banks								
Net loans and advances to customers	323.0	18.1	304.9		308.0	17.4	290.6	Interest rate
Reverse repos	41.8	37.7	4.1		39.9	38.6	1.3	Interest rate
Debt securities	72.5	24.5	48.0		82.5	35.9	46.6	Interest rate, credit spreads
Equity shares	0.7	0.2	0.5		1.4	0.7	0.7	Equities
Derivatives	247.2	244.2	3.0		262.5	260.0	2.5	Interest rate, credit spreads
Settlement balances	5.5	5.4	0.1		4.1	3.9	0.2	Settlement risk
Other assets	16.4	—	16.4		18.1	—	18.1	
Total assets	798.7	337.1	461.6		815.4	367.7	447.7	
Liabilities								
Deposits by banks	33.3	20.7	12.6		28.1	20.0	8.1	Interest rate
Customer deposits	353.9	13.2	340.7		346.0	11.4	334.6	Interest rate
Repos	32.3	27.3	5.0		37.4	35.2	2.2	Interest rate
Debt securities in issue	27.3	4.4	22.9		31.1	7.1	24.0	Interest rate
Settlement balances	3.6	3.5	0.1		3.4	3.3	0.1	Settlement risk
Short positions	22.1	22.1	—		20.8	20.8	—	Interest rate, credit spreads
Derivatives	236.5	234.6	1.9		254.7	252.4	2.3	Interest rate, credit spreads
Subordinated liabilities	19.4	—	19.4		19.8	—	19.8	Interest rate
Other liabilities	20.9	—	20.9		20.0	—	20.0	
Total liabilities	749.3	325.8	423.5		761.3	350.2	411.1	

Notes:

(1) Trading businesses are entities that primarily have exposures that are classified as trading book under regulatory rules. For these exposures, the main methods used by RBS to measure market risk are detailed under traded market risk measurement on page 354.

(2) Non-trading businesses are entities that primarily have exposures that are not classified as trading book. For these exposures, with the exception of pension-related activities, the main measurement methods are sensitivity analysis of net interest income, internal non-traded VaR and fair value calculations. For more information refer to pages 366 to 373.

(3) Foreign exchange risk affects all non-sterling denominated exposures on the balance sheet across trading and non-trading businesses, and therefore has not been listed in the above tables.

*unaudited

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Explanation of Responses:

Financial statements

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Report of Independent Registered Public Accounting Firm

Members of The Royal Bank of Scotland Group plc

We have audited the accompanying consolidated balance sheet of The Royal Bank of Scotland Group plc and subsidiaries (together, the “Group”) as at 31 December 2016, and the related consolidated statements of income, comprehensive income, changes in equity and cash flows for the year then ended, and the notes 1 to 42 and the information identified as ‘audited’ in the Capital and risk management section of the Business review (“financial statements”). These financial statements are the responsibility of the Group’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2016, and the consolidated results of its operations and cash flows for the year then ended, in conformity with International Financial Reporting Standards ("IFRS") as adopted for use in the European Union and IFRS as issued by the International Accounting Standards Board.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Group's internal control over financial reporting as of 31 December 2016, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated 23 February 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP
London, United Kingdom
23 February 2017

Explanation of Responses:

Report of Independent Registered Public Accounting Firm to the members of The Royal Bank of Scotland Group plc

We have audited the accompanying consolidated balance sheet of The Royal Bank of Scotland Group plc and its subsidiaries (together "the Group") as at 31 December 2015 and the related consolidated income statements, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated cash flow statements for the years ended 31 December 2015 and 2014, the accounting policies and the notes 1 to 42 and the information identified as ‘audited’ in the Capital and risk management section of the Business review (“consolidated financial statements”). These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such 2015 and 2014 consolidated financial statements present fairly, in all material respects, the financial position of The Royal Bank of Scotland Group plc and its subsidiaries as at 31 December 2015 and the results of their operations and their cash flows for the years ended 31 December 2015 and 2014, in conformity with International Financial Reporting Standards ("IFRS") as adopted for use in the European Union and IFRS as issued by the International Accounting Standards Board.

Note 42 to the consolidated financial statements was added for the inclusion of consolidating financial information in respect of The Royal Bank of Scotland plc in accordance with Regulation S-X Rule 3-10.

/s/ Deloitte LLP

London, United Kingdom

25 February 2016 (24 March 2016 for the consolidating financial information in Note 42)

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Explanation of Responses:

Consolidated income statement for the year ended 31 December 2016

	Note	2016	2015	2014
		£m	£m	£m
Interest receivable		11,258	11,925	13,079
Interest payable		(2,550)	(3,158)	(3,821)
Net interest income	1	8,708	8,767	9,258
Fees and commissions receivable		3,340	3,742	4,414
Fees and commissions payable		(805)	(809)	(875)
Income from trading activities		974	1,060	1,285
(Loss)/gain on redemption of own debt		(126)	(263)	20
Other operating income		499	426	1,048
Non-interest income	2	3,882	4,156	5,892
Total income		12,590	12,923	15,150
Staff costs		(5,124)	(5,726)	(5,757)
Premises and equipment		(1,388)	(1,827)	(2,081)
Other administrative expenses		(8,745)	(6,288)	(4,568)
Depreciation and amortisation		(778)	(1,180)	(930)
Write down of goodwill and other intangible assets		(159)	(1,332)	(523)
Operating expenses	3	(16,194)	(16,353)	(13,859)
(Loss)/profit before impairment (losses)/releases		(3,604)	(3,430)	1,291
Impairment (losses)/releases	11	(478)	727	1,352
Operating (loss)/profit before tax		(4,082)	(2,703)	2,643
Tax charge	6	(1,166)	(23)	(1,909)
(Loss)/profit from continuing operations		(5,248)	(2,726)	734
Profit/(loss) from discontinued operations, net of tax	18	—	1,541	(3,445)
Loss for the year		(5,248)	(1,185)	(2,711)
Attributable to:				
Non-controlling interests		10	409	60
Preference shareholders		260	297	330
Paid-in equity holders		244	88	49
Dividend access share	7	1,193	—	320
Ordinary shareholders		(6,955)	(1,979)	(3,470)
		(5,248)	(1,185)	(2,711)
Per ordinary share				
Basic and diluted (loss)/earnings from continuing operations	7	(59.5p)	(27.7p)	0.5p
Basic and diluted loss from continuing and discontinued operations	7	(59.5p)	(17.2p)	(30.6p)

The accompanying notes on pages 402 to 483, the accounting policies on pages 385 to 401 and the audited sections of the Business review: Capital and risk management on pages 218 to 374 form an integral part of these financial statements.

Consolidated statement of comprehensive income for the year ended 31 December 2016

	2016	2015	2014
	£m	£m	£m
Loss for the year	(5,248)	(1,185)	(2,711)
Items that do not qualify for reclassification			
Loss on remeasurement of retirement benefit schemes	(1,049)	(73)	(1,857)
Tax	288	306	314
	(761)	233	(1,543)
Items that do qualify for reclassification			
Available-for-sale financial assets	(94)	44	807
Cash flow hedges	765	(700)	1,413
Currency translation	1,263	(1,181)	307
Tax	(106)	108	(455)
	1,828	(1,729)	2,072
Other comprehensive income/(loss) after tax	1,067	(1,496)	529
Total comprehensive loss for the year	(4,181)	(2,681)	(2,182)
Attributable to:			
Non-controlling interests	121	370	246
Preference shareholders	260	297	330
Paid-in equity holders	244	88	49
Dividend access share	1,193	—	320
Ordinary shareholders	(5,999)	(3,436)	(3,127)
	(4,181)	(2,681)	(2,182)

The accompanying notes on pages 402 to 483, the accounting policies on pages 385 to 401 and the audited sections of the Business review: Capital and risk management on pages 218 to 374 form an integral part of these financial statements.

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Consolidated balance sheet as at 31 December 2016

	Note	2016 £m	2015 £m
Assets			
Cash and balances at central banks	8	74,250	79,404
Loans and advances to banks	8	30,138	30,646
Loans and advances to customers	8	351,950	333,892
Debt securities subject to repurchase agreements	29	18,107	20,224
Other debt securities		54,415	61,873
Debt securities	13	72,522	82,097
Equity shares	14	703	1,361
Settlement balances		5,526	4,116
Derivatives	12	246,981	262,514
Intangible assets	15	6,480	6,537
Property, plant and equipment	16	4,590	4,482
Deferred tax	22	1,803	2,631
Prepayments, accrued income and other assets	17	3,700	4,242
Assets of disposal groups	18	13	3,486
Total assets		798,656	815,408
Liabilities			
Deposits by banks	8	38,556	38,296
Customer accounts	8	380,968	370,298
Debt securities in issue	8	27,245	31,150
Settlement balances		3,645	3,390
Short positions	19	22,077	20,809
Derivatives	12	236,475	254,705
Provisions for liabilities and charges	20	12,836	7,366
Accruals and other liabilities	21	6,991	7,749
Retirement benefit liabilities	4	363	3,789
Deferred tax	22	662	882
Subordinated liabilities	23	19,419	19,847
Liabilities of disposal groups	18	15	2,980
Total liabilities		749,252	761,261
Non-controlling interests	24	795	716
Owners' equity	25, 26	48,609	53,431
Total equity		49,404	54,147
Total liabilities and equity		798,656	815,408

The accompanying notes on pages 402 to 483, the accounting policies on pages 385 to 401 and the audited sections of the Business review: Capital and risk management on pages 218 to 374 form an integral part of these financial statements.

The accounts were approved by the Board of directors on 23 February 2017 and signed on its behalf by:

Howard Davies	Ross McEwan	Ewen Stevenson
Chairman	Chief Executive	Chief Financial Officer

The Royal Bank of Scotland Group plc
Registered No. SC45551

Consolidated statement of changes in equity for the year ended 31 December 2016

	2016	2015	2014
	£m	£m	£m
Called-up share capital			
At 1 January	11,625	6,877	6,714
Ordinary shares issued	198	159	163
Conversion of B shares (1)	—	4,590	—
Preference shares redeemed (2)	—	(1)	—
At 31 December	11,823	11,625	6,877
Paid-in equity			
At 1 January	2,646	784	979
Redeemed/reclassified (3)	(110)	(150)	(195)
Additional Tier 1 capital notes issued (4)	2,046	2,012	—
At 31 December	4,582	2,646	784
Share premium account			
At 1 January	25,425	25,052	24,667
Ordinary shares issued	268	373	385
At 31 December	25,693	25,425	25,052
Merger reserve			
At 1 January	10,881	13,222	13,222
Transfer to retained earnings	—	(2,341)	—
At 31 December	10,881	10,881	13,222
Available-for-sale reserve			
At 1 January	307	299	(308)
Unrealised gains	282	31	980
Realised (gains)/losses	(376)	27	(333)
Tax	25	(16)	(67)
Recycled to profit or loss on disposal of businesses (5)	—	—	36
Recycled to profit or loss on ceding control of Citizens (6)	—	9	—
Transfer to retained earnings	—	(43)	(9)
At 31 December	238	307	299
Cash flow hedging reserve			
At 1 January	458	1,029	(84)
Amount recognised in equity	1,867	712	2,871
Amount transferred from equity to earnings	(1,102)	(1,354)	(1,458)
Tax	(193)	98	(334)
Recycled to profit or loss on ceding control of Citizens (7)	—	(36)	—

Transfer to retained earnings	—	9	34
At 31 December	1,030	458	1,029
Foreign exchange reserve			
At 1 January	1,674	3,483	3,691
Retranslation of net assets	1,470	(22)	113
Foreign currency (losses)/gains on hedges of net assets	(278)	(176)	108
Tax	62	(11)	(30)
Recycled to profit or loss on disposal of businesses (8)	(40)	4	—
Recycled to profit or loss on ceding control of Citizens (8)	—	(962)	—
Transfer to retained earnings	—	(642)	(399)
At 31 December	2,888	1,674	3,483
Capital redemption reserve			
At 1 January	4,542	9,131	9,131
Conversion of B shares (1)	—	(4,590)	—
Preference shares redeemed (2)	—	1	—
At 31 December	4,542	4,542	9,131
For notes to these tables see page 383.			

Consolidated statement of changes in equity for the year ended 31 December 2016

	2016	2015	2014
	£m	£m	£m
Retained earnings			
At 1 January	(4,020)	(4,001)	783
(Loss)/profit attributable to ordinary shareholders and other equity owners			
- continuing operations	(5,258)	(2,801)	756
- discontinued operations	—	1,207	(3,527)
Equity preference dividends paid	(260)	(297)	(330)
Paid-in equity dividends paid, net of tax	(244)	(88)	(49)
Dividend access share dividend	(1,193)	—	(320)
Transfer from available-for-sale reserve	—	43	9
Transfer from cash flow hedging reserve	—	(9)	(34)
Transfer from foreign exchange reserve	—	642	399
Transfer from merger reserve	—	2,341	—
Costs of placing Citizens equity	—	(29)	(45)
Redemption of equity preference shares (2)	(1,160)	(1,214)	—
Redemption/reclassification of paid-in equity	(21)	(27)	(33)
Loss on remeasurement of the retirement benefit schemes			
- gross	(1,049)	(67)	(1,857)
- tax	288	306	314
Loss on disposal of own shares held	—	—	(8)
Shares issued under employee share schemes	(10)	(58)	(91)
Share-based payments			
- gross	(9)	36	29
- tax	—	(4)	3
At 31 December	(12,936)	(4,020)	(4,001)
Own shares held			
At 1 January	(107)	(113)	(137)
Disposal of own shares	—	6	1
Shares issued under employee share schemes	41	—	—
Own shares acquired	(66)	—	23
At 31 December	(132)	(107)	(113)
Owners’ equity at 31 December	48,609	53,431	55,763

For notes to these tables refer to the following page.

The accompanying notes on pages 402 to 483, the accounting policies on pages 385 to 401 and the audited sections of the Business review: Capital and risk management on pages 218 to 374 form an integral part of these financial statements.

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Consolidated statement of changes in equity for the year ended 31 December 2016

	2016	2015	2014
	£m	£m	£m
Non-controlling interests (see Note 24)			
At 1 January	716	2,946	473
Currency translation adjustments and other movements	111	3	86
Profit/(loss) attributable to non-controlling interests			
- continuing operations	10	75	(22)
- discontinued operations	—	334	82
Dividends paid	—	(31)	(4)
Movements in available-for-sale securities			
- unrealised gains	—	22	36
- realised (gains)/losses	—	(6)	77
- tax	—	(5)	(13)
Movements in cash flow hedging reserve			
- amount recognised in equity	—	32	18
- amount transferred from equity to earnings	—	—	(18)
- tax	—	(4)	—
Actuarial losses recognised in retirement benefit schemes			
- gross	—	(6)	—
Equity raised (9)	—	2,537	2,232
Equity withdrawn and disposals	(42)	(24)	(1)
Loss of control of Citizens	—	(5,157)	—
At 31 December	795	716	2,946
Total equity at 31 December	49,404	54,147	58,709
Total equity is attributable to:			
Non-controlling interests	795	716	2,946
Preference shareholders	2,565	3,305	4,313
Paid-in equity holders	4,582	2,646	784
Ordinary shareholders	41,462	47,480	50,666
	49,404	54,147	58,709

Notes:

(1) In October 2015, all B shares were converted into ordinary shares of £1 each.

(2) In September 2016, non-cumulative US dollar preference shares were redeemed at their original issue price of US$1.5 billion (2015 - $1.9 billion). The nominal value of £0.3 million (2015 - £1 million) was transferred from share capital to capital redemption reserve and ordinary owners equity was reduced by £0.4 billion (2015 - £0.2 billion) in respect of the movement in exchange rates since

issue.

(3) Paid-in equity reclassified to liabilities as a result of the call of RBS Capital Trust C in May 2016 (redeemed in July 2016), the call of RBS Capital Trust IV in January 2015 (redeemed in March 2015) and the call RBS Capital Trust III in December 2014 (redeemed in January 2015).
(4) AT1 capital notes totalling £2.0 billion issued in August 2016.
(5) 2014 Net of tax - £11 million charge.
(6) 2015 Net of tax - £6 million charge.
(7) 2015 Net of tax - £16 million credit.
(8) No tax impact.
(9) Includes £2,491 million relating to the secondary offering of Citizens in March 2015 (2014 - £2,117 million relating to the IPO of Citizens).

The accompanying notes on pages 402 to 483, the accounting policies on pages 385 to 401 and the audited sections of the Business review: Capital and risk management on pages 218 to 374 form an integral part of these financial statements

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Consolidated cash flow statement for the year ended 31 December 2016

	Note	2016 £m	2015 £m	2014 £m
Cash flows from operating activities				
Operating (loss)/profit before tax from continuing operations		(4,082)	(2,703)	2,643
Profit/(loss) before tax from discontinued operations		—	1,766	(3,207)
Adjustments for non-cash items and other adjustments included within income statement		(3,024)	(5,601)	(84)
Contributions to defined benefit schemes		(4,786)	(1,060)	(1,065)
Changes in operating assets and liabilities		8,413	8,589	(18,260)
Income taxes paid		(171)	(73)	(414)
Net cash flows from operating activities	32	(3,650)	918	(20,387)
Cash flows from investing activities				
Sale and maturity of securities		8,599	8,229	28,020
Purchase of securities		(11,607)	(14,135)	(20,276)
Sale of property, plant and equipment		447	1,432	1,162
Purchase of property, plant and equipment		(912)	(783)	(816)
Net (investment in)/divestment of business interests and intangible assets	33	(886)	391	(1,481)
Net cash flows from investing activities		(4,359)	(4,866)	6,609
Cash flows from financing activities				
Issue of ordinary shares		300	307	314
Issue of Additional Tier 1 capital notes		2,046	2,012	—
Issue of subordinated liabilities		—	—	2,159
Proceeds of non-controlling interests issued		—	2,537	2,147
Redemption of paid-in equity		(110)	(150)	—
Redemption of equity preference shares		(1,160)	(1,214)	—
Non-controlling interests equity withdrawn and disposals		(42)	—	(1)
Own shares (acquired)/disposed		(25)	6	14
Redemption of subordinated liabilities		(3,606)	(3,047)	(3,480)
Dividends paid		(504)	(416)	(383)
Dividend access share		(1,193)	—	(320)
Interest on subordinated liabilities		(813)	(975)	(854)
Net cash flows from financing activities		(5,107)	(940)	(404)
Effects of exchange rate changes on cash and cash equivalents		8,094	576	909
Net decrease in cash and cash equivalents		(5,022)	(4,312)	(13,273)
Cash and cash equivalents at 1 January		103,592	107,904	121,177
Cash and cash equivalents at 31 December	36	98,570	103,592	107,904

The accompanying notes on pages 402 to 483, the accounting policies on pages 385 to 401 and the audited sections of the Business review: Capital and risk management on pages 218 to 374 form an integral part of these financial statements

Accounting policies

1. Presentation of accounts

The accounts are prepared on a going concern basis (see the Report of the directors, page 156) and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the IFRS Interpretations Committee of the IASB as adopted by the European Union (EU) (together IFRS). The EU has not adopted the complete text of IAS 39 ‘Financial Instruments: Recognition and Measurement’; it has relaxed some of the standard's hedging requirements. The Group has not taken advantage of this relaxation: its financial statements are prepared in accordance with IFRS as issued by the IASB.

The company is incorporated in the UK and registered in Scotland. Its accounts are presented in accordance with the Companies Act 2006. With the exception of investment property and certain financial instruments as described in Accounting policies 9, 14, 16 and 23, the accounts are presented on an historical cost basis.

The Group adopted a number of revisions to IFRSs effective 1 January 2016:

‘Accounting for Acquisitions of Interests in Joint Operations’ issued in May 2014 amends IFRS 11 ‘Joint Arrangements’. An acquirer of an interest in a joint operation that is a business applies the relevant principles for business combinations in IFRS 3 and other standards and makes the relevant disclosures accordingly.

‘Clarification of Acceptable Methods of Depreciation and Amortisation’ issued in May 2014 amends IAS 16 ‘Property, Plant and Equipment’ and IAS 38 ‘Intangible Assets’ requiring amortisation to be based on the consumption of an asset, introducing a rebuttable presumption that this is not achieved by an amortisation profile aligned to revenue.

Annual Improvements to IFRS 2012 - 2014 cycle was issued in September 2014 making a number of minor amendments to IFRS.

Amendments to IFRS 10 ‘Consolidated Financial Statements’, IFRS 12 ‘Disclosure of Interests in Other Entities’ and IAS 28 ‘Investments in Associates and Joint Ventures’ were issued in December 2014 to clarify the application of the investment entity consolidation exception.

An amendment to IAS 1, ‘Presentation of Financial Statements’ was issued in December 2014 to clarify the application of materiality to financial statements.

The implementation of these requirements has not had a material effect on the Group’s accounts.

2. Basis of consolidation

The consolidated accounts incorporate the financial statements of the company and entities (including certain structured entities) that are controlled by the Group. The Group controls another entity (a subsidiary) when it is exposed, or has rights, to variable returns from its involvement with that entity and has the ability to affect those returns through its power over the other entity; power generally arises from holding a majority of voting rights. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated accounts at their fair value. A subsidiary is included in the consolidated financial statements from the date it is controlled by the Group until the date the Group ceases to control it through a sale or a significant change in circumstances. Changes in the Group’s interest in a subsidiary that do not result in the Group ceasing to control that subsidiary are accounted for as equity transactions.

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

3. Revenue recognition

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

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

Accounting policies

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

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

- Interchange received: as issuer, the 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.

- Periodic fees payable by a credit card or debit card holder are deferred and taken to profit or loss over the period of the service.

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

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

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

Investment management - 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 expense as the related revenue is recognised.

4. Assets held for sale and discontinued operations

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

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

The results of discontinued operations, comprising the post-tax profit or loss of discontinued operations and the post-tax gain or loss recognised either on measurement to fair value less costs to sell or on disposal of the discontinued operation, are shown as a single amount on the face of the income statement; an analysis of this amount is presented in Note 18 on the accounts.

A discontinued operation is a cash generating unit or a group of cash generating units that either has been disposed of, or is classified as held for sale, and (a) represents a separate major line of business or geographical area of operations, (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or (c) is a subsidiary acquired exclusively with a view to resale.

5. Employee benefits

Short-term employee benefits, such as salaries, paid absences, and other benefits are accounted for on an accruals basis over the period in which the employees provide the related services. Employees may receive variable compensation satisfied by cash, by debt instruments issued by the Group or by RBSG shares. The treatment of share-based compensation is set out in Accounting policy 25. Variable compensation that is settled in cash or debt instruments is charged to profit or loss over the period from the start of the year to which the variable compensation relates to the expected settlement date taking account of forfeiture and clawback criteria.

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

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

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Explanation of Responses:

Accounting policies

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

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

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

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

6. Intangible assets and goodwill

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

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

Expenditure on internally generated goodwill and brands is written-off as incurred. Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have been established. These costs include payroll, the costs of materials and services, and

directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred as are all training costs and general overheads. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

Intangible assets include goodwill arising on the acquisition of subsidiaries and joint ventures. Goodwill on the acquisition of a subsidiary is the excess of the fair value of the consideration transferred, the fair value of any existing interest in the subsidiary and the amount of any non-controlling interest measured either at fair value or at its share of the subsidiary’s net assets over the Group's interest in the net fair value of the subsidiary’s identifiable assets, liabilities and contingent liabilities.

Goodwill arises on the acquisition of a joint venture when the cost of investment exceeds the Group’s share of the net fair value of the joint venture’s identifiable assets and liabilities. Goodwill is measured at initial cost less any subsequent impairment losses. Goodwill arising on the acquisition of associates is included within their carrying amounts. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

7. Property, plant and equipment

Items of property, plant and equipment (except investment property - see Accounting policy 9) are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, these are accounted for separately.

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

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

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

Property adaptation costs	10 to 15 years
Computer equipment	up to 5 years
Other equipment	4 to 15 years

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Accounting policies

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

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

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

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

A reversal of an impairment loss on intangible assets (excluding goodwill) or property, plant and equipment is recognised as it arises provided the increased carrying value is not greater than it would have been had no impairment loss been recognised. Impairment losses on goodwill are not reversed.

9. Investment property

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

10. Foreign currencies

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

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 cash flow hedges and hedges of net investments in foreign operations (see Accounting policy 23).

Non-monetary items denominated in foreign currencies that are stated at fair value are translated into the relevant functional currency at the foreign exchange rates ruling at the dates the values are determined. Translation differences arising on non-monetary items measured at fair value are recognised in profit or loss except for differences arising on 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 of a foreign operation.

11. 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.

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Accounting policies

Rental income from operating leases is recognised in income on a straight-line basis over the lease term unless another systematic basis better represents the time pattern of the asset's use. Operating lease assets are included within Property, plant and equipment and depreciated over their useful lives (see Accounting policy 7). Operating lease rentals receivable are included in Other operating income.

As lessee

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

12. Provisions

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

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

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

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

13. Tax

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

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

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that they will be recovered.

Deferred tax is not recognised on temporary differences that arise from initial recognition of an asset or a liability in a transaction (other than a business combination) that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is calculated using tax rates expected to apply in the periods when the assets will be realised or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, at the balance sheet date.

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.

14. Financial assets

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

Held-to-maturity investments - a financial asset may be classified as a held-to-maturity investment only if it has fixed or determinable payments, a fixed maturity and the Group has the positive intention and ability to hold to maturity. Held-to-maturity investments are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see Accounting policy 3) less any impairment losses.

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Explanation of Responses:

Accounting policies

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

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 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 or as held-for-trading, or designated as at fair value through profit or loss. Loans and receivables are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see Accounting policy 3) less any impairment losses.

Available-for-sale financial assets - financial assets that are not classified as held-to-maturity; 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 foreign currency monetary available-for-sale financial assets are recognised in profit or loss together with interest calculated using the effective interest method (see Accounting policy 3) as are gains and losses attributable to the hedged risk on available-for-sale financial assets that are hedged items in fair value hedges (see Accounting policy 23). Other changes in the fair value of available-for-sale financial assets and any related tax are reported in other comprehensive income until disposal, when the cumulative gain or loss is reclassified from equity to profit or loss.

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

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

Fair value - the 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 on the accounts.

15. 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 held-to-maturity, as available-for-sale or as loans and receivables is impaired. A financial asset or group of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

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 or as held-to-maturity investments 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 effective interest rate of the instrument at initial recognition. For collateralised loans and receivables, estimated future cash flows include cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

Where, in the course of the orderly realisation of a loan, it is exchanged for equity shares or property, the exchange is accounted for as the sale of the loan and the acquisition of equity securities or investment property. Where the Group's interest in equity shares following the exchange is such that the Group controls an entity, that entity is consolidated.

Explanation of Responses:

Accounting policies

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

Historical loss experience is adjusted, on the basis of observable data, to reflect current conditions not affecting the period of historical experience. Impairment losses are recognised in profit or loss and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses. If, in a subsequent period, the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

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

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

- Retail mortgages: write off usually occurs within five years, or when an account is closed if earlier.
- Credit cards: the irrecoverable amount is written off after 12 months; three years later any remaining amounts outstanding are written off.
- Overdrafts and other unsecured loans: write off occurs within six years.
- Business and commercial loans: write offs of commercial loans are determined in the light of individual circumstances; the period does not exceed five years. Business loans are generally written off within five years.

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

Financial assets carried at fair value - when a decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in other comprehensive income and there is objective evidence that it is impaired, the cumulative loss is reclassified from equity to profit or loss. The loss is measured as the difference between the amortised cost (including any hedge accounting adjustments) 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.

16. Financial liabilities

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

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

Designated as at fair value through profit or loss - financial liabilities may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both that the 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 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. Income from trading activities includes gains and losses on held-for-trading financial liabilities as they arise.

Financial liabilities designated as at fair value through profit or loss principally comprise structured liabilities issued by the Group: designation significantly reduces the measurement inconsistency between these liabilities and the related derivatives carried at fair value.

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

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 on the accounts.

Accounting policies

17. Financial guarantee contracts

Under a financial guarantee contract, the Group, in return for a fee, undertakes to meet a customer's obligations under the terms of a debt instrument if the customer fails to do so. A financial guarantee is recognised as a liability; initially at fair value and, if not designated as at fair value through profit or loss, subsequently at the higher of its initial value less cumulative amortisation and any provision under the contract measured in accordance with Accounting policy 12. Amortisation is calculated so as to recognise fees receivable in profit or loss over the period of the guarantee.

18. Loan commitments

Provision is made for loan commitments, other than those classified as held-for-trading, if it is probable that the facility will be drawn and the resulting loan will be recognised at an amount less than the cash advanced. Syndicated loan commitments in excess of the level of lending under the commitment approved for retention by the Group are classified as held-for-trading and measured at fair value.

19. Derecognition

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

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

20. Sale and repurchase transactions

Securities subject to a sale and repurchase agreement under which substantially all the risks and rewards of ownership are retained by the Group continue to be shown on the balance sheet and the sale proceeds recorded as a financial liability. Securities acquired in a reverse sale and repurchase transaction under which the Group is not exposed to substantially all the risks and rewards of ownership are not recognised on the balance sheet and the consideration paid is recorded as a financial asset.

Securities borrowing and lending transactions are usually secured by cash or securities advanced by the borrower. Borrowed securities are not recognised on the balance sheet or lent securities derecognised.

Cash collateral given or received is treated as a loan or deposit; collateral in the form of securities is not recognised. However, where securities borrowed are transferred to third parties, a liability for the obligation to return the securities to the stock lending counterparty is recorded.

21. Netting

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

22. Capital instruments

The Group classifies a financial instrument that it issues as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms and as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities. The components of a compound financial instrument issued by the Group are classified and accounted for separately as financial assets, financial liabilities or equity as appropriate.

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

The consideration for any ordinary shares of the company purchased by the Group (treasury shares) is deducted from equity. On the cancellation of treasury shares their nominal value is removed from equity

and any excess of consideration over nominal value is treated in accordance with the capital maintenance provisions of the Companies Act. On the sale or reissue of treasury shares the consideration received and related tax are credited to equity, net of any directly attributable incremental costs.

Accounting policies

23. Derivatives and hedging

Derivative financial instruments are initially recognised, and subsequently measured, at fair value. The Group's approach to determining the fair value of financial instruments is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 9 on the accounts.

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

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

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

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

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

Cash flow hedge - in a cash flow hedge, the effective portion of the gain or loss on the hedging instrument is recognised in other comprehensive income and the ineffective portion in profit or loss. When the forecast transaction results in the recognition of a financial asset or financial liability, the cumulative gain or loss is reclassified from equity to profit or loss in the same periods in which the hedged forecast cash flows affect profit or loss. Otherwise the cumulative gain or loss is removed from equity and recognised in profit or loss at the same time as the hedged transaction. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; if the hedging instrument expires or is sold, terminated or exercised; if the forecast transaction is no longer expected to occur; or if hedge designation is revoked. On the discontinuance of hedge accounting (except where a forecast transaction is no longer expected to occur), the cumulative unrealised gain or loss is reclassified from equity to profit or loss when the hedged cash flows occur or, if the forecast transaction results in the recognition of a financial asset or financial liability, when the hedged forecast cash flows affect profit or loss. Where a forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss is reclassified from equity to profit or loss immediately.

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

24. Associates and joint ventures

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

Accounting policies

25. Share-based compensation

The Group operates a number of share-based compensation schemes under which it awards RBSG shares and share options to its employees. Such awards are generally subject to vesting conditions: conditions that vary the amount of cash or shares to which an employee is entitled. Vesting conditions include service conditions (requiring the employee to complete a specified period of service) and performance conditions (requiring the employee to complete a specified period of service and specified performance targets to be met). Other conditions to which an award is subject are non-vesting conditions (such as a requirement to save throughout the vesting period).

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 and takes into account non-vesting conditions and market performance conditions (conditions related to the market price of RBSG shares): an award is treated as vesting irrespective of whether any market performance condition or non-vesting condition is met. 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 (the period during which all the specified vesting conditions must be satisfied) with a corresponding increase in equity in an equity-settled award, or a corresponding liability in a cash-settled award. The cost is adjusted for vesting conditions (other than market performance conditions) so as to reflect the number of shares or share options that actually vest.

If an award is modified, the original cost continues to be recognised as if there had been no modification. Where modification increases the fair value of the award, this increase is recognised as an expense over the modified vesting period. A new award of shares or share options is treated as the modification of a cancelled award if, on the date the new award is granted, the Group identifies them as replacing the cancelled award. The cancellation of an award through failure to meet non-vesting conditions triggers an immediate expense for any unrecognised element of the cost of an award.

26. Cash and cash equivalents

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

Critical accounting policies and key sources of estimation uncertainty

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

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

(i) Goodwill

The Group capitalises goodwill arising on the acquisition of businesses, as discussed in Accounting policy 6. The carrying value of goodwill as at 31 December 2016 was £5,558 million (2015 - £5,558 million).

Goodwill is the excess of the cost of an acquired business over the fair value of its net assets. Goodwill is not amortised but is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

Impairment testing in accordance with Accounting policy 8 inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of cash-generating units; and the valuation of their separable assets. The sensitivity of the assessment to changes in assumptions is discussed in Note 15 on the accounts.

(ii) Provisions for liabilities

As set out in Note 20 on the accounts, at 31 December 2016 the Group recognised provisions for liabilities in respect of Payment Protection Insurance, £1,253 million (2015 - £996 million), other customer redress, £1,105 million (2015 - £821 million), residential mortgage backed securities, £6,752 million (2015 - £3,772 million), litigation and other regulatory proceedings, £1,918 million (2015 - £519 million). 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.

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Explanation of Responses:

Accounting policies

Payment Protection Insurance - the Group has established a provision for redress payable in respect of the mis-selling of Payment Protection Insurance policies. The provision is management's best estimate of the anticipated costs of redress and related administration expenses. The determination of appropriate assumptions to underpin the provision requires significant judgement by management. The principal assumptions underlying the provision together with sensitivities to changes in those assumptions are given in Note 20 on the accounts.

Provisions for litigation - the Group and members of the Group are party to legal proceedings in the United Kingdom, the United States and other jurisdictions, arising out of their normal business operations. The measurement and recognition of liabilities in respect of litigation involves a high degree of management judgement. Before the existence of a present obligation as the result of a past event can be confirmed, numerous facts may need to be established, involving extensive and time-consuming discovery, and novel or unsettled legal questions addressed. Once it is determined there is an obligation, assessing the probability of economic outflows and estimating the amount of any liability can be very difficult. In many proceedings, it is not possible to determine whether any loss is probable or to estimate the amount of any loss.

Furthermore, for an individual matter, there can be a wide range of possible outcomes and often it is not practicable to quantify a range of such outcomes. The Group's outstanding litigation is periodically assessed in consultation with external professional advisers, where appropriate, to determine the likelihood of the Group incurring a liability. A detailed description of the Group's material legal proceedings and a discussion of the nature of the associated uncertainties are given in Note 31 on the accounts.

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

(iii) Deferred tax

The Group makes provision for deferred tax on temporary differences where tax recognition occurs at a different time from accounting recognition. Deferred tax assets of £1,803 million were recognised as at 31 December 2016 (2015 - £2,631 million).

The Group has recognised deferred tax assets in respect of losses, principally in the UK, and temporary differences. Deferred tax assets are recognised in respect of unused tax losses and other temporary differences to the extent that it is probable that there will be future taxable profits against which the losses and other temporary differences can be utilised. The Group has considered their carrying value as at 31 December 2016 and concluded that, based on management's estimates, sufficient taxable profits will be generated in future years to recover recognised deferred tax assets. These estimates are based on forecast performance and take into account the Group's plans to implement the UK ring-fencing regime and the resultant transfers between members of the Group.

Deferred tax assets of £7,940 million (2015 - £6,349 million) have not been recognised in respect of tax losses and other temporary differences where the availability of future taxable profits is uncertain. Further details about the Group's deferred tax assets are given in Note 22 on the accounts.

(iv) 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 in accordance with Accounting policy 16. At 31 December 2016, customer loan impairment provisions amounted to £4,455 million (2015 - £7,119 million).

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

The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate.

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

Accounting policies

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 - this is made up of two elements: loan impairment provisions for impaired loans that are below individual assessment thresholds (collectively assessed provisions) and for loan losses that have been incurred but have not been separately identified at the balance sheet date (latent loss provisions). Collectively assessed provisions are established on a portfolio basis using a present value methodology taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates and the related average life. These portfolios include mortgages, credit card receivables and other personal lending. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends. Latent loss provisions are held against estimated impairment losses in the performing portfolio that have yet to be identified as at the balance sheet date. To assess the latent loss within its portfolios, the 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.

(v) Fair value - financial instruments

In accordance with Accounting policies 14, 16 and 23, 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.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. It also uses the assumptions that market participants would use when pricing the asset or liability. In determining fair value the Group maximises the use of relevant observable inputs and minimises the use of unobservable inputs.

Where the Group manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, it measures the fair value of a group of financial assets and financial liabilities on the basis of the price that it would receive to sell a net long position (i.e. an asset) for a particular risk exposure or to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction at the measurement date under current market conditions.

Credit valuation adjustments are made when valuing derivative financial assets to incorporate counterparty credit risk. Adjustments are also made when valuing financial liabilities measured at fair value to reflect the Group's own credit standing.

Where the market for a financial instrument is not active, fair value is established using a valuation technique. These valuation techniques involve a degree of estimation, the extent of which depends on the instrument's complexity and the availability of market-based data. Further details about the Group's valuation methodologies and the sensitivity to reasonably possible alternative assumptions of the fair value of financial instruments valued using techniques where at least one significant input is unobservable are given in Note 9 on the accounts.

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.

Explanation of Responses:

Accounting policies

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 sections in IAS 39 setting out the criteria for the recognition and derecognition of financial instruments have 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 the 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 currently anticipates applying this option.

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 and forecasts of future events and economic conditions. The estimation of ECL also takes into account the time value of money. Recognition and measurement of credit impairments under IFRS 9 are more forward-looking than under IAS 39.

A Group-wide 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.

Accounting policies

The table below sets out the key 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. RBS intends to use 90 days past due as a consistent measure for default across all product classes. Also where RBS considers that the customers is unlikely to pay in credit obligations,	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 66 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: - RBS 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 adjusted to point in time metrics 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. For Wholesale, PD models reflect losses that would arise through-the-cycle; this represents a long run average view of default levels. For Retail PD models, the prevailing economic conditions at the reporting date (point in time) are used.

Accounting policies

Attribute	IFRS 9	IAS 39	Regulatory
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

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 generally 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.

Accounting policies

Attribute	IFRS 9	IAS 39	Regulatory
Exposure at default (EAD)	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.	Based on the current drawn balance plus future committed drawdowns	Models are used to provide estimates of credit facility utilisation at the time of a customer default, recognising that customers may make further drawings on unused credit facilities prior to default or that exposures may increase due to market movements. EAD cannot be lower than the reported balance sheet, but can be reduced by a legally enforceable netting agreement.
Date of initial recognition (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.
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	Modification is not separately defined but accounting impact arises as an EIR adjustment on changes that are not derecognition or impairment events.	Not applicable

	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).		

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Explanation of Responses:

Accounting policies

The table below summarises the existing Group balance sheet captions for financial assets and their IAS 39 classification, and indicates the expected classifications that will apply under 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							
Loans and advances to banks							
Held for trading							
Non held for trading							
Loans and advances to customers							
Held-for-trading							
Non held-for-trading							
Debt securities							
Held-for-trading							
Non held-for-trading:	Held-to-maturity						
	Available-for-sale						
	Other						
Equity shares							
Held-for-trading							
Non held-for-trading							
Settlement balances							
Non held-for-trading							
Derivatives							
Held-for-trading							

Notes:

(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 2 ‘Share-based payment’ was amended in June 2016 to clarify the accounting for net settlement of tax in respect of share-based payments and the calculation of the cost of modified awards and those with vesting conditions that are not market conditions. The effective date is 1 January 2018

IFRIC Interpretation 22 ‘Foreign Currency Transaction and Advance Consideration’ was issued in December 2016 clarifying the date of a foreign exchange transaction to be used on initial recognition of a related asset or other item. The effective date is 1 January 2018.

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

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

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Notes on the consolidated accounts

1 Net interest income			
	2016	2015	2014
	£m	£m	£m
Loans and advances to customers	10,706	11,268	12,339
Loans and advances to banks	246	340	367
Debt securities	306	317	373
Interest receivable (1)	11,258	11,925	13,079
Customer accounts: demand deposits	433	619	598
Customer accounts: savings deposits	432	446	731
Customer accounts: other time deposits	190	315	440
Balances with banks	97	45	75
Debt securities in issue	557	759	1,010
Subordinated liabilities	845	869	876
Internal funding of trading businesses	(4)	105	91
Interest payable (1)	2,550	3,158	3,821
Net interest income	8,708	8,767	9,258
2 Non-interest income			
	2016	2015	2014
	£m	£m	£m
Fees and commissions receivable			
Payment services	856	923	989
Credit and debit card fees	645	738	822
Lending (credit facilities)	1,044	1,076	1,250
Brokerage	154	262	321
Investment management	250	305	391
Trade finance	196	242	280
Other	195	196	361
	3,340	3,742	4,414
Fees and commissions payable			
Banking	(805)	(809)	(875)
Income from trading activities			
Foreign exchange	989	809	1,428
Interest rate	(480)	35	(108)
Credit	336	(80)	(82)

Explanation of Responses:

Changes in fair value of own debt and derivative liabilities attributable to own credit			
- debt securities in issue	87	252	44
- derivative liabilities	67	2	(84)
Equities and other	(25)	42	87
	974	1,060	1,285
(Loss)/gain on redemption of own debt	(126)	(263)	20
Other operating income			
Operating lease and other rental income	287	276	380
Changes in the fair value of own debt designated as at fair value through profit or loss			
attributable to own credit risk (2)			
- debt securities in issue	41	84	(89)
- subordinated liabilities	(15)	(29)	(17)
Other changes in the fair value of financial assets and liabilities designated as at fair			
value through profit or loss and related derivatives	(13)	375	83
Changes in the fair value of investment properties	(11)	2	(25)
Profit/(loss) on sale of securities	71	(4)	227
Profit on sale of property, plant and equipment	18	91	137
Profit/(loss) on sale of subsidiaries and associates	273	(102)	192
Loss on disposal or settlement of loans and receivables	(277)	(558)	(232)
Share of profits of associated entities	59	140	126
Other income (3)	66	151	266
	499	426	1,048

Notes:

(1) Negative interest on loans and advances is classed as interest payable.

(2) Measured as the change in fair value from movements in the year in the credit risk premium payable by RBS.

(3) Includes income from activities other than banking.

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Notes on the consolidated accounts

3 Operating expenses			
	2016	2015	2014
	£m	£m	£m
Salaries	3,097	3,177	3,503
Variable compensation	281	314	408
Temporary and contract costs	674	638	526
Social security costs	388	344	379
Share-based compensation	32	36	43
Pension costs			
- defined benefit schemes (see Note 4)	267	523	462
- loss/(gain) on curtailments or settlements (see Note 4)	1	(65)	—
- defined contribution schemes	89	74	87
Severance	229	511	196
Other	66	174	153
Staff costs	5,124	5,726	5,757
Premises and equipment	1,388	1,827	2,081
UK bank levy	190	230	250
Other administrative expenses (1)	8,555	6,058	4,318
Property, plant and equipment depreciation and write down (see Note 16)	574	950	671
Intangible assets amortisation (see Note 15)	204	230	259
Depreciation and amortisation	778	1,180	930
Write down of goodwill and other intangible assets (see Note 15)	159	1,332	523
	16,194	16,353	13,859

Restructuring and divestment costs

Included in operating expenses are the following restructuring and divestment costs.

	Staff	Premises and depreciation	Other (2)	Total
	£m	£m	£m	£m
Restructuring				
2016	490	153	1,107	1,750

Explanation of Responses:

2015	616	737	950	2,303
2014	261	269	268	798
Divestment				
2016	152	11	193	356
2015	214	9	405	628
2014	120	3	233	356

Notes:

(1) Includes litigation and conduct costs, net of amounts recovered. Further details are provided in Note 20.

(2) Includes other administrative expenses, write down of goodwill and other intangible assets.

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Notes on the consolidated accounts

3 Operating expenses continued

The average number of persons employed, rounded to the nearest hundred, in continuing operations during the year, excluding temporary staff, was 82,400 (2015 - 88,800; 2014 - 92,800); on the same basis there were no people employed in discontinued operations (2015 - 10,100; 2014 - 18,200). The average number of temporary employees during 2016 was 6,700 (2015 - 7,800; 2014 - 8,100). The number of persons employed in continuing operations at 31 December, excluding temporary staff, by reportable segment, was as follows:

	2016	2015	2014
UK Personal & Business Banking	20,300	24,600	24,400
Ulster Bank RoI	3,000	2,500	2,500
Personal & Business Banking	23,300	27,100	26,900
Commercial Banking	5,600	5,700	6,000
Private Banking	1,700	1,900	2,200
RBS International	800	700	600
Commercial & Private Banking	8,100	8,300	8,800
NatWest Markets	1,100	1,200	1,700
Capital Resolution	400	1,300	2,400
Williams & Glyn	4,800	5,300	4,700
Central items & other	39,300	44,600	45,100
Restructuring	—	—	100
Total	77,000	87,800	89,700
UK	57,300	64,100	63,400
USA	700	1,100	2,000
Europe	5,200	6,200	7,400
Rest of the World	13,800	16,400	16,900
Total	77,000	87,800	89,700
There were no people employed in discontinued operations at 31 December 2016 (2015 - nil; 2014 - 17,400).			

Share-based payments

As described in the Remuneration report on page 102, the Group grants share-based awards to employees principally on the following bases:

Award plan	Eligible employees	Nature of award (1)	Vesting conditions (2)	Settlement

Sharesave	UK, Republic of Ireland, Channel Islands, Gibraltar and Isle of Man	Option to buy shares under employee savings plan	Continuing employment or leavers in certain circumstances	2017 to 2021
Deferred performance awards	All	Awards of ordinary shares	Continuing employment or leavers in certain circumstances	2017 to 2019
Long-term incentives (3)	Senior employees	Awards of conditional shares or share options	Continuing employment or leavers in certain circumstances and/or achievement of performance conditions	2017 to 2021

Notes:

(1) Awards are equity-settled unless international comparability is better served by cash-settled awards.

(2) All awards have vesting conditions and therefore some may not vest.

(3) Long-term incentives include the Executive Share Option Plan, the Long-Term Incentive Plan and the Employee Share Plan.

Notes on the consolidated accounts

3 Operating expenses continued

The fair value of options granted in 2016 was determined using a pricing model that included: expected volatility of shares determined at the grant date based on historical volatility over a period of up to five years; expected option lives that equal the vesting period; no dividends on equity shares; and risk-free interest rates determined from UK gilts with terms matching the expected lives of the options.

The strike price of options and the fair value on granting awards of fully paid shares is the average market price over the five trading days (three trading days for Sharesave) preceding grant date.

Sharesave	2016		2015		2014	
	Average exercise price	Shares under option	Average exercise price	Shares under option	Average exercise price	Shares under option
	£	(million)	£	(million)	£	(million)
At 1 January	2.87	56	2.85	51	2.90	62
Granted	1.68	17	2.91	12	3.43	12
Exercised	2.37	—	2.38	(2)	2.34	(6)
Cancelled	3.02	(17)	2.98	(5)	3.61	(17)
At 31 December	2.46	56	2.87	56	2.85	51

Options are exercisable within six months of vesting; 8.1 million options were exercisable at 31 December 2016 (2015 - 1.0 million; 2014 - 1.9 million). The weighted average share price at the date of exercise of options was £1.78 (2015 - £3.54; 2014 - £3.65). At 31 December 2016, exercise prices ranged from £1.68 to £4.34 (2015 - £2.33 to £18.93; 2014 - £2.33 to £39.27) and the remaining average contractual life was 2.9 years (2015 - 2.9 years; 2014 - 3.7 years). The fair value of options granted in 2016 was £18 million (2015 - £12 million; 2014 - £18 million).

Deferred performance awards	2016		2015		2014	
	Value at grant	Shares awarded	Value at grant	Shares awarded	Value at grant	Shares awarded
	£m	(million)	£m	(million)	£m	(million)

At 1 January	276	80		272	85		180	55
Granted	170	75		186	50		311	95
Forfeited	(19)	(7)		(34)	(11)		(28)	(7)
Vested	(131)	(46)		(148)	(44)		(170)	(51)
Disposals	—	—		—	—		(21)	(7)
At 31 December	296	102		276	80		272	85

The awards granted in 2016 vest in three equal trenches on the first, second and third anniversary of the award.

Long-term incentives										
	2016				2015				2014		
	Value at grant	Shares awarded	Options over shares		Value at grant	Shares awarded	Options over shares		Value at grant	Shares awarded	Options over shares
	£m	(million)	(million)		£m	(million)	(million)		£m	(million)	(million)
At 1 January	153	44	5		214	69	7		320	94	13
Granted	37	16	—		39	11	—		72	22	—
Vested/exercised	(39)	(12)	—		(51)	(18)	(2)		(61)	(14)	(5)
Lapsed	(32)	(10)	(1)		(49)	(18)	—		(85)	(22)	(1)
Disposals	—	—	—		—	—	—		(32)	(11)	—
At 31 December	119	38	4		153	44	5		214	69	7

The market value of awards vested/exercised in 2016 was £40 million (2015 - £55 million; 2014 - £44 million). There are vested options over 4 million shares exercisable up to 2019 (2015 - 5 million; 2014 - 7 million).

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Notes on the consolidated accounts

3 Operating expenses continued

Variable compensation awards			
The following tables analyse the Group variable compensation awards for 2016.			
	Group		
	2016	2015	Change
	£m	£m	%
Non-deferred cash awards (2)	56	61	(8)
Total non-deferred variable compensation	56	61	(8)
Deferred bond awards	138	149	(7)
Deferred share awards	149	163	(9)
Total deferred variable compensation	287	312	(8)
Total variable compensation (3)	343	373	(8)
Variable compensation as a % of adjusted operating profit (4)	9%	8%	
Proportion of variable compensation that is deferred	84%	84%	
Of which			
- deferred bond awards	48%	48%	
- deferred share awards	52%	52%	

Reconciliation of variable compensation awards to income statement charge	2016	2015	2014
	£m	£m	£m
Variable compensation awarded	343	373	421
Less: deferral of charge for amounts awarded for current year	(103)	(97)	(150)
Income statement charge for amounts awarded in current year	240	276	271
Add: current year charge for amounts deferred from prior years	147	140	201
Less: forfeiture of amounts deferred from prior years	(106)	(102)	(64)
Income statement charge for amounts deferred from prior years	41	38	137
Income statement charge for variable compensation (3)	281	314	408

	Actual				Expected	
						2018

Year in which income statement charge is expected to be taken for deferred variable compensation	2014	2015	2016	2017	and beyond
	£m	£m	£m	£m	£m
Variable compensation deferred from 2014 and earlier	204	140	57	39	14
Variable compensation deferred from 2015	—	—	90	40	15
Less: clawback of variable compensation deferred from prior years	(3)	—	—	—	—
Less: forfeiture of amounts deferred from prior years	(64)	(102)	(106)	—	—
Variable compensation for 2016 deferred	—	—	—	80	23
	137	38	41	159	52

Notes:

(1) The tables above relate to continuing businesses only.

(2) Cash awards are limited to £2,000 for all employees.

(3) Excludes other performance related compensation.

(4) Adjusted operating profit before variable compensation expense.

Notes on the consolidated accounts

4 Pensions

The Group sponsors a number of pension schemes in the UK and overseas, including the Main Section of The Royal Bank of Scotland Group Pension Fund (the "Main scheme") which operates under UK trust law and is managed and administered on behalf of its members in accordance with the terms of the trust deed, the scheme rules and UK legislation (principally the Pension Schemes Act 1993, the Pensions Act 1995 and the Pensions Act 2004). Under UK legislation a defined benefit pension scheme is required to meet the statutory funding objective of having sufficient and appropriate assets to cover its liabilities. 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 Main scheme corporate trustee is RBS Pension Trustee Limited (the Trustee), a wholly owned subsidiary of National Westminster Bank Plc. The Trustee is the legal owner of the Main scheme assets which are held separately from the assets of the Group. The Board of the Trustee comprises four trustee directors nominated by members selected from eligible active staff and pensioner members who apply and six 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.

Similar governance principles apply to the Group's other pension schemes, although different legislative frameworks apply to the Group's overseas schemes.

Various changes have been made to the Group's defined benefit pension schemes to manage pension costs and risks. The Group announced in October 2016 that, following an extensive consultation process that, it would be increasing employee contributions in its UK defined benefit pension schemes by 2% of salary.

The Group's defined benefit schemes generally provide a pension of one-sixtieth of final pensionable salary for each year of service prior to retirement up to a maximum of 40 years. Employees making additional contributions can secure additional benefits.

Since October 2006, new UK entrants may join The Royal Bank of Scotland Retirement Savings Plan, a defined contribution pension scheme.

The Group also provides post-retirement benefits other than pensions, principally through subscriptions to private healthcare schemes in the UK and unfunded post-retirement benefit plans. Provision for the costs of these benefits is charged to the income statement over the average remaining future service lives of eligible employees. The amounts are not material.

Interim valuations of the Group's schemes under IAS 19 'Employee Benefits' were prepared at 31 December with the support of independent actuaries, using the following assumptions:

Principal IAS 19 actuarial assumptions	Main scheme	
	2016	2015
	%	%
Discount rate	2.7	3.9
Expected return on plan assets	2.7	3.9
Rate of increase in salaries	1.8	1.8
Rate of increase in pensions in payment	3.0	2.8
Rate of increase in deferred pensions	3.2	3.0
Inflation assumption (RPI)	3.2	3.0

Discount rate

The Group discounts its defined benefit pension obligations at discount rates determined by reference to the yield on 'high quality' corporate bonds.

The sterling yield curve (applied to 93% of the Group's defined benefit obligations) is 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. The weighted average duration of the Main scheme's defined benefit obligation at 31 December 2016 is 20.9 years (2015 – 19.1 years). Significant judgement is required when setting the criteria for bonds to be included in the population from which the yield curve is derived.

Notes on the consolidated accounts

4 Pensions continued

The criteria include issue size, quality of pricing and the exclusion of outliers. Judgement is also required in determining the shape of the yield curve at long durations: a constant credit spread relative to gilts is assumed.

	Main scheme	
	2016	2015
Major classes of plan assets as a percentage of total plan assets	%	%
Quoted assets		
Quoted equities		
- Consumer industry	4.6	5.3
- Manufacturing industry	1.8	3.2
- Energy and utilities	2.7	2.6
- Financial institutions	8.3	5.4
- Technology and telecommunications	2.3	3.4
- Other	0.8	0.9
Private equity	3.4	3.4
Index-linked bonds	31.4	28.2
Government fixed interest bonds	5.9	9.0
Corporate fixed interest bonds	17.9	18.0
Unquoted assets		
Corporate and other bonds	1.8	3.3
Hedge funds	0.2	0.2
Real estate	5.2	6.4
Derivatives	10.2	6.4
Cash and other assets	3.4	4.1
Equity exposure of equity futures	(1.8)	(1.4)
Cash exposure of equity futures	1.9	1.6
	100.0	100.0

The assets of the Main scheme, which represent 89% of plan assets at 31 December 2016 (2015 - 88%), are invested in a diversified portfolio of quoted and private equity, government and corporate fixed-interest and index-linked bonds, and other assets including real estate and hedge funds.

The Main scheme employs derivative instruments to achieve a desired asset class exposure or to match assets more closely to liabilities. The value of assets shown reflects the assets owned by the scheme, with

any derivative holdings valued on a mark-to-market basis.

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

	2016				2015		
	Notional	Fair value			Notional	Fair value	
	amounts	Assets	Liabilities		amounts	Assets	Liabilities
	£m	£m	£m		£m	£m	£m
Inflation rate swaps	11,649	299	549		9,576	76	647
Interest rate swaps	41,463	9,440	5,442		32,622	5,722	3,710
Currency forwards	15,314	191	136		10,247	25	247
Equity and bond call options	2,157	799	1		6,277	744	1
Equity and bond put options	1,860	—	2		6,109	2	12
Other	3,711	1,719	1,816		2,311	1,506	1,479

The investment strategy of other schemes is similar to that of the Main scheme, adjusted to take account of the nature of liabilities, risk appetite of the trustees, size of the scheme and any local regulatory constraints.

Swaps are used to manage interest rate and inflation risk of the liabilities, as well as being used to manage other risks within the Main scheme. They have been executed at prevailing market rates and within standard market bid/offer spreads with a number of counterparty banks, including The Royal Bank of Scotland plc.

At 31 December 2016, the gross notional value of the swaps was £55,874 million (2015 - £44,387 million) and had a net positive fair value of £3,629 million (2015 - £1,444 million). Collateral is required on all swap transactions. The counterparty banks had delivered a net amount of £3,991 million of collateral at 31 December 2016 (2015 - £2,153 million).

The schemes can have exposure to the Group within their investment programmes. At 31 December 2016 the Main scheme's exposure to the Group was £2,087 million (2015: £1,146 million) which includes indirect exposure to ordinary shares of the Group through index tracking investments, swaps contracts (before allowing for collateral posted against the mark value of the swaps) and cash deposits held with National Westminster Bank Plc.

Notes on the consolidated accounts

4 Pensions continued

IAS 19 post-retirement mortality assumptions (Main scheme)	2016	2015
Longevity at age 60 for current pensioners (years)		
Males	27.4	27.8
Females	29.1	29.8
Longevity at age 60 for future pensioners currently aged 40 (years)		
Males	29.0	29.1
Females	31.2	31.4

Changes in value of net pension liability	Main scheme				All schemes			
	Fair value of plan assets	Present value of defined benefit obligation	Asset ceiling/ minimum funding (1)	Net pension liability	Fair value of plan assets	Present value of defined benefit obligation	Asset ceiling/ minimum funding (1)	Net pension liability
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2015	30,077	31,776	1,739	3,438	34,359	36,643	1,854	4,138
Currency translation and other adjustments	—	—		—	(36)	(73)	—	(37)
Income statement								
Net interest expense	1,118	1,158	64	104	1,207	1,298	64	155
Current service cost		245		245		328		328
Past service cost		28		28		40		40
Gains on curtailments or settlements		—		—		(65)		(65)
	1,118	1,431	64	377	1,207	1,601	64	458
Statement of comprehensive income								
Return on plan assets above recognised interest income	(415)			415	(458)			458
Experience gains and losses		(233)		(233)		(258)		(258)
Effect of changes in actuarial financial assumptions		(1,124)		(1,124)		(1,387)		(1,387)

Effect of changes in actuarial demographic assumptions		112		112		48		48
Asset ceiling/minimum funding adjustments			1,178	1,178			1,212	1,212
	(415)	(1,245)	1,178	348	(458)	(1,597)	1,212	73
Contributions by employer	919	—		(919)	1,060	—		(1,060)
Contributions by plan participants and other scheme								
members	—	—		—	6	6		—
Benefits paid	(996)	(996)		—	(1,131)	(1,131)		—
Transfer to disposal groups	—	—		—	(299)	(297)		2
At 1 January 2016	30,703	30,966	2,981	3,244	34,708	35,152	3,130	3,574
Currency translation and other adjustments	—	—		—	533	602		69
Income statement								
Net interest expense	1,310	1,184	116	(10)	1,454	1,327	122	(5)
Current service cost		199		199		264		264
Past service cost		28		28		8		8
Loss on curtailments or settlement (5)		—		—		1		1
	1,310	1,411	116	217	1,454	1,600	122	268
Statement of comprehensive income								
Return on plan assets above recognised interest income	8,562			(8,562)	9,254			(9,254)
Experience gains and losses		(658)		(658)		(794)		(794)
Effect of changes in actuarial financial assumptions		8,803		8,803		9,565		9,565
Effect of changes in actuarial demographic assumptions		(402)		(402)		(542)		(542)
Asset ceiling/minimum funding adjustments			1,876	1,876			2,074	2,074
	8,562	7,743	1,876	1,057	9,254	8,229	2,074	1,049
Contributions by employer	4,518	—		(4,518)	4,786	—		(4,786)
Contributions by plan participants and other scheme								
members	—	—		—	12	12		—
Liabilities extinguished upon settlement	—	—		—	(43)	(130)		(87)
Benefits paid	(1,269)	(1,269)		—	(1,475)	(1,475)		—
At 31 December 2016	43,824	38,851	4,973	—	49,229	43,990	5,326	87

Note:

Explanation of Responses:

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

Explanation of Responses:

Notes on the consolidated accounts

4 Pensions continued

Analysis of net pension deficit	Main scheme	
	2016	2015
	£m	£m
Fund assets at fair value	43,824	30,703
Present value of fund liabilities	38,851	30,966
Funded status	4,973	263
Asset ceiling/minimum funding	(4,973)	2,981
Retirement benefit liability	—	3,244
Minimum funding requirement	—	3,657
Asset ceiling	—	(413)
	—	3,244

Net pension deficit comprises	2016	2015
	£m	£m
Net assets of schemes in surplus (included in Prepayments, accrued income and other assets, Note 17)	(276)	(215)
Net liabilities of schemes in deficit	363	3,789
	87	3,574

The income statement charge comprises:			
	2016	2015	2014
	£m	£m	£m
Continuing operations	268	458	462
Discontinued operations	—	—	4
	268	458	466

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

	2016	2015

	%	%
Active	18.1	17.5
Deferred	45.9	41.9
Pensioner	36.0	40.6
	100.0	100.0

The table below sets out the sensitivities of the present value of defined benefit obligations at 31 December to a separate change in the principal actuarial assumptions.

	Main scheme (decrease)/increase	
	in obligation at 31 December	
	2016	2015
	£m	£m
0.25% increase in the discount rate	(1,978)	(1,392)
0.25% increase in inflation	1,552	1,106
0.25% additional rate of increase in pensions in payment	1,339	945
Longevity increase of one year	1,522	853

Pension liabilities are calculated on the central assumptions and under the relevant sensitivity scenarios. The sensitivity to pension liabilities is the difference between these calculations.

The sensitivity analysis presented above may not be representative of the actual change in the defined benefit obligation as it is unlikely that the changes in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

Notes on the consolidated accounts

4 Pensions continued

History of defined benefit schemes	Main scheme						All schemes				
	2016	2015	2014	2013	2012		2016	2015	2014	2013	2012
	£m	£m	£m	£m	£m		£m	£m	£m	£m	£m
Fair value of plan assets	43,824	30,703	30,077	24,272	22,441		49,229	34,708	34,359	28,488	26,370
Present value of plan obligations	38,851	30,966	31,776	26,958	25,648		43,990	35,152	36,643	31,484	30,110
Net surplus/(deficit)	4,973	(263)	(1,699)	(2,686)	(3,207)		5,239	(444)	(2,284)	(2,996)	(3,740)
Experience gains/(losses) on plan liabilities	658	233	3	102	(232)		794	258	18	176	(207)
Experience gains/(losses) on plan assets	8,562	(415)	4,629	986	301		9,254	(458)	5,171	1,097	485
Actual return on plan assets	9,872	703	5,766	1,997	1,329		10,708	749	6,485	2,270	1,696
Actual return on plan assets - %	32.2%	2.3%	23.8%	8.9%	6.3%		30.9%	2.2%	22.8%	8.6%	6.8%

Triennial funding valuation

In January 2016, the Group accelerated the settlement of the future contributions agreed with the Trustee as part of the 31 March 2013 triennial valuation of the Main scheme. This amounted to £4.2 billion. At the same time it entered into a Memorandum of Understanding with the Trustee that included advancing the date of the 31 March 2016 triennial funding valuation to 31 December 2015. Consequently, the next triennial valuation does not need to be agreed until 31 March 2020.

In June 2016, the triennial funding valuation of the Main scheme as at 31 December 2015 was agreed. Using the actuarial assumptions set out in the table below (which are different to the assumptions used to calculate the IAS 19 defined benefit obligation) the pension liabilities calculated at 31 December 2015 totalled £37 billion and the deficit was £5.8 billion, subsequently reduced by the £4.2 billion cash payment in March 2016. Investment returns over the next 10 year period are forecast to absorb the £1.6 billion balance of the deficit. The average cost of the future service of current members has increased from 27% to 35% of basic salary before contributions from those members; it includes the expenses of running the scheme.

The Trustee of the Main scheme is responsible for setting the actuarial assumptions used in the triennial funding valuation having taken advice from the Scheme Actuary. These represent the Trustee's prudent estimate of the future experience of the Main scheme taking into account the covenant provided by the Group and the investment strategy of the scheme. They are agreed with the Group and documented in the Statement of Funding Principles.

The key assumption methodology used in the 31 December 2015 valuation is set out below. As at that date the funding level disclosed on the assumptions below was 84%. This is before any allowance for the £4.2 billion contribution made in March 2016.

Principal actuarial assumptions for 2015 and 2013 triennial valuations

Discount rate	Fixed interest swap yield curve plus 1.5% per annum at all durations		
Inflation assumption	Retail price index (RPI) swap yield curve		
Rate of increase in pensions in payment	(RPI floor 0%, cap 5%): Limited price indexation (LPI) (0,5) swap yield curve		
Post retirement mortality assumptions:			
		2015	2013
Longevity at age 60 for current pensioners (years)	Male	28.4	28.8
	Female	30.2	30.8
Longevity at age 60 for future pensioners currently aged 40 (years)	Male	29.9	30.7
	Female	32.4	32.9

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5 Auditor's remuneration

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

On 24 March 2016 Deloitte LLP (Deloitte) resigned as the Group's auditors and at the Annual General Meeting on 4 May 2016 the shareholders approved the appointment of Ernst & Young LLP (EY) as the Group's auditor for the audit of the 2016 annual accounts. Amounts paid to the Group's auditors for statutory audit and other services are set out below:

	2016	2015
Deloitte (1)	£m	£m
Fees payable for the audit of the Group's annual accounts	—	4.0
Fees payable to the auditor and its associates for other services to the Group		
- the audit of the company's subsidiaries	0.2	19.3
- audit-related assurance services (2)	0.5	4.8
Total audit and audit-related assurance services fees	0.7	28.1
Taxation compliance services	—	0.4
Taxation advisory services	—	0.1
Other assurance services	0.2	1.4
Corporate finance services (3)	1.3	1.1
Consulting services	—	—
Total other services	1.5	3.0
Total	2.2	31.1

	2016	2015
EY (4)	£m	£m
Fees payable for the audit of the Group's annual accounts	4.0	—
Fees payable to the auditor and its associates for other services to the Group		
- the audit of the company's subsidiaries	20.7	—
- audit-related assurance services (5)	4.0	—

Total audit and audit-related assurance services fees	28.7	—
Other assurance services	3.4	—
Corporate finance services (6)	0.2	—
Total other services	3.6	—

Notes:

(1) Includes fees for the period Deloitte were principal Group auditor (2016 - 1 January 2016 to effective resignation on 24 March 2016: 2015 - 1 January 2015 - 31 December 2015).

(2) Comprises no fees (2015 - £0.8 million) in relation to reviews of interim financial information, £0.1 million (2015 - £2.5 million) in respect of reports to the Group's regulators in the UK and overseas, £0.2 million (2015 - £0.4 million) in respect of internal controls assurance and no fees (2015 - £1.1 million) in relation to non-statutory audit opinions.

(3) Comprises fees of £1.4 million (2015 - £1.1 million) in respect of work performed by the auditors as reporting accountants on debt and equity issuances undertaken by the Group, including securitisations, £0.1 million (2015 - £0.6 million), and no fees in relation to a working capital report in connection with a circular to shareholders (2015 - £0.4 million).

(4) Includes fees for the period EY were principal Group auditor (2016: 1 January 2016 to 31 December 2016).

(5) Comprises fees of £1.1 million in relation to reviews of interim financial information, £2.2 million in respect of reports to the Group's regulators in the UK and overseas, £0.7 million in relation to non-statutory audit opinions.

(6) Comprises fees of £0.2 million in respect of work performed by the auditors as reporting accountants on debt and equity issuances undertaken by the Group.

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6 Tax			
	2016	2015	2014
	£m	£m	£m
Current tax:			
Charge for the year	(1,126)	(249)	(423)
Over provision in respect of prior years	186	220	247
	(940)	(29)	(176)
Deferred tax:			
Other credit/(charge) for the year	246	—	(259)
Reduction in the carrying value of deferred tax assets	(317)	—	(1,472)
(Under)/over provision in respect of prior years	(155)	6	(2)
Tax charge for the year	(1,166)	(23)	(1,909)

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%; 2014 - 21.50%) as follows:

	2016	2015	2014
	£m	£m	£m
Expected tax credit/(charge)	816	547	(568)
Losses and temporary differences in year where no deferred tax asset recognised	(742)	(1,086)	(89)
Foreign profits taxed at other rates	340	510	76
UK tax rate change impact (1)	6	94	—
Non-deductible goodwill impairment	—	(124)	(28)
Items not allowed for tax:			
- losses on disposals and write-downs	(45)	(23)	(12)
- UK bank levy	(41)	(50)	(54)
- regulatory and legal actions	(952)	(232)	(182)
- other disallowable items	(141)	(199)	(191)
Non-taxable items:			
- gain on sale of Direct Line Insurance Group	—	—	41
- other non-taxable items	136	173	79
Taxable foreign exchange movements	(57)	19	21
Losses brought forward and utilised	10	122	225
(Reduction)/increase in carrying value of deferred tax asset in respect of:			
- UK losses	(317)	—	(850)
- US losses and temporary differences	—	—	(775)
- Ireland losses	—	—	153

Banking surcharge	(210)	—	—
Adjustments in respect of prior years (2)	31	226	245
Actual tax charge	(1,166)	(23)	(1,909)

Notes:

(1) In recent years, the UK Government has steadily reduced the rate of UK corporation tax, with the latest enacted rates standing at 20% with effect from 1 April 2015, 19% from 1 April 2017 and 17% from 1 April 2020. The Finance (No 2) Act 2015 restricts the rate at which tax losses are given credit in future periods to the main rate of UK corporation tax, excluding the Banking Surcharge 8% rate introduced by this Act. Deferred tax assets and liabilities at 31 December 2016 take into account the reduced rates in respect of tax losses and non-banking temporary differences and where appropriate, the banking surcharge inclusive rate in respect of other banking temporary differences.

(2) Prior year tax adjustments include releases of tax provisions that reflect the reduction of exposures in countries where RBS is ceasing operations in line with the strategy to become a smaller, simpler UK focused bank. The prior year tax adjustments also reflect adjustments to reflect submitted tax computations in the UK and overseas.

Notes on the consolidated accounts

7 Earnings per ordinary share			
Earnings per ordinary share have been calculated based on the following:			
	2016	2015	2014
	£m	£m	£m
Earnings			
Loss attributable to ordinary shareholders	(6,955)	(1,979)	(3,470)
(Loss)/profit from discontinued operations attributable to ordinary shareholders	—	(1,207)	3,527
(Loss)/profit from continuing operations attributable to ordinary shareholders	(6,955)	(3,186)	57
Weighted average number of shares (millions) (1)			
Weighted average number of ordinary shares outstanding during the year	11,692	11,516	11,356
Effect of dilutive share options and convertible securities	51	60	91
Diluted weighted average number of ordinary shares outstanding during the year	11,743	11,576	11,447

Note:

(1) All periods include the effect of 51 billion B shares that were converted to 5.1 billion ordinary shares in October 2015 (see Note 25).

There were no basic earnings/(loss) per ordinary share from discontinued operations (2015 - 10.5p; 2014 – (31.1p)). There were no diluted earnings per ordinary share from discontinued operations (2015 – 10.4p; 2014 – no dilutive impact.)

An agreement on 25 June 2014 between RBS and Her Majesty's Treasury (HMT) set out the terms for the retirement of the Dividend Access Share (DAS). On 22 March 2016 the DAS was retired on payment the final dividend of £1,193 million to HMT; the DAS was re-designated as a single B share which was then cancelled.

Earnings per share for periods ended after 25 June 2014 and prior to the retirement of the DAS reflect DAS dividends recognised before the end of a reporting period; this amounted to £1,193 million in respect of the year ended 31 December 2016 (2015 – nil; 2014 - £320 million).

Prior to 25 June 2014 the DAS was entitled to a dividend amounting to the greater of 7% of the aggregate issue price of B shares and 250% of the ordinary dividend rate multiplied by the number of B shares issued, less any dividends paid on the B shares and on ordinary shares issued on their conversion. When calculating earnings per share, IFRS requires profit or loss to be allocated to participating equity instruments as if all of the profit or loss for the period had been distributed.

Notes on the consolidated accounts

8 Financial instruments - classification

The following tables analyse financial assets and liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown within other assets and other liabilities.

Assets	Held-for-trading	Designated as at fair value through profit or loss	Hedging derivatives	Available-for-sale	Loans and receivables	Held-to-maturity	Finance leases	Other assets	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	—	—		—	74,250	—			74,250
Loans and advances to banks									
- reverse repos	11,120	—		—	1,740	—			12,860
- other (1)	6,780	—		—	10,498	—			17,278
Loans and advances to customers									
- reverse repos	26,586	—		—	2,341	—			28,927
- other	17,504	82		—	301,885	—	3,552		323,023
Debt securities	24,504	27		39,254	3,968	4,769			72,522
Equity shares	166	172		365	—	—			703
Settlement balances	—			—	5,526				5,526
Derivatives	242,192		4,789						246,981
Assets of disposal groups								13	13
Other assets	—	—		—	—	—		16,573	16,573
31 December 2016	328,852	281	4,789	39,619	400,208	4,769	3,552	16,586	798,656
Cash and balances at	—	—		—	79,404	—			79,404

central banks									
Loans and advances to banks									
- reverse repos	11,069	—		—	1,216	—			12,285
- other (1)	11,295	—		—	7,066	—			18,361
Loans and advances to customers									
- reverse repos	27,532	—		—	26	—			27,558
- other	17,559	63		—	285,006	—	3,706		306,334
Debt securities	35,857	111		38,831	2,387	4,911			82,097
Equity shares	660	147		554	—	—			1,361
Settlement balances	—			—	4,116				4,116
Derivatives	258,689		3,825						262,514
Assets of disposal groups								3,486	3,486
Other assets	—	—		—	—	—		17,892	17,892
31 December 2015	362,661	321	3,825	39,385	379,221	4,911	3,706	21,378	815,408

Note:

(1) Includes items in the course of collection from other banks of £781 million (2015 - £830 million).

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Notes on the consolidated accounts

8 Financial instruments - classification continued

Liabilities	Held-for-trading	Designated as at fair value through profit or loss	Hedging derivatives	Amortised cost	Other liabilities	Total
	£m	£m	£m	£m	£m	£m
Deposits by banks						
- repos	4,125	—		1,114		5,239
- other (1)	20,756	—		12,561		33,317
Customer accounts						
- repos	23,186	—		3,910		27,096
- other (2)	12,778	1,506		339,588		353,872
Debt securities in issue (3)	1,614	4,621		21,010		27,245
Settlement balances	—	—		3,645		3,645
Short positions	22,077	—				22,077
Derivatives	232,418		4,057			236,475
Subordinated liabilities	—	955		18,464		19,419
Liabilities of disposal groups					15	15
Other liabilities	—	—		2,010	18,842	20,852
31 December 2016	316,954	7,082	4,057	402,302	18,857	749,252
Deposits by banks						
- repos	9,657	—		609		10,266
- other (1)	20,469	—		7,561		28,030
Customer accounts						
- repos	25,570	—		1,542		27,112
- other (2)	11,911	2,661		328,614		343,186
Debt securities in issue (3)	3,883	6,256		21,011		31,150
Settlement balances	—	—		3,390		3,390
Short positions	20,809	—				20,809
Derivatives	252,102		2,603			254,705
Subordinated liabilities	—	811		19,036		19,847
Liabilities of disposal groups					2,980	2,980
Other liabilities	—	—		1,826	17,960	19,786
31 December 2015	344,401	9,728	2,603	383,589	20,940	761,261

Notes:

(1) Includes items in the course of transmission to other banks of £295 million (2015 - £338 million).

(2) The carrying amount of other customer accounts designated as at fair value through profit or loss is £155 million (2015 - £297 million) higher than the principal amount. No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial both during the period and cumulatively. Measured as the change in fair value from movements in the period in the credit risk premium payable.

(3) Comprises bonds and medium term notes of £24,037 million (2015 - £30,206 million) and certificates of deposit and other commercial paper of £3,208 million

(2015 - £944 million).

Amounts included in operating (loss)/profit before tax:			
	2016	2015	2014
	£m	£m	£m
Gains on financial assets/liabilities designated as at fair value through profit or loss	13	388	55
Losses on disposal or settlement of loans and receivables	(277)	(558)	(232)

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Notes on the consolidated accounts

8 Financial instruments - classification continued

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

	Offsetable instruments			Offsetable potential not recognised by IFRS					
2016	Gross	IFRS offset	Balance sheet	Effect of master netting and similar agreements	Cash collateral	Other financial collateral	Net amount after the effect of netting arrangements and related collateral	Instruments outside netting arrangements	Balance sheet total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets									
Derivatives	293,728	(51,080)	242,648	(197,288)	(28,742)	(8,435)	8,183	4,333	246,981
Reverse repos	69,805	(31,728)	38,077	(1,052)	—	(36,938)	87	3,710	41,787
Loans to customers	600	(600)	—	—	—	—	—	323,023	323,023
Settlement balances	1,711	(1,529)	182	—	—	—	182	5,344	5,526
	365,844	(84,937)	280,907	(198,340)	(28,742)	(45,373)	8,452	336,410	617,317
Liabilities									
Derivatives	284,255	(50,574)	233,681	(197,288)	(20,417)	(11,048)	4,928	2,794	236,475
Repos	61,742	(31,728)	30,014	(1,052)	—	(28,960)	2	2,321	32,335
Customer accounts	1,106	(1,106)	—	—	—	—	—	353,872	353,872
Settlement balances	1,677	(1,529)	148	—	—	—	148	3,497	3,645
	348,780	(84,937)	263,843	(198,340)	(20,417)	(40,008)	5,078	362,484	626,327
2015									
Assets									

Derivatives	380,467	(123,662)	256,805		(214,800)	(27,629)	(7,535)	6,841		5,709	262,514
Reverse repos	74,204	(34,361)	39,843		(2,500)	—	(37,218)	125		—	39,843
Loans to customers	2,955	(2,955)	—		—	—	—	—		306,334	306,334
Settlement balances	1,271	(1,225)	46		(26)	—	—	20		4,070	4,116
	458,897	(162,203)	296,694		(217,326)	(27,629)	(44,753)	6,986		316,113	612,807
Liabilities											
Derivatives	368,378	(118,366)	250,012		(214,800)	(25,729)	(8,213)	1,270		4,693	254,705
Repos	71,739	(34,361)	37,378		(2,500)	—	(34,878)	—		—	37,378
Customer accounts	8,251	(8,251)	—		—	—	—	—		343,186	343,186
Settlement balances	1,872	(1,225)	647		(26)	—	—	621		2,743	3,390
	450,240	(162,203)	288,037		(217,326)	(25,729)	(43,091)	1,891		350,622	638,659

Reclassification of financial instruments

There were no reclassifications in 2016 and 2015. In 2008 and 2009, financial assets were reclassified from held-for-trading (HFT) into loans and receivables (LAR) and from HFT into available-for-sale (AFS). The tables below show the carrying value, fair value and the effect on profit or loss of these reclassifications.

					Amount that	Reduction/
			Amount recognised in		would have been	(increase) in
			the income statement		recognised had	profit or loss
	Carrying	Fair		Impairment	reclassification	as a result of
	value	value	Income	losses	not occurred	reclassification
2016	£m	£m	£m	£m	£m	£m
Reclassified from HFT to LAR	1,165	1,078	244	—	274	30
Reclassified from HFT to AFS (1)	222	222	23	—	21	(2)
	1,387	1,300	267	—	295	28
2015						
Reclassified from HFT to LAR	1,002	877	(19)	(15)	4	38
Reclassified from HFT to AFS (1)	206	206	14	—	8	(6)
	1,208	1,083	(5)	(15)	12	32

Note:

(1) A loss of £2 million (2015 - loss of £3 million) was taken to AFS reserves.

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Notes on the consolidated accounts

9 Financial instruments - valuation

Valuation of financial instruments carried at fair value

Control environment

RBS'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. RBS ensures that appropriate attention is given to bespoke transactions, structured products, illiquid products and other instruments which are difficult to price.

Independent price verification (IPV)

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

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

Governance framework

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

The Modelled Product Review Committee sets the policy for model documentation, testing and review, and prioritises models with significant exposure being reviewed by the RBS Pricing Model Risk team. The NatWest Markets and Capital Resolution Valuation Committee is made up of valuation specialists and senior business representatives from various functions and oversee pricing, reserving and valuations

issues. This committee meets monthly to review and ratify any methodology changes. The Executive Valuation Committee meets quarterly to address key material and subjective valuation issues, to review items escalated by the NatWest Markets and Capital Resolution Valuation Committee and to discuss other relevant matters including prudential valuation.

Valuation hierarchy

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

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

Valuation techniques

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

Non-modelled products

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

Modelled products

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

Explanation of Responses:

Notes on the consolidated accounts

9 Financial instruments - valuation continued

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

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

Notes on the consolidated accounts

9 Financial instruments - valuation continued

- 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.

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

- Price volatilities and correlations - volatility is a measure of the tendency of a price to change with time. Correlation measures the degree 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, RBS considers the value of the prepayment option.

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

Consensus pricing

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

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

Furthermore, on an ongoing basis, RBS assesses the appropriateness of any model used. To the extent that the price determined by internal models does not represent the fair value of the instrument, for instance in highly stressed market conditions, RBS makes adjustments to the model valuation to calibrate to other available pricing sources.

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

Valuation reserves

When valuing financial instruments in the trading book, adjustments are made to mid-market valuations to cover bid-offer spread, liquidity and credit risk. A breakdown of valuation adjustments is provided in Capital and risk management: Balance sheet analysis - derivatives on page 346.

Credit valuation adjustments (CVA)

CVA represent an estimate of the adjustment to fair value that a market participant would make to incorporate the counterparty credit risk inherent in derivative exposures. CVA is actively managed by a credit and market risk hedging process, and therefore movements in CVA are partially offset by trading revenue on the hedges.

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

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 RBS holds collateral against counterparty exposures, CVA is held to the extent that residual risk remains.

Notes on the consolidated accounts

9 Financial instruments - valuation continued

Bid-offer, liquidity and other reserves

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

Bid-offer adjustments for each risk factor (including delta (the degree to which the price of an instrument changes in response to a change in the price of the underlying), vega (the degree to which the price of an instrument changes in response to the volatility in the price of the underlying), correlation (the degree to which prices of different instruments move together)) are determined by aggregating similar risk exposures arising on different products. Additional basis bid-offer reserves are taken where these are charged in the market.

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

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

Vanilla risk on exotic products is typically reserved as part of the overall portfolio based calculation e.g. delta and vega risk on exotic products are included within the delta and vega bid-offer calculations.

Product related risks such as correlation risk, attract specific bid-offer reserves. Additional reserves are provided for exotic products to ensure overall reserves match market close-out costs. These market close-out costs inherently incorporate risk decay and cross-effects (taking into account how changes in one risk factor may affect other inputs rather than treating all risk factors independently) that are unlikely to be adequately reflected in a static hedge based on vanilla instruments. Where there is limited bid-offer information for a product, the pricing approach and risk management strategy are taken into account when assessing the reserve.

The discount rates applied to derivative cash flows in determining fair value reflect any underlying collateral agreements. Collateralised derivatives are generally discounted at the relevant OIS-related rates at an individual trade level. Uncollateralised derivatives are discounted with reference to funding levels by applying a funding spread over benchmark interest rates on a portfolio basis (funding valuation adjustment).

Funding valuation adjustment (FVA)

FVA represents an estimate of the adjustment to fair value that a market participant would make to incorporate funding costs and benefits that arise in relation to uncollateralised derivative exposures.

Funding levels are applied to estimated potential future exposures, the modelling of which is consistent with the approach used in the calculation of CVA. The counterparty contingent nature of the exposures is reflected in the calculation.

Amounts deferred on initial recognition

On initial recognition of financial assets and liabilities valued using valuation techniques incorporating information other than observable market data, any difference between the transaction price and that derived from the valuation technique is deferred. Such amounts are recognised in profit or loss over the life of the transaction; when market data becomes observable; or when the transaction matures or is closed out as appropriate. At 31 December 2016, net gains of £72 million (2015 - £81 million) were carried forward. During the year, net gains of £27 million (2015 - £16 million) were deferred, £48 million

(2015 - £53 million) were recognised in the income statement and £12 million (2015 – nil) were reclassified from other categories of Day 1 reserves.

Notes on the consolidated accounts

9 Financial instruments - valuation continued

Own credit

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

For issued debt this adjustment is based on debt issuance spreads above average inter-bank rates (at a range of tenors). Secondary senior debt issuance spreads are used in the calculation of the own credit adjustment applied to senior debt.

The fair value of RBS's derivative financial liabilities is also adjusted to reflect RBS's own credit risk through debit valuation adjustments (DVA). 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. Expected gains are determined from market implied probabilities of default and recovery levels. FVA is considered the primary adjustment applied to derivative liabilities. The extent to which DVA and FVA overlap is eliminated from DVA.

The own credit adjustment does not alter cash flows, is not used for performance management, is disregarded for regulatory capital reporting processes and will reverse over time provided the liability is not repaid at a premium or a discount.

The own credit adjustments (OCA) recorded on held-for-trading (HFT) and designated as at fair value through profit or loss (DFV) debt securities in issue, subordinated liabilities and derivative liabilities are set out below. The cumulative adjustments below represent reductions/(increases) to the balance sheet liability amounts.

	Debt Securities in issue (2)			Subordinated			
Cumulative own credit adjustment (1)	HFT	DFV	Total	liabilities DFV	Total	Derivatives	Total
	£m	£m	£m	£m	£m	£m	£m
2016	(34)	(6)	(40)	196	156	81	237
2015	(118)	(42)	(160)	180	20	14	34

Carrying values of underlying liabilities	£bn	£bn	£bn	£bn	£bn		
2016	1.6	4.6	6.2	1.0	7.2		
2015	3.9	6.3	10.2	0.8	11.0		

Notes:

(1) Includes wholesale and retail note issuances.

(2) The reserve movement between periods will not equate to the reported profit or loss for own credit. The balance sheet reserve is stated by conversion of underlying currency balances at spot rates for each period, whereas the income statement includes intra-period foreign exchange sell-offs.

(3) The cumulative adjustment for debt securities in issue is opposite to that for subordinated liabilities: debt securities in issue were issued relatively recently at wider than current spreads, whilst many of the subordinated liabilities were issued before the financial crisis at significantly tighter spreads.

Key points

- The cumulative OCA increase during the year was mainly due to the widening of spreads on RBS issuance. The OCA on senior debt is determined by reference to secondary debt issuance spreads, which widened to 62 basis points at 31 December 2016 (31 December 2015 – 54 basis points) at the five year level.

- RBS subordinated debt spreads widened to 281 basis points at 31 December 2016 (31 December 2015 – 267 basis points) at the five year level.

- RBS five year CDS credit spreads widened to 125 basis points at 31 December 2016 (31 December 2015 – 58 basis points).

Notes on the consolidated accounts

9 Financial instruments - valuation continued

Financial instruments carried at fair value - valuation hierarchy

The following tables show financial instruments carried at fair value on the Group's balance sheet by valuation hierarchy – level 1, level 2 and level 3 and related level 3 sensitivities.

	Level 1	Level 2	Level 3	Total	Level 3 sensitivity (5)	
2016	£bn	£bn	£bn	£bn	Favourable (£m)	Unfavourable (£m)
Assets						
Loans and advances	—	61.5	0.6	62.1	50	(50)
Debt securities	53.8	9.2	0.8	63.8	70	(20)
- of which AFS	35.1	4.0	0.1	39.2	20	(10)
Equity shares	0.1	0.2	0.4	0.7	40	(50)
- of which AFS	—	0.1	0.3	0.4	30	(40)
Derivatives	—	244.2	2.7	246.9	200	(200)
	53.9	315.1	4.5	373.5	360	(320)
Proportion	14.4%	84.4%	1.2%	100%		
Liabilities						
Deposits	—	62.0	0.4	62.4	10	(20)
Debt securities in issue	—	5.6	0.6	6.2	40	(40)
Short positions	19.7	2.4	—	22.1	—	—
Derivatives	—	234.4	2.0	236.4	120	(120)
Subordinated liabilities	—	1.0	—	1.0	—	—
	19.7	305.4	3.0	328.1	170	(180)
Proportion	6.0%	93.1%	0.9%	100%		
For the notes to this table refer to the following page.						

Notes on the consolidated accounts

9 Financial instruments - valuation continued

	Level 1	Level 2	Level 3	Total	Level 3 sensitivity (5)	
2015	£bn	£bn	£bn	£bn	Favourable (£m)	Unfavourable (£m)
Assets						
Loans and advances	-	67.2	0.3	67.5	50	(40)
Debt securities	60.3	13.5	1.0	74.8	40	(30)
- of which AFS	32.3	6.2	0.3	38.8	10	(10)
Equity shares	0.6	0.1	0.7	1.4	90	(50)
- of which AFS	—	0.1	0.5	0.6	60	(30)
Derivatives	—	260.6	1.9	262.5	380	(380)
	60.9	341.4	3.9	406.2	560	(500)
Proportion	15.0%	84.0%	1.0%	100%		
Liabilities						
Deposits	-	69.8	0.5	70.3	10	(20)
Debt securities in issue	—	9.6	0.5	10.1	30	—
Short positions	18.6	2.2	—	20.8	—	—
Derivatives	—	253.0	1.7	254.7	270	(270)
Subordinated liabilities	—	0.8	—	0.8	—	—
	18.6	335.4	2.7	356.7	310	(290)
Proportion	5.2%	94.0%	0.8%	100%		

Notes:

(1) Level 1: valued using unadjusted quoted prices in active markets, for identical financial instruments. Examples include G10 government securities, listed equity shares, certain exchange-traded derivatives and certain US agency securities.

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

(a) quoted prices for similar instruments or identical instruments in markets which are not considered to be active; or

(b) valuation techniques where all the inputs that have a significant effect on the valuations are directly or indirectly based on observable market data.

Level 2 instruments include non-G10 government securities, most government agency securities, investment-grade corporate bonds, certain mortgage products, including CLOs, most bank loans, repos and reverse repos, less liquid listed equities, state and municipal obligations, most notes issued, and certain money market securities and loan commitments and most OTC derivatives.

Level 3: instruments valued using a valuation technique where at least one input which could have a significant effect on the instrument's valuation, is not based on observable market data. Level 3 instruments primarily include cash instruments which trade infrequently, certain syndicated and commercial mortgage loans, certain emerging markets instruments, unlisted equity shares, certain residual interests in securitisations, CDOs, other mortgage-backed 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.

(2) Transfers between levels are deemed to have occurred at the beginning of the quarter in which the instruments were transferred. There were no significant transfers between level 1 and level 2.

(3) For an analysis of debt securities (by issuer, measurement classification and analysis of asset backed securities) and derivatives (by type of contract) refer to Capital and risk management: Balance sheet analysis – Debt securities and Derivatives respectively.

(4) The determination of an instrument's level cannot be made at a global product level as a single product type can be in more than one level. For example, a single name corporate credit default swap could be in level 2 or level 3 depending on whether the reference counterparty's obligations are liquid or illiquid.

(5) Sensitivity represents the favourable and unfavourable effect on the income statement or the statement of comprehensive income due to reasonably possible changes to valuations using reasonably possible alternative inputs in RBS's valuation techniques or models. Level 3 sensitivities are calculated on a trade or low level portfolio basis and hence these aggregated figures do not reflect the correlation between some of the sensitivities. In particular, for some portfolios, the sensitivities may be negatively correlated where a downward movement in one asset would produce an upward movement in another, but due to the additive presentation above, this correlation cannot be shown.

Notes on the consolidated accounts

9 Financial instruments - valuation continued

Valuation techniques

The table below shows a breakdown of valuation techniques and the ranges for those unobservable inputs used in valuation models and techniques that have a material impact on the valuation of level 3 financial instruments.

	Level 3 (£bn)				Range	
Financial instruments	Assets	Liabilities	Valuation technique	Unobservable inputs	Low	High
Loans and advances	0.6					
			Price-based	Price	0%	156%
Debt securities	0.8					
			Price-based	Price	0.01%	371.26%
Equity shares	0.4					
			Valuation	Discount factor	9%	25%
			Price-based	Price	80%	120%
Customer accounts		0.4				
			DCF based on recoveries	Credit spreads	0	25 bps
				Interest rate delta	(0.328%)	1.863%
Debt securities in issue		0.6				
			Price-based	Price	46.92%	151.98%
Derivatives	2.7	2.0				
Credit	0.2	0.2	DCF based on recoveries	Credit spreads	87 bps	925 bps
				Correlation	(27%)	(82%)
			Option pricing model	Volatility	40%	78%
Interest and foreign exchange contracts	2.5	1.7	Option pricing model	Correlation	(45%)	99%
				Volatility	30%	78%
				Prepayment rate	5%	15%
Equity		0.1	Option pricing model	Volatility	(40%)	99%

Notes:

(1) The table above excludes unobservable inputs where the impact on valuation is not significant. Movements in the underlying input may have a favourable or unfavourable impact on the valuation depending on the particular terms of the contract and the exposure. For example, an increase in the credit spread of a bond would be favourable for the issuer but unfavourable for the note holder. Whilst RBS indicates where it considers that there are significant relationships between the inputs, there inter-relationships will be affected by macro economic factors including interest rates, foreign exchange rates or equity index levels.

(2) Credit spreads and discount margins: credit spreads and margins express the return required over a benchmark rate or index to compensate for the credit risk associated with a cash instrument. A higher credit spread would indicate that the underlying instrument has more credit risk associated with it. Consequently, investors require a higher yield to compensate for the higher risk. the discount rate comprises credit spread or margin plus the benchmark rate; it is used to value future cash flows.

(3) Price and yield: There may be a range of prices used to value an instrument that may be a direct comparison of one instrument or portfolio with another or, movements in a more liquid instrument may be used to indicate the movement in the value of a less liquid instrument. The comparison may also be indirect in that adjustments are made to the price to reflect differences between the pricing source and the instrument being valued, for example different maturity, credit quality, seniority or expected pay-outs. Similarly to price, an instrument's yield may be compared with other instruments' yields either directly or indirectly.

(4) Recovery rate: reflects market expectations about the return of principal for a debt instrument or other obligations after a credit event or on liquidation. Recovery rates tend to move conversely to credit spreads.

(5) Valuation: for private equity investments, risk may be measured by beta, estimated by looking at past prices of similar stocks and from valuation statements where valuations are usually derived from earnings measures such as EBITDA or net asset value.

(6) Correlation: measures the degree by which two prices or other variables are observed to move together. If they move in the same direction there is positive correlation; if they move in opposite directions there is negative correlation. Correlations typically include relationships between: default probabilities of assets in a basket (a group of separate assets), exchange rates, interest rates and other financial variables.

(7) Volatility: a measure of the tendency of a price to change with time.

(8) Interest rate delta: these ranges represent the low/high marks on the relevant discounting curve.

(9) RBS does not have any material liabilities measured at fair value that are issued with an inseparable third party credit enhancement.

Notes on the consolidated accounts

9 Financial instruments - valuation continued

The Level 3 sensitivities on the previous page are calculated at a trade or low level portfolio basis. They are not calculated on an overall portfolio basis and therefore do not reflect the likely potential uncertainty on the portfolio as a whole. The figures are aggregated and do not reflect the correlated nature of some of the sensitivities. In particular, for some of the portfolios the sensitivities may be negatively correlated where a downwards movement in one asset would produce an upwards movement in another, but due to the additive presentation of the above figures this correlation cannot be displayed. The actual potential downside sensitivity of the total portfolio may be less than the non-correlated sum of the additive figures as shown in the above table.

Areas of judgment

Whilst the business has simplified, the diverse range of products historically traded by RBS results in a wide range of instruments that are classified into Level 3 of the hierarchy. Whilst the majority of these instruments naturally fall into a particular level, for some products an element of judgment is required. The majority of RBS's financial instruments carried at fair value are classified as Level 2: inputs are observable either directly (i.e. as a price) or indirectly (i.e. derived from prices).

Active and inactive markets

A key input in the decision making process for the allocation of assets to a particular level is market activity. In general, the degree of valuation uncertainty depends on the degree of liquidity of an input.

Where markets are liquid, little judgment is required. However, when the information regarding the liquidity in a particular market is not clear, a judgment may need to be made. This can be more difficult as assessing the liquidity of a market is not always straightforward. For an equity traded on an exchange, daily volumes of trading can be seen, but for an over-the-counter (OTC) derivative assessing the liquidity of the market with no central exchange is more difficult.

A key related matter is where a market moves from liquid to illiquid or vice versa. Where this change is considered to be temporary, the classification is not changed. For example, if there is little market trading in a product on a reporting date but at the previous reporting date and during the intervening period the market has been considered to be liquid, the instrument will continue to be classified in the same level in the hierarchy. This is to provide consistency so that transfers between levels are driven by genuine changes in market liquidity and do not reflect short term or seasonal effects. Material movements between levels are reviewed quarterly.

The breadth and depth of the IPV data allows for a rules based quality assessment to be made of market activity, liquidity and pricing uncertainty, which assists with the process of allocation to an appropriate level. Where suitable independent pricing information is not readily available, the quality assessment will result in the instrument being assessed as Level 3.

Modelled products

For modelled products the market convention is to quote these trades through the model inputs or parameters as opposed to a cash price equivalent. A mark-to-market is derived from the use of the independent market inputs calculated using RBS's model.

The decision to classify a modelled instrument as Level 2 or 3 will be dependent upon the product/model combination, the currency, the maturity, the observability and quality of input parameters and other factors. All these must be assessed to classify the asset.

If an input fails the observability or quality tests then the instrument is considered to be in Level 3 unless the input can be shown to have an insignificant effect on the overall valuation of the product.

The majority of derivative instruments for example vanilla interest rate swaps, foreign exchange swaps and liquid single name credit derivatives are classified as Level 2 as they are vanilla products valued using observable inputs. The valuation uncertainty on these is considered to be low and both input and output testing may be available.

Notes on the consolidated accounts

9 Financial instruments - valuation continued

Non-modelled products

Non-modelled products are generally quoted on a price basis and can therefore be considered for each of the three levels. This is determined by the market activity, liquidity and valuation uncertainty of the instruments which is in turn measured from the availability of independent data used by the IPV process to allocate positions to IPV quality levels.

The availability and quality of independent pricing information are considered during the classification process. An assessment is made regarding the quality of the independent information. For example, where consensus prices are used for non-modelled products, a key assessment of the quality of a price is the depth of the number of prices used to provide the consensus price. If the depth of contributors falls below a set hurdle rate, the instrument is considered to be Level 3. This hurdle rate is that used in the IPV process to determine the IPV quality rating. However, where an instrument is generally considered to be illiquid, but regular quotes from market participants exist, these instruments may be classified as Level 2 depending on frequency of quotes, other available pricing and whether the quotes are used as part of the IPV process or not.

For some instruments with a wide number of available price sources, there may be differing quality of available information and there may be a wide range of prices from different sources. In these situations the highest quality source is used to determine the classification of the asset. For example, a tradable quote would be considered a better source than a consensus price.

Level 3 portfolios and sensitively methodologies

Reasonably plausible alternative assumptions of unobservable inputs are determined based on a specified target level of certainty of 90%. The assessments recognise different favourable and unfavourable valuation movements where appropriate. Each unobservable input within a product is considered separately and sensitivity is reported on an additive basis.

Alternative assumptions are determined with reference to all available evidence including consideration of the following: quality of independent pricing information taking into account consistency between different sources, variation over time, perceived tradability or otherwise of available quotes; consensus service dispersion ranges; volume of trading activity and market bias (e.g. one-way inventory); day 1 profit or loss arising on new trades; number and nature of market participants; market conditions; modelling consistency in the market; size and nature of risk; length of holding of position; and market intelligence.

Other considerations

Whilst certain inputs used to calculate CVA, FVA and own credit adjustments are not based on observable market data, the uncertainty of the inputs is not considered to have a significant effect on the net valuation of the related derivative portfolios and issued debt. The classification of the derivative portfolios and issued debt is not determined by the observability of these inputs and any related sensitivity does not form part of the Level 3 sensitivities presented.

Level 3

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

	2016					2015			
	FVTPL	AFS	Total	Total		FVTPL	AFS	Total	Total
	assets (2)	assets	assets	liabilities		assets (2)	assets	assets	liabilities
	£m	£m	£m	£m		£m	£m	£m	£m
At 1 January	3,152	765	3,917	2,716		4,673	634	5,307	4,595
Amount recorded in the income statement (1)	(124)	5	(119)	(70)		(973)	(3)	(976)	(1,169)
Amount recorded in the statement of comprehensive									
income	—	71	71	—		—	198	198	—
Level 3 transfers in	2,135	29	2,164	1,408		1,722	150	1,872	1,532
Level 3 transfers out	(1,020)	(113)	(1,133)	(1,052)		(657)	(35)	(692)	(731)
Issuances	3	—	3	35		1	—	1	36
Purchases	1,298	42	1,340	600		557	7	564	40
Settlements	(758)	—	(758)	(610)		(868)	(117)	(985)	(1,573)
Sales	(624)	(382)	(1,006)	(87)		(1,312)	(69)	(1,381)	(15)
Foreign exchange and other adjustments	49	9	58	57		9	—	9	1
At 31 December	4,111	426	4,537	2,997		3,152	765	3,917	2,716
Amounts recorded in the income statement in respect									
of balances held at year end									
- unrealised	29	11	40	13		(154)	(1)	(155)	(472)
- realised	282	(4)	278	(34)		(43)	12	(31)	(4)

Notes:

(1) There were £45 million net losses on HFT instruments (2015 - nil) recorded in income from trading activities in continuing operations. Net losses on other instruments of

£4 million (2015 - £193 million) were recorded in other operating income and interest income as appropriate in continuing operations. There were no losses in discontinued operations.

(2) Fair value through profit or loss comprises held-for-trading predominantly and designated at fair value through profit and loss.

Notes on the consolidated accounts

9 Financial instruments - valuation continued

Fair value of financial instruments not carried at fair value

The following table shows the carrying value and fair value of financial instruments carried at amortised cost on the balance sheet.

	Items where fair value approximates carrying value	Carrying value	Fair value	Fair value of hierarchy level Level 1	Level 2	Level 3
2016	£bn	£bn	£bn	£bn	£bn	£bn
Financial assets						
Cash and balances at central banks	74.3					
Loans and advances to banks	0.8	11.4	11.5	—	3.3	8.2
Loans and advances to customers						
UK PBB						
- mortgages		117.0	118.0	—	—	118.0
- other		15.2	14.7	—	—	14.7
Ulster Bank RoI						
- mortgages		14.4	12.3	—	—	12.3
- other		4.5	4.5	—	—	4.5
Commercial Banking						
- commercial real estate		16.6	16.4	—	—	16.4
- other		83.7	84.4	—	0.1	84.3
Private Banking		12.2	12.2	—	—	12.2
RBS International		8.5	8.3	—	—	8.3
NatWest Markets		6.1	6.1	—	0.8	5.3
Capital Resolution		7.0	6.6	—	—	6.6
Williams & Glyn		20.5	20.4	—	—	20.4
Central items & other		2.1	2.1	—	—	2.1
Total loans and advances to customers		307.8	306.0	—	0.9	305.1
Of which:						

Performing		300.4	298.8	—	0.9	297.9
Non-performing		7.4	7.2	—	—	7.2
Debt securities		8.7	8.8	5.0	0.3	3.5
Settlement balances	5.5					
Financial liabilities						
Deposits by banks	4.3	9.4	9.5	—	6.2	3.3
Customer accounts	308.4	35.1	35.2	—	10.9	24.3
Debt securities in issue		21.0	21.6	—	17.1	4.5
Settlement balances	3.6					
Notes in circulation (1)	2.0					
Subordinated liabilities		18.5	18.5	—	18.4	0.1

Note:

(1) Included in Accurals and other liabilities.

Notes on the consolidated accounts

9 Financial instruments - valuation continued

	Items where fair value approximates carrying value	Carrying value	Fair value	Fair value of hierarchy level Level 1	Level 2	Level 3
2015	£bn	£bn	£bn	£bn	£bn	£bn
Financial assets						
Cash and balances at central banks	79.4					
Loans and advances to banks	0.8	7.5	7.5	—	3.6	3.9
Loans and advances to customers						
UK PBB						
- mortgages		104.5	105.3	—	—	105.3
- other		15.3	14.9	—	—	14.9
Ulster Bank RoI						
- mortgages		12.7	11.0	—	—	11.0
- other		4.0	3.9	—	—	3.9
Commercial Banking						
- commercial real estate		16.3	16.0	—	—	16.0
- other		75.0	71.3	—	0.1	71.2
Private Banking		11.2	11.2	—	—	11.2
RBS International		7.2	7.0	—	—	7.0
NatWest Markets		6.6	6.6	—	0.2	6.4
Capital Resolution		15.7	14.6	—	0.9	13.7
Williams & Glyn		20.0	19.9	—	—	19.9
Central items & other		0.2	0.2	—	0.1	0.1
Total loans and advances to customers		288.7	281.9	—	1.3	280.6
Of which:						
Performing		281.8	275.2	—	1.3	273.9
Non-performing		6.9	6.7	—	—	6.7
Debt securities		7.3	7.2	5.0	1.0	1.2
Settlement balances	4.1					
Financial liabilities						
Deposits by banks	4.5	3.7	3.7	—	0.9	2.8

Customer accounts	253.2	76.9	76.9	—	31.2	45.7
Debt securities in issue		21.0	21.8	—	19.5	2.3
Settlement balances	3.4					
Notes in circulation (1)	1.9					
Subordinated liabilities		19.0	19.3	—	19.2	0.1

Note:

(1) Included in Accruals and other liabilities.

Notes on the consolidated accounts

9 Financial instruments - valuation continued

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

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

Short-term financial instruments

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

Loans and advances to banks and customers

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

(a) Contractual cash flows are discounted using a market discount rate that incorporates the current spread for the borrower or where this is not observable, the spread for borrowers of a similar credit standing. This method is used for portfolios where counterparties have external ratings: institutional and corporate lending in NatWest Markets.

(b) Expected cash flows (unadjusted for credit losses) are discounted at the current offer rate for the same or similar products. This approach is adopted for lending portfolios in UK PBB, Ulster Bank RoI, Commercial Banking (SME loans) and Private Banking in order to reflect the homogeneous nature of these portfolios.

For certain portfolios where there are very few or no recent transactions, such as Ulster Bank RoI's portfolio of lifetime tracker mortgages, a bespoke approach is used based on available market data.

Debt securities

The majority of debt securities are valued using quoted prices in active markets, or using quoted prices for similar assets in active markets. Fair values of the rest are determined using discounted cash flow valuation techniques.

Deposits by banks and customer accounts

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

Debt securities in issue and subordinated liabilities

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

Notes on the consolidated accounts

10 Financial instruments - maturity analysis

Remaining maturity

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

	2016				2015		
	Less than 12 months	More than 12 months	Total		Less than 12 months	More than 12 months	Total
	£m	£m	£m		£m	£m	£m
Assets							
Cash and balances at central banks	74,250	—	74,250		79,404	—	79,404
Loans and advances to banks	30,078	60	30,138		30,536	110	30,646
Loans and advances to customers	115,925	236,025	351,950		111,455	222,437	333,892
Debt securities	19,530	52,992	72,522		28,188	53,909	82,097
Equity shares	—	703	703		—	1,361	1,361
Settlement balances	5,526	—	5,526		4,116	—	4,116
Derivatives	61,719	185,262	246,981		41,489	221,025	262,514
Liabilities							
Deposits by banks	32,043	6,513	38,556		37,937	359	38,296
Customer accounts	377,328	3,640	380,968		364,394	5,904	370,298
Debt securities in issue	6,689	20,556	27,245		9,556	21,594	31,150
Settlement balances and short positions	5,010	20,712	25,722		6,194	18,005	24,199
Derivatives	60,878	175,597	236,475		42,675	212,030	254,705
Subordinated liabilities	1,062	18,357	19,419		323	19,524	19,847

Assets and liabilities by contractual cash flow maturity

The tables below show the contractual undiscounted cash flows receivable and payable, up to a period of 20 years, including future receipts and payments of interest of financial assets and liabilities by contractual maturity. The balances in the following tables do not agree directly with the consolidated balance sheet, as the tables include all cash flows relating to principal and future coupon payments, presented on an undiscounted basis. The tables have been prepared on the following basis:

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 RBS. 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 instrument is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the asset is included in the time band that contains the latest date on which it can be repaid, regardless of early repayment.

The liability is included in the time band that contains the earliest possible date on which 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 RBS, 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 repayments of assets and liabilities are linked, the repayment of assets in securitisations is 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.

Held-for-trading assets of £328.9 billion (2015 - £362.7 billion) and liabilities of £317 billion (2015 - £344.4 billion) have been excluded from the following tables.

Notes on the consolidated accounts

10 Financial instruments – maturity analysis continued

	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years
2016	£m	£m	£m	£m	£m	£m
Assets by contractual maturity						
Cash and balances at central banks	73,822	428	—	—	—	—
Loans and advances to banks	11,753	438	47	—	—	—
Debt securities	4,999	5,424	11,262	8,567	13,541	3,291
Settlement balances	5,526	—	—	—	—	—
Total maturing assets	96,100	6,290	11,309	8,567	13,541	3,291
Loans and advances to customers	47,915	33,443	65,027	52,675	65,427	77,710
Derivatives held for hedging	455	1,178	2,319	531	337	125
	144,470	40,911	78,655	61,773	79,305	81,126
Liabilities by contractual maturity						
Deposits by banks	7,205	33	1,285	5,050	78	79
Debt securities in issue	2,269	4,537	7,239	5,381	7,604	798
Subordinated liabilities	996	966	4,835	2,638	12,421	2,532
Settlement balances and other liabilities	5,673	—	—	—	—	—
Total maturing liabilities	16,143	5,536	13,359	13,069	20,103	3,409
Customer accounts	338,436	4,943	1,484	149	51	35
Derivatives held for hedging	205	405	1,329	584	854	857
	354,784	10,884	16,172	13,802	21,008	4,301
Maturity gap	79,957	754	(2,050)	(4,502)	(6,562)	(118)
Cumulative maturity gap	79,957	80,711	78,661	74,159	67,597	67,479
Guarantees and commitments notional amount						
Guarantees (1)	7,867	—	—	—	—	—
Commitments (2)	134,324	—	—	—	—	—
	142,191	—	—	—	—	—
For the notes to this table refer to following page						

Notes on the consolidated accounts

10 Financial instruments – maturity analysis continued

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	79,404	—	—	—	—	—
Loans and advances to banks	8,143	25	—	26	—	—
Debt securities	6,262	8,815	8,280	7,700	12,692	2,442
Settlement balances	4,116	—	—	—	—	—
Total maturing assets	97,925	8,840	8,280	7,726	12,692	2,442
Loans and advances to customers	45,562	29,421	62,391	51,261	63,928	72,987
Derivatives held for hedging	484	1,106	1,571	433	228	88
	143,971	39,367	72,242	59,420	76,848	75,517
Liabilities by contractual maturity						
Deposits by banks	7,125	781	1	1	200	66
Debt securities in issue	3,779	4,832	7,347	8,035	4,448	336
Subordinated liabilities	41	957	4,955	2,344	13,037	3,986
Settlement balances and other liabilities	5,276	—	—	—	—	—
Total maturing liabilities	16,221	6,570	12,303	10,380	17,685	4,388
Customer accounts	325,099	5,501	1,740	339	12	26
Derivatives held for hedging	144	291	605	413	635	701
	341,464	12,362	14,648	11,132	18,332	5,115
Maturity gap	81,704	2,270	(4,023)	(2,654)	(4,993)	(1,946)
Cumulative maturity gap	81,704	83,974	79,951	77,297	72,304	70,358
Guarantees and commitments notional amount						
Guarantees (1)	9,036	—	—	—	—	—
Commitments (2)	132,198	—	—	—	—	—
	141,234	—	—	—	—	—

Notes:

Explanation of Responses:

(1) RBS is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. RBS expects most guarantees it provides to expire unused.

(2) RBS has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. RBS does not expect all facilities to be drawn, and some may lapse before drawdown.

Notes on the consolidated accounts

11 Financial assets - impairments					
The following table shows the movement in the provision for impairment losses on loans and advances.					
	Individually assessed	Collectively assessed	Latent	2016	2015
	£m	£m	£m	£m	£m
At 1 January	2,674	3,861	584	7,119	17,500
Transfers to disposal groups	—	—	—	—	(20)
Currency translation and other adjustments	245	223	32	500	(575)
Disposals	(2)	—	—	(2)	—
Amounts written-off	(2,093)	(1,602)	—	(3,695)	(8,964)
Recoveries of amounts previously written-off	67	42	—	109	175
Losses/(releases) to income statement	535	218	(216)	537	(853)
Unwind of discount (recognised in interest income)	(31)	(82)	—	(113)	(144)
At 31 December (1)	1,395	2,660	400	4,455	7,119

Notes:

(1) Includes nil relating to loans and advances to banks (2015 - £1 million).

(2) The table above excludes impairments relating to securities.

Impairment (releases)/losses charged to the income statement	2016	2015	2014
	£m	£m	£m
Loans and advances to customers	537	(849)	(1,354)
Loans and advances to banks	—	(4)	(10)
	537	(853)	(1,364)
Securities	(59)	126	12
	478	(727)	(1,352)

The following tables analyse impaired financial assets.

	2016			2015		
			Carrying			Carrying
	Cost	Provision	value	Cost	Provision	value
	£m	£m	£m	£m	£m	£m
Loans and receivables						
Loans and advances to banks (1)	—	—	—	1	1	—
Loans and advances to customers (2)	8,865	4,055	4,810	10,849	6,534	4,315
	8,865	4,055	4,810	10,850	6,535	4,315

Notes:

(1) Impairment provisions individually assessed.

(2) Impairment provisions individually assessed on balances of £4,186 million (2015 - £5,047 million).

	Carrying value	
	2016	2015
	£m	£m
Available-for-sale securities		
Debt securities	33	171
Equity shares	23	33
Loans and receivables		
Debt securities	2	19
	58	223

Financial and non-financial assets recognised on the balance sheet, obtained during the year by taking possession of collateral or calling on other credit enhancements, were £30 million (2015 - £34 million).

In general, RBS seeks to dispose of property and other assets not readily convertible into cash, obtained by taking possession of collateral, as rapidly as the market for the individual asset permits.

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Notes on the consolidated accounts

12 Derivatives

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

RBS enters into fair value hedges, cash flow hedges and hedges of net investments in foreign operations. The majority of RBS's interest rate hedges relate to the management of RBS's non-trading interest rate risk. RBS manages this risk within approved limits. Residual risk positions are hedged with derivatives principally interest rate swaps. Suitable larger financial instruments are fair value hedged; the remaining exposure, where possible, is hedged by derivatives documented as cash flow hedges and qualifying for hedge accounting. The majority of RBS's fair value hedges involve interest rate swaps hedging the interest rate risk in recognised financial assets and financial liabilities. Cash flow hedges relate to exposures to the variability in future interest payments and receipts on forecast transactions and on recognised financial assets and financial liabilities. RBS hedges its net investments in foreign operations with currency borrowings and forward foreign exchange contracts.

For cash flow hedge relationships of interest rate risk, the hedged items are actual and forecast variable interest rate cash flows arising from financial assets and financial liabilities with interest rates linked to LIBOR, EURIBOR or the Bank of England Official Bank Rate. The financial assets are customer loans and the financial liabilities are customer deposits and LIBOR linked medium-term notes and other issued securities. At 31 December 2016 variable rate financial assets of £81 billion (2015 - £77 billion) and variable rate financial liabilities of £55 billion (2015 - £29 billion) were hedged in such cash flow hedge relationships.

For cash flow hedging relationships, the initial and ongoing prospective effectiveness is assessed by comparing movements in the fair value of the expected highly probable forecast interest cash flows with movements in the fair value of the expected changes in cash flows from the hedging interest rate swap. Prospective effectiveness is measured on a cumulative basis i.e. over the entire life of the hedge relationship. The method of calculating hedge ineffectiveness is the hypothetical derivative method. Retrospective effectiveness is assessed by comparing the actual movements in the fair value of the cash flows and actual movements in the fair value of the hedged cash flows from the interest rate swap over the life to date of the hedging relationship.

For fair value hedge relationships of interest rate risk, the hedged items are typically large corporate fixed-rate loans, government securities, fixed rate finance leases, fixed rate medium-term notes or preference shares classified as debt. At 31 December 2016, fixed rate financial assets of £29 billion (2015 - £25 billion) and fixed rate financial liabilities of £23 billion (2015 - £21 billion) were hedged by interest rate swaps in fair value hedge relationships.

The initial and ongoing prospective effectiveness of fair value hedge relationships is assessed on a cumulative basis by comparing movements in the fair value of the hedged item attributable to the hedged risk with changes in the fair value of the hedging interest rate swap. Retrospective effectiveness is assessed by comparing the actual movements in the fair value of the hedged items attributable to the hedged risk with actual movements in the fair value of the hedging derivative over the life to date of the hedging relationship.

Notes on the consolidated accounts

12 Derivatives continued

	2016			2015		
	Notional amount	Assets	Liabilities	Notional amount	Assets	Liabilities
	£bn	£m	£m	£bn	£m	£m
Exchange rate contracts						
Spot, forwards and futures	2,278	35,817	33,986	1,962	22,922	22,403
Currency swaps	821	22,139	25,053	759	18,293	21,878
Options purchased	670	17,486	—	484	13,706	—
Options written	682	—	18,109	495	—	13,947
Interest rate contracts						
Interest rate swaps	11,523	139,004	127,151	12,535	174,438	162,040
Options purchased	1,413	31,457	—	1,372	31,310	—
Options written	1,370	—	31,298	1,333	—	32,497
Futures and forwards	3,667	63	36	4,543	390	317
Credit derivatives	42	682	557	67	909	840
Equity and commodity contracts	25	333	285	18	546	783
		246,981	236,475		262,514	254,705

Included in the table above are derivatives held for hedging purposes as follows:

	2016		2015	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Fair value hedging				
Interest rate contracts	1,365	2,612	1,480	1,667
Cash flow hedging				
Interest rate contracts	3,079	1,419	2,231	917
Exchange rate contacts	259	—	52	2
Net investment hedging				
Exchange rate contracts	86	26	62	17
	4,789	4,057	3,825	2,603

Hedge ineffectiveness recognised in other operating income in continuing operations comprised:			
	2016	2015	2014
	£m	£m	£m
Fair value hedging			
Gains/(losses) on the hedged items attributable to the hedged risk	1,146	110	809
(Losses)/gains on the hedging instruments	(1,117)	(39)	(840)
Fair value hedging ineffectiveness	29	71	(31)
Cash flow hedging ineffectiveness	(29)	(23)	(33)
	—	48	(64)

Substantially all forecast receivable hedged cash flows occur within 5 years (2015 - 10 years) and substantially all forecast payable cash flows occur within 10 years (2015 – 20 years); the income statement is impacted over the same periods.

Notes on the consolidated accounts

13 Debt securities								
	Central and local government				Other			
					financial			Of which
	UK	US	Other	Banks	institutions	Corporate	Total	ABS (1)
2016	£m	£m	£m	£m	£m	£m	£m	£m
Held-for-trading	2,615	4,133	14,087	821	2,299	549	24,504	886
Designated as at fair value through profit or loss	—	—	25	—	2	—	27	—
Available-for-sale	10,581	6,953	15,678	1,852	4,072	118	39,254	2,263
Loans and receivables	—	—	—	—	3,774	194	3,968	3,814
Held-to-maturity	4,769	—	—	—	—	—	4,769	—
	17,965	11,086	29,790	2,673	10,147	861	72,522	6,963
Available-for-sale								
Gross unrealised gains	768	56	504	8	93	2	1,431	75
Gross unrealised losses	(16)	(123)	(13)	(1)	(43)	(2)	(198)	(32)
2015								
Held-for-trading	4,107	4,627	22,222	576	3,689	636	35,857	707
Designated as at fair value through profit or loss	—	—	111	—	—	—	111	—
Available-for-sale	9,110	10,265	12,137	1,639	5,578	102	38,831	2,362
Loans and receivables	—	—	—	1	2,242	144	2,387	2,222
Held-to-maturity	4,911	—	—	—	—	—	4,911	—
	18,128	14,892	34,470	2,216	11,509	882	82,097	5,291
Available-for-sale								
Gross unrealised gains	383	104	269	3	110	7	876	88
Gross unrealised losses	(7)	(62)	(9)	(1)	(58)	(3)	(140)	(42)

Note:

(1) Includes asset-backed securities issued by US federal agencies and government sponsored entities, and covered bonds.

Gross gains of £115 million (2015 - £69 million) and gross losses of £107 million (2015 - £133 million) were realised on the sale of available-for-sale securities in continuing operations.

Gross gains of nil (2015 - £11 million) were realised on the sale of available-for-sale securities in discontinued operations. There were no gross losses in 2016 or 2015.

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Notes on the consolidated accounts

13 Debt securities continued

The following table analyses available-for-sale debt securities and the related yield (based on weighted averages) by remaining maturity and issuer.

	0-1 years		1-5 years		5-10 years		Over 10 years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
2016	£m	%	£m	%	£m	%	£m	%	£m	%
Central and local governments										
- UK	1,722	0.9	2,900	5.2	3,318	3.5	2,641	3.0	10,581	3.4
- US	41	1.9	2,797	1.9	2,799	2.1	1,316	3.0	6,953	2.2
- other	5,104	1.1	5,942	1.0	3,444	1.2	1,188	2.4	15,678	1.2
Banks	798	0.5	965	0.4	89	0.3	—	—	1,852	0.5
Other financial institutions	451	1.1	2,282	1.1	848	0.9	491	0.3	4,072	1.0
Corporate	27	0.7	56	0.7	35	0.7	—	—	118	0.7
	8,143	1.0	14,942	2.0	10,533	2.1	5,636	2.6	39,254	1.9
Of which ABS (1)	377	0.8	974	0.5	415	—	497	—	2,263	0.3
2015										
Central and local governments										
- UK	2,830	0.2	2,333	2.4	2,081	2.4	1,866	3.3	9,110	1.9
- US	4,544	0.9	2,254	2.0	2,528	2.1	939	2.9	10,265	1.6
- other	4,872	1.1	3,897	2.0	2,674	1.4	694	2.6	12,137	1.5
Banks	776	1.3	714	0.4	149	0.8	—	—	1,639	0.9
Other financial institutions	1,166	1.1	1,867	0.9	2,080	2.4	465	0.4	5,578	1.5
Corporate	102	0.1	—	—	—	—	—	—	102	0.1
	14,290	0.9	11,065	1.8	9,512	2.0	3,964	2.8	38,831	1.6
Of which ABS (2)	518	0.9	963	0.4	416	0.6	465	0.4	2,362	0.5

Notes:

(1) Includes covered bonds.

(2) Includes asset-backed securities issued by US federal agencies and government sponsored entities, and covered bonds.

14 Equity shares						
	2016			2015		
	Listed	Unlisted	Total	Listed	Unlisted	Total
	£m	£m	£m	£m	£m	£m
Held-for-trading	106	60	166	627	33	660
Designated as at fair value through profit or loss	3	169	172	1	146	147
Available-for-sale	30	335	365	53	501	554
	139	564	703	681	680	1,361
Available-for-sale						
Gross unrealised gains	13	48	61	8	281	289
Gross unrealised losses	—	(8)	(8)	—	(8)	(8)
	13	40	53	8	273	281

Gross gains of £73 million (2015 - £61 million) and gross losses of £10 million (2015 - £1 million) were realised on the sale of available-for-sale equity shares in continuing operations. There were no gains or losses in discontinued operations.

Dividend income from available-for-sale equity shares was £13 million (2015 - £45 million) in continuing operations and nil (2015 - £15 million) in discontinued operations.

Unquoted equity investments whose fair value cannot be reliably measured are carried at cost and classified as available-for-sale financial assets. Unquoted equity shares generated no material gains or losses in 2016 or 2015.

Notes on the consolidated accounts

15 Intangible assets						
	2016			2015		
	Goodwill	Other (1)	Total	Goodwill	Other (1)	Total
Cost	£m	£m	£m	£m	£m	£m
At 1 January	16,483	2,190	18,673	17,121	3,048	20,169
Transfers to disposal groups	—	—	—	(220)	(156)	(376)
Currency translation and other adjustments	1,273	76	1,349	(418)	(6)	(424)
Additions	—	480	480	—	614	614
Disposals and write-off of fully amortised assets	—	(651)	(651)	—	(1,310)	(1,310)
At 31 December	17,756	2,095	19,851	16,483	2,190	18,673
Accumulated amortisation and impairment						
At 1 January	10,925	1,211	12,136	10,857	1,531	12,388
Transfers to disposal groups	—	—	—	—	(149)	(149)
Currency translation and other adjustments	1,273	70	1,343	(430)	(13)	(443)
Disposals and write-off of fully amortised assets	—	(471)	(471)	—	(1,222)	(1,222)
Charge for the year						
- continuing operations	—	204	204	—	230	230
Write down of goodwill and other intangible assets						
- continuing operations	—	159	159	498	834	1,332
At 31 December	12,198	1,173	13,371	10,925	1,211	12,136
Net book value at 31 December	5,558	922	6,480	5,558	979	6,537

Note:

(1) Principally internally generated software.

The Group's goodwill acquired in business combinations is reviewed annually at 31 December for impairment.

Impairment testing involves the comparison of the carrying value of each cash-generating unit (CGU) with its recoverable amount. Recoverable amount is the higher of fair value and value in use. Value in use is the present value of expected future cash flows from the CGU. Fair value is the price that would be received to sell an asset in an orderly transaction between market participants.

Impairment testing inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of CGUs; and the valuation of the separable assets of each business whose goodwill is being reviewed. Sensitivity to the more significant variables in each assessment is presented in the tables on the following page.

The recoverable amounts for all CGUs at 31 December 2016 were based on value in use, using management's latest five-year forecasts. The long-term growth rates have been based on expected nominal growth of the CGUs. The risk discount rates are based on those observed to be applied to businesses regarded as peers of the CGUs.

The annual review at 31 December 2016 indicated no impairment to goodwill.

As a result of the changes to the reportable segments in 2015 goodwill of £0.3 billion was allocated to RBS International, £0.2 billion of which was previously reported in Commercial Banking and £0.1 billion of which was previously reported in Private Banking. Goodwill of £0.2 billion was allocated from Private Banking to International Private Banking which was included within disposal groups at 31 December 2015, see Note 18. The 2015 annual review indicated that the remaining £0.5 billion goodwill relating to Private Banking was impaired. Other CGUs' goodwill was not impaired.

The analysis of goodwill by reportable segment is shown in Note 37.

Notes on the consolidated accounts

15 Intangible assets continued

The carrying value of goodwill and the amount by which it is exceeded by the recoverable amount are set out below by reportable segment, along with the key assumptions applied in calculating the recoverable amount and sensitivities to changes in those assumptions.

							Consequential
					Consequential impact of 1%		impact of 5%
		Assumptions		Recoverable	adverse movement in		adverse movement
		Terminal	Pre-tax	amount exceeded	Discount	Terminal	in forecast
	Goodwill	growth rate	discount rate	carrying value	rate	growth rate	pre-tax earnings
31 December 2016	£bn	%	%	£bn	£bn	£bn	£bn
UK Personal & Business Banking	3.4	2.5	12.8	14.6	(2.3)	(1.5)	(1.4)
Commercial Banking	1.9	2.5	12.9	2.1	(1.2)	(0.8)	(0.8)
RBS International	0.3	2.5	10.9	0.2	(0.3)	(0.2)	(0.1)
31 December 2015							
UK Personal & Business Banking	3.4	4.5	12.0	10.7	(2.6)	(1.5)	(1.7)
Commercial Banking	1.9	4.5	12.1	6.4	(1.9)	(0.9)	(1.2)
RBS International	0.3	4.5	10.2	1.2	(0.5)	(0.3)	(0.2)

Other intangible assets are reviewed for indicators of impairment. In 2016 £159 million of previously capitalised software was impaired primarily as a result of legacy Services software which is no longer expected to derive future economic benefit (2015 - £834 million, primarily as a result of the reorganisation of NatWest Markets, formerly CIB).

16 Property, plant and equipment							
			Long	Short	Computers	Operating	
	Investment	Freehold	leasehold	leasehold	and other	lease	
	properties	premises	premises	premises	equipment	assets	Total
2016	£m	£m	£m	£m	£m	£m	£m
Cost or valuation							
At 1 January	915	2,559	177	1,259	2,305	1,556	8,771

Currency translation and other adjustments	140	91	5	73	108	25	442
Reclassifications	—	46	—	(46)	—	—	—
Additions	103	215	5	79	282	228	912
Change in fair value of investment properties							
- continuing operations	(11)	—	—	—	—	—	(11)
Disposals and write-off of fully depreciated assets	(52)	(175)	(35)	(118)	(228)	(496)	(1,104)
At 31 December	1,095	2,736	152	1,247	2,467	1,313	9,010
Accumulated impairment, depreciation and amortisation							
At 1 January	—	1,090	87	759	1,677	676	4,289
Currency translation and other adjustments	—	70	3	53	97	9	232
Reclassifications	—	9	—	(9)	—	—	—
Write down of property, plant and equipment	—	71	—	—	7	—	78
Disposals and write-off of fully depreciated assets	—	(137)	(22)	(86)	(180)	(250)	(675)
Charge for the year							
- continuing operations	—	74	4	82	183	153	496
At 31 December	—	1,177	72	799	1,784	588	4,420
Net book value at 31 December	1,095	1,559	80	448	683	725	4,590

Notes on the consolidated accounts

16 Property, plant and equipment

16 Property, plant and equipment continued			Long	Short	Computers	Operating	
	Investment	Freehold	leasehold	leasehold	and other	lease	
	properties	premises	premises	premises	equipment	assets	Total
2015	£m	£m	£m	£m	£m	£m	£m
Cost or valuation							
At 1 January	1,933	2,860	240	1,334	2,982	1,551	10,900
Transfers to disposal groups	—	(7)	—	(41)	(25)	—	(73)
Currency translation and other adjustments	(100)	13	(2)	(4)	1	15	(77)
Additions	31	139	8	125	350	202	855
Change in fair value of investment properties							
- continuing operations	2	—	—	—	—	—	2
Disposals and write-off of fully depreciated assets	(951)	(446)	(69)	(155)	(1,003)	(212)	(2,836)
At 31 December	915	2,559	177	1,259	2,305	1,556	8,771
Accumulated impairment, depreciation and amortisation							
At 1 January	—	1,006	130	798	2,137	662	4,733
Transfers to disposal groups	—	(3)	—	(24)	(23)	—	(50)
Currency translation and other adjustments	—	9	11	(3)	(2)	5	20
Write down of property, plant and equipment	—	279	—	—	93	—	372
Disposals and write-off of fully depreciated assets	—	(263)	(49)	(106)	(802)	(144)	(1,364)
Charge for the year							
- continuing operations	—	62	(5)	94	274	153	578
At 31 December	—	1,090	87	759	1,677	676	4,289
Net book value at 31 December	915	1,469	90	500	628	880	4,482

Investment property valuations principally employ present value techniques that discount expected cash flows. Expected cash flows reflect rental income, occupancy and residual market values; valuations are sensitive to changes in these factors. The fair value measurement of non-specialised properties in locations where the market for such properties is active and transparent are categorised as level 2 - 93% (2015 - 94%); otherwise investment property fair value measurements are categorised as level 3 - 7% (2015 - 6%).

Valuations were carried out by qualified surveyors who are members of the Royal Institution of Chartered Surveyors, or an equivalent overseas body; property with a fair value of £485 million (2015 - £700 million) was valued by independent valuers.

Rental income from investment properties in continuing operations was £79 million (2015 - £79 million). Direct operating expenses of investment properties in continuing operations were £16 million (2015 - £14 million).

Notes on the consolidated accounts

17 Prepayments, accrued income and other assets		
	2016	2015
	£m	£m
Prepayments	350	393
Accrued income	412	326
Tax recoverable	71	175
Pension schemes in net surplus (refer to Note 4)	276	215
Interests in associates	1,509	1,212
Other assets	1,082	1,921
	3,700	4,242

18 Discontinued operations and assets and liabilities of disposal groups

RBS sold the final tranche of its interest in Citizens Financial Group, Inc (Citizens) during October 2015. Consequently, Citizens was classified as a disposal group at 31 December 2014 and presented as a discontinued operation until October 2015. From 3 August 2015 until the final tranche was sold in October 2015, Citizens was an associated undertaking.

The gain on disposal in 2015 in relation to Citizens comprised £248 million on the derecognition of assets and liabilities, and £989 million in respect of reserves reclassified in accordance with IFRS.

(a) Profit/(loss) from discontinued operations, net of tax			
	2016	2015	2014
	£m	£m	£m
Citizens			
Interest receivable	—	1,433	2,204
Interest payable	—	(144)	(191)
Net interest income	—	1,289	2,013
Non-interest income	—	615	1,043
Total income	—	1,904	3,056
Operating expenses	—	(1,181)	(2,123)
Profit before impairment losses	—	723	933
Impairment losses	—	(103)	(197)

Operating profit before tax		— 620	736
Tax charge		— (212)	(228)
Profit after tax		— 408	508
Provision for gain/(loss) on disposal of subsidiary		— 10	(3,994)
Gain on disposal of subsidiary		— 1,147	—
Provision for loss on disposal of interest in associate		— (130)	—
Gain on disposal of interest in associate		— 90	—
Profit/(loss) from Citizens discontinued operation, net of tax		— 1,525	(3,486)
Other			
Profit from other discontinued operations, net of tax		— 16	41
Total profit/(loss) from discontinued operations, net of tax		— 1,541	(3,445)

There was no profit from discontinued operations attributable to non-controlling interests (2015 - £334 million; 2014 - £82 million).

Notes on the consolidated accounts

18 Discontinued operations and assets and liabilities of disposal groups continued

(b) Operating cash flows attributable to discontinued operations

Included within the Group's cash flows are the following amounts attributable to discontinued operations:

	2016	2015	2014
	£m	£m	£m
Net cash flows from operating activities	—	(57)	3,997
Net cash flows from investing activities	—	(6)	(4,194)
Net cash flows from financing activities	—	10	596
Net (decrease)/increase in cash and cash equivalents	—	(58)	129

(c) Assets and liabilities of disposal groups		
	2016	2015
	£m	£m
Assets of disposal groups		
Cash and balances at central banks	—	535
Loans and advances to banks	13	709
Loans and advances to customers	—	1,639
Debt securities and equity shares	—	443
Derivatives	—	30
Property, plant and equipment	—	19
Other assets	—	111
	13	3,486
Liabilities of disposal groups		
Deposits by banks	—	32
Customer accounts	—	2,805
Derivatives	—	28
Settlement balances	—	7
Other liabilities	15	108
	15	2,980

Disposal groups at 31 December 2015 are primarily International Private Banking (fair value less costs to sell reflects the agreed sale to Union Bancaire Privée: fair value hierarchy level 3) (£3,344 million assets; £2,724 million liabilities).

19 Short positions		
	2016	2015
	£m	£m
Debt securities		
- Government	20,979	19,840
- Other issuers	1,095	967
Equity shares	3	2
	22,077	20,809

Note:

(1) All short positions are classified as held-for-trading.

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Notes on the consolidated accounts

20 Provisions for liabilities and charges

Provisions for liabilities and charges	Payment protection insurance (1)	Other customer redress (2)	Residential mortgage backed securities (3)	Litigation and Other regulatory (4)	Property and other (5) (6)	Total
	£m	£m	£m	£m	£m	£m
At 1 January 2016	996	821	3,772	519	1,258	7,366
Transfer from accruals and other liabilities	—	37	17	17	36	107
Transfer	50	(27)	105	(74)	(54)	—
Currency translation and other movements	—	9	686	61	90	846
Charge to income statement	601	628	3,391	1,623	1,520	7,763
Releases to income statement	—	(29)	(91)	(73)	(354)	(547)
Provisions utilised	(394)	(334)	(1,128)	(155)	(688)	(2,699)
At 31 December 2016	1,253	1,105	6,752	1,918	1,808	12,836

(1) To reflect the developments detailed in Note 31, RBS increased its provision for PPI by £601 million in 2016 (2015 - £600 million; 2014 - £650 million), bringing the cumulative charge to £4.9 billion, of which £3.3 billion (67%) in redress and £0.4 billion in administrative expenses had been paid by 31 December 2016. Of the £4.9 billion cumulative charge, £4.5 billion relates to redress and £0.4 billion to administrative expenses.

The principal assumptions underlying RBS's provision in respect of PPI sales are: assessment of the total number of complaints that RBS will receive; the proportion of these that will result in redress; and the average cost of such redress. The number of complaints has been estimated from an analysis of RBS's portfolio of PPI policies sold by vintage and by product. Estimates of the percentage of policyholders that will lodge complaints (the take up rate) and of the number of these that will be upheld (the uphold rate) have been established based on recent experience, guidance in FCA policy statements and the expected rate of responses from proactive customer contact. The average redress assumption is based on recent experience and FCA calculation rules. The table below shows the sensitivity of the provision to changes in the principal assumptions (all other assumptions remaining the same).

Assumption	Actual	Current	Sensitivity Change in	Consequential

	to date	assumptions	assumption	change in provision
			%	
				£m
Single premium book past business review take up rate	57%	58%	+/-5	+/-55
Uphold rate (1)	91%	91%	+/-5	+/-50
Average redress	£1,693	£1,669	+/-5	+/-46

Note:

(1) Uphold rates exclude claims where no PPI policy was held.

Interest that will be payable on successful complaints has been included in the provision as has the estimated cost to RBS of administering the redress process. There are uncertainties as to the eventual cost of redress which will depend on actual complaint volumes, take up and uphold rates and average redress costs. Assumptions related to these are inherently uncertain and the ultimate financial impact may be different from the amount provided. We continue to monitor the position closely and refresh the underlying assumptions.

Background information in relation to PPI claims is given in Note 31.

(2) RBS has provided for other customer redress, primarily in relation to investment advice in retail and private banking, (2016 – nil: 2015 - £100 million), packaged accounts, (2016 – nil: 2015 - £157 million) and interest rate hedging products, (2016 – nil: 2015 - £149 million).

RBS has a provision of £64 million for its liability in respect of the sale of Interest Rate Hedging Products (IRHP), having an incurred costs of £1.5 billion. The Review is now materially complete (99.4%) with only a small number of claims for additional losses (Consequential Loss) remaining. Background information in relation to Interest Rate Hedging Products is given in note 31.

RBS established a provision of £400 million in November 2016 in respect of the FCA review of RBS's 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 31.

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Notes on the consolidated accounts

20 Provisions for liabilities and charges continued

(3) In the US, RBS is subject to civil litigation and various civil and criminal investigations relating to its issuance and underwriting of US mortgage-backed securities (RMBS). As announced on 26 January, an additional charge of £3.1 billion was taken in the fourth quarter of 2016 in connection with these matters. Detailed descriptions of RBS's legal proceedings and discussion of the associated uncertainties are given in Note 31.

(4) RBS is party to certain legal proceedings and regulatory investigations and continues to co-operate with a number of regulators. All such matters are periodically reassessed with the assistance of external professional advisers, where appropriate, to determine the likelihood of RBS incurring a liability and to evaluate the extent to which a reliable estimate of any liability can be made. Details of these investigations and a discussion of the nature of the associated uncertainties are given in Note 31.

(5) The Group has recognised a £750 million provision in 2016 as a consequence of the announcement that HM Treasury is seeking a revised package of remedies that would conclude its remaining State Aid commitments.

(6) The majority of property provisions relate to vacant leasehold property and comprise the present value of the shortfall between rentals payable and rentals receivable from sub-letting. Other provisions include restructuring provisions of £450 million principally termination benefits.

21 Accruals and other liabilities		
	2016	2015
	£m	£m
Notes in circulation	2,028	1,886
Current tax	336	368
Accruals	1,311	1,915
Deferred income	483	359
Other liabilities	2,833	3,221
	6,991	7,749
22 Deferred tax		
	2016	2015
	£m	£m
Deferred tax asset	(1,803)	(2,631)
Deferred tax liability	662	882

Net deferred tax asset	(1,141)	(1,749)

Net deferred tax asset comprised:	Pension	Accelerated capital allowances	Provisions	Deferred gains	Fair value of financial instruments	AFS financial assets	Intangibles	Cash flow hedging	Share schemes
	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2015	(718)	541	(253)	323	(28)	66	5	280	(30)
Acquisitions and disposals of subsidiaries	7	(19)	—	(3)	—	(5)	—	—	—
Charge/(credit) to income statement	162	(292)	(84)	(187)	48	(45)	—	100	3
(Credit)/charge to other comprehensive income	(314)	—	—	—	—	65	—	(128)	4
Currency translation and other adjustments	6	8	(7)	(1)	1	19	(1)	1	—
At 1 January 2016	(857)	238	(344)	132	21	100	4	253	(23)
Acquisitions and disposals of subsidiaries	(1)	(59)	—	3	—	4	—	—	—
(Credit)/charge to income statement	(39)	149	25	(22)	1	(24)	—	(143)	13
Charge/(credit) to other comprehensive income	240	—	—	—	—	(9)	—	193	—
Currency translation and other adjustments	(5)	33	(3)	1	—	2	1	(3)	—
At 31 December 2016	(662)	361	(322)	114	22	73	5	300	(10)

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Explanation of Responses:

Notes on the consolidated accounts

22 Deferred tax continued

Deferred tax assets in respect of unused tax losses are recognised if the losses can be used to offset probable future taxable profits after taking into account the expected reversal of other temporary differences. Recognised deferred tax assets in respect of tax losses are analysed further below.

	2016	2015
	£m	£m
UK tax losses carried forward		
- The Royal Bank of Scotland plc	182	462
- UK branch of RBS NV	—	1
- National Westminster Bank Plc	605	628
- Ulster Bank Limited	14	31
	801	1,122
Overseas tax losses carried forward		
- Ulster Bank Ireland DAC	249	210
	1,050	1,332

UK tax losses

Under UK tax rules, tax losses can be carried forward indefinitely. In periods from 1 April 2015, the Finance Act 2015 limits the offset of losses carried forward by UK banks to 50% of profits. In periods from 1 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 2016 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 non-banking temporary differences and where appropriate, the banking surcharge inclusive rate in respect of other banking temporary differences.

The Royal Bank of Scotland plc – The Royal Bank of Scotland plc reported taxable profits in 2011 and 2014, and tax losses in 2012, 2013 and 2015. The tax loss for 2012 reflected the reversal of previous own credit gains offset by core banking profitability. In 2013 UK tax losses were largely attributable to loan impairment charges arising from the accelerated recovery strategy recorded in the final quarter of the period. In 2014, core profitability remained strong and a taxable profit arose. In 2015 a further tax loss arises as a result of restructuring costs incurred as part of RBS's strategic plan. In 2016, a taxable profit arises. A reduction in the carrying value of deferred tax assets of £701 million was recorded in 2013, an additional reduction of £850 million was recorded in 2014, with a further reduction of £300 million being recorded in 2016. In addition, deferred tax of £150 million was not recognised in respect of excess 2013 UK taxable losses. RBS expects that the balance of recognised deferred tax asset at 31 December 2016 of £182 million in respect of tax losses amounting to £947 million will be recovered by the end of 2021.

National Westminster Bank plc – The deferred tax asset in respect of tax losses at 31 December 2016 relates to residual unrelieved trading losses that arose between 2009 and 2014. 59% of the losses that arose were relieved against taxable profits arising in other UK Group companies. Taxable profits arose in 2015 and 2016. Based on its strategic plan, RBS expects that the recognised deferred tax asset of £605 million in respect of tax losses amounting to £3,361 million will be recovered by the end of 2022.

Overseas tax losses

Ulster Bank Ireland DAC – A deferred tax asset of £249 million has been recognised in respect of losses of £1,992 million (2015 - £1,678 million; 2014 - £1,776 million) of total tax losses of £7,989 million (2015 - £7,083 million; 2014 - £8,599 million) carried forward at 31 December 2015. Please note that the increase in the total tax losses and associated deferred tax asset is due to the €:£ exchange rate. These losses arose principally as a result of significant impairment charges between 2008 and 2013 reflecting challenging economic conditions in the Republic of Ireland. Impairment charges have reduced and Ulster Bank Ireland DAC returned to profitability during 2014, 2015 & 2016. Based on RBS's strategic plan, the losses on which a deferred tax asset has been recognised will be substantially utilised against future taxable profits by the end of 2023.

Unrecognised deferred tax

Deferred tax assets of £7,940 million (2015 - £6,349 million; 2014 - £5,738 million) have not been recognised in respect of tax losses and other temporary differences carried forward of £33,376 million (2015 - £27,483 million; 2014 - £26,742 million) in jurisdictions where doubt exists over the availability of future taxable profits. Of these losses and other temporary differences, £5,280 million expire within five years and £10,331 million thereafter. The balance of tax losses and other temporary differences carried forward has no expiry date.

Deferred tax liabilities of £258 million (2015 - £256 million; 2014 - £186 million) have not been recognised in respect of retained earnings of overseas subsidiaries and held-over gains on the incorporation of overseas branches. Retained earnings of overseas subsidiaries are expected to be reinvested indefinitely or remitted to the UK free from further taxation. No taxation is expected to arise in the foreseeable future in respect of held-over gains. Changes to UK tax legislation largely exempts from UK tax, overseas dividends received on or after 1 July 2009.

Notes on the consolidated accounts

23 Subordinated liabilities		
	2016	2015
	£m	£m
Dated loan capital	15,288	13,866
Undated loan capital	2,775	4,826
Preference shares	1,356	1,155
	19,419	19,847

Certain preference shares issued by the company are classified as liabilities; these securities remain subject to the capital maintenance rules of the Companies Act 2006.

The following tables analyse the remaining contractual maturity of subordinated liabilities by the final redemption date and by the next call date.

		2017	2018	2019-2021	2022-2026	Thereafter	Perpetual	Total
2016 - final redemption		£m	£m	£m	£m	£m	£m	£m
Sterling		17	—	369	—	—	576	962
US dollar		98	700	168	7,955	967	2,479	12,367
Euro		913	1,817	243	1,725	263	215	5,176
Other		34	—	—	872	—	8	914
		1,062	2,517	780	10,552	1,230	3,278	19,419
	Currently	2017	2018	2019-2021	2022-2026	Thereafter	Perpetual	Total
2016 - call date	£m	£m	£m	£m	£m	£m	£m	£m
Sterling	15	68	113	407	140	22	197	962
US dollar	1,860	1,817	700	168	6,242	1,186	394	12,367
Euro	162	1,395	1,817	1,108	378	263	53	5,176
Other	8	906	—	—	—	—	—	914
	2,045	4,186	2,630	1,683	6,760	1,471	644	19,419
		2016	2017	2018-2020	2021-2025	Thereafter	Perpetual	Total
2015 - final redemption		£m	£m	£m	£m	£m	£m	£m
Sterling		19	—	—	369	—	631	1,019
US dollar		79	—	676	6,674	3,027	2,052	12,508

Euro		195	648	1,794	2,240	251	184	5,312
Other		30	—	—	737	—	241	1,008
		323	648	2,470	10,020	3,278	3,108	19,847
	Currently	2016	2017	2018-2020	2021-2025	Thereafter	Perpetual	Total
2015 - call date	£m	£m	£m	£m	£m	£m	£m	£m
Sterling	15	74	51	155	483	44	197	1,019
US dollar	3,208	880	1,435	750	5,240	995	—	12,508
Euro	—	1,091	1,063	2,540	321	250	47	5,312
Other	8	263	737	—	—	—	—	1,008
	3,231	2,308	3,286	3,445	6,044	1,289	244	19,847

Notes on the consolidated accounts

23 Subordinated liabilities continued Issuances and Redemptions during the year (values as at date of transaction) are set out below.			
	Capital		
	treatment	2016	2015
Redemptions	£m	£m	£m
The Royal Bank of Scotland Group plc			
US$1,285 million 5.90% Trust Preferred	Tier 1	902	—
US$200 million 6.25% Trust Preferred	Tier 1	140	—
US$1,800 million 6.08% Trust Preferred	Tier 1	1,263	—
€26 million 7.42% dated notes	Tier 2	21	—
€7 million 7.38% dated notes	Tier 2	6	—
US$25 million floating rate notes (partial redemption)	Tier 2	6	—
The Royal Bank of Scotland plc			
£54 million 5.13% undated notes	Ineligible	55	—
CAD474 million 5.37% undated notes	Ineligible	283	—
€1 billion 4.63% dated notes	Ineligible	866	—
€23 million floating dated notes	Ineligible	—	17
US$675 million 5.05% dated notes	Ineligible	—	445
AU$18 million floating rate dated notes	Ineligible	—	9
AU$36 million floating rate dated notes	Ineligible	—	18
US$ 238 million floating rate dated notes	Ineligible	—	154
€750 million 4.88% dated notes	Tier 2	—	546
£250 million 9.63% dated notes	Tier 2	—	250
CHF400 Million 2.38% dated notes	Tier 2	—	259
CHF100 Million 2.38% dated notes	Tier 2	—	65
CHF200 Million 2.38% dated notes	Tier 2	—	129
NatWest Plc			
£87 million 5.95% undated notes	Tier 2	—	87
£300 million 7.88% dated notes	Tier 2	—	300
RBS N.V. and subsidiaries			
US$22 million 6.14% dated notes (partial redemption)	Ineligible	—	15
AU$26 million floating rate dated notes	Ineligible	—	13
AU$123 million floating rate dated notes	Ineligible	—	62

US$564 million floating rate dated notes	Ineligible	—	380
€415 million floating rate dated notes	Ineligible	—	294
€5 million floating rate dated notes	Ineligible	—	4
		3,542	3,047

Note:

(1) There were no issuances in 2016 or 2015.

Explanation of Responses:

Notes on the consolidated accounts

24 Non-controlling interests				
			Other	
	Citizens	RBS N.V.	interests	Total
	£m	£m	£m	£m
At 1 January 2015	2,307	564	75	2,946
Currency translation and other adjustments	25	(29)	7	3
Profit attributable to non-controlling interests				
- continuing operations	—	73	2	75
- discontinued operations	318	16	—	334
Dividends paid	(31)	—	—	(31)
Gains/(losses) on available-for-sale financial assets, net of tax	19	(8)	—	11
Gains on cash flow hedging, net of tax	28	—	—	28
Actuarial losses, net of tax	—	—	(6)	(6)
Equity raised	2,491	46	—	2,537
Equity withdrawn and disposals	(5,157)	—	(24)	(5,181)
At 1 January 2016	—	662	54	716
Currency translation and other adjustments	—	108	3	111
Profit attributable to non-controlling interests				
- continuing operations	—	6	4	10
Equity withdrawn and disposals	—	(43)	1	(42)
At 31 December 2016	—	733	62	795

25 Share capital				
			Number of shares	
	2016	2015	2016	2015
Allotted, called up and fully paid	£m	£m	000s	000s
Ordinary shares of £1	11,823	11,625	11,823,163	11,624,564
Non-cumulative preference shares of US$0.01(1)	—	1	72,430	133,840
Non-cumulative convertible preference shares of US$0.01	—	—	65	65
Non-cumulative preference shares of €0.01	—	—	2,044	2,044
Non-cumulative convertible preference shares of £0.01	—	—	15	15
Non-cumulative preference shares of £1	—	—	54	54
Cumulative preference shares of £1	1	1	900	900

Notes:

Explanation of Responses:

(1) 61.4 million shares with a total nominal value of £0.3 million were redeemed in September 2016 (2015 – 75.8 million shares with a nominal value of £0.5 million were redeemed).

(2) The entire holding of B shares was converted into ordinary shares in October 2015.

Movement in allotted, called up and fully paid ordinary shares	£m	Number of shares - 000s
At 1 January 2015	6,366	6,365,896
Shares issued	159	158,668
Conversion of B shares	5,100	5,100,000
At 1 January 2016	11,625	11,624,564
Shares issued	198	198,599
At 31 December 2016	11,823	11,823,163

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Notes on the consolidated accounts

25 Share capital continued

Ordinary shares

There is no authorised share capital under the company's constitution. At 31 December 2016, the directors had authority granted at the 2016 Annual General Meeting to issue up to £1,166 million nominal of ordinary shares other than by pre-emption to existing shareholders.

During 2016, the company allotted and issued the following new ordinary shares of £1 each:

Month	Number of shares	Subscription price per share	Gross proceeds
April	37.6m	226.250p	£85 million
May	38.5m	220.687p	£85 million
September	35.5m	196.924p	£70 million
November	30.6m	195.930p	£60 million

In addition, the company issued 56 million ordinary shares of £1 each in connection with employee share plans. In October 2015, the company allotted and issued 5.1 billion new ordinary shares of £1 each to HM Treasury on conversion of 51 billion B shares.

The company did not pay an ordinary dividend in 2016 or 2015.

B shares and dividend access share

From December 2009, HM Treasury owned 51 billion B shares with a nominal value of £0.01 each and a dividend access share (DAS) with a nominal value of £0.01.

The B shares carried no voting rights at general meetings of ordinary shareholders and were convertible at any time at HM Treasury's option into ordinary shares at the rate of ten B shares for each ordinary share. In October 2015, all of the B shares were converted into ordinary shares of £1 each.

In March 2016, a final payment of £1,193 million was made to HM Treasury to retire the DAS. The terms for the removal of the DAS were provided by the 'DAS Retirement Agreement' between RBS and HM Treasury. In line with the terms of the DAS Retirement Agreement, upon the final payment, the DAS lost its preferential rights and become a single B share, which was subsequently cancelled.

Preference shares

Under IFRS certain of RBS's preference shares are classified as debt and are included in subordinated liabilities on the balance sheet.

Between 1 January 2017 and the date of approval of these accounts, dividends amounting to US$77 million and £0.4 million have been declared in respect of equity preference shares for payment on 31 March 2017.

Other securities

Certain of RBS's subordinated securities in the legal form of debt are classified as equity under IFRS.

These securities entitle the holders to interest which may be deferred at the sole discretion of the company. Repayment of the securities is at the sole discretion of the company on giving between 30 and 60 days notice.

Non-cumulative preference shares

Non-cumulative preference shares entitle the holders thereof (subject to the terms of issue) to receive periodic non-cumulative cash dividends at specified fixed rates for each Series payable out of distributable profits of the company.

The non-cumulative preference shares are redeemable at the option of the company, in whole or in part from time to time at the rates detailed in the table below plus dividends otherwise payable for the then current dividend period accrued to the date of redemption.

In September 2016 and September 2015, the company redeemed in whole the Series R and T, and Series M , N, P and Q non-cumulative preference shares of US$0.01 respectively.

In the context of macro-prudential policy discussions, the Board decided to partially neutralise any impact on CET1 capital of coupon and dividend payments from 2013 onwards. £300 million of new equity was issued during the course of 2016 and the Board has decided a further £300 million of new equity will be issued during the course of 2017 to again partially neutralise the CET1 impact of coupon and dividend payments.

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Notes on the consolidated accounts

25 Share capital continued

Class of preference share	Number of shares in issue	Interest rate	Redemption date on or after	Redemption price per share	Debt/equity (1)
Non-cumulative preference shares of US$0.01					
Series F	6.3 million	7.65%	31 March 2007	US$25	Debt
Series H	9.7 million	7.25%	31 March 2004	US$25	Debt
Series L	30.0 million	5.75%	30 September 2009	US$25	Debt
Series S	26.4 million	6.60%	30 June 2012	US$25	Equity
Series U	10,130	7.64%	29 September 2017	US$100,000	Equity
Non-cumulative convertible preference shares of US$0.01					
Series 1	64,772	9.118%	31 March 2010	US$1,000	Debt
Non-cumulative preference shares of €0.01					
Series 1	1.25 million	5.50%	31 December 2009	€ 1,000	Equity
Series 2	784,989	5.25%	30 June 2010	€ 1,000	Equity
Series 3	9,429	7.0916%	29 September 2017	€ 50,000	Equity
Non-cumulative convertible preference shares of £0.01					
Series 1	14,866	7.387%	31 December 2010	£1,000	Debt

Explanation of Responses:

Non-cumulative preference shares of £1						
Series 1	54,442	3 month LIBOR + 2.33%	5 October 2012		£1,000	Equity

Note:

(1) Those preference shares where RBS has an obligation to pay dividends are classified as debt; those where distributions are discretionary are classified as equity. The conversion rights attaching to the convertible preference shares may result in RBS delivering a variable number of equity shares to preference shareholders; these convertible preference shares are treated as debt.

In the event that the non-cumulative convertible preference shares are not redeemed on or before the redemption date, the holder may convert them into ordinary shares in the company at the prevailing market price.

Under existing arrangements, no redemption or purchase of any non-cumulative preference shares may be made by the company without the prior consent of the Prudential Regulation Authority.

On a winding-up or liquidation of the company, the holders of the non-cumulative preference shares are entitled to receive, out of any surplus assets available for distribution to the company's shareholders (after payment of arrears of dividends on the cumulative preference shares up to the date of repayment) pari passu with the cumulative preference shares and all other shares of the company ranking pari passu with the non-cumulative preference shares as regards participation in the surplus assets of the company, a liquidation distribution per share equal to the applicable redemption price detailed in the table above, together with an amount equal to dividends for the then current dividend period accrued to the date of payment, before any distribution or payment may be made to holders of the ordinary shares as regards participation in the surplus assets of the company.

Except as described above, the holders of the non-cumulative preference shares have no right to participate in the surplus assets of the company. Holders of the non-cumulative preference shares are not entitled to receive notice of or attend general meetings of the company except if any resolution is proposed for adoption by the shareholders of the company to vary or abrogate any of the rights attaching to the non-cumulative preference shares or proposing the winding-up or liquidation of the company. In any such case, they are entitled to receive notice of and to attend the general meeting of shareholders at which such resolution is to be proposed and are entitled to speak and vote on such resolution (but not on any other resolution). In addition, in the event that, prior to any general meeting of shareholders, the company has failed to pay in full the three most recent quarterly dividend payments due on the non-cumulative dollar preference shares (other than Series U), the two most recent semi-annual dividend payments due on the

non-cumulative convertible dollar preference shares and the most recent dividend payments due on the non-cumulative euro preference shares, the non-cumulative sterling preference shares, the Series U non-cumulative dollar preference shares and the non-cumulative convertible sterling preference shares, the holders shall be entitled to receive notice of, attend, speak and vote at such meeting on all matters together with the holders of the ordinary shares. In these circumstances only, the rights of the holders of the non-cumulative preference shares so to vote shall continue until the company shall have resumed the payment in full of the dividends in arrears.

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Notes on the consolidated accounts

26 Other equity

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

	2016 £m	2015 £m
EMTN notes (1)		
US$564 million 6.99% capital securities		
(callable October 2017)	275	275
CAD321 million 6.666% notes		
(callable October 2017)	156	156
Trust preferred issues: subordinated notes (2)		
€166 million 4.243% 2046		
(callable January 2016) (3)	—	110
£93 million 5.6457% 2047		
(callable June 2017) (4)	93	93
Additional Tier 1 notes (5)		
US$2.0 billion 7.5% notes callable August 2020 (6)	1,278	1,278
US$1.15 billion 8% notes callable August 2025 (6)	734	734
US$2.65 billion 8.625% notes callable August 2021 (7)	2,046	—
	4,582	2,646

Notes:

(1) If the US$ and CAD EMTN notes were called, RBS would issue, at the prevailing market price, ordinary shares to the value of US$78 million and CAD43 million respectively to settle the coupons deferred in 2009 and 2010.

(2) Subordinated notes issued to limited partnerships that have in turn issued partnership preferred securities to trusts that have issued trust preferred securities to investors. The trust preferred securities are redeemable only at the issuer's option and dividends are payable at RBS's discretion. On maturity of the subordinated notes, the partnerships are required to reinvest in eligible capital instruments issued by RBS.

(3) Preferred securities in issue - €166 million RBS Capital Trust C, fixed/floating rate non-cumulative trust preferred securities. Notice of redemption issued in May 2016 and settlement was in July 2016.

(4) Preferred securities in issue - £93 million RBS Capital Trust D, fixed/floating rate non-cumulative trust preferred securities.

(5) The coupons on these notes are non-cumulative and payable at the company's discretion. In the event the Group's CET1 ratio falls below 7% any outstanding notes will be converted into ordinary shares at a fixed price. While taking the legal form of debt these notes are classified as equity under IFRS.

(6) Issued in August 2015. In the event of conversion, converted into ordinary shares at a price of $3.606 nominal per £1 share.

(7) Issued in August 2016. In the event of conversion, converted into ordinary shares at a price of $2.284 nominal per £1 share.

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Notes on the consolidated accounts

26 Other equity continued

Merger reserve - the merger reserve comprises the premium on shares issued to acquire NatWest, less goodwill amortisation charged under previous GAAP, and the premium arising on shares issued to acquire Aonach Mor Limited, less amounts realised through subsequent share redemptions by Aonach Mor Limited. No share premium was recorded in the company financial statements through the operation of the merger relief provisions of the Companies Act.

Capital redemption reserve - under UK companies legislation, when shares are redeemed or purchased wholly or partly out of the company's profits, the amount by which the company's issued share capital is diminished must be transferred to the capital redemption reserve. The capital maintenance provisions of UK companies legislation apply to the capital redemption reserve as if it were part of the company's paid up share capital.

Own shares held - at 31 December 2016, 39 million ordinary shares of £1 each of the company (2015 - 26 million; 2014 - 28 million) were held by employee share trusts in respect of share awards and options granted to employees. During the year, the employee share trusts purchased 29 million ordinary shares and delivered 16 million ordinary shares in satisfaction of the exercise of options and the vesting of share awards under the employee share plans.

RBS optimises capital efficiency by maintaining reserves in subsidiaries, including regulated entities. Certain preference shares and subordinated debt are also included within regulatory capital. The remittance of reserves to the company or the redemption of shares or subordinated capital by regulated entities may be subject to maintaining the capital resources required by the relevant regulator.

UK law prescribes that only the reserves of the company are taken into account for the purpose of making distributions and in determining permissible applications of the share premium account.

Notes on the consolidated accounts

27 Leases						
	Finance lease contracts and hire purchase agreements					Operating lease assets:
	Gross	Present value	Other	Future	Present	future minimum
Year in which receipt will occur	amounts	adjustments	movements	drawdowns	value	lease rentals
	£m	£m	£m	£m	£m	£m
2016						
Within 1 year	3,174	(230)	(54)	(27)	2,863	139
After 1 year but within 5 years	5,002	(518)	(113)	(68)	4,303	296
After 5 years	2,715	(951)	(26)	—	1,738	25
Total	10,891	(1,699)	(193)	(95)	8,904	460
2015						
Within 1 year	3,119	(236)	(31)	—	2,852	166
After 1 year but within 5 years	4,801	(420)	(83)	—	4,298	294
After 5 years	2,784	(1,120)	(24)	—	1,640	72
Total	10,704	(1,776)	(138)	—	8,790	532

	2016	2015
Nature of operating lease assets on the balance sheet	£m	£m
Transportation	391	556
Cars and light commercial vehicles	56	56
Other	278	268
	725	880

	2016	2015	2014
	£m	£m	£m
Amounts recognised as income and expense in continuing operations			
Finance leases - contingent rental rebate	(76)	(81)	(85)
Operating leases - minimum rentals payable	239	239	249

Finance lease contracts and hire purchase agreements			
Accumulated allowance for uncollectable minimum receivables	54	65	104

There were no amounts recognised as income and expense in discontinued operations (2015 - £75 million; 2014 - £124 million) in relation to operating leases - minimum rentals payable.

Residual value exposures

The table below gives details of the unguaranteed residual values included in the carrying value of finance lease receivables (refer to page 415) and operating lease assets (refer to pages 440 and 441).

	2016						2015				
	Year in which residual value will be recovered						Year in which residual value will be recovered				
	Within 1 year	After 1 year but within 2 years	After 2 years but within 5 years	After 5 years	Total		Within 1 year	After 1 year but within 2 years	After 2 years but within 5 years	After 5 years	Total
	£m	£m	£m	£m	£m		£m	£m	£m	£m	£m
Operating leases											
- transportation	24	60	128	21	233		126	57	52	108	343
- cars and light commercial vehicles	5	5	12	—	22		8	3	10	—	21
- other	30	19	32	6	87		24	29	35	2	90
Finance lease contracts	43	27	46	26	142		30	22	58	24	134
Hire purchase agreements	24	25	2	—	51		1	—	3	—	4
	126	136	220	53	535		189	111	158	134	592

Acting as a lessor, RBS provides asset finance to its customers. It purchases plant, equipment and intellectual property, renting them to customers under lease arrangements that, depending on their terms, qualify as either operating or finance leases.

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Notes on the consolidated accounts

28 Structured entities

A structured entity (SE) is an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example, when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose. They do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions. As well as being a key element of securitisations, SEs are also used in fund management activities in order to segregate custodial duties from the provision of fund management advice.

Consolidated structured entities

Securitisations

In a securitisation, assets, or interests in a pool of assets, are transferred generally to an SE which then issues liabilities to third party investors. The majority of securitisations are supported through liquidity facilities or other credit enhancements. RBS arranges securitisations to facilitate client transactions and undertakes own asset securitisations to sell or to fund portfolios of financial assets. RBS also acts as an underwriter and depositor in securitisation transactions in both client and proprietary transactions.

RBS's involvement in client securitisations takes a number of forms. It may: sponsor or administer a securitisation programme; provide liquidity facilities or programme-wide credit enhancement; and purchase securities issued by the vehicle.

Own asset securitisations

In own-asset securitisations, the pool of assets held by the SE is either originated by RBS, or (in the case of whole loan programmes) purchased from third parties.

The table below analyses the asset categories for those own-asset securitisations where the transferred assets continue to be recorded on RBS's balance sheet.

	2016				2015		
			Debt securities in issue				Debt securities in issue

Asset type	Assets	Held by third parties	Held by RBS (1)	Total	Assets	Held by third parties	Held by RBS (1)	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Mortgages								
- UK	1,475	—	1,774	1,774	3,954	961	3,067	4,028
- Irish	7,054	1,180	6,621	7,801	7,395	1,472	6,836	8,308
- US	301	301	—	301	—	—	—	—
Other loans (2)	—	—	—	—	333	9	238	247
	8,830	1,481	8,395	9,876	11,682	2,442	10,141	12,583
Cash deposits	965				1,201			
	9,795				12,883			

Notes:

(1) Debt securities retained by RBS may be pledged with central banks.

(2) Corporate, social housing and student loans.

Commercial paper conduits

RBS consolidates a number of asset-backed commercial paper (ABCP) conduits. A conduit is an SE that issues commercial paper and uses the proceeds to purchase or fund a pool of assets. The commercial paper is secured on the assets and is redeemed by further commercial paper issuance, repayment of assets or funding from liquidity facilities. Commercial paper is typically short-dated, usually up to three months. At 31 December 2016 assets held by the conduits totalled £0.1 billion (2015 - £0.6 billion). At 31 December 2016 and 2015 the conduits were funded entirely by RBS.

Covered bond programme

Certain loans and advances to customers have been assigned to bankruptcy remote limited liability partnerships to provide security for issues of debt securities by RBS. RBS retains all of the risks and rewards of these loans. The partnerships are consolidated, the loans retained on RBS's balance sheet and the related covered bonds included within debt securities in issue. At 31 December 2016, £8,621 million of mortgages provided security for debt securities in issue of £3,935 million (2015: mortgages - £11,207 million, bonds - £5,585 million).

Notes on the consolidated accounts

28 Structured entities continued

Unconsolidated structured entities

RBS's interests in unconsolidated structured entities are analysed below.

	2016			2015		
	Asset backed securitisation vehicles	Investment funds and other	Total	Asset backed securitisation vehicles	Investment funds and other	Total
	£m	£m	£m	£m	£m	£m
Held-for-trading						
Loans and advances to customers	588	40	628	139	—	139
Debt securities	618	28	646	455	73	528
Equity shares	—	94	94	—	113	113
Derivative assets	318	77	395	548	13	561
Derivative liabilities	(509)	(102)	(611)	(152)	(23)	(175)
Total	1,015	137	1,152	990	176	1,166
Other than held-for-trading						
Loans and advances to customers	1,339	871	2,210	2,663	2	2,665
Debt securities	4,702	146	4,848	3,263	123	3,386
Total	6,041	1,017	7,058	5,926	125	6,051
Liquidity facilities/loan commitments	1,397	757	2,154	1,362	—	1,362
Guarantees	55	6	61	—	—	—
Maximum exposure	8,508	1,921	10,425	8,278	301	8,579

Notes:

(1) Income from interests in unconsolidated structured entities includes interest receivable, changes in fair value and other income less impairments.

(2) A sponsored entity is a structured entity established by RBS where RBS provides liquidity and/or credit enhancements or provides ongoing services to the entity. RBS can act as sponsor for its own or for customers' transactions.

(3) In 2016, no assets were transferred into sponsored structured entities (2015 - nil) which are not consolidated by RBS and for which RBS held no interest at 31 December 2016. Income arising from

sponsored entities where we hold net interest at year end was £18 million (2015 - £39 million).

29 Asset transfers

Transfers that do not qualify for derecognition

Securities repurchase agreements and lending transactions

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

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

Securities sold under repurchase transactions are not derecognised if RBS retains substantially all the risks and rewards of ownership. The fair value (and carrying value) of securities transferred under such repurchase transactions included on the balance sheet, are set out below. All of these securities could be sold or repledged by the holder.

Assets subject to securities repurchase agreements or security lending transactions	2016(1)	2015
	£m	£m
Debt securities	18,107	20,224
Equity shares	—	9

Note:

(1) Associated liabilities were £17,975 million.

Notes on the consolidated accounts

29 Asset transfers continued

Assets pledged as collateral

The Group pledges collateral with its counterparties in respect of derivative liabilities and bank and other borrowings.

	Assets pledged against liabilities					Liabilities secured by assets			
	Loans and advances to banks	Loans and advances to customers	Securities	Total		Deposits by banks	Customer accounts	Derivatives	Total
	£m	£m	£m	£m		£m	£m	£m	£m
2016	7,360	29,654	20,152	57,166		5,514	—	26,443	31,957
2015	11,477	17,633	14,517	43,627		293	—	31,131	31,424

30 Capital resources

RBS's regulatory capital resources in accordance with PRA definitions were as follows:

	PRA transitional basis	
	2016	2015
	£m	£m
Shareholders' equity (excluding non-controlling interests)		
Shareholders' equity	48,609	53,431
Preference shares - equity	(2,565)	(3,305)
Other equity instruments	(4,582)	(2,646)
	41,462	47,480
Regulatory adjustments and deductions		
Own credit	(304)	(104)
Defined benefit pension fund adjustment	(208)	(161)
Cash flow hedging reserve	(1,030)	(458)
Deferred tax assets	(906)	(1,110)
Prudential valuation adjustments	(532)	(381)
Goodwill and other intangible assets	(6,480)	(6,537)
Expected losses less impairments	(1,371)	(1,035)
Other regulatory adjustments	(8)	(64)
	(10,839)	(9,850)

CET1 capital	30,623	37,630	
Additional Tier 1 (AT1) capital			
Eligible AT1	4,041	1,997	
Qualifying instruments and related share premium subject to phase out	5,416	5,092	
Qualifying instruments issued by subsidiaries and held by third parties	339	1,627	
AT1 capital	9,796	8,716	
Tier 1 capital	40,419	46,346	
Qualifying Tier 2 capital			
Qualifying instruments and related share premium	7,066	6,265	
Qualifying instruments issued by subsidiaries and held by third parties	4,818	7,354	
Tier 2 capital	11,884	13,619	
Total regulatory capital	52,303	59,965	

It is RBS's policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, RBS has regard to the supervisory requirements of the PRA. The PRA uses capital ratios as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks); by international agreement, the Pillar 1 capital ratios should be not less than 8% with a Common Equity Tier 1 component of not less than 4.5%. RBS has complied with the PRA's capital requirements throughout the year.

A number of subsidiaries and sub-groups within RBS, principally banking entities, are subject to various individual regulatory capital requirements in the UK and overseas. Furthermore, the payment of dividends by subsidiaries and the ability of members of RBS to lend money to other members of RBS may be subject to restrictions such as local regulatory or legal requirements, the availability of reserves and financial and operating performance.

Notes on the consolidated accounts

31 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 RBS is exposed to credit risk in the event of a customer's failure to meet its obligations, the amounts shown do not, and are not intended to, provide any indication of RBS's expectation of future losses.

	Less than 1 year	More than 1 year but less than 3 years	More than 3 years but less than 5 years	Over 5 years	2016	2015
	£m	£m	£m	£m	£m	£m
Guarantees and assets pledged as collateral security	1,819	610	560	4,878	7,867	9,036
Other contingent liabilities	1,016	1,198	207	1,758	4,179	7,002
Standby facilities, credit lines and other commitments	67,421	21,478	43,101	6,645	138,645	137,714
Contingent liabilities and commitments	70,256	23,286	43,868	13,281	150,691	153,752

Note:

(1) Includes liquidity facilities provided to RBS sponsored conduits.

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. RBS's maximum exposure to credit loss, in the event of its obligation crystallising and all counterclaims, collateral or security proving valueless, is represented by the contractual nominal amount of these instruments included in the table above. These commitments and contingent obligations are subject to RBS's normal credit approval processes.

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

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

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

Contractual obligations for future expenditure not provided for in the accounts

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

	2016	2015
	£m	£m
Operating leases		
Minimum rentals payable under non-cancellable leases (1)		
- within 1 year	246	232
- after 1 year but within 5 years	786	759
- after 5 years	1,775	2,006
	2,807	2,997
Capital expenditure on property, plant and equipment	21	59
Contracts to purchase goods or services (2)	598	1,442
	3,426	4,498

Notes:

(1) Predominantly property leases.

(2) Of which due within 1 year: £231 million (2015 - £302 million).

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Explanation of Responses:

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Trustee and other fiduciary activities

In its capacity as trustee or other fiduciary role, the Group may hold or place assets on behalf of individuals, trusts, companies, pension schemes and others. The assets and their income are not included in the Group's financial statements. The Group earned fee income of £251 million (2015 - £321 million; 2014 - £425 million) from these activities.

The Financial Services Compensation Scheme

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

The FSCS has borrowed from HM Treasury to fund compensation costs associated with the failure of Bradford & Bingley, Heritable Bank, Kaupthing Singer & Friedlander, Landsbanki ‘Icesave’ and London Scottish Bank plc. The industry repaid the remaining balance on the non-Bradford and Bingley loans during the period. The Bradford and Bingley loan is interest bearing with the reference rate being the higher of 12 month LIBOR plus 111 basis points or the relevant gilt rate for the equivalent cost of borrowing from HMT. The FSCS and HM Treasury have agreed that the period of these loans will reflect the expected timetable for recoveries from the estate of Bradford & Bingley. In addition, the FSCS levied an interim payment relating to resolution costs for Dunfermline Building Society of £325 million in 2015, no further levy is expected in relation to this matter. The total interest element levied on the industry in the 2016/17 scheme year was £337 million (£353 million in the 2015/16 scheme year).

RBS Group has accrued £38 million for its share of estimated FSCS levies.

Litigation, investigations and reviews

The Royal Bank of Scotland Group plc (the “company” or RBSG) and certain members of the Group are party to legal proceedings and the subject of investigation and other regulatory and governmental action (“Matters”) in the United Kingdom (UK), the United States (US), the European Union (EU) and other jurisdictions.

RBS recognises a provision for a liability in relation to these Matters when it is probable that an outflow of economic benefits will be required to settle an obligation resulting from past events, and a reliable estimate can be made of the amount of the obligation. While the outcome of these Matters is inherently uncertain, the directors believe that, based on the information available to them, appropriate provisions have been made in respect of the Matters as at 31 December 2016 (see Note 20).

In many proceedings and investigations, it is not possible to determine whether any loss is probable or to estimate reliably the amount of any loss, either as a direct consequence of the relevant proceedings and investigations or as a result of adverse impacts or restrictions on RBS’s reputation, businesses and operations. Numerous legal and factual issues may need to be resolved, including through potentially lengthy discovery and document production exercises and determination of important factual matters, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a liability can reasonably be estimated for any claim. RBS cannot predict if, how, or when such claims will be resolved or what the eventual settlement, damages, fine, penalty or other relief, if any, may be, particularly for claims that are at an early stage in their development or where claimants seek substantial or indeterminate damages.

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

There are situations where RBS may pursue an approach that in some instances leads to a settlement agreement. This may occur in order to avoid the expense, management distraction or reputational implications of continuing to contest liability, or in order to take account of the risks inherent in defending claims or investigations even for those matters for which RBS believes it has credible defences and should prevail on the merits. The uncertainties inherent in all such matters affect the amount and timing of any potential outflows for both matters with respect to which provisions have been established and other contingent liabilities.

The future outflow of resources in respect of any matter may ultimately prove to be substantially greater than or less than the aggregate provision that RBS has recognised. Where (and as far as) liability cannot be reasonably estimated, no provision has been recognised.

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Other than those discussed below, no member of the Group is or has been involved in governmental, legal or regulatory proceedings (including those which are pending or threatened) that are expected to be material, individually or in aggregate. RBS expects that in future periods additional provisions, settlement amounts, and customer redress payments will be necessary, in amounts that are expected to be substantial in some instances.

For a discussion of certain risks associated with the Group's litigation, investigations and reviews, see "Risk Factors" on pages 509 to 578.

Litigation

UK 2008 rights issue shareholder litigation

Between March and July 2013, claims were issued in the High Court of Justice of England and Wales by sets of current and former shareholders, against RBSG (and in one of those claims, also against certain former individual officers and directors) alleging that untrue and misleading statements and/or improper omissions, in breach of the Financial Services and Markets Act 2000, were made in connection with the rights issue announced by RBS on 22 April 2008. In July 2013 these and other similar threatened claims were consolidated by the Court via a Group Litigation Order. RBS's defence to the claims was filed on 13 December 2013. Since then, further High Court claims have been issued against RBS under the Group Litigation Order which is now closed to further claimants. Prior to the partial settlement described below, the aggregate value of the shares subscribed for at 200 pence per share by all of the then claimant shareholders was approximately £4 billion.

In December 2016 RBS concluded full and final settlements with four of the five shareholder groups representing 78% of the claims by value. The maximum settlement figure of £800 million is covered by existing RBS provisions and that total figure assumes that agreement is reached with all groups, is split proportionally between each, and is subject to validation of claims.

Should the remaining group's claim not be settled, RBS will continue to defend it. Damages have not yet been quantified. The court timetable provides that a trial of the preliminary issue of whether the rights issue prospectus contained untrue and misleading statements and/or improper omissions will commence in May 2017. In the event that the court makes such a finding, further trial(s) will be required to consider whether any such statements and/or omissions caused loss and, if so, the quantum of that loss.

Residential mortgage-backed securities (RMBS) litigation in the US

RBS companies have been named as defendants in their various roles as issuer, depositor and/or underwriter in a number of claims in the US that relate to the securitisation and securities underwriting businesses. These cases include actions by individual purchasers of securities and a purported class action suit.

Together, the pending individual and class action cases (including those claims specifically described in this note) involve the issuance of approximately US$36.5 billion of RMBS issued primarily from 2005 to 2007.

In general, plaintiffs in these actions claim that certain disclosures made in connection with the relevant offerings contained materially false or misleading statements and/or omissions regarding the underwriting standards pursuant to which the mortgage loans underlying the securities were issued.

RBS companies remain as defendants in more than 10 lawsuits brought by or on behalf of purchasers of RMBS, including the purported class action identified below.

In the event of an adverse judgment in any of these cases, the amount of RBS's liability will depend on numerous factors that are relevant to the calculation of damages, which may include the recognised loss of principal value in the securities at the time of judgment (write-downs); the value of the remaining unpaid principal balance of the securities at the time the case began, at the time of judgment (if the plaintiff still owns the securities at the time of judgment), or at the time when the plaintiff disposed of the securities (if plaintiff sold the securities); and a calculation of pre and post judgment interest that the plaintiff could be awarded, which could be a material amount.

In September 2011, the US Federal Housing Finance Agency (FHFA) as conservator for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) filed RMBS-related lawsuits against RBS and a number of other financial institutions, all of which, except for the two cases described below, have since settled for amounts that were publicly disclosed.

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The primary FHFA lawsuit against RBS remains pending in the United States District Court for the District of Connecticut, and it relates to approximately US$32 billion of RMBS for which RBS entities acted as sponsor/depositor and/or lead underwriter or co-lead underwriter. Of the US$32 billion, approximately US$7.6 billion was outstanding at 31 December 2016 with cumulative write downs to date on the securities of approximately US$1.1 billion (being the recognised loss of principal value suffered by security holders). In September 2013, the Court denied the defendants' motion to dismiss FHFA's amended complaint in this case. The matter continues in the discovery phase.

The other remaining FHFA lawsuit that involves RBS relates to RMBS issued by Nomura Holding America Inc. (Nomura) and subsidiaries, and is the subject of an appeal. On 11 May 2015, following a trial, the United States District Court for the Southern District of New York issued a written decision in favour of FHFA on its claims against Nomura and RBS Securities Inc., finding, as relevant to RBS, that the offering documents for four Nomura-issued RMBS for which RBS Securities Inc. served as an underwriter, relating to US$1.4 billion in original principal balance, contained materially misleading statements about the mortgage loans that backed the securitisations, in violation of the Securities Act and Virginia securities law.

RBS Securities Inc. estimates that its net exposure under the Court's judgment is approximately US$383 million, which consists of the difference between the amount of the judgment against RBS Securities Inc. (US$636 million) and the estimated market value of the four RMBS that FHFA would return to RBS Securities Inc. pursuant to the judgment, plus the costs and attorney's fees that will be due to FHFA if the judgment is upheld.

The Court has stayed the judgment pending the result of the appeal that the defendants are taking to the United States Court of Appeals for the Second Circuit, though post-judgment interest on the judgment amount will accrue while the appeal is pending. RBS Securities Inc. intends to pursue a contractual claim for indemnification against Nomura with respect to any losses it suffers as a result of this matter.

Other remaining RMBS lawsuits against RBS companies include cases filed by the Federal Home Loan Banks of Boston and Seattle and the Federal Deposit Insurance Corporation.

RBS companies are also defendants in a purported RMBS class action entitled New Jersey Carpenters Health Fund v. Novastar Mortgage Inc. et al., which remains pending in the United States District Court for the Southern District of New York. RBS has reached an agreement in principle to settle this matter, subject to documentation and court approval. The amount of the settlement is covered by an existing provision.

As at 31 December 2016, the total aggregate of provisions in relation to certain of the RMBS litigation matters (described immediately above) and RMBS and other securitised products investigations (set out under "Investigations and reviews" on page 459), including an additional provision of £3.4 billion ($4.2 billion) in 2016, is £6.8 billion ($8.3 billion). The duration and outcome of these investigations and litigation matters remain uncertain, including in respect of whether settlements for all or any of such matters may be reached.

Further substantial provisions and costs may be recognised and, depending on the final outcome, other adverse consequences may occur.

In many of the securitisation and securities related cases in the US, RBS has or will have contractual claims to indemnification from the issuers of the securities (where an RBS company is underwriter) and/or the underlying mortgage originator (where an RBS company is issuer). The amount and extent of any recovery on an indemnification claim, however, is uncertain and subject to a number of factors, including the ongoing creditworthiness of the indemnifying party, a number of whom are or may be insolvent.

London Interbank Offered Rate (LIBOR)

Certain members of the Group have been named as defendants in a number of class actions and individual claims filed in the US with respect to the setting of LIBOR and certain other benchmark interest rates. The complaints are substantially similar and allege that certain members of the Group and other panel banks individually and collectively violated various federal laws, including the US commodities and antitrust laws, and state statutory and common law, as well as contracts, by manipulating LIBOR and prices of LIBOR-based derivatives in various markets through various means.

Most of the USD LIBOR-related actions in which RBS companies are defendants, including all purported class actions relating to USD LIBOR, were transferred to a coordinated proceeding in the United States District Court for the Southern District of New York.

In the coordinated proceeding, consolidated class action complaints were filed on behalf of (1) exchange-based purchaser plaintiffs, (2) over-the-counter purchaser plaintiffs, and (3) corporate debt purchaser plaintiffs. Over 35 other USD LIBOR-related actions naming RBS as a defendant, including purported class actions on behalf of lenders and mortgage borrowers, were also made part of the coordinated proceeding.

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In a series of orders issued in 2013 and 2014, the district court overseeing the coordinated USD proceeding dismissed class plaintiffs' antitrust claims and claims under RICO (Racketeer Influenced and Corrupt Organizations Act), but declined to dismiss (a) certain Commodity Exchange Act claims on behalf of persons who transacted in Eurodollar futures contracts and options on futures contracts on the Chicago Mercantile Exchange (on the theory that defendants' alleged persistent suppression of USD LIBOR caused loss to plaintiffs), and (b) certain contract and unjust enrichment claims on behalf of over-the-counter purchaser plaintiffs who transacted directly with a defendant. On 23 May 2016, the district court’s dismissal of plaintiffs’ antitrust claims was vacated by the United States Court of Appeals for the Second Circuit, which held that plaintiffs have adequately pled antitrust injury and an antitrust conspiracy, but remanded to the lower court for further consideration on the question of whether plaintiffs possess the requisite antitrust standing to proceed with antitrust claims.

In a decision issued on 20 December 2016, the district court held that it lacks personal jurisdiction over RBS with respect to certain claims asserted in the coordinated proceeding. Following that decision, RBS is dismissed from each of the USD LIBOR-related class actions in the coordinated proceeding, subject to appeal, although certain non-class cases on behalf of particular plaintiffs remain pending.

Certain members of the Group have also been named as defendants in class actions relating to (i) JPY LIBOR and Euroyen TIBOR (one case relating to Euroyen TIBOR futures contracts and one relating to other derivatives allegedly linked to JPY LIBOR and Euroyen TIBOR), (ii) Euribor, (iii) Swiss Franc LIBOR (iv) Pound sterling LIBOR, and (v) the Singapore Interbank Offered Rate and Singapore Swap Offer Rate, and (vi) the Australian Bank Bill Swap Reference Rate, all of which are pending before other judges in the United States District Court for the Southern District of New York. Each of these matters is subject to motions to dismiss that will be made or are currently pending, with the exceptions that on 28 March 2014, the Court in the action relating to Euroyen TIBOR futures contracts dismissed the plaintiffs’ antitrust claims, but declined to dismiss their claims under the Commodity Exchange Act for price manipulation and on 21 February 2017, the court in the action relating to Euribor dismissed all claims alleged against RBS for lack of personal jurisdiction.

Details of LIBOR investigations involving RBS are set out under ‘‘Investigations and reviews’’ on page 461.

ISDAFIX antitrust litigation

Beginning in September 2014, The Royal Bank of Scotland plc (RBS plc) and a number of other financial institutions were named as defendants in several purported class action complaints (subsequently consolidated into one complaint) in the United States District Court for the Southern District of New York

alleging manipulation of USD ISDAFIX rates In 2015, RBS plc reached an agreement to settle this matter for US$50 million, and that settlement received preliminary approval from the Court on 11 May 2016. The settlement amount has been paid into escrow pending the final court approval of the settlement.

FX antitrust litigation

In 2015, Group companies settled a consolidated antitrust class action (the "consolidated action"), pending in the United States District Court for the Southern District of New York, asserting claims on behalf of persons who entered into (a) over-the-counter foreign exchange (FX) spot transactions, forwards, swaps, futures, options or other FX transactions the trading or settlement of which is related in any way to FX rates, or (b) exchange-traded FX instruments. Following the Court's preliminary approval of the settlement on 15 December 2015, RBS paid the total settlement amount (US$255 million) into escrow pending final court approval of the settlement. On 8 June 2016, the Court denied a motion by the settling defendants to enjoin a second FX-related antitrust class action pending in the same court from proceeding, holding that the alleged class of "consumers and end-user businesses" in that action is not included within the classes at issue in the consolidated action. RBS has made a motion to dismiss the claims in this "consumer" action, and that motion remains pending.

A third FX-related class action, asserting Employee Retirement Income Security Act claims on behalf of employee benefit plans that engaged in FX transactions, including claims based on alleged non-collusive FX-related conduct, was dismissed on 20 September 2016 on the ground that the plaintiffs failed to plead that the defendants had ERISA-based fiduciary duties to the plaintiffs. Plaintiffs have commenced an appeal of this dismissal.

On 26 September 2016, a class action complaint was filed in the United States District Court for the Southern District of New York asserting claims on behalf of "indirect purchasers" of FX instruments. The complaint defines "indirect purchasers" as persons who were indirectly affected by FX instruments that others entered into directly with defendant banks or on exchanges. It is alleged that certain RBS companies and other defendant banks caused damages to the "indirect purchasers" by conspiring to restrain trade in the FX spot market. The complaint seeks damages and other relief under federal, California, and New York antitrust laws. RBS and the other defendants have made a motion to dismiss this matter.

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In September 2015, certain members of the Group, as well as a number of other financial institutions, were named as defendants in two purported class actions filed in Ontario and Quebec on behalf of persons in Canada who entered into foreign exchange transactions or who invested in funds that entered into foreign exchange transactions. The plaintiffs allege that the defendants violated the Canadian Competition Act by conspiring to manipulate the prices of currency trades. In January 2017, RBS reached an agreement in principle to settle these matters for approximately CAD 13 million, subject to settlement documentation and court approval.

Certain other foreign exchange transaction related claims have been or may be threatened against RBS in other jurisdictions. RBS cannot predict whether any of these claims will be pursued, but expects that several may.

US Treasury securities antitrust litigation

Beginning in July 2015, numerous class action antitrust complaints were filed in US federal courts against a number of primary dealers of US Treasury securities, including RBS Securities Inc. The complaints allege that the defendants rigged the US Treasury securities auction bidding process to deflate prices at which they bought such securities and colluded to increase the prices at which they sold such securities to plaintiffs. The complaints assert claims under the US antitrust laws and the Commodity Exchange Act on behalf of persons who transacted in US Treasury securities or derivatives based on such instruments, including futures and options. On 8 December 2015, all pending matters were transferred to the United States District Court for the Southern District of New York for coordinated or consolidated pre-trial proceedings. RBS anticipates making a motion to dismiss these claims.

Interest rate swaps antitrust litigation

Beginning in November 2015, RBS plc and other members of the Group, as well as a number of other interest rate swap dealers, were named as defendants in a number of class action antitrust complaints filed in the United States District Court for the Southern District of New York and the United States District Court for the Northern District of Illinois. The complaints, filed on behalf of persons who entered into interest rate swaps with the defendants, allege that the defendants violated the US antitrust laws by restraining competition in the market for interest rate swaps through various means and thereby caused inflated bid-ask spreads for interest rate swaps, to the alleged detriment of the plaintiff class.

In addition, two complaints containing similar allegations of collusion were filed in United States District Court for the Southern District of New York on behalf of TeraExchange and Javelin, who allege that they would have successfully established exchange-like trading of interest rate swaps if the defendant dealers had not unlawfully conspired to prevent that from happening through boycotts and other means, in violation

of the U.S. antitrust laws. On 2 June 2016, all of these matters were transferred to the United States District Court for the Southern District of New York for coordinated or consolidated pretrial proceedings.

RBS has made a motion to dismiss the operative complaints in these matters.

Madoff

In December 2010, Irving Picard, as trustee for the bankruptcy estates of Bernard L. Madoff and Bernard L. Madoff Investment Securities LLC., filed a clawback claim against The Royal Bank of Scotland N.V. (RBS N.V.) in the New York bankruptcy court. In the operative complaint, filed in August 2012, the trustee seeks to recover US$75.8 million in redemptions that RBS N.V. allegedly received from certain Madoff feeder funds and US$162.1 million that RBS N.V. allegedly received from its swap counterparties at a time when RBS N.V. allegedly 'knew or should have known of Madoff's possible fraud'. The Trustee alleges that those transfers were preferences or fraudulent conveyances under the US bankruptcy code and New York law and he asserts the purported right to claw them back for the benefit of Madoff's estate. A further claim, for US$21.8 million, was filed in October 2011. On 22 November 2016, the bankruptcy court dismissed the claims filed in October 2011 on the ground that the transfers at issue were extraterritorial to the United States and not subject to the fraudulent conveyance statute upon which the trustee's claim is based.

Thornburg adversary proceeding

RBS Securities Inc. and certain other RBS companies, as well as several other financial institutions, are defendants in an adversary proceeding filed in the US bankruptcy court in Maryland by the trustee for TMST, Inc. (formerly known as Thornburg Mortgage, Inc.). The trustee seeks recovery of transfers made under certain restructuring agreements as, among other things, avoidable fraudulent and preferential conveyances and transfers. On 25 September 2014, the Court largely denied the defendants' motion to dismiss this matter and, as a result, discovery is ongoing.

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CPDO litigation

Claims have been served on RBS N.V. in England, the Netherlands and Australia, relating to the sale of a type of structured financial product known as a constant proportion debt obligation (CPDO). The claims in England and the Netherlands have been settled. The remaining claim in Australia has been settled subject to judicial approval.

Interest rate hedging products litigation

RBS is dealing with a large number of active litigation claims in relation to the sale of interest rate hedging products (IRHPs). In general claimants allege that the relevant interest rate hedging products were mis-sold to them, with some also alleging RBS made misrepresentations in relation to LIBOR. Claims have been brought by customers who were considered under the UK Financial Conduct Authority (FCA) redress programme, as well as customers who were outside of the scope of that programme, which was closed to new entrants on 31 March 2015. RBS encouraged those customers that were eligible to seek redress under the FCA redress programme to participate in that programme. RBS remains exposed to potential claims from customers who were either ineligible to be considered for redress or who are dissatisfied with their redress offers.

Property Alliance Group (PAG) v The Royal Bank of Scotland plc was the leading case before the English High Court involving both IRHP mis-selling and LIBOR misconduct allegations. The amount claimed was approximately £33 million and the trial ended in October 2016. On 21 December 2016 the Court dismissed all of PAG’s claims. The decision (subject to any appeal by PAG) may have significance to other similar LIBOR-related cases currently pending in the English courts, some of which involve substantial amounts. The case of Wall v RBS plc, which concerns similar allegations to those in PAG, is currently scheduled to go to trial October 2017. The sum claimed is between £400 million and £700 million.

In addition to claims alleging that IRHPs were mis-sold, RBS has received a number of claims involving allegations that it breached a legal duty of care in its conduct of the FCA redress programme. These claims have been brought by customers who are dissatisfied with redress offers made to them through the FCA redress programme. The claims followed a preliminary decision against another UK bank. RBS has since been successful in opposing an application by a customer to amend its pleadings to include similar claims against RBS, on the basis that the bank does not owe a legal duty of care to customers in carrying out the FCA review. The customer has been granted leave to appeal by the Court of Appeal, and the appeal is scheduled for May 2017.

Tax dispute

HMRC issued a tax assessment in 2012 against RBS for approximately £86 million regarding a value-added-tax (“VAT”) matter in relation to the trading of European Union Allowances (“EUAs”) by an RBS joint venture subsidiary in 2009. RBS has commenced legal proceedings before the First-tier Tribunal (Tax), a specialist tax tribunal, challenging the assessment (the “Tax Dispute”). Separately, RBS is a named defendant in proceedings before the High Court brought in 2015 by ten companies (all in liquidation) (the “Liquidated Companies”) and their respective liquidators (together, “the Claimants”). The Liquidated Companies previously traded in EUAs in 2009 and are alleged to be defaulting traders within (or otherwise connected to) the EUA supply chains forming the subject of the Tax Dispute. The Claimants are claiming approximately £72.5 million by alleging that RBS dishonestly assisted the directors of the Liquidated Companies in the breach of their statutory duties and/or knowingly participated in the carrying on of the business of the Liquidated Companies with intent to defraud creditors. RBS strongly denies these allegations.

Weiss v. National Westminster Bank Plc (NatWest)

NatWest is defending a lawsuit filed by a number of US nationals (or their estates, survivors, or heirs) who were victims of terrorist attacks in Israel. The plaintiffs allege that NatWest is liable for damages arising from those attacks pursuant to the US Anti-terrorism Act because NatWest previously maintained bank accounts and transferred funds for the Palestine Relief & Development Fund, an organisation which plaintiffs allege solicited funds for Hamas, the alleged perpetrator of the attacks. On 28 March 2013, the trial court (the United States District Court for the Eastern District of New York) granted summary judgment in favour of NatWest on the issue of scienter, but on 22 September 2014, that summary judgment ruling was vacated by the United States Court of Appeals for the Second Circuit. The appeals court returned the case to the trial court for consideration of NatWest's other asserted grounds for summary judgment and, if necessary, for trial. On 31 March 2016, the trial court denied a motion by NatWest to dismiss the case in which NatWest had argued that the court lacked personal jurisdiction over NatWest. NatWest has since asserted other grounds for summary judgment that the trial court has not previously ruled upon.

Anti-Terrorism Act litigation against RBS N.V.

RBS N.V. and certain other financial institutions (HSBC, Barclays, Standard Chartered, Credit Suisse, Bank Saderat, and Commerzbank) are defendants in an action first commenced in the United States District Court for the Eastern District of New York in November 2014 by a number of US nationals (or their estates, survivors, or heirs), most of whom are or were US military personnel, who were killed or injured in more than 90 attacks in Iraq between 2004 and 2011.

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The attacks were allegedly perpetrated by Hezbollah and certain Iraqi terror cells allegedly funded by the Islamic Republic of Iran. According to the plaintiffs' allegations, RBS N.V. and the other defendants are liable for damages arising from the attacks because they allegedly conspired with Iran and certain Iranian banks to assist Iran in transferring money to Hezbollah and the Iraqi terror cells, in violation of the US Anti-terrorism Act, by agreeing to engage in "stripping" of transactions initiated by the Iranian banks so that the Iranian nexus to the transactions would not be detected. Since commencing this matter, the plaintiffs have amended the complaint twice. The second amended complaint is subject to a motion to dismiss that defendants filed on 14 September 2016.

On 2 November 2016, additional plaintiffs filed a second complaint in the United States District Court for the Southern District of Illinois against RBS N.V., the other financial institutions named as defendants to the first complaint and Deutsche Bank. The allegations in the complaint are substantially similar to the allegations contained in the complaint described above.

The plaintiffs are a number of US military personnel (or their estates, survivors, or heirs) who were killed or injured in 21 attacks in Iraq between 2006 and 2011. RBS N.V. has made a motion to have this case transferred to the United States District Court for the Eastern District of New York and intends to move to dismiss the complaint.

Investigations and reviews

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

The NatWest Markets (formerly CIB) segment in particular has been providing information regarding a variety of matters, including, for example, the setting of benchmark rates and related derivatives trading, conduct in the foreign exchange market, and various issues relating to the issuance, underwriting, and sales and trading of fixed-income securities, including structured products and government securities.

Any matters discussed or identified during such discussions and inquiries may result in, among other things, further inquiry or investigation, other action being taken by governmental and regulatory authorities, increased costs being incurred by RBS, remediation of systems and controls, public or private censure, restriction of RBS's business activities and/or fines. Any of the events or circumstances mentioned in this paragraph or below could have a material adverse effect on RBS, its business, authorisations and licences, reputation, results of operations or the price of securities issued by it.

RBS is co-operating fully with the investigations and reviews described below.

RMBS and other securitised products investigations

In the US, RBS is involved in reviews, investigations and proceedings (both formal and informal) by federal and state governmental law enforcement and other agencies and self-regulatory organisations, including the US Department of Justice (DOJ) and various other members of the Residential Mortgage-Backed Securities Working Group (RMBS Working Group) of the Financial Fraud Enforcement Task Force (including several state attorneys general, including those mentioned below), relating to, among other things, issuance, underwriting and trading in RMBS and other mortgage-backed securities, collateralised debt obligations (CDOs), collateralised loan obligations (CLOs) and synthetic products.

In connection with these inquiries, Group companies have received requests for information and subpoenas seeking information about, among other things, the structuring of CDOs, financing to loan originators, purchase of whole loans, sponsorship and underwriting of securitisations, due diligence, representations and warranties, communications with ratings agencies, disclosure to investors, document deficiencies, trading activities and practices and repurchase requests.

These ongoing matters include, among others, active civil and criminal investigations by the DOJ, relating primarily to due diligence on and disclosure related to loans purchased for, or otherwise included in, securitisations and related disclosures.

In June 2016, RBS Securities Inc. (RBSSI), a U.S. broker-dealer, reached an agreement in principle to resolve investigations by the office of the Attorney General of Connecticut on behalf of the Connecticut Department of Banking, concerning RBSSI's underwriting and issuance of RMBS and the potential consequences to RBSSI of RBS plc's May 2015 FX-related guilty plea. The agreement became final on 3 October 2016 through the publication by the Department of Banking of two agreed consent orders without RBSSI admitting or denying the Department of Banking's allegations.

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As required by the RMBS consent order, in addition to making certain undertakings, RBSSI has paid US$120 million to the State of Connecticut to resolve the investigation. The amount was covered by a provision that had previously been established. Pursuant to the FX consent order, RBSSI agreed, among other things, to certify to the Department of Banking its compliance with various obligations undertaken in connection with RBS plc's FX-related guilty plea and FX-related resolutions with the Commodity Futures Trading Commission and Board of Governors of the Federal Reserve System.

In 2007, the New York State Attorney General issued subpoenas to a wide array of participants in the securitisation and securities industry, focusing on the information underwriters obtained from the independent firms hired to perform due diligence on mortgages. RBS completed its production of documents requested by the New York State Attorney General in 2008, principally producing documents related to loans that were pooled into one securitisation transaction.

In May 2011, the New York State Attorney General requested additional information about RBS's mortgage securitisation business and, following the formation of the RMBS Working Group, has focused on the same or similar issues as the other state and federal RMBS Working Group investigations described above. The investigation is ongoing.

As at 31 December 2016, the total aggregate of provisions in relation to certain of the RMBS investigations (described immediately above) and RMBS and other securitised products litigation matters (set out under "Litigation" on page 460), including an additional provision of £3.4 billion ($4.2 billion) in 2016, is £6.8 billion ($8.3 billion). RBS continues to cooperate with the DOJ in its civil and criminal investigations of RMBS matters. The duration and outcome of these investigations and RMBS litigation matters remain uncertain, including in respect of whether settlements for all or any of such matters may be reached. Further substantial provisions and costs may be recognised and, depending on the final outcome, other adverse consequences as described above may occur.

RBSSI has also been responding to an ongoing criminal investigation by the United States Attorney for the District of Connecticut relating to alleged misrepresentations in the trading of various forms of asset-backed securities, including RMBS, commercial mortgage-backed securities, CDOs, and CLOs. In March and December 2015, two former RBSSI traders entered guilty pleas in the United States District Court for the District of Connecticut, each to one count of conspiracy to commit securities fraud while employed at RBSSI. RBSSI is in advanced discussions to resolve the matter.

US mortgages - loan repurchase matters

RBS's NatWest Markets business in North America was a purchaser of non-agency residential mortgages in the secondary market, and an issuer and underwriter of non-agency RMBS.

In issuing RMBS, NatWest Markets in some circumstances made representations and warranties regarding the characteristics of the underlying loans. As a result, NatWest Markets may be, or may have been, contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of such representations and warranties. Depending on the extent to which such loan repurchase related claims are pursued against and not rebutted by NatWest Markets on timeliness or other grounds, the aggregate potential impact on RBS, if any, may be material.

LIBOR and other trading rates

In February 2013, RBS announced settlements with the Financial Services Authority (FSA) in the UK, the United States Commodity Futures Trading Commission (CFTC) and the DOJ in relation to investigations into submissions, communications and procedures around the setting of LIBOR. RBS agreed to pay penalties of £87.5 million, US$325 million and US$150 million to these authorities respectively to resolve the investigations and also agreed to certain undertakings in its settlement with the CFTC. As part of the agreement with the DOJ, RBS plc entered into a Deferred Prosecution Agreement (DPA) in relation to one count of wire fraud relating to Swiss Franc LIBOR and one count for an antitrust violation relating to Yen LIBOR. The DPA expired in April 2015 and is of no further effect.

In April 2013, RBS Securities Japan Limited entered a plea of guilty to one count of wire fraud relating to Yen LIBOR and in January 2014, the US District Court for the District of Connecticut entered a final judgment in relation to the conviction of RBS Securities Japan Limited pursuant to the plea agreement.

In February 2014, RBS paid settlement penalties of approximately €260 million and €131 million to resolve investigations by the European Commission (EC) into Yen LIBOR competition infringements and EURIBOR competition infringements respectively. This matter is now concluded.

In July 2014, RBS entered into an Enforceable Undertaking with the Australian Securities and Investments Commission (ASIC) in relation to potential misconduct involving the Australian Bank Bill Swap Rate. RBS made various undertakings and agreed to make a voluntary contribution of A$1.6 million to fund independent financial literacy projects in Australia.

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In October 2014, the EC announced its findings that (1) RBS and one other financial institution had participated in a bilateral cartel aimed at influencing the Swiss Franc LIBOR benchmark interest rate between March 2008 and July 2009; and (2) RBS and three other financial institutions had participated in a related cartel on bid-ask spreads of Swiss Franc interest rate derivatives in the European Economic Area (EEA). RBS received full immunity from fines.

In December 2016 the Swiss ComCo announced the closure of four separate investigations into RBS and certain other banks relating to interest rate derivatives and LIBOR. RBS received full immunity for fines relating to the Swiss franc LIBOR benchmark investigation. RBS has agreed to pay a total of CHF17.06m in fines to settle the other investigations.

RBS is co-operating with investigations and requests for information by various other governmental and regulatory authorities, including in the UK, US and Asia, into its submissions, communications and procedures relating to a number of trading rates, including LIBOR and other interest rate settings, and non-deliverable forwards.

On 3 February 2017, it was announced that RBS and the CFTC entered into a civil settlement resolving the CFTC’s investigation of ISDAFIX and related trading activities.As part of the settlement, RBS has paid a penalty of US$85 million and agreed to certain undertakings.

Foreign exchange related investigations

In November 2014, RBS plc reached a settlement with the FCA and the CFTC in relation to investigations into failings in RBSG’s FX businesses within its NatWest Markets segment. RBS plc agreed to pay penalties of £217 million to the FCA and US$290 million to the CFTC to resolve the investigations. The fines were paid on 19 November 2014.

On 20 May 2015, RBS plc announced that it had reached settlements with the DOJ and the Board of Governors of the Federal Reserve System (Federal Reserve) in relation to investigations into its FX business within its NatWest Markets segment. RBS plc paid a penalty of US$274 million to the Federal Reserve and agreed to pay a penalty of US$395 million to the DOJ to resolve the investigations.

As part of its plea agreement with the DOJ, RBS plc pled guilty in the United States District Court for the District of Connecticut to a one-count information charging an antitrust conspiracy. RBS plc admitted that it knowingly, through one of its euro/US dollar currency traders, joined and participated in a conspiracy to eliminate competition in the purchase and sale of the euro/US dollar currency pair exchanged in the FX spot market.

The charged conspiracy occurred between as early as December 2007 to at least April 2010. On 5 January 2017, the United States District Court for the District of Connecticut imposed a sentence on RBS plc consisting of the US$395 million criminal fine previously agreed with the DOJ and a term of probation, which among other things, prohibits RBS plc from committing another crime in violation of US law or engaging in the FX trading practices that form the basis for the charged crime and requires RBS plc to implement a compliance program designed to prevent and detect the unlawful conduct at issue and to strengthen its compliance and internal controls as required by other regulators (including the FCA and the CFTC). A violation of the terms of probation could lead to the imposition of additional penalties. Subsequent to the sentencing, RBS plc paid the criminal fine, which had been covered by an existing provision.

RBS plc and RBS Securities Inc. have also entered into a cease and desist order with the Federal Reserve relating to FX and other designated market activities (the FX Order). In the FX Order, which is publicly available and will remain in effect until terminated by the Federal Reserve, RBS plc and RBS Securities Inc. agreed to take certain remedial actions with respect to FX activities and certain other designated market activities, including the creation of an enhanced written internal controls and compliance program, an improved compliance risk management program, and an enhanced internal audit program. RBS plc and RBS Securities Inc. are obligated to implement and comply with these programs as approved by the Federal Reserve, and are also required to conduct, on an annual basis, a review of applicable compliance policies and procedures and a risk-focused sampling of key controls.

RBS is co-operating with investigations and responding to inquiries from other governmental and regulatory (including competition) authorities on similar issues relating to failings in its FX business within its NatWest Markets segment. The timing and amount of financial penalties with respect to any further settlements and related litigation risks and collateral consequences remain uncertain and may well be material.

On 21 July 2014, the Serious Fraud Office in the UK (SFO) announced that it was launching a criminal investigation into allegations of fraudulent conduct in the foreign exchange market, apparently involving multiple financial institutions. On 15 March 2016, the SFO announced that it was closing its investigation, having concluded that, based on the information and material obtained, there was insufficient evidence for a realistic prospect of conviction.

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Interest rate hedging products (IRHP) redress programme

Since 2013, RBS and other banks have been undertaking a redress exercise and past business review in relation to the sale of interest rate hedging products to some small and medium sized businesses classified as retail clients or private customers under FSA rules. This exercise was scrutinised by an independent reviewer, KPMG (appointed as a Skilled Person under section 166 of the Financial Services and Markets Act), and overseen by the FCA. RBS has reached agreement with KPMG in relation to redress determinations for all in scope customers, as well as the majority of the consequential loss claims received.

RBS provisions in relation to the above redress exercises total £1.5 billion to date for these matters, of which £1.4 billion had been utilised at 31 December 2016.

Judicial Review of Skilled Person's role in IRHP review

RBS has been named as an interested party in a number of claims for judicial review of KPMG's decisions as Skilled Person in RBS's previously disclosed IRHP redress programme. This follows a similar claim from a customer of another UK bank, also against KPMG.

All of these claims were stayed pending the outcome of the other bank's case. The trial in that case was heard on 25 January 2016. The court decided in favour of KPMG, finding that (1) KPMG is not a body amenable to judicial review in respect of its role as Skilled Person in this matter; and (2) that there was no unfairness by the other bank in the procedure adopted. The claimant has sought permission to appeal the decision.

The majority of the claims that name RBS as an interested party have been discontinued but there are still several cases which remain stayed pending the outcome of any appeal in the other bank's case. If permission to appeal is granted and the appeal court finds that a section 166-appointed Skilled Person is susceptible to judicial review, these remaining claims against RBS may then proceed to full hearing to assess the fairness of KPMG's role in the redress programme in those particular cases. If deemed unfair, this could have a consequential impact on the reasonableness of the methodology applied to reviewed and settled IRHP files generally. As there remains some uncertainty, it is not practicable reliably to estimate the impact of this matter, if any, on RBS which may be material.

Investment advice review

In February 2013, the FSA announced the results of a mystery shopping review it undertook into the investment advice offered by banks and building societies to retail clients. As a result of that review the FSA announced that firms involved were cooperative and agreed to take immediate action. RBS was one of the firms involved.

The action required included a review of the training provided to advisers, considering whether changes are necessary to both advice processes and controls for new business, and undertaking a past business review to identify any historic poor advice (and where breaches of regulatory requirements are identified, to put this right for customers).

Subsequent to the FSA announcing the results of its mystery shopping review, the FCA has required RBS to carry out a past business review and customer contact exercise on a sample of historic customers that received investment advice on certain lump sum products through the UK Financial Planning channel of the UK Personal & Business Banking (UK PBB) segment of RBS, which includes RBS plc and NatWest, during the period from March 2012 until December 2012.

This review was conducted under section 166 of the Financial Services and Markets Act, under which a Skilled Person was appointed to carry out the exercise. Redress has been paid to certain customers in this sample group. Following discussions with the FCA after issue of the draft section 166 report, RBS agreed with the FCA that it would carry out a wider review/remediation exercise relating to certain investment, insurance and pension sales from 1 January 2011 to present. RBS started writing to the relevant customers during 2016 and redress payments have also commenced. The project is due to finish in Q4 2017. In addition, RBS agreed with the FCA that it would carry out a remediation exercise, for a specific customer segment who were sold a particular structured product, in response to concerns raised by the FCA with regard to (a) the target market for the product and (b) how the product may have been described to customers by certain advisers. Redress has been paid to certain customers who took out the structured product.

RBS provisions in relation to investment advice total £201 million to date for these matters, of which £62 million had been utilised at 31 December 2016.

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Packaged accounts

As a result of an uplift in packaged current account complaints, RBS proactively put in place dedicated resources in 2013 to investigate and resolve complaints on an individual basis. RBS has made gross provisions totalling £409 million to date for this matter.

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 focused 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.

RBS estimates the costs associated with the new complaints review process and the automatic refund of complex fees to be approximately £400 million, which has been recognised as a provision in 2016. This includes operational costs together with the cost of refunded complex fees and the additional estimated redress costs arising from the new complaints process.

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

Multilateral interchange fees

On 11 September 2014, the Court of Justice upheld earlier decisions by the EU Commission and the General Court that MasterCard's multilateral interchange fee (MIF) arrangements for cross border payment card transactions with MasterCard and Maestro branded consumer credit and debit cards in the EEA are in breach of competition law.

In April 2013, the EC announced it was opening a new investigation into interchange fees payable in respect of payments made in the EEA by MasterCard cardholders from non-EEA countries. The EC's case is ongoing.

On 8 June 2015, a regulation on interchange fees for card payments entered into force. The regulation requires the capping of both cross-border and domestic MIF rates for debit and credit consumer cards. The regulation also sets out other reforms including to the Honour All Cards Rule which require merchants to accept all cards with the same level of MIF but not cards with different MIF levels.

On 6 May 2015, the Competition & Markets Authority (CMA), announced that it had closed the investigations into domestic interchange fees on the grounds of administrative priorities.

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Whilst there are no recent developments on the above to report, there remains uncertainty around the outcomes of the ongoing EC investigation, and the impact of the regulation, and they may have a material adverse effect on the structure and operation of four party card payment schemes in general and, therefore, on RBS's business in this sector.

Payment Protection Insurance (PPI)

Since 2011, RBS has been implementing a policy statement agreed with the FCA for the handling of complaints about the mis-selling of PPI. RBS is also monitoring developments following the UK Supreme Court's decision in the case of Plevin v Paragon Personal Finance Ltd in November 2014. That decision was that the sale of a single premium PPI policy could create an 'unfair relationship' under s.140A of the Consumer Credit Act 1974 (the 'Consumer Credit Act') because the premium contained a particularly high level of undisclosed commission.

The Financial Ombudsman Service (FOS) has confirmed on its website that unfair relationship provisions in the Consumer Credit Act and the Plevin judgment are 'potentially relevant considerations' in some of the PPI complaints referred to FOS.

On 26 November 2015, the FCA issued Consultation Paper 15/39, in which it set out proposed rules and guidance for how firms should handle PPI complaints fairly in light of the Plevin decision and how the FOS should consider relevant PPI complaints. The Consultation Paper also contained proposals for the introduction in 2018 on a date to be confirmed of a deadline for submission of PPI complaints. RBS submitted its response to the Consultation Paper on 26 February 2016.

The proposals in the Consultation Paper included an FCA-led communications campaign to raise awareness of the deadline and to prompt those who intend to complain to act ahead of the deadline.

Following feedback received on its Consultation Paper, on 2 August 2016, the FCA issued a further Consultation Paper (CP 16/20) on certain aspects of the proposed rules and guidance. As a result of this second Consultation Paper, it was expected that the complaint deadline would be end of June 2019 rather than 2018 as proposed in the initial Consultation Paper. The BBA and RBS submitted responses to the Consultation Paper on 11 October 2016.

Following feedback received on its second Consultation Paper (CP16/20), on 9 December 2016, the FCA issued a statement explaining that it is carefully considering the issues raised and will make a further announcement before 31 March 2017. In light of this statement, RBS expects that the implementation of the complaint deadline will be pushed back from end of June 2019 to 1 October or 31 December 2019. The introduction of new Plevin rules and guidance will also be delayed.

If the proposals contained in these Consultation Papers are agreed and implemented, RBS would expect higher claims volumes, persisting longer than previously modelled, and additional compensation payments in relation to PPI claims made as a result of the Plevin judgment. If the end of June 2019 deadline is implemented by the FCA, complaints made after that time would lose the right to be assessed by firms or by the Financial Ombudsman Service, bringing an end to new PPI cases on 1 October or 31 December 2019.

RBS has made provisions totalling £4.9 billion to date for PPI claims, including an additional provision of £601 million in 2016, in response to the anticipated further delay in guidance. Of the £4.9 billion cumulative provision, £3.3 billion in redress and £0.4 billion administrative expenses had been utilised by 31 December 2016.

UK retail banking

In November 2014, the CMA announced its decision to proceed with a market investigation reference (MIR) into retail banking, which would cover PCA and SME banking. On 9 August 2016, the CMA published its final report. The CMA concluded that there are a number of competition concerns in the provision of PCAs, business current accounts and SME lending, particularly around low levels of customers searching and switching, resulting in banks not being put under enough competitive pressure, and new products and new banks not attracting customers quickly enough. The final report sets out remedies to address these concerns. These include remedies making it easier for customers to compare products, ensure customers benefit from technological advantages around open banking, improve the current account switching service and provide PCA overdraft customers with greater control over their charges along with additional measures targeted at SME customers.

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On 2 February 2017 the CMA published the Retail Banking Market Investigation Order 2017 which is the primary legal framework setting out the obligations for the implementation of the majority of remedies, including an implementation deadline for each. Other remedies are to be delivered via undertakings signed by Bacs and recommendations to be taken forward by other regulators (including the FCA).

At this stage there remains uncertainty around the financial impact of the remedies once implemented and it is not practicable to estimate the potential impact on RBS, which may be material.

FCA Wholesale Sector Competition Review

In February 2015, the FCA launched a market study into investment and corporate banking. On 18 October 2016 by publication by the FCA published its final report. It found that whilst many clients feel well served by primary capital market services there were some areas where improvements could be made to encourage competition, particularly for smaller clients. It set out a package of remedies, including prohibiting the use of restrictive contractual clauses and ending league table misrepresentation by asking league table providers to review their recognition criteria.

In November 2015, the FCA also announced that a market study would be undertaken into asset management. On 18 November 2016, the FCA published the interim report which indicated that price competition is weak and expressed concerns around the lack of transparency on the objectives, and appropriate benchmarks, for reporting fund performance. The FCA has proposed a number of remedies. The deadline for responses to the interim report was 20 February 2017 and the FCA expects to publish the final report in Q2 2017.

FCA Mortgages Market Study

In December 2016, the FCA launched a market study into the provision of mortgages. The FCA has announced that it intends to publish an interim report in summer 2017 with the final report expected in Quarter 1 2018.

At this very early stage, as there is considerable uncertainty around the outcome of this market study, it is not practicable reliably to estimate the aggregate impact, if any, on RBS which may be material.

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Governance and risk management consent order

In July 2011, RBS agreed with the Board of Governors of the Federal Reserve System, the New York State Banking Department, the Connecticut Department of Banking, and the Illinois Department of Financial and Professional Regulation to enter into a consent Cease and Desist Order (Governance Order) (which is publicly available) to address deficiencies related to governance, risk management and compliance systems and controls in the US branches of RBS plc and RBS N.V. branches (the US Branches).

In the Governance Order, RBS agreed to create the following written plans or programmes:

Key points

- a plan to strengthen board and senior management oversight of the corporate governance, management, risk management, and operations of RBS's US operations on an enterprise-wide and business line basis;
- an enterprise-wide risk management programme for RBS's US operations;
- a plan to oversee compliance by RBS's US operations with all applicable US laws, rules, regulations, and supervisory guidance;
- a Bank Secrecy Act/anti-money laundering compliance programme for the US Branches on a consolidated basis;
- a plan to improve the US Branches' compliance with all applicable provisions of the Bank Secrecy Act and its rules and regulations as well as the requirements of Regulation K of the Federal Reserve;
- a customer due diligence programme designed to ensure reasonably the identification and timely, accurate, and complete reporting by the US Branches of all known or suspected violations of law or suspicious transactions to law enforcement and supervisory authorities, as required by applicable suspicious activity reporting laws and regulations; and
- a plan designed to enhance the US Branches' compliance with Office of Foreign Assets Control (OFAC) requirements.

The Governance Order identified specific items to be addressed, considered, and included in each proposed plan or programme. RBS also agreed in the Governance Order to adopt and implement the plans and programmes after approval by the regulators, to comply fully with the plans and programmes thereafter, and to submit to the regulators periodic written progress reports regarding compliance with the Governance Order.

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RBS has created, submitted, and adopted plans and/or programmes to address each of the areas identified above. In connection with RBS's efforts to implement these plans and programmes, it has, among other things, made investments in technology, hired and trained additional personnel, and revised compliance, risk management, and other policies and procedures for RBS's US operations. RBS continues to test the effectiveness of the remediation efforts it has undertaken to ensure they are sustainable and meet regulators' expectations. Furthermore, RBS continues to work closely with the regulators in its efforts to fulfil its obligations under the Governance Order, which will remain in effect until terminated by the regulators.

RBS may be subject to formal and informal supervisory actions and may be required by its US banking supervisors to take further actions and implement additional remedial measures with respect to these and additional matters. RBS's activities in the US may be subject to significant limitations and/or conditions.

US dollar processing consent order

In December 2013 RBS and RBS plc agreed a settlement with the Federal Reserve, the New York State Department of Financial Services (DFS), and the Office of Foreign Assets Control (OFAC) with respect to RBS plc's historical compliance with US economic sanction regulations outside the US. As part of the settlement, RBS and RBS plc entered into a consent Cease and Desist Order with the Federal Reserve (US Dollar Processing Order), which remains in effect until terminated by the Federal Reserve. The US Dollar Processing Order (which is publicly available) indicated, among other things, that RBS and RBS plc lacked adequate risk management and legal review policies and procedures to ensure that activities conducted outside the US comply with applicable OFAC regulations.

RBS agreed to create an OFAC compliance programme to ensure compliance with OFAC regulations by RBS's global business lines outside the US, and to adopt, implement, and comply with the programme. Prior to and in connection with the US Dollar Processing Order, RBS has made investments in technology, hired and trained personnel, and revised compliance, risk management, and other policies and procedures.

Under the US Dollar Processing Order (as part of the OFAC compliance programme) RBS was required to appoint an independent consultant to conduct an annual review of OFAC compliance policies and procedures and their implementation and an appropriate risk-focused sampling of US dollar payments. RBS appointed the independent consultant and their reports were submitted to the authorities on 14 June 2015. The independent consultant review examined a significant number of sanctions alerts and no reportable issues were identified.

Pursuant to the US Dollar Processing Order, the authorities requested a second annual review to be conducted by an independent consultant. The second review was conducted by the independent consultant and reports were submitted to the authorities on 30 September 2016. In line with the first review, and following examination of a significant number of sanctions alerts, the independent consultant did not identify any reportable issues. In addition, pursuant to requirements of the US Dollar Processing Order, RBS has provided the required written submissions, including quarterly updates, in a timely manner, and RBS continues to participate in a constructive dialogue with the authorities.

US/Swiss tax programme

In August 2013, the DOJ announced a programme for Swiss banks (the Programme) which provides Swiss banks with an opportunity to obtain resolution, through non-prosecution agreements or non-target letters, of the DOJ's investigations of the role that Swiss banks played in concealing the assets of US tax payers in offshore accounts (US related accounts). In December 2013, Coutts & Co Ltd., a member of the Group incorporated in Switzerland, notified the DOJ that it intended to participate in the Programme.

As required by the Programme, Coutts & Co Ltd. subsequently conducted a review of its US related accounts and presented the results of the review to the DOJ. On 23 December 2015, Coutts & Co Ltd. entered into a non-prosecution agreement (the NPA) in which Coutts & Co Ltd. paid a US$78.5 million penalty and acknowledged responsibility for certain conduct set forth in a statement of facts accompanying the agreement. Under the NPA, which has a term of four years, Coutts & Co Ltd. is required, among other things, to provide certain information, cooperate with DOJ's investigations, and commit no U.S. federal offences. If Coutts & Co Ltd. abides by the NPA, the DOJ will not prosecute it for certain tax-related and monetary transaction offenses in connection with US related accounts.

Enforcement proceedings and investigations in relation to Coutts & Co Ltd

The Swiss Financial Market Supervisory Authority (FINMA) has been taking enforcement proceedings against Coutts & Co Ltd, a member of RBS incorporated in Switzerland, with regard to certain client accounts held with Coutts & Co Ltd relating to allegations in connection with the Malaysian sovereign wealth fund 1MDB. On 2 February 2017, FINMA announced that Coutts & Co Ltd had breached money laundering regulations by failing to carry out adequate background checks into business relationships and transactions associated with 1MDB.

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FINMA accordingly required Coutts & Co Ltd to disgorge profits of CHF 6.5 million.

Coutts & Co Ltd is also cooperating with investigations and enquiries from authorities in other jurisdictions in relation to the same subject matter. In this context, the Monetary Authority of Singapore (MAS)'s supervisory examination of Coutts & Co Ltd's Singapore branch revealed breaches of anti-money laundering requirements. MAS imposed on Coutts & Co Ltd financial penalties amounting to SGD 2.4 million in December 2016. The outcomes of other proceedings, investigations and enquiries are uncertain but may include financial consequences and/or regulatory sanctions.

Review of suitability of advice provided by Coutts & Co

In 2013 the FCA conducted a thematic review of the advice processes across the UK wealth management industry. As a result of this review, Coutts & Co undertook a past business review into the suitability of investment advice provided to its clients. This review has concluded, as Coutts & Co has contacted affected clients and offered redress in appropriate cases. The majority of these redress payments have now been paid, having been met by RBS's existing provision.

Regulator requests concerning Mossack Fonseca

In common with other banks, RBS received a letter from the FCA in April 2016 requesting information about any relationship RBS has with the Panama-based law firm Mossack Fonseca or any individuals named in recent media coverage in connection with the same. RBS responded to the FCA setting out details of the limited services provided to Mossack Fonseca and its clients.

Review and investigation of treatment of tracker mortgage customers in Ulster Bank Ireland DAC (formerly Ulster Bank Ireland Limited)

On 22 December 2015, the Central Bank of Ireland (CBI) announced that it had written to a number of lenders requiring them to put in place a robust plan and framework to review the treatment of customers who have been sold mortgages with a tracker interest rate or with a tracker interest rate entitlement. The CBI stated that the intended purpose of the review was to identify any cases where customers' contractual rights under the terms of their mortgage agreements were not fully honoured, or where lenders did not fully comply with various regulatory requirements and standards regarding disclosure and transparency for customers. The CBI has required Ulster Bank Ireland DAC (UBI DAC), a member of RBS, incorporated in the Republic of Ireland, to participate in this review and UBI DAC is co-operating with the CBI in this regard. RBS has made a lifetime provision totalling EUR 211 million for this matter.

Separately, on 15 April 2016, the CBI notified UBI DAC 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.

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32 Net cash flow from operating activities			
	2016	2015	2014
	£m	£m	£m
Operating (loss)/profit before tax - continuing operations	(4,082)	(2,703)	2,643
Profit/(loss) before tax - discontinued operations	—	1,766	(3,207)
(Increases)/decrease in prepayments and accrued income	(42)	410	5
Interest on subordinated liabilities	845	875	886
Decrease in income accruals	(444)	(1,075)	(313)
Impairment losses/(releases)	478	(624)	(1,155)
Loans and advances written-off net of recoveries	(3,586)	(8,789)	(5,073)
Unwind of discount on impairment losses	(113)	(144)	(247)
Profit on sale of property, plant and equipment	(18)	(91)	(137)
Profit on sale of subsidiaries and associates	(22)	(1,135)	(363)
(Profit)/loss on sale of securities	(71)	4	(244)
Charge for defined benefit pension schemes	267	523	466
Pension schemes curtailments or settlements loss/(gain)	1	(65)	—
Cash contribution to defined benefit pension schemes	(4,786)	(1,060)	(1,065)
Other provisions charged net of releases	7,216	4,566	2,711
Other provisions utilised	(2,699)	(2,202)	(3,528)
Depreciation and amortisation	778	1,180	1,109
Loss/(gain) on redemption of own debt	126	263	(20)
Loss on reclassification to disposal groups	—	273	3,994
Write down of goodwill and other intangible assets	159	1,332	533
Elimination of foreign exchange differences	(6,518)	(1,501)	(724)
Other non-cash items	619	599	2,016
Net cash outflow from trading activities	(11,892)	(7,598)	(1,713)
(Increase)/decrease in loans and advances to banks and customers	(12,960)	58,766	11,245
Decrease in securities	16,741	13,149	8,399
Decrease in other assets	1,195	2,808	413
Decrease/(increase) in derivative assets	15,562	91,311	(65,958)
Changes in operating assets	20,538	166,034	(45,901)
Increase/(decrease) in deposits by banks and customers	10,418	(43,597)	(11,508)
Decrease in debt securities in issue	(3,967)	(20,580)	(15,894)
(Decrease)/increase in other liabilities	(422)	4,465	(4,500)
(Decrease)/increase in derivative liabilities	(18,258)	(94,951)	64,424
Increase/(decrease) in settlement balances and short positions	104	(2,782)	(4,881)
Changes in operating liabilities	(12,125)	(157,445)	27,641
Income taxes paid	(171)	(73)	(414)
Net cash (outflow)/inflow from operating activities	(3,650)	918	(20,387)

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Explanation of Responses:

Notes on the consolidated accounts

33 Analysis of the net investment in business interests and intangible assets			
	2016	2015	2014
Acquisitions and disposals	£m	£m	£m
Fair value given for businesses acquired	(87)	(59)	(54)
Net outflow of cash in respect of acquisitions	(87)	(59)	(54)
Net (liabilities)/assets sold	(400)	(2,041)	(1,180)
Non-cash consideration	(5)	—	—
Profit on disposal	22	1,135	363
Net cash and cash equivalents disposed	55	1,959	11
Net (outflow)/inflow of cash in respect of disposals	(328)	1,053	(806)
Dividends received from associates	9	11	10
Cash expenditure on intangible assets	(480)	(614)	(631)
Net (outflow)/inflow	(886)	391	(1,481)

Note:

(1) Includes cash proceeds of £1,628 million in 2015 relating to the disposal of the controlling interest in Citizens.

34 Interest received and paid			
	2016	2015	2014
	£m	£m	£m
Interest received	11,321	11,788	13,453
Interest paid	(2,638)	(3,598)	(4,194)
	8,683	8,190	9,259

35 Analysis of changes in financing during the year							
	Share capital, share premium, paid-in equity and merger reserve				Subordinated liabilities		
	2016	2015	2014		2016	2015	2014
	£m	£m	£m		£m	£m	£m
At 1 January	50,577	45,935	45,582		19,847	22,905	24,012

Issue of ordinary shares	300	307	314				
Issue of Additional Tier 1 capital notes	2,046	2,012	—				
Redemption of paid-in equity	(110)	(150)	—				
Issue of subordinated liabilities					—	—	2,159
Redemption of subordinated liabilities					(3,606)	(3,047)	(3,480)
Net cash inflow/(outflow) from financing	2,236	2,169	314		(3,606)	(3,047)	(1,321)
Conversion of B shares	—	4,590	—				
Ordinary shares issued in respect of employee share schemes	166	225	234				
Reclassification of paid-in equity	—	—	(195)				
Redemption of equity preference shares	—	(1)	—				
Transfer of merger reserve to retained earnings	—	(2,341)	—				
Other adjustments including foreign exchange	—	—	—		3,178	(11)	214
At 31 December	52,979	50,577	45,935		19,419	19,847	22,905

36 Analysis of cash and cash equivalents

	2016	2015	2014
	£m	£m	£m
At 1 January			
- cash	94,832	92,060	101,172
- cash equivalents	8,760	15,844	20,005
	103,592	107,904	121,177
Net cash outflow	(5,022)	(4,312)	(13,273)
At 31 December	98,570	103,592	107,904
Comprising:			
Cash and balances at central banks	74,250	79,404	74,872
Treasury bills and debt securities	387	1,578	1,899
Loans and advances to banks	23,933	22,610	31,133
Cash and cash equivalents	98,570	103,592	107,904

Note:

(1) Includes cash collateral posted with bank counterparties in respect of derivative liabilities of £6,661 million (2015 - £11,031 million; 2014 - £11,508 million).

Notes on the consolidated accounts

36 Analysis of cash and cash equivalents continued

Certain members of RBS are required by law or regulation to maintain balances with the central banks in the jurisdictions in which they operate. These balances are set out below.

	2016	2015	2014
Bank of England	£0.5bn	£0.5bn	£0.6bn
US Federal Reserve	—	—	US$1.3bn
De Nederlandsche Bank	€0.4bn	€0.3bn	€0.2bn

37 Segmental analysis

(a) Reportable segments

The directors manage RBS primarily by class of business and present the segmental analysis on that basis. This includes the review of net interest income for each class of business - interest receivable and payable for all reportable segments is therefore presented net. Segments charge market prices for services rendered between each other; funding charges between segments are determined by RBS Treasury, having regard to commercial demands. The segment performance measure is operating profit/(loss).

Organisational structure

RBS continues to deliver on its plan to build a strong, simple and fair bank for both customers and shareholders. On 5 December 2016 the Corporate & Institutional Banking (CIB) business was re-branded as NatWest Markets (NWM) in readiness for our future ring-fenced structure; this included the renaming of the reportable operating segment as NatWest Markets. NatWest Markets will continue to offer financing, rates and currencies products to its customers. Reported operating segments are as follows:

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

Commercial & Private Banking (CPB) comprises three reportable segments; Commercial Banking, Private Banking and RBS International (RBSI). Commercial Banking serves commercial and mid-corporate customers in the UK and Western Europe. Private Banking serves UK connected high net worth individuals and RBSI serves retail, commercial, corporate and financial institution customers in Jersey, Guernsey, Isle of Man and Gibraltar and financial institution customers in Luxembourg.

NatWest Markets, formerly Corporate and Institutional Banking (CIB), serves UK and Western European corporate customers, and global financial institutions, supported by trading and distribution platforms in the UK, US and Singapore.

Capital Resolution was established to execute the sale or wind down of most of the global footprint, from 38 countries to 13, and trade finance and cash management outside the UK and Ireland. Additionally non-strategic markets, portfolio and banking assets

identified are being sold or wound down.

Williams & Glyn refers to the business formerly intended to be divested as a separate legal entity and comprises the RBS England and Wales branch-based businesses, along with certain small and medium enterprises and corporate activities across the UK. During the period presented W&G has not operated as a separate legal entity. The perimeter of the segment currently reported does not include certain portfolios that were intended to be divested as part of W&G, for example, certain NatWest branches in Scotland.

Central items & other comprises corporate functions, such as RBS Treasury, Finance, Risk Management, Compliance, Legal, Communications and Human Resources. Central functions manages RBS capital resources and RBS-wide regulatory projects and provides services to the reportable segments. Balances relating to Citizens and the international private banking business are also included in relevant years.

Citizens Financial Group

RBS sold the final tranche of its interest in Citizens Financial Group, Inc. during the second half of 2015. Consequently, Citizens was classified as a disposal group at 31 December 2014 and presented as a discontinued operation until October 2015. From 3 August 2015 until the final tranche was sold in October 2015, Citizens was an associated undertaking.

Notes on the consolidated accounts

37 Segmental analysis continued

2016	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses £m	Depreciation and amortisation £m	Impairment (losses)/ releases £m	Operating profit/(loss) £m
UK Personal & Business Banking	4,287	1,003	5,290	(3,828)	2	(83)	1,381
Ulster Bank RoI	409	167	576	(669)	—	113	20
Personal & Business Banking	4,696	1,170	5,866	(4,497)	2	30	1,401
Commercial Banking	2,143	1,272	3,415	(2,324)	(143)	(206)	742
Private Banking	449	208	657	(549)	—	3	111
RBS International	303	71	374	(174)	—	(10)	190
Commercial & Private Banking	2,895	1,551	4,446	(3,047)	(143)	(213)	1,043
NatWest Markets	104	1,470	1,574	(1,959)	(1)	—	(386)
Capital Resolution	239	(601)	(362)	(4,242)	(13)	(253)	(4,870)
Williams & Glyn	658	179	837	(450)	—	(42)	345
Central items & other	116	113	229	(1,221)	(623)	—	(1,615)
Total	8,708	3,882	12,590	(15,416)	(778)	(478)	(4,082)

2015							
UK Personal & Business Banking	4,152	1,048	5,200	(4,177)	—	7	1,030
Ulster Bank RoI	365	185	550	(429)	—	141	262
Personal & Business Banking	4,517	1,233	5,750	(4,606)	—	148	1,292
Commercial Banking	1,997	1,257	3,254	(1,780)	(141)	(69)	1,264
Private Banking	436	208	644	(1,101)	—	(13)	(470)
RBS International	303	64	367	(160)	—	—	207
Commercial & Private Banking	2,736	1,529	4,265	(3,041)	(141)	(82)	1,001

NatWest Markets	87	1,440	1,527	(2,367)	(2)	5	(837)
Capital Resolution	365	174	539	(4,938)	(13)	725	(3,687)
Williams & Glyn	658	175	833	(387)	—	(15)	431
Central items & other	404	(395)	9	166	(1,024)	(54)	(903)
Total	8,767	4,156	12,923	(15,173)	(1,180)	727	(2,703)

2014							
UK Personal & Business Banking	4,221	1,223	5,444	(4,157)	—	(154)	1,133
Ulster Bank RoI	467	137	604	(421)	—	306	489
Personal & Business Banking	4,688	1,360	6,048	(4,578)	—	152	1,622
Commercial Banking	1,976	1,329	3,305	(1,823)	(141)	(85)	1,256
Private Banking	454	235	689	(595)	—	5	99
RBS International	323	68	391	(160)	—	7	238
Commercial & Private Banking	2,753	1,632	4,385	(2,578)	(141)	(73)	1,593
NatWest Markets	(11)	1,942	1,931	(2,650)	—	9	(710)
Capital Resolution	673	1,119	1,792	(2,466)	(31)	1,307	602
Williams & Glyn	664	188	852	(330)	—	(55)	467
Central items & other	491	(349)	142	(327)	(758)	12	(931)
Total	9,258	5,892	15,150	(12,929)	(930)	1,352	2,643

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Notes on the consolidated accounts

37 Segmental analysis continued

	2016			2015			2014		
		Inter			Inter			Inter	
	External	segment	Total	External	segment	Total	External	segment	Total
Total income	£m	£m	£m	£m	£m	£m	£m	£m	£m
UK Personal & Business Banking	5,262	28	5,290	5,137	63	5,200	5,340	104	5,444
Ulster Bank RoI	584	(8)	576	569	(19)	550	559	45	604
Personal & Business Banking	5,846	20	5,866	5,706	44	5,750	5,899	149	6,048
Commercial Banking	3,787	(372)	3,415	3,619	(365)	3,254	3,642	(337)	3,305
Private Banking	554	103	657	534	110	644	542	147	689
RBS International	239	135	374	200	167	367	195	196	391
Commercial & Private Banking	4,580	(134)	4,446	4,353	(88)	4,265	4,379	6	4,385
NatWest Markets	1,722	(148)	1,574	1,530	(3)	1,527	2,046	(115)	1,931
Capital Resolution	(426)	64	(362)	660	(121)	539	1,825	(33)	1,792
Williams & Glyn	853	(16)	837	852	(19)	833	872	(20)	852
Central items & other	15	214	229	(178)	187	9	129	13	142
Total	12,590	-	12,590	12,923	-	12,923	15,150	-	15,150

	2016			2015			2014		
		Inter			Inter			Inter	
	External	segment	Total	External	segment	Total	External	segment	Total
Total revenue	£m	£m	£m	£m	£m	£m	£m	£m	£m
UK Personal & Business Banking	6,285	52	6,337	6,244	51	6,295	6,403	39	6,442
Ulster Bank RoI	660	1	661	640	15	655	672	50	722

Personal & Business Banking	6,945	53	6,998		6,884	66	6,950		7,075	89	7,164
Commercial Banking	3,638	68	3,706		3,482	42	3,524		3,554	51	3,605
Private Banking	567	172	739		577	191	768		624	240	864
RBS International	313	156	469		275	177	452		287	208	495
Commercial & Private Banking	4,518	396	4,914		4,334	410	4,744		4,465	499	4,964
NatWest Markets	1,852	399	2,251		1,838	1,236	3,074		2,536	1,221	3,757
Capital Resolution	(144)	1,140	996		1,259	1,677	2,936		2,920	3,069	5,989
Williams & Glyn	912	—	912		920	—	920		954	—	954
Central items & other	1,862	(1,988)	(126)		1,655	(3,389)	(1,734)		1,895	(4,878)	(2,983)
Total	15,945	—	15,945		16,890	—	16,890		19,845	—	19,845

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Notes on the consolidated accounts

37 Segmental analysis continued

	2016			2015			2014		
	Assets	Liabilities	Cost to acquire fixed assets and intangible assets	Assets	Liabilities	Cost to acquire fixed assets and intangible assets	Assets	Liabilities	Cost to acquire fixed assets and intangible assets
	£m	£m	£m	£m	£m	£m	£m	£m	£m
UK Personal & Business Banking	155,551	148,811	—	143,871	140,659	—	137,827	136,958	—
Ulster Bank RoI	24,111	19,299	—	21,264	15,837	—	22,488	17,962	—
Personal & Business Banking	179,662	168,110	—	165,135	156,496	—	160,315	154,920	—
Commercial Banking	150,453	104,441	288	133,546	94,619	214	127,903	89,754	227
Private Banking	18,578	26,673	—	17,022	23,257	—	17,724	22,558	17
RBS International	23,420	25,280	—	23,130	21,398	—	23,449	20,997	—
Commercial & Private Banking	192,451	156,394	288	173,698	139,274	214	169,076	133,309	244
NatWest Markets	239,963	222,494	—	215,272	193,589	2	276,153	261,477	23
Capital Resolution	132,533	117,977	6	201,476	186,470	27	327,253	272,499	111
Williams & Glyn	25,806	24,229	—	24,088	24,171	—	23,634	22,065	—
	28,241	60,048	1,098	35,739	61,261	1,227	94,588	148,040	1,047

Explanation of Responses:

Central items & other									
	798,656	749,252	1,392	815,408	761,261	1,470	1,051,019	992,310	1,425

Segmental analysis of assets and liabilities included in disposal groups:						
	2016		2015		2014	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m	£m	£m
RBS International	—	—	—	—	2	—
NatWest Markets	—	—	—	—	18	14
Capital Resolution	13	15	130	251	569	2
Central items & other	—	—	3,356	2,729	81,422	71,304
	13	15	3,486	2,980	82,011	71,320

Segmental analysis of goodwill is as follows:					
	UK Personal & Business Banking	Commercial Banking	Private Banking	RBS International	Total
	£m	£m	£m	£m	£m
At 1 January 2015	3,351	1,907	706	300	6,264
Transfer to disposal groups	—	—	(220)	—	(220)
Currency translation and other adjustments	—	—	12	—	12
Write down of goodwill - continuing operations	—	—	(498)	—	(498)
At 1 January 2016	3,351	1,907	—	300	5,558
Transfers to disposal groups	—	—	—	—	—
Currency translation and other adjustments	—	—	—	—	—
Write down of goodwill - continuing operations	—	—	—	—	—
At 31 December 2016	3,351	1,907	—	300	5,558

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Notes on the consolidated accounts

37 Segmental analysis continued

(b) Geographical segments					
The geographical analysis in the tables below has been compiled on the basis of location of office where the transactions are recorded.					
	UK	USA	Europe	RoW	Total
2016	£m	£m	£m	£m	£m
Total revenue	14,606	264	738	337	15,945
Net interest income	8,243	82	302	81	8,708
Net fees and commissions	2,287	9	175	64	2,535
Income from trading activities	790	159	18	7	974
Other operating income	261	(40)	9	143	373
Total income	11,581	210	504	295	12,590
Operating (loss)/profit before tax	(2,214)	(1,652)	(266)	50	(4,082)
Total assets	715,685	44,447	32,142	6,382	798,656
Of which total assets held for sale	—	13	—	—	13
Total liabilities	675,089	44,513	26,311	3,339	749,252
Of which total liabilities held for sale	—	15	—	—	15
Net assets attributable to equity owners and non-controlling interests	40,596	(66)	5,831	3,043	49,404
Contingent liabilities and commitments	141,963	639	8,038	51	150,691
Cost to acquire property, plant and equipment and intangible assets	1,323	3	54	12	1,392
2015					
Total revenue	14,724	315	1,247	604	16,890
Net interest income	7,947	162	407	251	8,767
Net fees and commissions	2,377	139	334	83	2,933
Income from trading activities	942	44	85	(11)	1,060
Other operating income	102	(118)	34	145	163
Total income	11,368	227	860	468	12,923
Operating profit before tax	(87)	(2,723)	261	(154)	(2,703)

Total assets	673,409	77,514	42,133	22,352	815,408
Of which total assets held for sale	—	15	1,251	2,220	3,486
Total liabilities	630,818	75,971	34,942	19,530	761,261
Of which total liabilities held for sale	—	16	418	2,546	2,980
Net assets attributable to equity owners and non-controlling interests	42,591	1,543	7,191	2,822	54,147
Contingent liabilities and commitments	127,781	9,729	14,961	1,281	153,752
Cost to acquire property, plant and equipment and intangible assets	1,331	70	36	33	1,470
2014					
Total revenue	15,913	1,261	1,817	854	19,845
Net interest income	7,976	223	637	422	9,258
Net fees and commissions	2,483	285	595	176	3,539
Income from trading activities	530	538	238	(21)	1,285
Other operating income	941	89	(83)	121	1,068
Total income	11,930	1,135	1,387	698	15,150
Operating (loss)/profit before tax	828	375	1,354	86	2,643
Total assets	780,141	182,471	51,227	37,180	1,051,019
Of which total assets held for sale	48	80,985	—	978	82,011
Total liabilities	746,343	166,489	45,417	34,061	992,310
Of which total liabilities held for sale	2	71,282	—	36	71,320
Net assets attributable to equity owners and non-controlling interests	33,798	15,982	5,810	3,119	58,709
Contingent liabilities and commitments	103,576	89,002	41,399	7,209	241,186
Cost to acquire property, plant and equipment and intangible assets	1,025	244	133	23	1,425

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Explanation of Responses:

Notes on the consolidated accounts

38 Directors' and key management remuneration		
	2016	2015
Directors' remuneration	£000	£000
Non-executive directors emoluments	1,466	1,466
Chairman and executive directors emoluments	5,801	5,781
	7,267	7,247
Amounts receivable under long-term incentive plans and share option plans	993	324
	8,260	7,571

No directors accrued benefits under defined benefit schemes or money purchase schemes during 2016 and 2015.

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

Compensation of key management

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

	2016	2015
	£000	£000
Short-term benefits	20,350	19,395
Post-employment benefits	471	435
Share-based payments	2,606	3,472
	23,427	23,302

Key management comprises members of the Executive Committee.

39 Transactions with directors and key management

(a) At 31 December 2016, amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions, as defined in UK legislation, in the Group, were £207,284 in respect of loans to four persons who were directors of the company at any time during the financial period.

(b) For the purposes of IAS 24 'Related Party Disclosures', key management comprise directors of the company and members of the Executive Committee. The captions in the Group's primary financial statements include the following amounts attributable, in aggregate, to key management:

	2016	2015
	£000	£000
Loans and advances to customers	3,276	2,741
Customer accounts	17,045	12,332

Key management have banking relationships with Group entities which are entered into in the normal course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with other persons of a similar standing or, where applicable, with other employees. These transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Notes on the consolidated accounts

40 Related parties

UK Government

On 1 December 2008, the UK Government through HM Treasury became the ultimate controlling party of The Royal Bank of Scotland Group plc. The UK Government's shareholding is managed by UK Financial Investments Limited, a company wholly owned by the UK Government. As a result, the UK Government and UK Government controlled bodies became related parties of the Group. During 2015, all of the B shares held by the UK Government were converted into ordinary shares of £1 each (see Note 24).

The Group enters into transactions with many of these bodies on an arm’s length basis. Transactions include the payment of: taxes principally UK corporation tax (see Note 6) and value added tax; national insurance contributions; local authority rates; and regulatory fees and levies (including the bank levy (see Note 3) and FSCS levies (see Note 30) together with banking transactions such as loans and deposits undertaken in the normal course of banker-customer relationships.

Bank of England facilities

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

Members of the Group that are UK authorised institutions are required to maintain non-interest bearing (cash ratio) deposits with the Bank of England amounting to 0.18% of their average eligible liabilities in excess of £600 million. They also have access to Bank of England reserve accounts: sterling current accounts that earn interest at the Bank of England Rate.

Other related parties

(a) In their roles as providers of finance, RBS companies provide development and other types of capital support to businesses. These investments are made in the normal course of business and on arm's length terms. In some instances, the investment may extend to ownership or control over 20% or more of the voting rights of the investee company. However, these investments are not considered to give rise to transactions of a materiality requiring disclosure under IAS 24.

(b) RBS recharges The Royal Bank of Scotland Group Pension Fund with the cost of administration services incurred by it. The amounts involved are not material to the Group.

(c) In accordance with IAS 24, transactions or balances between RBS entities that have been eliminated on consolidation are not reported.

(d) The captions in the primary financial statements of the parent company include amounts attributable to subsidiaries. These amounts have been disclosed in aggregate in the relevant notes to the financial statements.

41 Post balance sheet events

There have been no other significant events between 31 December 2016 and the date of approval of these accounts which would require a change to or additional disclosure in the accounts.

42 Consolidating financial information

The Royal Bank of Scotland plc ('RBS plc') is a wholly owned subsidiary of The Royal Bank of Scotland Group plc ('RBSG plc') and is able to offer and sell certain securities in the US from time to time pursuant to a registration statement on Form F-3 filed with the SEC with a full and unconditional guarantee from RBSG plc.

RBS plc utilises an exception provided in Rule 3-10 of Regulation S-X, and therefore does not file its financial statements with the SEC. In accordance with the requirements to qualify for the exception, presented below is condensed consolidating financial information for:

- RBSG plc on a stand-alone basis as guarantor;
- RBS plc on a stand-alone basis as issuer;
- Non-guarantor Subsidiaries of RBSG plc and RBS plc on a combined basis ('Subsidiaries');
- Consolidation adjustments; and
- RBSG plc consolidated amounts ('RBSG Group').

Under IAS 27, RBSG plc and RBS plc account for investments in their subsidiary undertakings at cost less impairment. Rule 3-10 of Regulation S-X requires a company to account for its investments in subsidiary undertakings using the equity method, which would increase the results for the period of RBSG plc and decrease RBS plc in the information below by £142 million and £1,316 million respectively for the year ended 31 December 2016 (increase by £379 million and decreased by £875 million for the year ended 31 December 2015; decreased by £3,920 million and £1,115 million for the year ended 31 December 2014).

The net assets of RBSG plc and RBS plc in the information below would also be decreased by £6,108 million and £10,119 million respectively at 31 December 2016 (decreased £6,883 million and £9,324 million at 31 December 2015).

Notes on the consolidated accounts

42 Consolidating financial information continued

Income statement

For the year ended 31 December 2016	RBSG plc £m	RBS plc £m	Subsidiaries £m	Consolidation adjustments £m	RBS Group £m
Net interest income	267	2,139	6,050	252	8,708
Non-interest income	(4,945)	5,356	(5,099)	8,570	3,882
Total income	(4,678)	7,495	951	8,822	12,590
Operating expenses	(738)	(9,885)	(5,911)	340	(16,194)
Impairment (losses)/releases	—	(546)	(4)	72	(478)
Operating (loss)/profit before tax	(5,416)	(2,936)	(4,964)	9,234	(4,082)
Tax credit/(charge)	7	(515)	(827)	169	(1,166)
(Loss)/profit for the year	(5,409)	(3,451)	(5,791)	9,403	(5,248)
Attributable to:					
Non-controlling interests	—	—	5	5	10
Preference shareholders	260	23	—	(23)	260
Paid-in equity holders	235	—	—	9	244
Dividend access share	1,193	—	—	—	1,193
Ordinary shareholders	(7,097)	(3,474)	(5,796)	9,412	(6,955)
	(5,409)	(3,451)	(5,791)	9,403	(5,248)

Statement of comprehensive income

For the year ended 31 December 2016	RBSG plc £m	RBS plc £m	Subsidiaries £m	Consolidation adjustments £m	RBS Group £m
(Loss)/profit for the year	(5,409)	(3,451)	(5,791)	9,403	(5,248)
Items that do not qualify for reclassification					
Profit/(loss) on remeasurement of retirement benefit schemes	—	63	(1,112)	—	(1,049)
Tax (charge)/credit	—	(21)	309	—	288
	—	42	(803)	—	(761)
Items that do qualify for reclassification					
Available-for-sale financial assets	—	(61)	293	(326)	(94)
Cash flow hedges	189	(40)	1	615	765
Currency translation	—	(90)	709	644	1,263
Tax (charge)/credit	(35)	28	50	(149)	(106)

	154	(163)	1,053	784	1,828
Other comprehensive income/(loss) after tax	154	(121)	250	784	1,067
Total comprehensive (loss)/income for the year	(5,255)	(3,572)	(5,541)	10,187	(4,181)
Total comprehensive (loss)/income is attributable to:					
Non-controlling interests	—	—	87	34	121
Preference shareholders	260	23	—	(23)	260
Paid-in equity holders	235	—	—	9	244
Dividend access share	1,193	—	—	—	1,193
Ordinary shareholders	(6,943)	(3,595)	(5,628)	10,167	(5,999)
	(5,255)	(3,572)	(5,541)	10,187	(4,181)

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Notes on the consolidated accounts

42 Consolidating financial information continued

Income statement

For the year ended 31 December 2015	RBSG plc £m	RBS plc £m	Subsidiaries (1) £m	Consolidation adjustments (2) £m	RBS Group £m
Net interest income	401	2,327	6,988	(949)	8,767
Non-interest income	(2,239)	4,629	(448)	2,214	4,156
Total income	(1,838)	6,956	6,540	1,265	12,923
Operating expenses	38	(8,667)	(8,625)	901	(16,353)
Impairment (losses)/releases	(5)	260	314	158	727
Operating (loss)/profit before tax	(1,805)	(1,451)	(1,771)	2,324	(2,703)
Tax (charge)/credit	(177)	420	(552)	286	(23)
(Loss)/profit from continuing operations	(1,982)	(1,031)	(2,323)	2,610	(2,726)
Profit from discontinued operations, net of tax	—	—	16	1,525	1,541
(Loss)/profit for the year	(1,982)	(1,031)	(2,307)	4,135	(1,185)
Attributable to:					
Non-controlling interests	—	—	2	407	409
Preference shareholders	297	44	—	(44)	297
Paid-in equity holders	79	—	—	9	88
Ordinary shareholders	(2,358)	(1,075)	(2,309)	3,763	(1,979)
	(1,982)	(1,031)	(2,307)	4,135	(1,185)

Statement of comprehensive income

For the year ended 31 December 2015	RBSG plc £m	RBS plc £m	Subsidiaries (1) £m	Consolidation adjustments (2) £m	RBS Group £m
(Loss)/profit for the year	(1,982)	(1,031)	(2,307)	4,135	(1,185)
Items that do not qualify for reclassification					
Profit/(loss) on remeasurement of retirement benefit schemes	—	84	(157)	—	(73)
Tax (charge)/credit	—	(20)	326	—	306
	—	64	169	—	233
Items that do qualify for reclassification					

Available-for-sale financial assets	—	77	(96)	63	44
Cash flow hedges	40	(546)	93	(287)	(700)
Currency translation	—	54	(206)	(1,029)	(1,181)
Tax (charge)/credit	(8)	45	(21)	92	108
	32	(370)	(230)	(1,161)	(1,729)
Other comprehensive income/(loss) after tax	32	(306)	(61)	(1,161)	(1,496)
Total comprehensive (loss)/income for the year	(1,950)	(1,337)	(2,368)	2,974	(2,681)
Total comprehensive (loss)/income is attributable to:					
Non-controlling interests	—	—	(77)	447	370
Preference shareholders	297	44	—	(44)	297
Paid-in equity holders	79	—	—	9	88
Ordinary shareholders	(2,326)	(1,381)	(2,291)	2,562	(3,436)
	(1,950)	(1,337)	(2,368)	2,974	(2,681)
For notes to this table please see page 489.					

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Notes on the consolidated accounts

42 Consolidating financial information continued **Income statement**					
				Consolidation	RBS
	RBSG plc	RBS plc	Subsidiaries (1)	adjustments (2)	Group
For the year ended 31 December 2014	£m	£m	£m	£m	£m
Net interest income	257	2,995	7,770	(1,764)	9,258
Non-interest income	980	4,880	1,693	(1,661)	5,892
Total income	1,237	7,875	9,463	(3,425)	15,150
Operating expenses	(151)	(8,880)	(7,261)	2,433	(13,859)
Impairment releases	15	46	1,051	240	1,352
Operating profit/(loss) before tax	1,101	(959)	3,253	(752)	2,643
Tax credit/(charge)	27	(1,099)	(1,299)	462	(1,909)
Profit/(loss) from continuing operations	1,128	(2,058)	1,954	(290)	734
Profit/(loss) from discontinued operations, net of tax	—	—	42	(3,487)	(3,445)
Profit/(loss) for the year	1,128	(2,058)	1,996	(3,777)	(2,711)
Attributable to:					
Non-controlling interests	—	—	4	56	60
Preference shareholders	330	61	—	(61)	330
Paid-in equity holders	28	—	—	21	49
Dividend access share	320	—	—	—	320
Ordinary shareholders	450	(2,119)	1,992	(3,793)	(3,470)
	1,128	(2,058)	1,996	(3,777)	(2,711)

Statement of comprehensive income					
				Consolidation	RBS
	RBSG plc	RBS plc	Subsidiaries (1)	adjustments (2)	Group
For the year ended 31 December 2014	£m	£m	£m	£m	£m
Profit/(loss) for the year	1,128	(2,058)	1,996	(3,777)	(2,711)
Items that do not qualify for reclassification					
Loss on remeasurement of retirement benefit schemes	—	(107)	(1,750)	—	(1,857)
Tax	—	16	298	—	314
	—	(91)	(1,452)	—	(1,543)

Items that do qualify for reclassification					
Available-for-sale financial assets	—	(62)	775	94	807
Cash flow hedges	—	506	277	630	1,413
Currency translation	—	111	316	(120)	307
Tax	—	(89)	(156)	(210)	(455)
	—	466	1,212	394	2,072
Other comprehensive income/(loss) after tax	—	375	(240)	394	529
Total comprehensive income/(loss) for the year	1,128	(1,683)	1,756	(3,383)	(2,182)
Total comprehensive income/(loss) is attributable to:					
Non-controlling interests	—	—	(40)	286	246
Preference shareholders	330	61	—	(61)	330
Paid-in equity holders	28	—	—	21	49
Dividend access share	320	—	—	—	320
Ordinary shareholders	450	(1,744)	1,796	(3,629)	(3,127)
	1,128	(1,683)	1,756	(3,383)	(2,182)
For notes to this table see page 489.					

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Notes on the consolidated accounts

42 Consolidating financial information continued

Balance sheet

At 31 December 2016	RBSG plc £m	RBS plc £m	Subsidiaries £m	Consolidation adjustments £m	RBS Group £m
Assets					
Cash and balances at central banks	—	70,615	3,635	—	74,250
Loans and advances to banks	28,867	39,018	129,665	(167,412)	30,138
Loans and advances to customers	97	160,191	218,966	(27,304)	351,950
Debt securities	398	67,669	16,041	(11,586)	72,522
Equity shares	—	298	1,342	(937)	703
Investments in Group undertakings	44,608	35,169	2,122	(81,899)	—
Settlement balances	—	4,707	1,647	(828)	5,526
Derivatives	373	251,476	6,312	(11,180)	246,981
Intangible assets	—	521	566	5,393	6,480
Property, plant and equipment	—	1,523	3,071	(4)	4,590
Deferred tax	—	272	1,660	(129)	1,803
Prepayments, accrued income and other assets	70	1,563	2,414	(347)	3,700
Assets of disposals groups	—	591	13	(591)	13
Total assets	74,413	633,613	387,454	(296,824)	798,656
Liabilities					
Deposits by banks	944	139,288	50,930	(152,606)	38,556
Customer accounts	—	142,218	278,228	(39,478)	380,968
Debt securities in issue	6,832	18,881	3,934	(2,402)	27,245
Settlement balances	—	2,774	1,699	(828)	3,645
Short positions	—	17,590	4,591	(104)	22,077
Derivatives	260	240,898	6,497	(11,180)	236,475
Provisions for liabilities and charges	875	4,884	7,077	—	12,836
Accruals and other liabilities	73	3,269	3,785	(136)	6,991
Retirement benefit liabilities	—	65	293	5	363
Deferred tax	44	—	701	(83)	662
Subordinated liabilities	10,668	17,870	2,789	(11,908)	19,419
Liabilities of disposal groups	—	—	15	—	15
Total liabilities	19,696	587,737	360,539	(218,720)	749,252
Non-controlling interests	—	—	483	312	795

Owners' equity	54,717	45,876	26,432	(78,416)	48,609
Total equity	54,717	45,876	26,915	(78,104)	49,404
Total liabilities and equity	74,413	633,613	387,454	(296,824)	798,656

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Explanation of Responses:

Notes on the consolidated accounts

42 Consolidating financial information continued

Balance sheet

At 31 December 2015	RBSG plc £m	RBS plc £m	Subsidiaries £m	Consolidation adjustments £m	RBS Group £m
Assets					
Cash and balances at central banks	—	76,904	2,595	(95)	79,404
Loans and advances to banks	22,148	45,350	149,771	(186,623)	30,646
Loans and advances to customers	268	161,652	200,351	(28,379)	333,892
Debt securities	1,119	76,602	16,153	(11,777)	82,097
Equity shares	—	931	1,058	(628)	1,361
Investments in Group undertakings	52,129	34,482	5,832	(92,443)	—
Settlement balances	—	3,053	2,173	(1,110)	4,116
Derivatives	217	265,601	4,955	(8,259)	262,514
Intangible assets	—	544	626	5,367	6,537
Property, plant and equipment	—	1,612	2,865	5	4,482
Deferred tax	—	902	1,824	(95)	2,631
Prepayments, accrued income and other assets	3	1,549	2,861	(171)	4,242
Assets of disposals groups	—	—	3,326	160	3,486
Total assets	75,884	669,182	394,390	(324,048)	815,408
Liabilities					
Deposits by banks	907	147,220	70,038	(179,869)	38,296
Customer accounts	—	138,774	256,042	(24,518)	370,298
Debt securities in issue	5,049	23,361	6,441	(3,701)	31,150
Settlement balances	—	2,363	2,137	(1,110)	3,390
Short positions	—	17,593	3,216	—	20,809
Derivatives	65	257,372	5,523	(8,255)	254,705
Provisions for liabilities and charges	—	1,847	5,519	—	7,366
Accruals and other liabilities	175	3,829	3,628	117	7,749
Retirement benefit liabilities	—	112	3,656	21	3,789
Deferred tax	8	—	841	33	882
Subordinated liabilities	9,366	25,534	4,600	(19,653)	19,847
Liabilities of disposal groups	—	—	2,742	238	2,980
Total liabilities	15,570	618,005	364,383	(236,697)	761,261
Non-controlling interests	—	—	401	315	716

Owners' equity	60,314	51,177	29,606	(87,666)	53,431
Total equity	60,314	51,177	30,007	(87,351)	54,147
Total liabilities and equity	75,884	669,182	394,390	(324,048)	815,408

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Notes on the consolidated accounts

42 Consolidating financial information continued **Balance sheet**					
				Consolidation	RBS
	RBSG plc	RBS plc	Subsidiaries (1)	adjustments (2)	Group
At 31 December 2014	£m	£m	£m	£m	£m
Assets					
Cash and balances at central banks	—	70,952	4,542	(622)	74,872
Loans and advances to banks	24,490	54,901	160,668	(196,324)	43,735
Loans and advances to customers	299	217,777	260,750	(100,588)	378,238
Debt securities	911	87,594	39,221	(41,077)	86,649
Equity shares	—	4,880	1,954	(1,199)	5,635
Investments in Group undertakings	54,858	39,857	9,428	(104,143)	—
Settlement balances	—	3,381	2,017	(731)	4,667
Derivatives	179	359,825	9,841	(16,255)	353,590
Intangible assets	—	917	5,523	1,341	7,781
Property, plant and equipment	—	1,976	4,669	(478)	6,167
Deferred tax	—	733	1,776	(598)	1,911
Prepayments, accrued income and other assets	193	2,203	5,670	(2,303)	5,763
Assets of disposals groups	—	—	1,044	80,967	82,011
Total assets	80,930	844,996	507,103	(382,010)	1,051,019
Liabilities					
Deposits by banks	1,202	174,455	79,707	(194,699)	60,665
Customer accounts	—	173,516	316,688	(98,565)	391,639
Debt securities in issue	7,510	36,743	24,358	(18,331)	50,280
Settlement balances	—	3,098	2,136	(731)	4,503
Short positions	—	16,590	6,893	(454)	23,029
Derivatives	30	354,747	11,025	(15,997)	349,805
Provisions for liabilities and charges	—	1,570	3,204	—	4,774
Accruals, income and other liabilities	165	4,052	5,027	(672)	8,572
Retirement benefit liabilities	—	192	4,301	(175)	4,318

Deferred tax	—	—	1,244	(744)	500
Subordinated liabilities	10,708	27,480	5,876	(21,159)	22,905
Liabilities of disposal groups	—	—	52	71,268	71,320
Total liabilities	19,615	792,443	460,511	(280,259)	992,310
Non-controlling interests	—	—	451	2,495	2,946
Owners' equity	61,315	52,553	46,141	(104,246)	55,763
Total equity	61,315	52,553	46,592	(101,751)	58,709
Total liabilities and equity	80,930	844,996	507,103	(382,010)	1,051,019
Notes:					
(1) The financial statements of CFG are incorporated on a line-by-line basis up to 3 August 2015 and was fully disposed of on 30 October 2015.					
(2) Includes adjustments to present CFG as a disposal group to the disposal date.					

Explanation of Responses:

Notes on the consolidated accounts

42 Consolidating financial information continued

Cash flow statement

For the year ended 31 December 2016	RBSG plc £m	RBS plc £m	Subsidiaries £m	Consolidation adjustments £m	RBS Group £m
Net cash flows from operating activities	(3,026)	3,098	(6,228)	2,506	(3,650)
Net cash flows from investing activities	2,538	(4,495)	(1,962)	(440)	(4,359)
Net cash flows from financing activities	(1,445)	(13,459)	(2,042)	11,839	(5,107)
Effects of exchange rate changes on cash and cash equivalents	122	7,316	4,260	(3,604)	8,094
Net(decrease)/increase in cash and cash equivalents	(1,811)	(7,540)	(5,972)	10,301	(5,022)
Cash and cash equivalents at 1 January 2016	3,006	106,613	95,403	(101,430)	103,592
Cash and cash equivalents at 31 December 2016	1,195	99,073	89,431	(91,129)	98,570

For the year ended 31 December 2015	RBSG plc £m	RBS plc £m	Subsidiaries £m	Consolidation adjustments £m	RBS Group £m
Net cash flows from operating activities	3,593	5,488	5,832	(13,995)	918
Net cash flows from investing activities	(183)	2,456	(7,941)	802	(4,866)
Net cash flows from financing activities	(1,518)	(3,276)	3,163	691	(940)
Effects of exchange rate changes on cash and cash equivalents	9	575	333	(341)	576
Net increase/(decrease) in cash and cash equivalents	1,901	5,243	1,387	(12,843)	(4,312)
Cash and cash equivalents at 1 January 2015	1,105	101,370	94,016	(88,587)	107,904
Cash and cash equivalents at 31 December 2015	3,006	106,613	95,403	(101,430)	103,592

For the year ended 31 December 2014	RBSG plc £m	RBS plc £m	Subsidiaries £m	Consolidation adjustments £m	RBS Group £m
Net cash flows from operating activities	(3,159)	(27,651)	(17,376)	27,799	(20,387)
Net cash flows from investing activities	1,782	8,437	(5,110)	1,500	6,609
Net cash flows from financing activities	1,140	(4,585)	2,654	387	(404)

Effects of exchange rate changes on cash and cash equivalents	(3)	541	344	27	909
Net(decrease)/increase in cash and cash equivalents	(240)	(23,258)	(19,488)	29,713	(13,273)
Cash and cash equivalents at 1 January 2014	1,345	124,628	113,504	(118,300)	121,177
Cash and cash equivalents at 31 December 2014	1,105	101,370	94,016	(88,587)	107,904

Trust preferred securities

The Group has issued trust preferred securities through trusts 100% owned by the Group (through partnership interests held by RBSG Capital Corporation and RBS) which meet the definition of a finance subsidiary in Regulation S-X, Rule 3-10. The securities represent undivided beneficial interests in the assets of the trusts, which consist of partnership preferred securities representing non-cumulative perpetual preferred limited partnership interests issued by Delaware limited partnerships. The Royal Bank of Scotland Group plc has provided subordinated guarantees for the benefit of the holders of the trust preferred securities and the partnership preferred securities. Under the terms of the guarantees, the Group has fully and unconditionally guaranteed on a subordinated basis, payments on such trust preferred securities and partnership preferred securities, to the extent they are due to be paid and have not been paid by, or on behalf of the trusts and the partnerships, as the case may be. Following implementation of IFRS 10 the trusts are no longer consolidated by the Group. For those trust preferred securities that were classified as non-controlling interests, the Group’s outstanding instruments with the trusts have been classified as Other equity. For those securities that were classified as subordinated liabilities, the Group’s outstanding instruments with the trusts are classified as subordinated liabilities.

Additional information

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Additional information

Financial summary

RBS's financial statements are prepared in accordance with IFRS. Selected data under IFRS for each of the last five years is presented below.

Summary consolidated income statement	2016	2015	2014	2013	2012
	£m	£m	£m	£m	£m
Net interest income	8,708	8,767	9,258	9,017	9,356
Non-interest income (1,2,3)	3,882	4,156	5,892	7,720	5,359
Total income	12,590	12,923	15,150	16,737	14,715
Operating expenses (4)	(16,194)	(16,353)	(13,859)	(17,466)	(15,757)
(Loss)/profit before impairment (losses)/releases	(3,604)	(3,430)	1,291	(729)	(1,042)
Impairment (losses)/releases	(478)	727	1,352	(8,120)	(5,010)
Operating (loss)/profit before tax	(4,082)	(2,703)	2,643	(8,849)	(6,052)
Tax charge	(1,166)	(23)	(1,909)	(186)	(156)
(Loss)/profit from continuing operations	(5,248)	(2,726)	734	(9,035)	(6,208)
Profit/(loss) from discontinued operations, net of tax (5)	—	1,541	(3,445)	558	318
Loss for the year	(5,248)	(1,185)	(2,711)	(8,477)	(5,890)
Attributable to:					
Non-controlling interests	10	409	60	120	(136)
Preference shareholders	260	297	330	349	273
Paid-in equity holders	244	88	49	49	28
Dividend access share	1,193	—	320	—	—
Ordinary shareholders	(6,955)	(1,979)	(3,470)	(8,995)	(6,055)
	(5,248)	(1,185)	(2,711)	(8,477)	(5,890)

Notes:

(1) Includes profit on strategic disposals of £164 million (2015 - £157 million loss; 2014 - £191 million profit; 2013 - £161 million profit; 2012 - £111 million profit).

(2) Includes loss on redemption of own debt of £126 million (2015 - £263 million loss; 2014 - £20 million gain; 2013 - £175 million gain; 2012 - £454 million gain).

(3) Includes own credit adjustments of £180 million gain (2015 - £309 million gain; 2014 - £146 million loss; 2013 - £120 million loss; 2012 - £4,649 million loss).

(4) Includes write down of goodwill of nil in 2016 (2015 - £498 million; 2014 - £130 million; 2013 - £1,059 million; 2012 - £18 million).

(5) Includes a gain of £1,117 million relating to the sell-down of Citizens in 2015 (2014 - £3,994 million loss).

Summary consolidated balance sheet	2016	2015	2014	2013	2012
	£m	£m	£m	£m	£m
Loans and advances	382,088	364,538	421,973	494,793	564,086
Debt securities and equity shares	73,225	83,458	92,284	122,410	172,670
Derivatives and settlement balances	252,507	266,630	358,257	293,630	447,644
Other assets	90,836	100,782	178,505	116,989	127,873
Total assets	798,656	815,408	1,051,019	1,027,822	1,312,273
Owners' equity	48,609	53,431	55,763	58,658	68,639
Non-controlling interests	795	716	2,946	473	1,770
Subordinated liabilities	19,419	19,847	22,905	24,012	26,773
Deposits	419,524	408,594	452,304	534,859	622,684
Derivatives, settlement balances and short positions	262,197	278,904	377,337	318,861	467,802
Other liabilities	48,112	53,916	139,764	90,959	124,605
Total liabilities and equity	798,656	815,408	1,051,019	1,027,822	1,312,273

Additional information

Other financial data	2016	2015	2014	2013	2012
Basic and diluted (loss)/earnings per ordinary share from					
continuing operations - pence (1)	(59.5)	(27.7)	0.5	(85.0)	(58.9)
Share price per ordinary share at year end - £	2.25	3.02	3.94	3.38	3.25
Market capitalisation at year end - £bn	26.6	35.1	45.2	38.2	36.3
Net asset value per ordinary share - £	4.18	4.66	5.12	5.23	6.30
Return on average total assets (2)	(0.8%)	(0.2%)	(0.3%)	(0.7%)	(0.4%)
Return on average total equity (3)	(10.2%)	(2.9%)	(4.6%)	(12.8%)	(7.8%)
Return on average ordinary shareholders' equity (4)	(15.3%)	(4.0%)	(6.5%)	(14.7%)	(8.9%)
Average total equity as a percentage of average total assets	6.2%	6.0%	5.8%	5.5%	5.2%
Risk asset ratio - Tier 1 (5)	17.7%	19.1%	13.2%	13.1%	12.4%
Risk asset ratio - Total (5)	22.9%	24.7%	17.1%	16.5%	14.5%
Ratio of earnings to combined fixed charges and preference share dividends (6,7)					
- including interest on deposits	(0.45)	0.17	1.52	(0.51)	0.13
- excluding interest on deposits	(2.13)	(1.17)	2.61	(5.12)	(3.73)
Ratio of earnings to fixed charges only (6,7)					
- including interest on deposits	(0.53)	0.19	1.67	(0.55)	0.13
- excluding interest on deposits	(3.25)	(1.60)	3.58	(6.95)	(4.80)

Notes:

(1) None of the convertible securities had a dilutive effect in the years 2012 to 2016.

(2) Return on average total assets represents loss attributable to ordinary shareholders as a percentage of average total assets.

(3) Return on average total equity represents loss attributable to equity owners expressed as a percentage of average shareholder funds.

(4) Return on average ordinary shareholders' equity represents loss attributable to ordinary shareholders expressed as a percentage of average ordinary shareholders' equity.

(5) 2016, 2015 and 2014 are calculated on a PRA transitional basis; 2013 and 2012 are calculated on a

Basel 2.5 basis.

(6) For this purpose, earnings consist of income before tax and non-controlling interests, plus fixed charges less the unremitted income of associated undertakings (share of profits less dividends received). Fixed charges consist of total interest expense, including or excluding interest on deposits and debt securities in issue, as appropriate, and the proportion of rental expense deemed representative of the interest factor (one third of total rental expenses).

(7) The earnings for the years ended 31 December 2016, 2015, 2013 and 2012 were inadequate to cover total fixed charges and preference share dividends. The coverage deficiency for total fixed charges and preference share dividends for the years ended 31 December 2016, 2015, 2013 and 2012 was £4,586 million, £3,088 million, £9,247 million and £6,353 million respectively. The coverage deficiency for fixed charges for the years ended 31 December 2016, 2015, 2013 and 2012 was £4,082 million, £2,703 million, £8,849 million and £6,052 million respectively.

Additional information

The geographic analysis, including the average balance sheet and interest rates, changes in net interest income and average interest rates, yields, spreads and margins in this report have generally been compiled on the basis of location of office - UK and overseas - unless indicated otherwise. 'UK' in this context includes transactions conducted through the offices in the UK which service international banking transactions.

Analysis of loans and advances to customers

The following table analyses gross loans and advances to customers by remaining maturity, geographical area (location of office) and type of customer.

	Within 1 year	After 1 year but within 5 years	After 5 years	2016 Total	2015	2014	2013	2012
	£m	£m	£m	£m	£m	£m	£m	£m
UK								
Central and local government	3,893	95	2,016	6,004	6,166	7,665	6,951	8,087
Finance	24,253	5,752	2,021	32,026	29,748	31,762	28,937	33,955
Residential mortgages	10,685	29,295	97,447	137,427	123,653	113,521	110,515	109,530
Personal lending	6,544	4,271	3,383	14,198	14,348	15,923	17,098	19,692
Property	7,977	16,381	9,523	33,881	34,100	37,547	44,252	53,730
Construction	2,226	1,419	416	4,061	3,906	4,098	4,691	6,507
Manufacturing	4,492	3,911	698	9,101	8,071	9,332	8,739	10,058
Service industries and business activities	21,373	22,186	9,459	53,018	51,257	50,621	52,253	56,435
Agriculture, forestry and fishing	1,222	1,197	1,026	3,445	3,471	3,211	2,887	2,699
Finance leases and instalment credit	4,930	5,045	1,992	11,967	11,134	10,933	10,524	10,532
Accrued interest	252	12	8	272	346	258	136	263
Total UK	87,847	89,564	127,989	305,400	286,200	284,871	286,983	311,488
Overseas								
US	821	—	350	1,171	2,331	9,308	60,440	63,496
Rest of the World	2,793	6,251	11,863	20,907	24,921	57,532	68,555	76,240
Total overseas	3,614	6,251	12,213	22,078	27,252	66,840	128,995	139,736

Reverse repos								
UK	21,399	8	—	21,407	18,000	29,228	19,777	42,989
US	7,476	—	—	7,476	9,532	8,216	18,603	22,811
Rest of the World	44	—	—	44	26	6,543	11,517	4,247
Total reverse repos	28,919	8	—	28,927	27,558	43,987	49,897	70,047
Loans and advances to customers - gross	120,380	95,823	140,202	356,405	341,010	395,698	465,875	521,271
Loan impairment provisions				(4,455)	(7,118)	(17,460)	(25,153)	(21,136)
Loans and advances to customers - net				351,950	333,892	378,238	440,722	500,135
Fixed rate	13,370	26,677	78,269	118,316	118,300	114,664	117,452	123,941
Variable rate	78,091	69,138	61,933	209,162	195,152	237,047	298,526	327,283
Reverse repos	28,919	8	—	28,927	27,558	43,987	49,897	70,047
Loans and advances to customers - gross	120,380	95,823	140,202	356,405	341,010	395,698	465,875	521,271

RBS provides credit facilities at variable rates to its corporate and retail customers. Variable rate credit extended to RBS's corporate and commercial customers includes bullet and instalment loans, finance lease agreements and overdrafts; interest is generally charged at a margin over a benchmark rate such as LIBOR or base rate. Interest on variable rate retail loans may also be based on LIBOR or base rate; other variable rate retail lending is charged at variable interest rates set by RBS such as its mortgage standard variable rate in the UK.

Additional information

Average balance sheet and related interest								
		Statutory 2016				Statutory 2015		
		Average balance	Interest	Rate		Average balance	Interest	Rate
		£m	£m	%		£m	£m	%
Assets								
Loans and advances to banks	- UK	27,986	159	0.57		38,626	253	0.65
	- Overseas	31,555	11	0.03		39,211	87	0.22
Loans and advances to customers	- UK	267,142	10,098	3.78		247,678	10,205	4.12
	- Overseas	26,583	608	2.29		48,511	1,063	2.19
Debt securities	- UK	40,933	243	0.59		33,198	234	0.70
	- Overseas	5,300	63	1.19		6,007	83	1.38
Interest-earning assets	- UK	336,061	10,500	3.12		319,502	10,692	3.35
	- Overseas	63,438	682	1.08		93,729	1,233	1.32
Total interest-earning assets	- banking business (1,2,3,4)	399,499	11,182	2.80		413,231	11,925	2.89
	- trading business (3)	132,027				139,642		
Interest-earning assets		531,526				552,873		
Non-interest-earning assets		338,753				417,515		
Total assets		870,279				970,388		
Percentage of assets applicable to overseas operations		12.0%				26.4%		
Liabilities								
Deposits by banks	- UK	2,772	13	0.47		3,601	25	0.69
	- Overseas	1,348	8	0.59		2,462	20	0.81
Customer accounts: demand deposits	- UK	146,340	390	0.27		131,617	537	0.41
	- Overseas	13,101	43	0.33		18,178	82	0.45
Customer accounts: savings deposits	- UK	62,097	425	0.68		70,803	435	0.61
	- Overseas	1,477	7	0.47		1,436	11	0.77
Customer accounts: other time deposits	- UK	8,302	149	1.79		12,060	221	1.83

	- Overseas	3,301	41	1.24		5,143	94	1.83
Debt securities in issue	- UK	17,329	551	3.18		26,122	747	2.86
	- Overseas	1,560	6	0.38		1,581	12	0.76
Subordinated liabilities	- UK	16,908	733	4.34		16,226	676	4.17
	- Overseas	1,598	112	7.01		3,047	193	6.33
Internal funding of trading business	- UK	(15,302)	(4)	0.03		(13,909)	104	(0.75)
	- Overseas	(1,706)	-	-		(669)	1	(0.15)
Interest-bearing liabilities	- UK	238,446	2,257	0.95		246,520	2,745	1.11
	- Overseas	20,679	217	1.05		31,178	413	1.32
Total interest-bearing liabilities	- banking business (1)	259,125	2,474	0.95		277,698	3,158	1.14
	- trading business (3)	142,796				147,117		
Interest-bearing liabilities		401,921				424,815		
Demand deposits	- UK	78,480				69,873		
	- Overseas	10,278				10,619		
Other liabilities		325,586				407,011		
Owners' equity		54,014				58,070		
Total liabilities and owners' equity		870,279				970,388		
Percentage of liabilities applicable to overseas operations		14.4%				25.5%		

For the notes to this table refer to following page

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Additional information

		Statutory 2014		
		Average		
		balance	Interest	Rate
		£m	£m	%
Assets				
Loans and advances to banks	- UK	34,592	216	0.62
	- Overseas	33,481	151	0.45
Loans and advances to customers	- UK	252,656	10,784	4.27
	- Overseas	72,188	1,555	2.15
Debt securities	- UK	28,626	264	0.92
	- Overseas	11,203	109	0.97
Interest-earning assets	- UK	315,874	11,264	3.57
	- Overseas	116,872	1,815	1.55
Total interest-earning assets	- banking business (1,2,3,4)	432,746	13,079	3.02
	- trading business (3)	166,643		
Interest-earning assets		599,389		
Non-interest-earning assets		442,092		
Total assets		1,041,481		
Percentage of assets applicable to overseas operations		33.1%		
Liabilities				
Deposits by banks	- UK	5,860	49	0.84
	- Overseas	4,244	26	0.61
Customer accounts: demand deposits	- UK	118,628	470	0.40
	- Overseas	23,075	128	0.55
Customer accounts: savings deposits	- UK	85,649	710	0.83
	- Overseas	1,596	21	1.32
Customer accounts: other time deposits	- UK	17,008	278	1.63
	- Overseas	9,440	162	1.72
Debt securities in issue	- UK	33,967	985	2.90
	- Overseas	2,156	25	1.16
Subordinated liabilities	- UK	18,819	684	3.63
	- Overseas	3,834	192	5.01
Internal funding of trading business	- UK	(15,426)	89	(0.58)
	- Overseas	(4,635)	2	(0.04)

Interest-bearing liabilities	- UK	264,505	3,265	1.23
	- Overseas	39,710	556	1.40
Total interest-bearing liabilities	- banking business (1)	304,215	3,821	1.26
	- trading business (3)	177,156		
Interest-bearing liabilities		481,371		
Non-interest-bearing liabilities:				
Demand deposits	- UK	58,060		
	- Overseas	11,153		
Other liabilities		430,124		
Owners' equity		60,773		
Total liabilities and owners' equity		1,041,481		
Percentage of liabilities applicable to overseas operations		32.8%		
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Notes:

(1) Interest receivable and interest payable have both been decreased by £76 million in respect of negative interest relating to financial assets that attracted negative interest.

(2) Interest receivable includes £290 million (2015 - £400 million; 2014 - £453 million) in respect of loan fees forming part of the effective interest rate of loans and receivables.

(3) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.

(4) Interest receivable includes amounts (unwind of discount) recognised on impaired loans and receivables. The average balances of such loans are included in average loans and advances to banks and loans and advances to customers.

(5) The analysis into UK and overseas has been compiled on the basis of location of office.

Additional information

Analysis of change in net interest income - volume and rate analysis

Volume and rate variances have been calculated based on movements in average balances over the period and changes in interest rates on average interest-earning assets and average interest-bearing liabilities. Changes due to a combination of volume and rate are allocated pro rata to volume and rate movements.

	2016 over 2015 - statutory				2015 over 2014 - statutory		
	(Decrease)/increase due to changes in:				Increase/(decrease) due to changes in:		
	Average	Average	Net		Average	Average	Net
	volume	rate	change		volume	rate	change
	£m	£m	£m		£m	£m	£m
Interest-earning assets							
Loans and advances to banks							
UK	(65)	(29)	(94)		26	11	37
Overseas	(14)	(62)	(76)		23	(87)	(64)
Loans and advances to customers							
UK	769	(876)	(107)		(208)	(371)	(579)
Overseas	(501)	46	(455)		(520)	28	(492)
Debt securities							
UK	49	(40)	9		38	(68)	(30)
Overseas	(9)	(11)	(20)		(62)	36	(26)
Total interest receivable of the banking business							
UK	753	(945)	(192)		(144)	(428)	(572)
Overseas	(524)	(27)	(551)		(559)	(23)	(582)
	229	(972)	(743)		(703)	(451)	(1,154)
Interest-bearing liabilities							
Deposits by banks							
UK	5	7	12		16	8	24
Overseas	7	5	12		13	(7)	6
Customer accounts: demand deposits							
UK	(55)	202	147		(55)	(12)	(67)
Overseas	20	19	39		25	21	46

Customer accounts: savings deposits							
UK	56	(46)	10		109	166	275
Overseas	—	4	4		2	8	10
Customer accounts: other time deposits							
UK	67	5	72		88	(31)	57
Overseas	28	25	53		78	(10)	68
Debt securities in issue							
UK	273	(77)	196		225	13	238
Overseas	—	6	6		6	7	13
Subordinated liabilities							
UK	(29)	(28)	(57)		102	(94)	8
Overseas	100	(19)	81		44	(45)	(1)
Internal funding of trading business							
UK	(10)	118	108		9	(24)	(15)
Overseas	(1)	2	1		3	(2)	1
Total interest payable of the banking business							
UK	307	181	488		494	26	520
Overseas	154	42	196		171	(28)	143
	461	223	684		665	(2)	663
Movement in net interest income							
UK	1,060	(764)	296		350	(402)	(52)
Overseas	(370)	15	(355)		(388)	(51)	(439)
	690	(749)	(59)		(38)	(453)	(491)

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Additional information

Loan impairment provisions

For details of the factors considered in determining the amount of provisions, refer to the accounting policy on page 390 and 'Critical accounting policies and key sources of estimation uncertainty' on page 395. The following table shows the movements in loan impairment provisions.

	2016	2015	2014	2013	2012
	£m	£m	£m	£m	£m
Provisions at the beginning of the year					
UK	4,037	8,185	11,005	9,754	8,222
Overseas	3,082	9,315	14,211	11,496	11,661
	7,119	17,500	25,216	21,250	19,883
Transfer (to)/from disposal groups					
UK	—	—	—	—	764
Overseas	—	(20)	(553)	(9)	—
	—	(20)	(553)	(9)	764
Currency translation and other adjustments					
UK	94	(27)	929	323	635
Overseas	406	(548)	(1,596)	(202)	(945)
	500	(575)	(667)	121	(310)
Disposals					
Overseas	(2)	—	(6)	(77)	(5)
Amounts written-off					
UK	(1,670)	(4,142)	(3,570)	(2,547)	(2,127)
Overseas	(2,025)	(4,822)	(1,708)	(1,799)	(2,139)
	(3,695)	(8,964)	(5,278)	(4,346)	(4,266)
Recoveries of amounts previously written-off					
UK	80	130	77	78	164
Overseas	29	45	128	178	177
	109	175	205	256	341
(Releases)/losses to income statement - continuing operations (1)					
UK	684	(11)	(110)	3,593	2,351
Overseas	(147)	(842)	(1,254)	4,512	2,703
	537	(853)	(1,364)	8,105	5,054
Losses to income statement - discontinued operations					
Overseas	—	—	194	307	265

Explanation of Responses:

Unwind of discount (recognised in interest income)					
UK	(75)	(98)	(146)	(196)	(255)
Overseas	(38)	(46)	(101)	(195)	(221)
	(113)	(144)	(247)	(391)	(476)
Provisions at the end of the year					
UK	3,150	4,037	8,185	11,005	9,754
Overseas	1,305	3,082	9,315	14,211	11,496
	4,455	7,119	17,500	25,216	21,250
Provisions at the end of the year comprise					
Customers	4,455	7,118	17,460	25,153	21,136
Banks	—	1	40	63	114
	4,455	7,119	17,500	25,216	21,250
Gross loans and advances to customers (2)					
UK	305,400	286,200	284,871	286,983	311,488
Overseas	22,078	27,252	66,840	128,995	139,736
	327,478	313,452	351,711	415,978	451,224

For the notes to this table refer to the following page

Additional information

	2016	2015	2014	2013	2012
Closing customer provisions as a % of gross loans and advances to customers (2)					
UK	1.0%	1.4%	2.9%	3.8%	3.1%
Overseas	5.9%	11.3%	13.9%	11.0%	8.2%
Total	1.4%	2.3%	5.0%	6.0%	4.7%
Customer (releases)/losses to income statement as a % of gross loans and					
advances to customers (2)					
UK	0.2%	—	—	1.3%	0.8%
Overseas	(0.7%)	(3.1%)	(1.9%)	3.5%	1.9%
Total	0.2%	(0.3%)	(0.4%)	2.0%	1.1%
Average loans and advances to customers - gross	373,644	387,956	472,545	509,937	541,588
As a % of average loans and advances to customers during the year					
Total customer provisions (released)/charged to income statement	0.1%	(0.2%)	(0.3%)	1.6%	0.9%
Amounts written-off (net of recoveries) - customers	1.0%	2.3%	1.1%	0.8%	0.7%

Notes:

(1) Includes nil release relating to loans and advances to banks (2015 - £4 million release; 2014 - £10 million release; 2013 - £15 million release; 2012 - £23 million loss.)

(2) Excludes reverse repos.

Analysis of closing customer loan impairment provisions

The following table analyses customer loan impairment provisions by geographical area and type of UK customer.

	2016			2015			2014			2013			2012	
	Closing provision	Total loans		Closing provision	Total loans		Closing provision	Total loans		Closing provision	Total loans		Closing provision	Total loans
	£m	%		£m	%		£m	%		£m	%		£m	%

UK										
Central and local government	1	1.8	1	2.0	1	2.2	2	1.7	—	1.8
Manufacturing	69	2.8	78	2.6	142	2.7	140	2.1	134	2.2
Construction	172	1.2	234	1.2	365	1.2	515	1.1	483	1.4
Finance	12	9.8	17	9.5	65	9.0	73	7.0	104	7.5
Service industries and business activities	1,131	16.2	993	16.4	1,510	14.4	2,192	12.6	1,480	12.5
Agriculture, forestry and fishing	17	1.1	24	1.1	33	0.9	45	0.7	34	0.6
Property	365	10.3	1,048	10.9	3,671	10.7	5,190	10.6	3,944	11.9
Residential mortgages	143	42.0	158	39.4	191	32.3	319	26.6	457	24.3
Personal lending	853	4.3	1,086	4.6	1,453	4.5	1,718	4.1	2,152	4.4
Finance leases and instalment credit	69	3.7	69	3.6	82	3.1	136	2.5	184	2.3
Accrued interest	—	0.1	—	0.1	—	—	—	—	—	0.1
Total UK	2,832	93.3	3,708	91.4	7,513	81.0	10,330	69.0	8,972	69.0
Overseas	1,223	6.7	2,826	8.6	8,931	19.0	12,820	31.0	10,204	31.0
Impaired book provisions	4,055	100	6,534	100	16,444	100	23,150	100	19,176	100
Latent book provisions	400		584		1,016		2,003		1,960	
Total provisions	4,455		7,118		17,460		25,153		21,136	

Additional information

Analysis of write-offs					
The following table analyses amounts written-off by geographical area and type of UK customer.					
	2016	2015	2014	2013	2012
	£m	£m	£m	£m	£m
UK					
Manufacturing	26	61	48	41	61
Construction	279	269	175	159	158
Finance	5	94	28	47	30
Service industries and business activities	580	646	719	422	542
Agriculture, forestry and fishing	6	11	3	6	11
Property	397	2,504	1,917	950	490
Residential mortgages	3	36	76	180	32
Personal lending	362	501	546	681	610
Finance leases and instalment credit	12	20	58	61	193
Total UK	1,670	4,142	3,570	2,547	2,127
Overseas	2,025	4,822	1,708	1,799	2,139
Total write-offs (1)	3,695	8,964	5,278	4,346	4,266

Note:

(1) Includes nil written-off in respect of loans and advances to banks (2015 - £33 million; 2014 - £8 million; 2013 - £40 million).

Analysis of recoveries					
The following table analyses recoveries of amounts written-off by geographical area and type of UK customer.					
	2016	2015	2014	2013	2012
	£m	£m	£m	£m	£m
UK					
Manufacturing	1	—	2	1	1
Construction	4	2	9	1	10
Finance	1	3	—	—	1
Service industries and business	28	32	11	21	16

activities					
Property	17	40	29	5	33
Residential mortgages	—	—	—	—	6
Personal lending	28	42	26	48	93
Finance leases and instalment credit	1	11	—	2	4
Total UK	80	130	77	78	164
Overseas	29	45	128	178	177
Total recoveries	109	175	205	256	341

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Additional information

Risk elements in lending

Risk elements in lending (REIL) comprises of impaired loans and accruing loans past due 90 days or more as to principal or interest.

Impaired loans are all loans (including loans subject to forbearance) for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans.

Accruing loans past due 90 days or more comprises loans past due 90 days where no impairment loss is expected.

	2016	2015	2014	2013	2012
	£m	£m	£m	£m	£m
Impaired loans (1)					
UK	5,557	6,095	11,562	17,480	18,412
Overseas	3,308	4,755	13,681	19,691	20,074
Total	8,865	10,850	25,243	37,171	38,486
Accruing loans which are contractually overdue 90 days or more as to principal					
or interest					
UK	1,122	1,262	1,536	1,962	2,007
Overseas	323	25	105	259	634
Total	1,445	1,287	1,641	2,221	2,641
Total REIL	10,310	12,137	26,884	39,392	41,127
Closing provisions for impairment as a % of total REIL	43%	59%	65%	64%	52%
REIL as a % of gross lending to customers excluding reverse repos	3.1%	3.9%	7.6%	9.5%	9.1%

Notes:

(1) The write-off of impaired loans affects closing provisions for impairment as a % of total REIL (the coverage ratio). The coverage ratio reduces if the loan written-off carries a higher than average provision and increases if the loan written-off carries a lower than average provision.

(2) Impaired loans at 31 December 2016 include £2,496 million (2015 - £2,300 million; 2014 - £7,052 million) of loans subject to forbearance granted during the year.

	2016	2015	2014	2013	2012
	£m	£m	£m	£m	£m
Gross income not recognised but which would have been recognised under					
the original terms of impaired loans					
UK	243	311	404	571	665
Overseas	122	125	165	601	805
	365	436	569	1,172	1,470
Interest on impaired loans included in net interest income					
UK	75	98	146	196	255
Overseas	38	46	101	195	221
	113	144	247	391	476

Potential problem loans

Potential problem loans (PPL) are loans for which an impairment event has taken place but no impairment loss is expected. This category is used for advances which are not past due 90 days or revolving credit facilities where identification as 90 days overdue is not feasible.

	2016	2015	2014	2013	2012
	£m	£m	£m	£m	£m
Potential problem loans	1,196	1,277	1,206	789	807

Both REIL and PPL are reported gross and take no account of the value of any security held which could reduce the eventual loss should it occur, nor of any provision marked. Therefore impaired assets which are highly collateralised, such as mortgages, will have a low coverage ratio of provisions held against the reported impaired balance.

Additional information

Forbearance

The table below shows loans granted forbearance during the year. These loans are unimpaired: either the loan was performing before and after the granting of forbearance or the loan was non-performing before but subsequently transferred to the performing book. Loans with impairment provisions subject to forbearance continue to be reported as impaired loans.

	2016	2015	2014	2013	2012
	£m	£m	£m	£m	£m
Loans granted forbearance	2,257	3,760	6,091	7,901	11,196

Notes:

(1) Wholesale loans subject to forbearance include only those arrangements above thresholds set individually by the segments, ranging from nil to £3 million.

(2) For 2016, wholesale loans subject to forbearance were £1,807 million (2015 - £2,258 million; 2014 - £3,040 million) and secured retail loans subject to forbearance were £450 million (2015 - £1,502 million; 2014 - £3,051 million). Unsecured retail loans subject to forbearance amounting to £37 million (2015 - £96 million; 2014 - £244 million) are not included.

Cross border exposures

Cross border exposures are loans and advances including finance leases and instalment credit receivables and other monetary assets, such as debt securities, including non-local currency claims of overseas offices on local residents. RBS monitors the geographical breakdown of these exposures based on the country of domicile of the borrower or guarantor of ultimate risk. Cross border exposures exclude exposures to local residents in local currencies.

The table below sets out cross border exposures greater than 0.5% of RBS's total assets. None of these countries have experienced repayment difficulties that have required restructuring of outstanding debt.

					Short	Net of short
2016						

	Government	Banks	Other	Total	positions	positions
	£m	£m	£m	£m	£m	£m
United States	7,677	6,012	8,138	21,827	5,099	16,728
Japan	8,291	5,441	375	14,107	1	14,106
Germany	8,868	4,836	2,138	15,842	4,207	11,635
France	4,275	7,045	2,003	13,323	2,392	10,931
Netherlands	2,809	563	6,699	10,071	1,061	9,010
2015						
United States	10,971	3,528	9,150	23,649	3,380	20,269
Japan	7,172	2,444	211	9,827	—	9,827
Germany	9,574	4,211	1,565	15,350	3,272	12,078
France	6,221	10,794	2,626	19,641	1,778	17,863
Netherlands	3,820	1,021	7,148	11,989	796	11,193
2014						
United States	393	2,576	18,403	21,372	7,029	14,343
Japan	3,093	3,626	2,125	8,844	66	8,778
Germany	15,923	5,111	2,442	23,476	2,166	21,310
France	7,405	11,660	4,240	23,305	2,226	21,079
Netherlands	5,050	1,308	6,925	13,283	1,392	11,891

Additional information

Analysis of deposits - product analysis			
The following table analyses deposits excluding repos by geographical area (location of office) and type of deposit.			
	2016	2015	2014
	£m	£m	£m
UK			
Deposits			
- interest-free	108,433	97,772	98,582
- interest-bearing	255,588	242,120	243,315
Total UK	364,021	339,892	341,897
Overseas			
Deposits			
- interest-free	6,286	7,452	13,992
- interest-bearing	16,882	23,872	34,205
Total overseas	23,168	31,324	48,197
Total deposits	387,189	371,216	390,094
Overseas			
US	310	271	1,915
Rest of the World	22,858	31,053	46,282
Total overseas	23,168	31,324	48,197
Repos			
UK	15,351	21,800	42,708
US	16,984	15,578	14,626
Rest of the World	—	—	4,876
Total repos	32,335	37,378	62,210

Certificates of deposit and other time deposits					
The following table shows certificates of deposit and other time deposits over $100,000 or equivalent by remaining maturity.					
				Over	
	0-3 months	3-6 months	6-12 months	12 months	Total
2016	£m	£m	£m	£m	£m

UK based companies and branches					
Certificates of deposit	691	1,944	180	3	2,818
Other time deposits	6,573	1,417	1,526	1,405	10,921
Overseas based companies and branches					
Other time deposits	892	695	956	2,019	4,562
	8,156	4,056	2,662	3,427	18,301

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Additional information

Short-term borrowings

Short-term borrowings comprise repurchase agreements, borrowings from financial institutions, commercial paper and certificates of deposit. Derivative collateral received from financial institutions is excluded from the table, as are certain long-term borrowings.

	At the year end		During the year		
		Weighted			Weighted
		average	Maximum	Average	average
	Balance	interest rate	balance	balance	interest rate
2016	£bn	%	£bn	£bn	%
Repos	32	0.3	62	46	0.3
Financial institutions (1)	63	0.2	71	55	0.3
Commercial paper	—	—	—	—	—
Certificates of deposits	3	0.2	3	1	0.8
Total	98	0.2	136	102	0.3
2015					
Repos	37	0.6	105	70	0.3
Financial institutions (1)	53	0.3	71	54	0.4
Commercial paper	—	—	1	—	0.4
Certificates of deposits	1	0.9	2	1	0.9
Total	91	0.5	179	125	0.3
2014					
Repos	62	0.4	129	91	0.3
Financial institutions (1)	56	0.3	72	59	0.4
Commercial paper	1	0.4	2	1	0.5
Certificates of deposits	1	0.9	2	2	0.8
Total	120	0.3	205	153	0.3

Note:

(1) Excludes derivative cash collateral of £32 billion at 31 December 2016 (2015 - £30 billion; 2014 - £39 billion); and 2016 average of £34 billion (2015 - £36 billion; 2014 - £30 billion).

Balances are generally based on monthly data. Average interest rates during the year are computed by dividing total interest expense by the average amount borrowed. Weighted average interest rates at year end are for a single day and as such may reflect one-day market distortions, which may not be indicative of generally prevailing rates.

Other contractual cash obligations

The table below summarises other contractual cash obligations by payment date.

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	64	182	425	361	684	1,091
Contractual obligations to purchase goods or services	64	168	266	93	7	—
	128	350	691	454	691	1,091
2015						
Operating leases	60	172	421	338	692	1,314
Contractual obligations to purchase goods or services	81	221	570	570	—	—
	141	393	991	908	692	1,314
2014						
Operating leases	62	175	424	360	695	1,415
Contractual obligations to purchase goods or services	104	285	703	734	1	—
	166	460	1,127	1,094	696	1,415

Undrawn formal facilities, credit lines and other commitments to lend were £134,324 million (2015 - £132,198 million; 2014 - £212,777 million). While RBS has given commitments to provide these funds, some facilities may be subject to certain conditions being met by the counterparty. RBS does not expect all facilities to be drawn, and some may lapse before drawdown.

Additional information

Exchange rates

The following tables show the Noon Buying Rate in New York for cable transfers in sterling as certified for customs purposes by the Federal Reserve Bank of New York.

US dollars per £1	February 2017	January 2017	December 2016	November 2016	October 2016	September 2016
Noon Buying Rate						
High	1.2643	1.2620	1.2708	1.2546	1.2840	1.3429
Low	1.2427	1.2118	1.2222	1.2218	1.2155	1.2959
		2016	2015	2014	2013	2012
Noon Buying Rate						
Period end rate		1.2337	1.4746	1.5578	1.6574	1.6262
Average rate for the year (1)		1.3444	1.5250	1.6461	1.5673	1.5924
Consolidation rate (2)						
Period end rate		1.2323	1.4830	1.5615	1.6542	1.6164
Average rate for the year		1.3552	1.5284	1.6475	1.5646	1.5850

Notes:

(1) The average of the Noon Buying Rates on the last US business day of each month during the year.

(2) The rates used for translating US dollars into sterling in the preparation of the financial statements.

(3) On 17 March 2017, the Noon Buying Rate was £1.00 = US$1.2372

Material contracts

The company and its subsidiaries are party to various contracts in the ordinary course of business. Material contracts include the following:

B Share Acquisition and Contingent Capital Agreement

On 26 November 2009, the company and HM Treasury entered into the Acquisition and Contingent Capital Agreement pursuant to which HM Treasury subscribed for the initial B shares and the Dividend Access Share (the Acquisitions) and agreed the terms of HM Treasury's contingent subscription (the Contingent Subscription) for an additional £8 billion in aggregate in the form of further B shares (the Contingent B shares), to be issued on the same terms as the initial B shares. The Acquisitions were subject to the satisfaction of various conditions, including the company having obtained the approval of its shareholders in relation to the Acquisitions.

On 16 December 2013, the company announced that, having received approval from the PRA, it had terminated the £8 billion Contingent Subscription. RBS was able to cancel the Contingent Subscription as a result of the actions announced in the second half of 2013 to further strengthen its capital position.

On 9 October 2015, the company announced that on 8 October 2015, it had received a valid conversion notice from HM Treasury in respect of all outstanding B shares held by HM Treasury. The new ordinary shares issued on conversion of the B shares were admitted to the official list of the UKLA, and to trading on the London Stock Exchange plc, on 14 October 2015. Following such conversion, HM Treasury no longer holds any B shares and its resulting holding represents 72.6% of the company’s ordinary share capital.

The company gave certain representations and warranties to HM Treasury on the date of the Acquisition and Contingent Capital Agreement, on the date the circular was posted to shareholders, on the first date on which all of the conditions precedent were satisfied, or waived, and on the date of the Acquisitions. The company also agreed to a number of undertakings.

The company agreed to reimburse HM Treasury for its expenses incurred in connection with the Acquisitions.

For as long as it is a substantial shareholder of the company (within the meaning of the UKLA's Listing Rules), HM Treasury has undertaken not to vote on related party transaction resolutions at general meetings and to direct that its affiliates do not so vote.

Additional information

DAS Retirement Agreement

The Dividend Access Share (DAS) was created in 2009 (see B Share Acquisition and Contingent Capital Agreement above). On 9 April 2014, the company entered into the DAS Retirement Agreement (DRA) with HMT which was approved by the company's shareholders on 25 June 2014. Pursuant to the terms of the DRA the company paid HMT an initial DAS dividend of £320 million. A further £1.18 billion was payable to HMT (together with the initial dividend, the DAS Retirement Dividend Amount), in the form of one or more further DAS dividends, at the discretion of the directors of the company. The unpaid portion of the DAS Retirement Dividend Amount was subject to an increase of 5 percent. per annum, calculated on a daily accruals basis from 1 January 2016, and an increase of 10 per cent. per annum, calculated on a daily accruals basis from 1 January 2021, on any part of the balance that had not been paid before 1 January 2021. On 22 March 2016, the company paid HMT a dividend of £1.193 billion representing the final amount payable to HMT and effecting the immediate retirement of the DAS. Upon its retirement, the DAS was re-designated as a single B share which was subsequently cancelled.

State Aid Commitment Deed

As a result of the State Aid granted to the company, it was required to work with HM Treasury to submit a State Aid restructuring plan to the European Commission (EC), which was then approved under the State Aid rules. The company agreed a series of measures which supplemented the measures in the company's strategic plan.

RBS entered into a State Aid Commitment Deed with HM Treasury at the time of the initial EC decision and following the European Commission's approval of amendments to the restructuring plan in April 2014 entered into a Revised State Aid Commitment Deed with HM Treasury (together referred to as the "State Aid Commitment Deeds").

These provide that RBS will comply or procure compliance with certain measures and behavioural commitments. RBS agreed to do all acts and take all measures to ensure HM Treasury's compliance with its obligations under any EC decision approving State Aid to RBS.

The State Aid Commitment Deeds also provide that if the EC adopts a decision that the UK Government must recover any State Aid (a "Repayment Decision") and the recovery order of the Repayment Decision has not been annulled or suspended by the General Court or the European Court of Justice, then RBS must repay HM Treasury any aid ordered to be recovered under the Repayment Decision.

The State Aid Commitment Deeds also provide for RBS's undertakings in respect of State Aid to be modified in certain limited circumstances. However, HM Treasury has undertaken that it will not, without the consent of RBS, agree modifications to RBS's undertakings with respect to State Aid which are significantly more onerous to RBS than those granted in order to obtain the State Aid approval. Further details are provided in the Risk Factors.

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Additional information

Material contracts continued

State Aid Costs Reimbursement Deed

Under the State Aid Costs Reimbursement Deed, RBS has agreed to reimburse HM Treasury for fees, costs and expenses associated with the State Aid and State Aid approval.

Sale of RBS England & Wales and NatWest Scotland branch based business (Williams & Glyn)

Pursuant to the terms of the State Aid Commitment Deed, RBS is required to dispose of its RBS England & Wales and NatWest Scotland branch based business by the end of 2017. The agreement entered into with a consortium of investors on 27 September 2013 in relation to a pre-IPO investment was terminated on 21 October 2016 when the £600 million exchangeable bond which was issued by RBS on 21 October 2013 was redeemed by RBS. Further details are provided in the Risk Factors.

HMT and UKFI Relationship Deed

On 7 November 2014, in order to comply with an amendment to the UK Listing Rules, the company entered into a Relationship Deed with HM Treasury and UK Financial Investments Limited in relation to the company’s obligations under the UK Listing Rules to put in place an agreement with any controlling shareholder (as defined for these purposes in the Listing Rules). The Relationship Deed covers the three independence provisions mandated by the Listing Rules: (i) that contracts between the company and HM Treasury (or any of its subsidiaries) will be arm's length and normal commercial arrangements, (ii) that neither HM Treasury nor any of its associates will take any action that would have the effect of preventing the company from complying with its obligations under the Listing Rules; and (iii) neither HM Treasury nor any of its associates will propose or procure the proposal of a shareholder resolution which is intended or appears to be intended to circumvent the proper application of the Listing Rules.

ADR payment information

Fees paid by ADR holders

The depositary collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees.

The depository may collect its annual fee for depository services by deductions from cash distributions or by directly billing investors or by changing the book-entry system accounts of participants acting for them. The depository may generally refuse to provide fee-attracting services until its fees for those services are paid.

Persons depositing or withdrawing shares must pay:	For:
$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)	Issuance of ADSs, including issuances resulting from a distribution of shares or rights or other property.
	Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates.
$0.02 (or less) per ADS	Any cash distribution to ADS registered holders.
A fee equivalent to the fee that would be payable if securities distributed to you had been shares and the shares had been deposited for issuance of ADSs	Distribution of securities distributed to holders of securities of deposited securities to ADS registered holders.
Registration or transfer fees	Transfer and registration of shares on our share register to or from the name of the depository or its agent when you deposit or withdraw shares.
Expenses of the depository	Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement).
	Converting foreign currency to U.S. dollars.
Taxes and other governmental charges the depositary or the custodian have to pay on any ADS or share underlying an ADS, for example, stock transfer taxes, stamp duty or withholding taxes	As necessary.
Any charges incurred by the depository or its agents for servicing the deposited securities	As necessary.

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Explanation of Responses:

Additional information

Fees payable by the depository to the issuer

Fees incurred in past annual Period

From 1 January 2016 to 31 December 2016, the company received from the depository $300,000 for continuing annual stock exchange listing fees, standard out-of-pocket maintenance costs for the ADRs (consisting of the expenses of postage and envelopes for mailing annual and interim financial reports, printing and distributing dividend cheques, electronic filling of U.S. Federal tax information, mailing required tax forms, stationary, postage, facsimile, and telephone calls), any applicable performance indicators relating to the ADR facility, underwriting fees and legal fees.

Fees to be paid in the future

The Bank of New York Mellon, as depository, has agreed to reimburse the Company for expenses they incur that are related to establishment and maintenance expenses of the ADS program. The depository has agreed to reimburse the Company for its continuing annual stock exchange listing fees, the depository has also agreed to pay the standard out-of-pocket maintenance costs for the ADRs, which consist of the expenses of postage and envelopes for mailing annual and interim reports, printing and distributing dividend cheques, electronic filing of U.S. federal tax information, mailing required tax forms, stationary, postage, facsimile, and telephone calls. It has also agreed to reimburse the Company annually for certain investor relationship programs of special investor relations promotional activities. In certain instances, the depository has agreed to provide additional payments to the Company based on any applicable performance indicators relating to the ADR facility. There are limits on the amount of expenses for which the depository will reimburse the Company, but the amount of reimbursement available to the Company is not necessarily tied to the amount of fees the depository collects from investors.

Additional information

Risk factors

Set out below are certain risk factors that could adversely affect the Group's future results, its financial condition and prospects and cause them to be materially different from what is expected. The factors discussed below and elsewhere in this report should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties facing the Group.

The Group is subject to a number of legal, regulatory and governmental actions and investigations. Unfavourable outcomes in such actions and investigations could have a material adverse effect on the Group’s operations, operating results, reputation, financial position and future prospects.

The Group’s operations remain diverse and complex and it operates in legal and regulatory environments that expose it to potentially significant legal and regulatory actions, including litigation claims and proceedings and civil and criminal regulatory and governmental investigations, and other regulatory risk. The Group has settled a number of legal and regulatory actions over the past several years but continues to be, and may in the future be, involved in a number of legal and regulatory actions in the US, the UK, Europe and other jurisdictions.

The legal and regulatory actions specifically referred to below are, in the Group’s view, the most significant legal and regulatory actions to which the Group is currently exposed. However, the Group is also subject to a number of additional claims, proceedings and investigations, the adverse resolution of which may also have a material adverse impact on the Group and which include ongoing reviews, investigations and proceedings (both formal and informal) by governmental law enforcement and other agencies and litigation proceedings (including class action litigation), relating to, among other matters, the offering of securities, including residential mortgage-backed securities (RMBS), conduct in the foreign exchange market, the setting of benchmark rates such as LIBOR and related derivatives trading, the issuance, underwriting, and sales and trading of fixed-income securities (including structured products and government securities), product mis-selling, customer mistreatment, anti-money laundering, sanctions, and various other compliance issues. See “Litigation, investigations and reviews” on pages 459 to 471 and “Recent Developments” on page 3 for details for these matters. The Group continues to cooperate with governmental and regulatory authorities in relation to ongoing informal and formal inquiries or investigations regarding these and other matters. Legal and regulatory actions are subject to many uncertainties, and their outcomes, including the timing, amount of fines or settlements or the form of any settlements, which may be material, are often difficult to predict, particularly in the early stages of a case or investigation. It is expected that the Group will continue to have a material exposure to legal and regulatory actions relating to legacy issues in the medium term.

Explanation of Responses:

Additional information

Risk factors continued

In the US, ongoing matters include various civil claims relating to legacy RMBS activities, the most material of which are those of the Federal Housing Finance Agency (FHFA), and investigations by the civil and criminal divisions of the U.S. Department of Justice (DOJ) and various other members of the RMBS Working Group of the Financial Fraud Enforcement Task Force (including several state attorneys general). A further provision of £3.1 billion ($3.8 billion) was recorded by the Group in Q4 2016 in relation to RBS's various RMBS investigations and litigation matters, taking the total of such provisions to £6.8 billion ($8.3 billion) at 31 December 2016.

The duration and outcome of the DOJ's civil and criminal investigations and other related RMBS matters remain uncertain, including in respect of whether settlements for all or any such matters may be reached. Further substantial provisions and costs may be recognised. Any finding of criminal liability by US authorities (including as a result of guilty pleas) could also have material collateral consequences for the Group's operations. These may include consequences resulting from the need to reapply for various important licences or obtain waivers to conduct certain existing activities of the Group, particularly but not solely in the US, which may take a significant period of the time and the results of which are uncertain. Failure to obtain such licenses or waivers could adversely impact the Group's business, in particular the NatWest Markets business in the US, including if it results in the Group being precluded from carrying out certain activities.

The Group is also facing litigation in the UK in connection with its 2008 shareholder rights issue. In December 2016, the Group concluded full and final settlements with four of the five shareholder groups representing 78% of the claims by value. As announced in December, the Group has determined a settlement figure of up to £800 million for the resolution of these matters (including the settlement referred to above), which amount is covered by existing provisions. This figure assumes that agreement is also reached with the remaining claimant group, is split proportionally and is subject to validation of claims. Following the settlements described above, a number of claims remain outstanding with the final shareholder group and the Group may not manage to reach a settlement agreement with the remaining claimants, and as a result remains exposed to continuing litigation. Trial is scheduled to commence in May 2017.

Additional information

Risk factors continued

In addition, the Group is undertaking various remediation programmes in response to past conduct issues. As announced on 8 November 2016, the Group is also taking steps, including automatic refunds of certain complex fees and a new complaints process, overseen by an independent third party for small and medium entity (SME) customers in the UK and the Republic of Ireland that were in its Global Restructuring Group (GRG) between 2008 and 2013. This new complaints review process and the automatic refund of complex fees was developed with the involvement of the Financial Conduct Authority (FCA). The FCA's review into these activities is continuing and fines or additional redress commitments may be accepted by or imposed upon the Group, notwithstanding the steps the Group has already taken. The Group booked a provision of £400 million in Q4 2016, based on its estimates of the costs associated with the new complaints review process and the automatic refund of complex fees for SME customers in GRG.

In 2016, the Group booked additional provisions of £601 million with respect to payment protection insurance (PPI), resulting in total provisions made for such matters of £4.9 billion, of which £3.7 billion had been utilised by 31 December 2016. On 2 March 2017, the FCA published Policy Statement 17/3 containing its final rules and guidance on PPI complaint handling. Although the proposals in the Policy Statement are largely as previously anticipated and RBS does not currently consider that an additional provision will be required, any changes in the assumptions underlying such provisions may result in additional provisions being incurred.

Settlements, resolutions and outcomes in relation to ongoing legal or regulatory actions may result in material financial fines or penalties, non-monetary penalties, restrictions upon or revocation of regulatory permissions and licences and other collateral consequences and may prejudice both contractual and legal rights otherwise available to the Group. The costs of resolving these legal and regulatory actions could individually or in aggregate prove to be substantial and monetary penalties and other outcomes could be materially in excess of provisions, if any, made by the Group. New provisions or increases in existing provisions relating to existing or future legal or regulatory actions may be substantial and may have a material adverse effect on the Group's financial condition and results of operations as well as its reputation. The outcome of on-going claims against the Group may give rise to additional legal claims being asserted against the Group. Adverse outcomes or resolution of current or future legal or regulatory actions could result in restrictions or limitations on the Group's operations, adversely impact the implementation of Group's current transformation programme as well as its capital position and its ability to meet regulatory capital adequacy requirements. The remediation programmes or commitments which the Group has agreed to in connection with past settlements or investigations, could require significant financial costs and personnel investment for the Group and may result in changes in its operations or product offerings, and failure to comply with undertakings made by the Group to its regulators may result in additional measures or penalties being taken against the Group.

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Explanation of Responses:

Additional information

Risk factors continued

The Group is subject to political risks, including economic, regulatory and political uncertainty arising from the outcome of the referendum on the UK's membership of the European Union (EU Referendum) which could adversely impact the Group's business, results of operations, financial condition and prospects.

In a referendum held on 23 June 2016, a majority voted for the UK to leave the European Union (EU). There is now prevailing uncertainty relating to the timing of the UK's exit from the EU, as well as the negotiation and form of the UK's relationships with the EU, with other multilateral organisations and with individual countries at the time of exit and beyond. Once the exit process is triggered by the UK government, Article 50 of the Treaty on the EU stipulates that a maximum two year period of negotiation will begin to determine the new terms of the UK's exit from the EU ad set the framework for the UK's new relationship with the EU, after which period its EU membership and all associated treaties will cease to apply, unless some form of transitional arrangement encompassing those associated treaties is agreed or there is unanimous agreement amongst EU member states and the European Commission to extend the negotiation period. The direct and indirect effects of the UK's decision to leave the EU are expected to affect many aspects of the Group's business, including as described elsewhere in these risk factors, and may be material. During the period in which the UK is negotiating its exit from the EU, the Group may face an increasingly uncertain operating environment.

The longer term effects of the EU Referendum on the Group's operating environment are difficult to predict, and subject to wider global macro-economic trends and events, but are likely to significantly impact the Group and its customers and counterparties who are themselves dependent on trading with the EU or personnel from the EU and may result in periodic financial volatility and slower economic growth, in the UK in particular, but also in Republic of Ireland (ROI), Europe and potentially the global economy. These longer-term effects may endure until the bilateral and multilateral trading and economic relationships between the UK, the EU, members of the World Trade Organisation and other key trading partners are agreed, implemented and settled.

Additional information

Risk factors continued

There is related uncertainty as to the respective legal and regulatory arrangements under which the Group and its subsidiaries will operate when the UK is no longer a member of the EU. In addition, the Group and its counterparties may no longer be able to rely on the EU passporting framework for financial services and could be required to apply for authorisation in multiple jurisdictions in the EU, the costs, timing and viability of which is uncertain. This uncertainty and any actions taken as a result of this uncertainty, as well as new or amended rules, could have a significant impact on the Group's operations or legal entity structure, including attendant restructuring costs, capital requirements and tax implications and as a result adversely impact the Group's profitability, business model and product offering. See also "Changes to the prudential regulatory framework for banks and investment banks within the EU may require additional structural changes to the Group's operations which may affect current restructuring plans and have a material adverse effect on the Group."

The outcome of the EU Referendum has created constitutional and political uncertainty as to how the Scottish parliamentary process may impact the negotiations relating to the UK's exit from the EU. As RBSG and RBS plc, its principal operating subsidiary, are both headquartered and incorporated in Scotland, any changes to Scotland's relationship with the UK or the EU may further impact the environment in which the Group and its subsidiaries operate, including as it may require changes to be made to the Group's structure, independently or in conjunction with other mandatory or strategic structural and organisational changes and as a result could adversely impact the Group.

Additional information

Risk factors continued

Changes to the prudential regulatory framework for banks and investment banks within the EU may require additional structural changes to the Group's operations which may affect current restructuring plans and have a material adverse effect on the Group.

The exit from the European Union by the UK following the EU Referendum may result in one or more structural and reorganisation changes being implemented within the Group, in addition to those currently planned for. Current proposed changes to the European prudential regulatory framework for banks and investment banks may result in additional prudential or structural requirements being imposed on financial institutions based outside the EU wishing to provide financial services within the EU which may apply to the Group once the UK has formally exited the EU. One of the proposals would impose a requirement for any third country banks with two or more institutions within the EU to establish a single intermediate parent undertaking in the European Union. These are currently draft proposals which, if adopted, are not expected to come into force until after the implementation deadline for the UK ring fencing regime (1 January 2019). The Group is currently assessing how these proposals, if adopted, may impact the Group and its current restructuring plans to implement the UK ring-fencing regime. If implemented, the impact of these proposals could be material given the expectation that both the ring-fenced banking entities organised as a sub-group (the "RFB") and the non-ring fenced group would continue to carry out operations in the EU. If adopted, these proposals would require further additional restructuring of the Group's operations and legal structure, in addition to the changes already planned to be implemented for the purposes of compliance with the UK ring-fencing regime and any other changes required to be implemented as a result of other regulatory, political or strategic developments and could result in material additional capital requirements and have adverse tax implications. Planning and implementation of any additional restructuring of the Group's activities may also divert management and personnel resources from the effective conduct of the Group's operations, result in further material restructuring costs, jeopardise the delivery and implementation of a number of other significant change projects resulting from mandatory regulatory developments or as part of its transformation programme, impact the Group's product offering or business model or adversely impact the Group's ability to deliver its strategy and meet its targets and guidance, each of which could have a material adverse impact on the Group's results of operations, financial condition and prospects.

Additional information

Risk factors continued

The Group is in the process of seeking to satisfy its commitments arising as a result of the receipt of State Aid in December 2008. The process to amend the Group's State Aid obligations in respect of Williams & Glyn may not ultimately amend such obligations or the revised obligations may be more onerous than those currently being discussed. The diversion of Group resources required to meeting the Group's obligations in respect of Williams & Glyn, associated costs or delays in meeting, or a failure to meet, the deadline for compliance, could have a material adverse effect on the Group's operations, operating results, financial position and reputation.

State Aid approval was received from the European Commission in connection with the financial assistance provided to the Group by the UK Government in 2008. In connection with the receipt of such financial assistance, and as a condition for State Aid approval, the Group entered into a state aid commitment deed with HM Treasury (as amended from time to time, the State Aid Commitment Deed) which set out conditions upon which such State Aid approval was granted including the requirement for the Group to divest its RBS branches in England and Wales, NatWest branches in Scotland, Direct SME banking and certain mid-corporate customers (Williams & Glyn) by the end of 2017. In light of its obligations under the State Aid Commitment Deed, the Group actively sought to fully divest Williams & Glyn and engaged in discussions with a number of interested parties concerning a transaction related to substantially all of the Williams & Glyn business. However, as none of these proposals could deliver full divestment by 31 December 2017, the Group announced on 28 April 2016 that there was a significant risk that the previously planned separation and divestment of Williams & Glyn would not be achieved by the 31 December 2017 deadline. On 5 August 2016, the Group announced that the Board had determined that it would not be prudent to continue with the plan for separating and divesting Williams & Glyn and announced that various alternative divestment structures were being actively explored.

Additional information

Risk factors continued

The Group subsequently announced on 17 February 2017 that the Commissioner responsible for EU competition policy planned to propose to the European Commission to open proceedings to develop an alternative plan for the Group to meet its remaining State Aid obligations in regards to Williams & Glyn. If adopted, it is intended that this alternative plan would replace the existing requirement to achieve separation and divestment of Williams & Glyn by 31 December 2017 and the current conditions set out in the State Aid Commitment Deed would be amended accordingly.

Under the current form of the alternative plan, the Group will deliver a package of measures to promote competition in the market for banking services to small and medium enterprises (SMEs) in the UK. This package will include: (i) an SME banking capability fund, administered by an independent body, which eligible challenger banks could access to increase their SME business banking capabilities; (ii) funding for eligible challenger banks to help them incentivise UK SME customers to switch their accounts from RBS to eligible challenger banks by paying in the form of “dowries”; (iii) the Group granting business customers of eligible challenger banks access to its branch network for cash and cheque handling, to support the incentivised switching programme; and (iv) the funding of an independent financial services innovation fund to invest in and help support the growth of existing businesses providing or developing innovative financial services or products for UK SMEs. In connection with this package of alternative measures, the Group has taken a £750 million provision in 2016. However, actual costs associated with the implementation of such measures may be materially higher as a result of unforeseen complexities and factors outside of the Group’s control.

Discussions will continue between the Group, HM Treasury and the European Commission to further develop the design of this package of alternative measures and the duration of them. The timing of the approval for this or any package of alternative measures is uncertain and there is no guarantee that the European Commission will ultimately agree to this or any package of alternative measures in replacement of the original terms of the State Aid Commitment Deed in relation to Williams & Glyn. In addition, the final scope and content of the package of alternative measures will be subject to further market testing by HM Treasury and a consultation exercise by the European Commission, either of which may result in amendments to the scope of and costs associated with this package as a result of which the final terms of a package of alternative measures may be more onerous than the scope of the plan set out above.

Risk factors continued

Implementation of the package, or if required as a result of the above process a more onerous package, and any associated business restructuring could divert resources from the Group's operations and jeopardise the delivery and implementation of other significant plans and initiatives. The incentivised transfer of SME customers to third parties places reliance on those third parties to achieve satisfactory customer outcomes which could give rise to reputational damage if these are not forthcoming.

Execution of the alternative measures package plan entails significant costs, including the funding commitments and financial incentives envisaged to be provided under the plan. In addition, the final terms of the agreement entered into among the Group, HM Treasury and the European Commission may include sanctions or additional financial incentives designed to ensure that the Group delivers its commitments. The Group will also need to assess the timing and manner in which to reintegrate the remaining Williams & Glyn business into the Group which is expected to result in additional restructuring charges and may adversely impact the Group's existing restructuring plans, including in respect of the implementation of the UK ring-fencing regime.

As a direct consequence of the incentivised switching component of the package of alternative measures described above, the Group will lose existing customers and deposits and associated revenues and margins. Furthermore, the SME banking capability fund and financial services innovation fund envisaged by the alternative plan is intended to benefit challenger banks and negatively impact the Group's competitive position. To support this incentivised switching initiative, the Group will also have to agree to grant business customers of eligible challenger banks access to its branch network for cash and cheque handling, which may result in reputational and financial exposure for the Group and impact customer service quality for RBS's own customers with consequent competitive, financial and reputational implications.

Additional information

Risk factors continued

If the Group fails to come to an agreement with HM Treasury and the European Commission in respect of the proposed package of alternative measures, and a determination is made that the Group remains required to divest Williams & Glyn, there is no guarantee that the Group will be able to identify or recommence discussions with interested buyers for Williams & Glyn at that time or that it will be able to agree a divestment on commercially beneficial terms, and there is no certainty that any such discussions would lead to a viable transaction. In addition, the Group would be required to conduct further restructuring in order to divest the Williams & Glyn business, at the same time that it is implementing significant restructuring changes in connection with the implementation of the UK ring-fencing regime and other restructuring changes which may be required as a result of the UK terminating its membership of the European Union, which entails material execution risks and costs, as well as diverting Group and management resources. In addition, if no alternative to the Group's current State Aid Commitment Deed obligations becomes effective, the Group would be unable to meet the principal obligation in the State Aid Commitment Deed to divest Williams & Glyn by 31 December 2017, which could entail material sanctions (including the appointment of a divestiture trustee, with the mandate to complete the divestment at no minimum price).

A failure to comply with the terms of the revised State Aid Commitment Deed, once agreed, could result in the imposition of additional measures or limitations on the Group's operations, additional supervision by the Group's regulators, and loss of investor confidence, any of which could have a material adverse impact on the Group. Delays in execution may also impact the Group's ability to carry out its transformation programme, including the implementation of cost saving initiatives and implement mandatory regulatory requirements, including the UK ring-fencing regime. Such risks will increase in line with any additional delays.

Implementation of the ring-fencing regime in the UK which began in 2015 and must be completed before 1 January 2019 will result in material structural changes to the Group's business. These changes could have a material adverse effect on the Group.

The requirement to "ring-fence" retail banking operations was introduced under the UK Financial Services (Banking Reform) Act 2013 (the "Banking Reform Act 2013") and adopted through secondary legislation (the UK ring-fencing regime). These reforms form part of a broader range of structural reforms of the banking industry seeking to improve the resilience and resolvability of banks and which range from structural reforms (including ring-fencing) to the implementation of a new recovery and resolution framework (which in the UK will incorporate elements of the ring-fencing regime). See "The Group and its subsidiaries are subject to a new and evolving framework on recovery and resolution, the impact of which remains uncertain, and which may result in additional compliance challenges and costs."

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Explanation of Responses:

Additional information

Risk factors continued

On 30 September 2016, the Group announced plans for its future ring-fencing compliant structure. By the end of 2018, the Group intends to place the majority of its UK and Western European banking business in ring-fenced banking entities organised as a sub-group under an intermediate holding company named NatWest Holdings Limited which will be a direct subsidiary of RBSG and will ultimately assume ownership of National Westminster Bank Plc, Adam & Company PLC (to be renamed The Royal Bank of Scotland plc) and Ulster Bank Ireland DAC (Ulster Bank). As a result, National Westminster Bank Plc will no longer be a subsidiary of RBS plc. The NatWest Markets franchise (formerly known as the Corporate and Institutional Banking business) and the RBS International business will be outside the ring-fence in other banking subsidiaries of RBSG.

As part of this restructuring, in mid-2018, the majority of existing personal, private, business and commercial customers of RBS plc will be transferred to the RFB, specifically to National Westminster Bank Plc and Adam & Company PLC which (on the same day) will be renamed The Royal Bank of Scotland plc. At the same time, RBS plc (which will sit outside the RFB) will be renamed NatWest Markets Plc to bring its legal name in line with the rebranding of the NatWest Markets franchise which was initiated in December 2016, and will continue to operate the NatWest Markets franchise as a direct subsidiary of RBSG.

As a result of the changes described above, the establishment of the RFB sub-group will have a material impact on how the Group conducts its business and requires a significant legal and organisational restructuring of the Group and the transfer of large numbers of assets, liabilities and customers between legal entities and the realignment of employees which started in early 2017. The Group is still considering whether a number of its current activities will be conducted within or outside of the RFB.

The Group’s final ring-fenced legal structure and the actions taken to achieve it, remain subject to, amongst other factors, additional regulatory, board and other approvals as well as employee representative information and consultation procedures. In particular, transfers of assets and liabilities through a ring-fencing transfer scheme are now subject to review by an Independent Skilled Person designated by the PRA in advance of commencing the formal court process in late 2017 prior to such transfers and migrations taking place in 2018, which may result in amendments being required to be made to the Group’s current plan and in delays in the implementation of the UK ring-fencing regime, additional costs and/or changes to the Group’s business.

Additional information

Risk factors continued

The implementation of these changes involves a number of risks related to both the revised Group structure and also the process of transition to that new structure. Those risks include the following:

- The Group is unable to predict how some customers may react to the required changes, including for some customers a requirement to deal with both the RFB and other Group entities outside the RFB to obtain the full range of products and services or to take any affirmative steps in connection with the reorganisation.

- As part of the establishment of the RFB, the RFB will need to operate independently from the rest of the Group and material changes to the existing corporate governance structure will need to be put in place by the Group to ensure the RFB's independence. This new structure may result in divergences between the various governance bodies within the Group and create operational challenges. In addition, the Group may experience difficulties in attracting qualified candidates to occupy these new positions and the new governance structure may result in an increase in overhead and compliance costs.

- In order to comply with the requirements of the UK ring-fencing regime, the Group will need to revise its operations infrastructure so as to comply with the shared services, independence and resolvability requirements set out in the UK ring-fencing rules, including in areas such as information technology (IT) infrastructure, human resources and critical service providers which may involve associated execution risk and may result in increased costs. Arrangements between RFB and other Group entities will also need to be reviewed in light of these requirements and the requirement that all such transactions take place on an arm's-length basis.

- The implementation of the UK ring-fencing regime will significantly impact the management of the Group's treasury operations, including internal and external funding arrangements. The changes required may adversely impact the assessment made by credit rating agencies, creditors and other stakeholders of the credit strength of the different entities on a standalone basis and may heighten the cost of capital and funding for the Group and its subsidiaries. The ability of bank entities outside the RFB to meet funding and capital prudential requirements will be dependent on obtaining an adequate credit rating. Reliance on intragroup exemptions in relation to the calculation of risk-weighted assets and large exposures may not be possible between the RFB and other Group entities and may result in risk-weighted assets inflation. Intragroup distributions (including payments of dividends) between RFB and other Group entities (with the exception of distributions to the Group parent company) will also be prohibited.

Additional information

Risk factors continued

- From 2026 it will not be possible for the RFB and other Group entities that are not RFB entities or wholly owned subsidiaries of the RFB to participate in the same defined benefit pension plan. As a result, it will be necessary to restructure the Group's defined benefit pension plans (including The Royal Bank of Scotland Group Pension Fund, the Group's main defined benefit pension scheme (the "Main Scheme")), such that either the RFB or other Group entities that are not wholly owned subsidiaries of the RFB leave the current scheme. The costs of separation may be material and may trigger certain legal and regulatory obligations including possibly increased contributions. Such restructuring may also result in additional or increased cash contributions in the event the pension trustees determine that the employer covenant has been weakened as a result of such separation.

- The restructuring and planned transfers may also result in accounting consequences for the Group. Although a number of transfers will be made at book value between fully owned Group entities and will therefore not have an accounting impact, certain transfers will be made at fair value which may result in a profit or loss being recognised by Group entities. In addition, transfers of assets that have related hedging arrangements may result in adverse operational, financial or accounting consequences if the transfer is not consistent with the unaffected continuation of such hedging arrangements.

- In addition, the proposed transfers may have tax costs, or may impact the tax attributes of the RFB or other Group entities and the ability to transfer tax losses between RFB and other Group entities.

The steps required to implement the UK ring-fencing regime within the Group to comply with the relevant rules and regulations are extraordinarily complex and require an extended period of time to plan, execute and implement and entail significant costs and operational, legal and execution risks, which risks may be exacerbated by the Group's other ongoing restructuring efforts. External or internal factors including new and developing legal requirements relating to the regulatory framework for the banking industry and the evolving regulatory and economic landscape resulting from the UK's planned exit from the EU, as well as further political developments or changes to the Group's current strategy or means of compliance with its EU State Aid Commitment, may require the Group to further restructure its operations (including its operations in Western Europe) and may in turn require further changes to be made to the Group's ring-fencing plans (including the planned structure of the Group post implementation).

Additional information

Risk factors continued

See "Changes to the prudential regulatory framework for banks and investment banks within the EU may require additional structural changes to the Group's operations which may affect current restructuring plans and have a material adverse effect on the Group". There is no certainty that the Group will be able to complete the legal restructuring and migration of customers by the 1 January 2019 deadline or in accordance with future rules and the consequences of non-compliance are currently uncertain. Conducting the Group's operations in accordance with the new rules may result in additional costs (transitional and recurring) following implementation and impact the Group's profitability. As a result, the implementation of the UK ring-fencing regime could have a material adverse effect on the Group's reputation, results of operations, financial condition and prospects.

The Group has been, and will remain, in a period of major restructuring through to 2019, which carries significant execution and operational risks, and the Group may not be a viable, competitive, customer-focused and profitable bank as a result.

Since early 2015, the Group has been implementing a major restructuring and transformation programme, articulated around a strategy focused on the growth of its strategic operations in Personal & Business Banking (PBB) and Commercial & Private Banking (CPB) and the further restructuring of the NatWest Markets franchise, to focus mainly on UK and Western European corporate and financial institutions. As part of this programme, the Group also continues to run-down certain of its operations, businesses and portfolios in order to reduce risk-weighted assets as well as the scope and complexity of its activities, including through the run-down of the higher risk and capital intensive assets in Capital Resolution. Throughout 2016, the Group stepped up the run-down of the higher risk and capital intensive assets in Capital Resolution, reducing risk-weighted assets by £14.5 billion.

Part of the focus of this transformation programme is to downsize and simplify the Group, reduce underlying costs, strengthen its overall capital position, improve customer experience and employee engagement, update its operational and technological capabilities, strengthen governance and control frameworks and better position the Group for the implementation of the UK ring-fencing regime by 1 January 2019. Together, these initiatives are referred to as the Group's "transformation programme".

Additional information

Risk factors continued

As part of its transformation programme, a number of financial, capital, operational and diversity targets, expectations and trends have been set by management for the Group, both for the short term and throughout the restructuring period. These include (but are not limited to) expectations relating to the Group's return to profitability and the timing thereof, one-off costs incurred in connection with material litigation and conduct matters and the timing thereof, expected growth rates in income, customer loans and advances and volumes and underlying drivers and trends, cost:income ratio targets, expectations with respect to reductions in operating costs, including remediation costs, expectations relating to restructuring costs and charges as well as impairment charges, disposal losses relating to Capital Resolution, CET1 ratio targets and expectations regarding funding plans and requirements, expectations with respect to reductions in risk-weighted assets and the timing thereof, expectations with respect to employees engagement and diversity targets.

The successful implementation of the Group's transformation programme and the Group's ability to meet associated targets and expectations, are subject to various internal and external factors and risks, including those described in this risk factor, the other risk factors included in this section and the disclosure included in the rest of this document. These include, but are not limited to, market, regulatory, economic and political uncertainties, developments relating to litigation and regulatory matters, operational risks, risks relating to the Group's business model and strategy and delays or difficulties in implementing its transformation programme, including the restructuring of its NatWest Markets franchise, the implementation of the UK ring-fencing regime and compliance with the Group's State Aid obligations. A number of factors may impact the Group's ability to maintain its CET1 ratio target at or over 13% throughout the restructuring period, including conduct related costs, pension or legacy charges, accounting impairments or limited organic capital generation through profits. In addition, the run-down of risk-weighted assets may be accompanied by the recognition of disposal losses which may be higher than anticipated, including due to a degraded economic environment. Further regulatory changes may also result in risk-weighted assets inflation in the medium term. For a further discussion of the risks associated with meeting the Group's capital targets, see" The Group's business performance and financial position could be adversely affected if its capital is not managed effectively or if it is unable to meet its capital targets.". The Group's ability to meet its cost:income ratio target and the planned reductions in its annual underlying costs (excluding restructuring and conduct-related charges) may also be impacted, and the focus on meeting cost reduction targets may result in limited investment in other areas which could affect the Group's long-term product offering or competitive position.

Additional information

Risk factors continued

Due to the changed nature of the Group's business model, the Group's expectations with respect to its return to profitability and the timing thereof may not be achieved in the timescale envisaged or at any time. An adverse macroeconomic environment, including sustained low interest rates, political and regulatory uncertainty, increased market competition and/or heightened litigation costs may also pose significant headwinds to the profitability of the Group. In addition there can be no certainty that the new business model defined for the NatWest Markets franchise will result in a sustainable or profitable business.

More generally, the targets, expectations and trends which accompany the Group's transformation programme are based on management plans, projections and models and are subject to a number of key assumptions and judgments any of which may prove to be inaccurate. Among others, the targets, expectations and trends set as part of the Group's transformation programme assume that the Group will be successful in implementing its business model and strategy, in executing its transformation programme and reducing the complexity of its business and infrastructure at the same time that it will be implementing significant structural changes to comply with the regulatory environment and that it will implement and maintain a robust control environment and effective culture, including with respect to risk management.

The Group may not be able to successfully implement any part of its transformation programme or reach any of its related targets or expectations in the time frames contemplated or at all. The Group's transformation programme comprises a large number of concurrent actions and initiatives, any of which could fail to be implemented due to operational or execution issues. Implementation of the Group's transformation programme is expected to result in significant costs, which could be materially higher than currently contemplated, including due to material uncertainties and factors outside of the Group's control.

Implementing the Group's current transformation programme, including the restructuring of its NatWest Markets franchise, requires further material changes to be implemented within the Group over the medium term concurrent with the implementation of significant structural changes to comply with the UK ring-fencing regime and resulting from the Group's seeking to comply with its State Aid obligations. This restructuring period will be disruptive, will increase operational and people risks for the Group and will continue to divert management resources from the conduct of the Group's operations and development of its business.

Additional information

Risk factors continued

The scale of changes being concurrently implemented has and will continue to require the implementation and application of robust governance and controls frameworks and there is no guarantee that the Group will be successful in doing so.

Due to changes in the micro and macro-economic and political and regulatory environment in which it operates, in particular as a result of the consequences of the EU Referendum, the Group may also be required to reconsider certain aspects of its current restructuring programme, or the timeframe for its implementation. In particular, there may be a need to further restructure the Group's Western European operations, including for example, as a result of potential changes in the prudential regulatory framework for banks and investment banks within the EU or if the Group is no longer able to rely on the passporting framework for financial services applicable in the EU. Any such additional restructuring will be likely to increase operational and people risks for the Group.

As a result, there can be no certainty that the implementation of the Group's transformation programme will prove to be a successful strategy, that the Group will meet its targets and expectations during the restructuring period or that the restructured Group will be a viable, competitive, customer-focused or profitable bank.

Operational risks are inherent in the Group's businesses and these risks are heightened as the Group implements its transformation programme, including significant cost reductions, the UK ring-fencing regime and compliance with its State Aid obligations against the backdrop of legal and regulatory changes.

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events, including legal risks. The Group has complex and diverse operations and operational risk and losses can result from a number of internal or external factors, including:

- internal and external fraud and theft from the Group;
- compromise of the confidentiality, integrity, or availability of the Group's data, systems and services;
- failure to identify or maintain the Group's key data within the limits of the Group's agreed risk appetite;
- failure of the Group's technology services due to loss of data, systems or data centre failure or failure by third parties to restore services;

- failure to appropriately or accurately manage the Group’s operations, transactions or security;
- incorrect specification of models used by the Group, implementing or using such models incorrectly;
- failure to effectively design, execute or deliver the Group’s transformation programme;
- failure to attract retain or engage staff;
- insufficient resources to deliver change and business-as-usual activity;
- decreasing employee engagement or failure by the Group to embed new ways of working and values; or
- incomplete, inaccurate or untimely statutory, regulatory or management reporting.

Additional information

Risk factors continued

Operational risks are and will continue to be heightened as a result of the number of initiatives being concurrently implemented by the Group, including the implementation of its transformation programme, including its cost-reduction programme, the implementation of the UK ring-fencing regime compliance with its State Aid obligations. Individually, these initiatives carry significant execution and delivery risk and such risks are heightened as their implementation is generally highly correlated and dependent on the successful implementation of interdependent initiatives.

These initiatives are being delivered against the backdrop of ongoing cost challenges and increasing legal and regulatory uncertainty and will put significant pressure on the Group's ability to maintain effective internal controls and governance frameworks. Although the Group has implemented risk controls and loss mitigation actions and significant resources and planning have been devoted to mitigate operational risk, it is not possible to be certain that such actions have been or will be effective in controlling each of the operational risks faced by the Group. Ineffective management of operational risks could have a material adverse effect on the Group's business, financial condition and results of operations.

The Group is exposed to cyberattacks and a failure to prevent or defend against such attacks could have a material adverse effect on the Group's operations, results of operations or reputation.

The Group is subject to cybersecurity attacks which have regularly targeted financial institutions and corporates as well as governments and other institutions and have materially increased in frequency, sophistication and severity in recent years. The Group relies on the effectiveness of its internal policies and associated procedures, IT infrastructure and capabilities to protect the confidentiality, integrity and availability of information held on its computer systems, networks and mobile devices, and on the computer systems, networks and mobile devices of third parties on whom the Group relies.

Additional information

Risk factors continued

The Group takes measures to protect itself from attacks designed to prevent the delivery of critical business processes to its customers. Despite these preventative measures, the Group's computer systems, software, networks and mobile devices, and those of third parties on whom the Group relies, are vulnerable to cyberattacks, sabotage, unauthorised access, computer viruses, worms or other malicious code, and other events that have a security impact. Financial institutions, such as the Group, with complex legacy infrastructure may be even more susceptible to attack due to the increased number of potential entry points and weaknesses.

Failure to protect the Group's operations from cyberattacks or to continuously review and update current processes in response to new threats could result in the loss of customer data or other sensitive information as well as instances of denial of service for the Group's customers. Although the Group experienced attempted distributed denial of service (DDoS) attacks in 2016, none of these attacks were successful. During 2015, the Group experienced a number of DDoS attacks, one of which had a temporary impact on some of NatWest's web services, as well as a smaller number of malware attacks.

The Bank of England, the FCA and HM Treasury in the UK and regulators, in the US and in Europe have identified cybersecurity as a systemic risk to the financial sector and highlighted the need for financial institutions to improve resilience to cyberattacks and the Group expects greater regulatory engagement, supervision and enforcement on cybersecurity in the future. The Group continues to participate in initiatives led by the Bank of England and other regulators designed to test how major firms respond to significant cyberattacks. The outputs of this exercise and other regulatory and industry-led initiatives are being incorporated into the Group's on-going IT priorities and improvement measures. However, the Group expects to be the target of continued attacks in the future and there can be no certainty that the Group will be able to effectively mitigate the impact of such attacks.

Any failure in the Group's cybersecurity policies, procedures or capabilities, or cyber-related crime, could lead to the Group suffering reputational damage and a loss of customers, regulatory investigations or sanctions being imposed and could have a material adverse effect on the Group's results of operations, financial condition or prospects.

Additional information

Risk factors continued

The Group’s business performance and financial position could be adversely affected if its capital is not managed effectively or if it is unable to meet its capital targets.

Effective management of the Group’s capital is critical to its ability to operate its businesses, comply with its regulatory obligations, pursue its strategy of returning to stand-alone strength, resume dividend payments on its ordinary shares and maintain discretionary payments. The Group is required by regulators in the UK, the EU and other jurisdictions in which it undertakes regulated activities to maintain adequate capital resources. Adequate capital also gives the Group financial flexibility in the face of continuing turbulence and uncertainty in the global economy and specifically in its core UK and European markets.

The Group currently targets a CET1 ratio at or above 13% throughout the period until completion of its restructuring. On a fully loaded basis, the Group’s CET1 ratio was 13.4% at 31 December 2016, compared with 15.5% at 31 December 2015.

The Group’s target capital ratio is based on its expected regulatory requirements and internal modelling, including of stress scenarios. However, the Group’s ability to achieve such targets depends on a number of factors, including the implementation of its transformation programme and any of the factors described below. A shortage of capital, which could in turn affect the Group’s capital ratio, could arise from:

- a depletion of the Group’s capital resources through increased costs or liabilities (including pension, conduct and litigation costs), reduced profits or increased losses (which would in turn impact retained earnings), sustained periods of low or lower interest rates, reduced asset values resulting in write-downs or impairments or accounting charges;

- an increase in the amount of capital that is required to meet the Group’s regulatory requirements, including as a result of changes to the actual level of risk faced by the Group, factors influencing the Group’s regulator’s determination of the firm-specific Pillar 2B buffer applicable to the Group (PRA buffer), changes in the minimum levels of capital or liquidity required by legislation or by the regulatory authorities or the calibration of capital or leverage buffers applicable to the Group, including countercyclical buffers, increases in risk-weighted assets or in the risk weighting of existing asset classes, or an increase in the Group’s view of any management buffer it needs, taking account of, for example, the capital levels or capital targets of the Group’s peer banks and criteria set by the credit rating agencies.

Explanation of Responses:

Additional information

Risk factors continued

The Group's current capital strategy is based on the expected accumulation of additional capital through the accrual of profits over time and/or through the planned reduction of its risk-weighted assets through disposals or natural attrition, the execution of which is subject to operational and market risks.

Further losses or a failure to meet profitability targets or reduce risk-weighted assets in accordance with or within the timeline contemplated by the Group's capital plan, a depletion of its capital resources, earnings and capital volatility resulting from the implementation of IFRS 9 as of 1 January 2018, or an increase in the amount of capital it needs to hold (including as a result of the reasons described above), would adversely impact the Group's ability to meet its capital targets or requirements and achieve its capital strategy during the restructuring period.

If the Group is determined to have a shortage of capital as a result of any of the circumstances described above, the Group may suffer a loss of confidence in the market with the result that access to liquidity and funding may become constrained or more expensive or may result in the Group being subject to regulatory interventions and sanctions. The Group's regulators may also request that the Group carry out certain capital management actions or, in an extreme scenario, this may also trigger the implementation of its recovery plans. Such actions may, in turn, affect the Group's product offering, capacity to continue its business operations, pay future dividends and make other distributions (including discretionary coupons on capital instruments) or pursue strategic opportunities, affecting the underlying profitability of the Group and future growth potential.

Additional information

Risk factors continued

If, in response to such shortage, certain regulatory capital instruments are converted into equity or the Group raises additional capital through the issuance of share capital or regulatory capital instruments, existing shareholders may experience a dilution of their holdings. The success of such issuances will also be dependent on favourable market conditions and the Group may not be able to raise the amount of capital required or on satisfactory terms. Separately, the Group may address a shortage of capital by taking action to reduce leverage and/or risk-weighted assets, by modifying the Group's legal entity structure or by asset or business disposals. Such actions may affect the underlying profitability of the Group.

Failure by the Group to comply with regulatory capital and leverage requirements may result in intervention by its regulators and loss of investor confidence, and may have a material adverse effect on its results of operations, financial condition and reputation and may result in distribution restrictions and adversely impact existing shareholders.

The Group is subject to extensive regulatory supervision in relation to the levels and quality of capital it is required to hold in connection with its business, including as a result of the transposition of the Basel Committee on Banking Supervision's regulatory capital framework (Basel III) in Europe by a Directive and Regulation (collectively known as CRD IV).

In addition, the Group is currently identified as a global systemically important bank (G-SIB) by the Financial Stability Board (FSB) and is therefore subject to more intensive oversight and supervision by its regulators as well as additional capital requirements, although the Group belongs to the last "bucket" of the FSB G-SIB list and is therefore subject to the lowest level of additional loss-absorbing capital requirements. As the Group reduces its global footprint and its balance sheet, the FSB may, at its discretion, determine that the Group is no longer a G-SIB.

Additional information

Risk factors continued

Under CRD IV, the Group is required to hold at all times a minimum amount of regulatory capital calculated as a percentage of risk-weighted assets (Pillar 1 requirement). CRD IV also introduced a number of new capital buffers that are in addition to the Pillar 1 and Pillar 2A requirements (as described below) that must be met with CET1 capital. The combination of the capital conservation buffer (which, subject to transitional provisions, will be set at 2.5% from 2019), the countercyclical capital buffer (of up to 2.5% which is currently set at 0% by the FPC for UK banks) and the higher of (depending on the institution) the systemic risk buffer, the global systemically important institutions buffer (G-SIB Buffer) and the other systemically important institutions buffer, is referred to as the “combined buffer requirement”. These rules entered into force on 1 May 2014 for the countercyclical capital buffer and on 1 January 2016 for the capital conservation buffer and the G-SIB buffer. The G-SIB buffer is currently set at 1.0% for the Group (from 1 January 2017), and is being phased in over the period to 1 January 2019. The systemic risk buffer will be applicable from 1 January 2019. The Bank of England’s Financial Policy Committee (the FPC) was responsible for setting the framework for the systemic risk buffer and the PRA adopted in December 2016 a final statement of policy implementing the FPC’s framework. In early 2019, the PRA is expected to determine which institutions the systemic risk buffer should apply to, and if so, how large the buffer should be up to a maximum of 3% of a firm’s risk-weighted assets. The systemic risk buffer will apply to ring-fenced entities only and not all entities within a banking group. The systemic risk buffer is part of the UK framework for identifying and setting higher capital buffers for domestic systemically important banks (D-SIBs), which are groups that, upon distress or failure, could have an important impact on their domestic financial systems. This follows on the 2012 framework recommendations by the FSB that national authorities should identify D-SIBs and take measures to reduce the probability and impact of the distress or failure of D-SIBs.

In addition, national supervisory authorities may add extra capital requirements (the Pillar 2A requirements) to cover risks that they believe are not covered or insufficiently covered by Pillar 1 requirements. The Group’s current Pillar 2A requirement set by the PRA at an equivalent of 3.8% of risk-weighted assets. The PRA has also introduced the PRA buffer which is a forward-looking requirement set annually and based on various factors including firm-specific stress test results and credible recovery and resolution planning and is to be met with CET1 capital (in addition to any CET1 Capital used to meet any Pillar 1 or Pillar 2A requirements).

Additional information

Risk factors continued

Where appropriate, the PRA may require an increase in an institution's PRA buffer to reflect additional capital required to be held to mitigate the risk of additional losses that could be incurred as a result of risk management and governance weaknesses, including with respect to the effectiveness of the internal stress testing framework and control environment. UK banks are required to meet the higher of the combined buffer requirement or PRA buffer requirement.

In addition to capital requirements and buffers, the regulatory framework adopted under CRD IV, as transposed in the UK, sets out minimum leverage ratio requirements for financial institutions, namely: (i) a minimum leverage requirement of 3% which applies to major UK banks, (ii) an additional leverage ratio to be met by G-SIBs and ring-fenced institutions to be calibrated at 35% of the relevant firm's capital G-SIB Buffer or systemic risk buffer and which is being phased in from 2016 (currently set at 0.175% from 1 January 2017) and (iii) a countercyclical leverage ratio buffer for all firms subject to the minimum leverage ratio requirements which is calibrated at 35% of a firm's countercyclical capital buffer. Further changes may be made to the current leverage ratio framework as a result of future regulatory reforms, including FSB proposals and proposed amendments to the CRD IV proposed by the European Commission in November 2016.

Most of the capital requirements which apply or will apply to the Group will need to be met in whole or in part with CET1 capital. CET1 capital broadly comprises retained earnings and equity instruments, including ordinary shares. As a result, the Group's ability meet applicable CET1 capital requirements is dependent on organic generation of CET1 through sustained profitability and/or the Group's ability to issue ordinary shares, and there is no guarantee that the Group may be able to generate CET1 capital through either of these alternatives.

The amount of regulatory capital required to meet the Group's regulatory capital requirements (and any additional management buffer), is determined by reference to the amount of risk-weighted assets held by the Group. The models and methodologies used to calculate applicable risk-weightings are a combination of individual models, subject to regulatory permissions, and more standardised approaches. The rules are applicable to the calculation of the Group's risk-weighted assets are subject to regulatory changes which may impact the levels of regulatory capital required to be met by the Group.

Explanation of Responses:

Additional information

Risk factors continued

The Basel Committee and other agencies remain focused on changes that will increase, or recalibrate, measures of risk-weighted assets as the key measure of the different categories of risk in the denominator of the risk-based capital ratio. While they are at different stages of maturity, a number of initiatives across risk types and business lines are in progress that are expected to impact the calculation of risk-weighted assets.

The Basel Committee is currently consulting on new rules relating to the risk weighting of real estate exposures and other changes to risk-weighting calculations, including proposals to introduce floors for the calculation of risk-weighted assets, which could directly affect the calculation of capital ratios. However, given recent delays, the timing and outcome of this consultation is increasingly uncertain. In the UK, the PRA is also considering ways of reducing the sensitivity of UK mortgage risk weights to economic conditions. The Basel Committee is also consulting on a revised standardised measurement approach for operational risk. Certain EU officials have raised concerns in relation to the new proposed rules and there is therefore uncertainty as to the way in which the FSB's proposals would be implemented in the EU. The new approach for operational risk would replace the three existing standardised approaches for calculating operational risk, as well as the internal model-based approach. The proposed new methodology combines a financial statement-based measure of operational risk, with an individual firm's past operational losses. While the quantum of impact of these reforms remains uncertain owing to lack of clarity of the proposed changes and the timing of their introduction, the implementation of such initiatives may result in higher levels of risk-weighted assets and therefore higher levels of capital, and in particular CET1 capital, required to be held by the Group, under Pillar 1 requirements. Such requirements would be separate from any further capital overlays required to be held as part of the PRA's determination of the Group's Pillar 2A or PRA buffer requirements with respect to such exposures.

Additional information

Risk factors continued

Although the above provides an overview of the capital and leverage requirements currently applicable to the Group, such requirements are subject to ongoing amendments and revisions, including as a result of final rules and recommendations adopted by the FSB or by European or UK regulators. In particular, on 23 November 2016, the European Commission published a comprehensive package of reforms including proposed amendments to CRD IV and the EU Bank Recovery and Resolution Directive “BRRD”. Although such proposals are currently being considered and discussed among the European Commission, the European Parliament and the European Council and their final form and the timetable for their implementation are not known, such amendments may result in increased or more stringent requirements applying to the Group or its subsidiaries. This uncertainty is compounded by the UK’s decision to leave the EU following the outcome of the EU Referendum which may result in further changes to the prudential and regulatory framework applicable to the Group.

If the Group is unable to raise the requisite amount of regulatory capital (including loss absorbing capital), or to otherwise meet regulatory capital and leverage requirements, it may be exposed to increased regulatory supervision or sanctions, loss of investor confidence, restrictions on distributions and it may be required to reduce further the amount of its risk-weighted assets or total assets and engage in the disposal of core and other non-core businesses, which may not occur on a timely basis or achieve prices which would otherwise be attractive to the Group.

This may also result in write-down or the conversion into equity of certain regulatory capital instruments issued by the Group or the issue of additional equity by the Group, each of which could result in the dilution of the Group’s existing shareholders. A breach of the Group’s applicable capital or leverage requirements may also trigger the application of the Group’s recovery plan to remediate a deficient capital position.

Additional information

Risk factors continued

Failure by the Group to comply with its capital requirements or to maintain sufficient distributable reserves may result in the application of restrictions on its ability to make discretionary distributions, including the payment of dividends to its ordinary shareholders and coupons on certain capital instruments.

In accordance with the provisions of CRD IV, a minimum level of capital adequacy is required to be met by the Group in order for it to be entitled to make certain discretionary payments.

Pursuant to Article 141 (Restrictions on distribution) of the CRD IV Directive, as transposed in the UK, institutions that fail to meet the "combined buffer requirement" will be subject to restricted "discretionary payments" (which are defined broadly by CRD IV as payments relating to CET1 instruments (dividends), variable remuneration and coupon payments on additional tier 1 instruments). The resulting restrictions are scaled according to the extent of the breach of the "combined buffer requirement" and calculated as a percentage of the profits of the institution since the last distribution of profits or "discretionary payment" which gives rise to a maximum distributable amount (MDA) (if any) that the financial institution can distribute through discretionary payments. The EBA has clarified that the CET1 capital to be taken into account for the MDA calculation should be limited to the amount not used to meet the Pillar 1 and Pillar 2 own funds requirements of the institution. In the event of a breach of the combined buffer requirement,

the Group will be required to calculate its MDA, and as a consequence it may be necessary for the Group to reduce or cease discretionary payments to the extent of the breach.

The ability of the Group to meet the combined buffer requirement will be subject to the Group holding sufficient CET1 capital in excess of its minimum Pillar 1 and Pillar 2 capital requirements. In addition, the interaction of such restrictions on distributions with the capital requirements and buffers applicable to the Group remains uncertain in many respects while the relevant authorities in the EU and the UK consult on and develop their proposals and guidance on the application of the rules. In particular, the proposals published by the European Commission in November 2016 contain certain proposed amendments to Article 141, including to introduce a "stacking order" in the calculation of the maximum distributable amount and establish certain priorities in the payments which could be made in the event the restrictions apply (with payments relating to additional tier 1 instruments being required to be made before payments on CET1 instruments (dividends) or other discretionary payments). The treatment of MDA breaches under the European Commission proposals differ from the proposed consequences set out in the final PRA rules and may result in uncertainty in the application of these rules.

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Additional information

Risk factors continued

In addition to these rules, in order to make distributions (including dividend payments) in the first place, RBSG is required to have sufficient distributable reserves available. Furthermore, coupon payments due on the additional tier 1 instruments issued by RBSG must be cancelled in the event that RBSG has insufficient "distributable items" as defined under CRD IV. Both distributable reserves and distributable items are largely impacted by the Group's ability to generate and accumulate profits or conversely by material losses (including losses resulting from conduct related-costs, restructuring costs or impairments).

RBSG's distributable reserves and distributable items are sensitive to the accounting impact of factors including the redemption of preference shares, restructuring costs and impairment charges and the carrying value of its investments in subsidiaries which are carried at the lower of cost and their prevailing recoverable amount. Recoverable amounts depend on discounted future cash flows which can be affected by restructurings, including the restructuring required to implement the UK ring-fencing regime, or unforeseen events. The distributable reserves of RBSG also depend on the receipt of income from subsidiaries, principally as dividends. The ability of subsidiaries to pay dividends is subject to their performance and applicable local laws and other restrictions, including their respective regulatory requirements and distributable reserves. Any of these factors, including restructuring costs, impairment charges and a reduction in the carrying value of RBSG subsidiaries or a shortage of dividends from them could limit RBSG's ability to maintain sufficient distributable reserves to be able to pay coupons on certain capital instruments and dividends to its ordinary shareholders. In Q3 2016, the Group reviewed the value of the investments in subsidiaries held in the parent company, RBSG, and in light of the deterioration in the economic outlook, impaired the carrying value of the investments by £6.0 billion to £44.7 billion.

Additional information

Risk factors continued

This had the effect of reducing distributable profits of RBSG by £6.0 billion and the Group may be required to recognise further impairments in the future if the outlook for its subsidiaries were to worsen. Whilst this level of distributable profits does not impact upon RBSG's ability to pay coupons on existing securities, the Group intends to implement a capital reorganisation in 2017 (subject to shareholder and court approval) in order to increase RBSG's distributable reserves, providing greater flexibility for potential future distributions and preference share redemptions (if any).

Failure by the Group to meet the combined buffer requirement or retain sufficient distributable reserves or distributable items as a result of reduced profitability or losses, or changes in regulation or taxes adversely impacting distributable reserves or distributable items, may therefore result in limitations on the Group's ability to make discretionary distributions which may negatively impact the Group's shareholders, holders of additional tier 1 instruments, staff receiving variable compensation (such as bonuses) and other stakeholders and impact its market valuation and investors' and analysts' perception of its financial soundness.

The Group is subject to stress tests mandated by its regulators in the UK and in Europe which may result in additional capital requirements or management actions which, in turn, may impact the Group's financial condition, results of operations and investor confidence or result in restrictions on distributions.

The Group is subject to annual stress tests by its regulator in the UK and also subject to stress tests by the European regulators with respect to RBSG, RBS NV and Ulster Bank. Stress tests provide an estimate of the amount of capital banks might deplete in a hypothetical stress scenario. In addition, if the stress tests reveal that a bank's existing regulatory capital buffers are not sufficient to absorb the impact of the stress, it is possible that it will need to take action to strengthen its capital position. There is a strong expectation that the PRA would require a bank to take action if, at any point during the stress, a bank were projected to breach any of its minimum CET1 capital or leverage ratio requirements. However, if a bank is projected to fail to meet its systemic buffers, it will still be expected to strengthen its capital position over time but the supervisory response is expected to be less intensive than if it were projected to breach its minimum capital requirements. The PRA will also use the annual stress test results to inform its determination of whether individual banks' current capital positions are adequate or need strengthening. For some banks, their individual stress-test results might imply that the capital conservation buffer and countercyclical rates set for all banks is not consistent with the impact of the stress on them. In that case, the PRA can increase regulatory capital buffers for individual banks by adjusting their PRA buffers.

Explanation of Responses:

Additional information

Risk factors continued

Under the 2016 Bank of England stress tests, which were based on the balance sheet of the Group for the year ended 31 December 2015, the Group did not meet its CET1 capital or Tier 1 leverage hurdle rates before additional tier 1 conversion. After additional tier 1 conversion, it did not meet its CET1 systemic reference point or Tier 1 leverage ratio hurdle rate. In light of the stress test results the Group agreed a revised capital plan with the PRA to improve its stress resilience in light of the various challenges and uncertainties facing both the Group and the wider economy highlighted by the concurrent stress testing process. As part of this revised capital plan, the Group intends to execute an array of capital management actions to supplement organic capital generation from its core franchises and further improve its stress resilience, including: further decreasing the cost base of the Group; further reductions in risk-weighted assets across the Group; further run-down and sale of other non-core loan portfolios in relation to the personal and commercial franchises and the management of undrawn facilities in 2017. Additional management actions may be required by the PRA until the Group's balance sheet is sufficiently resilient to meet the regulator's stressed scenarios.

Consistent with the approach set out in the 2015, the 2017 Bank of England stress test will, for the first time, test the resilience of the system, and individual banks within it, against two stress scenarios. In addition to the annual cyclical scenario, there will be an additional 'exploratory' scenario that will be tested for the first time in 2017. This will allow the Bank of England to assess the resilience of the system, and the individual banks within it, to a wider range of potential threats, including weak global supply growth, persistently low interest rates, and a continuation of declines in both world trade relative to GDP and cross-border banking activity. If the Group were to fail under either of these scenarios, it may be required to take further action to strengthen its capital position. In addition, the introduction of IFRS 9, effective for annual periods beginning on or after 1 January 2018, is expected to result in capital volatility for the Group, which in turn could have an impact on the Group's ability to meet its required CET1 ratio in a stress test scenario.

Additional information

Risk factors continued

Failure by the Group to meet the thresholds set as part of the stress tests carried out by its regulators in the UK and elsewhere may result in the Group's regulators requiring the Group to generate additional capital, increased supervision and/or regulatory sanctions, restrictions on capital distributions and loss of investor confidence, which may impact the Group's financial condition, results of operations and prospects.

As a result of extensive reforms being implemented relating to the resolution of financial institutions within the UK, the EU and globally, material additional requirements will arise to ensure that financial institutions maintain sufficient loss-absorbing capacity. Such changes to the funding and regulatory capital framework may require the Group to meet higher capital levels than the Group anticipated within its strategic plans and affect the Group's funding costs.

In addition to the prudential requirements applicable under CRD IV, the BRRD introduces, among other things, a requirement for banks to maintain at all times a sufficient aggregate amount of own funds and "eligible liabilities" (that is, liabilities that can absorb loss and assist in recapitalising a firm in accordance with a predetermined resolution strategy), known as the minimum requirements for own funds and eligible liabilities (MREL), designed to ensure that the resolution of a financial institution may be carried out, without public funds being exposed to the risk of loss and in a way which ensures the continuity of critical economic functions, maintains financial stability and protects depositors.

In November 2015, the FSB published a final term sheet setting out its total loss-absorbing capacity (TLAC) standards for G-SIBs. The EBA was mandated to assess the implementation of MREL in the EU and the consistency of MREL with the final TLAC standards and published an interim report setting out the conclusions of its review in July 2016 and its final report in December 2016. On the basis of the EBA's work and its own assessment of CRD IV and the BRRD, the European Commission published in November 2016 a comprehensive set of proposals, seeking to make certain amendments to the existing MREL framework. In particular, the proposals make a number of amendments to the MREL requirements under the BRRD, in part in order to transpose the FSB's final TLAC term sheet.

Additional information

Risk factors continued

The UK government is required to transpose the BRRD's provisions relating to MREL into law through further secondary legislation. In November 2016, the Bank of England published its final rules setting out its approach to setting MREL for UK banks. These final rules (which were adopted on the basis of the current MREL framework in force in the EU) do not take into account the European Commission’s most recent proposals with respect to MREL and differ in a number of respects. In addition, rules relating to a number of specific issues under the framework remain to be implemented, following the publication of further rules by the FSB, in particular rules on internal MREL requirements, cross holdings and disclosure requirements are outstanding.

The Bank of England is responsible for setting the MREL requirements for each UK bank, building society and certain investment firms in consultation with the PRA and the FCA, and such requirement will be set depending on the resolution strategy of the financial institution. In its final rules, the Bank of England has set out a staggered compliance timeline for UK banks, including with respect to those requirements applicable to G-SIBs (including the Group). Under the revised timeline, G-SIBs will be expected to (i) meet the minimum requirements set out in the FSB’s TLAC term sheet from 1 January 2019 (i.e. the higher of 16% of risk-weighted assets or 6% of leverage exposures), and (ii) meet the full MREL requirements to be phased in from 1 January 2020, with the full requirements applicable from 2 January 2022 (i.e. for G-SIBs two times Pillar 1 plus Pillar 2A or the higher of two times the applicable leverage ratio requirement or 6.75% of leverage exposures). MREL requirements are expected to be set on consolidated, sub-consolidated and individual bases, and are in addition to regulatory capital requirements(so that there can be no double counting of instruments qualifying for capital requirements).

For institutions, including the Group, for which bail-in is the required resolution strategy and which are structured to permit single point of entry resolution due to their size and systemic importance, the Bank of England has indicated that in order to qualify as MREL, eligible liabilities must be issued by the resolution entity (i.e. the holding company for the Group) and be structurally subordinated to operating and excluded liabilities (which include insured deposits, short-term debt, derivatives, structured notes and tax liabilities).

Additional information

Risk factors continued

The final PRA rules set out a number of liabilities which cannot qualify as MREL and are therefore “excluded liabilities”. As a result, senior unsecured issuances by RBSG will need to be subordinated to the excluded liabilities described above. The proceeds from such issuances will be transferred downstream to material operating subsidiaries in the form of capital or another form of subordinated claim. In this way, MREL resources will be “structurally subordinated” to senior liabilities of operating companies, allowing losses from operating companies to be transferred to the holding company and - if necessary - for resolution to occur at the holding company level, without placing the operating companies into a resolution process. The TLAC standard includes an exemption from this requirement if the total amount of excluded liabilities on RBSG’s balance sheet does not exceed 5% of its external TLAC (i.e. the eligible liabilities RBSG has issued to investors which meet the TLAC requirements) and the Bank of England has adopted this criterion in its final rules. If the Group were to fail to comply with this “clean balance sheet” requirement, it could disqualify otherwise eligible liabilities from counting towards MREL and result in the Group breaching its MREL requirements.

Compliance with these and other future changes to capital adequacy and loss-absorbency requirements in the EU and the UK by the relevant deadline will require the Group to restructure its balance sheet and issue additional capital compliant with the rules which may be costly whilst certain existing Tier 1 and Tier 2 securities and other senior instruments issued by the Group will cease to count towards the Group’s loss-absorbing capital for the purposes of meeting MREL/TLAC requirements. The Group’s resolution authority can impose an MREL requirement over and above the regulatory minima and potentially higher than the Group’s peers, if it has concerns regarding the resolvability of the Group. As a result, RBSG may be required to issue additional loss-absorbing instruments in the form of CET1 capital or subordinated or senior unsecured debt instruments or may result in an increased risk of a breach of the Group’s combined buffer requirement, triggering the restrictions relating to the MDA described above.

There remain some areas of uncertainty as to how these rules will be implemented within the UK, the EU and globally and the final requirements to which the Group will be subject, and the Group may therefore need to revise its capital plan accordingly. The European Commission’s recent proposals also include a proposal seeking to harmonise the priority ranking of unsecured debt instruments under national insolvency proceedings to facilitate the implementation of MREL across Europe. This rule is currently subject to consideration and negotiation by the European institutions but, to the extent it were to apply to the Group, it could impact the ranking of current or future senior unsecured creditors of the Group.

Explanation of Responses:

Additional information

Risk factors continued

The Group's borrowing costs, its access to the debt capital markets and its liquidity depend significantly on its credit ratings and, to a lesser extent, on the rating of the UK Government.

The credit ratings of RBSG, RBS plc and other Group members directly affect the cost of funding and capital instruments issued by the Group, as well as secondary market liquidity in those instruments. A number of UK and other European financial institutions, including RBSG, RBS plc and other Group companies, have been downgraded multiple times in recent years in connection with rating methodology changes and credit rating agencies' revised outlook relating to regulatory developments, macroeconomic trends and a financial institution's capital position and financial prospects.

The senior unsecured long-term and short-term credit ratings of RBSG are below investment grade by Moody's, and investment grade by S&P and Fitch. The senior unsecured long-term and short-term credit ratings of RBS plc are investment grade by Moody's, S&P and Fitch. The outlook for RBSG and RBS plc by Moody's is currently positive and is stable for S&P and Fitch.

Rating agencies regularly review the RBSG and Group entity credit ratings and their ratings of long-term debt are based on a number of factors, including the Group's financial strength as well as factors not within the Group's control, including political developments and conditions affecting the financial services industry generally. In particular, the rating agencies may further review the RBSG and Group entity ratings as a result of the implementation of the UK ring-fencing regime, pension and litigation/regulatory investigation risk, including potential fines relating to investigations relating to legacy conduct issues, and other macroeconomic and political developments, including in light of the outcome of the negotiations relating to the shape and timing of the UK's exit from the EU. A challenging macroeconomic environment, reduced profitability and greater market uncertainty could negatively impact the Group's performance and potentially lead to credit ratings downgrades which could adversely impact the Group's ability and cost of funding. The Group's ability to access capital markets on acceptable terms and hence its ability to raise the amount of capital and funding required to meet its regulatory requirements and targets, including those relating to loss-absorbing instruments to be issued by the Group, could be affected.

Additional information

Risk factors continued

Any further reductions in the long-term or short-term credit ratings of RBSG or of certain of its subsidiaries (particularly RBS plc), including further downgrades below investment grade, could adversely affect the Group's issuance capacity in the financial markets, increase its funding and borrowing costs, require the Group to replace funding lost due to the downgrade, which may include the loss of customer deposits and may limit the Group's access to capital and money markets and trigger additional collateral or other requirements in derivatives contracts and other secured funding arrangements or the need to amend such arrangements, limit the range of counterparties willing to enter into transactions with the Group and its subsidiaries and adversely affect its competitive position, all of which could have a material adverse impact on the Group's earnings, cash flow and financial condition.

As discussed above, the success of the implementation of the UK ring-fencing regime and the restructuring of the Group's NatWest Markets franchise, is in part dependent upon the relevant banking entities obtaining a sustainable credit rating. A failure to obtain such a rating, or any subsequent downgrades to current ratings may threaten the ability of the NatWest Markets franchise or other entities outside of the RFB, in particular with respect to their ability to meet prudential capital requirements. At 31 December 2016, a simultaneous one-notch long-term and associated short-term downgrade in the credit ratings of RBSG and RBS plc by the three main ratings agencies would have required the Group to post estimated additional collateral of £3.3 billion, without taking account of mitigating action by management. Individual credit ratings of RBSG, RBS plc, RBS N.V, RBS International and Ulster Bank are also important to the Group when competing in certain markets such as corporate deposits and over-the-counter derivatives.

The major credit rating agencies downgraded and changed their outlook to negative on the UK's sovereign credit rating following the results of the EU Referendum in June 2016. Any further downgrade in the UK Government's credit ratings could adversely affect the credit ratings of Group companies and may result in the effects noted above. Further political developments, including in relation to the UK's exit from the EU or the outcome of any further Scottish referendum could negatively impact the credit ratings of the UK Government and result in a downgrade of the credit ratings of RBSG and Group entities.

Additional information

Risk factors continued

The Group's ability to meet its obligations including its funding commitments depends on the Group's ability to access sources of liquidity and funding.

Liquidity risk is the risk that a bank will be unable to meet its obligations, including funding commitments, as they fall due. This risk is inherent in banking operations and can be heightened by a number of factors, including an over-reliance on a particular source of wholesale funding (including, for example, short-term and overnight funding), changes in credit ratings or market-wide phenomena such as market dislocation and major disasters. Credit markets worldwide, including interbank markets, have experienced severe reductions in liquidity and term funding during prolonged periods in recent years. In 2016, although the Group's overall liquidity position remained strong, credit markets experienced elevated volatility and certain European banks, in particular in the peripheral countries of Spain, Portugal, Greece and Italy, remained reliant on the ECB as one of their principal sources of liquidity.

The Group relies on retail and wholesale deposits to meet a considerable portion of its funding. The level of deposits may fluctuate due to factors outside the Group's control, such as a loss of confidence, increasing competitive pressures for retail customer deposits or the repatriation of deposits by foreign wholesale depositors, which could result in a significant outflow of deposits within a short period of time.

An inability to grow, or any material decrease in, the Group's deposits could, particularly if accompanied by one of the other factors described above, have a material adverse impact on the Group's ability to satisfy its liquidity needs. Increases in the cost of retail deposit funding may impact the Group's margins and profitability.

The Group is using the Bank of England's term funding scheme which was introduced in August 2016, in order to reduce the funding costs for the Group. Such funding has a short maturity profile and hence the Group will diversify its sources of funding.

Additional information

Risk factors continued

The market view of bank credit risk has changed radically as a result of the financial crisis and banks perceived by the market to be riskier have had to issue debt at significantly higher costs. Although conditions have improved, there have been recent periods where corporate and financial institution counterparties have reduced their credit exposures to banks and other financial institutions, limiting the availability of these sources of funding. Rules currently proposed by the FSB and in the EU in relation to the implementation of TLAC and MREL may also limit the ability of certain large financial institutions to hold debt instruments issued by other large financial institutions. The ability of the Bank of England to resolve the Group in an orderly manner may also increase investors' perception of risk and hence affect the availability and cost of funding for the Group. Any uncertainty relating to the credit risk of financial institutions may lead to reductions in levels of interbank lending or may restrict the Group's access to traditional sources of funding or increase the costs or collateral requirements for accessing such funding.

The Group has, at times, been required to rely on shorter-term and overnight funding with a consequent reduction in overall liquidity, and to increase its recourse to liquidity schemes provided by central banks. Such schemes require assets to be pledged as collateral. Changes in asset values or eligibility criteria can reduce available assets and consequently available liquidity, particularly during periods of stress when access to the schemes may be needed most. The implementation of the UK ring-fencing regime may also impact the Group's funding strategy and the cost of funding may increase for certain Group entities which will be required to manage their own funding and liquidity strategy, in particular those entities outside the ring-fence which will no longer be able to rely on retail deposit funding.

Additional information

Risk factors continued

In addition, the Group is subject to certain regulatory requirements with respect to liquidity coverage, including a liquidity coverage ratio set by the PRA in the UK. This requirement is currently being phased in and is set at 90% from 1 January 2017 to increase 100% in January 2018 (as required by the CRR). The PRA may also impose additional liquidity requirements to reflect risks not captured in the leverage coverage ratio by way of Pillar 2 add-ons, which may increase from time to time and require the Group to obtain additional funding or diversify its sources of funding. Current proposals by the FSB and the European Commission also seek to introduce certain liquidity requirements for financial institutions, including the introduction of a net stable funding ratio (NSFR). Under the European Commission November 2016 proposals, the NSFR would be calculated as the ratio of an institution's available stable funding relative to the required stable funding it needs over a one-year horizon.

The NSFR would be expressed as a percentage and set at a minimum level of 100%, which indicates that an institution holds sufficient stable funding to meet its funding needs during a one-year period under both normal and stressed conditions. If an institution’s NSFR were to fall below the 100% level, the institution would be required to take the measures laid down in the CRD IV Regulation for a timely restoration to the minimum level. Competent authorities would assess the reasons for non-compliance with the NSFR requirement before deciding on any potential supervisory measures. These proposals are currently being considered and negotiated among the European Commission, the European Parliament and the Council and, in light of the UK’s decision to leave the EU, there is considerable uncertainty as to the extent to which such rules will apply to the Group.

If the Group is unable to raise funds through deposits and/or in the capital markets, its liquidity position could be adversely affected and it might be unable to meet deposit withdrawals on demand or at their contractual maturity, to repay borrowings as they mature, to meet its obligations under committed financing facilities, to comply with regulatory funding requirements or to fund new loans, investments and businesses. The Group may need to liquidate unencumbered assets to meet its liabilities, including disposals of assets not previously identified for disposal to reduce its funding commitments. In a time of reduced liquidity, the Group may be unable to sell some of its assets, or may need to sell assets at depressed prices, which in either case could have a material adverse effect on the Group’s financial condition and results of operations.

Additional information

Risk factors continued

The Group's businesses and performance can be negatively affected by actual or perceived economic conditions in the UK and globally and other global risks and the Group will be increasingly impacted by developments in the UK as its operations become increasingly concentrated in the UK.

Actual or perceived difficult global economic conditions create challenging economic and market conditions and a difficult operating environment for the Group's businesses and its customers and counterparties. As part of its revised strategy, the Group has been refocusing its business in the UK, the ROI and Western Europe and, accordingly is more exposed to the economic conditions of the British economy as well as the Eurozone. In particular, the longer term effects of the EU Referendum are difficult to predict, and subject to wider global macro-economic trends, but may include periods of financial market volatility and slower economic growth, in the UK in particular, but also in the ROI, Europe and the global economy, at least in the short to medium term.

The outlook for the global economy over the medium-term remains uncertain due to a number of factors including: political instability, continued slowdown of global growth, an extended period of low inflation and low interest rates and delays in normalising monetary policy. Such conditions could be worsened by a number of factors including political uncertainty or macro-economic deterioration in the Eurozone or the US, increased instability in the global financial system and concerns relating to further financial shocks or contagion, a further weakening of the pound sterling, new or extended economic sanctions, volatility in commodity prices or concerns regarding sovereign debt. In particular, concerns relating to emerging markets, including lower economic growth or recession, concerns relating to the Chinese economy and financial markets, reduced global trade in emerging market economies to which the Group is exposed (including those economies to which the Group remains exposed pending the exit of certain of its businesses and which include China, India and Saudi Arabia) or increased financing needs as existing debt matures, may give rise to further instability and financial market volatility. Any of the above developments could impact the Group directly by resulting in credit losses and indirectly by further impacting global economic growth and financial markets.

Developments relating to current economic conditions, including those discussed above, could have a material adverse effect on the Group's business, financial condition, results of operations and prospects. Any such developments may also adversely impact the financial position of the Group's pension schemes, which may result in the Group being required to make additional contributions. See "The Group is subject to pension risks and may be required to make additional contributions to cover pension funding deficits as a result of degraded economic conditions or as a result of the restructuring of its pension schemes in relation to the implementation of the UK ring-fencing regime".

In addition, the Group is exposed to risks arising out of geopolitical events or political developments, such as trade barriers, exchange controls, sanctions and other measures taken by sovereign governments that can hinder economic or financial activity levels. Furthermore, unfavourable political, military or diplomatic events, armed conflict, pandemics and terrorist acts and threats, and the responses to them by governments, could also adversely affect economic activity and have an adverse effect upon the Group's business, financial condition and results of operations.

Additional information

Risk factors continued

Changes in interest rates or foreign exchange rates have significantly affected and will continue to affect the Group's business and results of operations.

Some of the most significant market risks that the Group faces are interest rate and foreign exchange risks. Monetary policy has been highly accommodative in recent years, including as a result of certain policies implemented by the Bank of England and HM Treasury such as the 'Funding for Lending' scheme, which have helped to support demand at a time of very pronounced fiscal tightening and balance sheet repair. In the UK, the Bank of England lowered interest rates to 0.25% in August 2016 and there remains considerable uncertainty as to whether or when the Bank of England and other central banks will increase interest rates. While the ECB has been conducting a quantitative easing programme since January 2015 designed to improve confidence in the Eurozone and encourage more private bank lending, there remains considerable uncertainty as to whether such measures have been or will be sufficient or successful and the extension of this programme during 2017 may put additional pressure on margins. Further decreases in interest rates by the Bank of England or other central banks, continued sustained low or negative interest rates or any divergences in monetary policy approach between the Bank of England and other major central banks could put further pressure on the Group's interest margins and adversely affect the Group's profitability and prospects. A continued period of low interest rates and yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs, the effect of which may be heightened during periods of liquidity stress.

Conversely while increases in interest rates may support Group income, sharp increases in interest rates could lead to generally weaker than expected growth, or even contracting GDP, reduced business confidence, higher levels of unemployment or underemployment, adverse changes to levels of inflation, potentially higher interest rates and falling property prices in the markets in which the Group operates. In turn, this could cause stress in the loan portfolio of the Group, particularly in relation to non-investment grade lending or real estate loans and consequently to an increase in delinquency rates and default rates among customers, leading to the possibility of the Group incurring higher impairment charges. Similar risks result from the exceptionally low level of inflation in developed economies, which in Europe particularly could deteriorate into sustained deflation if policy measures prove ineffective. Reduced monetary stimulus and the actions and commercial soundness of other financial institutions have the potential to impact market liquidity.

Additional information

Risk factors continued

Changes in currency rates, particularly in the sterling-US dollar and sterling-euro exchange rates, affect the value of assets, liabilities, income and expenses denominated in foreign currencies and the reported earnings of the Group's non-UK subsidiaries and may affect the Group's reported consolidated financial condition or its income from foreign exchange dealing. Such changes may result from the decisions of the Bank of England, ECB or of the US Federal Reserve or from political events and lead to sharp and sudden variations in foreign exchange rates, such as those seen in the GBP/USD exchange rates during the second half of 2016 following the EU Referendum.

The Group's earnings and financial condition have been, and its future earnings and financial condition may continue to be, materially affected by depressed asset valuations resulting from poor market conditions.

The Group's businesses and performance are affected by financial market conditions. The performance and volatility of financial markets affect bond and equity prices and have caused, and may in the future cause, changes in the value of the Group's investment and trading portfolios. Financial markets have recently experienced and may in the near term experience significant volatility, including as a result of concerns about the outcome of the EU Referendum, political and financial developments in the US and in Europe, including as a result of general elections, geopolitical developments and developments relating to trade agreements volatility and instability in the Chinese and global stock markets, expectations relating to or actions taken by central banks with respect to monetary policy, and weakening fundamentals of the Chinese economy, resulting in further short-term changes in the valuation of certain of the Group's assets. Uncertainty about potential fines for past misconduct and concerns about the longer-term viability of business models have also weighed heavily on the valuations of some financial institutions in Europe and in the UK, including the Group.

Additional information

Risk factors continued

Any further deterioration in economic and financial market conditions or weak economic growth could require the Group to recognise further significant write-downs and realise increased impairment charges or goodwill impairments, all of which may have a material adverse effect on its financial condition, results of operations and capital ratios. As part of its transformation programme, the Group is executing the run-down or disposal of a number of businesses, assets and portfolios. In addition, the Group's interest in the remainder of the businesses and portfolios within the exiting business may be difficult to sell due to unfavourable market conditions for such assets or businesses.

Moreover, market volatility and illiquidity (and the assumptions, judgements and estimates in relation to such matters that may change over time and may ultimately not turn out to be accurate) make it difficult to value certain of the Group's exposures. Valuations in future periods reflecting, among other things, the then-prevailing market conditions and changes in the credit ratings of certain of the Group's assets may result in significant changes in the fair values of the Group's exposures, such as credit market exposures, and the value ultimately realised by the Group may be materially different from the current or estimated fair value. As part of its ongoing derivatives operations, the Group also faces significant basis, volatility and correlation risks, the occurrence of which are also impacted by the factors noted above.

In addition, for accounting purposes, the Group carries some of its issued debt, such as debt securities, at the current market price on its balance sheet. Factors affecting the current market price for such debt, such as the credit spreads of the Group, may result in a change to the fair value of such debt, which is recognised in the income statement as a profit or loss.

Additional information

Risk factors continued

The financial performance of the Group has been, and may continue to be, materially affected by customer and counterparty credit quality and deterioration in credit quality could arise due to prevailing economic and market conditions and legal and regulatory developments.

The Group has exposure to many different industries, customers and counterparties, and risks arising from actual or perceived changes in credit quality and the recoverability of monies due from borrowers and other counterparties are inherent in a wide range of the Group's businesses.

In particular, the Group has significant exposure to certain individual customers and other counterparties in weaker business sectors and geographic markets and also has concentrated country exposure in the UK, the US and across the rest of Europe principally Germany, the Netherlands, Ireland and France.

At 31 December 2016, current exposure in the UK was £338.9 billion, in the US was £22.4 billion and in Western Europe (excluding the UK) was £79.7 billion); and within certain business sectors, namely personal, financial institutions, property, shipping and the oil and gas sector (at 31 December 2016, personal lending amounted to £166.2 billion, lending to banks and other financial institutions was £47.7 billion, property lending was £42.4 billion, lending to the oil and gas sector was £2.9 billion and shipping was £4.6 billion).

Provisions held on loans in default have decreased in recent years due to asset sales and the portfolio run-down in Ulster Bank ROI and Capital Resolution. If the risk profile of these loans were to increase, including as a result of a degradation of economic or market conditions, this could result in an increase in the cost of risk and the Group may be required to make additional provisions, which in turn would reduce earnings and impact the Group's profitability. The Group's lending strategy or processes may also fail to identify or anticipate weaknesses or risks in a particular sector, market or borrower category, which may result in an increase in default rates, which may, in turn, impact the Group's profitability. Any adverse impact on the credit quality of the Group's customers and other counterparties, coupled with a decline in collateral values, could lead to a reduction in recoverability and value of the Group's assets and higher levels of impairment allowances, which could have an adverse effect on the Group's operations, financial position or prospects.

Additional information

Risk factors continued

The credit quality of the Group's borrowers and its other counterparties is impacted by prevailing economic and market conditions and by the legal and regulatory landscape in their respective markets. Credit quality has improved in certain of the Group's core markets, in particular the UK and Ireland, as these economies have improved. However, a further deterioration in economic and market conditions or changes to legal or regulatory landscapes could worsen borrower and counterparty credit quality and also impact the Group's ability to enforce contractual security rights. In particular, the UK's decision to leave the EU may adversely impact credit quality in the UK.

In addition, as the Group implements its new strategy and withdraws from many geographic markets and continues to materially scale down its international activities, the Group's relative exposure to the UK and certain sectors and asset classes in the UK will increase significantly as its business becomes more concentrated in the UK. The level of UK household indebtedness remains high and the ability of some households to service their debts could be challenged by a period of higher unemployment. Highly indebted households are particularly vulnerable to shocks, such as falls in incomes or increases in interest rates, which threaten their ability to service their debts.

In particular, in the UK the Group is at risk from volatility in property prices in both the residential and commercial sectors. With UK home loans representing the most significant portion of the Group's total loans and advances to the retail sector, the Group has a large exposure to adverse developments in the UK residential property sector. In the UK commercial real estate market, activity slowed during the second half of 2016 following the EU Referendum. There is a risk of further adjustment given the reliance of the UK commercial real estate market in recent years on inflows of foreign capital and, in some segments, stretched property valuations. As a result, a fall in house prices, particularly in London and the South East of the UK, would be likely to lead to higher impairment and negative capital impact as loss given default rate increases. In addition, reduced affordability of residential and commercial property in the UK, for example, as a result of higher interest rates or increased unemployment, could also lead to higher impairments on loans held by the Group being recognised.

Additional information

Risk factors continued

The Group also remains exposed to certain counterparties operating in certain industries which have been under pressure in recent years, including the oil and gas and shipping industries, and any further deterioration in the outlook the credit quality of these counterparties may require the Group to make additional provisions, which in turn would reduce earnings and impact the Group's profitability.

In addition, the Group's credit risk is exacerbated when the collateral it holds cannot be realised as a result of market conditions or regulatory intervention or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due to the Group, which is most likely to occur during periods of illiquidity and depressed asset valuations, such as those experienced in recent years. This has particularly been the case with respect to large parts of the Group's commercial real estate portfolio. Any such deteriorations in the Group's recoveries on defaulting loans could have an adverse effect on the Group's results of operations and financial condition.

Concerns about, or a default by, one financial institution could lead to significant liquidity problems and losses or defaults by other financial institutions, as the commercial and financial soundness of many financial institutions may be closely related as a result of credit, trading, clearing and other relationships. Even the perceived lack of creditworthiness of, or questions about, a counterparty may lead to market-wide liquidity problems and losses for, or defaults by, the Group. This systemic risk may also adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with which the Group interacts on a daily basis.

The effectiveness of recent prudential reforms designed to contain systemic risk in the EU and the UK is yet to be tested. Counterparty risk within the financial system or failures of the Group's financial counterparties could have a material adverse effect on the Group's access to liquidity or could result in losses which could have a material adverse effect on the Group's financial condition, results of operations and prospects.

The trends and risks affecting borrower and counterparty credit quality have caused, and in the future may cause, the Group to experience further and accelerated impairment charges, increased repurchase demands, higher costs, additional write-downs and losses for the Group and an inability to engage in routine funding transactions.

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Explanation of Responses:

Additional information

Risk factors continued

The Group’s operations are highly dependent on its IT systems. A failure of the Group’s IT systems, including as a result of the lack of or untimely investments, could adversely affect its operations, competitive position and investor and customer confidence and expose the Group to regulatory sanctions.

The Group’s operations are dependent on the ability to process a very large number of transactions efficiently and accurately while complying with applicable laws and regulations where it does business. The proper functioning of the Group’s payment systems, financial and sanctions controls, risk management, credit analysis and reporting, accounting, customer service and other IT systems, as well as the communication networks between its branches and main data processing centres, are critical to the Group’s operations.

The vulnerabilities of the Group’s IT systems are due to their complexity, attributable in part to overlapping multiple dated systems that result from the Group’s historical acquisitions and insufficient investment prior to 2013 to keep the IT applications and infrastructure up-to-date. A complex IT estate containing end-of-life hardware and software creates challenges in recovering from system breakdowns. IT failures adversely affect the Group’s relationship with its customers and reputation and have led, and may in the future, lead to regulatory investigations and redress.

The Group experienced a limited number of IT failures in 2016 affecting customers, although improvements introduced since 2012 allowed the Group to contain the impact of such failures. The Group’s regulators in the UK are actively surveying progress made by banks in the UK to modernise, manage and secure their IT infrastructures, in order to prevent future failures affecting customers. Any critical system failure, any prolonged loss of service availability or any material breach of data security could cause serious damage to the Group’s ability to service its customers, could result in significant compensation costs or fines resulting from regulatory investigations and could breach regulations under which the Group operates.

In particular, failures or breaches resulting in the loss or publication of confidential customer data could cause long-term damage to the Group’s reputation, business and brands, which could undermine its ability to attract and keep customers.

Explanation of Responses:

Risk factors continued

The Group is currently implementing a number of complex initiatives, including its transformation programme, the UK ring-fencing regime and the restructuring of the NatWest Markets franchise, all which put additional strains on the Group's existing IT systems. A failure to safely and timely implement one or several of these initiatives could lead to disruptions of the Group's IT infrastructure and in turn cause long-term damage to the Group's reputation, brands, results of operations and financial position.

The Group has made, and will continue to make, considerable investments in its IT systems to further simplify and upgrade the systems and capabilities to make them more cost-effective and improve controls and procedures, strengthen cyber security defences, enhance the digital services provided to its bank customers and improve its competitive position and address system failures which adversely affect its relationship with its customers and reputation and may lead to regulatory investigations and redress. However, the Group's current focus on cost-saving measures as part of its transformation programme may impact the resources available to implement further improvements to the Group IT infrastructure or limit the resources available for investments in technological developments and innovations. Should such investment and rationalisation initiatives fail to achieve the expected results, or prove to be insufficient, it could have a material adverse impact on the Group's operations, its ability to retain or grow its customer business or its competitive position and could negatively impact the Group's financial position.

The Group's businesses are subject to substantial regulation and oversight. Significant regulatory developments and increased scrutiny by the Group's key regulators has had and is likely to continue to increase compliance and conduct risks and could have a material adverse effect on how the Group conducts its business and on its results of operations and financial condition.

The Group is subject to extensive laws, regulations, corporate governance requirements, administrative actions and policies in each jurisdiction in which it operates. Many of these have been introduced or amended recently and are subject to further material changes. Among others, the implementation and strengthening of the prudential and resolution framework applicable to financial institutions in the UK, the EU and the US, and future amendments to such rules, are considerably affecting the regulatory landscape in which the Group operates and will operate in the future, including as a result of the adoption of rules relating to the UK ring-fencing regime, prohibitions on proprietary trading, CRD IV and the BRRD and certain other measures. Increased regulatory focus in certain areas, including conduct, consumer protection regimes, anti-money laundering, payment systems, and antiterrorism laws and regulations, have resulted in the Group facing greater regulation and scrutiny in the UK, the US and other countries in which it operates.

Explanation of Responses:

Additional information

Risk factors continued

Recent regulatory changes, proposed or future developments and heightened levels of public and regulatory scrutiny in the UK, Europe and the US have resulted in increased capital, funding and liquidity requirements, changes in the competitive landscape, changes in other regulatory requirements and increased operating costs, and have impacted, and will continue to impact, product offerings and business models.

Such changes may also result in an increased number of regulatory investigations and proceedings and have increased the risks relating to the Group's ability to comply with the applicable body of rules and regulations in the manner and within the time frames required.

Such risks are currently exacerbated by the outcome of the EU Referendum and the UK's decision to leave the EU and the unprecedented degree of uncertainty as to the respective legal and regulatory frameworks in which the Group and its subsidiaries will operate when the UK is no longer a member of the EU. For example, current proposed changes to the European prudential regulatory framework for banks and investment banks may result in additional prudential or structural requirements being imposed on financial institutions based outside the EU wishing to provide financial services within the EU (which may apply to the Group once the UK has formally exited the EU). See also "Changes to the prudential regulatory framework for banks and investment banks within the EU may require additional structural changes to the Group's operations which may affect current restructuring plans and have a material adverse effect Group". In addition, the Group and its counterparties may no longer be able to rely on the European passporting framework for financial services and could be required to apply for authorisation in multiple European jurisdictions, the costs, timing and viability of which is uncertain.

Any of these developments (including failures to comply with new rules and regulations) could have a significant impact on how the Group conducts its business, its authorisations and licences, the products and services it offers, its reputation and the value of its assets, the Group's operations or legal entity structure, including attendant restructuring costs and consequently have a material adverse effect on its business, funding costs, results of operations, financial condition and future prospects.

Additional information

Risk factors continued

Areas in which, and examples of where, governmental policies, regulatory and accounting changes and increased public and regulatory scrutiny could have an adverse impact (some of which could be material) on the Group include, but are not limited to, those set out above as well as the following:

- amendments to the framework or requirements relating to the quality and quantity of regulatory capital to be held by the Group as well as liquidity and leverage requirements, either on a solo, consolidated or subgroup level (and taking into account the Group's new legal structure following the implementation of the UK ring-fencing regime), including amendments to the rules relating to the calculation of risk-weighted assets and reliance on internal models and credit ratings as well as rules affecting the eligibility of deferred tax assets;

- the design and implementation of national or supranational mandated recovery, resolution or insolvency regimes or the implementation of additional or conflicting loss-absorption requirements, including those mandated under MREL or by the FSB's recommendations on TLAC;

- new or amended regulations or taxes that reduce profits attributable to shareholders which may diminish, or restrict, the accumulation of the distributable reserves or distributable items necessary to make distributions or coupon payments or limit the circumstances in which such distributions may be made or the extent thereof;

- the monetary, fiscal, interest rate and other policies of central banks and other governmental or regulatory bodies;

- further investigations, proceedings or fines either against the Group in isolation or together with other large financial institutions with respect to market conduct wrongdoing;

- the imposition of government-imposed requirements and/or related fines and sanctions with respect to lending to the UK SME market and larger commercial and corporate entities;

- increased regulatory scrutiny with respect to mortgage lending, including through the implementation of the UK mortgage market review and other initiatives led by the Bank of England or European regulators;

- additional rules and regulatory initiatives and review relating to customer protection, including the FCA's Treating Customers Fairly regime and increased focus by regulators on how institutions conduct business, particularly with regard to the delivery of fair outcomes for customers and orderly/transparent markets

- the imposition of additional restrictions on the Group's ability to compensate its senior management and other employees and increased responsibility and liability rules applicable to senior and key employees;

- regulations relating to, and enforcement of, anti-bribery, anti-money laundering, anti-terrorism or other similar sanctions regimes;

- rules relating to foreign ownership, expropriation, nationalisation and confiscation of assets;

- changes to financial reporting standards (including accounting standards or guidance) and guidance or the timing of their implementation;

- changes to risk aggregation and reporting standards;

- changes to corporate governance requirements, senior manager responsibility, corporate structures and conduct of business rules;

- competition reviews and investigations relating to the retail banking sector in the UK, including with respect to SME banking and PCAs;

- financial market infrastructure reforms establishing new rules applying to investment services, short selling, market abuse, derivatives markets and investment funds, including the European Market Infrastructure Regulation and the Markets in Financial Instruments Directive and Regulation in the EU and the Dodd Frank Wall Street Reform Consumer Protection Act of 2010 in the US;

- increased attention to competition and innovation in UK payment systems following the establishment of the new Payments Systems Regulator and developments relating to the UK initiative on Open Banking and the European directive on payment services;

- new or increased regulations relating to customer data and privacy protection, including the EU General Data Protection Regulation;

Additional information

Risk factors continued

- restrictions on proprietary trading and similar activities within a commercial bank and/or a group;

- the introduction of, and changes to, taxes, levies or fees applicable to the Group's operations, such as the imposition of a financial transaction tax, changes in tax rates, increases in the bank corporation tax surcharge in the UK, restrictions on the tax deductibility of interest payments or further restrictions imposed on the treatment of carry-forward tax losses that reduce the value of deferred tax assets and require increased payments of tax;

- investigations into facilitation of tax evasion or avoidance or the creation of new civil or criminal offences relating thereto;

- the regulation or endorsement of credit ratings used in the EU (whether issued by agencies in European member states or in other countries, such as the US); and

- other requirements or policies affecting the Group's profitability or product offering, including through the imposition of increased compliance obligations or obligations which may lead to restrictions on business growth, product offerings, or pricing.

Changes in laws, rules or regulations, or in their interpretation or enforcement, or the implementation of new laws, rules or regulations, including contradictory laws, rules or regulations by key regulators in different jurisdictions, or failure by the Group to comply with such laws, rules and regulations, may have a material adverse effect on the Group's business, financial condition and results of operations. In addition, uncertainty and lack of international regulatory coordination as enhanced supervisory standards are developed and implemented may adversely affect the Group's ability to engage in effective business, capital and risk management planning.

Additional information

Risk factors continued

The Group is subject to pension risks and may be required to make additional contributions to cover pension funding deficits as a result of degraded economic conditions or as a result of the restructuring of its pension schemes in relation to the implementation of the UK ring-fencing regime.

The Group maintains a number of defined benefit pension schemes for certain former and current employees. Pension risk includes the risk that the assets of the Group's various defined benefit pension schemes do not fully match the timing and amount of the schemes' liabilities, as a result of which the Group is required or chooses to make additional contributions to address deficits that may emerge. Risk arises from the schemes because the value of the asset portfolios may be less than expected and because there may be greater than expected increases in the estimated value of the schemes' liabilities and additional future contributions to the schemes may be required.

The value of pension scheme liabilities varies with changes to long-term interest rates (including prolonged periods of low interest rates as is currently the case), inflation, monetary policy, pensionable salaries and the longevity of scheme members, as well as changes in applicable legislation. In particular, as life expectancies increase, so too will the pension scheme liabilities; the impact on the pension scheme liabilities due to a one year increase in longevity would have been expected to be £1.5 billion as at 31 December 2016.

In addition, as the Group expects to continue to materially reduce the scope of its operations as part of the implementation of its transformation programme and of the UK ring-fencing regime, pension liabilities will therefore increase relative to the size of the Group, which may impact the Group's results of operations and capital position.

Given economic and financial market difficulties and volatility, the low interest rate environment and the risk that such conditions may occur again over the near and medium term, some of the Group's pension schemes have experienced increased pension deficits.

The last triennial valuation of the Main Scheme, had an effective date of 31 December 2015. This valuation was concluded with the acceleration of the nominal value of all committed contributions in respect of past service (£4.2 billion), which was paid in Q1 2016.

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Explanation of Responses:

Additional information

Risk factors continued

The next triennial period valuation will take place in Q4 2018 and the Main Scheme pension trustee has agreed that it would not seek a new valuation prior to that date, except where a material change arises. The 2018 triennial valuation is expected to result in a significant increase in the regular annual contributions in respect of the ongoing accrual of benefits. Notwithstanding the 2016 accelerated payment and any additional contributions that may be required beforehand as a result of a material change, the Group expects to have to agree to additional contributions, over and above the existing committed past service contributions, as a result of the next triennial valuation. Under current legislation, such agreement would need to be reached no later than Q1 2020. The cost of such additional contributions could be material and any additional contributions that are committed to the Main Scheme following new actuarial valuations would trigger the recognition of a significant additional liability on the Group's balance sheet and/or an increase in any pension surplus derecognised, which in turn could have a material adverse effect on the Group's results of operations, financial position and prospects.

In addition, the UK ring-fencing regime will require significant changes to the structure of the Group's existing defined benefit pension schemes as RFB entities may not be liable for debts to pension schemes that might arise as a result of the failure of an entity that is not an RFB or wholly owned subsidiary thereof after 1 January 2026. The restructuring of the Group and its defined benefit pension plans to implement the UK ring-fencing regime could affect assessments of the Group's pension scheme deficits or result in the pension scheme trustees considering that the employer covenant has been weakened and result in additional contributions being required.

The Group is developing a strategy to meet these requirements, which has been discussed with the PRA and is likely to require the agreement of the pension scheme trustee. Discussions with the pension scheme trustee are ongoing and will be influenced by the Group's overall ring-fence strategy and its pension funding and investment strategies.

Additional information

Risk factors continued

If agreement is not reached with the pension trustee, alternative options less favourable to the Group may need to be developed to meet the requirements of the pension regulations. The costs associated with the restructuring of the Group's existing defined benefit pension schemes could be material and could result in higher levels of additional contributions than those described above and currently agreed with the pension trustee which could have a material adverse effect on the Group's results of operations, financial position and prospects.

Pension risk and changes to the Group's funding of its pension schemes may have a significant impact on the Group's capital position.

The Group's capital position is influenced by pension risk in several respects: Pillar 1 capital is impacted by the requirement that net pension assets are to be deduced from capital and that actuarial gains/losses impact reserves and, by extension, CET1 capital; Pillar 2A requirements result in the Group being required to carry a capital add-on to absorb stress on the pension fund and finally the risk of additional contributions to the Group's pension fund is taken into account in the Group's capital framework plan.

The Group believes that the accelerated payment to the Group's Main Scheme pension fund made in Q1 2016 improved the Group's capital planning and resilience through the period to 2019 and provided the Main Scheme pension trustee with more flexibility over its investment strategy. This payment has resulted in a reduction in prevailing Pillar 2A add-on. However, subsequent contributions required in connection with the 2018 triennial valuation may adversely impact the Group's capital position. The Group's expectations as to the impact on its capital position of this payment in the near and medium term and of the accounting impact under its revised accounting policy are based on a number of assumptions and estimates, including with respect to the beneficial impact on its Pillar 2A requirements and confirmation of such impact by the PRA and the timing thereof, any of which may prove to be inaccurate (including with respect to the calculation of the CET1 ratio impact on future periods), including as a result of factors outside of the Group's control (which include the PRA's approval).

Additional information

Risk factors continued

As a result, if any of these assumptions proves inaccurate, the Group's capital position may significantly deteriorate and fall below the minimum capital requirements applicable to the Group or Group entities, and in turn result in increased regulatory supervision or sanctions, restrictions on discretionary distributions or loss of investor confidence, which could individually or in aggregate have a material adverse effect on the Group's results of operations, financial prospects or reputation.

The impact of the Group's pension obligations on its results and operations are also dependent on the regulatory environment in which it operates. There is a risk that changes in prudential regulation, pension regulation and accounting standards, or a lack of coordination between such sets of rules, may make it more challenging for the Group to manage its pension obligations resulting in an adverse impact on the Group's CET1 capital.

The Group relies on valuation, capital and stress test models to conduct its business, assess its risk exposure and anticipate capital and funding requirements. Failure of these models to provide accurate results or accurately reflect changes in the micro-and macroeconomic environment in which the Group operates or findings of deficiencies by the Group's regulators resulting in increased regulatory capital requirements could have a material adverse effect on the Group's business, capital and results.

Given the complexity of the Group's business, strategy and capital requirements, the Group relies on analytical models to manage its business, assess the value of its assets and its risk exposure and anticipate capital and funding requirements, including with stress testing. The Group's valuation, capital and stress test models and the parameters and assumptions on which they are based, need to be periodically reviewed and updated to maximise their accuracy.

Failure of these models to accurately reflect changes in the environment in which the Group operates or to be updated in line with the Group's business model or operations, or the failure to properly input any such changes could have an adverse impact on the modelled results or could fail to accurately capture the Group's risk exposure or the risk profile of the Group's financial instruments or result in the Group being required to hold additional capital as a function of the PRA buffer. The Group also uses valuation models that rely on market data inputs. If incorrect market data is input into a valuation model, it may result in incorrect valuations or valuations different to those which were predicted and used by the Group in its forecasts or decision making. Internal stress test models may also rely on different, less severe, assumptions or take into account different data points than those defined by the Group's regulators.

Some of the analytical models used by the Group are predictive in nature. In addition, a number of internal models used by Group subsidiaries are designed, managed and analysed by the Group and may not appropriately capture risks and exposures at subsidiary level. Some of the Group's internal models are subject to periodic review by its regulators and, if found deficient, the Group may be required to make changes to such models or may be precluded from using any such models, which could result in an additional capital requirement which could have a material impact on the Group’s capital position.

The Group could face adverse consequences as a result of decisions which may lead to actions by management based on models that are poorly developed, implemented or used, or as a result of the modelled outcome being misunderstood or such information being used for purposes for which it was not designed. Risks arising from the use of models could have a material adverse effect on the Group’s business, financial condition and/or results of operations, minimum capital requirements and reputation.

Additional information

Risk factors continued

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Its results in future periods may be affected by changes to applicable accounting rules and standards.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, results reported in future periods may reflect amounts which differ from those estimates. Estimates, judgements and assumptions take into account historical experience and other factors, including market practice and expectations of future events that are believed to be reasonable under the circumstances.

The accounting policies deemed critical to the Group’s results and financial position, based upon materiality and significant judgements and estimates, include goodwill, provisions for liabilities, deferred tax, loan impairment provisions, fair value of financial instruments, which are discussed in detail in “Critical accounting policies and key sources of estimation uncertainty” on pages 396 and 398. IFRS Standards and Interpretations that have been issued by the International Accounting Standards Board (the IASB) but which have not yet been adopted by the Group are discussed in “Accounting developments” on pages 308 to 313. Changes in accounting standards or guidance by internal accounting bodies or in the timing of their implementation, whether mandatory or as a result of recommended disclosure relating to the future implementation of such standards could result in the Group having to recognise additional liabilities on its balance sheet, or in further write-downs or impairments and could also significantly impact the financial results, condition and prospects of the Group.

In July 2014, the IASB published a new accounting standard for financial instruments (IFRS 9) effective for annual periods beginning on or after 1 January 2018. It introduces a new framework for the recognition and measurement of credit impairment, based on expected credit losses, rather than the incurred loss model currently applied under IAS 39. The inclusion of loss allowances with respect to all financial assets that are not recorded at fair value will tend to result in an increase in overall impairment balances when compared with the existing basis of measurement under IAS 39. As a result of ongoing regulatory consultation, there is currently uncertainty as to the impact of the implementation of this standard on the Group’s CET1 capital (and therefore CET1 ratio), although it is expected that this will result in increased earnings and capital volatility for the Group.

The valuation of financial instruments, including derivatives, measured at fair value can be subjective, in particular where models are used which include unobservable inputs. Generally, to establish the fair value of these instruments, the Group relies on quoted market prices or, where the market for a financial instrument is not sufficiently active, internal valuation models that utilise observable market data. In certain circumstances, the data for individual financial instruments or classes of financial instruments utilised by

such valuation models may not be available or may become unavailable due to prevailing market conditions. In such circumstances, the Group's internal valuation models require the Group to make assumptions, judgements and estimates to establish fair value, which are complex and often relate to matters that are inherently uncertain. Resulting changes in the fair values of the financial instruments has had and could continue to have a material adverse effect on the Group's earnings, financial condition and capital position.

Additional information

Risk factors continued

The Group's operations entail inherent reputational risk.

Reputational risk, meaning the risk of brand damage and/or financial loss due to a failure to meet stakeholders' expectations of the Group's conduct, performance and business profile, is inherent in the Group's business. Stakeholders include customers, investors, rating agencies, employees, suppliers, governments, politicians, regulators, special interest groups, consumer groups, media and the general public.

Brand damage can be detrimental to the business of the Group in a number of ways, including its ability to build or sustain business relationships with customers, low staff morale, regulatory censure or reduced access to, or an increase in the cost of, funding. In particular, negative public opinion resulting from the actual or perceived manner in which the Group conducts its business activities and operations, including as a result of speculative or inaccurate media coverage, the Group's financial performance, ongoing investigations and proceedings and the settlement of any such investigations and proceedings, IT failures or cyber-attacks resulting in the loss or publication of confidential customer data or other sensitive information, the level of direct and indirect government support, or the actual or perceived strength or practices in the banking and financial industry may adversely affect the Group's ability to keep and attract customers and, in particular, corporate and retail depositors.

Modern technologies, in particular online social networks and other broadcast tools which facilitate communication with large audiences in short time frames and with minimal costs, may also significantly enhance and accelerate the impact of damaging information and allegations.

Reputational risks may also be increased as a result of the restructuring of the Group to implement its transformation programme and the UK ring-fencing regime. Although the Group has implemented a Reputational Risk Policy across customer-facing businesses to improve the identification, assessment and management of customers, transactions, products and issues which represent a reputational risk, the Group cannot ensure that it will be successful in avoiding damage to its business from reputational risk, which could result in a material adverse effect on the Group's business, financial condition, results of operations and prospects.

Additional information

Risk factors continued

The Group is exposed to conduct risk which may adversely impact the Group or its employees and may result in conduct having a detrimental impact on the Group's customers or counterparties.

In recent years, the Group has sought to refocus its culture on serving the needs of its customers and continues to redesign many of its systems and processes to promote this focus and strategy. However, the Group is exposed to various forms of conduct risk in its operations. These include business and strategic planning that does not consider customers' needs, ineffective management and monitoring of products and their distribution, a culture that is not customer-centric, outsourcing of customer service and product delivery via third parties that do not have appropriate levels of control, oversight and culture, the possibility of alleged mis-selling of financial products or the mishandling of complaints related to the sale of such product, or poor governance of incentives and rewards. Some of these risks have materialised in the past and ineffective management and oversight of conduct issues may result in customers being poorly or unfairly treated and may in the future lead to further remediation and regulatory intervention/enforcement.

The Group's businesses are also exposed to risk from employee misconduct including non-compliance with policies and regulatory rules, negligence or fraud, any of which could result in regulatory sanctions and serious reputational or financial harm to the Group. In recent years, a number of multinational financial institutions, including the Group, have suffered material losses due to the actions of employees, including, for example, in connection with the foreign exchange and LIBOR investigations and the Group may not succeed in protecting itself from such conduct in the future. It is not always possible to deter employee misconduct and the precautions the Group takes to prevent and detect this activity may not always be effective.

The Group has implemented a number of policies and allocated new resources in order to help mitigate against these risks. The Group has also prioritised initiatives to reinforce good conduct in its engagement with the markets in which it operates, together with the development of preventative and detective controls in order to positively influence behaviour.

The Group's transformation programme is also intended to improve the Group's control environment. Nonetheless, no assurance can be given that the Group's strategy and control framework will be effective and that conduct issues will not have an adverse effect on the Group's results of operations, financial condition or prospects.

Explanation of Responses:

Additional information

Risk factors continued

The Group may be adversely impacted if its risk management is not effective and there may be significant challenges in maintaining the effectiveness of the Group's risk management framework as a result of the number of strategic and restructuring initiatives being carried out by the RBS Group simultaneously.

The management of risk is an integral part of all of the Group's activities. Risk management includes the definition and monitoring of the Group's risk appetite and reporting of the Group's exposure to uncertainty and the consequent adverse effect on profitability or financial condition arising from different sources of uncertainty and risks as described throughout these risk factors.

Ineffective risk management may arise from a wide variety of events and behaviours, including lack of transparency or incomplete risk reporting, unidentified conflicts or misaligned incentives, lack of accountability control and governance, lack of consistency in risk monitoring and management or insufficient challenges or assurance processes.

Failure to manage risks effectively could adversely impact the Group's reputation or its relationship with its customers, shareholders or other stakeholders, which in turn could have a significant effect on the Group's business prospects, financial condition and/or results of operations.

Risk management is also strongly related to the use and effectiveness of internal stress tests and models. See "The Group relies on valuation, capital and stress test models to conduct its business, assess its risk exposure and anticipate capital and funding requirements. Failure of these models to provide accurate results or accurately reflect changes in the micro-and macroeconomic environment in which the Group operates or findings of deficiencies by the Group's regulators resulting in increased regulatory capital requirements could have a material adverse effect on the Group's business, capital and results."

Additional information

Risk factors continued

A failure by the Group to embed a strong risk culture across the organisation could adversely affect the Group's ability to achieve its strategic objective.

In response to weaknesses identified in previous years, the Group is currently seeking to embed a strong risk culture within the organisation based on a robust risk appetite and governance framework. A key component of this approach is the three lines of defence model designed to identify, manage and mitigate risk across all levels of the organisation. This framework has been implemented and improvements continue and will continue to be made to clarify and improve the three lines of defence and internal risk responsibilities and resources, including in response to feedback from regulators. Notwithstanding the Group's efforts, changing an organisation's risk culture requires significant time, investment and leadership, and such efforts may not insulate the Group from future instances of misconduct. A failure by any of these three lines to carry out their responsibilities or to effectively embed this culture could have a material adverse effect on the Group through an inability to achieve its strategic objectives for its customers, employees and wider stakeholders.

The Group's business and results of operations may be adversely affected by increasing competitive pressures and technology disruption in the markets in which it operates.

The markets for UK financial services, and the other markets within which the Group operates, are very competitive, and management expects such competition to continue or intensify in response to customer behaviour, technological changes (including the growth of digital banking), competitor behaviour, new entrants to the market (including non-traditional financial services providers such as large retail or technology conglomerates), new lending models (such as peer-to-peer lending), industry trends resulting in increased disaggregation or unbundling of financial services or conversely the re-intermediation of traditional banking services, and the impact of regulatory actions and other factors. In particular, developments in the financial sector resulting from new banking, lending and payment solutions offered by rapidly evolving incumbents, challengers and new entrants, in particular with respect to payment services and products, and the introduction of disruptive technology may impede the Group's ability to grow or retain its market share and impact its revenues and profitability, particularly in its key UK retail banking segment. These trends may be catalysed by regulatory and competition policy implemented by the UK government, particularly as a result of the Open Banking initiative and remedies imposed by the Competition and Markets Authority (CMA) designed to support the objectives of this initiative.

Additional information

Risk factors continued

Increasingly many of the products and services offered by the Group are, and will become, technology intensive and the Group's ability to develop such services has become increasingly important to retaining and growing the Group's customer business in the UK.

There can be no certainty that the Group's investment in its IT capability intended to address the material increase in customer use of online and mobile technology for banking will be successful or that it will allow the Group to continue to grow such services in the future. Certain of the Group's current or future competitors may have more efficient operations, including better IT systems allowing them to implement innovative technologies for delivering services to their customers. Furthermore, the Group's competitors may be better able to attract and retain customers and key employees and may have access to lower cost funding and/or be able to attract deposits on more favourable terms than the Group. Although the Group invests in new technologies and participates in industry and research led initiatives aimed at developing new technologies, such investments may be insufficient, especially against a backdrop of cost savings targets for the Group, or the Group may fail to identify future opportunities or derive benefits from disruptive technologies. If the Group is unable to offer competitive, attractive and innovative products that are also profitable, it will lose market share, incur losses on some or all of its activities and lose opportunities for growth.

In addition, recent and future disposals and restructurings by the Group relating to the implementation of non-customer facing elements of its transformation programme and the UK ring-fencing regime, or required by the Group's regulators, as well as constraints imposed on the Group's ability to compensate its employees at the same level as its competitors, may also have an impact on its ability to compete effectively. Intensified competition from incumbents, challengers and new entrants in the Group's core markets could lead to greater pressure on the Group to maintain returns and may lead to unsustainable growth decisions. These and other changes in the Group's competitive environment could have a material adverse effect on the Group's business, margins, profitability, financial condition and prospects.

The Group operates in markets that are subject to intense scrutiny by the competition authorities and its business and results of operations could be materially affected by competition rulings and other government measures.

The competitive landscape for banks and other financial institutions in the UK, the rest of Europe and the US is changing rapidly. Recent regulatory and legal changes have and may continue to result in new market participants and changed competitive dynamics in certain key areas, such as in retail and SME banking in the UK where the introduction of new entrants is being actively encouraged by the UK Government. The competitive landscape in the UK is also likely to be affected by the UK Government's

implementation of the UK ring-fencing regime and other customer protection measures introduced by the Banking Reform Act 2013. The implementation of these reforms may result in the consolidation of newly separated businesses or assets of certain financial institutions with those of other parties to realise new synergies or protect their competitive position and is likely to increase competitive pressures on the Group.

The UK retail banking sector has been subjected to intense scrutiny by the UK competition authorities and by other bodies, including the FCA, in recent years, including with a number of reviews/inquiries being carried out, including market reviews conducted by the CMA and its predecessor the Office of Fair Trading regarding SME banking and Personal Current Accounts (PCAs), the Independent Commission on Banking and the Parliamentary Commission on Banking Standards. These reviews raised significant concerns about the effectiveness of competition in the banking sector. The CMA's Retail Banking Market Investigation report sets out measures primarily intended to make it easier for consumers and businesses to compare PCA and SME bank products, increase the transparency of price comparison between banks and amend PCA overdraft charging. The CMA is working with HM Treasury and other regulators to implement these remedies which are likely to impose additional compliance requirements on the Group and could, in aggregate, adversely impact the Group's competitive position, product offering and revenues.

Additional information

Risk factors continued

Adverse findings resulting from current or future competition investigations may result in the imposition of reforms or remedies which may impact the competitive landscape in which the Group operates or result in restrictions on mergers and consolidations within the UK financial sector.

The impact of any such developments in the UK will become more significant as the Group's business becomes increasingly concentrated in the UK retail sector. These and other changes to the competitive framework in which the Group operates could have a material adverse effect on the Group's business, margins, profitability, financial condition and prospects.

As a result of the commercial and regulatory environment in which it operates, the Group may be unable to attract or retain senior management (including members of the board) and other skilled personnel of the appropriate qualification and competence. The Group may also suffer if it does not maintain good employee relations.

Implementation of the Group's transformation programme and its future success depend on its ability to attract, retain and remunerate highly skilled and qualified personnel, including senior management (which includes directors and other key employees), in a highly competitive labour market. This cannot be guaranteed, particularly in light of heightened regulatory oversight of banks and the increasing scrutiny of, and (in some cases) restrictions placed upon, employee compensation arrangements, in particular those of banks in receipt of Government support (such as the Group), which may place the Group at a competitive disadvantage. In addition, the market for skilled personnel is increasingly competitive, thereby raising the cost of hiring, training and retaining skilled personnel.

Certain of the Group's directors as well as members of its executive committee and certain other senior managers and employees are also subject to the new responsibility regime introduced under the Banking Reform Act 2013 which introduces clearer accountability rules for those within the new regime. The senior managers' regime and certification regime took effect on 7 March 2016, whilst the conduct rules will apply to the wider employee population from 7 March 2017 onwards, with the exception of some transitional provisions. The new regulatory regime may contribute to reduce the pool of candidates for key management and non-executive roles, including non-executive directors with the right skills, knowledge and experience, or increase the number of departures of existing employees, given concerns over the allocation of responsibilities and personal liability introduced by the new rules.

In addition, in order to ensure the independence of the RFB, the Group will be required to recruit new independent directors and senior members of management to sit on the boards of directors and board committees of the RFB and other Group entities, and there may be a limited pool of competent candidates from which such appointments can be made.

The Group's evolving strategy has led to the departure of a large number of experienced and capable employees. The restructuring relating to the ongoing implementation of the Group's transformation programme and related cost-reduction targets may cause experienced staff members to leave and prospective staff members not to join the Group. The lack of continuity of senior management and the loss of important personnel coordinating certain or several aspects of the Group's restructuring could have an adverse impact on its implementation.

The failure to attract or retain a sufficient number of appropriately skilled personnel to manage the complex restructuring required to implement the Group's strategy could prevent the Group from successfully implementing its strategy and meeting regulatory commitments. This could have a material adverse effect on the Group's business, financial condition and results of operations.

In addition, many of the Group's employees in the UK, continental Europe and other jurisdictions in which the Group operates are represented by employee representative bodies, including trade unions. Engagement with its employees and such bodies is important to the Group and a breakdown of these relationships could adversely affect the Group's business, reputation and results.

Additional information

Risk factors continued

HM Treasury (or UKFI on its behalf) may be able to exercise a significant degree of influence over the Group and any further offer or sale of its interests may affect the price of securities issued by the Group.

On 6 August 2015, the UK Government made its first sale of RBSG ordinary shares since its original investment in 2009 and sold approximately 5.4% of its stake in RBSG. Following this initial sale, the UK Government exercised its conversion rights under the B Shares on 14 October 2015 which resulted in HM Treasury holding 72.88% of the ordinary share capital of RBSG. The UK Government, through HM Treasury, currently holds 71.3% of the issued ordinary share capital of the Group. The UK Government has indicated its intention to continue to sell down its shareholding in the Group.

Any offers or sale, or expectations relating to the timing thereof, of a substantial number of ordinary shares by HM Treasury, could negatively affect prevailing market prices for the outstanding ordinary shares of RBSG and other securities issued by the Group and lead to a period of increased price volatility for the Group's securities.

In addition, UKFI manages HM Treasury's shareholder relationship with the Group and, although HM Treasury has indicated that it intends to respect the commercial decisions of the Group and that the Group will continue to have its own independent board of directors and management team determining its own strategy, its position as a majority shareholder (and UKFI's position as manager of this shareholding) means that HM Treasury or UKFI might be able to exercise a significant degree of influence over, among other things, the election of directors and appointment of senior management, the Group's capital strategy, dividend policy, remuneration policy or the conduct of the Group's operations. The manner in which HM Treasury or UKFI exercises HM Treasury's rights as majority shareholder could give rise to conflicts between the interests of HM Treasury and the interests of other shareholders. The Board has a duty to promote the success of the Group for the benefit of its members as a whole.

The Group is committed to executing the run-down and sale of certain businesses, portfolios and assets forming part of the businesses and activities being exited by the Group. Failure by the Group to do so on commercially favourable terms could have a material adverse effect on the Group's operations, operating results, financial position and reputation.

The Group's ability to dispose of the remaining businesses, portfolios and assets forming part of the businesses and activities being exited by the Group and the price achieved for such disposals will be dependent on prevailing economic and market conditions, which remain volatile.

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Explanation of Responses:

Additional information

Risk factors continued

As a result, there is no assurance that the Group will be able to sell, exit or run down these businesses, portfolios or assets either on favourable economic terms to the Group or at all or that it may do so within the intended timetable. Material tax or other contingent liabilities could arise on the disposal or run-down of assets or businesses and there is no assurance that any conditions precedent agreed will be satisfied, or consents and approvals required will be obtained in a timely manner or at all. The Group may be exposed to deteriorations in the businesses, portfolios or assets being sold between the announcement of the disposal and its completion, which period may span many months.

In addition, the Group may be exposed to certain risks, including risks arising out of ongoing liabilities and obligations, breaches of covenants, representations and warranties, indemnity claims, transitional services arrangements and redundancy or other transaction-related costs, and counterparty risk in respect of buyers of assets being sold.

The occurrence of any of the risks described above could have a material adverse effect on the Group’s business, results of operations, financial condition and capital position and consequently may have the potential to impact the competitive position of part or all of the Group’s business.

Additional information

Risk factors continued

The value or effectiveness of any credit protection that the Group has purchased depends on the value of the underlying assets and the financial condition of the insurers and counterparties.

The Group has some remaining credit exposure arising from over-the-counter derivative contracts, mainly credit default swaps (CDSs), and other credit derivatives, each of which are carried at fair value.

The fair value of these CDSs, as well as the Group's exposure to the risk of default by the underlying counterparties, depends on the valuation and the perceived credit risk of the instrument against which protection has been bought. Many market counterparties have been adversely affected by their exposure to residential mortgage-linked and corporate credit products, whether synthetic or otherwise, and their actual and perceived creditworthiness may deteriorate rapidly. If the financial condition of these counterparties or their actual or perceived creditworthiness deteriorates, the Group may record further credit valuation adjustments on the credit protection bought from these counterparties under the CDSs. The Group also recognises any fluctuations in the fair value of other credit derivatives.

Any such adjustments or fair value changes may have a material adverse impact on the Group's financial condition and results of operations.

The Group and its subsidiaries are subject to a new and evolving framework on recovery and resolution, the impact of which remains uncertain, and which may result in additional compliance challenges and costs.

In the EU, the UK and the US, regulators have implemented or are in the process of implementing recovery and resolution regimes designed to prevent the failure of financial institutions and resolution tools to ensure the timely and orderly resolution of financial institutions. These initiatives have been complemented by a broader set of initiatives to improve the resilience of financial institutions and reduce systemic risk, including the UK ring-fencing regime, the introduction of certain prudential requirements and powers under CRD IV, and certain other measures introduced under the BRRD, including the requirements relating to loss absorbing capital.

The BRRD which was implemented in the UK from January 2015, provides a framework for the recovery and resolution of credit institutions and investment firms, their subsidiaries and certain holding companies in the EU, and the tools and powers introduced under the BRRD include preparatory and preventive measures, early supervisory intervention powers and resolution tools.

Implementation of certain provisions of the BRRD remains subject to secondary rulemaking as well as a review by the European Parliament and the European Commission of certain topics mandated by the BRRD. In November 2016, as a result of this review, the European Commission published a package of proposals seeking to introduce certain amendments to CRD IV and the BRRD as well as a new proposal seeking to harmonize creditor hierarchy. These proposals are now subject to further discussions and negotiations among the European institutions and it is not possible to anticipate their final content. Further amendments to the BRRD or the implementing rules in the EU may also be necessary to ensure continued consistency with the FSB recommendations on resolution regimes and resolution planning for G-SIBs, including with respect to TLAC requirements.

In light of these potential developments as well as the impact of the UK’s decision to leave the EU following the result of the EU Referendum, there remains uncertainty as to the rules which may apply to the Group going forward. In addition, banks headquartered in countries which are members of the Eurozone are now subject to the European banking union framework. In November 2014, the ECB assumed direct supervisory responsibility for RBS NV and Ulster Bank Ireland under the Single Supervisory Mechanism (SSM). As a result of the above, there remains uncertainty as to how the relevant resolution regimes in force in the UK, the Eurozone and other jurisdictions, would interact in the event of a resolution of the Group.

Additional information

Risk factors continued

The BRRD requires national resolution funds to raise “ex ante” contributions on banks and investment firms in proportion to their liabilities and risk profiles and allow them to raise additional “ex post” funding contributions in the event the ex-ante contributions do not cover the losses, costs or other expenses incurred by use of the resolution fund. Although receipts from the UK bank levy are currently being used to meet the ex-ante and ex post funding requirements, the Group may be required to make additional contributions in the future. In addition, Group entities in countries subject to the European banking union are required to pay supervisory fees towards the funding of the SSM as well as contributions to the single resolution fund.

The new recovery and resolution regime implementing the BRRD in the UK replaces the previous regime and has imposed and is expected to impose in the near-to medium-term future, additional compliance and reporting obligations on the Group which may result in increased costs, including as a result of the Group’s mandatory participation in resolution funds, and heightened compliance risks and the Group may not be in a position to comply with all such requirements within the prescribed deadlines or at all.

In addition, the PRA has adopted a new framework requiring financial institutions to ensure the continuity of critical shared services (provided by entities within the group or external providers) to facilitate recovery action, orderly resolution and post-resolution restructuring, which will apply from 1 January 2019.

The application of such rules to the Group may require the Group to restructure certain of its activities or reorganise the legal structure of its operations, may limit the Group’s ability to outsource certain functions and/or may result in increased costs resulting from the requirement to ensure the financial and operational resilience and independent governance of such critical services.

In addition, compliance by the Group with this new recovery and resolution framework has required and is expected to continue to require significant work and engagement with the Group’s regulators, including in order for the Group to submit to the PRA credible recovery and resolution plans, the outcome of which may impact the Group’s operations or structure. Such rules will need to be implemented consistently with the UK ring-fencing regime.

The Group may become subject to the application of stabilisation or resolution powers in certain significant stress situations, which may result in various actions being taken in relation to the

Group and any securities of the Group, including the write-off, write-down or conversion of the Group's securities.

The Banking Act 2009, as amended to implement the BRRD ("Banking Act") confers substantial powers on relevant UK authorities designed to enable them to take a range of actions in relation to UK banks or investment firms and certain of their affiliates in the event a bank or investment firm in the same group is considered to be failing or likely to fail. Under the Banking Act, wide powers are granted to the relevant resolution authorities, as appropriate as part of a special resolution regime (the "SRR"). These powers enable the relevant UK resolution authority to implement resolution measures with respect to a UK bank or investment firm and certain of its affiliates (including, for example, RBSG) (each a "relevant entity") in circumstances in which the relevant UK resolution authority is satisfied that the resolution conditions are met. Under the applicable regulatory framework and pursuant to guidance issued by the Bank of England, governmental capital support, if any is provided, would only be used as a last resort measure where a serious threat to financial stability cannot be avoided by other measures (such as the stabilisation options described below, including the UK bail-in power) and subject to the limitations set out in the Banking Act.

Several stabilisation options and tools are available to the relevant UK resolution authority under the SRR, where a resolution has been triggered. In addition, the UK resolution authority may commence special administration or liquidation procedures specifically applicable to banks. Where stabilisation options are used which rely on the use of public funds, the option can only be used once there has been a contribution to loss absorption and recapitalisation of at least 8% of the total liabilities of the institution under resolution. The Bank of England has indicated that among these options, the UK bail-in tool (as described further below) would apply in the event a resolution of the Group were triggered.

Additional information

Risk factors continued

Further, the Banking Act grants broad powers to the UK resolution authority, the application of which may adversely affect contractual arrangements and which include the ability to (i) modify or cancel contractual arrangements to which an entity in resolution is party, in certain circumstances; (ii) suspend or override the enforcement provisions or termination rights that might be invoked by counterparties facing an entity in resolution, as a result of the exercise of the resolution powers; and (iii) disapply or modify laws in the UK (with possible retrospective effect) to enable the powers under the Banking Act to be used effectively.

The stabilisation options are intended to be applied prior to the point at which any insolvency proceedings with respect to the relevant entity would otherwise have been initiated. Accordingly, the stabilisation options may be exercised if the relevant UK resolution authority: (i) is satisfied that a UK bank or investment firm is failing, or is likely to fail; (ii) determines that it is not reasonably likely that (ignoring the stabilisation powers) action will be taken by or in respect of a UK bank or investment firm that will result in condition (i) above ceasing to be met; (iii) considers the exercise of the stabilisation powers to be necessary, having regard to certain public interest considerations (such as the stability of the UK financial system, public confidence in the UK banking system and the protection of depositors, being some of the special resolution objectives) and (iv) considers that the special resolution objectives would not be met to the same extent by the winding-up of the UK bank or investment firm.

In the event that the relevant UK resolution authority seeks to exercise its powers in relation to a UK banking group company (such as RBSG), the relevant UK resolution authority has to be satisfied that (A) the conditions set out in (i) to (iv) above are met in respect of a UK bank or investment firm in the same banking group (or, in respect of an EEA or third country credit institution or investment firm in the same banking group, the relevant EEA or third country resolution authority is satisfied that the conditions for resolution applicable in its jurisdiction are met) and (B) certain criteria are met, such as the exercise of the powers in relation to such UK banking group company being necessary having regard to public interest considerations. The use of different stabilisation powers is also subject to further “specific conditions” that vary according to the relevant stabilisation power being used. Although the SRR sets out the pre-conditions for determining whether an institution is failing or likely to fail, it is uncertain how the Bank of England would assess such conditions in any particular pre-insolvency scenario affecting RBSG and/or other members of the Group and in deciding whether to exercise a resolution power. Further regulatory developments, including proposals by the FSB on cross-border recognition of resolution actions, could also influence the conditions for the exercise of the stabilisation powers. There has been no application of the SRR powers in the UK to a large financial institution, such as RBSG, to date, which could provide an indication of the relevant UK resolution authority’s approach to the exercise of the resolution powers, and even if such examples existed, they may not be indicative of how such powers would be applied to RBSG. Therefore, holders of shares and other securities issued by the Group may not be able to anticipate a potential exercise of any such powers.

The UK bail-in tool is one of the powers available to the UK resolution authority under the SRR and was introduced under the Banking Reform Act 2013. The UK government amended the provisions of the Banking Act to ensure the consistency of these provisions with the bail-in provisions under the BRRD, which amendments came into effect on 1 January 2015. The UK bail-in tool includes both a power to write-down or convert capital instruments and triggered at the point of non-viability of a financial institution and a bail-in tool applicable to eligible liabilities (including senior unsecured debt securities issued by the Group) and available in resolution.

Additional information

Risk factors continued

The capital instruments write-down and conversion power may be exercised independently of, or in combination with, the exercise of a resolution tool, and it allows resolution authorities to cancel all or a portion of the principal amount of capital instruments and/or convert such capital instruments into common equity Tier 1 instruments when an institution is no longer viable. The point of non-viability for such purposes is the point at which the Bank of England or the PRA determines that the institution meets the conditions for entry into the Special Resolution Regime as defined under the Banking Act or will no longer be viable unless the relevant capital instruments are written down or extraordinary public support is provided, and without such support the appropriate authority determines that the institution would no longer be viable.

Where the conditions for resolution exist and it is determined that a stabilisation power may be exercised, the Bank of England may use the bail-in tool (in combination with other resolution tools under the Banking Act) to, among other things, cancel or reduce all or a portion of the principal amount of, or interest on, certain unsecured liabilities of a failing financial institution and/or convert certain debt claims into another security, including ordinary shares of the surviving entity.

Additional information

Risk factors continued

In addition, the Bank of England may use the bail-in tool to, among other things, replace or substitute the issuer as obligor in respect of debt instruments, modify the terms of debt instruments (including altering the maturity (if any) and/or the amount of interest payable and/or imposing a temporary suspension on payments) and discontinue the listing and admission to trading of financial instruments. The exercise of the bail-in tool will be determined by the Bank of England which will have discretion to determine whether the institution has reached a point of non-viability or whether the conditions for resolution are met, by application of the relevant provisions of the Banking Act, and involves decisions being taken by the PRA and the Bank of England, in consultation with the FCA and HM Treasury. As a result, it will be difficult to predict when, if at all, the exercise of the bail-in power may occur.

The potential impact of these powers and their prospective use may include increased volatility in the market price of shares and other securities issued by the Group, as well as increased difficulties in issuing securities in the capital markets and increased costs of raising such funds.

If these powers were to be exercised (or there is an increased risk of exercise) in respect of the Group or any entity within the Group such exercise could result in a material adverse effect on the rights or interests of shareholders which would likely be extinguished or very heavily diluted. Holders of debt securities (which may include holders of senior unsecured debt), would see the conversion of part (or all) of their claims into equity or written down in part or written off entirely. In accordance with the rules of the Special Resolution Regime, the losses imposed on holders of equity and debt instruments through the exercise of bail-in powers would be subject to the “no creditor worse off” safeguard, which requires losses not to exceed those which would be realised in insolvency.

Although the above represents the risks associated with the UK bail-in power currently in force in the UK and applicable to the Group’s securities, changes to the scope of, or conditions for the exercise of the UK bail-in power may be introduced as a result of further political or regulatory developments. In addition, further political, legal or strategic developments may lead to structural changes to the Group, including at the holding company level. Notwithstanding any such changes, the Group expects that its securities would remain subject to the exercise of a form of bail-in power, either pursuant to the provisions of the Banking Act, the BRRD or otherwise.

Additional information

Risk factors continued

In the UK and in other jurisdictions, the Group is responsible for contributing to compensation schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers.

In the UK, the Financial Services Compensation Scheme (FSCS) was established under the Financial Services and Markets Act 2000 and is the UK's statutory fund of last resort for customers of authorised financial services firms. The FSCS pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising levies on the industry, including the Group. In relation to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits.

In the event that the FSCS needs to raise additional and unexpected funding, is required to raise funds more frequently or significantly increases the levies to be paid by authorised firms, the associated costs to the Group may have an adverse impact on its results of operations and financial condition. For example the deposit protection limit increased by £10,000 to £85,000 effective from 30 January 2017, which will result in an increase to the Group's FSCS levies.

To the extent that other jurisdictions where the Group operates have introduced or plan to introduce similar compensation, contributory or reimbursement schemes, the Group may make further provisions and may incur additional costs and liabilities, which may have an adverse impact on its financial condition and results of operations.

The Group's results could be adversely affected in the event of goodwill impairment.

The Group capitalises goodwill, which is calculated as the excess of the cost of an acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Acquired goodwill is recognised initially at cost and subsequently at cost less any accumulated impairment losses. As required by IFRS Standards, the Group tests goodwill for impairment annually, or more frequently when events or circumstances indicate that it might be impaired. An impairment test involves comparing the recoverable amount (the higher of the value in use and fair value less cost to sell) of an individual cash generating unit with its carrying value.

Explanation of Responses:

Additional information

Risk factors continued

At 31 December 2016, the Group carried goodwill of £5.6 billion on its balance sheet. The value in use and fair value of the Group's cash-generating units are affected by market conditions and the performance of the economies in which the Group operates.

Where the Group is required to recognise a goodwill impairment, it is recorded in the Group's income statement, but it has no effect on the Group's regulatory capital position. Further impairments of the Group's goodwill could have an adverse effect on the Group's results and financial condition.

Recent and anticipated changes in the tax legislation in the UK are likely to result in increased tax payments by the Group and may impact the recoverability of certain deferred tax assets recognised by the Group.

In accordance with IFRS Standards, the Group has recognised deferred tax assets on losses available to relieve future profits from tax only to the extent it is probable that they will be recovered. The deferred tax assets are quantified on the basis of current tax legislation and accounting standards and are subject to change in respect of the future rates of tax or the rules for computing taxable profits and offsetting allowable losses.

In the UK, legislation has been introduced over the past few years which seeks to impose restrictions on the use of certain brought forward tax losses of banking companies.. This has impacted and will continue to impact the extent to which the Group is able to recognise deferred tax assets. Failure to generate sufficient future taxable profits or further changes in tax legislation (including rates of tax) or accounting standards may reduce the recoverable amount of the recognised deferred tax assets. Further changes to the treatment of deferred tax assets may impact the Group's capital, for example by reducing further the Group's ability to recognise deferred tax assets. The implementation of the rules relating to the UK ring-fencing regime and the resulting restructuring of the Group may further restrict the Group's ability to recognise tax deferred tax assets in respect of brought forward losses.

Additional information

Description of property and equipment

RBS operates from a number of locations worldwide, principally in the UK. At 31 December 2016 the Royal Bank and NatWest had 257 and 1,058 retail branches, respectively, in the UK. Ulster Bank has a footprint of 110 branches and an extensive network of business banking offices across Northern Ireland and the Republic of Ireland. A substantial majority of the UK branches are owned by the Royal Bank, NatWest and their subsidiaries or are held under leases with unexpired terms of over 50 years. RBS's principal properties include its headquarters at Gogarburn, Edinburgh, its principal offices in London is 280 Bishopsgate and the Drummond House administration centre located at South Gyle, Edinburgh.

Total capital expenditure on premises (excluding investment properties), computers and other equipment in the year ended 31 December 2016 was £581 million (2015 - £622 million; 2014 - £433 million).

Major shareholders

In December 2008, The Solicitor for the Affairs of Her Majesty's Treasury (HMT) acquired 22,854 million ordinary shares of 25p each representing 57.9% of the company's issued ordinary share capital. During 2009, HMT acquired a further 16,791 million ordinary shares of 25p each raising their holding to 70.3 % of the company's issued ordinary share capital. In December 2009, HMT acquired 51 billion B shares in the company representing the entire issued B share capital. As a result of the ordinary share sub-division and consolidation which took place in June 2012, HMTs holding in the company's ordinary shares became 3,964 million ordinary shares of £1 each. In August 2015, HMT sold 630 million of the company's ordinary shares. In October 2015, HMT converted its entire holding of B shares into 5.1 billion new ordinary shares of £1 each, resulting in a total shareholding of 8,434 million ordinary shares of £1 each. At 31 December 2016, HM Treasury's holding in the company's ordinary shares was 71.3%. As far as the company is aware, there have been no significant changes in the percentage ownership of major shareholders of the company's ordinary shares or preference shares during the three years ended 23 February 2017. All shareholders within a class of the company's shares have the same voting rights. As at 31 December 2016, almost all of the company's US$ denominated preference shares and American Depository Shares representing ordinary shares were held by shareholders registered in the US. All other shares were predominantly held by shareholders registered outside the US.

Our Code of conduct

The Group's Code of Conduct (Our Code) lets everyone know what to expect of each other, what to do when unsure of a decision, and where to go for advice when needed. It is available at rbs.com>about us>our values, or without charge, and upon request, by contacting Corporate Governance and Regulatory Affairs at the telephone number listed on page 627. In 2016 we incorporated five new standards of

behaviour into Our Code: (1) You must act with integrity; (2) You must act with due skill, care and diligence; (3) You must be open and cooperative with the Financial Conduct Authority (FCA), the Prudential Regulatory Authority (PRA) and other regulators; (4) You must pay due regard to the interests of customers and treat them fairly; and (5) You must observe proper standards of market conduct. These new conduct rules are part of the changes our UK banking regulators, the PRA and FCA, are making to improve accountability across the financial sector as part of the Individual Accountability Regime. The rules themselves are new, but very much in keeping with the values and behaviours that we are already following across the Group.

Additional information

Iran sanctions and related disclosures

Disclosure pursuant to section 13(r) of the Securities Exchange Act

Section 13(r) of the Securities Exchange Act, as amended by section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012, requires an issuer to disclose in its annual or quarterly reports, as applicable, whether, during the period covered by the report, it or any of its affiliates knowingly engaged in specified activities or transactions relating to Iran or with individuals or entities designated under Executive Order 13382 or 13224. Disclosure is required of certain activities conducted outside the United States by non-U.S. entities in compliance with local law, whether or not the activities are sanctionable under U.S. law. In order to comply with this requirement, the following activities of RBS Group's affiliates are disclosed in response to section 13(r).

Iranian government payments

During 2016, in full compliance with applicable sanctions and under applicable licenses granted by appropriate authorities, affiliates of RBS Group facilitated a number of payments that were remitted by or to Iranian government-owned entities, including government-owned financial institutions. The payments made by Iranian government-owned entities were received by non-designated, non-Iranian customers of RBS Group affiliates in relation to the purchase of machinery equipment for a production plant in Iran, sponsorship fees for a business conference, salary payments, legal fees and the cost of purchasing tires. The payments sent to Iranian government-owned entities were made by non-designated customers of RBS Group affiliates based outside of Iran in relation to legal services (including a refund of legal expenses) and insurance claims. In addition, during 2016, an affiliate of RBS Group received a payment made to one of its customers that is owned/controlled by persons designated under Executive Order 13324. The payment related to an outstanding obligation. The customer's account has since been closed. The funds were returned to customer's account held by a third party bank. The transactions described in the above paragraphs totalled 101 and resulted in less than the equivalent of £30 in gross revenue to RBS Group per transaction. RBS Group has not made any profit from these transactions. RBS Group intends to continue to engage in transactions similar to those described above as long as such transactions are in compliance with applicable sanctions laws and within RBS Group's risk appetite.

Guarantees

Under applicable licenses granted by appropriate authorities, affiliates of RBS Group hold eight legacy guarantees entered into between 1998 and 2005, which support arrangements entered into lawfully by affiliates of RBS Group customers with Iranian counterparties. These legacy guarantees are in favour of Iranian government-owned financial institutions. The affiliates of RBS Group have made considerable efforts to exit and formally cancel the guarantees. However, despite the lifting of EU nuclear proliferation sanctions against Iran these RBS Group affiliates have been unable to do so to date.

RBS Group received no revenue in the reporting period in respect of these legacy guarantees and no other payments were made under these guarantees in 2016.

Clearing System

RBS Group participates in local government-run clearing and settlement exchange systems in a number of countries in compliance with applicable laws and regulations. Iranian government-owned banks also participate in some of these clearing systems, which creates the risk that RBS Group could participate in transactions in which such Iranian banks are involved.

Where legally permissible, RBS Group has instituted procedures to screen and halt any outgoing and incoming payments to and from Iranian banks in these clearing systems prior to settlement. BS Group has obtained a license from Her Majesty's Treasury to participate in local payment and settlement systems in the United Arab Emirates (UAE). RBS Group intends to continue to participate in the clearing and settlement exchange systems in various countries and will continue to seek to limit the risk of participating in transactions involving Iranian government-owned financial institutions in accordance with applicable laws and regulations. RBS Group intends to participate in transactions involving such entities only pursuant to licenses from the appropriate authorities. No transactions involving Iranian government-owned financial institutions were processed by affiliates of RBS Group in 2016 through the local payment settlement system in the UAE.

Additional information

Iran sanctions and related disclosures continued

Iranian Petroleum Industry

Section 13(r) of the Securities Exchange Act (as amended) requires disclosure of any knowing engagement in activity described in section 5 (a) or (b) of the Iran Sanctions Act, including significant investments in or transactions that could develop the Iranian petroleum or petrochemical sectors. In full compliance with applicable laws, and after discussions with relevant sanctions authorities, an affiliate of RBS Group maintained transactional banking facilities on behalf of a UK company (the "Non-Iranian Party") and a company owned and controlled by the Government of Iran (the "Iranian Party") in relation to their interest in a joint operating agreement relating to a UK oil and gas field located in the North Sea.

Under authorisation from relevant sanctions authorities, the Non-Iranian Party was able to undertake all transactions and activities incident to the operation and production of the UK field, including the sale of gas, oil, condensate, natural gas liquids or other hydrocarbon products produced from the field. Under license from relevant sanctions authorities, the affiliate of RBS Group operated a Temporary Management Account to facilitate the transactions relating to these activities for the joint venture.

Following the lifting of EU nuclear proliferation sanctions against Iran, the Iranian Party was no longer subject to UK Sanctions and the monies held in the Temporary Management Account that were due to the Iranian Party were remitted to it, and the Temporary Management Account was closed. The affiliate of RBS Group has continued to facilitate transactions and activities incident to the operation and production of the UK field, including the sale of gas, oil, condensate, natural gas liquids or other hydrocarbon products from the field for the non-Iranian party and other non-Iranian parties, including receiving payments from Iranian parties which involve Iranian government-owned financial institutions. All such payments were made or received in compliance with applicable sanctions and under applicable licenses.

In addition, during 2016, affiliates of RBS Group have also made and received a number of payments connected to the production, sale and transport of Iranian petroleum or related hydrocarbon products. Some of these transactions have involved Iranian government-owned entities and Iranian government-owned financial institutions. All such payments were made or received in compliance with applicable sanctions and under applicable licenses.

The transactions described in connection with the Iranian Petroleum Industry above totalled 37 and resulted in less than the equivalent of £30 in gross revenue to RBS Group per transaction. RBS Group has not made any profit from these transactions. RBS Group intends to continue to engage in transactions similar to those described in this paragraph as long as such transactions are in compliance with applicable sanctions laws and within RBS Group's risk appetite.

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Explanation of Responses:

Additional information

Supervision

United Kingdom

The home supervisors for RBS are the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). As with all significant banking institutions, the PRA is the consolidated supervisor of RBS. The PRA, an operationally independent subsidiary of the Bank of England, is responsible for promoting the safety and soundness of systemically important financial institutions in the UK. The FCA's overall objective is to ensure financial markets function well. This is supported by its operational objectives of: securing an appropriate degree of protection for consumers; protecting and enhancing the integrity of the UK financial system; and promoting effective competition in the interests of consumers.

As at 31 December 2016, 17 companies in RBS, spanning a range of financial services sectors (banking, insurance and investment business), were authorised to conduct financial activities in the UK. The UK authorised banks in RBS Group include The Royal Bank of Scotland plc, National Westminster Bank Plc, Coutts & Co and Ulster Bank Limited. Wholesale activities, other than Treasury activities, are concentrated in the NatWest Markets (formerly Corporate and Institutional Banking) business, and are undertaken under the names of The Royal Bank of Scotland plc and National Westminster Bank Plc in Great Britain and by Ulster Bank Limited in Northern Ireland. Retail banking activities in England, Scotland and Wales are managed by the Personal and Business Banking and Commercial and Private Banking businesses. The banking service in the Republic of Ireland is provided by Ulster Bank Ireland DAC, which is supervised by the Central Bank of Ireland and the European Central Bank under the Single Supervisory Mechanism.

Investment management business is principally undertaken by companies in the Commercial and Private Banking business, including Coutts & Co, Adam & Company Investment Management Limited, RBS Asset Management Limited and The Royal Bank of Scotland plc.

RBS is subject to extensive regulations that impose obligations on financial institutions to maintain appropriate policies, procedures and controls to ensure compliance with the rules and regulations to which they are subject.

United States

The Royal Bank of Scotland Group plc is both a bank holding company and a financial holding company within the meaning of the US Bank Holding Company Act of 1956. As such, it is subject to the regulation and supervision of the Board of Governors of the Federal Reserve System (the Federal Reserve). Among

other things, the Group's direct and indirect activities and investments in the United States are limited to those that are 'financial in nature' or 'incidental' or 'complementary' to a financial activity, as determined by the Federal Reserve. The Group is also required to obtain the prior approval of the Federal Reserve before acquiring directly or indirectly, the ownership or control of more than 5% of any class of the voting shares of any US bank or holding company. Under current Federal Reserve policy, the Group is required to act as a source of financial strength for its US bank subsidiaries. Among other things, this source of strength obligation could require the Group to inject capital into any of its US bank subsidiaries if any of them became undercapitalised.

Anti-money laundering, anti-terrorism and economic sanctions regulations are a major focus of the US government for financial institutions and are rigorously enforced by the US government agencies.

RBS’s US bank and non-bank subsidiaries are also subject to supervision and regulation by a variety of other US regulatory agencies. RBS plc’s Connecticut branch and Connecticut representative office are supervised by the Connecticut Department of Banking (CT DoB) and the Federal Reserve Bank of New York (FRB-NY). On 22 December 2016, the CT DoB approved RBS’s application to establish a representative office in the State of Connecticut, which was opened on 1 February 2017. All third-party assets have been removed from the Connecticut branch and it is expected that the branch will be officially closed by the end of Q1 2017. From that point forward, RBS plc’s banking-related activity in the US will be conducted through the representative office.

Additional information

RBS's primary US broker dealer, RBS Securities Inc. (RBSSI) is also subject to regulation and supervision by a number of US regulators. With respect to its securities activities, RBSSI is mainly regulated by the US Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) and various state regulators. The futures activities of RBSSI are subject to regulation and oversight mainly by the US Commodity Futures Trading Commission (CFTC), National Futures Association (NFA) and the Chicago Mercantile Exchange Group (CME). RBSSI is also under the supervision of the FRB-NY.

On 5 December 2016, the RBS investment bank, Corporate and Investment Banking, was renamed “NatWest Markets” and in the US the new name is “NatWest Markets US”. NatWest Markets US includes all legal entities in the US, including RBSSI, RBS plc CT branch and RBS plc CT representative office. NatWest Markets is the marketing name of RBSSI and RBS plc, although RBSSI’s client communications and legal documents continue to name RBSSI as the broker-dealer. The renaming has no impact on RBS’s regional business strategy and product offering, or to any of the US legal entities.

RBS plc is a provisionally registered swap dealer and as such it is subject to oversight by the CFTC and the NFA in the US.

The NatWest Markets US legal entities are subject to extensive regulations from the various US regulators mentioned above, and others, which impose obligations on financial institutions to maintain appropriate policies, procedures and controls to ensure compliance with the rules and regulations to which they are subject.

Other jurisdictions

RBS operates in a number of countries through a network of branches, local banks and non-bank subsidiaries and these activities are subject to supervision in most cases by a local regulator or central

Shareholder information

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Shareholder information

Financial calendar

Dividends

Payment dates	
Cumulative preference shares	31 May and 29 December 2017
Non-cumulative preference shares	31 March, 30 June, 29 September and 29 December 2017
Ex-dividend date	
Cumulative preference shares	4 May 2017
Record date	
Cumulative preference shares	5 May 2017
Interim results	4 August 2017

Shareholder enquiries

Shareholdings in the company may be checked by visiting the

Shareholder centre section of our website, www.rbs.com. You will need the shareholder reference number printed on your share certificate or tax voucher to gain access to this information.

Listed below are the most commonly used features on the website:

- holding enquiry - view balances, values, history, payments and reinvestments;

- address change - change your registered address;

- e-Comms sign-up - choose to receive email notification when your shareholder communications become available instead of paper communications;

- outstanding payments - reissue any uncashed payments using our online replacement service; and

- downloadable forms - including stock transfer and change of address forms.

You may also check your shareholding by contacting our Registrar:

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ
Telephone: +44 (0)370 702 0135
Fax: +44 (0)370 703 6009
Website: www.investorcentre.co.uk/contactus

Shareholder information

Braille and audio Strategic report with additional information

Shareholders requiring a Braille or audio version of the Strategic report with additional information should contact the Registrar on +44 (0)370 702 0135.

ShareGift

The company is aware that shareholders who hold a small number of shares may be retaining these shares because dealing costs make it uneconomical to dispose of them. ShareGift, the charity share donation scheme, is a free service operated by The Orr Mackintosh Foundation (registered charity 1052686) to enable shareholders to donate shares to charity.

Donating your shares in this way will not give rise to either a gain or a loss for UK capital gains tax purposes and you may be able to reclaim UK income tax on gifted shares. Further information can be obtained from HM Revenue & Customs.

Should you wish to donate your shares to charity in this way you should contact ShareGift for further information:

ShareGift, The Orr Mackintosh Foundation
17 Carlton House Terrace, London SW1Y 5AH
Telephone: +44 (0)20 7930 3737
Website: www.sharegift.org

Share fraud warning

Investment scams are designed to look like genuine investments. If you have been contacted out of the blue, promised tempting returns and told the investment is safe, called repeatedly, or told the offer is only available for a limited time, you may have been contacted by fraudsters.

How to avoid share fraud

Reject cold calls

If you have been cold called with an offer to buy or sell shares, chances are it is a high risk investment or a scam. You should treat the call with extreme caution. The safest thing to do is to hang up.

Check the firm on the Financial Services Register at www.fca.org.uk/register

The Financial Services Register is a public record of all firms and individuals in the financial services industry that are regulated by the FCA.

Get impartial advice

Think about getting impartial financial advice before you hand over any money. Seek advice from someone unconnected to the firm that has approached you.

Remember, if it sounds too good to be true, it probably is.

Report a scam

If you suspect that you have been approached by fraudsters please tell the FCA using the share fraud reporting form at scamsmart.fca.org.uk, where you can find out more about investment scams. You can also call the FCA Consumer Helpline on 0800 111 6768.

If you have lost money to investment fraud, you should report it to Action Fraud on 0300 123 2040 or online at www.actionfraud.police.uk.

Find out more at www.scamsmart.fca.org.uk

Shareholder information

Analyses of ordinary shareholders			
At 31 December 2016	Shareholdings	Number of shares - millions	%
Individuals	187,579	105.1	0.9
Banks and nominee companies	5,762	11,684.6	98.8
Investment trusts	65	0.7	—
Insurance companies	74	0.3	—
Other companies	537	8.6	0.1
Pension trusts	25	0.2	—
Other corporate bodies	79	23.7	0.2
	194,121	11,823.2	100.0
Range of shareholdings:			
1 - 1,000	168,270	41.5	0.3
1,001 - 10,000	24,335	54.8	0.5
10,001 - 100,000	938	27.7	0.2
100,001 - 1,000,000	372	132.2	1.1
1,000,001 - 10,000,000	154	505.5	4.3
10,000,001 and over	52	11,061.5	93.6
	194,121	11,823.2	100.0

Trading market

Non-cumulative dollar preference shares

The following series of American Depositary shares (ADSs) representing non-cumulative preference shares issued in the US were outstanding at 31 December 2016:

Date of issue	Series of ADS	Number of ADSs/non-cumulative preference shares in issue	Number of registered holders
26 March 1997	F	6,255,408	42
8 February 1999	H	9,687,654	30
30 September 2004	L	30,027,877	16
28 June 2007	S	26,449,040	3
4 October 2007	U	10,130	1

Each of the respective ADSs set out above represents the right to receive one corresponding preference share, and is evidenced by an American Depository Receipt (ADR) and is listed on the New York Stock Exchange, a subsidiary of NYSE Euronext (NYSE).

The ADRs evidencing the ADSs above were issued pursuant to Deposit Agreements, among the company, The Bank of New York, as depository, and all holders from time-to-time of ADRs issued thereunder. Currently, there is no non-United States trading market for any of the non-cumulative dollar preference shares. All of the non-cumulative dollar preference shares are held by the depository, as custodian, in registered form.

In September 2016 and September 2015, the company redeemed in whole the Series R and T, and Series M , N, P and Q non-cumulative preference shares of US$0.01 respectively.

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Shareholder information

PROs

In August 2001, the company issued US$1.2 billion perpetual regulatory tier one securities (PROs) which are listed on the NYSE.

ADSs representing ordinary shares

In October 2007, the company listed ADSs, each representing one ordinary share nominal value 25p each (or a right to receive one ordinary share), and evidenced by an ADR or uncertificated securities, on the NYSE. With effect from 7 November 2008, the ratio of one ADS representing one ordinary share changed to one ADS representing 20 ordinary shares.

Following a sub-division and one-for-ten consolidation of RBS's ordinary shares in June 2012, the ratio of one ADS representing 20 ordinary shares was adjusted to one ADS representing two ordinary shares. As at 31 December 2016, 48.7 million ordinary ADSs were outstanding.

The ordinary ADSs were issued pursuant to a Deposit Agreement, among the company, The Bank of New York Mellon, as depository, and all owners and holders from time to time of ordinary ADSs issued thereunder. The ordinary shares of the company are listed and traded on the London Stock Exchange. All ordinary shares are deposited with the principal London office of The Bank of New York Mellon, as custodian for the depository.

Shareholder information

The following table shows the high and low sales prices for each of the outstanding ADSs representing non-cumulative dollar preference shares, PROs, ordinary shares and ADSs representing ordinary shares.

		Series F ADSs (1)	Series H ADSs (1)	Series L ADSs (1)	Series S ADSs (1)	Series U ADSs (1)	PROs (1,2)	Ordinary Shares (3)	Ordinary ADSs (4)
		US$	US$	US$	US$	US$	US$	US$	US$
By month									
Feb 2017	High	26.42	25.92	25.19	25.62	96.40	116.39	2.59	6.29
	Low	26.03	25.58	24.51	25.26	91.00	115.50	2.23	5.63
Jan 2017	High	26.14	25.78	24.95	25.48	94.75	115.61	2.34	5.90
	Low	25.96	25.43	24.18	25.09	92.54	114.35	2.15	5.41
Dec 2016	High	26.28	25.56	24.53	25.42	95.88	115.09	2.31	5.68
	Low	25.74	25.17	23.80	24.94	90.05	113.81	1.93	4.91
Nov 2016	High	26.07	25.60	25.11	25.30	97.41	118.22	2.13	5.33
	Low	25.68	25.32	24.53	25.05	90.79	115.17	1.83	4.52
Oct 2016	High	25.98	25.73	25.23	25.65	99.75	119.88	1.96	4.83
	Low	25.80	25.42	25.05	25.19	95.75	118.61	1.70	4.20
Sep 2016	High	26.37	26.00	25.85	25.86	101.25	120.83	2.07	5.46
	Low	25.66	25.41	25.08	25.23	96.02	119.33	1.75	4.50
By quarter									
2016: Q4	High	26.28	25.73	25.23	25.65	99.75	119.88	2.31	5.68
	Low	25.68	25.17	23.80	24.94	90.05	113.81	1.70	4.20
2016: Q3	High	26.47	26.15	25.85	25.86	101.25	120.83	2.07	5.46
	Low	25.59	25.37	24.74	24.92	92.37	115.29	1.49	4.04
2016: Q2	High	26.54	26.01	25.50	25.77	99.96	118.42	2.56	7.56
	Low	25.11	24.94	23.30	24.04	91.54	114.95	1.72	4.69
2016: Q1	High	25.91	25.86	25.21	25.21	104.50	124.48	2.97	8.73
	Low	24.27	23.79	21.77	21.77	95.54	114.81	2.20	6.20
2015: Q4	High	26.05	25.99	25.09	25.09	106.50	125.04	3.34	10.22
	Low	25.27	25.20	24.10	24.10	103.73	124.08	2.83	8.60
2015: Q3	High	25.81	25.73	25.03	25.38	107.75	125.54	3.66	11.37
	Low	25.34	25.31	24.08	24.82	104.48	124.90	3.08	9.30
2015: Q2	High	26.14	25.74	24.67	25.29	110.25	126.73	3.69	11.52
	Low	25.35	25.29	24.03	24.60	106.50	124.81	3.39	10.17
2015: Q1	High	26.73	25.94	24.62	25.48	110.38	126.62	4.04	12.43
	Low	25.65	25.44	23.50	24.82	104.25	124.66	3.40	10.09
By year									

2016	High	26.54	26.15	25.85	25.86	104.50	124.40	2.97	8.73
	Low	24.27	23.79	21.77	21.77	90.05	113.81	1.49	4.04
2015	High	26.73	25.99	25.09	25.48	110.38	127.71	4.04	12.43
	Low	25.27	25.20	23.50	24.10	103.73	117.04	2.83	8.60
2014	High	26.44	25.92	24.05	25.07	107.13	121.97	4.04	12.57
	Low	24.93	24.23	19.89	21.68	97.25	105.04	2.96	9.86
2013	High	25.86	25.55	24.00	24.45	98.50	107.70	3.85	12.35
	Low	24.07	23.52	18.46	20.23	84.00	90.27	2.66	8.15
2012	High	25.35	24.96	23.57	23.31	90.00	100.59	3.25	10.79
	Low	17.60	16.76	15.46	11.83	53.63	66.58	1.97	6.09

Notes:

(1) Prices as reported on the NYSE or NASDAQ.

(2) Price quoted as a % of US$1,000 nominal.

(3) Prices as reported in the Daily List of the London Stock Exchange. Following the sub-division and one-for-ten consolidation of ordinary shares in June 2012, prices prior to that date were restated accordingly.

(4) Prices as reported on the NYSE. Following the sub-division and one-for-ten consolidation of ordinary shares in June 2012, the ratio of one ADS representing 20 ordinary shares was adjusted to one ADS representing two ordinary shares.

Shareholder information

On 17 March 2017, the closing price of the ordinary shares on the London Stock Exchange was £2.44, equivalent to $3.02 per ordinary share translated at the Noon Buying Rate of $1.2372 per £1.00, and the closing price of the ordinary ADSs on the NYSE was $6.04.

In addition to the securities referred to above, the Group also issues SEC-registered contingent convertible additional tier 1 capital notes from time to time, which are listed on the Irish Stock Exchange (ISE).

Dividend history						
Preference dividends						
	2016	2016	2015	2014	2013	2012
Amount per share	$	£	£	£	£	£
Non-cumulative preference shares of US$0.01						
- Series F (1)	2.07	1.53	1.25	1.16	1.16	1.21
- Series H (1)	1.81	1.34	1.19	1.10	1.10	1.14
- Series L (1)	1.44	1.06	0.94	0.87	0.87	0.91
- Series M (2)	—	—	0.60	0.97	1.03	0.75
- Series N (2)	—	—	0.60	0.96	1.03	0.74
- Series P (2)	—	—	0.59	0.95	1.01	0.73
- Series Q (2)	—	—	0.63	1.02	1.09	0.79
- Series R (2)	1.00	0.71	0.99	0.93	0.99	0.72
- Series S (2)	1.65	1.22	1.06	1.00	1.07	0.77
- Series T (2)	1.18	0.84	1.17	1.10	1.17	0.85
- Series U (2)	7,640	5,637	4,912	4,637	4,881	2,406
Non-cumulative convertible preference shares of US$0.01						
- Series 1 (1)	91.18	67.28	59.66	55.34	55.12	57.86
Non-cumulative preference shares of €0.01						
- Series 1 (2)	63.61	46.94	38.64	44.32	45.76	44.65
- Series 2 (2)	54.21	40.00	37.27	42.31	44.83	42.25
- Series 3 (2)	4,110	3,033	2,533	2,833	3,027	2,813
Non-cumulative convertible preference shares of £0.01						
- Series 1 (1)	100.11	73.87	73.87	73.87	73.87	73.87
Non-cumulative preference shares of £1						
- Series 1 (2)	38.76	28.60	29.04	29.01	28.42	89.62

Notes:

(1) Classified as subordinated liabilities.

(2) Classified as equity.

On 26 November 2009, RBS entered into a State Aid Commitment Deed with HM Treasury containing commitments and undertakings that were designed to ensure that HM Treasury was able to comply with the commitments to be given by it to the European Commission for the purposes of obtaining approval for the State aid provided to RBS. As part of these commitments and undertakings, RBS agreed not to pay discretionary coupons and dividends on its existing hybrid capital instruments for a period of two years. This period commenced on 30 April 2010 for RBS Group instruments and ended on 30 April 2012; the two year deferral period for RBS Holdings N.V. instruments commenced on 1 April 2011 and ended on 1 April 2013.

On 4 May 2012, RBS determined that it was in a position to recommence payments on RBS Group instruments. In June 2013 RBS Holdings N.V. resumed payments on its hybrid capital instruments. Future coupons and dividends on hybrid capital instruments will only be paid subject to, and in accordance with, the terms of the relevant instruments.

Ordinary dividends

The company has not paid an ordinary dividend since 2007. In 2008, the company issued new ordinary shares by way of a capitalisation issue rather than paying an interim dividend.

Shareholder information

Taxation for US Holders

The following discussion summarises certain US federal and UK tax consequences of the ownership and disposition of ordinary shares, ADSs representing ordinary shares (ordinary ADSs), ADSs representing noncumulative dollar preference shares (preference ADSs) or PROs by a beneficial owner that is a citizen or resident of the United States or that otherwise will be subject to US federal income tax on a net income basis in respect of the ordinary shares, ordinary ADSs, preference ADSs or PROs (a "US Holder"). This summary assumes that a US Holder is holding ordinary shares, ordinary ADSs, preference ADSs or PROs, as applicable, as capital assets. This summary does not address the tax consequences to a US Holder (i) that is resident in the UK for UK tax purposes, (ii) that carries on a trade, profession or vocation through a branch, agency or permanent establishment in the UK in connection with which their ordinary shares, ordinary ADSs, preference ADSs or PROs are held, used or acquired, or (iii) generally, that is a corporation which alone or together with one or more associated companies, controls, directly or indirectly, 10% or more of the voting stock of the company, nor does this summary address all of the tax consequences that may be relevant to a US Holder in light of its particular circumstances, including alternative minimum tax and Medicare contribution tax consequences, as well as differing tax consequences that may apply to US Holders subject to special rules, such as certain financial institutions, dealers or traders in securities who use a mark-to-market method of tax accounting, persons holding ordinary shares, ordinary ADSs, preference ADSs or PROs as part of a hedging transaction, straddle, wash sale, conversion transaction or integrated transaction or persons entering into a constructive sale with respect to such securities, persons whose functional currency for US federal income tax purposes is not the US dollar, entities classified as partnerships for US federal income tax purposes, tax-exempt entities or persons that own or are deemed to own 10% or more of the voting stock of the company.

The statements and practices set forth below regarding US and UK tax laws, including the US/UK double taxation convention relating to income and capital gains which entered into force on 31 March 2003 (the "Treaty") and the US/UK double taxation convention relating to estate and gift taxes (the "Estate Taxation Treaty"), are based on those laws and practices as in force and as applied in practice on the date of this report. This summary is not exhaustive of all possible tax considerations and holders are advised to satisfy themselves as to the overall tax consequences, including specifically the consequences under US federal, state, local and other laws, and possible changes in taxation law, of the acquisition, ownership and disposition of ordinary shares, ordinary ADSs, preference ADSs or PROs by consulting their own tax advisers.

The following discussion assumes that the company was not a passive foreign investment company for the taxable year ended 31 December 2016 - see 'Passive Foreign Investment Company (PFIC) considerations' on page 421.

Explanation of Responses:

Shareholder information

Ordinary shares, ordinary ADSs and preference ADSs

Taxation of dividends

For the purposes of the Treaty, the Estate Taxation Treaty and the US Internal Revenue Code of 1986 as amended (the "Code"), US Holders of ordinary ADSs and preference ADSs should be treated as owners of the respective ordinary shares and the non-cumulative dollar preference shares underlying such ADSs.

The US Treasury has expressed concerns that parties to whom depositary receipts are released before shares are delivered to the depositary, or intermediaries in the chain of ownership between US holders and the issuer of the security underlying the depositary receipts, may be taking actions that are inconsistent with the claiming of foreign tax credits for US holders of depositary receipts. Such actions would also be inconsistent with the claiming of the favourable US tax rates applicable to dividends received by certain non-corporate US holders (described below). Accordingly, the availability of the favourable tax rates for dividends received by certain non-corporate US holders could be affected by actions taken by such parties or intermediaries.

The company is not required to withhold UK tax at source from dividend payments it makes or from any amount (including any amounts in respect of accrued dividends) distributed by the company. US Holders who are not resident in the UK and who do not carry on a trade, profession or vocation in the UK through a branch, agency or permanent establishment in connection with which their ordinary shares, ordinary ADSs or preference ADSs are held, used or acquired will not be subject to UK tax in respect of any dividends received on the relevant shares or ADSs.

Distributions by the company (other than certain pro-rata distributions of ordinary shares or rights to receive such shares) will constitute foreign source dividend income for US federal income tax purposes to the extent paid out of the current or accumulated earnings and profits of the company, as determined under US federal income tax principles. Because the company does not maintain calculations of its earnings and profits under US federal income tax principles, it is expected that distributions will be reported to US Holders as dividends. Payments will not be eligible for the dividends-received deduction generally allowed to corporate US holders.

Subject to applicable limitations that vary depending upon a US Holder's particular circumstances and the discussion above regarding concerns expressed by the US Treasury, dividends paid to certain non-corporate US Holders may be taxable at the favourable rates applicable to long-term capital gain. Non-corporate US Holders should consult their own tax advisers to determine whether they are subject to any special rules that limit their ability to be taxed at these favourable rates.

Dividends will be included in a US Holder's income on the date of the US Holder's (or in the case of ADSs, the depositary's) receipt of the dividend. The amount of any dividend paid in pounds sterling to be included in income by a US Holder will be the US dollar amount calculated by reference to the relevant exchange rate in effect on the date of such receipt regardless of whether the payment is in fact converted into US dollars. If the dividend is converted into US dollars on the date of receipt, the US Holder generally should not be required to recognise foreign currency gain or loss in respect of the dividend income. If the amount of such dividend is converted into US dollars after the date of receipt, the US Holder may have foreign currency gain or loss.

Shareholder information

Taxation of Capital Gains

A US Holder that is not resident in the UK will not normally be liable for UK tax on capital gains realised on the disposition of an ordinary share, an ordinary ADS or a preference ADS unless at the time of the disposal, in the case of a corporate US Holder, such US Holder carries on a trade in the UK through a permanent establishment or, in the case of any other US Holder, such US Holder carries on a trade, profession or vocation in the UK through a branch or agency and, in each case, such ordinary share, ordinary ADS or preference ADS is or has been used, held or acquired by or for the purposes of such trade (or profession or vocation), carried on through such permanent establishment, branch or agency. Special rules apply to individuals who are temporarily not resident in the UK.

A US Holder will, upon the sale or other disposition of an ordinary share, an ordinary ADS or a preference ADS, or upon the redemption of preference ADS, generally recognise capital gain or loss for US federal income tax purposes (assuming that in the case of a redemption of a preference ADS, such US Holder does not own, and is not deemed to own, any ordinary shares or ordinary ADSs of the company) in an amount equal to the difference between the amount realised (excluding, in the case of preference ADSs, any amounts attributable to declared but unpaid dividends, which will generally be treated as dividends for U.S. federal income tax purposes and excluding, in the case of a redemption, any amount otherwise treated as a dividend for US federal income tax purposes) and the US Holder's tax basis in such share or ADS. This capital gain or loss will be long-term capital gain or loss if the US Holder held the share or ADS so sold, disposed or redeemed for more than one year. The deductibility of capital losses is subject to limitations.

A US Holder who is liable for both UK and US tax on a gain recognised on the disposal of an ordinary share, an ordinary ADS or a preference ADS may be entitled, subject to certain limitations, to credit the UK tax against its US federal income tax liability in respect of such gain.

Estate and gift tax

Subject to the discussion of the Estate Tax Treaty in the following paragraph, ordinary shares, ordinary ADSs or preference ADSs beneficially owned by an individual may be subject to UK inheritance tax (subject to exemptions and reliefs) on the death of the individual or in certain circumstances, if such shares or ADSs are the subject of a gift (including a transfer at less than market value) by such individual. Inheritance tax is not generally chargeable on gifts to individuals made more than seven years before the death of the donor. Ordinary shares, ordinary ADSs or preference ADSs held by the trustees of a settlement may also be subject to UK inheritance tax. Special rules apply to such settlements.

An ordinary share, an ordinary ADS or a preference ADS beneficially owned by an individual, whose domicile is determined to be the United States for purposes of the Estate Tax Treaty and who is not a national of the UK, will not be subject to UK inheritance tax on the individual's death or on a lifetime transfer of such share or ADS, except in certain cases where the share or ADS (i) is comprised in a settlement (unless, at the time of the settlement, the settlor was domiciled in the United States and was not a national of the UK); (ii) is part of the business property of a UK permanent establishment of an enterprise; or (iii) pertains to a UK fixed base of an individual used for the performance of independent personal services.

The Estate Tax Treaty generally provides a credit against US federal estate or gift tax liability for the amount of any tax paid in the UK in a case where the ordinary share, ordinary ADS or preference ADS is subject to both UK inheritance tax and US federal estate or gift tax.

UK stamp duty and stamp duty reserve tax (SDRT)

The following is a summary of the UK stamp duty and SDRT consequences of transferring an ADS (otherwise than to the custodian on cancellation of the ADS) or of transferring an ordinary share. A transfer of an ADS executed and retained in the United States will not give rise to a liability to pay stamp duty and an agreement to transfer an ADS will not give rise to SDRT. Stamp duty or SDRT will normally be payable on or in respect of transfers of ordinary shares and accordingly any holder that acquires or intends to acquire ordinary shares is advised to consult its own tax adviser in relation to stamp duty and SDRT.

Shareholder information

PROs

United States

Payments of interest on a PRO (including any UK withholding tax, as to which see below) will constitute foreign source dividend income for US federal income tax purposes to the extent paid out of the current or accumulated earnings and profits of the company, as determined under US federal income tax principles. Because the company does not maintain calculations of its earnings and profits under US federal income tax principles, it is expected that distributions will be reported to US Holders as dividends. Payments will not be eligible for the dividends-received deduction generally allowed to corporate US holders. A US Holder who is entitled under the Treaty to a refund of UK tax, if any, withheld on a payment will not be entitled to claim a foreign tax credit with respect to the refundable tax. Subject to applicable limitations that vary depending upon a US Holder's particular circumstances, dividends paid to certain non-corporate US Holders may be taxable at the favourable rates applicable to long-term capital gain. Non-corporate US Holders should consult their own tax advisers to determine whether they are subject to any special rules that limit their ability to be taxed at these favourable rates.

A US Holder will, upon the sale, exchange or redemption of a PRO, generally recognise capital gain or loss for US federal income tax purposes (assuming that in the case of a redemption, such US Holder does not own, and is not deemed to own, any ordinary shares or ordinary ADSs of the company) in an amount equal to the difference between the amount realised (excluding any amount in respect of mandatory interest and any missed payments which are to be satisfied on a missed payment satisfaction date, which would be treated as ordinary income) and the US Holder's tax basis in the PRO. This capital gain or loss will be long-term capital gain or loss if the US Holder held the PRO so sold, disposed or redeemed for more than one year. The deductibility of capital losses is subject to limitations.

A US Holder who is liable for both UK and US tax on gain recognised on the disposal of PROs may be entitled, subject to certain limitations, to credit the UK tax against all or a portion of its US federal income tax liability in respect of such gain.

United Kingdom

Taxation of payments on the PROs

Payments on the PROs will constitute interest rather than dividends for UK withholding tax purposes. With effect from 1 January 2016, the PROs are expected to fall within the exemption from withholding tax provided for in the Taxation of Regulatory Capital Securities Regulations 2013 (as amended by the Taxation of Regulatory Capital Securities (Amendment) Regulations 2015). Further, payments of interest will not be subject to withholding or deduction for or on account of UK tax as long as the PROs continue to be listed on a ‘recognised stock exchange’ within the meaning of section 1005 of the Income Tax Act 2007,

such as the main market of the New York Stock Exchange. In all other cases, an amount must be withheld on account of UK income tax at the basic rate (currently 20%) subject to any direction to the contrary by HM Revenue & Customs under the Treaty and except that the withholding obligation does not apply to payments to persons who the company reasonably believes are within the charge to corporation tax or fall within various categories enjoying a special tax status (including charities and pension funds), or are partnerships consisting of such persons (unless HM Revenue & Customs directs otherwise). Where interest has been paid under deduction of UK withholding tax, US Holders may be able to recover the tax deducted under the Treaty.

HM Revenue & Customs have powers in certain circumstances to obtain information in relation to interest and payments derived from securities. HM Revenue & Customs may communicate this information to the tax authorities of other jurisdictions.

HM Revenue & Customs confirmed at around the time of the issue of the PROs that interest payments would not be treated as distributions for UK tax purposes by reason of (i) the fact that interest may be deferred under the terms of issue; or (ii) the undated nature of the PROs, provided that at the time an interest payment is made, the PROs are not held by a company which is 'associated' with the company or by a 'funded company'. A company will be associated with the company if, broadly speaking, it is part of the same group as the company. A company will be a 'funded company' for these purposes if there are arrangements involving that company being put in funds (directly or indirectly) by the company, or an entity associated with the company. In this respect, HM Revenue & Customs has confirmed that a company holding an interest in the PROs which incidentally has banking facilities with any company associated with the company will not be a 'funded company' by virtue of such facilities.

Interest on the PROs constitutes UK source income for UK tax purposes and, as such, may be subject to income tax by direct assessment even where paid without withholding. However, interest with a UK source received without deduction or withholding on account of UK tax will not be chargeable to UK tax in the hands of a US Holder unless, in the case of a corporate US Holder, such US Holder carries on a trade in the UK through a UK permanent establishment or in the case of other US Holders, such persons carry on a trade, profession or vocation in the UK through a branch or agency in each case in connection with which the interest is received or to which the PROs are attributable. There are also exemptions for interest received by certain categories of agents (such as some brokers and investment managers).

Shareholder information

Disposal (including redemption)

A disposal (including redemption) of PROs by a non-corporate US Holder will not give rise to any liability to UK tax on capital gains unless the US Holder carries on a trade (which for this purpose includes a profession or a vocation) in the UK through a branch or agency and the PROs are, or have been, held or acquired for the purposes of that trade, carried on through such branch or agency.

A transfer of PROs by a US Holder will not give rise to a charge to UK tax on accrued but unpaid interest payments, unless the US Holder is an individual or other non-corporate taxpayer and at any time in the relevant year of assessment or accounting period carries on a trade, profession or vocation in the UK through a branch or agency to which the PROs are attributable.

Annual tax charges

Corporate US Holders of PROs may be subject to UK tax charges (or tax relief) by reference to fluctuations in exchange rates and in respect of profits, gains and losses arising from the PROs (including on a disposal or redemption), but only if such corporate US Holders carry on a trade in the UK through a UK permanent establishment to which the PROs are attributable.

Inheritance tax

In relation to PROs held through Depository Trust Company (or any other clearing system), the UK inheritance tax position is not free from doubt in respect of a lifetime transfer, or death of, a US Holder who is not domiciled nor deemed to be domiciled in the UK for inheritance tax purposes; HM Revenue & Customs is known to consider that the situs of securities held in this manner is not necessarily determined by the place where the securities are registered. In appropriate circumstances, there may be a charge to UK inheritance tax as a result of a lifetime transfer at less than market value by, or on the death of, such US Holder. Inheritance tax is not generally chargeable on gifts to individuals made more than seven years before the death of the donor. However, exemption from, or a reduction of, any such UK tax liability may be available under the Estate Tax Treaty (see below). US Holders should consult their professional advisers in relation to such potential liability. PROs beneficially owned by an individual, whose domicile is determined to be the United States for the purposes of the Estate Tax Treaty and who is not a national of the UK, will not be subject to UK inheritance tax on the individual's death or on a lifetime transfer of the PRO, except in certain cases where the PRO (i) is comprised in a settlement (unless, at the time of the settlement, the settlor was domiciled in the United States and was not a national of the UK); (ii) is part of the business property of a UK permanent establishment of an enterprise; or (iii) pertains to a UK fixed base of an individual used for the performance of independent personal services.

The Estate Tax Treaty generally provides a credit against US federal estate or gift tax liability for the amount of any tax paid in the UK in a case where the PRO is subject to both UK inheritance tax and US federal estate or gift tax.

Stamp duty and SDRT

No stamp duty, SDRT or similar tax is imposed in the UK on the issue, transfer or redemption of the PROs.

Shareholder information

Passive Foreign Investment Company (PFIC) considerations

In general, a foreign corporation will be a PFIC for any taxable year in which, after taking into account the income and assets of the corporation and certain subsidiaries pursuant to applicable 'look-through rules', either (i) at least 75% of its gross income is 'passive income' or (ii) at least 50% of the average quarterly value of its assets is attributable to assets that produce passive income or are held for the production of passive income. The company does not believe that it was a PFIC for its 2016 taxable year. Although interest income is generally passive income, a special rule allows banks to treat their banking business income as non-passive. To qualify for this rule, a bank must satisfy certain requirements regarding its licensing and activities. The company's possible status as a PFIC is determined annually, however, and may be subject to change if the company fails to qualify under this special rule for any year in which a US Holder owned ordinary shares, ordinary ADSs, preference ADSs or PROs. If the company were to be treated as a PFIC for any taxable year during which a US Holder owns ordinary shares, ordinary ADSs, preference ADSs or PROs, US Holders would generally be subject to adverse US federal income tax consequences and certain reporting obligations. Holders should consult their own tax advisers as to the potential application of the PFIC rules to the ownership and disposition of the company's ordinary shares, ordinary ADSs, preference ADSs or PROs.

Information reporting and backup withholding

Payments on, and proceeds from the sale of, ordinary shares, ordinary ADSs, preference ADSs or PROs that are made within the United States or through certain U.S-related financial intermediaries may be subject to information reporting and backup withholding unless (i) the US Holder is an exempt recipient or (ii) in the case of backup withholding, the US Holder provides a correct taxpayer identification number and certifies that it is not subject to backup withholding. The amount of any backup withholding from a payment to a US Holder will be allowed as a credit against the US Holder’s US federal income tax liability and may entitle it to a refund, provided that the required information is timely furnished to the Internal Revenue Service.

Foreign financial assets reporting

Certain US Holders who are individuals (and certain entities controlled by individuals) may be required to report information relating to the company’s securities, subject to certain exceptions (including an exception for securities held in accounts maintained by US financial institutions). US Holders are urged to consult their tax advisers regarding the application of these rules in the US Holders’ particular circumstances.

Exchange controls

The company has been advised that there are currently no UK laws, decrees or regulations which would prevent the import or export of capital, including the availability of cash or cash equivalents for use by the

Group, or the remittance of dividends, interest or other payments to non-UK resident holders of the company's securities.

There are no restrictions under the Articles of Association of the company or under UK law, as currently in effect, which limit the right of non-UK resident owners to hold or, when entitled to vote, freely to vote the company's securities.

Shareholder information

Memorandum and Articles of Association

The company's Memorandum and Articles of Association as in effect at the date of this Annual Report are registered with the Registrar of Companies of Scotland.

The following information is a summary of certain terms of the company's Memorandum of Association (the "Memorandum") and Articles of Association (the "Articles") as in effect at the date of this Annual Report and certain relevant provisions of the Companies Act 2006 (the "2006 Act") where appropriate and as relevant to the holders of any class of share. The current Articles were adopted on 28 April 2010. The Articles were updated primarily to reflect the coming into force of the remaining provisions of the 2006 Act and the implementation of the Shareholder Rights Directive in the UK. An amendment was made to the Articles at a General Meeting held on 28 April 2010 in relation to the price at which certain classes of preference shares may be purchased.

A further amendment was made to the Articles at the Annual General Meeting held on 19 April 2011 to the effect that subject to existing class rights of shareholders, new preference shares can be issued with such rights and restrictions as the directors may determine. A further amendment was made to the Articles at the Annual General Meeting held on 30 May 2012 to include a new sub-article specifying the rights attaching to the Deferred shares arising as a result of share subdivision and consolidation.

The following summary description is qualified in its entirety by reference to the terms and provisions of the Memorandum and Articles (and, in the case of the summary description of the non-cumulative preference shares, the B Shares and the Dividend Access Share, by reference to the terms of issue of those shares determined by the Directors pursuant to the Articles prior to allotment). The Memorandum and Articles are registered with the Registrar of Companies of Scotland. Holders of any class of share are encouraged to read the full Memorandum and Articles, which have been filed as an exhibit to this Annual Report on Form 20-F.

Incorporation and registration

The company was incorporated and registered in Scotland under the Companies Act 1948 as a limited company on 25 March 1968 under the name National and Commercial Banking Group Limited. On 3 September 1979 the name was changed to The Royal Bank of Scotland Group Limited and on 10 March 1982, it changed its name to its present name and was registered under the Companies Acts 1948 to 1980 as a public company with limited liability. The company is registered under Company No. SC 45551.

Purpose and objects

The 2006 Act greatly reduces the constitutional significance of a company's memorandum of association and provides that a memorandum of association will record only the names of the subscribers and the number of shares each subscriber has agreed to take in the company. The 2006 Act further states that, unless a company's articles provide otherwise, a company's objects are unrestricted and abolishes the need for companies to have objects clauses. The company removed its objects clause together with all other provisions of its memorandum of association which by virtue of the 2006 Act were treated as forming part of the company's articles. The articles of association contain an express statement regarding the limited liability of the shareholders.

Shareholder information

Directors

At each annual general meeting of the company, any Director appointed since the last annual general meeting and any Directors who were not appointed at one of the preceding two annual general meetings shall retire from office and may offer themselves for re-election by the members. Directors may be appointed by the company by ordinary resolution or by the Board. A director appointed by the Board holds office only until the next annual general meeting, whereupon he will be eligible for re-election. Unless and until otherwise determined by ordinary resolution, the directors (other than alternate directors) shall be not more than twenty five. There is no stipulation in the Articles regarding a minimum number of directors; under the 2006 Act, and in the absence of express provision, the minimum number is two.

Directors' interests

A director shall not vote at a meeting of the Board or a Committee of the Board on any resolution of the Board concerning a matter in which he has an interest (otherwise than by virtue of his interest in shares, debentures or other securities of, or otherwise in or through, the company) which (together with any interest of any person connected with him) is, to his knowledge, material unless his interests arises only because the resolution relates to one or more of the following matters:

(i) the giving of any security or indemnity to him pursuant to the Articles or in respect of money lent, or obligations incurred, by him at the request of, or for the benefit of, the company or any of its subsidiary undertakings;

(ii) the giving of any security or indemnity to a third party in respect of a debt or obligation of the company or any of its subsidiary undertakings for which he has assumed responsibility (in whole or in part) under a guarantee or indemnity or by the giving of security;

(iii) a proposal concerning an offer of shares, debentures or other securities of the company, or any of its subsidiary undertakings, for subscription or purchase, in which offer he is, or may be, entitled to participate as a holder of securities or in the underwriting or sub-underwriting of which he is to participate;

(iv) any proposal concerning any other body corporate in which he is interested, directly or indirectly, whether as an officer or shareholder or otherwise, provided that he is not the holder of shares representing one per cent or more of any class of the equity share capital of such body corporate;

(v) any proposal concerning the adoption, modification or operation of a pension fund or retirement, death or disability benefits scheme or employees' share scheme which relates both to directors and employees of the company or a subsidiary of the company and does not provide any privilege or advantage in respect of any director which it does not accord to the employees to which the fund or scheme relates;

(vi) a contract or arrangement for the benefit of the employees of the company or any of its subsidiary undertakings which does not accord him any privilege or advantage not generally accorded to the employees to whom the contract or arrangement relates; and

(vii) a proposal concerning any insurance which the company proposes to purchase and/or maintain for the benefit of any directors or for persons who include directors of the company.

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Shareholder information

Under the 2006 Act, a director must avoid a situation where he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the company's interests. The 2006 Act allows directors of public companies, where appropriate, to authorise conflicts and potential conflicts where the articles of association contain a provision to this effect. The 2006 Act also allows the articles of association to contain other provisions for dealing with directors' conflicts of interest to avoid a breach of duty.

Clause 92 of the Articles, gives the directors authority to authorise any matter which would or might otherwise constitute or give rise to a breach of the duty of a director under the 2006 Act to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict with the company.

Authorisation of any matter pursuant to Clause 92 must be approved in accordance with normal board procedures by directors who have no interest in the matter being considered. In taking the decision, the directors must act in a way they consider, in good faith, will be most likely to promote the company's success.

Any authorisation of a matter may be given on or subject to such conditions or limitations as the directors determine, whether at the time of authorisation or subsequently, including providing for the exclusion of the interested directors from the receipt of information or participation in discussion relating to the matter authorised by the directors and providing that interested directors in receipt of confidential information from a third party are not obliged to disclose such information to the company or use the information in relation to the company's affairs. Any authorisation may be terminated by the directors at any time.

A director is not, except as otherwise agreed by him, accountable to the company for any benefit which he, or a person connected with him, derives from any matter authorised by the directors and any contract, transaction or arrangement relating to such matter is not liable to be avoided on the grounds of such benefit.

Directors' power to allot securities

In line with market practice, the Articles provide that the authority to allot shares and the disapplication of pre-emption rights will not be set out in the Articles, but subject to resolutions passed at the company's annual general meeting to obtain these authorities on an annual basis.

Borrowing powers

The directors may exercise all the powers of the company to borrow money and to mortgage or charge its undertaking, property and uncalled capital and to issue debentures and other securities, whether outright or as collateral security for any debt, guarantee, liability or obligation of the company, or of any third party.

Qualifying shareholding

Directors are not required to hold any shares of the company by way of qualification.

Classes of shares

The company has issued and outstanding the following four general classes of shares, namely ordinary shares, preference shares, B Shares and a Dividend Access Share, to which the provisions set forth below apply. In addition, the company has as part of its share capital Additional Value Shares (“AVSs”). All of the issued AVSs were converted into non-voting deferred shares in December 2003. The terms of those AVSs are set out in Schedule 3 to the Articles. The terms of the issued B Shares (designated Series 1 Class B Shares) and the Dividend Access Share (designated a Series 1 Dividend Access Share) were determined by the directors pursuant to the Articles prior to the time of allotment, and apply as if they were set out in the Articles.

Shareholder information

Dividends

General

Subject to the provisions of the 2006 Act and Clause 123 of the Articles, the company may, by ordinary resolution, declare dividends on ordinary shares save that no dividend shall be payable except out of profits available for distribution, or in excess of the amount recommended by the Board or in contravention of the special rights attaching to any share. Any dividend which has remained unclaimed for 12 years from the date of declaration shall be forfeited and shall revert to the company.

The company may cease sending dividend warrants and cheques by post or otherwise to a member if such instruments have been returned undelivered to, or left uncashed by, that member on at least two consecutive occasions, or, following one such occasion, reasonable enquiries have failed to establish any new address or account of the registered holder. The company may resume sending warrants and cheques if the holder requests such recommencement in writing.

Preference shares

Each cumulative preference share confers the right to a fixed cumulative preferential dividend payable half-yearly. Each non-cumulative preference share confers the right to a preferential dividend (not exceeding a specified amount) payable in the currency of the relevant share. The rate of such dividend and the date of payment thereof, together with the terms and conditions of the dividend, are as may be determined by the directors prior to allotment. Cumulative preference share dividends are paid in priority to any dividend on any other class of share.

The non-cumulative preference shares rank for dividend after the cumulative preference shares but rank pari passu with each other and any shares expressed to rank, in terms of participation in the profits of the company, in some or all respects pari passu therewith and otherwise in priority to dividends payable on the ordinary shares and any other share capital in the company.

The directors may resolve prior to the issue and allotment of any series of non-cumulative preference shares that full dividends in respect of a particular dividend payment date will not be declared and paid if, (i) in its sole and absolute discretion, the directors resolve prior to the relevant dividend payment date that such dividend (or part thereof) shall not be paid and/or (ii) in the opinion of the directors, payment of a dividend would cause a breach of the UK Financial Services Authority’s capital adequacy requirements applicable to the company or its subsidiaries, or subject to the next following paragraph, insufficient distributable profits of the company are available to cover the payment in full of all dividends after having paid any dividends payable on any of the cumulative preference shares.

If dividends will be paid but, in the opinion of the directors, insufficient distributable profits of the company are available to cover the payment in full of dividends after having paid any dividends payable on any of the cumulative preference shares, dividends will be declared by the directors, pro rata on the non-cumulative preference shares to the extent of the available distributable profits.

The non-cumulative preference shares will carry no further rights to participate in the profits of the company and if, and to the extent, any dividend or part of any dividend is on any occasion not paid for any of the reasons described above, holders of non-cumulative preference shares will have no claim in respect of such non-payment.

If any dividend is not payable for the reasons described in clause (ii) of the third paragraph of this subsection, the directors may pay a special dividend not exceeding US$0.01, £0.01 or €0.01 (depending on the currency of the relevant preference share) per share.

If the dividend payable on any series of non-cumulative preference shares on the most recent payment date is not paid in full, or if a sum is not set aside to provide for such payment in full, in either case for the reasons set forth in clause (ii) of the third paragraph of this subsection, no dividends may be declared on any other share capital of the company and no sum may be set aside for the payment of a dividend on any other share capital (in each case other than the cumulative preference shares), unless, on the date of declaration, an amount equal to the dividend payable in respect of the then current dividend period for such series of non-cumulative preference shares is set aside for payment in full on the next dividend payment date.

Shareholder information

If any dividend payable on the non-cumulative preference shares is not paid in full or if a sum is not set aside to provide for such payment in full (in either case for the reasons set forth in clause (ii) of the third paragraph of this subsection), the company may not redeem or purchase or otherwise acquire any other share capital of the company and may not set aside any sum nor establish any sinking fund for its redemption, purchase or other such acquisition, until such time as dividends have been declared and paid in full in respect of successive dividend periods together aggregating not less than twelve months.

The non-payment of any dividend (in full or in part) by reason of the exercise of the directors' discretion referred to in clause (i) of the third paragraph of this subsection, shall not prevent or restrict (a) the declaration and payment of dividends on any other series of non-cumulative preference shares or on any non-cumulative preference shares expressed to rank pari passu with the non-cumulative preference shares, (b) the setting aside of sums for the payment of such dividends, (c) except as set forth in the following paragraph, the redemption, purchase or other acquisition of shares in the company by the company, or (d) except as set forth in the following paragraph, the setting aside of sums, or the establishment of sinking funds, for any such redemption, purchase or other acquisition by the company.

If dividends are not declared and paid in full on any series of non-cumulative preference shares as a result of the directors' discretion referred to in clause (i) of the third paragraph of this subsection, then the company may not redeem, purchase or otherwise acquire for any consideration any share capital ranking after such preference shares, and may not set aside any sum nor establish any sinking fund for the redemption, purchase or other acquisition thereof, until such time as the company has declared and paid in full dividends on such series of non-cumulative preference shares in respect of successive dividend periods together aggregating no less than twelve months. In addition, no dividend may be declared or paid on any of the company's share capital ranking after such preference shares until the dividend in respect of a particular dividend payment date payable on the preference shares to which the directors' discretion in clause (i) of the third paragraph of this subsection applies has been declared and paid in full.

With effect from 19 April 2011, subject to existing class rights of shareholders, new preference shares can be issued with such rights and restrictions as the directors may determine.

Non-voting deferred shares

The holders of non-voting deferred shares are not entitled to the payment of any dividend or other distribution.

B Shares

Prior to the occurrence of a Trigger Event (as defined below) in respect of any Series 1 Class B Shares, those Series 1 Class B Shares rank equally with the holders of ordinary shares in respect of any cash dividends, and each Series 1 Class B Share will entitle its holder to the same cash dividend as is (or may, at the election of a holder of the ordinary share, be) payable to the holder of one ordinary share, as adjusted from time to time to reflect any consolidation, reclassification or subdivision in relation to the ordinary shares.

If a Trigger Event has occurred in respect of any Series 1 Class B Shares, the Series 1 Class B Shares in respect of which the Trigger Event has occurred will rank pari passu with the holders of the ordinary shares in respect of any dividends paid on the ordinary shares. Each Series 1 Class B Share will entitle its holder to the same dividend as is (or may, at the election of a holder of an ordinary share, be) payable to the holder of one (as adjusted from time to time) ordinary share. If a bonus issue of fully paid ordinary shares is made to holders of ordinary shares in lieu of a dividend, a holder of a Series 1 Class B Share in respect of which the Trigger Event has occurred will be entitled to receive the same number of ordinary shares as is payable to the holder of one (as adjusted from time to time) ordinary share, save that if the issue of such ordinary share(s) to such holder would result in it holding directly or indirectly more than 75% of the total issued ordinary shares, then such holder will instead receive further Series 1 Class B Shares of the same value.

A Trigger Event occurs in relation to the Series 1 Class B Shares in issue at the relevant time, if the daily volume weighted average price of the company’s ordinary shares on the London Stock Exchange equals or exceeds £0.65 per ordinary share (subject to adjustment) for 20 or more complete dealing days in any period of 30 consecutive dealing days.

In October 2015, HMT converted its entire holding of B shares into 5.1 billion new ordinary shares of £1 each.

Shareholder information

Dividend Access Share

Subject to the discretions, limitations and qualifications described in this subsection, non-cumulative dividends on the Series 1 Dividend Access Share will be payable from 22 December 2009 up to and including the Stop Date (if any). No dividends will be payable on the Series 1 Dividend Access Share after the Stop Date (if any). Up to and including the Stop Date, the company will pay dividends on the Series 1 Dividend Access Share when, as and if declared by its board of directors or a duly authorised committee of such board of directors (the ''board of directors''). Up to and including the Stop Date, subject to the discretions, limitations and qualifications described in this section, the Series 1 Dividend Access Share will entitle the holder to receive out of the distributable profits of the company a non-cumulative dividend at the rate described below (the ''Dividend Access Share Dividend''), in priority to the payment of any dividend to the holders of any class of ordinary share or Class B Share and pari passu in such regard with the holder of any other dividend access share then in issue.

The board of directors may in its sole and absolute discretion resolve that no Dividend Access Share Dividend shall be paid on a Dividend Access Share Dividend payment date.

The board of directors will, by 31 October in each financial year of the company, decide whether or not to pay an interim dividend on the ordinary shares or make an interim Ordinary Share Bonus Issue in that financial year. If it is decided that an interim dividend on the ordinary shares or an interim Ordinary Share Bonus Issue is to be paid or made in any financial year, the corresponding semi-annual (hereinafter referred to as ''first semi-annual'') Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share in the same financial year will be paid or made at the time set out below. The record date for any first semi-annual Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share will be the same as the record date for any interim dividend on the ordinary shares or interim Ordinary Share Bonus Issue in the relevant financial year or otherwise will be three business days before 31 October in each year. If paid or made, the first semi-annual Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share in a financial year will be paid or made on the same date that the corresponding interim dividend on the ordinary shares is paid or interim Ordinary Share Bonus Issue is made. If it is decided that no such interim dividend on the ordinary shares or interim Ordinary Share Bonus Issue will be paid or made in a financial year, the first semi-annual Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share in such financial year will, if to be paid or made, be so paid or made on 31 October in such financial year (commencing in 2010).

The Board of directors will, by 31 May in each financial year of the company, decide whether or not to recommend a dividend on the ordinary shares or make an Ordinary Share Bonus Issue which is expressed to be a final dividend for the immediately preceding financial year. If it is decided that such a dividend on the ordinary shares or Ordinary Share Bonus Issue is to be recommended and is subsequently approved by shareholders, the corresponding semi-annual (hereinafter referred to as ''second semi-annual'') Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share expressed to be for the

corresponding period will be paid at the time set out below. The record date for any second semi-annual Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share will be the same as the record date for any final dividend on the ordinary shares or final Ordinary Share Bonus Issue for the relevant financial year or otherwise will be three business days before 31 May in each year. If paid or made, the second semi-annual Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share in a financial year will be paid or made on the same date that the corresponding final dividend on the ordinary shares is paid or final Ordinary Share Bonus Issue is made. If it is decided that no such final dividend on the ordinary shares or Ordinary Share Bonus Issue will be paid or made in any year (the ''current year'') for the immediately preceding financial year, any second semi-annual Dividend Access Share Dividend or Bonus Issue on the Series 1 Dividend Access Share expressed to be for the corresponding period will, if to be paid or made, be so paid or made on 31 May in the current year (commencing in 2010).

Any first semi-annual Dividend Access Share Dividend or second semi-annual Dividend Access Share Dividend will only be paid if (to the extent legally required) profits are available for distribution and are permitted by law to be distributed.

If paid or made, the first semi-annual Dividend Access Share Dividend on the Series 1 Dividend Access Share will be equal to an amount which, before taking account of any withholding or deduction required to be made on account of tax from such dividend and when added to any other cash dividends previously paid by the Company on the Series 1 Dividend Access Share since the Issue Date (before taking account of any withholding or deduction required to be made on account of tax from such cash dividends) equals the DAS Retirement Dividend Amount.

Shareholder information

If paid or made, any second semi-annual Dividend Access Share Dividend on the Series 1 Dividend Access Share will be equivalent to (a) the greater of (i) on an annual basis, 7 per cent. of the aggregate issue price of all B Shares issued to HM Treasury, and (ii) 25 per cent. (subject to adjustment) of any cash dividend paid per Ordinary Shares, multiplied by the number of B Shares issued to HM Treasury, less (b) the fair market value of the aggregate amount of any dividends or distributions paid or made on any B Shares and/or on any Ordinary Shares issued on conversion of the B Shares, provided that any second semi-annual Dividend Access Share Dividend will not in any event exceed a sum which, before taking account of any withholding or deduction required to be made on account of tax from such dividend and when added to any other cash dividends previously paid by the Company on the Series 1 Dividend Access Share since the Issue Date (before taking account of any withholding or deduction required to be made on account of tax from such cash dividends), would exceed the DAS Retirement Dividend Amount.

In the event of a change in the frequency of dividend payments on the ordinary shares such that they are not paid semi-annually consistent with the payment of Dividend Access Share Dividends on the Series 1 Dividend Access Share, the company will make such changes to the Dividend Access Share Dividend payment arrangements described above as, following consultation with the Independent Financial Adviser (acting as an expert), it determines are fair and reasonable to take account of such changed frequency.

Non-cumulative dividends on the Series 1 Dividend Access Share will be payable in respect of the period up to and including the Stop Date (if any). After the Stop Date (if any), the right of the holder of the Series 1 Dividend Access Share to any dividends (including any Dividend Access Share Dividends) shall cease and the Series 1 Dividend Access Share shall, without the need for any consent or approval from the holder of the Series 1 Dividend Access Share or any other action by the Company or the holder of the Series 1 Dividend Access Share, be re-designated as a Single Series 1 Class B Share on terms identical to all other Series 1 Class B Shares in issue at the Stop Date.

Any unpaid portion of the DAS Retirement Dividend Amount will be subject to an increase of 5 per cent per annum, calculated on a daily accrual basis from 1 January 2016, if such portion has not been paid before 1 January 2016 and an increase of 10 per cent. per annum calculated on a daily accruals basis from 1 January 2021, on any part of the balance that has not been paid before 1 January 2021.

Bonus Issue of Series 1 Class B Shares on the Series 1 Dividend Access Share

If the board of directors decides to pay a Dividend Access Share Dividend and either (i) no dividend has been paid on the ordinary shares and/or distribution made thereon in respect of the corresponding period, or (ii) a dividend has been paid and/or a distribution has been made on the ordinary shares otherwise than in cash in respect of the corresponding period, the board of directors may in its discretion determine that such Dividend Access Share Dividend will be paid in whole or in part by the company issuing Series 1

Class B Shares, credited as fully paid, to the holder of the Series 1 Dividend Access Share. The number of such further Series 1 Class B Shares to be issued to the holder will be such number of Series 1 Class B Shares as is certified by an Independent Financial Adviser (acting as an expert) to be as nearly as possible equal to (but not greater than) the cash amount (disregarding any withholding or deduction required to be made on account of any tax and any associated tax credit) of such semi-annual Dividend Access Share Dividend or part thereof otherwise payable to such holder of the Series 1 Dividend Access Share, based on the fair market value of a Series 1 Class B Share at the time of such determination. A written opinion of such Independent Financial Adviser will be conclusive and binding on all parties, save in the case of manifest error. The additional Series 1 Class B Shares will rank pari passu in all respects with the fully paid Series 1 Class B Shares then in issue save only as regards participation in the relevant dividend.

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Shareholder information

Restrictions following non-payment of dividend

If any Dividend Access Share Dividend is not declared and paid in full in cash or otherwise, the company:

(i) may not, and will procure that no subsidiary undertaking of the company will, declare or pay dividends or other distributions on any Parity Securities (whether in cash or otherwise, and whether payable on the same date as the relevant Dividend Access Share Dividend or subsequently) or make any Ordinary Share Bonus Issue (whether to be made on the same date as the relevant Dividend Access Share Dividend or subsequently), and the company may not, and will procure that no subsidiary undertaking of the company shall, set aside any sum for the payment of these dividends or distributions; and

(ii) may not, and will procure that no subsidiary undertaking of the company will, redeem, purchase or otherwise acquire (whether on the same date as the relevant Dividend Access Share Dividend is payable or subsequently) for any consideration any of its Parity Securities or any depository or other receipts or certificates representing Parity Securities (other than any such purchases or acquisitions which are made in connection with any Employee Share Scheme (as defined in the terms of issue of the Series 1 Dividend Access Share) and (save as aforesaid) the company may not, and will procure that no subsidiary undertaking of the company shall, set aside any sum or establish any sinking fund (whether on the same date as the relevant Dividend Access Share Dividend is payable or subsequently) for the redemption, purchase or other acquisition of Parity Securities or any depositary or other receipts or certificates representing Parity Securities.

In each case until such time as Dividend Access Share Dividends are no longer payable (including as a result of the Stop Date occurring), or payment of Dividend Access Share Dividends in cash or otherwise has resumed in full, as the case may be.

Definitions in relation to this Dividend Access Share subsection

“Bonus Issue” means a bonus issue of Series 1 Class B Shares to the holder of the Series 1 Dividend Access Share.

“DAS Retirement Dividend Amount” means £1,500,000,000 (subject to increase).

"Independent Financial Adviser" means an independent financial institution appointed by the company and approved by HM Treasury.

"Ordinary Share Bonus Issue" means a bonus issue of fully paid ordinary shares to holders of ordinary shares in lieu of a dividend.

"Parity Securities" means ordinary shares, Series 1 Class B Shares and any other securities of the company or its subsidiary undertakings which rank pari passu with the ordinary shares, and/or Series 1 Class B Shares on a return of capital on a winding up, either issued by the company or issued by a subsidiary undertaking of the company with terms attached which benefit from a guarantee or support agreement entered into by the company which ranks pari passu with the ordinary shares, and/or Series 1 Class B Shares on a return of capital on a winding up.

"Series 1 Class B Dividend Trigger Event" means in relation to any Series 1 Class B Shares in issue at any time, the payment by the Company of total cash dividends on the Series 1 Dividend Access Share since the Issue Date in an aggregate amount (before taking account of any withholding or deduction required to be made on account of tax from such cash dividends) equal to the DAS Retirement Dividend Amount.

"Stop Date" means the date on which the Series 1 Class B Dividend Trigger Event occurs.

The final dividend payment on the Dividend Access Share (DAS) owned by HMT of £1.2 billion was paid in March 2016, effecting the immediate retirement of the DAS which was redesignated as a single B share and subsequently cancelled.

Shareholder information

Distribution of assets on liquidation

Cumulative preference shares

In the event of a return of capital on a winding-up or otherwise, the holders of cumulative preference shares are entitled to receive out of t he surplus assets of the company available for distribution amongst the members (i) in priority to the holders of the non-cumulative preference shares and any other shares ranking pari passu therewith, the arrears of any fixed dividends including the amount of any dividend due for a payment after the date of commencement of any winding-up or liquidation but which is payable in respect of a half-year period ending on or before such date and (ii) pari passu with the holders of the non-cumulative preference shares and any other shares ranking pari passu therewith, the amount paid up or credited as paid up on such shares together with any premium.

Non-cumulative preference shares

Each non-cumulative preference share will confer on a winding up or liquidation (except (unless otherwise provided by the terms of issue) a redemption or purchase by the company of any shares in the capital of the company), the right to receive out of surplus assets of the company available for distribution amongst the members after payment of the arrears (if any) of the cumulative dividend on the cumulative preference shares and in priority to the holders of the ordinary shares, repayment of the amount paid up or credited as paid up on the non-cumulative preference shares together with any premium paid on issue pari passu with the holders of the cumulative preference shares and together with an amount equal to accrued and unpaid dividends.

Non-voting deferred shares

On a winding-up or other return of capital of the company, holders of non-voting deferred shares are entitled only to payment of the amounts paid up on the non-voting deferred shares, after repayment to the holders of ordinary shares of the nominal amount paid up on the ordinary shares held by them and payment of £100,000 on each ordinary share.

B Shares

On a winding-up, holders of the Series 1 Class B Shares will rank equally with the holders of the ordinary shares, the Series 1 Dividend Access Share and any other class of shares or securities of the company which rank equally with the Series 1 Class B Shares, the Series 1 Dividend Access Share or the ordinary shares on a winding-up or liquidation, and junior to all other shareholders and all creditors of the company. For these purposes, on a winding-up each holder of a Series 1 Class B Share will be deemed to hold one (as adjusted from time to time) ordinary share of the company for every Series 1 Class B Share held at the date of the commencement of such winding-up, and will be entitled to receive out of the surplus assets of

the company remaining after payment of all prior-ranking claims, a sum equal to that payable to a holder of one (as adjusted) ordinary share in such event.

In October 2015, HMT converted its entire holding of B shares into 5.1 billion new ordinary shares of £1 each.

Dividend Access Share

On a winding-up, the holder of the Series 1 Dividend Access Share will rank equally with the holders of the ordinary shares, the Series 1 Class B Shares and any other class of shares or securities of the company which rank equally with the Series 1 Dividend Access Share, the Series 1 Class B Shares or the ordinary shares on a winding-up or liquidation, and junior to all other shareholders and all creditors of the company. For these purposes, on a winding-up the holder of the Series 1 Dividend Access Share will be deemed to hold one-tenth (as adjusted from time to time) of one ordinary share of the company, and will be entitled to receive out of the surplus assets of the company remaining after payment of all prior-ranking claims, a sum equal to that payable to a holder of one-tenth (as adjusted) of one ordinary share in such event.

The final dividend payment on the Dividend Access Share (DAS) owned by HMT of £1.2 billion was paid in March 2016, effecting the immediate retirement of the DAS which was redesignated as a single B share and subsequently cancelled.

General

On a winding-up of the company, the liquidator may, with the authority of any extraordinary resolution and any other sanction required by the Insolvency Act 1986 and subject to the rights attaching to any class of shares after payment of all liabilities, including the payment to holders of preference shares, divide amongst the members in specie or kind the whole or any part of the assets of the company or vest the whole or any part of the assets in trustees upon such trusts for the benefit of the members and may determine the scope and terms of those trusts. No member shall be compelled to accept any assets on which there is a liability.

Shareholder information

Voting Rights

General

Subject to any rights or restrictions as to voting attaching to any shares or class of shares, on a show of hands every member who is present in person or by proxy at a general meeting shall have one vote (except that a proxy who is appointed by more than one member has one vote for and one vote against if the proxy has been instructed by one or more members to vote for the resolution and by one or more members to vote against the resolution) and on a poll every member present in person or by proxy shall have one vote for each 25 pence in nominal amount of shares held by him. No member shall, unless the directors otherwise determine, be entitled to vote at a general meeting or at a separate meeting of the holders of shares in the capital of the company, either in person or by proxy, in respect of any share held by him unless all monies presently payable by him in respect of that share have been paid. There is no obligation on the company to check and ensure that a proxy is voting at a general meeting in accordance with the voting directions provided by the appointing member. The chairman of a general meeting does not have a casting vote in the event of an equality of votes, as this is not permitted under the 2006 Act. The quorum required for a meeting of members is not less than five members present in person and entitled to vote. If a meeting is adjourned because of the lack of a quorum, the members present in person or by proxy and entitled to vote will constitute a quorum at the adjourned meeting.

Meetings are convened upon written notice of not less than 21 days in respect of annual general meetings of members and not less than 14 days in respect of other meetings of members subject to certain conditions. An adjourned meeting may be called at shorter notice than applied to the original meeting, but where a meeting is adjourned for lack of quorum only if the adjourned meeting is held at least ten days after the original meeting and does not include any new business.

Cumulative preference shares

At a general meeting of the company, every holder of a cumulative preference share who is present in person or by proxy shall be entitled to one vote on a show of hands and, on a poll, every person who is present in person or by proxy shall have one vote for each 25 pence in nominal amount of shares held. No member shall be entitled to vote any share in person or by proxy unless all moneys owed in respect of that share have been paid.

Non-cumulative preference shares

Holders of non-cumulative preference shares are not entitled to attend or vote at any general meeting unless the business of the meeting includes the consideration of a resolution for the winding-up of the company or any resolution directly varying or abrogating the rights attached to any such shares and then in such case only to speak to and vote upon any such resolution. However, holders have the right to vote in

respect of any matter when the dividend payable on their shares has not been declared in full for such number of dividend periods as the directors shall determine prior to the allotment thereof. Whenever a holder is entitled to vote at a general meeting, on a show of hands every shareholder who is present in person has one vote and, on a poll, every such holder who is present in person or by proxy shall have such number of votes as may be determined by the directors prior to allotment.

Non-voting deferred shares

The holders of non-voting deferred shares are not entitled to receive notice of or to attend or vote at any general meeting of the company or otherwise receive any shareholder communication.

B Shares

Holders of the Series 1 Class B Shares are not entitled to attend or vote at any general meeting unless the business of the meeting includes the consideration of a resolution for the winding-up of the company or any resolution varying or abrogating the rights attached to any such shares and then in such case only to speak to and vote upon any such resolution. If entitled to vote, each holder is entitled on a poll to two votes for each Series 1 Class B Share held.

In October 2015, HMT converted its entire holding of B shares into 5.1 billion new ordinary shares of £1 each.

Shareholder information

Dividend Access Share

The holder of the Series 1 Dividend Access Share is not entitled to attend or vote at any general meeting unless the business of the meeting includes the consideration of a resolution for the winding-up of the company or any resolution varying or abrogating the rights attached to such share and then in such case only to speak to and vote upon any such resolution. If entitled to vote, the holder is entitled on a poll to one vote.

The final dividend payment on the Dividend Access Share (DAS) owned by HMT of £1.2 billion was paid in March 2016, effecting the immediate retirement of the DAS which was redesignated as a single B share and subsequently cancelled.

Redemption

Except as set forth in the following paragraph, unless the directors determine, prior to allotment of any particular series of non-cumulative preference shares, that such series shall be non-redeemable, the preference shares will be redeemable at the option of the company on any date which (subject to certain exceptions described in the terms of such shares) falls no earlier than such date (if any) as may be fixed by the directors, prior to allotment of such shares. On redemption, there shall be paid on each non-cumulative preference share the aggregate of its nominal amount together with any premium paid on issue, where applicable a redemption premium and accruals of dividend.

If the company wishes to issue redeemable shares, the Directors are authorised to determine the terms and manner of redemption.

Purchase

General

Under the 2006 Act a company requires shareholder authority to purchase its own shares, consolidate and sub-divide its shares and reduce its share capital. Whenever non-cumulative preference shares are issued in the future the Articles have no restriction on the maximum purchase price payable by the company unless such restriction is expressly applied by the directors in relation to an issuance of non-cumulative preference shares.

Conversion rights

Convertible preference shares carry the right to convert into ordinary shares if they have not been the subject of a notice of redemption from the company, on or before a specified date determined by the directors. The right to convert will be exercisable by service of a conversion notice on the company within a specified period. The company will use reasonable endeavours to arrange the sale, on behalf of convertible preference shareholders who have submitted a conversion notice, of the ordinary shares which result from such conversion and to pay to them the proceeds of such sale so that they receive net proceeds equal to the nominal value of the convertible preference shares which were the subject of the conversion notice and any premium at which such shares were issued, provided that ordinary shares will not be sold at below a benchmark price (as determined prior to the issue of the relevant convertible preference shares by the directors).

B Shares

The B Shares are convertible into ordinary shares at HM Treasury's option at an initial conversion price of £0.50 per share, subject to adjustment.

In October 2015, HMT converted its entire holding of B shares into 5.1 billion new ordinary shares of £1 each.

Additional Value Shares

In December 2003, following the payment of aggregate dividends of £1 in respect of each AVS, all issued and outstanding AVSs were de-listed from the Official List and from trading on the London Stock Exchange's market for listed securities and converted into non-voting deferred shares of £0.01 each.

Shareholder information

Changes in share capital and variation of rights

Subject to the provisions of the 2006 Act and without prejudice to any rights attached to any existing shares or class of shares, any share may be issued with such rights or restrictions as the company may by ordinary resolution determine or, subject to and in default of such determination, as the Board shall determine. Subject to the provisions of the 2006 Act, the company may issue shares which are, or at the option of the company or the holder are liable, to be redeemed. Subject to the provisions of the 2006 Act and the Articles, unissued shares are at the disposal of the Board.

The company may by ordinary resolution: increase its share capital; consolidate and divide all or any of its share capital into shares of larger amount than its existing shares; subject to the provisions of the 2006 Act, subdivide its shares, or any of them, into shares of smaller amount than is fixed by the Memorandum; or cancel any shares which have not been taken or agreed to be taken by any person and diminish the amount of its share capital by the amount of the shares so cancelled.

Subject to the provisions of the 2006 Act, if at any time the capital of the company is divided into different classes of shares, the rights attached to any class of shares may (unless further conditions are provided by the terms of issue of the shares of that class) be varied or abrogated, whether or not the company is being wound up, either with the consent in writing of the holders of three-quarters in-nominal value of the issued shares of the class or with the sanction of an extraordinary resolution passed at a separate general meeting of holders of the shares of the class (but not otherwise). To any such separate general meeting the provision of the Articles relating to general meeting s will apply, save that:

(i) if at any adjourned meeting of such holders a quorum as defined above is not present, two people who hold shares of the class, or their proxies, are a quorum; and

(ii) any such holder present in person or by proxy may demand a poll

The rights attaching to any class of shares having preferential rights are not, unless otherwise expressly provided by the terms of issue thereof, deemed to be varied by the creation or issue of further shares ranking, as regards participation in t he profits or assets of the company, pari passu therewith, but in no respect in priority thereto.

Disclosure of interests in shares

The 2006 Act gives the company the power to require persons who it believes to be, or have been within the previous three years, interested in its shares, to disclose prescribed particulars of those interests. Failure to supply the information or supplying a statement which is materially false may lead to the Board imposing restrictions upon the relevant shares. The restrictions available are the suspension of voting or other rights conferred by membership in relation to meetings of the company in respect of the relevant shares and, additionally, in the case of a shareholding representing at least 0.25 per cent of the class of shares concerned, the withholding of payment of dividends on, and the restriction of transfers of, the relevant shares.

Limitations on rights to own share

There are no limitations imposed by UK law or the Memorandum and Articles on the right of non-residents or foreign persons to hold or vote the company's shares other than the limitations that would generally apply to all of the company's shareholders.

Members resident abroad

Members with registered addresses outside the United Kingdom are not entitled to receive notices from the company unless they have given the company an address within the United Kingdom at which such notices may be served.

Sending notices and other documents to shareholders

The company may communicate with members by electronic and/or website communications. A member whose registered address is not within the United Kingdom shall not be entitled to receive any notice from the Company unless he gives the Company a postal address within the United Kingdom at which notices may be given to him.

Shareholder information

Documents on display

Documents concerning the company may be inspected at 36 St Andrew Square, Edinburgh, EH2 2YB.

Executive directors' service contracts and copies of directors' indemnities granted by the company in terms of section 236 of the Companies Act 2006 may be inspected at the company's office at Gogarburn, Edinburgh, EH12 1HQ (telephone +44 (0)131 626 4114).

In addition, we file reports and other information with the SEC. You can read and copy these reports and other information at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You can call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room or contact the offices of The New York Stock Exchange, on which certain of our securities are listed, at 20 Broad Street, New York, New York 10005. The SEC also maintains a website at www.sec.gov which contains in electronic form each of the reports and other information that we have filed electronically with the SEC.

Incorporation and registration

The company was incorporated and registered in Scotland under the Companies Act 1948 as a limited company on 25 March 1968 under the name National and Commercial Banking Group Limited, and changed its name to The Royal Bank of Scotland Group Limited on 3 September 1979. On 10 March 1982 it was re-registered under the Companies Acts 1948 to 1980 as a public company with limited liability. The company is registered under Company No. SC45551.

Abbreviations and acronyms

ABS	Asset-backed securities
AFS	Available-for-sale
ALCo	Asset and Liability Management Committee
AQ	Asset quality
AT1	Additional Tier 1
BCBS	Basel Committee on Banking Supervision
BoE	Bank of England
C&RA	Conduct & Regulatory Affairs
CDO	Collateralised debt obligation
CDS	Credit default swap
CEC	Control Environment Certification
CET1	Common equity tier 1
CFG	Citizens Financial Group Inc.
CIB	Corporate & Institutional Banking
CLO	Collateralised loan obligation
CMBS	Commercial mortgage-backed securities
CPB	Commercial & Private Banking
CRD	Capital Requirements Directive
CRE	Commercial real estate
CVA	Credit valuation adjustment
DFV	Designated as at fair value through profit or loss
DVA	Debit valuation adjustment
EAD	Exposure at default
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
ECL	Expected credit losses
EMEA	Europe, the Middle East and Africa
ERF	Executive Risk Forum
EU	European Union
FCA	Financial Conduct Authority
FI	Financial institution
FSA	Financial Services Authority
FSB	Financial Stability Board
FSCS	Financial Services Compensation Scheme
FVTPL	Fair value through profit or loss
GDP	Gross domestic product
GSIB	Global systemically important bank
HFT	Held-for-trading
HMT	HM Treasury
HTM	Held-to-maturity
IAS	International Accounting Standards

IASB	International Accounting Standards Board
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards

Abbreviations and acronyms

ILAAP	Internal Liquidity Adequacy Assessment Process
IPV	Independent price verification
IRC	Incremental risk charge
IRHP	Interest rate hedging product
L-SREP	Liquidity Supervisory Review and Evaluation Process
LAR	Loans and receivables
LCR	Liquidity coverage ratio
LIBOR	London Interbank Offered Rate
LGD	Loss given default
LTI	Long term incentive awards
LTV	Loan-to-value
MDA	Maximum distributable amount
MREL	Minimum requirement for own funds and eligible liabilities
MRM	Model risk management
NI	Northern Ireland
NSFR	Net stable funding ratio
NTIRR	Non-traded interest rate risk
NWM	NatWest Markets
PBB	Personal & Business Banking
PD	Probability of default
PPI	Payment Protection Insurance
PRA	Prudential Regulation Authority
RBSG	The Royal Bank of Scotland Group plc
RCR	RBS Capital Resolution
REIL	Risk elements in lending
RFB	Ring-fenced banking entities
RFS	RFS Holdings B.V.
RMBS	Residential mortgage-backed securities
RNIV	Risks not In VaR
ROI	Republic of Ireland
RoW	Rest of the World
RWA	Risk-weighted asset
SE	Structured entity
SEC	US Securities and Exchange Commission
SME	Small and medium-sized enterprise
SVaR	Stressed value-at-risk
TLAC	Total loss absorbing capacity
TSR	Total Shareholder Return
UBI DAC	Ulster Bank Ireland Designated Activity Company
UK	United Kingdom
UKFI	UK Financial Investments Limited
US/USA	United States of America
VaR	Value-at-risk

Explanation of Responses:

Glossary of terms

Arrears - the aggregate of contractual payments due on a debt that have not been met by the borrower. A loan or other financial asset is said to be 'in arrears' when payments have not been made.

Asset-backed commercial paper (ABCP) - a form of asset-backed security generally issued by a commercial paper conduit.

Asset-backed securities (ABS) - securities that represent interests in specific portfolios of assets. They are issued by a structured entity following a securitisation. The underlying portfolios commonly comprise residential or commercial mortgages but can include any class of asset that yields predictable cash flows. Payments on the securities depend primarily on the cash flows generated by the assets in the underlying pool and other rights designed to assure timely payment, such as guarantees or other credit enhancements. Collateralised debt obligations, collateralised loan obligations, commercial mortgage backed securities and residential mortgage backed securities are all types of ABS.

Asset quality (AQ) band - probability of default banding for all counterparties on a scale of 1 to 10.

Assets under management - assets managed by RBS on behalf of clients.

Back-testing - statistical techniques that assess the performance of a model, and how that model would have performed had it been applied in the past.

Basel II - the capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the ‘International Convergence of Capital Measurement and Capital Standards’.

Basel III - in December 2010, the Basel Committee on Banking Supervision issued final rules: ‘Basel III: A global regulatory framework for more resilient banks and banking systems’ and ‘Basel III: International framework for liquidity risk measurement, standards and monitoring’.

Basis point - one hundredth of a per cent i.e. 0.01 per cent. 100 basis points is 1 per cent. Used when quoting movements in interest rates or yields on securities.

Buy-to-let mortgages - mortgages to customers for the purchase of residential property as a rental investment.

Capital requirements regulation (CRR) - refer to CRD IV.

Central counterparty (CCP) - an intermediary between a buyer and a seller (generally a clearing house).

Certificates of deposit (CDs) - bearer negotiable instruments acknowledging the receipt of a fixed term deposit at a specified interest rate.

Collateralised debt obligations (CDOs) - asset-backed securities for which the underlying asset portfolios are debt obligations: either bonds (collateralised bond obligations) or loans (collateralised loan obligations) or both. The credit exposure underlying synthetic CDOs derives from credit default swaps. The CDOs issued by an individual vehicle are usually divided in different tranches: senior tranches (rated AAA), mezzanine tranches (AA to BB), and equity tranches (unrated). Losses are borne first by the equity securities, next by the junior securities, and finally by the senior securities; junior tranches offer higher coupons (interest payments) to compensate for their increased risk.

Collateralised loan obligations (CLOs) - asset-backed securities for which the underlying asset portfolios are loans, often leveraged loans.

Collectively assessed loan impairment provisions - impairment loss provisions in respect of impaired loans, such as credit cards or personal loans, that are below individual assessment thresholds. Such provisions are established on a portfolio basis, taking account of the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends.

Commercial mortgage backed securities (CMBS) - asset-backed securities for which the underlying asset portfolios are loans secured on commercial real estate.

Commercial paper (CP) - unsecured obligations issued by a corporate or a bank directly or secured obligations (asset-backed CP), often issued through a commercial paper conduit, to fund working capital. Maturities typically range from two to 270 days. However, the depth and reliability of some CP markets means that issuers can repeatedly roll over CP issuance and effectively achieve longer term funding. CP is issued in a wide range of denominations and can be either discounted or interest-bearing.

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Glossary of terms

Commercial paper conduit - a structured entity that issues commercial paper and uses the proceeds to purchase or fund a pool of assets. The commercial paper is secured on the assets and is redeemed either by further commercial paper issuance, repayment of assets or liquidity drawings.

Commercial real estate - freehold and leasehold properties used for business activities. Commercial real estate includes office buildings, industrial property, medical centres, hotels, retail stores, shopping centres, agricultural land and buildings, warehouses, garages etc.

Common Equity Tier 1 capital - the highest quality form of regulatory capital under Basel III comprising common shares issued and related share premium, retained earnings and other reserves excluding reserves which are restricted or not immediately available, less specified regulatory adjustments.

Contractual maturity - the date in the terms of a financial instrument on which the last payment or receipt under the contract is due for settlement.

Cost:income ratio - operating expenses as a percentage of total income.

Counterparty credit risk - the risk that a counterparty defaults before the maturity of a derivative or sale and repurchase contract. In contrast to non-counterparty credit risk, the exposure to counterparty credit risk varies by reference to a market factor (e.g. interest rate, exchange rate, asset price).

Coverage ratio - impairment provisions as a percentage of impaired loans.

Covered bonds - debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds.

CRD IV - the European Union has implemented the Basel III capital proposals through the CRR and the CRD, collectively known as CRD IV. CRD IV was implemented on 1 January 2014. The EBA’s technical standards are still to be finalised through adoption by the European Commission and implemented within the UK.

Credit default swap (CDS) - a contract where the protection seller receives premium or interest-related payments in return for contracting to make payments to the protection buyer upon a defined credit event in relation to a reference financial asset or portfolio of financial assets. Credit events usually include bankruptcy, payment default and rating downgrades.

Credit derivative product company (CDPC) - a structured entity that sells credit protection under credit default swaps or certain approved forms of insurance policies. CDPCs are similar to monoline insurers. However, unlike monoline insurers, they are not regulated as insurers.

Credit derivatives - contractual agreements that provide protection against a credit event on one or more reference entities or financial assets. The nature of a credit event is established by the protection buyer and protection seller at the inception of a transaction, and such events include bankruptcy, insolvency or failure to meet payment obligations when due. The buyer of the credit derivative pays a periodic fee in return for a payment by the protection seller upon the occurrence of a credit event. Credit derivatives include credit default swaps, total return swaps and credit swap options.

Credit enhancements - techniques that improve the credit standing of financial obligations; generally those issued by a structured entity in a securitisation. External credit enhancements include financial guarantees and letters of credit from third party providers. Internal enhancements include excess spread - the difference between the interest rate received on the underlying portfolio and the coupon on the issued securities; and over-collateralisation – at inception, the value of the underlying portfolio is greater than the securities issued.

Credit grade - a rating that represents an assessment of the creditworthiness of a customer. It is a point on a scale representing the probability of default of a customer.

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

Credit risk mitigation - reducing the credit risk of an exposure by application of techniques such as netting, collateral, guarantees and credit derivatives.

Credit valuation adjustment (CVA) - the CVA is the difference between the risk-free value of a portfolio of trades and its market value, taking into account the counterparty's risk of default. It represents the market value of counterparty credit risk, or an estimate of the adjustment to fair value that a market participant would make to reflect the creditworthiness of its counterparty.

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Explanation of Responses:

Glossary of terms

Currency swap - an arrangement in which two parties exchange specific principal amounts of different currencies at inception and subsequently interest payments on the principal amounts. Often, one party will pay a fixed rate of interest, while the other will pay a floating rate (though there are also fixed-fixed and floating-floating currency swaps). At the maturity of the swap, the principal amounts are usually re-exchanged.

Customer accounts - money deposited with RBS by counterparties other than banks and classified as liabilities. They include demand, savings and time deposits; securities sold under repurchase agreements; and other short term deposits. Deposits received from banks are classified as deposits by banks.

Debit valuation adjustment (DVA) - an adjustment made in valuing OTC derivative liabilities to reflect the entity's own credit risk.

Debt securities - transferable instruments creating or acknowledging indebtedness. They include debentures, bonds, certificates of deposit, notes and commercial paper. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue, such as the right to receive certain information. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured or unsecured.

Debt securities in issue - unsubordinated debt securities issued by RBS. They include commercial paper, certificates of deposit, bonds and medium-term notes.

Deferred tax asset - income taxes recoverable in future periods as a result of deductible temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in tax deductible amounts in future periods) and the carry-forward of tax losses and unused tax credits.

Deferred tax liability - income taxes payable in future periods as a result of taxable temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in taxable amounts in future periods).

Defined benefit obligation - the present value of expected future payments required to settle the obligations of a defined benefit plan resulting from employee service.

Defined benefit plan/scheme - pension or other post-retirement benefit plan other than a defined contribution plan.

Defined contribution plan/scheme - pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.

Deposits by banks - money deposited with RBS by banks and recorded as liabilities. They include money-market deposits, securities sold under repurchase agreements, federal funds purchased and other short term deposits. Deposits received from customers are recorded as customer accounts.

Derivative - a contract or agreement whose value changes with changes in an underlying variable such as interest rates, foreign exchange rates, share prices or indices and which requires no initial investment or an initial investment that is smaller than would be required for other types of contracts with a similar response to market factors. The principal types of derivatives are: swaps, forwards, futures and options.

Discontinued operation - a component of RBS that either has been disposed of or is classified as held for sale. A discontinued operation is either: a separate major line of business or geographical area of operations or part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or a subsidiary acquired exclusively with a view to resale.

Economic capital - an internal measure of the capital required by RBS to support the risks to which it is exposed.

Economic profit - the difference between the return on shareholders funds and the cost of that capital. Economic profit is usually expressed as a percentage.

Effective interest rate 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.

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Explanation of Responses:

Glossary of terms

Encumbrance - an interest in an asset held by another party. Encumbrance usually restricts the asset's transferability until the encumbrance is removed.

Equity risk - the risk of changes in the market price of the equities or equity instruments arising from positions, either long or short, in equities or equity-based financial instruments.

Eurozone - the 19 European Union countries that have adopted the euro: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

Expected credit loss (ECL, an IFRS 9 accounting measure) – generally is the weighted average of credit losses; for collectively assessed portfolios it is the product of the exposure, probability of default at the reporting date and the lifetime loss given default. At initial recognition of a financial asset, an allowance is made for the 12 month expected credit loss, using the probability of default in the first 12 months only. On a significant increase in credit risk, the expected credit loss is increased to the lifetime probability of default. ECL is applied to exposures to all financial assets and contractual facilities whose performance is not recognised at fair value in the income statement.

Expected loss (EL, a regulatory measure) – is the product of the regulatory credit exposure, the probability of default over the next 12 months, averaged through an economic cycle, and the downturn loss given default. It is applied to exposures whether performance is recognised in income or reserves. Credit exposures include all financial assets, customer facilities and are subject to regulatory overlays.

Exposure - a claim, contingent claim or position which carries a risk of financial loss.

Exposure at default (EAD) - an estimate of the extent to which the bank will be exposed under a specific facility, in the event of the default of a counterparty.

FICO score - a credit score calculated using proprietary software developed by the Fair Isaac Corporation in the US from a consumer's credit profile. The scores range between 300 and 850 and are used in credit decisions made by banks and other providers of credit.

Financial Conduct Authority (FCA) - the statutory body responsible for conduct of business regulation and supervision of UK authorised firms from 1 April 2013. The FCA also has responsibility for the prudential regulation of firms that do not fall within the PRA's scope.

Financial Services Compensation Scheme (FSCS) - the UK's statutory fund of last resort for customers of authorised financial services firms. It 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 financial services industry.

First/second lien - a lien is a charge such as a mortgage held by one party, over property owned by a second party, as security for payment of some debt, obligation, or duty owed by that second party. The holder of a first lien takes precedence over all other encumbrances on that property i.e. second and subsequent liens.

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

Forward contract - a contract to buy (or sell) a specified amount of a physical or financial commodity, at an agreed price, at an agreed future date.

Futures contract - a contract which provides for the future delivery (or acceptance of delivery) of some type of financial instrument or commodity under terms established at the outset. Futures differ from forward contracts in that they are standardised and traded on recognised exchanges and rarely result in actual delivery; most contracts are closed out prior to maturity by acquisition of an offsetting position.

G10 - the Group of Ten comprises the eleven industrial countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States) that have agreed to participate in the International Monetary Fund's (IMF's) General Arrangements to Borrow.

Government Sponsored Enterprises (GSEs) - a group of financial services corporations created by the US Congress. Their function is to improve the efficiency of capital markets and to overcome statutory and other market imperfections which otherwise prevent funds from moving easily from suppliers of funds to areas of high loan demand. They include the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association. *Gross yield* - the interest rate earned on average interest-earning assets i.e. interest income divided by average interest-earning assets.

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Explanation of Responses:

Glossary of terms

Haircut - a downward adjustment to collateral value to reflect its nature and any currency or maturity mismatches between the collateral and the exposure it secures.

Hedge funds - pooled investment vehicles that are not widely available to the public; their assets are managed by professional asset managers who participate in the performance of the fund.

Impaired loans - all loans for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans.

Impairment allowance - refer to Loan impairment provisions.

Impairment losses - (a) for impaired financial assets measured at amortised cost, impairment losses - the difference between carrying value and the present value of estimated future cash flows discounted at the asset's original effective interest rate - are recognised in profit or loss and the carrying amount of the financial asset reduced by establishing a provision (allowance) (b) for impaired available-for-sale financial assets, the cumulative loss that had been recognised directly in equity is removed from equity and recognised in profit or loss as an impairment loss.

Individual liquidity guidance (ILG) - guidance from the PRA on a firm's required quantity of liquidity resources and funding profile.

Individually assessed loan impairment provisions - impairment loss provisions for individually significant impaired loans assessed on a case-by-case basis, taking into account the financial condition of the counterparty and any guarantor and the realisable value of any collateral held.

Interest rate swap - a contract under which two counterparties agree to exchange periodic interest payments on a predetermined monetary principal, the notional amount.

Interest spread - the difference between the gross yield and the interest rate paid on average interest-bearing liabilities.

Internal Capital Adequacy Assessment Process (ICAAP) - RBS's own assessment, as part of Basel III requirements, of its risks, how it intends to mitigate those risks and how much current and future capital is necessary having considered other mitigating factors.

Internal funding of trading business - the internal funding of the trading book comprises net banking book financial liabilities that fund financial assets in RBS's trading portfolios. Interest payable on these financial liabilities is charged to the trading book.

Internal Liquidity Adequacy Assessment Process (ILAAP) an ongoing exercise as part of the PRA's regulatory framework to comply with best practice and regulatory standards for liquidity management.

International Accounting Standards Board (IASB) - the independent standard-setting body of the IFRS Foundation. Its members are responsible for the development and publication of International Financial Reporting Standards (IFRSs) and for approving Interpretations of IFRS as developed by the IFRS Interpretations Committee.

International Swaps and Derivatives Association (ISDA) master agreement - a standardised contract developed by ISDA for bilateral derivatives transactions. The contract grants legal rights of set-off for derivative transactions with the same counterparty.

Investment grade - generally represents a risk profile similar to a rating of BBB-/Baa3 or better, as defined by independent rating agencies.

Key management - members of the RBS Executive Committee.

L-SREP - An annual Liquidity Supervisory Review and Evaluation Process with the PRA, that involves a comprehensive review of the RBS ILAAP, liquidity policies and risk management framework.

Latent loss provisions - loan impairment provisions held against impairments in the performing loan portfolio that have been incurred as a result of events occurring before the balance sheet date but which have not been identified at the balance sheet date.

Level 1 - level 1 fair value measurements are derived from quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

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Glossary of terms

Level 2 - level 2 fair value measurements use inputs, other than quoted prices included within level 1, that are observable for the asset or liability, either directly or indirectly.

Level 3 - level 3 fair value measurements use one or more unobservable inputs for the asset or liability.

Leverage ratio - a measure prescribed under Basel III. It is the ratio of Tier 1 capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives, and generally follow the accounting measure of exposure.

Liquidity and funding risk - the risk that RBS is unable to meet its financial liabilities when they fall due.

Liquidity coverage ratio (LCR) - the ratio of the stock of high quality liquid assets to expected net cash outflows over the following 30 days. High quality liquid assets should be unencumbered, liquid in markets during a time of stress and, ideally, central bank eligible.

Loan:deposit ratio - the ratio of loans and advances to customers net of provision for impairment losses and excluding reverse repurchase agreements to customer deposits excluding repurchase agreements.

Loan impairment provisions - loan impairment provisions are established to recognise incurred impairment losses on a portfolio of loans classified as loans and receivables and carried at amortised cost. It has three components: individually assessed loan impairment provisions, collectively assessed loan impairment provisions and latent loss provisions.

Loan-to-value ratio - the amount of a secured loan as a percentage of the appraised value of the security e.g. the outstanding amount of a mortgage loan as a percentage of the property's value.

London Interbank Offered Rate (LIBOR) - the benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.

Loss given default (LGD) - an estimate of the amount that will not be recovered by RBS in the event of default, plus the cost of debt collection activities and the delay in cash recovery.

Market risk - the risk of loss arising from fluctuations in interest rates, credit spreads, foreign currency rates, equity prices, commodity prices and other risk-related factors such as market volatilities that may lead to a reduction in earnings, economic value or both.

Master netting agreement - an agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.

Maximum distributable amount (MDA) - a restriction on distributions which may be made by a bank which does not meet the combined buffer requirements as set out in the PRA Supervisory Statement SS6/14 ‘Implementing CRD IV: capital buffers’.

Medium term notes (MTNs) - debt securities usually with a maturity of five to ten years, but the term may be less than one year or as long as 50 years. They can be issued on a fixed or floating coupon basis or with an exotic coupon; with a fixed maturity date (non-callable) or with embedded call or put options or early repayment triggers. MTNs are generally issued as senior unsecured debt.

Minimum requirement for own funds and eligible liabilities (MREL) – Tier 1 and Tier 2 capital plus specific loss absorbing instruments, including senior notes, that may be used to cover certain gone concern requirements in the EU.

Monoline insurers (monolines) - entities that specialise in providing credit protection against the notional and interest cash flows due to the holders of debt instruments in the event of default. This protection is typically in the form of derivatives such as credit default swaps.

Model Risk Management - performs independent model validation for material models where necessary.

Mortgage-backed securities - asset-backed securities for which the underlying asset portfolios are loans secured on property. See Residential mortgage backed securities and Commercial mortgage backed securities.

Mortgage servicing rights - the rights of a mortgage servicer to collect mortgage payments and forward them, after deducting a fee, to the mortgage lender.

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Glossary of terms

Net interest income - the difference between interest receivable on financial assets classified as loans and receivables or available-for-sale and interest payable on financial liabilities carried at amortised cost.

Net interest margin - net interest income as a percentage of average interest-earning assets.

Net stable funding ratio (NSFR) - the ratio of available stable funding to required stable funding over a one year time horizon, assuming a stressed scenario. Available stable funding includes items such as equity capital, preferred stock with a maturity of over one year and liabilities with an assessed maturity of over one year.

Non-performing loans - loans classified as Risk elements in lending and potential problem loans. They have a 100% probability of default and have been assigned an AQ10 internal credit grade.

Operational risk - the risk of loss resulting from inadequate or failed processes, people, systems or from external events.

Option - an option is a contract that gives the holder the right but not the obligation to buy (or sell) a specified amount of an underlying physical or financial commodity, at a specific price, at an agreed date or over an agreed period. Options can be exchange-traded or traded over-the-counter.

Over-the-counter (OTC) derivatives - derivatives with tailored terms and conditions negotiated bilaterally, in contrast to exchange traded derivatives that have standardised terms and conditions.

Own credit adjustment (OCA) - the effect of the RBS’s own credit standing on the fair value of financial liabilities.

Past due - a financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.

Pillar 1 - the part of CRD IV that sets out the process by which regulatory capital requirements should be calculated for credit, market and operational risk.

Pillar 2 - Pillar 2 is intended to ensure that firms have adequate capital to support all the relevant risks in their business and is divided into capital held against risks not captured or not fully captured by the Pillar 1 regulations (Pillar 2A) and risks to which a firm may become exposed over a forward-looking planning horizon (Pillar 2B). Capital held under Pillar 2A, in addition to the Pillar 1 requirements, is the minimum level of regulatory capital a bank should maintain at all times to cover adequately the risks to which it is or might be exposed, and to comply with the overall financial adequacy rules. Pillar 2B is a capital buffer which helps to ensure that a bank can continue to meet minimum requirements during a stressed period, and is determined by the PRA evaluating the risks to which the firm may become exposed (e.g. due to changes to the economic environment) during the supervisory review and evaluation process. All firms will be subject to a PRA buffer assessment and the PRA will set a PRA buffer only if it judges that the CRD IV buffers are inadequate for a particular firm given its vulnerability in a stress scenario, or where the PRA has identified risk management and governance failings, which the CRD IV buffers are not intended to address.

Pillar 3 - the part of CRD IV that sets out the information banks must disclose about their risks, the amount of capital required to absorb them, and their approach to risk management. The aim is to strengthen market discipline.

Potential future exposure - is a measure of counterparty risk/credit risk. It is calculated by evaluating existing trades done against the possible market prices in future during the lifetime of the transactions.

Potential problem loans (PPL) - loans for which an impairment event has taken place but no impairment loss is expected. This category is used for advances which are not past due 90 days or revolving credit facilities where identification as 90 days overdue is not feasible.

PRA Rule Book - contains provisions made by the PRA that apply to PRA authorised firms. Within ‘Banking and Investment Rules’, the Capital Requirements firms’ section applies to RBS.

Private equity - equity investments in operating companies not quoted on a public exchange. Capital for private equity investment is raised from retail or institutional investors and used to fund investment strategies such as leveraged buyouts, venture capital, growth capital, distressed investments and mezzanine capital.

Probability of default (PD) - the likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon.

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Explanation of Responses:

Glossary of terms

Prudential Regulation Authority (PRA) - the statutory body responsible for the prudential supervision of banks, building societies, insurers and a small number of significant investment firms in the UK. The PRA is a subsidiary of the Bank of England.

Regular way purchase or sale - a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.

Regulatory capital - the amount of capital that RBS holds, determined in accordance with rules established by the PRA for the consolidated Group and by local regulators for individual Group companies.

Repurchase agreement (Repo) - refer to Sale and repurchase agreements.

Residential mortgage - a loan to purchase a residential property where the property forms collateral for the loan. The borrower gives the lender a lien against the property and the lender can foreclose on the property if the borrower does not repay the loan per the agreed terms. Also known as a home loan.

Residential mortgage backed securities (RMBS) - asset-backed securities for which the underlying asset portfolios are residential mortgages. RBS RMBS classifications, including prime, non-conforming and sub-prime, reflect the characteristics of the underlying mortgage portfolios. RMBS are classified as prime RMBS where the loans have low default risk and are made to borrowers with good credit records and reliable payment histories and there is full documentation. Non-conforming RMBS include US Alt-A RMBS, together with RMBS in jurisdictions other than the US where the underlying mortgages are not classified as either prime or sub-prime. Classification of RMBS as subprime or Alt-A is based on Fair Isaac Corporation (FICO) scores, level of documentation and loan-to-value ratios of the underlying mortgage loans. US RMBS are classified as sub-prime if the mortgage portfolio comprises loans with FICO scores between 500 and 650 with full or limited documentation. Mortgages in Alt-A RMBS portfolios have FICO scores of 640 to 720, limited documentation and an original LTV of 70% to 100%. In other jurisdictions, RMBS are classified as sub-prime if the mortgage portfolio comprises loans with one or more high risk characteristics such as: unreliable or poor payment histories; high loan-to-value ratios; high debt-to-income ratio; the loan is not secured on the borrower's primary residence; or a history of delinquencies or late payments on the loan.

Retail loans - loans made to individuals rather than institutions. The loans may be for car purchases, home purchases, medical care, home repair, holidays and other consumer uses.

Return on equity - profit attributable to ordinary shareholders divided by average shareholders' equity as a percentage.

Reverse repurchase agreement (Reverse repo) - refer to Sale and repurchase agreements.

Risk appetite - an expression of the maximum level of risk that RBS is prepared to accept to deliver its business objectives.

Risk asset ratio (RAR) - total regulatory capital as a percentage of risk-weighted assets.

Risk elements in lending (REIL) - impaired loans and accruing loans which are contractually overdue 90 days or more as to principal or interest.

Risk-weighted assets (RWAs) - assets adjusted for their associated risks using weightings established in accordance with the CRD IV as implemented by the PRA. Certain assets are not weighted but deducted from capital.

Sale and repurchase agreements - in a sale and repurchase agreement one party, the seller, sells a financial asset to another party, the buyer, at the same time the seller agrees to reacquire and the buyer to resell the asset at a later date. From the seller's perspective such agreements are repurchase agreements (repos) and from the buyer's reverse repurchase agreements (reverse repos).

Securitisation - a process by which assets or cash flows are transformed into transferable securities. The underlying assets or cash flows are transferred by the originator or an intermediary, typically an investment bank, to a structured entity which issues securities to investors. Asset securitisations involve issuing debt securities (asset-backed securities) that are backed by the cash flows of income-generating assets (ranging from credit card receivables to residential mortgage loans).

Settlement balances - payables and receivables that result from purchases and sales of financial instruments recognised on trade date. Asset settlement balances are amounts owed to RBS in respect of sales and liability settlement balances are amounts owed by RBS in respect of purchases.

Explanation of Responses:

Glossary of terms

Sovereign exposures - exposures to governments, ministries, departments of governments and central banks.

Standardised approach - a method used to calculate credit risk capital requirements under Pillar 1. In this approach the risk weights used in the capital calculation are determined by regulators. For operational risk, capital requirements are determined by multiplying three years' historical gross income by a percentage determined by the regulator. The percentage ranges from 12 to 18%, depending on the type of underlying business being considered.

Standstill - is an agreement, usually for a specified period of time, not to enforce the lender's rights as a result of a customer breaching the terms and conditions of their facilities. This is a concession to the customer. A standstill is most commonly used in a complex restructuring of a company's debts, where a group of creditors agree to delay enforcement action to give the company time to gather information and formulate a strategy with a view to establishing a formal restructuring.

Stress testing - a technique used to evaluate the potential effects on an institution's financial condition of an exceptional but plausible event and/or movement in a set of financial variables.

Stressed value-at-risk (SVaR) - a VaR measure using historical data from a one year period of stressed market conditions. For the purposes of calculating regulatory SVaR, a time horizon of ten trading days is assumed at a confidence level of 99%. Refer also to Value-at-risk below.

Structured credit portfolio (SCP) - a portfolio of certain illiquid assets - principally CDO super senior positions, negative basis trades and monoline exposures.

Structured entity (SE) - an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose, they do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions.

Structured notes - securities that pay a return linked to the value or level of a specified asset or index. Structured notes can be linked to equities, interest rates, funds, commodities and foreign currency.

Subordinated liabilities - liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.

Super senior CDO - the most senior class of instrument issued by a CDO vehicle. They benefit from the subordination of all other instruments, including AAA rated securities, issued by the CDO vehicle.

Tier 1 capital - a component of regulatory capital, comprising Common Equity Tier 1 and Additional Tier 1. Additional Tier 1 capital includes eligible non-common equity capital securities and any related share premium. Under Basel II, Tier 1 capital comprises Core Tier 1 capital plus other Tier 1 securities in issue, less certain regulatory deductions.

Tier 2 capital - qualifying subordinated debt and other Tier 2 securities in issue, eligible collective impairment allowances less certain regulatory deductions.

Total loss absorbing capacity (TLAC) - a Financial Stability Board requirement for global systemically important banks to have a sufficient amount of specific types of liabilities which can be used to absorb losses and recapitalise a bank in resolution. The implementation of the TLAC requirements is being discussed within local regulators.

Unaudited - financial information that has not been subjected to the audit procedures undertaken by RBS's auditors to enable them to express an opinion on RBS's financial statements.

US Federal Agencies - are independent bodies established by the US Government for specific purposes such as the management of natural resources, financial oversight or national security. A number of agencies, including, the Government National Mortgage Association, issue or guarantee publicly traded debt securities.

Value-at-risk (VaR) - a technique that produces estimates of the potential loss in the market value of a portfolio over a specified time period at a given confidence level.

Wholesale funding - wholesale funding comprises Deposits by banks, Debt securities in issue and Subordinated liabilities.

Write-down - a reduction in the carrying value of an asset to record a decline in its fair value or value in use.

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Shareholder information

Important addresses

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06901 USA

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St Helier Jersey Channel Islands JE4 8PJ

RBS Holdings N.V.

Gustav Mahlerlaan 350

Amsterdam

1082 ME

The Netherlands

628

Explanation of Responses:

Shareholder information

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Exhibit Number	**Description**
1.1[1]	Memorandum and Articles of Association of The Royal Bank of Scotland Group plc
2.1[2]	Form of Deposit agreement among The Royal Bank of Scotland Group plc, The Bank of New York as Depositary, and all Owners and Holders from time to time of American Depositary Receipts issued thereunder
2.2[3]	Form of American Depositary Receipt for ordinary shares of the par value of £1 each
2.3[4]	Letter dated May 12, 2008 from The Bank of New York Mellon as Depository to The Royal Bank of Scotland Group plc relating to the Prerelease of American Depository Receipts
2.4	Neither The Royal Bank of Scotland Group plc nor The Royal Bank of Scotland plc is party to any single instrument relating to long-term debt pursuant to which a total amount of securities exceeding 10% of the Group's total assets (on a consolidated basis) is authorized to be issued. Each of The Royal Bank of Scotland Group plc and The Royal Bank of Scotland plc hereby agrees to furnish to the Securities and Exchange Commission (the "Commission"), upon its request, a copy of any instrument defining the rights of holders of its long-term debt or the rights of holders of the long-term debt of any of its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed with the Commission
4.1[5]	Service agreement for Ross McEwan, Group Chief Executive, dated September 2013
4.2[6]	Service Agreement for Ewen Stevenson, Chief Financial Officer, dated May 2014
4.3[7]	Letter of Appointment for Howard Davies, Non-Executive Director and Chairman, dated February 27, 2015
4.4[7]	Letter of Appointment for Michael Rogers, Non-Executive Director, dated January 2016
4.5	Letter of Appointment for Frank Dangeard, Non-Executive Director, dated 16 May 2016
4.6	Letter of Appointment for Mark Seligman, Non-Executive Director, dated 23 February 2016
4.7[8]	Standard Terms of Appointment for Non-Executive Directors
4.8[9]	Form of Deed of Indemnity for Directors
4.9[7]	Memorandum of Understanding between National Westminster Bank Plc and RBS Pension Trustee Limited, dated January 26, 2016
4.10[10]	Acquisition and contingent capital agreement dated 26 November 2009 among The Royal Bank of Scotland Group plc and The Commissioners of Her Majesty's Treasury
4.11[10,11]	State Aid Commitment Deed dated 26 November 2009 among The Commissioners of Her Majesty's Treasury and The Royal Bank of Scotland Group plc
4.12[10,11]	State Aid Cost Reimbursement Deed dated 26 November 2009 among The Commissioners of Her Majesty's Treasury and The Royal Bank of Scotland Group plc
4.13[5,11]	Revised State Aid Commitment Deed dated 9 April 2014 among The Commissioners of Her Majesty's Treasury and The Royal Bank of Scotland Group plc
4.14[5,11]	Dividend Access Share Retirement Agreement, dated 9 April 2014 among The Commissioners of Her Majesty's Treasury and The Royal Bank of Scotland Group plc
4.15[6]	Relationship Agreement, dated November 7, 2014 among Her Majesty's Treasury and The Royal Bank of Scotland Group plc
7.1	Statement regarding computation of ratio of earnings to fixed charges

8.1	Principal subsidiaries of The Royal Bank of Scotland Group plc
12.1	CEO certification required by Rule 13a-14(a)
12.2	CFO certification required by Rule 13a-14(a)
13.1	Certification required by Rule 13a-14(b)
15.1	Consent of independent registered public accounting firm (Deloitte LLP)
15.2	Consent of independent registered public accounting firm (Ernst & Young LLP)

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Shareholder information

Notes:

(1) Previously filed and incorporated by reference to Exhibit 1 to the Group's Annual Report on Form 20-F for the fiscal year ended 31 December 2012 (File No. 1-10306)
(2) Previously filed and incorporated by reference to Exhibit 1 to the Registration Statement on Form F-6 (Registration No. 333-144756) (filed on 20 July 2007)
(3) Previously filed and incorporated by reference to the prospectus filed pursuant to Rule 424(b)(3) (filed on 7 June 2012) relating to the Registration Statement on Form F-6 (Registration No. 333-144756) (filed on 20 July 2007)
(4) Previously filed and incorporated by reference to Exhibit 2.3 to the Group's Annual Report on Form 20-F for the fiscal year ended 31 December 2007 (File No. 1-10306)
(5) Previously filed and incorporated by reference to Exhibit 4.1, 4.11, 4.12, 4.13 and 4.14 to the Group's Annual Report on Form 20-F for the fiscal year ended 31 December 2013 (file No. 1-10306)
(6) Previously filed and incorporated by reference to Exhibit 4.2, and 4.12, respectively, to the Group's Annual Report on Form 20-F for the fiscal year ended 31 December 2014 (File No. 1-10306)
(7) Previously filed and incorporated by reference to Exhibit 4.3, 4.4 and 4.6, respectively, to the Group's Annual Report on Form 20-F for the fiscal year ended 31 December 2015 (File No. 1-10306)
(8) The terms of the letters of appointment of current non-executive directors, which have previously been filed as exhibits to The Group's annual reports, have been amended to reflect changes to the Standard Terms of Appointment of Non-Executive Directors, attached as an exhibit hereto.
(9) Previously filed and incorporated by reference to Exhibit 4.11 to the Group's Annual Report on Form 20-F for the fiscal year ended 31 December 2006 (file No. 1-10306) except that the sentence "PROVIDED THAT this Indemnity is given subject to the provisions of Section 309A Company Act 1985" has been replaced with "PROVIDED THAT this Indemnity is given subject to the provisions of Section 234 Company Act 2001"
(10) Previously filed and incorporated by reference to Exhibit 4.19, 4.24 and 4.25, respectively, to the Group's Annual Report on Form 20-F for the fiscal year ended 31 December 2009 (File No. 1-10306)
(11) Confidential treatment has been requested. Confidential materials have been redacted and separately filed with the SEC.

SIGNATURE

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

The Royal Bank of Scotland Group plc

Registrant

/s/ Ewen Stevenson

Ewen Stevenson

Chief Financial Officer

24 March 2017

Explanation of Responses: