Royal Bank of Scotland N.V.

Annual Report and Accounts 2017

Annual report and accounts

Chairman's statement

In 2017 RBS N.V. (the Group) continued to de-risk its balance sheet in close consultation with the Group's regulators. Total assets reduced to €6.1 billion at the end of 2017 compared with €8.3 billion at the end of 2016. In 2017 the Group did not originate new transactions with clients and local banking licences were handed back in a number of countries. Our presence outside the Netherlands and the UK decreased materially as a result of the wind-down.

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

The de-risking and wind-down of the Group is part of the Royal Bank of Scotland Group plc's (RBS Group) business restructuring, as announced in February 2015. The reorganisation agenda of the RBS Group and the Group are fully aligned.

Idzard van Eeghen, who served on the Managing Board for more than three years, two years as the Chairman, stepped down on 1 November 2017. He leaves with our thanks for his dedication and commitment to the Group during that time.

Outlook [1]

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

Results of operations in 2017

Operating loss before tax was €115 million compared with a profit of €92 million in 2016. Total income decreased and expenses increased in line with the wind-down. The Group's 2017 results included a number of non-recurring items, including foreign exchange losses reported in income of €163 million compared with €7 million in 2016, following the repatriation of the proceeds from the disposal of foreign operations. Expenses in 2016 included an amount received due to the favourable outcome of a legacy litigation case.

Capital and RWA

The Group continues to be well capitalised. Total equity as at 31 December 2017 was €2.9 billion, a decrease of €0.2 billion compared with 31 December 2016. At 31 December 2017, the Group's Total capital ratio was 25.9% with Common Equity Tier 1 (CET1) and Tier 1 ratios of 24.9%.

The Group's total risk-weighted assets were €11.1 billion at 31 December 2017 (2016 - €13.4 billion) of which €7.4 billion (2016 - €9.2 billion) related to Alawwal Bank, which is proportionally consolidated due to the Group's 40% equity participation.

On behalf of the Managing Board, I would like to thank all the RBS Group employees who have executed the wind-down and supported the management of the Group during 2017.

Harm Bots
Chairman of the Managing Board of RBS N.V.
Amsterdam, 24 April 2018

Note:
(1) The targets, expectations and trends discussed in this section represent management's current expectations and are subject to change, including as a result of the factors described in the Risk factors section on pages 112 to 127 and Forward-looking statements on pages 128 and 129.

Financial review

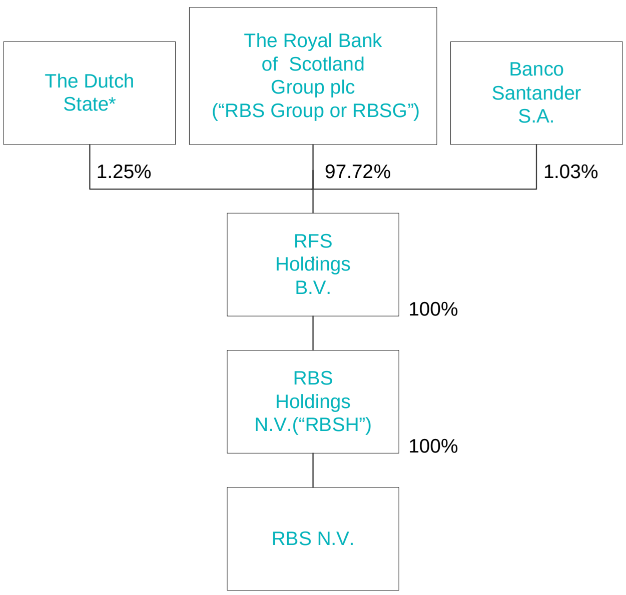
Presentation of information

In the Report and Accounts and unless specified otherwise, the term 'bank' means The Royal Bank of Scotland N.V., the 'Group' or 'RBS N.V.' means the bank and its subsidiaries, and 'RBS Holdings' means RBS Holdings N.V.. RBS Holdings N.V. is the parent company of RBS N.V.. RBSH Group is RBS Holdings and its consolidated subsidiaries and associated companies. The Royal Bank of Scotland Group plc (RBSG) is the ultimate holding company of RBSH Group. RBS Group refers to RBSG and its consolidated subsidiaries and associated companies. RBS plc refers to The Royal Bank of Scotland plc.

Governance and management are conducted on an overall basis within RBSH Group. Therefore the discussions in this document that refer to RBSH Group also apply to RBS N.V..

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

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



*interest is held by Stichting Administratiekantoor Beheer Financiële Instellingen.

Description of business

Introduction

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

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

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

International Financial Reporting Standards

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

India business

The India business which was sold at its book value to the Royal Bank of Scotland plc in February 2017 is classified as a disposal group at 31 December 2016 and its assets and liabilities presented in aggregate in accordance with IFRS 5. The India business is also presented as a discontinued operation and comparatives have been re-presented accordingly.

Glossary

A glossary of terms is included on pages 131 to 136.

Financial review

Summary consolidated income statement

	2017 €m	2016 €m	2015 €m
Net interest income	(1)	(70)	(106)
Fees and commissions receivable	19	7	6
Fees and commissions payable	(2)	(2)	(9)
Income from trading activities	(156)	92	8
Foreign exchange gains and losses related to net investment hedges reclassified to income following disposals of foreign operations (1)	(163)	(7)	(2)
Other operating income	242	30	264
Non-interest income	(60)	120	267
Total income	(61)	50	161
Operating expenses	(57)	33	(138)
(Loss)/profit before impairment releases/(losses)	(118)	83	23
Impairment releases/(losses)	3	9	(105)
Operating (loss)/profit before tax	(115)	92	(82)
Tax credit/(charge)	24	(36)	30
(Loss)/profit from continuing operations	(91)	56	(52)
(Loss)/profit from discontinued operations, net of tax	(1)	(33)	46
(Loss)/profit for the year	(92)	23	(6)
Attributable to:			
Controlling interests	(92)	23	(6)

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

2017 compared with 2016

Operating loss before tax was €115 million compared with an operating profit of €92 million in 2016. This decrease was due to lower total income which decreased by €111 million to a loss of €61 million, higher operating expenses of €57 million compared with a credit of €33 million in 2016 and lower impairment releases of €3 million compared with €9 million in 2016.

Loss attributable to controlling interests was €92 million compared with a profit of €23 million in 2016. Loss from discontinued operations was €1 million compared with €33 million in 2016.

Net interest income was a net expense of €1 million compared with a net expense of €70 million in 2016. Lower interest receivable, reflecting the overall run down of banking book assets, was more than offset by lower interest payable, mainly due to a reduction in subordinated liabilities.

Non-interest income decreased by €180 million to a loss of €60 million compared with income of €120 million in 2016.

Loss from trading activities was €156 million, primarily in relation to mark-to-market movements in derivatives, compared with income of €92 million in 2016 which included €138 million received in respect of a distribution to successful plaintiffs in the Madoff related class action.

Foreign exchange losses of €163 million (2016 - €7 million) were reported in income following the repatriation of the proceeds from the disposal of foreign operations. They represent the cumulative exchange movement recorded in equity during the lifetime of those foreign operations that were the subject of a net investment hedge.

Other operating income increased by €212 million to €242 million, compared with €30 million in 2016. This included an increase in the share in profits from associated companies, up €47 million to €101 million, compared with €54 million in 2016, all from Alawwal Bank; an increase in the fair value of financial instruments designated at fair value through profit and loss of €67 million, to €70 million; and an increase in other income of €66 million to €53 million compared with a loss of €13 million in 2016, due primarily to a revaluation of insurance reserves which resulted in a realised profit of €40 million.

Operating expenses increased by €90 million to €57 million compared with a credit of €33 million in 2016. This was mainly due to increases in administrative expenses of €92 million largely reflecting a non-repeat provisions release in 2016, partly offset by staff costs which were down €8 million to €5 million, reflecting a reduction in headcount.

Impairments were a release of €3 million compared with €9 million in 2016.

Tax credit for 2017 was €24 million compared with a charge of €36 million in 2016.

Loss from discontinued operations of €1 million compared with a loss of €33 million in 2016 related to the India business transferred to RBS plc in February 2017.

Consolidated balance sheet as at 31 December 2017

	2017 €m	2016 €m
Assets		
Cash and balances at central banks	68	368
Loans and advances to banks	2,998	3,195
Loans and advances to customers	93	188
Amounts due from ultimate holding company	125	142
Debt securities and equity shares	514	517
Settlement balances	4	10
Derivatives	761	1,581
Deferred tax	—	1
Interests in associates	1,214	1,266
Prepayments, accrued income and other assets	299	252
Assets of disposal groups	—	810
Total assets	6,076	8,330
Liabilities		
Deposits by banks	1,132	1,400
Customer accounts	64	230
Debt securities in issue	27	55
Settlement balances and short positions	13	48
Derivatives	549	1,244
Provisions, accruals and other liabilities	392	629
Deferred tax	22	22
Subordinated liabilities	993	1,438
Liabilities of disposal groups	—	219
Total liabilities	3,192	5,285
Total equity	2,884	3,045
Total liabilities and equity	6,076	8,330

Commentary on consolidated balance sheet

2017 compared with 2016

Total assets were €6,076 million at 31 December 2017, a decrease of €2,254 million, or 27%, compared with €8,330 million at 31 December 2016, mainly driven by a decrease in derivatives and assets of disposal groups with the transfer of the India business to RBS plc in February 2017.

Cash and balances at central banks decreased by €300 million or 82% to €68 million at 31 December 2017 reflecting reduced liquidity requirements.

Loans and advances to banks decreased by €197 million, or 6%, to €2,998 million at 31 December 2017, with the majority of the balance, €2,643 million, being with fellow subsidiaries.

Loans and advances to customers declined by €95 million, or 51%, to €93 million, reflecting continued repayments and business run-down.

Debt securities and equity shares remained stable at €514 million.

Derivative assets decreased by €820 million, or 52%, to €761 million, and derivative liabilities decreased by €695 million, or 56%, to €549 million. €489 million of the assets and €360 million of the liabilities are balances with fellow subsidiaries.

Prepayments, accrued income and other assets remained stable at €299 million.

Deposits by banks decreased by €268 million, or 19%, to €1,132 million, mainly due to a reduced borrowing from RBS plc on the disposal on the India business. €1,073 million of the balance is with fellow subsidiaries.

Customer accounts were down €166 million, 72%, to €64 million, reflecting continued balance sheet reduction.

Debt securities in issue declined €28 million, 51%, to €27 million reflecting decreases in medium-term-notes.

Subordinated liabilities decreased by €445 million, or 31%, to €993 million primarily due the liquidity management exercise to buy back Tier 2 subordinated liabilities completed in 2017 as part of the ongoing management of the capital structure and the impact of US dollar to Euro exchange rate movements during the year.

The assets and liabilities of disposal groups were nil compared with €810 million and €219 million respectively in 2016, due to the transfer of the India business.

Total equity decreased by €161 million, 5%, to €2,884 million reflecting the attributable loss for the period.

Presentation of information

Except as otherwise indicated, information in the Capital and risk management section (pages 6 to 34) is within the scope of the Independent auditor’s report. Unless otherwise indicated, disclosures in this section include disposal groups in relevant exposures and measures.

Capital and risk management are generally conducted on an overall basis within RBS Group such that common policies, procedures, frameworks and models apply across the RBS Group. Therefore, for the most, discussion on these qualitative aspects reflect those in RBS Group as relevant for the businesses and operations in the Group.

Risk management framework (unaudited)

Introduction

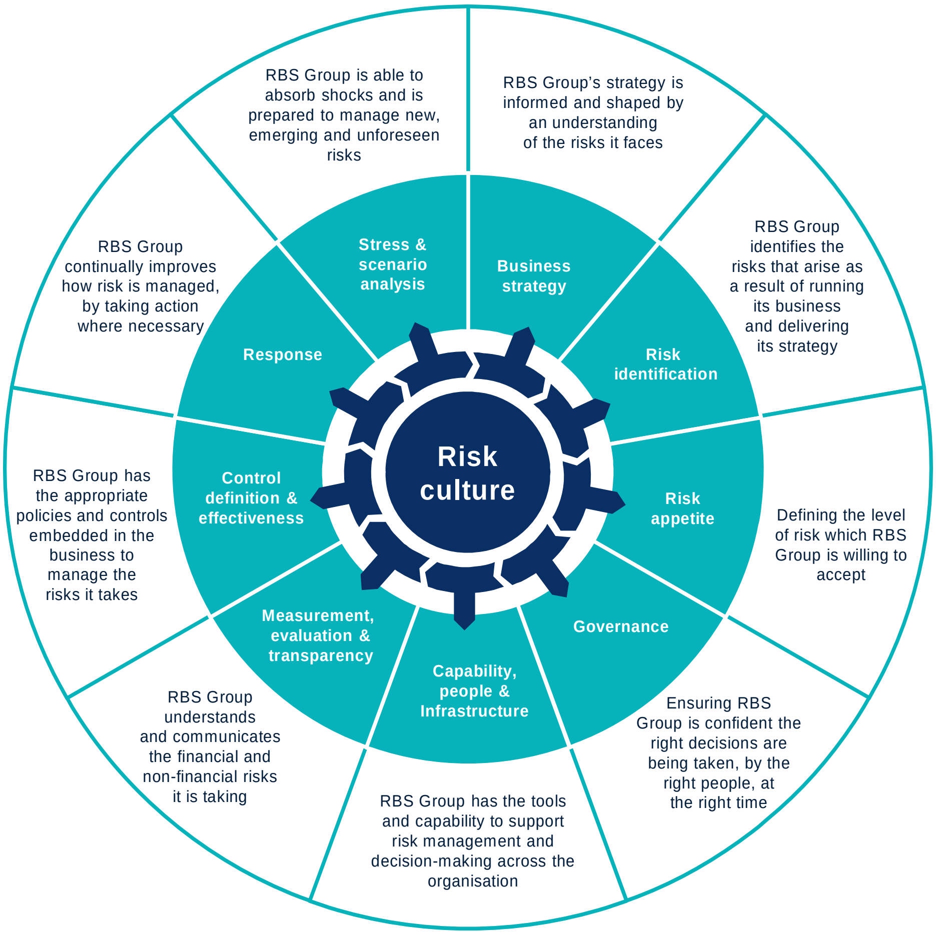
Capital and risk management are conducted on an overall basis within the RBS Group. The RBS Group operates an integrated risk management framework, centred around the embedding of a strong risk culture, which is designed to achieve the correct balance between prudential and conduct obligations. Each element of the RBS Group risk management framework functions both individually and as part of a larger continuum. The framework ensures the tools and capability are in place to facilitate risk management and decision-making across the organisation.

RBS Group's strategy is informed and shaped by an understanding of the risk landscape, including a range of significant risks and uncertainties in the external economic, political and regulatory environment. Identifying these risks and understanding how they affect the RBS Group, informs risk appetite and risk management practice.

Risk appetite, which is supported by a robust set of principles, policies and practices, defines the levels of tolerance for a variety of risks. It is a key element of the RBS Group's risk management framework and culture, providing a structured approach to risk-taking within agreed boundaries.

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

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



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

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

Risk management framework (unaudited) continued

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

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

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

Risk culture

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

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

To achieve this, the RBS Group is focusing on leaders as role models and taking action to build clarity, continuing to develop capability and motivate employees to reach the required standards of risk culture behaviour, including:
- Taking personal accountability and proactively managing risk.
- Respecting risk management and the part it plays in daily work.
- Understanding clearly the risks associated with individual roles.
- Aligning decision-making to the RBS Group's risk appetite.
- Considering risk in all actions and decisions.
- Escalating risks and issues early.
- Taking action to mitigate risks.
- Learning from mistakes and near-misses.
- Challenging others' attitudes, ideas and actions.
- Reporting and communicating risks transparently.

To embed and strengthen the required risk culture, a number of RBS Group-wide activities were undertaken in 2017. These included ethical scenario training, mandatory Group Policy Learning, and Managing Our Performance meetings designed to enhance risk culture at a team and individual employee level.

To support a consistent tone from the top, senior management regularly communicate the importance of the required risk behaviours, linking them to the achievement of good customer outcomes.

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

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

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

Risk-based key performance indicators

The RBS Group-wide remuneration policy ensures that the remuneration arrangements for all employees reflect the principles and standards prescribed by the PRA rulebook and the FCA handbook.

Training

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

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

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

Code of Conduct

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

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

Risk management framework (unaudited) continued

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

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

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

If conduct falls short of the RBS Group's required standards, the accountability review process is used to assess how this should be reflected in pay outcomes for those individuals concerned. The RBS Group's approach to remuneration and related policies promotes effective risk management through a clear distinction between fixed remuneration – which reflects the role undertaken by an individual – and variable remuneration, which is directly linked to, and reflects performance and can be risk-adjusted.

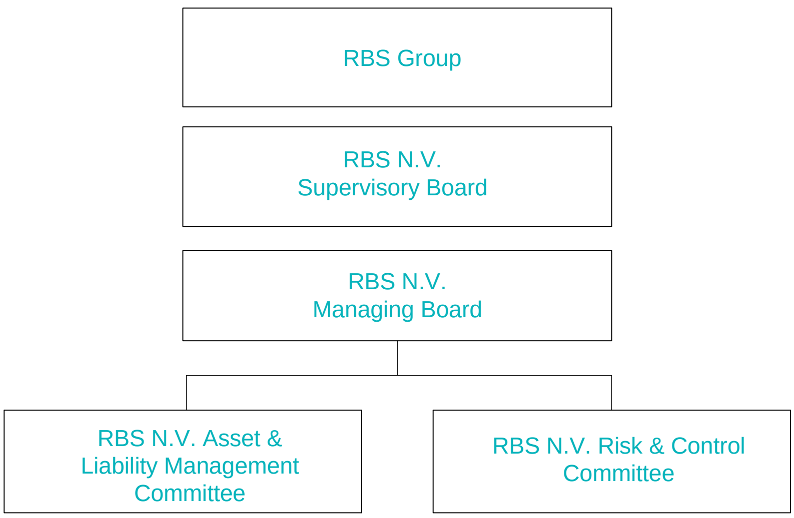
The RBS Group Performance & Remuneration Committee considers risk performance and conduct when determining overall bonus pools. Such pay decisions aim to reinforce the need for all employees to demonstrate acceptable risk management practice.

Risk governance

Governance structure

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

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



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

Liquidity risk and the day-to-day management of liquidity and funding of the portfolio are the overall responsibility of the Managing Board and further delegated to the Asset & Liability Management Committee (ALCo).

Risk management framework (unaudited) continued

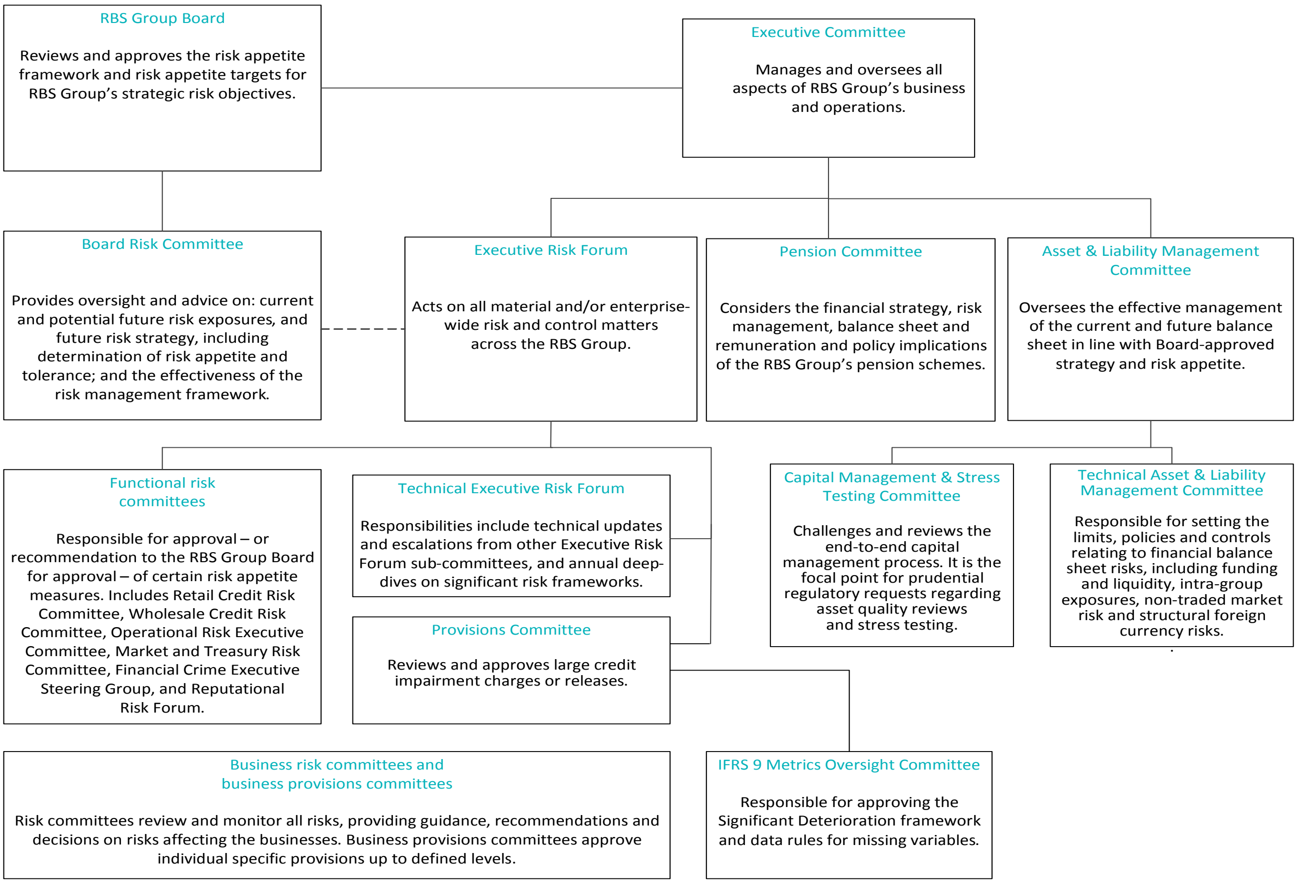
The following table shows details of the Group's key boards and committees together with an overview of their responsibilities.

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

Risk management framework (unaudited) continued

Committee structure

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

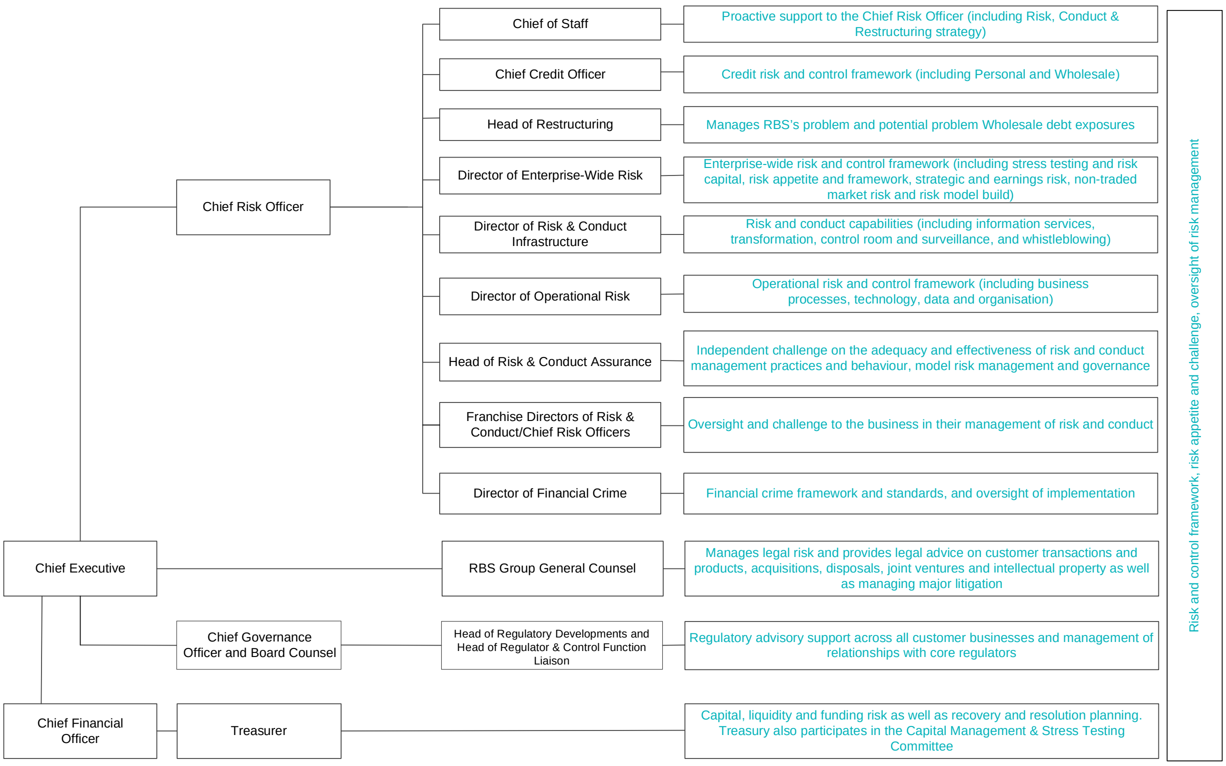


Note:
(1) The RBS Group IFRS 9 Metrics Oversight Committee has delegated authority from the Provisions Committee to approve the Significant Deterioration framework, the data rules for missing variables, materiality decisions relating to the expected credit loss calculation, adjustments relating to the expected credit loss calculation if necessary, and changes in expected credit loss provision calculation methodology.

Risk management framework (unaudited) continued

Risk management structure

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



Notes:

(1) The RBS Group risk management framework
In 2017, the RBS Group Chief Risk Officer led Risk, Conduct & Restructuring. The RBS Group Chief Risk Officer reported directly to the RBS Group Chief Executive and had a dotted reporting line to the RBS Group Board Risk Committee, as well as a right of access, to the chairman of the RBS Group Board Risk Committee.
Risk, Conduct & Restructuring was a function independent of the franchises, structured by risk discipline to facilitate the effective management of risk.
Risk, Conduct & Restructuring was organised into eight functional areas: Chief of Staff; Credit Risk; Restructuring; Enterprise-Wide Risk; Risk & Conduct Infrastructure; Operational Risk; Risk & Conduct Assurance; and Financial Crime. There were also Directors of Risk & Conduct/Chief Risk Officers for each of the franchises and for Services.
Risk committees in the customer businesses and key functional risk committees oversaw risk exposures arising from management and business activities and focused on ensuring that they were adequately monitored and controlled.

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

Risk management framework (unaudited) continued

Three lines of defence

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

First line of defence – Management and supervision

The first line of defence includes customer franchises, Technology and Services as well as support and control functions such as Human Resources, Communications & Marketing and Finance. Responsibilities include:

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

Second line of defence – Oversight and control

The second line of defence includes Risk, Conduct & Restructuring, Legal, and the financial control element of the Finance function. Responsibilities include:

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

Third line of defence – Internal Audit

Responsibilities include:

- Providing assurance to the Supervisory Board that the main business risks have been identified and effective controls are in place to manage these risks.
- Engaging with management to provide perspectives, insights and challenge in order to influence the building of a sustainable bank.
- Providing independent assurance to the key jurisdictional regulators on specific risks and controls.

Risk appetite

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

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

Risk appetite framework

The risk appetite framework bolsters effective risk management by promoting sound risk-taking through a structured approach, within agreed boundaries. It also ensures emerging risks and risk-taking activities that would be out of appetite are identified, assessed, escalated and addressed in a timely manner.

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

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

The RBS Group Board approves the risk appetite framework annually.

Risk management framework (unaudited) continued

Establishing risk appetite

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

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

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

The annual process of establishing risk appetite statements is completed alongside the business and financial planning process. This ensures plans and risk appetite are appropriately aligned.

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

The RBS Group's risk profile is frequently reviewed and monitored to ensure it remains within appetite and that management focus is concentrated on all strategic risks, material risks and emerging risk issues. Effective processes are in place for reporting risk profile relative to risk appetite to the Managing Board and Supervisory Board.

Risk control frameworks and limits

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

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

Risk identification and measurement

Risk identification and measurement within the risk management process comprise:

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

The RBS Group has developed a risk directory which contains details of the financial and non-financial risks that it faces each day. It provides a common risk language to ensure consistent terminology is used across the RBS Group. The risk directory is subject to annual review. This ensures that the directory continues to provide a comprehensive and meaningful list of the inherent risks within the businesses.

Risk treatment and mitigation

Risk treatment and mitigation is an important aspect of ensuring that risk profile remains within risk appetite. Risk mitigation strategies are discussed and agreed with the businesses.

When evaluating possible strategies, costs and benefits, residual risks (risks that are retained) and secondary risks (those caused by the risk mitigation actions) are considered. Monitoring and review processes are in place to track results.

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

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

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

The Board Risk Committee, Asset & Liability Management Committee and Executive Risk Forum provide governance and oversight.

Risk management framework (unaudited) continued

Risk and conduct assurance

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

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

The Head of Risk & Conduct Assurance also oversees the three lines of defence model, including relevant principles. For further information refer to page 12.

Assurance

Qualitative reviews are carried out to assess various risk aspects as appropriate, including: the quality of risk portfolios, the accuracy of the Basel Model Inputs and related probability of default/loss given default classifications, the quality of risk management practices, policy compliance and adherence to risk appetite. This can include testing the bank's credit portfolios and market risk exposures to assist in early identification of emerging risks, as well as undertaking targeted reviews to examine specific concerns raised either by these teams or by their stakeholders.

Assurance is carried out on Anti-Money Laundering, Sanctions, and Anti-Bribery & Corruption processes and controls. This helps inform whether or not the financial crime control environment is adequate and effective and whether financial crime risk is appropriately identified, managed and mitigated. Assurance of conduct policies is predominantly focused on the Risk, Conduct & Restructuring-owned conduct policies. Targeted work is also carried out to assist the RBS Group in meeting its promises to customers as well as its regulatory requirements.

The Risk & Conduct Assurance Committee ensures a consistent and fair approach to all aspects of the team's assurance review activities. The committee also monitors and validates the ongoing programme of reviews and tracks the remediation of the more material review actions.

Model risk

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

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

Model Risk Governance

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

Model Risk Management

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

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

Model Risk Management reviews may test and challenge the logic and conceptual soundness of the methodology, or the assumptions underlying a model. Reviews may also test whether or not all appropriate risks have been sufficiently captured as well as checking the accuracy and robustness of calculations. Based on the review and findings from Model Risk Management, the RBS Group's model or risk committees consider whether a model can be approved for use. Models used for regulatory reporting may additionally require regulatory approval before implementation.

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

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

For more specific information relating to market risk models and pricing models, refer to page 28.

Capital, liquidity and funding risk

Definitions (unaudited)

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

Capital adequacy risk is the risk that there is or will be insufficient capital and other loss absorbing debt instruments to operate effectively including meeting minimum regulatory requirements, operating within Board-approved risk appetite and supporting strategic goals.

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

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

Liquidity and funding risks arise in a number of ways, including through the maturity transformation role that banks perform. The risks are dependent on factors such as:

- Maturity profile.
- Composition of sources and uses of funding.
- The quality and size of the liquidity portfolio.
- Wholesale market conditions.
- Depositor and investor behaviour.

For a description of sources of capital, liquidity and funding as utilised by the RBS Group, refer to the RBS Group Annual Report and Accounts 2017 on page 161.

Key developments in 2017 (unaudited)

- CET1 capital reduced by €0.1 billion during 2017, predominantly as a result of capital repatriation to the Dutch State of €90 million and loss in the period, partially offset by regulatory adjustments for own credit and foreign currency reserve movements.
- The CET1 and Tier 1 ratios increased to 24.9% (2016 - 21.2%), primarily driven by a reduction in RWAs, largely relating to Alawwal Bank (€1.8 billion reduction) and transfer of the India branch to RBS plc. These RWA reductions outweighed the impact of lower capital compared with 2016.
- Liability management activity in 2017 included a DNB-approved buyback of subordinated debt, which contributed to the €0.3 billion reduction in Tier 2 capital.
- Total regulatory capital reduced to €2.9 billion (2016 - €3.2 billion) as a result of the above factors impacting Tier 1 and Tier 2. The total capital ratio of 25.9% was a moderate increase compared to the prior year, due to lower RWAs as mentioned above.
- The liquidity portfolio and funding levels, at €1.0 billion and €2.2 billion respectively, were lower than in 2016 and reflective of lower balance sheet levels in 2017.

Regulatory framework (unaudited)

Capital requirements regulation and directive

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

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

CRD IV continues to require a total amount of capital equal to at least 8% of risk-weighted assets but the share that has to be of the highest quality, which is CET1 capital, of at least 4.5%.

The CRD IV package also introduces more stringent criteria for capital instruments, harmonised adjustments made to capital recognised for regulatory purposes and establishes new capital buffers to be phased in from 1 January 2014. Once fully implemented on 1 January 2019 the following minimum requirements must be met:

- Pillar 1 requirement of: CET1 of 4.5% of RWAs; Tier 1 of 6%; and total capital of 8%.
- Capital buffers: 'capital conservation buffer' of 2.5% of RWAs; 'countercyclical capital buffer' of up to 2.5%; an 'other systemically important institutions buffer' for domestically or EU important institutions and if required by a member state an additional 'systemic risk buffer'.
- Minimum Tier 1 leverage ratio of 3%.

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

Regulatory oversight

With effect from 1 January 2017, the Group has been subject to the direct supervision of De Nederlandsche Bank (DNB) following the notification from the ECB in 2016 that the Group's classification had changed to 'Less Significant Institution'. Consequently, direct supervision by the ECB has ceased although specific ECB regulations continue to be applicable to the Group.

The Group continues to comply with the local regulatory framework for the assessment and management of liquidity risk as well as meeting internal standards. During 2017 the Group submitted an Internal Liquidity Adequacy Assessment Process document to the DNB.

Banking Union: Single Supervisory Mechanism (unaudited)

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

Capital, liquidity and funding risk continued

The ECB has to ensure that credit institutions not only meet the minimum prudential capital requirements set by the CRR/CRD IV but also have an additional buffer reflecting their individual intrinsic risk profile. This is organised through the SSM.

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

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

Capital management (unaudited)

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

Capital planning

The Group operates a rigorous capital planning process via ALCo aimed at ensuring the capital position is controlled within the agreed parameters. This incorporates regular re-forecasts of the capital position of the Group. In the event that the projected position deteriorates below acceptable levels, the Group would revise business plans accordingly. The Group manages changes to capital requirements from new regulation as well as model changes and the resulting impact on the Common Equity Tier 1 ratio, focusing on risk reduction and de-leveraging. This is principally being achieved through the transfers to interested parties including RBS plc and the continued run-off and disposal of assets as it focuses on the most productive returns on capital.

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

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

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

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

Liquidity and funding management

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

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

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

Liquidity portfolio management

The size of the portfolio is determined by referencing RBS's liquidity risk appetite. RBS retains a prudent approach to setting the composition of the liquidity portfolio, which is subject to internal policies and limits over quality of counterparty, maturity mix and currency mix.

The Group's liquidity portfolio is managed centrally by RBS Group Treasury although local liquidity reserve requirements are the responsibility of the legal entity Treasurer under the ultimate oversight of the RBS Group Treasurer.

Within the liquidity portfolio the Group holds cash at central banks of €0.1 billion (2016 - €0.4 billion) and government and other high quality securities of €0.9 billion (2016 - €0.9 billion) which are principally obtained via reverse repo transactions with RBS plc.

Funding risk management (unaudited)

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

Governance (unaudited)

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

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

Capital, liquidity and funding risk continued

Capital ratios and risk-weighted assets (unaudited)

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

Capital ratios	2017 %	2016 %
Common Equity Tier 1 (CET1)	24.9	21.2
Tier 1	24.9	21.2
Total	25.9	24.1

Risk-weighted assets	€m	€m
Credit risk	10,052	12,315
Market risk	418	455
Operational risk	674	624
	11,144	13,394

- Within RWAs, €7,445 million (2016 - €9,220 million) relates to the proportional consolidation of the Group’s 40% interest in Alawwal Bank. This amount is made up of €7,432 million credit risk RWAs (2016 - €9,199 million) and €13 million market risk RWAs (2016 - €21 million), the decrease in the year relates to both FX and asset reductions.
- Market risk RWAs include €70 million relating to credit valuation adjustments (2016 - €61 million).
- The operational risk capital charge has increased slightly in 2017, reflecting the three year average operating income of Alawwal Bank factored in by the Group under the basic indicator approach to calculating RWAs.

Capital resources

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

	2017 €m	2016 €m
Tier 1		
Controlling interests	2,884	3,045
Adjustment for:		
- Goodwill and other intangible assets	(3)	(3)
- Other regulatory adjustments (1)	(111)	(208)
Common Equity Tier 1	2,770	2,834
Total Tier 1 capital	2,770	2,834
Tier 2		
Subordinated debt	238	536
Deductions from Tier 2 capital	(125)	(144)
Total Tier 2 capital	113	392
Total regulatory capital	2,883	3,226

Note:

(1) Includes reversal of own credit risk of €106 million (2016 - €202 million).

Capital, liquidity and funding risk continued

CET1 flow statement

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

	€m
At 1 January 2017	2,834
Regulatory adjustment: fair value changes in own credit spreads	78
Foreign currency reserves	79
Result current year	(92)
Share premium account	(67)
Other	(62)
At 31 December 2017	2,770

Funding sources

The table below shows the Group's primary funding sources. Deposit balances are predominantly with fellow subsidiaries.

	2017		2016	
	€m	%	€m	%
Deposits by banks	1,132	51.1	1,423	44.2
Debt securities in issue - medium term notes and other bonds	27	1.2	55	1.7
Subordinated liabilities	993	44.8	1,438	44.7
Wholesale funding	2,152	97.1	2,916	90.6
Customer accounts	64	2.9	302	9.4
Total funding	2,216	100.0	3,218	100.0

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.

Sources of credit risk (unaudited)

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

Credit risk management function (unaudited)

Risk governance

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

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

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

Controls

Credit policy standards are in place for the Wholesale portfolio. They are expressed as a set of mandatory controls.

Risk appetite (unaudited)

The Group's approach to lending is governed by comprehensive credit risk appetite frameworks. The frameworks are closely monitored and actions are taken to adapt lending criteria as appropriate.

Credit risk appetite aligns to the strategic risk appetite set by the RBS Group Board, which includes capital adequacy, earnings volatility, funding and liquidity, and stakeholder confidence.

The credit risk appetite frameworks have been designed to reflect factors (e.g. strategic and emerging risks) that influence the ability to operate within risk appetite. Tools such as stress testing and economic capital are used to measure credit risk volatility and develop links between the credit risk appetite frameworks and risk appetite limits. The frameworks are supported by a suite of policies and transaction acceptance standards that set out the risk parameters within which franchises must operate.

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

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

Note:
(1) Potential exposure as defined on the following page.

Risk identification and measurement (unaudited)

Credit stewardship

Risks are identified through relationship management and credit stewardship of portfolios or customers. Credit risk stewardship takes place throughout the customer relationship, beginning with the initial approval. It includes the application of credit assessment standards, credit risk mitigation and collateral, ensuring that credit documentation is complete and appropriate, carrying out regular portfolio or customer reviews and problem debt identification and management.

Risk measurement

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

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

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

Credit risk: management basis continued

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

Product	Current exposure	Potential exposure[1,2]
Lending	Drawn balances	Legally-committed limits
Derivatives and securities financing	Measured using the mark-to-market value after the effect of enforceable netting agreements and net of legally enforceable financial collateral.[3]	Measured using scaled credit limit utilisation, which takes into account mark-to-market movements, any collateral held and expected market movements over a specified horizon.[3]
Contingent obligations	Issued amount of the guarantee or letter of credit	Legally-committed amount
Leases	Net present value plus residual value	
Banking book debt securities	Purchase value less subsequent amortisation	
Trading book bonds Equity securities Settlement risk Suretyships Intra-group credit exposures	Not reported as credit risk	

Notes:
(1) Potential exposure includes all drawn exposure and all legally-committed undrawn exposure.
(2) Potential exposure cannot be less than current exposure.
(3) Current exposure and potential exposure for exchange-traded derivatives are defined as exposure at default.

Risk models (unaudited)

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

Asset quality

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

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

Risk mitigation (unaudited)

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

Counterparty credit risk

The Group 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 the Group to a counterparty are netted against amounts the counterparty owes the Group, in accordance with relevant regulatory and internal policies. This is only done if a netting agreement is in place.

Risk assessment and monitoring (unaudited)

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

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

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

For all other transactions credit is only granted to customers following joint approval by an approver from the business and the credit risk function. Credit risk management is organised in terms of the complexity of the assessment rather than aligned to franchises. The joint business and credit approvers act within a delegated approval authority under the Wholesale Credit Authorities Framework approved by the Executive Risk Forum.

Credit risk: management basis continued

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 Wholesale Credit Authorities Framework.

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

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

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

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

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

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

Problem debt management

Wholesale (unaudited)

Early problem identification

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

Risk of Credit Loss framework

The framework focuses on Wholesale customers whose credit profiles have deteriorated since origination. Expert judgement is applied by experienced credit risk officers to classify cases into categories that reflect progressively deteriorating credit risk to the bank. There are two classifications which apply to non-defaulted customers within the framework – Heightened Monitoring and Risk of Credit Loss. The framework also applies to those customers that have met the bank's default criteria (AQ10 exposures).

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

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

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

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

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

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.

Restructuring

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

Credit risk: management basis continued

Specialists in Restructuring work with customers experiencing financial difficulties and showing signs of financial stress. Throughout Restructuring's involvement the mainstream relationship manager will remain an integral part of the customer relationship, unless an exit strategy is deemed appropriate. The objective is to find a mutually acceptable solution, including restructuring of existing facilities, repayment or refinancing.

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

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 the accounting policies on page 53 for details of the quantification of impairment losses.

Days-past-due measures are typically used to identify evidence of impairment. In the Wholesale portfolio, 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 loan restructuring; the probability of bankruptcy; or evidence of diminished cash flows.

Provisioning

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

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

Sensitivity of impairments to assumptions

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

In addition, for secured lending, key assumptions relate to the valuation of the security and collateral held, as well as the timing and cost of asset disposals based on underlying market depth and liquidity.

Assessments are made by relationship managers on a case-by-case basis for individually-assessed provisions and are validated by credit teams. Impairments less than £1 million are approved by credit officers under their delegated authority. For individual impairments greater than £1 million, oversight is provided by the RBS Group Provisions Committee.

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 and similar events.

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

Credit risk: management basis continued

Summary of country exposures

The table below summarises both current exposure, net of provisions and after risk transfer by geographic region.

	Current exposure				Potential
2017	Banks and other FIs €m	Sovereigns €m	Corporates €m	Total €m	exposure total €m
Netherlands	276	3,845	1	4,122	4,197
UK	532	—	936	1,468	1,533
Other Western Europe	71	—	—	71	83
US	91	—	—	91	91
Rest of world	163	1	50	214	221
Total	1,133	3,846	987	5,966	6,125
2016					
Netherlands	416	4,152	—	4,568	4,573
UK	563	—	1,172	1,735	1,810
Other Western Europe	148	—	4	152	158
US	155	—	2	157	1,517
Rest of world	395	585	117	1,097	1,139
Total	1,677	4,737	1,295	7,709	9,197

Key points (unaudited)

- Total current exposure reduced in line with the Group's strategy to exit legacy business in certain jurisdictions. 64% (2016 - 49%) of the current exposure related to a remote contingent liability.
- Sovereigns included exposures to central governments, central banks and sub-sovereigns such as local authorities, the most significant being the €3.8 billion (2016 - €3.8 billion) cross-liability guarantee (refer to Note 22 Memorandum items - Guarantees for more details). The likelihood of cross-liability crystallising is considered remote.

Credit risk: balance sheet analysis

Sector and geographic concentration

The analysis in this section is provided to support the discussion on credit risk on pages 19 to 23. All disclosures in this section are audited.

The tables in this section include balances relating to disposal groups for 2016, reflecting the total credit risk and losses faced by the Group at 31 December 2016. Assets and liabilities of disposal groups related to the India business which was sold to the Royal Bank of Scotland plc in February 2017.

The following table provides an analysis of the concentration of financial assets by sector.

2017	Loans and advances €m	Securities €m	Derivatives €m	Other [1] €m	Total €m
Central and local government	1	21	—	—	22
Financial institutions [2]	3,135	279	719	68	4,201
Corporate	117	237	42	4	400
Total gross of provisions	3,253	537	761	72	4,623
Provisions	(37)	(23)	—	—	(60)
Total	3,216	514	761	72	4,563
2016					
Central and local government	10	614	—	—	624
Financial institutions [2]	3,566	453	1,366	395	5,780
Personal	4	—	—	—	4
Corporate	137	69	219	—	425
Total gross of provisions	3,717	1,136	1,585	395	6,833
Provisions	(51)	(23)	—	—	(74)
Total	3,666	1,113	1,585	395	6,759

Notes:
(1) Includes settlement balances of €4 million (2016 - €10 million).
(2) Includes reverse repurchase agreements of €899 million (2016 - €949 million).

Loans and advances to banks and customers by geographical region

The table below analyses loans and advances net of provisions by geographical region (location of office).

	2017 €m	2016 €m
Loans and advances to banks		
Netherlands	2,457	1,465
US	43	57
RoW	498	1,678
	2,998	3,200
Loans and advances to customers		
Netherlands	81	180
RoW	12	144
	93	324
Balances with ultimate holding company		
Netherlands	125	142
Total	3,216	3,666

Refer to the previous page for additional disclosures on lending and other exposures by country.

Note:
(1) Disposal groups for 2016 are in relation to the RBS N.V. India business which comprises loans and advances to customers of €136 million and loans and advances to banks of €5 million.

Asset quality

The asset quality analysis is based on RBS Group's internal asset quality (AQ) ratings which have ranges for the probability of default. Customers are assigned credit grades that reflect the key drivers of default for the customer type. All credit grades map to both an AQ scale, used for external financial reporting, and a master grading scale, for wholesale exposures used for internal management reporting. Debt securities are analysed by external ratings and are therefore excluded.

The table below details the relationship between internal AQ bands and external ratings published by Standard & Poor's (S&P). It is for illustrative purposes only, applying mainly to wholesale portfolios and does not indicate that exposures reported against S&P ratings either have been or would be assigned those ratings if assessed by S&P.

Internal AQ band	Probability of default range	Indicative S&P rating
Investment grades:		
AQ1 - AQ4	0% - 0.381%	AAA to BBB-
Non-investment grades:		
AQ5 - AQ10	0.381% - 100%	BB+ to D

2017 compared with 2016

- €3.0 billion (2016 - €3.4 billion) of loans and advances comprised €2.6 billion (2016 - €2.6 billion) of balances with fellow subsidiaries and €0.4 billion (2016 - €0.8 billion) of third party loans. Of the third party loans, €0.4 billion (2016 - €0.7 billion) were investment grade.
- Derivatives of €0.8 billion (2016 - €1.6 billion) included €0.5 billion (2016 - €1.0 billion) with fellow subsidiaries and €0.2 billion (2016 - €0.5 billion) investment grade third party balances.
- Contingent liabilities and commitments of €4.9 billion (2016 - €6.0 billion) were predominantly investment grade, with nil balances with fellow subsidiaries (2016 - €0.8 billion).

Sector and geographical regional analyses

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

2017	Gross loans €m	REIL €m	Provisions €m	REIL as a % of gross loans	Provisions as a % of REIL	Provisions as a % of gross loans	Impairment (releases)/losses €m	Amounts written-off €m
Central and local government	1	—	—	—	—	—	—	—
Financial institutions	13	6	3	46.2	50	23.1	—	—
Corporate	116	39	34	33.6	87	29.3	(4)	—
Latent	—	—	—	—	—	—	(2)	—
Total	130	45	37	34.6	82	28.5	(6)	—
Of which:								
- Netherlands	113	40	32	35.4	80	28.3	(4)	—
- Overseas	17	5	5	29.4	100	29.4	(2)	—
Total	130	45	37	34.6	82	28.5	(6)	—
2016								
Central and local government	10	—	—	—	—	—	—	—
Financial institutions	224	8	3	3.6	38	1.3	(8)	3
Personal	4	—	—	—	—	—	—	—
Corporate	137	66	46	48.2	70	33.6	6	36
Latent	—	—	2	—	—	—	4	—
Total	375	74	51	19.7	69	13.6	2	39
Of which:								
- Netherlands	220	47	40	21.4	85	18.2	(4)	—
- Overseas	155	27	11	17.4	41	7.1	6	39
Total	375	74	51	19.7	69	13.6	2	39

Market risk

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

Traded market risk

Definition (unaudited)

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

Sources of risk (unaudited)

From a market risk perspective, the Group's trading activities are focused on the following markets: rates; currencies; securitised products; and traded credit.

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

The key categories of traded market risk are:

- Interest rate risk – which is the risk that a position's fair value will change due to a change in the absolute level of interest rates, in the spread between two rates, in the shape of the yield curve or in any other interest rate relationship.
- Credit spread risk – which is the risk that the value of a position will change due to changes in the real or market-perceived ability of a borrower to pay related cash flows or obligations.
- Foreign currency price risk – which is the risk that the fair value of a position will change due to the change in foreign currency rates, including gold.
- Equity price risk – which is the risk that the fair value of a position will change due to the change in equity prices.
- Commodity price risk – which is the risk that the fair value of a position will change due to the change in commodity prices.

For more information on the management of counterparty credit risk, refer to the Credit risk section on page 20.

Risk governance (unaudited)

Responsibility for identifying, measuring, monitoring and controlling the market risk arising from trading activities lies with the relevant trading business, with second-line-of-defence oversight provided by RBS Group's Traded Market Risk function.

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

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

Risk appetite (unaudited)

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

Its quantitative appetite is expressed in terms of exposure limits in the form of Board risk measures (approved by the RBS Group Board on the recommendation of the Board Risk Committee) and key risk measures (approved by the Technical Executive Risk Forum).

These limits are cascaded further down the organisation as required, as approved by the Technical Executive Risk Forum.

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

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

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

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

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

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

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

Risk controls and assurance (unaudited)

For information on risk controls and assurance, refer to page 14.

Risk identification and assessment (unaudited)

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

This is complemented by the New Product Approval process, in which the market risk team participates to assess and quantify the market risk associated with all proposed new products.

Traded market risk continued

Risk monitoring (unaudited)

The Group's traded market risk exposures are monitored against limits and analysed daily by market risk reporting and control functions. A daily report that summarises the Group's market risk exposures against the limits is sent to management.

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.

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

Finally, a Market Risk update is included in the monthly risk management report sent to the RCC.

Risk measurement

RBS Group uses a comprehensive set of methodologies and techniques to measure traded market risk. At the Group level, these chiefly comprise VaR and SVaR. In addition, stress testing is used to identify any vulnerabilities and potential losses in excess of VaR and SVaR. The incremental risk charge is no longer material at the Group level.

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

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

Value-at-risk (unaudited)

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%. RBS Group's internal VaR model – which captures all trading book positions including those products approved by the regulator – is based on a historical simulation, utilising market data from the previous 500 days on an equally weighted basis.

At the Group level, a different VaR model is employed. It remains based on a historical simulation model and assumes a time horizon of one trading day and a confidence level of 99%. However, it uses 401 observations of historical market data exponentially weighted with a weighted average history of six months.

The internal VaR model captures the potential impact on the income statement of the following risk factors: interest rate risk; credit spread risk; foreign currency price risk; equity price risk; and commodity price risk. These are defined under Sources of risk.

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 (refer to the following page).
- Ongoing model validation – VaR model performance is assessed both regularly and on an ad-hoc basis if market conditions or book constitution change significantly.
- Model Risk Management review – As part of the model lifecycle, all risk models (including the VaR model) are independently reviewed to ensure that the model is still fit for purpose given current market conditions and book constitution (refer to page 14).

1–day 99% traded internal VaR

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

	2017				2016			
	Average €m	Maximum €m	Minimum €m	Period end €m	Average €m	Maximum €m	Minimum €m	Period end €m
Interest rate	0.7	2.5	0.1	0.1	1.6	3.6	1.1	2.1
Credit spread	2.0	2.5	1.5	1.5	1.7	2.6	1.4	1.7
Currency	0.5	3.2	0.2	0.7	1.0	4.2	0.4	0.8
Equity	—	—	—	—	—	0.2	—	—
Diversification (1)	(0.8)			(0.5)	(1.6)			(1.9)
Total	2.4	4.7	1.6	1.8	2.7	5.8	2.0	2.7

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

Key point

- Average total VaR utilisation remained low and at similar levels to 2016, reflecting a predominantly static trading portfolio.

Traded market risk continued

VaR back-testing (unaudited)

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. Both Actual and Hypo back-testing exceptions are monitored.

SVaR (unaudited)

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

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

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

The internal traded SVaR model captures all trading book positions.

Model validation (unaudited)

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

For general information on the independent model validation carried out by Model Risk Management, which applies also to market risk models (including VaR models), refer to page 14. 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. Model approval by such a committee requires review and approval by these stakeholders, including independent model review by Model Risk Management.

The review process includes the following steps:

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

Risk models

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

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

In addition to Model Risk Management's independent oversight, the model testing team monitors the model performance for market risk through back-testing and other processes.

Non-traded market risk

Definition (unaudited)

Non-traded market risk is the risk to the value of assets or liabilities outside the trading book, or the risk to income, that arises from changes in market prices such as interest rates, foreign exchange rates and equity prices, or from changes in managed rates.

Sources of risk (unaudited)

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

Non-traded market risk is largely managed in line with the following two key categories: interest rate risk and foreign exchange risk.

Interest rate risk

Non-traded interest rate risk arises from the provision to customers 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.

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 the euro; and
- *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.

Risk governance (unaudited)

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

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

Risk appetite (unaudited)

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

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

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

The limit framework at RBS Group level comprises VaR, SVaR, sensitivity and stress limits, and earnings-at-risk limits.

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

To ensure approved limits are not breached and that RBS Group remains within its risk appetite, triggers at RBS Group 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.

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

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

Risk controls and assurance (unaudited)

For information on risk controls and assurance, refer to page 14.

Risk monitoring and measurement

Non-traded market risk positions are reported monthly to ALCo and subsequently to the Managing and Supervisory Boards.

Interest rate risk

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

Residual risk positions are routinely reported to ALCo, the Managing and Supervisory Boards and the RCC.

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

Non-traded market risk continued

NTIRR is measured using a version of the same VaR methodology that is used by RBS Group. VaR metrics are based on interest rate repricing gap reports as at the reporting date.

NTIRR one-day VaR at a 99% confidence level for the Group's retail and commercial banking activities was as follows.

	Average €m	Maximum €m	Minimum €m	Period end €m
2017	1.1	1.8	0.9	0.9
2016	1.6	1.9	1.3	1.7

Key point

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

Foreign exchange risk

The only material non-traded open currency positions are the structural foreign exchange exposures arising from investments in foreign subsidiaries, branches and associates and their related currency funding. These exposures are assessed and managed by RBS Group Treasury to predefined risk appetite levels under delegated authority from the Group's ALCo.

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

2017	Net investments in foreign operations (1) €m	Net investment hedges €m	Structural foreign currency exposures €m
US dollar	156	(15)	141
Saudi Arabian riyal	1,177	(1,178)	(1)
Other non-euro	11	(51)	(40)
	1,344	(1,244)	100
2016			
US dollar	773	(30)	743
Saudi Arabian riyal	1,257	(1,289)	(32)
Other non-euro	667	(457)	210
	2,697	(1,776)	921

Note:
(1) Includes non-controlling interests.

Key points

- Net investments in foreign operations and hedging both decreased in the year. The US dollar exposure reduction was largely due to the wind-down of RBS (China) Co Ltd and subsequent capital repatriation. Other non-euro reductions were in part due to the transfer of the India business to RBS plc and the disposal of joint venture interests in China during the year.
- Changes in foreign currency exchange rates will affect equity in proportion to structural foreign currency exposure. A 5% weakening of the euro against foreign currencies would result in a gain of €5 million (2016 - €48 million), while a 5% strengthening would result in a loss of €5 million (2016 - €44 million) in equity.

Conduct risk (unaudited)

Definition

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

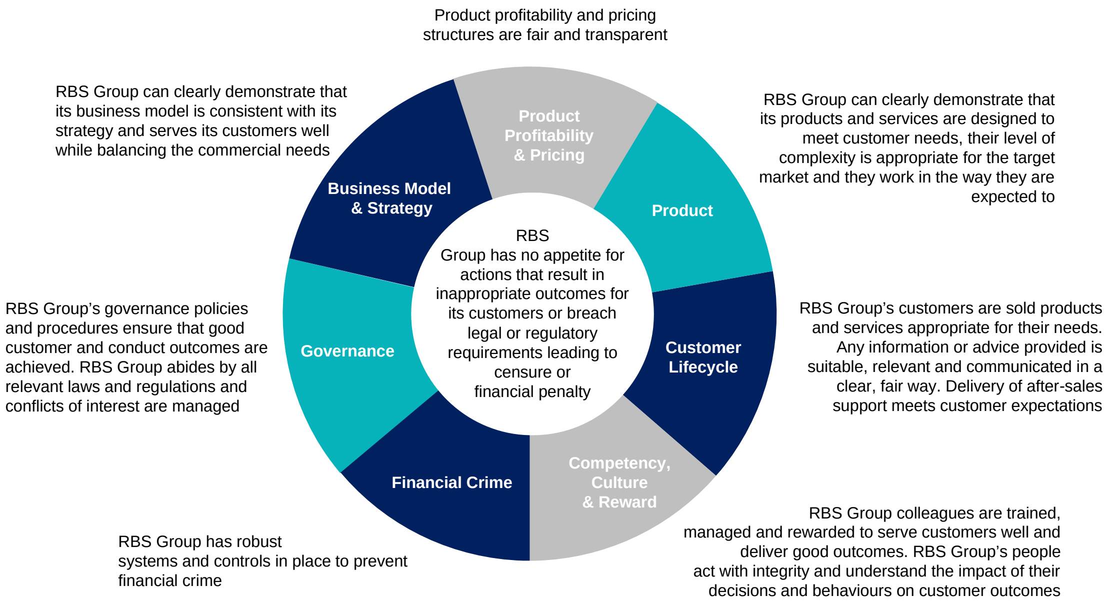
Sources of conduct risk

Conduct risk exists across all stages of the Group's relationships with its customers – from the development of its business strategies, to post-sales processes – and arises from a variety of activities. These include product design, marketing and sales, complaint handling, staff training, and handling of confidential insider information.

Conduct risk also exists if the Group does not take effective action to prevent fraud, bribery and money laundering.

Conduct risk management function

The management of conduct risk is based on seven key elements, ensuring that conduct risk exposures are understood and managed in accordance with agreed risk appetite.



Conduct risk (unaudited) continued

Risk governance

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

Key elements of the governance structure are set out below:

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

Controls

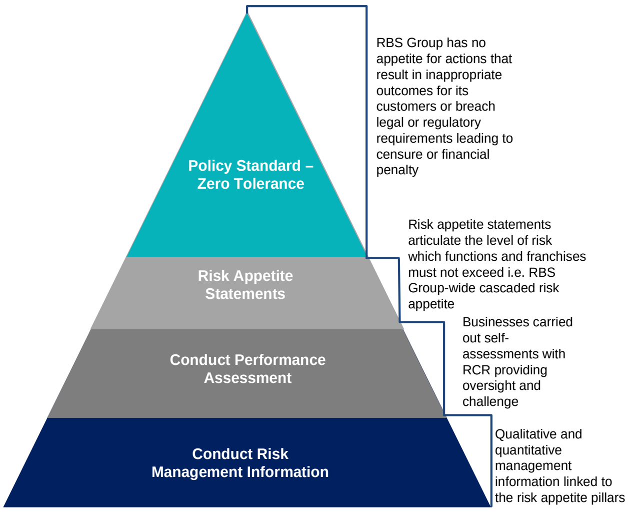
Under the RBS Group's policy framework, there are 18 conduct policies. These are designed to provide both high-level direction and stipulate RBS Group-wide requirements. The policies provide the necessary clarity to staff on their conduct obligations and ensure that regulatory obligations are met.

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

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

Risk appetite

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



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

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

The Conduct Performance Assessment was run in Q1 and Q3 2017, reporting on risk exposures and the operating effectiveness of controls across RBS Group. During Q4 2017, the Conduct Performance Assessment was discontinued, in advance of the roll-out of a new approach in early 2018, providing a real-time quantitative view, supported by qualitative assessment.

Risk monitoring and measurement

The RBS Group Board and senior RBS Group committees receive updates on conduct risk exposures and action plans through regular 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 RBS Group Board, the Group Audit Committee and Board Risk Committee.

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

The Group Audit Committee is provided with a whistleblowing report twice a year. The report comments on the operational effectiveness of our whistleblowing framework, internally branded as 'Speak Up', and any trends emerging from completed investigations. It details cases by internal reporting categories based on the RBS Group definition of whistleblowing included in the Speak Up policy. The Speak Up policy encompasses both the legislative definition contained within the Public Interest Disclosure Act 1998 and the regulatory definition within FCA and PRA regulations and guidance. It extends these to include conduct or behaviour which does not meet the expected standards documented in Our Code.

Each business in the RBS Group has enhanced its use of management information by linking it to the relevant Conduct risk appetite statements. 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 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 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.

Mandatory learning, across the RBS Group, helps to ensure colleagues have the information necessary to carry out their duties in a way that complies with expected standards.

Operational risk (unaudited)

Definition

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

Operational risk may directly affect customers, lead to financial loss or damage RBS Group'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.

Sources of operational risk

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

Risk governance

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

The 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 Group.

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 Group Policy Framework and provides direction for the consistent identification, assessment, management, monitoring and reporting of operational risk.

Through a network of oversight teams, the function seeks to ensure the integrity of the framework, and manages overall operational risk profile against risk appetite.

The Operational Risk Executive Committee, which is a sub-committee of the Executive Risk Forum, acts on all operational risk matters and approves material operational risk policy management framework changes.

Controls and assurance

The Control Environment Certification process is a self-assessment used to review and assess the internal control framework.

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.

The Group's operational risk appetite is expressed through a set of qualitative risk appetite statements and quantitative measures tailored to the wind down strategy of the Group and ultimately approved by the Supervisory Board.

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 regularly 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.

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.

The RBS Group 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 Group's operational risk management processes, which aim to ensure that risks are identified, considered by senior executives, and managed effectively. The most material operational risks and their position relevant to risk appetite are regularly reviewed.

Risk measurement

The Group uses the basic indicator 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.

Event and loss data management

The operational risk event and loss data management process ensures the RBS Group captures and records operational risk loss events that meet defined criteria. Loss data is used for regulatory and industry reporting.

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

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

Business risk (unaudited)

Definition and sources of risk

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

Governance, management, measurement and mitigation

The Managing Board has ultimate responsibility for business risk.

The Group seeks to minimise its exposure to business risk subject to its wider strategic objectives. Business risk is identified, measured and managed through planning cycles and performance management processes. Expected profiles for revenues and costs are determined on a bottom-up basis, through plans reflecting expectations of the external environment and the Group's strategic priorities. The Managing Board has ultimate responsibility for the impact of any volatility in revenues and costs on the Group's performance.

Reputational risk (unaudited)

Definition and sources of risk

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

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

Governance, management, measurement and mitigation

Reputational risk has RBS Group Board-level oversight reinforced by a Reputational Risk Policy. The Board Risk Committee and Board Sustainable Banking Committee are responsible for overseeing how RBS Group manages its reputation. The RBS Group Board's oversight of reputational issues is supported by the senior RBS Group-wide Reputational Risk Forum 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, also acts as a central forum to review sector or theme-specific reputational risk acceptance positions, including Environmental, Social and Ethical risk positions.

The RBS Group articulated its appetite for reputational risk through the implementation of a qualitative reputational risk appetite statement and framework.

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 Group's reputation continued to originate from historical and more recent conduct issues.

Corporate governance

Corporate governance

Introduction
Corporate governance is conducted on an overall basis within RBSH Group, therefore discussion in relation to RBSH Group is relevant for RBS N.V..

The Group adheres to high standards of corporate governance and its operations are guided by its code of conduct.

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

The Supervisory Board of the Group has prepared its annual report which is included on pages 37 to 39 of this report. The report provides an overview of its activities during 2017.

Corporate governance in the Netherlands
Dutch Corporate Governance Code
As a result of its delisting in 2008, RBS Holdings is no longer required to adhere to the Dutch Corporate Governance Code. The most recent version came into force on 1 January 2017. The Group ensures proper corporate governance by focusing on the Dutch Banking Code (Code Banken) which contains specific corporate governance rules for banks. However the Group adheres where possible with the Dutch Corporate Governance Code.

The Dutch Banking Code (Code Banken)
The updated Code Banken came into force on 1 January 2015. It requires banks to either comply with the Code Banken or explain any deviation from it. The Code Banken is applicable to RBS N.V. as it has a banking licence issued under the Dutch Financial Supervision Act. A further explanation on compliance with the updated Code Banken is provided on page 42 of this report.

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

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

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

Further details of the remuneration policy can be found in the RBS Group's 2017 Annual Report & Accounts, available at www.rbs.com.

Approval of Annual Report
The Managing Board approved the Annual Report at its meeting on 24 April 2018. The Supervisory Board approved the Annual Report at its meeting on 24 April 2018. The Group has proposed to its Shareholders that it adopts the 2017 financial statements, as included in this Annual Report, and discharge the Managing Board and Supervisory Board in respect of their management and supervision respectively.

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

The report of the Supervisory Board

Dear Reader,

It is with great pleasure that I present the 2017 report of the Supervisory Board. This report provides an overview of the tasks and the activities of the Board during 2017.

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

The Supervisory Board had oversight of the execution of this strategy, working together with the Managing Board through both face to face meetings and conference calls. The Supervisory Board challenged the Managing Board on client focus, the timing and speed at which the further derisking is taking place and the work that is taking place to ensure the banking licence is maintained and the entity is made operationally ready. The corporate strategy of the Group has been discussed during all the Supervisory Board meetings in 2017.

On 1 January 2017, Mr John Cummins stepped down as member of the Supervisory Board. He was replaced by Mr Robert Begbie as per 19 April 2017.

On 1 November 2017 Mr Mark Bailie stepped down from the Supervisory Board. He was replaced by Mr Chris Marks as chairman of the Supervisory Board on the same date.

Succession planning for the Managing Board and senior management was another important subject addressed by the Supervisory Board through the execution of the integration activities. On 1 November 2017, Mr Idzard van Eeghen stepped down from the Managing Board and was replaced by Mr Harm Bots.

The tasks of the Supervisory Board

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

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

Members of the Supervisory Board

The Supervisory Board is an independent corporate body. Members of the Supervisory Board are appointed at the General Meeting of Shareholders. For each vacant seat the Supervisory Board nominates one or more candidates. Under the Dutch Corporate Governance Code, which is mandatory for listed companies and which the RBSH Group adheres to where possible, all members of the Supervisory Board must be independent with the exception of not more than one person. RBSH Group has three Supervisory Board members who cannot be considered as independent within the scope of the Dutch Corporate Governance Code and one formal independent member.

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

The Supervisory Board confirms that its current composition has the necessary experience, expertise and independence to ensure that its members are able to properly execute their duties. All appointments were made in accordance with the Supervisory Board profile resulting in the current composition of the board. The Supervisory Board is of the opinion that the addition of a female Supervisory Board member would be beneficial to its functioning and would then align with the RBS Group policy on diversity and inclusion. The Supervisory Board will therefore strive to identify and nominate a female candidate on the company's Supervisory Board if a vacancy should arise.

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

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

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

In case of a (potential) conflict of interest of material significance between a member of the Supervisory Board and RBS Holdings, the Chairman of the Supervisory Board shall be notified. If the Chairman of the Supervisory Board has a (potential) conflict of interest of material significance, the Vice-Chairman is notified. The Supervisory Board member concerned will not take part in the assessment by the Supervisory Board where a conflict of interest exists. During 2017, no conflicts of interest have arisen.

Details of the remuneration of the Supervisory Board can be found in Note 28 on the consolidated accounts.

Activities of the Supervisory Board

Risk and audit topics are discussed on a regular basis and a report with deliberations and findings is prepared for each regular meeting. Specific nomination and remuneration topics are also discussed on a regular basis. The members of the Supervisory Board collectively have sufficient accounting and financial management expertise to understand the Group's business, financial statements and risk profile.

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

The Supervisory Board met on six occasions during 2017, either in person or by telephone conference. On a few occasions, the members were asked to give their approval on matters via email.

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

Throughout 2017, the Supervisory Board received regular updates on the further de-risking of the RBSH Group. The financial performance of the Group was extensively discussed during a number of Supervisory Board meetings, which were attended by members of the Managing Board who presented the results. Also, relevant members discussed the findings of the internal and external auditors.

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

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

Composition of the Supervisory Board

The members of the Supervisory Board as at 24 April 2018 are as follows:

		Date of first appointment	Date for re-election
Chris Marks (Chairman)	(46, British, male)	1 November 2017	1 November 2021
Christopher Campbell (Vice-Chairman)	(59, British, male)	23 June 2011	23 June 2019
Maarten Klessens	(59 Dutch, male)	2 September 2015	2 September 2019
Robert Begbie	(56, British, male)	19 April 2017	19 April 2021

Mark Bailie stepped down from the Supervisory Board on 1 November 2017.

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

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

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

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

Christopher Campbell - Vice-Chairman of the Supervisory Board
Mr Campbell joined the RBS Group in August 2005 as Deputy General Counsel and Director, Group Legal and became Group General Counsel in May 2010, in which role Mr Campbell had overall responsibility for advising the RBS Group Board and Executive Committee and for the provision of legal support to all of RBS Group’s business globally. Mr Campbell retired from his executive role with RBS Group with effect from 31 March 2015 but continues to be associated with the bank as a member of the Supervisory Board of RBS Holdings and RBS N.V. and a Board member for RFS Holdings B.V..

Prior to joining the RBS Group, Mr Campbell was a partner for 18 years in Scotland’s largest law firm, Dundas & Wilson, and was Managing Partner from 1996 until he joined RBS Group.

Robert Begbie
Mr Begbie is the RBS Treasurer and first joined our Treasury function in 2009 after spending 20 years in our Markets business. He has been a key member of the team that has transformed the RBS Group balance sheet since the financial crises.

Mr Begbie has been with the RBS Group for 38 years, having progressed from his first job in his local branch in Musselburgh, Scotland to a career in Financial Markets and Treasury. He became a member of the Supervisory Board of RBS Holdings and RBS N.V. on 19 April 2017.

He holds an MBA from CASS Business School and is a former president of the Chartered Institute of Bankers Scotland (London Branch).

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

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

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

The report of the Managing Board

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

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

The Chairman of the Managing Board leads the Managing Board in its overall management of RBSH Group to achieve its performance goals and ambitions. The Chairman of the Managing Board is the main point of liaison with the Supervisory Board. The Chief Financial Officer is responsible for the financial affairs of RBSH Group. Alongside their overall corporate responsibilities, the members of the Managing Board are responsible for the management of the control and support functions. The Managing Board has delegated certain tasks to a number of Managing Board committees which are described on page 40 of this report.

Composition of the Managing Board
The members of the Managing Board as at 24 April 2017 are as follows:

		Date of first appointment	Date for re-election
Harm Bots (Chairman)	(47, Dutch, male)	1 November 2017	1 November 2022
Cornelis Visscher	(52, Dutch, male)	18 July 2013	18 July 2021

Mr Van Eeghen stepped down from the Managing Board on 1 November 2017.

Harm Bots
Chairman of the Managing Board
Mr Bots joined ABN AMRO in 1999 as a Management Trainee and has been with the RBS Group since 2008, when he joined through the acquisition of ABN AMRO. Currently, Mr Bots is the Head of Strategy for NatWest Markets in the United Kingdom. He was appointed as Director in GBM Strategy in 2010. Prior to that, Mr Bots held several customer facing roles in Transaction Banking, Sales and Relationship Management including developing business and product capability as Transaction Banking Country Head in Malaysia and Japan. Mr Bots was appointed as Chairman of the Managing Board on 1 November 2017.

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

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

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

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

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

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

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

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

Target End State Plan Executive Steering Group (TESP ESG)
In light of the decision to discontinue the Licence Hand Back, the TESP ESG has been disbanded.

Group structure

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

Code of conduct

The RBS Group's Code of Conduct (Our Code) lets everyone know what to expect of each other, what to do when unsure of a decision, and where to go for advice when needed. It is available at rbs.com>about us>our values, or without charge, and upon request, by contacting Company Secretariat at the telephone number listed on page 137. In 2016 we incorporated five new standards of behaviour into Our Code: (1) You must act with integrity; (2) You must act with due skill, care and diligence; (3) You must be open and cooperative with the Financial Conduct Authority (FCA), the Prudential Regulatory Authority (PRA) and other regulators; (4) You must pay due regard to the interests of customers and treat them fairly; and (5) You must observe proper standards of market conduct. These new conduct rules are part of the changes our UK banking regulators, the PRA and FCA, are making to improve accountability across the financial sector as part of the Individual Accountability Regime. The rules themselves are new, but very much in keeping with the values and behaviours that we are already following across RBS Group and the Group.

Relations with shareholders

Rights of shareholders

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

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

Meetings of shareholders and convocation

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

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

Employees

Our colleagues

As at 31 December 2017, the Group employed approximately 20 people (full-time equivalent basis, including temporary workers), within continuing operations. Details of related costs are included in Note 3 on the consolidated accounts.

Rewarding our colleagues

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

Employee consultation

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

Inclusion

Building a more inclusive RBS Group is essential for our customers and colleagues. Our inclusion policy standard applies to all our colleagues globally and includes: the roll out of unconscious bias learning to create a solid platform for the wider inclusion agenda; working towards our goal of having at least 30% senior women in our top three leadership layers across each Franchise and Function by 2020 and to be fully gender balanced (50/50) by 2030; becoming a disability smart organisation by 2018; building an ethnically diverse RBS Group; an LGBT agenda which continues to deliver a better experience for our LGBT colleagues and customers.

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

The Dutch Banking Code (Code Banken)

Introduction

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

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

Corporate Governance codes and the global footprint of RBS Group

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

Compliance with the Code Banken

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

Supervisory Board

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

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

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

All Supervisory Board members have committed themselves to fulfil their responsibilities as board members to the best of their ability. Their attendance at meetings is recorded. The board furthermore operates according to a set of rules governing the Supervisory Board's principles and best practices. These have been agreed by all board members. The remuneration received as Supervisory Board members is not dependent on RBSH Group's results.

A programme covering aspects as stated in the Code Banken is ongoing to accommodate for life long learning of Supervisory Board members and such programme is assessed on an annual basis.

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

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

Managing Board

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

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

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

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

Risk Policy

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

The Managing Board, through its sub committees, the Risk & Control Committee (RCC) and the Asset & Liability Management Committee (ALCo) takes any decision that is of material significance to the risk profile, the capital position or the liquidity impact.

The Supervisory Board reviews and discusses the risk profile of the Group during each of its meetings. This is based on a Risk Appetite statement which it reviews on a regular (i.e. a minimum of once a year) basis. More information on the Risk organisation of the Group can be found on pages 8 to 11 of this report.

Audit

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

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

Remuneration Policy

Set out below is an overview of the RBS N.V. Remuneration policy. RBS N.V. only became an employing entity on 1 December 2017 therefore full disclosure of remuneration of staff will commence in full for the 2018 performance year.

As RBS N.V. is a indirectly owned subsidiary of The Royal Bank of Scotland Group plc (RBSG), its Remuneration Policy is fully aligned to RBS Group's Remuneration Policy Principles with amendments only to comply with Dutch Remuneration Rules, as set down in regulation Book 1 of the FSA. It applies to all workers who work under the responsibility of RBS N.V. and is compliant with CRD IV, UK and Dutch regulatory requirements.

The Group's Remuneration Policy is aligned to the business strategy, objectives, values, risk appetite and long-term interests and in turn that of RBSG and its shareholders. Our chosen performance metrics reflect the aims of delivering sustained performance against our objectives. The policy explicitly aligns remuneration with effective risk management. A range of measures are considered to assess risk performance, specifically the overall Risk profile, Capital, liquidity and funding risk, Credit risk, Market risk, Conduct risk, Operational risk, Business risk and Reputational risk. Consideration is also given to overall Risk culture. The remuneration policy aims to reward workers for delivering good performance provided this is achieved in a manner consistent with our values and within acceptable risk parameters.

The RBS N.V. remuneration policy applies the same principles to all workers who work under the responsibility of RBS N.V., including Material Risk Takers (i.e. those employees who can have a material impact on RBS N.V.'s risk profile as identified at an RBS N.V. subsidiary level in accordance with Commission Delegated Regulation 604/2014).

There is a clear distinction between the criteria for setting basic fixed remuneration and variable remuneration. Fixed pay is set to ensure that it reflects relevant professional experience and organisational responsibility, all considered in the wider context of the business. Performance related remuneration is typically based on a balanced scorecard approach which measures individual and business performance against both financial and non-financial measures with at least 50% of such measures being based on non-financial criteria. The variable remuneration component (annual bonus) is designed to reflect sustainable and risk adjusted performance against financial and strategic measures. Control Functions are assessed independently of the business units they oversee, with the Supervisory Board oversight on their remuneration to ensure independence is maintained.

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

The Group recognises that remuneration structures for the 2017 performance year need to comply with the remuneration requirements of CRD IV, including the cap which limits the maximum ratio of variable to fixed remuneration. The Group is operating within the 20% Bonus Cap under section 1.7 of the FSA including the relevant concessions for employees working within the EEA. RBS N.V. may make payments to, and/or arrangements with, individuals to settle actual or potential claims relating to the termination of their employment. Such payments and arrangements will be based on the potential liability involved and will only be made to the extent RBS N.V. considers appropriate, taking into account the financial soundness and the conduct of the individual. In any event, those individuals whose remit encompasses the day-to-day policy of RBS N.V. are prohibited from receiving a severance payment that is more than 100% of their Fixed Pay on an annual basis.

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

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

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

Different sections of this Annual Report 2017, including capital and risk management on pages 5 to 34, elaborate on the Group's identified risks, such as capital, liquidity and funding risk, credit risk, market risk, conduct risk, operational risk, business risk and reputational risk.

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

Based on its assessment, management has concluded that, as of 31 December 2017, the Group’s internal control over financial reporting is effective.

Managing Board
Amsterdam, 24 April 2018

Management’s report on the Annual Report 2017 for purposes of Section 5:25 sub 2 Financial Supervision Act

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

- the financial statements give a true and fair view, in all material respects, of the assets, liabilities, financial position and loss of the Group and its consolidated entities; and
- the Annual Report gives a true and fair view, in all material respects, of the Group and its consolidated entities as at 31 December 2017 and their state of affairs during 2017; and the Annual Report describes the material risks that the Group is facing.

Managing Board
Amsterdam, 24 April 2018

Financial statements

Consolidated income statement for the year ended 31 December 2017

	Note	2017 €m	2016 €m	2015 €m
Interest receivable		25	51	130
Interest payable		(26)	(121)	(236)
Net interest income	1	(1)	(70)	(106)
Fees and commissions receivable		19	7	6
Fees and commissions payable		(2)	(2)	(9)
Income from trading activities		(156)	92	8
Foreign exchange gains and losses related to net investment hedges reclassified to income following disposals of foreign operations [1]		(163)	(7)	(2)
Other operating income		242	30	264
Non-interest income	2	(60)	120	267
Total income		(61)	50	161
Staff costs		(5)	(13)	(42)
Premises and equipment		(1)	5	(4)
Other administrative expenses		(51)	41	(92)
Operating expenses	3	(57)	33	(138)
(Loss)/profit before impairment releases/(losses)		(118)	83	23
Impairment releases/(losses)	10	3	9	(105)
Operating (loss)/profit before tax		(115)	92	(82)
Tax credit/(charge)	5	24	(36)	30
(Loss)/profit from continuing operations		(91)	56	(52)
(Loss)/profit from discontinued operations, net of tax	14	(1)	(33)	46
(Loss)/profit for the year		(92)	23	(6)
Attributable to:				
Controlling interests [2]		(92)	23	(6)

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

Consolidated statement of comprehensive income for the year ended 31 December 2017

	2017 €m	2016 €m	2015 €m
(Loss)/profit for the year	(92)	23	(6)
Items that do not qualify for reclassification			
Actuarial (losses)/gains on defined benefit plans	—	(9)	2
Loss on fair value of credit in financial liabilities designated at fair value through profit or loss due to own credit risk	(65)	—	—
	(65)	(9)	2
Items that do qualify for reclassification			
Available-for-sale financial assets	4	2	54
Cash flow hedges	1	—	2
Currency translation	78	20	80
Tax	—	1	—
	83	23	136
Other comprehensive income after tax	18	14	138
Total comprehensive (loss)/income for the year	(74)	37	132
Attributable to:			
Controlling interests	(74)	37	132

The accompanying notes on pages 59 to 88, the accounting policies on pages 50 to 58 and the audited sections of the Financial review: Capital and risk management on pages 5 to 34 form an integral part of these financial statements.

Consolidated balance sheet as at 31 December 2017

	Note	2017 €m	2016 €m
Assets			
Cash and balances at central banks	7	68	368
Loans and advances to banks	7	2,998	3,195
Loans and advances to customers	7	93	188
Amounts due from the ultimate holding company	7	125	142
Debt securities and equity shares	7	514	517
Settlement balances		4	10
Derivatives	11	761	1,581
Deferred tax	16	—	1
Interests in associates	12	1,214	1,266
Prepayments, accrued income and other assets	13	299	252
Assets of disposal groups	14	—	810
Total assets		6,076	8,330
Liabilities			
Deposits by banks	7	1,132	1,400
Customer accounts	7	64	230
Debt securities in issue	7	27	55
Settlement balances		13	48
Derivatives	11	549	1,244
Provisions, accruals and other liabilities	15	392	629
Deferred tax	16	22	22
Subordinated liabilities	17	993	1,438
Liabilities of disposal groups	14	—	219
Total liabilities		3,192	5,285
Total equity		2,884	3,045
Total liabilities and equity		6,076	8,330

The accompanying notes on pages 59 to 88, the accounting policies on pages 50 to 58 and the audited sections of the Financial review: Capital and risk management on pages 5 to 34 form an integral part of these financial statements.

Consolidated statement of changes in equity for the year ended 31 December 2017

	2017 €m	2016 €m	2015 €m
Share capital and share premium account (1)			
At 1 January	7,092	7,743	7,686
Capital injection (2)	—	—	57
Distribution (3)	(68)	(651)	—
At 31 December	7,024	7,092	7,743
Available-for-sale reserve			
At 1 January	—	(3)	(58)
Unrealised gains/(losses)	3	(2)	(10)
Realised losses	1	4	64
Tax	—	1	1
At 31 December	4	—	(3)
Cash flow hedging reserve			
At 1 January	(1)	(1)	(2)
Amount recognised in equity	1	—	2
Tax	—	—	(1)
At 31 December	—	(1)	(1)
Foreign exchange reserve			
At 1 January	(120)	(140)	(220)
(Losses)/gains arising during the year	(85)	13	78
Reclassification of foreign currency losses included in the income statement	163	7	2
At 31 December	(42)	(120)	(140)
Retained earnings	.		
At 1 January	(3,926)	(3,940)	(3,936)
(Loss)/profit attributable to controlling interests			
- continuing operations	(91)	56	(52)
- discontinued operations	(1)	(33)	46
Actuarial (losses)/gains	—	(9)	2
Changes in fair value of credit in financial liabilities designated at fair value through profit or loss	(65)	—	—
Disposal of business	3	—	—
Distribution (4)	(22)	—	—
At 31 December	(4,102)	(3,926)	(3,940)
Equity attributable to controlling interests	2,884	3,045	3,659

Notes:
(1) Includes Ordinary share capital of €50,000 (2016 - €50,000; 2015 - €50,000) – see Note 18 of the Notes on the consolidated accounts for further details
(2) Capital injection of €57 million in 2015 from RBS Holdings N.V. reflecting amounts received by RBS Holdings N.V. from RFS Holdings B.V..
(3) 2017 includes N-share capital repatriation and reallocation of €68 million. 2016 includes distribution of €596 million to RBS Holdings N.V. and €54 million to Santander.
(4) 2017 includes N-share capital repatriation and reallocation of €22 million.

The accompanying notes on pages 59 to 88, the accounting policies on pages 50 to 58 and the audited sections of the Financial review: Capital and risk management on pages 5 to 34 form an integral part of these financial statements.

Consolidated cash flow statement for the year ended 31 December 2017

	Note	2017 €m	2016 €m	2015 €m
Operating activities				
Operating (loss)/profit before tax from continuing operations		(115)	92	(82)
(Loss)/profit before tax from discontinued operations		(1)	(29)	73
Adjustments for:				
Interest on subordinated liabilities		24	106	204
Elimination of foreign exchange differences		232	(48)	302
Impairment losses on debt securities		—	2	126
Other non-cash items		(437)	(194)	(217)
Changes in operating assets and liabilities	23	(182)	2,820	(2,199)
Net cash flows from operating activities before tax		(479)	2,749	(1,793)
Income taxes paid		(44)	(56)	(16)
Net cash flows from operating activities		(523)	2,693	(1,809)
Investing activities				
Sale and maturity of securities		296	345	1,819
Purchase of securities		(202)	(70)	(232)
Net divestment of/(investment in) business interests		372	43	458
Net cash flows from investing activities		466	318	2,045
Financing activities				
Capital injection		—	—	57
Redemption of subordinated liabilities		(378)	(2,988)	(1,069)
Distribution		(90)	(651)	—
Interest on subordinated liabilities		(19)	(108)	(235)
Net cash flows from financing activities	25	(487)	(3,747)	(1,247)
Effects of exchange rate changes on cash and cash equivalents		(50)	(9)	60
Net decrease in cash and cash equivalents		(594)	(745)	(951)
Cash and cash equivalents at 1 January		1,016	1,761	2,712
Cash and cash equivalents at 31 December	26	422	1,016	1,761

The accompanying notes on pages 59 to 88, the accounting policies on pages 50 to 58 and the audited sections of the Financial review: Capital and risk management on pages 5 to 34 form an integral part of these financial statements.

Accounting policies

1. Corporate information

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

The company is wholly owned by RFS Holdings B.V., itself 97.7% owned by The Royal Bank of Scotland Group plc (RBSG). RBSG is incorporated in the UK and registered at 36 St. Andrew Square, Edinburgh, Scotland. RBSG is the ultimate parent company of RBS Holdings N.V.. The consolidated financial statements of RBS Holdings N.V. are included in the consolidated financial statements of RBS Group.

The consolidated financial statements of the Group incorporate financial information of the bank, its controlled entities and interests in associates and joint ventures, and are included in the consolidated financial statements of RBS Holdings N.V.. The consolidated financial statements were signed and authorised for issue by the Managing Board on 24 April 2018 and by the Supervisory Board on 24 April 2018. The right to request an amendment of the financial statements is embedded in the Netherlands Civil Code. Interested parties have the right to ask the Enterprise Chamber of the Amsterdam Court of Appeal for an amendment of the financial statements

2. Presentation of accounts

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

The Managing Board, having made such enquiries as they considered appropriate, including: a review of the Group's activity; the plan to repurpose the banking licence in the Netherlands for EU passporting; and forecasts, projections and other relevant evidence regarding the continuing availability of sufficient resources from the RBS Group; have prepared the financial statements on a going concern basis.

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and interpretations as issued by the IFRS Interpretations Committee (IFRIC) of the IASB and IFRS as adopted by the European Union (EU) (together IFRS). 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 and has adopted IAS 39 as issued by the IASB: the Group's financial statements are prepared in accordance with IFRS as issued by the IASB.

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

- In January 2016, the IASB amended IAS 7 'Cash Flow Statements' to require disclosure of the movements in financing liabilities.
- In January 2016, the IASB amended IAS 12 'Income taxes' to clarify the recognition of deferred tax assets in respect of unrealised losses.

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

The accounts are prepared on a historical cost basis of measurement except for certain financial instruments that are measured at fair value as described in Accounting Policies 11, 13 and 20.

3. 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.

4. 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 a significant fee type is outlined below.

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.

Accounting policies

5. Assets held for sale and discontinued operations

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

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

The results of discontinued operations - comprising the post-tax profit or loss of discontinued operations and the post-tax gain or loss recognised either on measurement to fair value less costs to sell or on disposal of the discontinued operation - are shown as a single amount on the face of the income statement: an analysis of this amount is presented in Note 14 on the accounts.

A discontinued operation is a cash generating unit or a group of cash generating units that either has been disposed of, or is classified as held for sale, and (a) represents a separate major line of business or geographical area of operations, (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or (c) is a subsidiary acquired exclusively with a view to resale.

6. Employee benefits

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

7. Foreign currencies

The Group's consolidated financial statements are presented in euros 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 20).

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

8. Leases

As lessor

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

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

As lessee

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

9. Provisions

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

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

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

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

10. Tax

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

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

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that they will be recovered.

Deferred tax is not recognised on temporary differences that arise from initial recognition of an asset or a liability in a transaction (other than a business combination) that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is calculated using tax rates expected to apply in the periods when the assets will be realised or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, at the balance sheet date.

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

11. Financial 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 4) less any impairment losses.

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 4) 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 4), 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 20). 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 8 on the accounts.

12. 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 portfolio 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.

Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant.

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-offs will be prompted by bankruptcy, insolvency, renegotiation and similar events. The Group had no collectively assessed portfolios in 2017 or 2016.

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 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.

13. 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. Income from trading activities includes gains and losses on held-for-trading financial liabilities 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. Gains and losses are recognised in profit or loss 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 4).

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 8 on the accounts.

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

15. 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.

16. 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.

17. 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.

18. 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.

19. 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.

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

20. 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 8 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.

21. 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. Investments are assessed for impairment at each reporting date and an investment is tested if there is an indication that it may be impaired.

22. 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.

Accounting policies

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. Dutch company law and IFRS require the management, 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 ‘Framework for the Preparation and Presentation of Financial Statements’. The judgements and assumptions involved in the Group's accounting policies that are considered by management 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) Provisions for liabilities

As set out in Note 15, at 31 December 2017, the Group recognised provisions for liabilities in respect of litigation, €13 million (2016 - €25 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.

Provisions for litigation - the Group is party to legal proceedings in the Netherlands, 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 22.

(ii) 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 12.

At 31 December 2017, customer loan impairment provisions amounted to €37 million (2016 - €41 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 latent.

Individual component - all impaired loans that exceed specific thresholds are individually assessed for impairment. Individually assessed loans principally comprise the Group's portfolio of commercial loans to medium and large businesses. Impairment losses are recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held. These estimates take into account the customer's debt capacity and financial flexibility; the level and quality of its earnings; the amount and sources of cash flows; the industry in which the counterparty operates; and the realisable value of any security held.

Estimating the quantum and timing of future recoveries involves significant judgement. The size of receipts will depend on the future performance of the borrower and the value of security, both of which will be affected by future economic conditions; additionally, collateral may not be readily marketable. The actual amount of future cash flows and the date they are received may differ from these estimates and consequently actual losses incurred may differ from those recognised in these financial statements.

Latent component - latent loss provisions are held against estimated impairment losses in the performing portfolio that have yet to be identified as at the balance sheet date. To assess the latent loss within its portfolios, the Group has developed methodologies to estimate the time that an asset can remain impaired within a performing portfolio before it is identified and reported as such.

(iii) Fair value – financial instruments

In accordance with Accounting policies 11, 13 and 20, 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 8 on the accounts.

Accounting developments

International Financial Reporting Standards (IFRS)

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

Effective 1 January 2018 - IFRS 9

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

Recognition and derecognition

The material in IAS 39 setting out the criteria for the recognition and derecognition of financial instruments 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 measurement basis of the majority of the Group's financial assets will be unchanged on application of IFRS 9.

Financial liabilities –Since early adopting in 2017, the IFRS 9 accounting for fair value attributable to own credit risk there are no further material changes on accounting for financial liabilities on adoption of IFRS 9.

Hedge accounting

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

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.

Accounting policies

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

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

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 accounts prior to 2018.

In summary, there is no impact on classification and measurement, and expected credit loss is not deemed to be material, in either the Group or the Company.

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

Effective 1 January 2018 – other standards

IFRS 15 'Revenue from Contracts with Customers' was issued in May 2014. It will replace IAS 11 'Construction Contracts', IAS 18 'Revenue' and several Interpretations.

Contracts are bundled or unbundled into distinct performance obligations with revenue recognised as the obligations are met. A restatement is not expected on initial application of this standard.

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

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

On adoption, none of these standards are expected to have a material effect on the Group's results.

Effective after 2018

IFRS 16 'Leases' was issued in January 2016 to replace IAS 17 'Leases'. There are no substantial changes to the accounting for leases by lessors nor for finance leases; 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 that exist. The effective date is 1 January 2019.

The RBS Group is currently working on the implementation of the new requirements and currently anticipates that the property lease portfolio will have the most significant implementation impact as property represents 87% of the operating lease commitments of the RBS Group. A preliminary estimate (excluding the impacts of tax) of the opening balance sheet adjustment as a result of the RBS Group's property portfolio using a modified retrospective approach to transition would be to create a Right of Use asset of approximately £1.4 billion, also impacting RWAs and an estimated decrease (excluding the impacts of tax) in retaining earnings of approximately £0.3 billion. As permitted by the standard, the RBS Group intends to apply IFRS 16 on a retrospective basis but to take advantage of the option not to restate.

The RBS Group will continue to work on the implementation throughout 2018 and therefore this estimate of the impact is subject to change. Changes could arise from the addition of non property leases, further development of calibration of models and processes, methodology and approach refinement, and sensitivity analysis performed on key assumptions such as discount factors and lease term.

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

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

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

In February 2018 the IASB amended IAS 'Employee Benefits' to clarify the need to update assumptions whenever there is a plan amendment, curtailment or settlement during the reporting period. The effective date is 1 January 2019.

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

1 Net interest income

	2017 €m	2016 €m	2015 €m
Loans and advances to customers	4	11	75
Loans and advances to banks	5	22	34
Amounts due from ultimate holding company	11	11	11
Debt securities	5	7	10
Interest receivable (1)	25	51	130
Customer accounts	1	4	13
Balances with banks	1	12	11
Debt securities in issue	—	—	8
Subordinated liabilities	24	106	204
Internal funding of trading businesses	—	(1)	—
Interest payable (1)	26	121	236
Net interest income	(1)	(70)	(106)

Note:
(1) Negative interest on loans and advances is classified as interest payable.

2 Non-interest income

	2017 €m	2016 €m	2015 €m
Lending (credit facilities), trade finance and payment services	—	1	6
Brokerage and other	19	6	—
Fees and commissions receivable	19	7	6
Fees and commissions payable	(2)	(2)	(9)
Foreign exchange	(69)	(75)	(54)
Interest rate	(80)	152	1
Credit	(9)	—	7
Equities and other	2	15	54
Income from trading activities	(156)	92	8
Foreign exchange gains and losses related to net investment hedges reclassified to income following disposals of foreign operations (1)	(163)	(7)	(2)
Changes in the fair value of own debt designated as at fair value through profit or loss attributable to own credit net of the effect of economic hedges (2)	—	(6)	(33)
Changes in the fair value of financial assets designated at fair value through profit or loss	70	3	162
Loss on sale of securities	(1)	(7)	(49)
Profit/(loss) on sale of subsidiaries and associates	4	(1)	79
Share of profits of associated entities	101	54	155
Other income	68	(13)	(50)
Other operating income	242	30	264
Non-interest income	(60)	120	267

Notes:
(1) Foreign exchange losses of €163 million (2016 - €7 million; 2015 - €2 million) following the repatriation of the proceeds from the disposal of foreign operations, representing the cumulative exchange movement recorded in equity during the lifetime of those foreign operations that were the subject of a net investment hedge.
(2) Measured as the change in fair value from movements in the year in the credit risk premium payable by the Group. Ahead of adopting IFRS 9 Financial Instruments from 1 January 2018, the Group has adopted the provisions in respect of the presentation of gains and losses on financial liabilities designated as at fair value through profit or loss from 1 January 2017.

3 Operating expenses

	2017 €m	2016 €m	2015 €m
Wages, salaries and other staff costs	—	7	15
Social security costs	—	1	2
Restructuring costs	5	5	25
Staff costs	5	13	42
Premises and equipment	1	(5)	4
Other administrative expenses	51	(41)	92
Operating expenses	57	(33)	138

There were 20 people employed (full time equivalent rounded to the nearest ten) in continuing operations at 31 December 2017 (2016 - 30; 2015 - 200); on the same basis there were no people employed in discontinued operations (2016 - 210; 2015 - 650). The average number of persons employed in continuing operations during the year was 20 (2016 - 120; 2015 - 310) and in discontinued operations was 40 (2016 - 430; 2015 - 980).

4 Auditor’s remuneration

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

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

Ernst & Young LLP	2017 €m	2016 €m
Fees for the audit of the Group's annual accounts	1.5	1.8
Audit related services (1)	0.7	0.7
Total audit and audit-related services	2.2	2.5
Total	2.2	2.5

Note:
(1) Includes fees of €0.75 million for 2017 in respect of regulatory audits (2016 - €0.70 million).

EY Accountants B.V. provided audit and audit-related services amounting to €0.75 million (2016 - €0.70 million). The amount paid to Ernst & Young LLP (EY LLP) in 2017 in respect of audit fees was €1.30 million (2016 - €1.30 million). The remaining amounts relate to services provided by other EY Member Firms.

5 Tax

	2017 €m	2016 €m	2015 €m
Current tax			
Charge for the year	17	(66)	(12)
Over/(under) provision in respect of prior periods	9	(7)	17
	26	(73)	5
Deferred tax			
(Charge)/credit for the year	(2)	37	24
Over provision in respect of prior periods	—	—	1
Tax credit/(charge) for the year	24	(36)	30

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

	2017 €m	2016 €m	2015 €m
Expected tax credit/(charge)	29	(23)	20
Non-deductible items	—	—	(2)
Non-taxable items (including recycling of foreign exchange reserve)	6	36	73
Foreign profits taxed at other rates	4	2	14
Losses in year not recognised	(24)	(40)	(158)
Losses brought forward and utilised	8	2	27
Reduction/(increase) in carrying value of deferred tax liability in respect of associates	—	37	38
Adjustments in respect of prior years (1)	9	(7)	18
Other	(8)	(43)	—
Actual tax credit/(charge)	24	(36)	30

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

6 Dividends

In 2017 RBS N.V. made a distribution of €90 million (2016 - €651 million; 2015 - nil).

7 Financial instruments - classification

The following tables analyse the Group's 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.

	Held-for-trading €m	Designated as at fair value through profit or loss €m	Available-for-sale €m	Loans and receivables €m	Other assets €m	Total €m
Assets						
Cash and balances at central banks	—	—	—	68		68
Loans and advances to banks (1,4)	3	—	—	2,995		2,998
Loans and advances to customers (4)	10	—	—	83		93
Amounts due from ultimate holding company	—	—	—	125		125
Debt securities and equity shares	5	95	414	—		514
Settlement balances	—	—	—	4		4
Derivatives (4)	761					761
Other assets	—	—	—	—	1,513	1,513
31 December 2017	779	95	414	3,275	1,513	6,076
Cash and balances at central banks	—	—	—	368		368
Loans and advances to banks (1,4)	67	—	—	3,128		3,195
Loans and advances to customers (4)	4	—	—	184		188
Amounts due from ultimate holding company	—	—	—	142		142
Debt securities and equity shares	48	90	379	—		517
Settlement balances	—	—	—	10		10
Derivatives (4)	1,581					1,581
Assets of disposal groups					810	810
Other assets	—	—	—	—	1,519	1,519
31 December 2016	1,700	90	379	3,832	2,329	8,330

	Held-for-trading €m	Designated as at fair value through profit or loss €m	Amortised cost €m	Other liabilities €m	Total €m
Liabilities					
Deposits by banks (4)	7	—	1,125		1,132
Customer accounts	6	—	58		64
Debt securities in issue (2)	—	27	—		27
Settlement balances	—	—	13		13
Derivatives (4)	549				549
Subordinated liabilities	—	592	401		993
Other liabilities	—	—	—	414	414
31 December 2017	562	619	1,597	414	3,192
Deposits by banks (4)	127	—	1,273		1,400
Customer accounts	169	—	61		230
Debt securities in issue (2,3)	—	55	—		55
Settlement balances	—	—	48		48
Derivatives (4)	1,244				1,244
Subordinated liabilities	—	668	770		1,438
Liabilities of disposal groups				219	219
Other liabilities	—	—	—	651	651
31 December 2016	1,540	723	2,152	870	5,285

Notes:
(1) Includes reverse repurchase agreements of €899 million (2016 - €949 million).
(2) Bonds and medium term notes.
(3) No change has been recognised in profit or loss for changes in credit risk associated with debt securities in issue designated as at fair value through profit or loss measured as the change in fair value from movements in the period in the credit risk premium payable by the Group (2016 - nil).
(4) Includes the following intergroup balances:
- Loans and advances to banks of €2,643 million (2016 - €2,547 million).
- Loans and advances to customers of €3 million (2016 - €81 million).
- Derivative assets of €489 million (2016 - €969 million).
- Bank deposits of €1,073 million (2016 - €1,313 million).
- Derivative liabilities of €360 million (2016 - €1,164 million).

7 Financial instruments – classification continued

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

	2017 €m	2016 €m	2015 €m
(Losses)/gains on financial assets/liabilities designated as at fair value through profit or loss	(68)	(4)	125
Losses on disposal or settlement of loans and receivables	(1)	(8)	(2)

There were no amounts included in loss from discontinued operations, net of tax (2016 - €23 million, 2015 - €13 million) in relation to gains on financial assets/liabilities as at fair value through profit or loss.

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

	Offsetable instruments			Offsetable potential not recognised by IFRS				
2017	Gross €m	IFRS offset €m	Balance sheet €m	Effect of master netting and similar agreements €m	Financial collateral €m	Net amount after the effect of netting arrangements and related collateral €m	Amounts not subject to netting €m	Balance sheet total €m
Financial assets								
Derivatives	697	—	697	(74)	(4)	619	64	761
Loans and advances to customers	394	(394)	—	—	—	—	93	93
	1,091	(394)	697	(74)	(4)	619	157	854
Financial liabilities								
Derivatives	496	—	496	(74)	(4)	418	53	549
Customer accounts	394	(394)	—	—	—	—	64	64
	890	(394)	496	(74)	(4)	418	117	613
2016								
Financial assets								
Derivatives	1,440	—	1,440	(501)	(49)	890	141	1,581
Loans and advance to customers	497	(497)	—	—	—	—	188	188
	1,937	(497)	1,440	(501)	(49)	890	329	1,769
Financial liabilities								
Derivatives	1,105	—	1,105	(501)	(5)	599	139	1,244
Customer accounts	497	(497)	—	—	—	—	230	230
	1,602	(497)	1,105	(501)	(5)	599	369	1,474

8 Financial instruments - valuation

Valuation of financial instruments carried at fair value

Control environment

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

The Group's control environment for the determination of the fair value of financial instruments includes formalised protocols for the review and validation of fair values independent of the businesses entering into the transactions. There are specific controls to ensure consistent pricing policies and procedures, incorporating disciplined price verification. The Group ensures that appropriate attention is given to 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 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 all fair value positions. 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 Group Pricing Model Risk team. The Valuation Committee is made up of valuation specialists and senior business representatives from various functions and oversees 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 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

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

Non-modelled products

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

Modelled products

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

Inputs to valuation models

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

- Bond prices - quoted prices are generally available for government bonds, certain corporate securities and some mortgage-related products.
- 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 rate (OIS) and other quoted interest rates in the swap, bond and futures markets.

8 Financial instruments – valuation continued

- Foreign currency exchange rates - there are observable markets 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, the Group considers the value of the prepayment option.
- Recovery rates/loss given default - these are used as an input to valuation models and reserves for asset-backed securities and other credit products as an indicator of severity of losses on default. Recovery rates are primarily sourced from market data providers or inferred from observable credit spreads.

Consensus pricing

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

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

Furthermore, on an ongoing basis, the Group 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, the Group makes adjustments to the model valuation to calibrate to other available pricing sources.

Where unobservable inputs are used, the Group may determine a range of possible valuations derived from differing stress scenarios to determine the sensitivity associated with the valuation.

When establishing the fair value of a financial instrument using a valuation technique, the Group considers certain 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. Total valuation reserves for the Group at 31 December 2017 were €219 million (2016 - €72 million) with the increase during the year driven by an increase in the level of adjustments held in relation to indemnified subordinated receivables arising from swaps facing securitisation SPVs where the payments are considered to be at risk, together with an increase in the expected funding costs arising from the potential future requirement to post collateral in relation to an intermediation trade.

Credit valuation adjustments (CVA)

CVA represents an estimate of the adjustment to fair value that a market participant would make to incorporate the risk inherent in counterparty derivative exposures. The CVA component of the valuation reserves at 31 December 2017 was €3 million (2016 - €21 million).

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

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

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

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

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.

Financial instruments – valuation continued
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.

Reserves are held to the extent that the discount rates applied do not reflect all of the terms of the collateral agreements.

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.

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

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 the Group's derivative financial liabilities is also adjusted to reflect the Group'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 calculation of CVA. Expected gains are determined from market implied probabilities of default and recovery levels. Funding valuation adjustments (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 for fair value does not alter cash flows, is not used for performance management, is disregarded for regulatory capital reporting processes and will reverse over time as the liabilities mature.

The cumulative own credit adjustments on own liabilities are set out below.

Cumulative own credit adjustment - decrease in liability	Debt securities in issue and subordinated liabilities (1) €m	Derivatives €m	Total €m
2017	(107)	—	(107)
2016	(176)	(8)	(184)

Book values of underlying liabilities	€bn
2017	0.6
2016	0.7

Note:
(1) Includes wholesale and retail note issuances.

8 Financial instruments: carried at fair value - valuation hierarchy

The following tables show financial instruments carried at fair value on the balance sheet by valuation hierarchy - level 1, level 2 and level 3, and related level 3 sensitivities.

				Level 3 sensitivity (2)	
2017	Level 2 €bn	Level 3 €bn	Total €bn	Favourable €m	Unfavourable €m
Assets					
Debt securities and equity shares	0.5	—	0.5	—	—
Derivatives	0.8	—	0.8	—	—
	1.3	—	1.3	—	—
Proportion	100%	—	100%		
Liabilities					
Derivatives	0.5	0.1	0.6	21	(54)
Subordinated liabilities	0.6	—	0.6	—	—
	1.1	0.1	1.2	21	(54)
Proportion	91.7%	8.3%	100%		

				Level 3 sensitivity (2)	
2016	Level 2 €bn	Level 3 €bn	Total €bn	Favourable €m	Unfavourable €m
Assets					
Loans and advances	0.1	—	0.1	—	—
Debt securities and equity shares	0.4	0.1	0.5	8	(9)
Derivatives	1.3	0.3	1.6	26	(25)
	1.8	0.4	2.2	34	(34)
Proportion	81.8%	18.2%	100%		
Liabilities					
Deposits	0.2	0.1	0.3	10	(10)
Debt securities in issue	0.1	—	0.1	—	—
Derivatives	0.9	0.3	1.2	35	(34)
Subordinated liabilities	0.7	—	0.7	—	—
	1.9	0.4	2.3	45	(44)
Proportion	82.6%	17.4%	100%		

Notes:

(1) 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 3: instruments in this category have been valued using a valuation technique where at least one input which could have a significant effect on the instrument's valuation, is not based on observable market data. Where inputs can be observed from market data without undue cost and effort, the observed input is used. Otherwise, the Group determines a reasonable level for the input.

(2) 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 to the Group's valuation techniques or models. Totals for sensitivities are not indicative of the total potential effect on the income statement or the statement of comprehensive income. The level 3 sensitivities above 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 overall potential uncertainty on the whole portfolio. 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 observed. 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.

(3) Transfers between levels are deemed to have occurred at the beginning of the quarter in which the instruments were transferred. There were no transfers between level 1 and level 2.

(4) The Group does not have any material liabilities measured at fair value that are issued with an inseparable third party credit enhancement.

(5) Level 3 instruments were nil for assets and €0.1 billion for liabilities (2016 - €0.4 billion for assets and €0.4 billion for liabilities). The decrease during the year in assets relates to transfers out €0.2 billion, income statement €0.1 billion, sales €0.1 billion and decrease in liabilities primarily relates to transfers out of €0.3 billion, income statement €0.1 billion (2016 - The decrease during the year in assets primarily related to transfers in €0.5 billion which is offset by transfers out €0.2 billion, settlements €0.3 billion and sales €0.1 billion, income statement €0.1 billion and decrease in liabilities primarily relates to transfers in of €0.3 billion offset by transfers out of €0.1 billion, settlements €0.2 billion, income statement €0.2 billion and sales €0.1 billion).

The amount of the total gains or losses included in profit or loss that is attributable to the change in unrealised gains or losses relating to those assets and liabilities held at the end of the reporting period was not material for any period presented.

(6) For an analysis of derivatives by type of contract – see Note 11.

8 Financial instruments – valuation continued

Areas of judgement

Whilst the business has simplified, the diverse range of products historically traded by the Group results in a 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 judgement is required. The majority of the Group'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 judgement is required. However, when the information regarding the liquidity in a particular market is not clear, a judgement 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 can be 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 instrument will be considered to be 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 the Group's model.

The decision to classify a modelled asset 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 need to be assessed to classify the asset.

If an input fails the observability or quality tests then the instrument is considered to be in Level 3 unless the input can be shown to have an insignificant effect on the overall valuation of the product.

The majority of derivative instruments, for example, vanilla interest rate swaps, foreign exchange swaps and liquid single name credit derivatives are classified as Level 2 as they are vanilla products valued using observable inputs. The valuation uncertainty on these is considered to be low and both input and output testing may be available.

Non-modelled products

Non-modelled products are generally quoted on a price basis and can therefore be considered for each of the three levels. This is determined by the market activity liquidity and valuation uncertainty of the instruments which is in turn measured from the availability of independent data used by the IPV process to allocate positions to IPV quality levels.

The availability and quality of independent pricing information is 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 is 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.

8 Financial instruments: level 3 portfolios and sensitivity methodologies

Reasonably possible 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.

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.

				Fair value hierarchy level	
2017	Items where fair value approximates carrying value €m	Carrying value €m	Fair value €m	Level 2 €m	Level 3 €m
Financial assets					
Cash and balances at central banks	68				
Loans and advances to banks		2,995	2,994	948	2,046
Loans and advances to customers		83	48	3	45
Amount due from ultimate holding company		125	192	192	—
Settlement balances	4				
Financial liabilities					
Deposits by banks	430	695	695	—	695
Customer accounts	3	55	64	18	46
Settlement balances	13				
Subordinated liabilities		401	466	466	—
2016					
Financial assets					
Cash and balances at central banks	368				
Loans and advances to banks		3,128	3,128	1,068	2,060
Loans and advances to customers		184	139	36	103
Amount due from ultimate holding company		142	156	156	—
Settlement balances	10				
Financial liabilities					
Deposits by banks	326	947	947	492	455
Customer accounts	6	55	61	13	48
Settlement balances	48				
Subordinated liabilities		770	781	781	—

8 Financial instruments: fair value instruments not carried at fair value 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, demand deposits and notes in circulation, fair value approximates to carrying value.

Loans and advances to banks and customers

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

(a) Contractual cash flows are discounted using a market discount rate that incorporates the current spread for the borrower or where this is not observable, the spread for borrowers of a similar credit standing. This method is used for the majority of portfolios where most counterparties have external ratings.

(b) Expected cash flows (unadjusted for credit losses) are discounted at the current offer rate for the same or similar products. This approach is adopted for lending portfolios in order to reflect the homogeneous nature of these portfolios.

Debt securities

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

Fair values are determined using discounted cash flow valuation techniques.

Deposits by banks and customer accounts

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

Debt securities in issue and subordinated liabilities

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

9 Financial instruments - maturity analysis

Remaining maturity

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

	2017			2016		
	Less than 12 months €m	More than 12 months €m	Total €m	Less than 12 months €m	More than 12 months €m	Total €m
Assets						
Cash and balances at central banks	68	—	68	368	—	368
Loans and advances to banks	2,998	—	2,998	3,127	68	3,195
Loans and advances to customers	2	91	93	52	136	188
Amounts due from ultimate holding company	—	125	125	—	142	142
Debt securities and equity shares	104	410	514	154	363	517
Settlement balances	4	—	4	10	—	10
Derivatives	39	722	761	132	1,449	1,581
Liabilities						
Deposits by banks	1,116	16	1,132	1,388	12	1,400
Customer accounts	11	53	64	170	60	230
Debt securities in issue	25	2	27	14	41	55
Settlement balances and short positions	13	—	13	48	—	48
Derivatives	9	540	549	195	1,049	1,244
Subordinated liabilities	172	821	993	6	1,432	1,438

9 Financial instruments - maturity analysis continued

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 on-balance sheet assets 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 the Group. Financial liabilities are included at the earliest date on which the counterparty can require repayment, regardless of whether or not such early repayment results in a penalty.

If the repayment of a financial 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 the Group, depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date. As the 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 and liabilities - held-for-trading assets of €0.8 billion (2016 - €1.7 billion) and liabilities of €0.6 billion (2016 - €1.5 billion) have been excluded from the tables below.

2017	0 - 3 months €m	3 - 12 months €m	1 - 3 years €m	3 - 5 years €m	5 - 10 years €m	10 - 20 years €m
Assets by contractual maturity						
Cash and balances at central banks	68	—	—	—	—	—
Loans and advances to banks	2,994	—	—	—	—	—
Amounts due from ultimate holding company	—	10	20	20	50	100
Securities	44	61	91	95	132	—
Settlement balances	4	—	—	—	—	—
Total maturing assets	3,110	71	111	115	182	100
Loans and advances to customers	17	7	24	10	54	—
Derivatives held for hedging	4	3	—	—	—	—
	3,131	81	135	125	236	100
Liabilities by contractual maturity						
Deposits by banks	781	327	13	3	—	—
Debt securities in issue	25	—	2	—	—	—
Subordinated liabilities	4	43	463	84	280	281
Settlement balances and other liabilities	13	—	—	—	—	—
Total maturing liabilities	823	370	478	87	280	281
Customer accounts	3	1	57	1	3	6
Derivatives held for hedging	4	1	—	—	—	—
	830	372	535	88	283	287
Maturity gap	2,287	(299)	(367)	28	(98)	(181)
Cumulative maturity gap	2,287	1,988	1,621	1,649	1,551	1,370

9 Financial instruments - maturity analysis continued

2016	0 - 3 months €m	3 - 12 months €m	1 - 3 years €m	3 - 5 years €m	5 - 10 years €m	10 - 20 years €m
Assets by contractual maturity						
Cash and balances at central banks	368	—	—	—	—	—
Loans and advances to banks	3,059	—	33	35	—	—
Amounts due from ultimate holding company	—	11	23	23	57	114
Securities	111	42	111	46	68	—
Settlement balances	10	—	—	—	—	—
Total maturing assets	3,548	53	167	104	125	114
Loans and advances to customers	46	1	75	—	60	—
Derivatives held for hedging	5	16	6	—	—	—
	3,599	70	248	104	185	114
Liabilities by contractual maturity						
Deposits by banks	936	325	12	1	—	—
Debt securities in issue	1	13	27	5	9	—
Subordinated liabilities	2	58	905	67	232	202
Settlement balances and other liabilities	44	—	—	—	—	—
Total maturing liabilities	983	396	944	73	241	202
Customer accounts	6	1	5	49	3	6
Derivatives held for hedging	67	13	3	1	1	—
	1,056	410	952	123	245	208
Maturity gap	2,565	(343)	(777)	31	(116)	(88)
Cumulative maturity gap	2,565	2,222	1,445	1,476	1,360	1,272

Guarantees and commitments notional amount	2017 €m	2016 €m
Guarantees (1)	4,453	4,602
Commitments (2)	78	76
	4,531	4,678

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

10 Financial assets - impairments

The following table shows the movement in the provision for impairment losses for loans and advances.

	Individually assessed €m	Latent €m	Total 2017 €m	Total 2016 €m
At 1 January	39	2	41	86
Currency translation and other adjustments	2	—	2	(2)
Amounts written-off and disposals	—	—	—	(41)
Recoveries of amounts previously written-off	—	—	—	6
Transfer to disposal group	—	—	—	(10)
Releases to the income statement - continuing operations	(4)	(2)	(6)	(6)
Charges to the income statement - discontinued operations	—	—	—	8
At 31 December	37	—	37	41

Impairment (releases)/charges to the income statement	2017 €m	2016 €m	2015 €m
Loans and advances to customers - continuing operations	(6)	(6)	(25)
Recoveries to RBS plc under credit protection arrangements	3	(5)	4
Debt securities	—	2	126
	(3)	(9)	105

There were no charges/(releases) to the income statement in relation to discontinued operations (2016 - €8 million release; 2015 - €2 million charge).

	2017			2016		
Impaired financial assets	Cost €m	Provision €m	Carrying value €m	Cost €m	Provision €m	Carrying value €m
Loans and advances to customers (1)	45	37	8	47	39	8

Note:
(1) Impairment provisions individually assessed.

Carrying value of impaired debt securities was nil (2016 - nil).

The Group holds collateral in respect of certain loans and advances to banks and to customers that are past due or impaired. Such collateral includes mortgages over property; charges over business assets such as plant, inventories and trade debtors; and guarantees of lending from parties other than the borrower.

No loans have been subject to forbearance in 2017 and 2016 that would otherwise have been past due or impaired.

11 Derivatives

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

The Group enters into fair value hedges, cash flow hedges and hedges of net investments in foreign operations. The majority of the Group's interest rate hedges relate to the management of the Group's non trading interest rate risk. The Group manages this risk within approved limits. Residual risk positions are hedged with derivatives principally interest rate swaps. Suitable larger ticket financial instruments are fair value hedged and qualifying for hedge accounting. The majority of the Group's fair value hedges involve interest rate swaps hedging the interest rate risk in recognised financial assets and financial liabilities. The Group hedges its net investments in foreign operations with currency borrowings and forward foreign exchange contracts.

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

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

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

	2017			2016		
	Notional amounts €bn	Assets €m	Liabilities €m	Notional amounts €bn	Assets €m	Liabilities €m
Exchange rate contracts						
Spot, forwards and futures	1,358	12	4	4,806	35	81
Currency swaps	771	60	58	1,462	141	139
Interest rate swaps	4,866	662	482	8,064	1,325	975
Credit derivatives	—	—	—	200	—	1
Equity and commodity contracts	52	27	5	125	80	48
		761	549		1,581	1,244

Included above are derivatives held for hedging purposes as follows:

	2017		2016	
	Assets €m	Liabilities €m	Assets €m	Liabilities €m
Fair value hedging				
Interest rate contracts	2	—	19	6
Net investment hedging				
Exchange rate contracts	12	3	7	66

Hedge ineffectiveness recognised in other operating income in continuing operations comprised:

	2017 €m	2016 €m	2015 €m
Fair value hedging			
Gains/(losses) on the hedged items attributable to the hedged risk	16	15	(35)
(Losses)/gains on the hedging instruments	(14)	(15)	42
Fair value ineffectiveness	2	—	7

12 Interests in associates

The Group has one significant associate, Alawwal Bank which is incorporated and has its principal place of business in the Kingdom of Saudi Arabia. The Group holds 40% of Alawwal Bank's shares. It is accounted for using the equity method.

	2017		2016	
	Carrying value €m	Fair value €m	Carrying value €m	Fair value €m
Alawwal Bank	1,212	1,204	1,264	1,610
Other associates	2		2	
Interests in associates	1,214		1,266	

The investment in Alawwal Bank is equity accounted. At 31 December 2017 the market value of the company's share was below carrying value. However, market value was higher than carrying value for much of 2017 and also subsequently. As there has not been a significant or prolonged decline in market value below the carrying value that would indicate objective evidence for an impairment, nor other impairment indicators under IAS 39, no impairment has been recognised. The opening carrying value of Alawwal net assets will be adjusted for the impact of IFRS 9 as a 1 January 2018 movement.

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

Alawwal Bank	2017 €m	2016 €m	2015 €m
Total income	878	888	864
Total expenses	(563)	(631)	(378)
Profit before tax	315	257	486
Share of profit after tax	101	54	155

	2017 €m	2016 €m
Cash and balances at central banks	3,365	1,891
Loans to banks	470	259
Loans and advances to customers	14,149	18,376
Debt securities and equity shares	3,758	5,370
Other assets	462	646
Total assets	22,204	26,542
Deposits by banks	744	340
Customer deposits	17,403	21,563
Other liabilities	1,033	1,390
Total liabilities	19,180	23,293

13 Prepayments, accrued income and other assets

	2017 €m	2016 €m
Prepayments and deferred expenses	62	48
Current tax	30	6
Property, plant & equipment	21	17
Other assets	186	181
	299	252

14 Discontinued operations and assets and liabilities of disposal groups

The Group sold its India business to the Royal Bank of Scotland plc in February 2017 at its book value less costs to sell (fair value hierarchy level 2). Consequently, it has been included in profit or loss from discontinued operations to February 2017 and was classified as a discontinued operation and its assets and liabilities were reclassified to disposal groups at 31 December 2016. 2015 discontinued operation include the Dutch State acquired business.

(a) Profit from discontinued operations, net of tax

	2017 €m	2016 €m	2015 €m
Net interest income	4	56	94
Other income	(1)	6	69
Total income	3	62	163
Operating expenses	(4)	(83)	(92)
Profit before impairment losses	(1)	(21)	71
Impairment (losses)/releases	—	(8)	2
Operating (loss)/profit before tax	(1)	(29)	73
Tax	—	(4)	(27)
(Loss)/profit after tax	(1)	(33)	46

(b) Assets and liabilities of disposal groups

	2017 €m	2016 €m
Assets of disposal groups		
Cash and balances at central banks	—	17
Loans and advances to banks	—	5
Loans and advances to customers	—	136
Debt securities and equity shares	—	596
Derivatives	—	4
Other assets	—	52
	—	810
Liabilities of disposal groups		
Deposits by banks	—	23
Customer accounts	—	72
Derivatives	—	38
Other liabilities	—	86
	—	219

15 Provisions, accruals and other liabilities

	2017 €m	2016 €m
Current taxation	5	59
Accruals	6	11
Insurance reserves	200	242
Other liabilities	181	317
	392	629

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

In 2017, the reduction in insurance reserves was attributable to exposures that had expired without settlement. No material settlements were paid.

Included in other liabilities are provisions for liabilities and charges of €13 million (2016 - €31 million), of which litigation provisions are €13 million (2016 - €25 million) and restructuring provisions are nil (2016 - €6 million). Arising out of its normal business operations, the Group is party to legal proceedings in the Netherlands, United Kingdom, the United States of America and other jurisdictions. Litigation provisions at 31 December 2017 related to numerous proceedings; no individual provision is material. Detailed descriptions of the Group's legal proceedings and discussion of the associated uncertainties are given in Note 22.

16 Deferred taxation

	2017 €m	2016 €m
Deferred tax asset	—	(1)
Deferred tax liability	22	22
Net deferred tax liability	22	21

	Accelerated capital allowances €m	Provisions €m	Revaluations/ deferred gains €m	Available -for-sale financial assets €m	Other €m	Total €m
At 1 January 2016	(1)	(18)	47	1	19	48
Transfers to and from disposal groups	1	18	—	(1)	(8)	10
Credit to income statement	—	—	(37)	—	—	(37)
At 1 January 2017	—	—	10	—	11	21
Transfers to and from disposal groups	—	—	(1)	—	—	(1)
Charge to income statement	—	—	—	—	2	2
At 31 December 2017 (1)	—	—	9	—	13	22

Note:
(1) In jurisdictions where doubt exists over the availability of future taxable profits, deferred tax assets of €1,793 million (2016 - €2,477 million; 2015 - €2,593 million; 2014 - €2,259 million) have not been recognised in respect of tax losses carried forward of €7,171 million (2016 - €10,092 million; 2015 - €10,430 million; 2014 - €9,242 million). Of these losses, €3,628 million will expire within one year, €561 million within five years and €1,134 million thereafter. The balance of tax losses carried forward has no time limit.

17 Subordinated liabilities

	2017	2016
	€m	€m
Dated loan capital	993	1,438

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

The following tables analyse the remaining contractual maturity of subordinated liabilities by the final redemption date; and by the next call date.

2017 - final redemption and call date	2018 €m	2019 €m	2020-2022 €m	2023-2027 €m	Thereafter €m	Total €m
US dollar	162	71	—	113	125	471
Euro	10	164	13	—	335	522
	172	235	13	113	460	993

2016 - final redemption and call date	2017 €m	2018 €m	2019-2021 €m	2022-2026 €m	Thereafter €m	Total €m
US dollar	—	496	76	131	144	847
Euro	—	—	284	—	307	591
	—	496	360	131	451	1,438

Redemptions in the period (values as at date of transaction)	Capital treatment	2017 €m	2016 €m
€15 million floating rate notes 2020 (Partial redemption)	Tier 2	2	—
€250 million 4.70% notes 2019 (Partial redemption)	Tier 2	91	—
US$500 million 4.65% notes 2018 (Partial redemption)	Tier 2	278	—
US$1,285 million 5.90% Trust Preferred notes	Tier 1	—	1,164
US$200 million 6.25% Trust Preferred notes	Tier 1	—	177
US$1,800 million 6.08% Trust Preferred notes	Tier 1	—	1,594
€26 million 7.42% dated notes	Tier 2	—	26
€7 million 7.38% dated notes	Tier 2	—	7
US$25 million floating rate notes (partial redemption)	Tier 2	—	8
		371	2,976

Note:
(1) There were no issuances in 2017 or 2016.

Subordinated liabilities held at 31 December:

Dated loan capital	Capital treatment	2017 €m	2016 €m
€250 million floating rate notes 2019	Tier 2	170	270
€170 million floating rate notes 2041	Tier 2	339	307
€15 million floating rate notes 2020	Tier 2	13	14
US$165 million floating rate notes 2019 (part redeemed April, June, September and December 2016)	Tier 2	15	16
US$72 million 5.98% notes 2019	Tier 2	56	60
US$500 million 4.65% notes 2018	Tier 2	159	496
US$136 million 7.75% notes 2023	Tier 2	114	131
US$150 million 7.13% notes 2093	Tier 2	127	144
		993	1,438

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

18 Share capital

The company's share capital at 31 December 2017 and 2016 consisted of 11,112 issued and fully paid ordinary shares of €4.50 each. The Company's authorised share capital amounts to €225,000. It comprises 41,500 ordinary shares and 8,500 preference shares, each with a nominal value of €4.50.

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

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

19 Reserves

Share premium reserve

In 2017 there was N-share capital repatriation and reallocation of €68 million. In 2016 there was a distribution of €600 million to RBSG plc and €54 million to Santander. In addition, in 2015 there was capital injection of €57 million from RFS Holdings B.V. reflecting amounts received by RFS Holdings B.V. from Santander.

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

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

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

20 Structured entities and asset transfers

Structured entities

A structured entity (SE) is an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose. They do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions. As well as being a key element of securitisations, SEs are also used in fund management activities to segregate custodial duties from the fund management advice.

Consolidated structured entities

Securitisations

In a securitisation, assets, or interests in a pool of assets, are transferred generally to a SE which then issues liabilities to third party investors. The majority of securitisations are supported through liquidity facilities or other credit enhancements. The Group arranges securitisations to facilitate client transactions and undertakes own asset securitisations to sell or to fund portfolios of financial assets. The Group also acts as an underwriter and depositor in securitisation transactions in both client and proprietary transactions.

The Group's involvement in client securitisations takes a number of forms. It may: sponsor or administer a securitisation programme; provide liquidity facilities or programme-wide credit enhancement; and purchase securities issued by the vehicle.

Own asset securitisations

In own-asset securitisations, the pool of assets held by the SE is either originated by the Group, or (in the case of whole loan programmes) purchased from third parties.

Unconsolidated structured entities

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

	2017			2016		
	Asset backed Securitisation vehicles €m	Investment funds and other €m	Total €m	Asset backed Securitisation vehicles €m	Investment funds and other €m	Total €m
Loans and advances to customers and securities	18	4	22	17	2	19
Derivative assets	1	—	1	2	—	2
Derivative liabilities	(4)	—	(4)	(4)	—	(4)
Maximum exposure	15	4	19	15	2	17

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

Transfers that do not qualify for derecognition

Asset transfers

Under IAS 39 a financial asset is transferred if the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. Following a transfer the financial asset will be derecognised; not derecognised and retained in full on the Group's balance sheet; continue to be recognised on the balance sheet to the extent of the Group's continuing involvement.

Securities repurchase agreements and lending transactions

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

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

Securities sold under such repurchase transactions are not derecognised if the Group retains substantially all the risks and rewards of ownership. The fair value (and carrying value) of debt securities transferred under repurchase transactions included on the balance sheet was nil (2016 - nil). Securities received as collateral under reverse repurchase agreements were €0.9 billion (2016 - €1.0 billion) of which €0.1 billion (2016 - €0.2 billion) had been sold or repledged as collateral of the Group's own transactions.

Assets pledged as collateral

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

There were no assets pledged against liabilities in 2017 (2016 - €9 million) and no liabilities secured by assets (2016 - €9 million).

21 Capital resources

The Group's regulatory capital resources were as follows:

	2017 CRR transitional basis €m	2016 CRR transitional basis €m
Tier 1		
Controlling interests	2,884	3,045
Adjustment for:		
- Goodwill and other intangible assets	(3)	(3)
- Other regulatory adjustments	(111)	(208)
Common Equity Tier 1	2,770	2,834
Total Tier 1 capital	2,770	2,834
Tier 2		
Subordinated debt	238	536
Deductions from Tier 2 capital	(125)	(144)
Total Tier 2 capital	113	392
Total regulatory capital	2,883	3,226

It is the Group's policy to maintain an appropriate capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders, while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Group has regard to the supervisory requirements of DNB. DNB uses Capital Ratios as a measure of capital adequacy in the Dutch banking sector, comparing a bank's capital resources with its risk-weighted assets (RWAs) (the assets and off-balance sheet exposures are weighted to reflect the inherent credit and other risks). The Group has complied with its capital requirements during the year.

A number of subsidiaries and sub-groups within the Group are subject to various individual regulatory capital requirements in the Netherlands and overseas. Furthermore, the payment of dividends by subsidiaries and the ability of members of the Group to lend money to other members of the Group may be subject to restrictions such as local regulatory or legal requirements, the availability of reserves and financial and operating performance.

Notes on the consolidated accounts

22 Memorandum items

Contingent liabilities and commitments

The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December 2017. Although the Group is exposed to credit risk in the event of non-performance of the obligations undertaken by customers, the amounts shown do not, and are not intended to, provide any indication of the Group's expectation of future losses.

	Less than 5 years €m	Over 5 years €m	2017 €m	2016 €m
Contingent liabilities and commitments				
Guarantees and assets pledged as collateral security	674	3,779	4,453	4,602
Other contingent liabilities	—	1,019	1,019	1,284
Standby facilities, credit lines and other commitments	72	6	78	78
	746	4,804	5,550	5,964

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

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

Also included within guarantees and assets pledged as collateral security as at 31 December 2017 is €3.8 billion (2016 - €3.8 billion) which relates to the Group's obligations over liabilities held within the Dutch State acquired businesses included in the new ABN AMRO Bank N.V.. On the division of an entity by demerger, Dutch law establishes a cross liability between surviving entities in respect of the creditors at the time of the demerger. The Group's cross liability is limited by law to the lower of its equity and the eligible debts of ABN AMRO Bank N.V. on 6 February 2010. The likelihood of cross liability crystallising is considered remote.

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

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

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

Contractual obligations for future expenditure not provided in the accounts

Unprovided contractual obligations for future expenditure, primarily relating to property leases, amounted to €3 million at 31 December 2017 (2016 - €9 million).

Litigation, investigations and reviews

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

The Group recognises a provision for a liability in relation to these matters when it is probable that an outflow of economic benefits will be required to settle an obligation resulting from past events, and a reliable estimate can be made of the amount of the obligation. While the outcome of these matters is inherently uncertain, the directors believe that, based on the information available to them, appropriate provisions have been made in respect of the matters as at 31 December 2017.

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 the Group's reputation, businesses and operations. Numerous legal and factual issues may need to be resolved, including through potentially lengthy discovery and document production exercises and determination of important factual matters, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a liability can reasonably be estimated for any claim. The Group cannot predict if, how, or when such claims will be resolved or what the eventual settlement, damages, fine, penalty or other relief, if any, may be, particularly for claims that are at an early stage in their development or where claimants seek substantial or indeterminate damages.

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

There are situations where the Group may pursue an approach that in some instances leads to a settlement agreement. This may occur in order to avoid the expense, management distraction or reputational implications of continuing to contest liability, or in order to take account of the risks inherent in defending claims or investigations even for those matters for which the Group believes it has credible defences and should prevail on the merits. There are also situations where it may be in the interests of members of the Group to settle adverse claims, including involving significant amounts, on a commercial basis in order to facilitate the achievement of a wider commercial or strategic objective. The uncertainties inherent in all such matters affect the amount and timing of any potential outflows for both matters with respect to which provisions have been established and other contingent liabilities.

The future outflow of resources in respect of any matter may ultimately prove to be substantially greater than or less than the aggregate provision that the Group has recognised. Where (and as far as) liability cannot be reasonably estimated, no provision has been recognised.

Other than those discussed below, no member of 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 Group is involved in ongoing litigation, investigations and reviews that are not described below but are described on pages 313 to 325 in RBS Group's Annual Report & Accounts 2017. RBS Group expects that in future periods, additional provisions, settlement amounts and customer redress payments will be necessary, in amounts that are expected to be substantial in some instances. While the Group may not be directly involved in such RBS Group matters, any final adverse outcome of those matters may also have an adverse effect on the Group.

For a discussion of certain risks associated with the Group's litigation, investigations and reviews see the Risk Factor relating to legal, regulatory and governmental actions and investigations set out on page 117.

Litigation

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 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.

RBS N.V. made a motion to dismiss in this case on the ground that many of the transfers at issue were extraterritorial to the United States and therefore not subject to the fraudulent conveyance statute upon which the trustee's claim is based, but the bankruptcy court denied that motion in November 2016. RBS N.V. sought leave to appeal, but this was denied on 3 October 2017. A further claim by the trustee against RBS N.V., for clawback of an additional US$21.8 million, was filed in October 2011. With respect to that claim, the bankruptcy court granted RBS N.V.'s motion to dismiss on extraterritorial grounds, and the trustee has commenced an appeal of that decision.

Australian Bank Bill Swap Reference Rate (BBSW)
In August 2016, a class action complaint was filed in the United States District Court for the Southern District of New York against certain RBS Group companies (including RBS N.V.) and a number of other financial institutions. The complaint alleges that the defendants conspired to manipulate the BBSW and asserts claims under the U.S. antitrust laws, the Commodity Exchange Act, RICO (Racketeer Influenced and Corrupt Organizations Act), and the common law. This matter is subject to a motion to dismiss that is currently pending.

FX antitrust litigation
In September 2015, certain members of RBS Group (including RBS N.V.), 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. RBS Group has settled these matters for approximately CAD 13 million. The settlement amount has been paid and the settlement has received final court approval.

Certain other foreign exchange transaction related claims have been or may be threatened against RBS Group in other jurisdictions. RBS Group cannot predict whether any of these claims will be pursued, but expects that several may.

Fondazione Monte dei Paschi di Siena
A claim for €285.9 million was brought by Fondazione Monte dei Paschi di Siena (FMPS) in July 2014 against former directors and 13 syndicate banks, including RBS N.V., in connection with an Italian law-governed term facility agreement for €600 million dated 4 June 2011. The claim is a civil action based on a non-contractual liability arising from the alleged breach of the by-laws of FMPS which set a 20 per cent limit for its debt to equity ratio (the Ratio). The lenders are alleged to have aided and abetted the former directors of FMPS to breach the Ratio. It is alleged that as sophisticated financial institutions, each lender should have known FMPS's financial situation, including its debt to equity ratio, and that putting the facility in place would cause it to breach the Ratio. RBS N.V. will defend the claim, which has been transferred to the Florence courts. A hearing is due to begin on 27 September 2018.

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. 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 in September 2016.

In November 2016, additional plaintiffs commenced a second action in the United States District Court for the Southern District of Illinois against the same defendants (including RBS N.V.), as well as Deutsche Bank. The allegations were substantially similar to the allegations contained in the complaint described above. The plaintiffs were 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. In April 2017, this case was transferred to the United States District Court for the Eastern District of New York. On 3 October 2017, the plaintiffs in this second case, instead of responding to defendants' motion to dismiss, voluntarily dismissed their claims without prejudice to re-filing at a later date.

On 9 November 2017, a third action was commenced by an additional group of plaintiffs in the United States District Court for the Southern District of New York, against the same defendants as the November 2016 action (including RBS N.V.), as well as RBS plc. The allegations are substantially similar to the allegations contained in the complaints described above and concern 55 attacks in Iraq between 2003 and 2011. The defendants have filed a motion to dismiss the claims in this case.

Interest rate swap claim by Ville d'Aubagne
Ville d'Aubagne, a French local authority, filed a claim in April 2013 against RBS N.V. and RBS plc in respect of two structured interest rates swaps, which were entered into between Ville d'Aubagne and RBS N.V., and novated to RBS plc in 2009. In the same year, they were terminated early and a rescheduling agreement was entered into under which payments were rescheduled over 28 years. Ville d'Aubagne sought retroactive cancellation of the swaps and the rescheduling agreement. The amount claimed was approximately €65 million (which was subject to fluctuations in market value from time to time). The bank was successful in its defence of the claim, winning at first instance in November 2015. An appeal of that decision was dismissed by the French Court of Appeal in January 2018. Ville d'Aubagne has now appealed to the French Supreme Court.

Notes on the consolidated accounts

Investigations and reviews

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

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

The Group is co-operating fully with the investigations and reviews described below.

LIBOR and other trading rates

Certain members of RBS Group continue to co-operate with investigations and requests for information by various governmental and regulatory authorities into submissions, communications and procedures around the setting of LIBOR and other interest rates and interest rate trading.

Foreign exchange related investigations

Certain members of RBS Group continue to co-operate with investigations and requests for information by various governmental and regulatory authorities on certain issues relating to failings in its FX business within its NatWest Markets segment.

Governance and risk management consent order

In July 2011, RBS Group, RBS plc and RBS N.V. 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 ('the Order') to address deficiencies related to governance, risk management and compliance systems and controls in the US branches of RBS plc and RBS N.V. All of the RBS N.V. branches in the United States have been closed since the issuance of the Order. The RBS Group entities' obligations under the Order have been terminated by the Federal Reserve Board (on 8 March 2018), the Illinois Department of Financial and Professional Regulation (on 23 March 2018), and the Connecticut Department of Banking (on 13 April 2018).

23 Changes in operating assets and liabilities

	2017 €m	2016 €m	2015 €m
Decrease in loans and advances to banks and customers	12	5,165	2,314
(Increase)/decrease in securities	54	603	(334)
Increase in other assets	(42)	(52)	(327)
Decrease in derivative assets	820	636	2,008
Changes in operating assets	844	6,352	3,661
Decrease in deposits by banks and customers	(434)	(2,700)	(3,659)
Decrease in debt securities in issue	(28)	(348)	(614)
Increase in other liabilities	160	22	902
Decrease in derivative liabilities	(695)	(579)	(2,491)
(Decrease)/increase in settlement balances	(29)	73	2
Changes in operating liabilities	(1,026)	(3,532)	(5,860)
Changes in operating assets and liabilities	(182)	2,820	(2,199)

24 Interest received and paid

	2017 €m	2016 €m	2015 €m
Interest received	21	137	306
Interest paid	(21)	(152)	(346)
	—	(15)	(40)

25 Analysis of changes in financing during the year

	Share capital and share premium			Subordinated liabilities		
	2017 €m	2016 €m	2015 €m	2017 €m	2016 €m	2015 €m
At 1 January	7,092	7,743	7,686	1,438	4,456	5,104
Redemption of subordinated liabilities				(378)	(2,988)	(1,069)
Capital injection			57			
Distribution	(68)	(651)				
Net cash (outflow)/inflow from financing	(68)	(651)	57	(378)	(2,988)	(1,069)
Foreign exchange				(79)	(37)	467
Other adjustments				12	7	(46)
At 31 December	7,024	7,092	7,743	993	1,438	4,456

26 Analysis of cash and cash equivalents

	2017 €m	2016 €m	2015 €m
At 1 January			
- cash	773	835	2,417
- cash equivalents	243	926	295
	1,016	1,761	2,712
Net cash outflow	(594)	(745)	(951)
At 31 December	422	1,016	1,761
Comprising:			
Cash and balances at central banks	68	368	543
Loans and advances to banks (1)	354	648	1,037
Treasury bills and debt securities	—	—	181
Cash and cash equivalents	422	1,016	1,761

Note:
(1) Cash collateral posted with bank counterparties in respect of derivative liabilities is nil (2016 - €9 million, 2015 - nil).

The Group had mandatory reserve deposits with central banks of €55 million (2016 - €355 million; 2015 - €255 million).

27 Segmental analysis

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

Geographical segments

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

2017	Netherlands €m	UK €m	RoW €m	Total €m
Net interest income	(18)	—	17	(1)
Net fees and commissions	(1)	19	(1)	17
Income from trading activities	(53)	(99)	(4)	(156)
Other operating income	(72)	—	151	79
Total income	(144)	(80)	163	(61)
Operating (loss)/profit before tax	(182)	(79)	146	(115)
Total assets	3,049	555	2,472	6,076
Total liabilities	1,797	558	837	3,192
Net assets/(liabilities) attributable to equity owners and non-controlling interests	1,252	(3)	1,635	2,884
Contingent liabilities and commitments	5,478	72	—	5,550

2016	Netherlands €m	UK €m	RoW €m	Total €m
Net interest income	(87)	3	14	(70)
Net fees and commissions	—	5	—	5
Income from trading activities	(64)	157	(1)	92
Other operating income	(11)	(24)	58	23
Total income	(162)	141	71	50
Operating (loss)/profit before tax	(158)	172	78	92
Total assets	2,544	1,055	4,731	8,330
- of which assets held for sale	—	—	810	810
Total liabilities	2,414	922	1,949	5,285
- of which liabilities held for sale	—	—	219	219
Net assets attributable to equity owners and non-controlling interests	130	133	2,782	3,045
Contingent liabilities and commitments	5,838	71	55	5,964

2015	Netherlands €m	UK €m	RoW €m	Total €m
Net interest income	(184)	1	77	(106)
Net fees and commissions	(6)	(5)	8	(3)
Income from trading activities	(42)	64	(14)	8
Other operating income	87	8	167	262
Total income	(145)	68	238	161
Operating (loss)/profit before tax	(203)	95	26	(82)
Total assets	6,923	2,021	7,002	15,946
Total liabilities	6,939	1,603	3,745	12,287
Net (liabilities)/assets attributable to equity owners and non-controlling interests	(16)	418	3,257	3,659
Contingent liabilities and commitments	5,758	—	731	6,489
Cost to acquire property, plant and equipment and intangible assets	—	—	21	21

28 Remuneration of the Managing Board and Supervisory Board

Remuneration of the Managing Board

The Managing Board during the year comprised the following members:

(1) H. Bots (appointed Chairman 1 November 2017).
(2) I. van Eeghen (stepped down 1 November 2017).
(3) C. Visscher.

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

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

	2017 €000	2016 €000
Salaries and short-term benefits	361	361
Pensions	29	39
Profit sharing and bonus payments	72	72
Long term incentive plan	—	10
Total	462	482

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

Remuneration of the Supervisory Board

The Supervisory Board during the year comprised the following members:

(1) C. Marks (appointed chairman 1 November 2017).
(2) C. Campbell.
(3) M. Bailie (stepped down on 1 November 2017).
(4) M. Klessens.
(5) R. Begbie (appointed 19 April 2017).

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

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

	2017 €000	2016 €000
Remuneration	80	80

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

29 Related parties

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

Parties are considered to be related if one party has the ability to control or exercise significant influence over the other party in making financial or operational decisions. The Group enters into a number of banking transactions with related parties in the normal course of business. These transactions, which include loans, deposits and foreign currency transactions, have taken place on an arm's length basis. These transactions are carried out on commercial terms and at market rates. Employees are offered preferential terms for certain banking products. No allowances for loan losses have been recognised in respect of loans to related parties in 2017, 2016 and 2015.

Balances with Consortium Members

A substantial part of the business activities of RBS N.V. was successfully transferred to RBS plc by the end of 2013 following an announcement in April 2011 by the Boards of RBSG, RBS plc, RBS Holdings and RBS N.V.. The Group entered into two agreements with RBS plc under which it bought credit protection over the exposures held by the Group that were subject to RBS Group's Asset Protection Scheme agreement with HM Treasury. These agreements cover 100% of losses on these assets. RBS Group exited the APS effective 18 October 2012. The Group agreements are not impacted by RBS Group's exit from APS and as a result, there has been no change to these agreements although with effect from 1 January 2013, the Managing Board of RBS Holdings N.V. agreed with RBS plc to reduce the number of covered assets. The assets covered under the agreement at 31 December 2017 was €0.2 billion (2016 - €0.3 billion; 2015 - €0.9 billion). At 31 December 2017 the prepaid fee for the financial guarantee contract had been fully amortised (2016 – fully amortised; 2015 – fully amortised).

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

Balances with associates

Pursuant to an agreement dated 22 July 2016 with an associate, a certain proportion of any proceeds of sale of RBS N.V.'s investment in that associate, up to a maximum of approximately €240 million, is payable to that associate.

On 25 April 2017 Alawwal Bank announced the start of merger discussions with Saudi British Bank (SABB). A 40% stake in its associate, Alawwal Bank, is the last significant shared asset of the RFS Holding Consortium.

	Amounts due from/to holding company and fellow subsidiaries	
	2017 €m	2016 €m
Continuing operations		
Derivatives	489	968
Loans and advances	2,646	2,626
Amounts due from ultimate holding company	125	142
Other assets	22	6
Derivatives	360	1,164
Due to banks	1,073	1,313
Other liabilities	6	60
Contingent liabilities and commitments	674	813
Disposal Groups	—	(51)

Balances with the Dutch State and UK Government

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

There may be other significant transactions with entities under the common control of or subject to significant influence by the Dutch and/or the UK Government. These would include, amongst others, loans, deposits, guarantees, fee based relationships, or equity holdings. Disclosure is made of any significant transactions with these entities.

At 31 December 2017 there were no transactions outstanding with directors or key management (for the Group this comprises the members of the Managing and Supervisory Boards). Refer to Note 28 for further details of remuneration of the Managing and Supervisory Boards.

	2017 €m	2016 €m
Assets		
Balances at central banks	66	368

30 Post balance sheet events

There have been no significant events between 31 December 2017 and the date of approval of these accounts which would require a change to, or additional disclosure in, the accounts.

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

Accounting policies

The company financial statements of RBS N.V. have been prepared in accordance with the requirements in Title 9 Book 2 of the Dutch Civil Code. The Group prepares its consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as issued by the IASB and IFRS as adopted by the EU. The accounting policies applied in the company financial statements are the same as those applied in the consolidated financial statements on pages 59 to 88.
The Group applies the exemption as included in the section 2:362 paragraph 8 of the Netherlands Civil Code.

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

Basis of preparation

The financial statements are presented in euros, which is the presentation currency of the company. Refer to Accounting policy 2 of the consolidated accounts for further information on going concern.

Company income statement for the year ended 31 December 2017

	Note	2017 €m	2016 €m	2015 €m
Interest receivable	1	19	41	61
Interest payable	1	(26)	(119)	(235)
Net interest from subsidiaries	1	2	21	3
Net interest income	1	(5)	(57)	(171)
Fees and commissions receivable		—	2	(4)
Fees and commissions payable		(2)	(2)	(9)
Income from trading activities	2	(155)	95	114
Income from consolidated subsidiaries	2	356	(50)	216
Other operating income	2	(271)	63	(82)
Non-interest income		(72)	108	235
Total income		(77)	51	64
Staff costs		(4)	(4)	(17)
Other administrative expenses		(51)	(16)	(49)
Operating expenses	3	(55)	(20)	(66)
(Loss)/profit before impairment releases		(132)	31	(2)
Impairment releases	10	3	8	—
Operating (loss)/profit before tax		(129)	39	(2)
Tax charge		37	(16)	(4)
(Loss)/profit for the year		(92)	23	(6)
Attributable to:				
Controlling interests		(92)	23	(6)

The accompanying notes on pages 92 to 101 form an integral part of these financial statements.

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

Company balance sheet as at 31 December 2017 (before appropriation of result)

	Note	2017 €m	2016 €m
Assets			
Cash and balances at central banks	7	66	317
Loans and advances to banks	7	2,921	3,897
Loans and advances to customers	7	93	184
Amounts due from ultimate holding company	7	125	142
Debt securities and equity shares	7	5	50
Investments in Group undertakings	12	1,639	2,143
Derivatives	11	1,158	2,173
Deferred tax		—	1
Other assets	13	99	877
Total assets		6,106	9,784
Liabilities			
Deposits by banks	7	1,524	3,274
Customer accounts	7	64	230
Debt securities in issue	7	27	55
Derivatives	11	549	1,244
Provisions and other liabilities	14	65	497
Deferred tax		—	1
Subordinated liabilities	15	993	1,438
Total liabilities		3,222	6,739
Equity			
Share capital and share premium		7,024	7,092
Available-for-sale reserve		(6)	(10)
Cash flow hedging reserve		—	(1)
Foreign exchange reserve		(40)	(118)
Group undertakings reserve		8	8
Retained earnings		(4,102)	(3,926)
Total equity	16	2,884	3,045
Total liabilities and equity		6,106	9,784

As at 31 December contingent liabilities and commitments were €4,531 million (2016 - €4,723 million).

The accompanying notes on pages 92 to 101 form an integral part of these financial statements.

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

Company statement of changes in equity for the year ended 31 December 2017

	2017 €m	2016 €m	2015 €m
Share capital and share premium account (1)			
At 1 January	7,092	7,743	7,686
Capital injection (2)	—	—	57
Distribution (3)	(68)	(651)	—
At 31 December	7,024	7,092	7,743
Available-for-sale reserve			
At 1 January	(10)	(13)	(66)
Unrealised gains/(losses)	3	(2)	(10)
Realised gains	1	4	64
Tax	—	1	(1)
At 31 December	(6)	(10)	(13)
Cash flow hedging reserve			
At 1 January	(1)	(1)	(2)
Amount recognised in equity	1	—	2
Tax	—	—	(1)
At 31 December	—	(1)	(1)
Foreign exchange reserve			
At 1 January	(118)	(138)	(220)
(Losses)/gains arising during the year	(85)	20	80
Reclassification of foreign currency gains included in the income statement	163	—	2
At 31 December	(40)	(118)	(138)
Group undertakings reserve			
At 1 January	8	8	8
Recycled to profit or loss on disposal of business	—	—	—
At 31 December	8	8	8
Retained earnings			
At 1 January	(3,926)	(3,940)	(3,936)
(Loss)/profit attributable to controlling interests	(92)	23	(6)
Changes in fair value of credit in financial liabilities designated at fair value through profit or loss	(65)	—	—
Capital repatriation (4)	(22)	—	—
Other changes	3	(9)	2
At 31 December	(4,102)	(3,926)	(3,940)
Equity attributable to controlling interests	2,884	3,045	3,659

Notes:
(1) Includes Ordinary share capital of €50,000 (2016: €50,000) – see Note 18 of the Notes on the consolidated accounts for further details.
(2) Capital injection of €57 million in 2015 from RBS Holdings N.V. reflecting amounts received by RBS Holdings N.V. from RFS Holdings BV.
(3) 2017 includes N-share capital repatriation and reallocation of €68 million. 2016 includes distribution of €600 million to RBSG plc and €54 million to Santander.
(4) 2017 includes N-share capital repatriation and reallocation of €22 million.

The accompanying notes on pages 92 to101 form an integral part of these financial statements.

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

1 Net interest income

	2017 €m	2016 €m	2015 €m
Loans and advances to customers	4	11	22
Loans and advances to banks	4	19	28
Amounts due from ultimate holding company	11	11	11
Interest receivable (1)	19	41	61
Customer accounts	1	3	3
Balances with banks	1	11	25
Debt securities in issue	—	—	3
Subordinated liabilities	24	106	204
Internal funding of trading businesses	—	(1)	—
Interest payable (1)	26	119	235
Net interest from subsidiaries	2	21	3
Net interest income	(5)	(57)	(171)

Note:
(1) Negative interest on loans and advances is classified as interest payable.

2 Non-interest income

Non interest income includes Income from trading activities as follows:

	2017 €m	2016 €m	2015 €m
Foreign exchange	(67)	52	786
Interest rate	(81)	70	42
Credit	(9)	—	—
Equities and other	2	(27)	(714)
	(155)	95	114

Non interest income includes Income from consolidated subsidiaries of €356 million (2016 - (€50) million; 2015 - €216 million), which includes income from associated entities.

Non interest income includes Other operating income as follows:

	2017 €m	2016 €m	2015 €m
(Loss)/profit from discontinued operations (1)	(1)	(33)	46
Other	(270)	96	(128)
	(271)	63	(82)

Note:
(1) Refer to Note 14 on the consolidated accounts for further details on the (loss)/profit from discontinued operations.

3 Operating expenses

There were 20 people employed (full time equivalent rounded to the nearest ten) in continuing operations at 31 December 2017 (2016 - 10; 2015 - 90); on the same basis there were no people employed in discontinued operations (2016 - 210; 2015 - 640). The average number of persons employed in continuing operations during the year was 20 (2016 - 50; 2015 - 150) and in discontinued operations was 40 (2016 - 430; 2015 - 760).

4 Auditors remuneration

Refer to Note 4 on the consolidated accounts for further details.

5 Tax

Refer to Note 5 on the consolidated accounts for further details.

6 Dividends

In 2017 RBS N.V. made a distribution of €90 million (2016 - €651 million; 2015 - nil)

7 Financial instruments - classification

The following tables analyse the Company's 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.

	Held-for-trading €m	Designated as at fair value through profit or loss €m	Available-for-sale €m	Loans and receivables €m	Other assets €m	Total €m
Assets						
Cash and balances at central banks	—	—	—	66		66
Loans and advances to banks	3	551	—	2,367		2,921
Loans and advances to customers	10	—	—	83		93
Amounts due from ultimate holding company	—	—	—	125		125
Debt securities and equity shares	5	—	—	—		5
Derivatives	1,158					1,158
Investment in Group Undertakings	—	—	—	—	1,639	1,639
Other assets	—	—	—	4	95	99
31 December 2017	1,176	551	—	2,645	1,734	6,106
Cash and balances at central banks	—	—	—	317		317
Loans and advances to banks	67	591	—	3,239		3,897
Loans and advances to customers	4	—	—	180		184
Amounts due from ultimate holding company	—	—	—	142		142
Debt securities and equity shares	48	—	2	—		50
Derivatives	2,173					2,173
Investment in Group Undertakings	—	—	—	—	2,143	2,143
Other assets	—	—	—	10	868	878
31 December 2016	2,292	591	2	3,888	3,011	9,784

	Held-for-trading €m	Designated as at fair value through profit or loss €m	Amortised cost €m	Other liabilities €m	Total €m
Liabilities					
Deposits by banks	7	925	592		1,524
Customer accounts	6	—	58		64
Debt securities in issue	—	27	—		27
Derivatives	549				549
Subordinated liabilities	—	592	401		993
Other liabilities	—	—	13	52	65
31 December 2017	562	1,544	1,064	52	3,222
Deposits by banks	127	1,149	1,998		3,274
Customer accounts	169	—	61		230
Debt securities in issue	—	55	—		55
Derivatives	1,244				1,244
Subordinated liabilities	—	668	770		1,438
Other liabilities	—	—	48	450	498
31 December 2016	1,540	1,872	2,877	450	6,739

7 Financial instruments – classification continued

	Offsetable instruments			Offsetable potential not recognised by IFRS				
2017	Gross €m	IFRS offset €m	Balance sheet €m	Effect of master netting and similar agreements €m	Financial collateral €m	Net amount after the effect of netting arrangements and related collateral €m	Amounts not subject to netting €m	Balance sheet total €m
Financial assets								
Derivatives	697	—	697	(74)	(4)	619	461	1,158
Financial liabilities								
Derivatives	496	—	496	(74)	(4)	418	53	549
2016								
Financial assets								
Derivatives	1,440	—	1,440	(501)	(49)	890	733	2,173
Loans and advances to customers	497	(497)	—	—	—	—	184	184
	1,937	(497)	1,440	(501)	(49)	890	917	2,357
Financial liabilities								
Derivatives	1,105	—	1,105	(501)	(5)	599	139	1,244
Customer accounts	497	(497)	—	—	—	—	230	230
	1,602	(497)	1,105	(501)	(5)	599	369	1,474

8 Financial instruments – valuation

For further information relating to the following tables, refer to Note 9 on the consolidated accounts.

Valuation hierarchy

The following tables show the Company's financial instruments carried at fair value on the balance sheet by valuation hierarchy - level 1, level 2 and level 3, and related level 3 sensitivities.

				Level 3 sensitivity (2)	
	Level 2	Level 3	Total	Favourable	Unfavourable
2017	€bn	€bn	€bn	€m	€m
Assets					
Loans and advances	0.6	—	0.6	—	—
Derivatives	1.1	—	1.1	—	—
	1.7	—	1.7	—	—
Proportion	100%	—	100%		
Liabilities					
Deposits	0.9	—	0.9	—	—
Derivatives	0.5	0.1	0.6	21	(54)
Subordinated liabilities	0.6	—	0.6	—	—
	2.0	0.1	2.1	21	(54)
Proportion	95.2%	4.8%	100%		

				Level 3 sensitivity (2)	
	Level 2	Level 3	Total	Favourable	Unfavourable
2016	€bn	€bn	€bn	€m	€m
Assets					
Loans and advances	0.7	—	0.7	—	—
Derivatives	1.9	0.3	2.2	26	(25)
	2.6	0.3	2.9	26	(25)
Proportion	89.7%	10.3%	100%		
Liabilities					
Deposits	1.3	0.1	1.4	10	(10)
Debt securities in issue	0.1	—	0.1	—	—
Derivatives	0.9	0.3	1.2	35	(34)
Subordinated liabilities	0.7	—	0.7	—	—
	3.0	0.4	3.4	45	(44)
Proportion	88.2%	11.8%	100%		

Notes:

(1) 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 3: instruments in this category have been valued using a valuation technique where at least one input which could have a significant effect on the instrument’s valuation, is not based on observable market data. Where inputs can be observed from market data without undue cost and effort, the observed input is used. Otherwise, the Group determines a reasonable level for the input.

(2) 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 to the Group's valuation techniques or models. Totals for sensitivities are not indicative of the total potential effect on the income statement or the statement of comprehensive income. The level 3 sensitivities above 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 overall potential uncertainty on the whole portfolio. 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 observed. 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.

(3) Transfers between levels are deemed to have occurred at the beginning of the quarter in which the instruments were transferred. There were no transfers between level 1 and level 2.

(4) The Group does not have any material liabilities measured at fair value that are issued with an inseparable third party credit enhancement.

(5) Level 3 instruments were nil for assets and €0.1 billion for liabilities (2016 - €0.3 billion for assets and €0.4 billion for liabilities). The decrease during the year in assets relates to transfers out €0.2 billion, income statement €0.1 billion and decrease in liabilities primarily relates to transfers out of €0.3 billion, income statement €0.1 billion (2016 - The decrease during the year in assets primarily related to transfers in €0.7 billion which is offset by transfers out €0.2 billion, settlements €0.3 billion and sales €0.1 billion, income statement €0.1 billion and decrease in liabilities primarily relates to transfers in of €0.5 billion offset by transfers out of €0.1 billion, settlements €0.2 billion, income statement €0.2 billion and sales €0.1 billion).

The amount of the total gains or losses included in profit or loss that is attributable to the change in unrealised gains or losses relating to those assets and liabilities held at the end of the reporting period was not material for any period presented.

(6) For an analysis of derivatives by type of contract – see Note 11 of the notes on the consolidated accounts.

8 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.

2017	Items where fair value approximates carrying value €m	Carrying value €m	Fair value €m	Fair value hierarchy level Level 2 €m	Level 3 €m
Financial assets					
Cash and balances at central banks	66				
Loans and advances to banks		2,367	2,367	354	2,013
Loans and advances to customers		83	48	3	45
Amount due from ultimate holding company		125	192	192	—
Settlement balances	4				
Financial liabilities					
Deposits by banks	430	162	162	—	162
Customer accounts	3	55	64	18	46
Settlement balances	13				
Subordinated liabilities		401	466	466	—
2016					
Financial assets					
Cash and balances at central banks	317				
Loans and advances to banks		3,239	3,239	424	2,815
Loans and advances to customers		180	135	36	99
Amount due from ultimate holding company		142	156	156	—
Settlement balances	10				
Financial liabilities					
Deposits by banks	326	1,672	1,672	492	1,180
Customer accounts	6	55	61	13	48
Settlement balances	48				
Subordinated liabilities		770	781	781	—

9 Financial instruments - maturity analysis

Remaining maturity

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

	2017			2016		
	Less than 12 months €m	More than 12 months €m	Total €m	Less than 12 months €m	More than 12 months €m	Total €m
Assets						
Cash and balances at central banks	66	—	66	317	—	317
Loans and advances to banks	2,921	—	2,921	3,829	68	3,897
Loans and advances to customers	2	91	93	50	134	184
Amounts due from ultimate holding company	—	125	125	—	142	142
Debt securities and equity shares	—	5	5	1	49	50
Settlement balances	4	—	4	10	—	10
Derivatives	39	1,119	1,158	132	2,041	2,173
Liabilities						
Deposits by banks	1,508	16	1,524	2,113	1,161	3,274
Customer accounts	10	54	64	170	60	230
Debt securities in issue	25	2	27	14	41	55
Settlement balances and short positions	13	—	13	47	1	48
Derivatives	9	540	549	195	1,049	1,244
Subordinated liabilities	172	821	993	6	1,432	1,438

9 Financial instruments - maturity analysis continued

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 on-balance sheet assets 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. For further information on how the tables have been prepared refer to Note 10 of the Notes on the consolidated accounts.

2017	0 - 3 months €m	3 - 12 months €m	1 - 3 years €m	3 - 5 years €m	5 - 10 years €m	10 - 20 years €m
Assets by contractual maturity						
Cash and balances at central banks	66	—	—	—	—	—
Loans and advances to banks	2,896	—	—	—	—	—
Amounts due from ultimate holding company	—	10	20	20	50	100
Settlement balances	4	—	—	—	—	—
Total maturing assets	2,966	10	20	20	50	100
Loans and advances to customers	17	7	24	10	54	—
Derivatives held for hedging	4	3	—	—	—	—
	2,987	20	44	30	104	100
Liabilities by contractual maturity						
Deposits by banks	781	327	13	3	—	—
Debt securities in issue	25	—	2	—	—	—
Subordinated liabilities	4	43	463	84	280	281
Settlement balances and other liabilities	13	—	—	—	—	—
Total maturing liabilities	823	370	478	87	280	281
Customer accounts	3	1	57	1	3	6
Derivatives held for hedging	4	1	—	—	—	—
	830	372	535	88	283	287
Maturity gap	2,143	(360)	(458)	(67)	(230)	(181)
Cumulative maturity gap	2,143	1,783	1,325	1,258	1,028	847

2016	0 - 3 months €m	3 - 12 months €m	1 - 3 years €m	3 - 5 years €m	5 - 10 years €m	10 - 20 years €m
Assets by contractual maturity						
Cash and balances at central banks	317	—	—	—	—	—
Loans and advances to banks	3,763	—	33	35	—	—
Amounts due from ultimate holding company	—	11	23	23	57	114
Settlement balances	10	—	—	—	—	—
Total maturing assets	4,090	11	56	58	57	114
Loans and advances to customers	49	—	73	(2)	1	—
Derivatives held for hedging	5	16	6	—	—	—
	4,144	27	135	56	58	114
Liabilities by contractual maturity						
Deposits by banks	2,810	325	12	1	—	—
Debt securities in issue	1	13	27	5	9	—
Subordinated liabilities	2	58	905	67	232	202
Settlement balances and other liabilities	48	—	—	—	—	—
Total maturing liabilities	2,861	396	944	73	241	202
Customer accounts	6	1	5	48	3	6
Derivatives held for hedging	67	13	3	1	1	—
	2,934	410	952	122	245	208
Maturity gap	1,229	(385)	(888)	(15)	(184)	(88)
Cumulative maturity gap	1,229	844	(44)	(59)	(243)	(331)

9 Financial instruments - maturity analysis continued

Guarantees and commitments notional amount	2017 €m	2016 €m
Guarantees (1)	4,453	4,602
Commitments (2)	78	74
	4,531	4,676

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

10 Financial assets - impairments

The following table shows the movement in the Company's provision for impairment losses for loans and advances.

	Individually assessed €m	Latent €m	Total 2017 €m	Total 2016 €m
At 1 January	39	2	41	82
Currency translation and other adjustments	2	—	2	(2)
Amounts written-off and disposals	—	—	—	(37)
Recoveries of amounts previously written-off	—	—	—	5
Transfer to disposal group	—	—	—	(10)
Charges/(releases) to the income statement	(4)	(2)	(6)	3
At 31 December	37	—	37	41

Impairment losses/(releases) charged to the income statement	2017 €m	2016 €m	2015 €m
Loans and advances to customers - continuing operations	(6)	(5)	(24)
Recoveries to RBS plc under credit protection arrangements	3	(5)	4
Debt securities	—	2	20
	(3)	(8)	—

Refer to Credit risk: management basis of Capital and risk management section for further details.

The following tables analyse impaired financial assets.

	2017			2016		
	Cost €m	Provision €m	Carrying value €m	Cost €m	Provision €m	Carrying value €m
Loans and advances to customers (1)	45	37	8	47	39	8

Note:
(1) Impairment provisions individually assessed.

Carrying value of impaired debt securities was nil (2016 - nil).

The Group holds collateral in respect of certain loans and advances to banks and to customers that are past due or impaired. Such collateral includes mortgages over property; charges over business assets such as plant, inventories and trade debtors; and guarantees of lending from parties other than the borrower.

No loans have been subject to forbearance in 2017 and 2016 that would otherwise have been past due or impaired.

11 Derivatives

Refer to Note 11 on the consolidated accounts for further information on the tables below.

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

	2017			2016		
	Notional amounts €bn	Assets €m	Liabilities €m	Notional amounts €bn	Assets €m	Liabilities €m
Exchange rate contracts						
Spot, forwards and futures	1,358	12	4	4,806	35	81
Currency swaps	771	60	58	1,462	141	139
Interest rate contracts						
Interest rate swaps	5,397	1,059	482	8,627	1,917	975
Credit derivatives	—	—	—	200	—	1
Equity and commodity contracts	52	27	5	125	80	48
		1,158	549		2,173	1,244

Included above are derivatives held for hedging purposes as follows:

	2017		2016	
	Assets €m	Liabilities €m	Assets €m	Liabilities €m
Fair value hedging				
Interest rate contracts	2	—	19	6
Net investment hedging				
Exchange rate contracts	12	3	7	66

Hedge ineffectiveness recognised in other operating income in continuing operations comprised:

	2017 €m	2016 €m	2015 €m
Fair value hedging			
Gains/(losses) on the hedged items attributable to the hedged risk	16	15	(35)
(Losses)/gains on the hedging instruments	(14)	(15)	42
Fair value ineffectiveness	2	—	7

12 Investments in Group undertakings

	2017 €m	2016 €m
Investment in subsidiaries	434	886
Interests in associates	1,205	1,257
	1,639	2,143

The parent company's principal subsidiary undertakings and participating interests are shown below.

	Country of incorporation	Group interest
RBS Hollandsche N.V., Rotterdam	The Netherlands	100%
RBS WCS Holding Company, New York	Unites States of America	100%
Alawwal Bank, Riyadh (1)	Saudi Arabia	40%

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

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

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

Some of RBS N.V. subsidiaries and participating investments are regulated entities and therefore their ability to transfer funds to RBS N.V. is subject to regulatory approvals.

The movement in investment in Group undertakings during the year reflects the sale of the India business to RBS plc in February 2017 and changes in the underlying net asset value of the Group undertakings.

13 Other assets

	2017 €m	2016 €m
Settlement balances	4	10
Assets of disposal groups	—	810
Other	95	57
	99	877

14 Provisions and other liabilities

	2017 €m	2016 €m
Settlement balances and short positions	13	48
Liabilities of disposal groups	—	219
Other liabilities	52	230
	65	497

Included in other liabilities are provisions for liabilities and charges of €13 million (2016 - €31 million), of which litigation provisions are €13 million (2016 - €25 million) and restructuring provisions are nil (2016 - €6 million). Arising out of its normal business operations, the Group is party to legal proceedings in the Netherlands, United Kingdom, the United States of America and other jurisdictions. Litigation provisions at 31 December 2017 related to numerous proceedings; no individual provision is material. Detailed descriptions of the Group’s legal proceedings and discussion of the associated uncertainties are given in Note 22 on the consolidated accounts.

15 Subordinated liabilities

Refer to Note 17 on the consolidated accounts for further details.

16 Share capital and reserves
There were 11,112 ordinary shares of $4.50 each in issue as at 31 December 2017 and 2016.

	2017 €m	2016 €m
Reserves		
Share premium account	7,024	7,092
Non-distributable reserve shares	10	10
Non-distributable profit participations	1,110	994
Group undertakings reserve	8	8
Other reserves	(5,268)	(5,059)
Total reserves	2,884	3,045

The legal reserves of the Parent Company increased by €119 million, 12%, to €1,125 million as at 31 December 2017 compared to €1,006 million as at 31 December 2016, primarily due to interests in associates.

17 Contingent liabilities and commitments
The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December 2017. Although the Company is exposed to credit risk in the event of non-performance of the obligations undertaken by customers, the amounts shown do not, and are not intended to, provide any indication of the Company's expectation of future losses. Refer to Note 22 on the consolidated accounts for further details.

	Less than 5 years €m	Over 5 years €m	2017 €m	2016 €m
Contingent liabilities and commitments				
Guarantees and assets pledged as collateral security	674	3,779	4,453	4,602
Other contingent liabilities	—	—	—	45
Standby facilities, credit lines and other commitments	72	6	78	76
	746	3,785	4,531	4,723

18 Segmental analysis
Refer to Note 26 on the consolidated accounts for further details.

19 Remuneration of the Managing Board and Supervisory Board
Refer to Note 27 on the consolidated accounts for further details.

20 Related parties
Refer to Note 28 on the consolidated accounts for further details.

21 Post balance sheet events
There have been no significant events between 31 December 2017 and the date of approval of these accounts which would require a change to, or additional disclosure in the accounts.

The publication of these accounts was approved by the Supervisory Board on 24 April 2017. The financial statements will be presented to the General Meeting to be held on 2 May 2017, for adoption. With regard to the adoption of the financial statements of RBS N.V., the Articles of Association state: 'The resolution to adopt the financial statements will be passed by an absolute majority of votes validly cast be the General Members' Council.'

Amsterdam, 24 April 2018

Supervisory Board	Managing Board
Chris Marks	Harm Bots
Christopher Campbell	Cornelis Visscher
Maarten Klessens	
Robert Begbie	

Other information

Independent auditor's report

To the shareholders and Supervisory Board of The Royal Bank of Scotland N.V.

Report on the audit of the 2017 financial statements included in the Annual report and accounts

Our opinion

We have audited the 2017 financial statements of The Royal Bank of Scotland N.V. (RBS N.V. or the Company), based in Amsterdam. The financial statements include the consolidated financial statements and the company financial statements.

In our opinion:
- The accompanying consolidated financial statements give a true and fair view of the financial position of RBS N.V. as at 31 December 2017, and of its result and its cash flows for 2017 in accordance with International Financial Reporting Standards as adopted by the European Union (EU-IFRS) and with Part 9 of Book 2 of the Dutch Civil Code.
- The accompanying company financial statements give a true and fair view of the financial position of RBS N.V. as at 31 December 2017, and of its result for 2017 in accordance with Part 9 of Book 2 of the Dutch Civil Code.

The consolidated financial statements comprise:
- The consolidated balance sheet as at 31 December 2017.
- The following statements for 2017: the consolidated income statement, the consolidated statements of comprehensive income, changes in equity and the consolidated cash flow statement.
- The notes comprising a summary of the significant accounting policies and other explanatory information.

The company financial statements comprise:
- The company balance sheet as at 31 December 2017.
- The company income statement for 2017.
- The notes comprising a summary of the accounting policies and other explanatory information.

Basis for our opinion

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

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

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

Materiality

Materiality	EUR 43 million (2016: EUR 46 million)
Benchmark applied	1.5% of total equity (2016: 1.5%)
Explanation	Based on our professional judgment, a benchmark of 1.5% of total equity is an appropriate quantitative indicator of materiality and it best reflects the focus of users of the financial statements on repayment (capacity) of equity, while earnings are subject to incidental gains and losses following the winding down of operations.

We have also taken misstatements into account and/or possible misstatements that in our opinion are material for the users of the financial statements for qualitative reasons.

Other information

We agreed with the Supervisory Board that misstatements in excess of EUR 2.2 million, which are identified during the audit, would be reported to them, as well as smaller misstatements that in our view must be reported on qualitative grounds.

Scope of the group audit

RBS N.V. is the head of a group of entities and subsidiary undertakings and participating interests. The financial information of this group is included in its consolidated financial statements. RBS N.V. is structured covering the geographical segments: the Netherlands, United Kingdom and rest of the world.

Because we are ultimately responsible for the opinion, we are responsible for directing, supervising and performing the group audit. We determined the scope of our audit by first considering the internal organisation of RBS N.V. and then identifying the components of the audit that have most significance to the financial statements. With most processes serviced centrally by the Royal Bank of Scotland Group plc, the significant components of our audit comprise several functions at RBSG. Our group audit activities focused on components in the Netherlands, the UK and Switzerland based on size and risk. This resulted in a coverage of 91% of profit before taxes and 99% of total assets.

The components in scope for group reporting are all audited by an EY member firm. We sent detailed instructions to the component auditors, covering significant areas including the relevant risks of material misstatement and set out the information required to be reported to the group audit team. We held calls with the auditors of these components and discussed the planning, risk assessment, procedures performed, findings and observations reported to the group auditor.

The group audit team has set a component materiality level of EUR 21 million, based on the mix of size and financial statement risk profile of the component within the group to reduce the aggregation risk to an acceptable level. The consolidation of the group, the disclosures in the financial statements and certain accounting topics that are performed at group level are audited by the group audit team. The accounting matters on which audit procedures are performed by the group audit team include, but are not limited to, equity, group financing, certain elements of the loan loss provisioning process, corporate income tax for the Dutch fiscal unity and claims and litigations.

By performing the procedures mentioned above at group entities, together with additional procedures at group level, we have been able to obtain sufficient and appropriate audit evidence about the group's financial information to provide an opinion about the financial statements.

Our key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements. We have communicated the key audit matters to the Supervisory Board. The key audit matters are not a comprehensive reflection of all matters discussed.

The key audit matters were addressed in the context of our audit of the financial statements as a whole and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

The key audit matters are similar to those reported following our 2016 audit, except for the Target End State Plan and the going concern assumption that is no longer considered as a key audit matter since RBS N.V.'s ultimate parent The Royal Bank of Scotland Group plc's NatWest Markets franchise (NatWest Markets) started preparations in 2017 for repurposing RBS N.V.'s existing banking licence in the Netherlands in order to minimise disruption to its business and to allow it to continue to serve customers in the event of any loss of EU passporting after the UK's departure from the EU. .

We included a new key audit matter regarding the breakdown and allocation of the remaining foreign exchange reserve for investments made in subsidiaries and branches across the world and for which RBS N.V. is exposed to the risk of currency movement due to translation of such investments back into RBS N.V.'s presentation currency in the financial statements. Furthermore, we now include our observations for the key audit matters.

Valuation of associate Alawwal Bank

Key audit matter	RBS N.V. owns a 40% stake in Alawwal Bank in The Kingdom of Saudi Arabia. This investment is accounted for under the equity method, reflecting the initial cost price, adjusted thereafter for the post-acquisition change in RBS N.V.'s share of the net assets of the associate, less any potential impairments on this investment. In April 2017 Alawwal Bank and Saudi British Bank announced the negotiations to a potential merger. Since then, these negotiations are ongoing and the ultimate outcome is uncertain. Alawwal Bank's market value has been below its carrying amount for certain months in 2017. As a result, management assessed whether there is any objective evidence for impairment. Based on the fair value at the end of 2017, reflecting the listed share price, and the subsequent development of the share price in 2018 on the market, management concluded that there was no significant or prolonged decline in the fair value of its investment in Alawwal's below its cost, and neither identified any other indication for impairment. Considering the impact of any potential impairment and the classification for this significant investment in Alawwal Bank, amounting to EUR 1,212 million as at 31 December 2017, we consider this as a key audit matter.
Our audit approach	We obtained an understanding of the status of the merger proposal and its impact in terms of accounting and disclosure in the financial statements, as well as the consequence for the related party settlement transaction in 2016. Furthermore, we tested RBS N.V.'s assessments of potential impairment. We also assessed managements' judgements on the classification of the investment as at 31 December 2017. Finally we assessed the completeness and accuracy of the disclosures on compliance with the requirements included in EU-IFRS. Reference is made to the 'Critical accounting policies and key sources of estimation uncertainty and judgements' sections in the 'Accounting Policies' to the financial statements, Note 12 'Interests in associates' and Note 28 'Related parties'.
Our observations	Based on our audit of management's assessment of potential impairment, we concluded that the valuation of the investment in Alawwal Bank is reasonable. Furthermore, we concur with the classification as associate at 31 December 2017. The related disclosures in the 2017 annual accounts meet the requirements under EU-IFRS.

Valuation of financial instruments

Key audit matter	Fair value measurement of financial instruments and associated valuation techniques, models and adjustments can be a subjective area and more so for areas were RBS N.V. uses model based valuation or with weak liquidity and price discovery. In addition, the number of factors influencing the determination of fair value can be extensive and can vary both by type of instrument and within instrument types. The use of different valuation techniques and assumptions could produce significantly different estimates. Although the size of the portfolio of financial instruments of RBS N.V. has declined in recent years, some positions held at fair value are complex and difficult to value and include structured derivatives which are subject to higher risk estimates and judgements. We therefore consider the valuation of financial instruments a key audit matter.
Our audit approach	As part of our audit we tested the effectiveness of internal controls around the net investment hedging programme, including the controls on disposal of foreign entities. We specifically tested the substantiation of the opening and closing balance of the currency translation adjustments reserve as well as the movements during the year on an entity by entity basis.
Our Observations	Based on our procedures performed we consider the financial instruments to be reasonable valued. We concur with the reporting methodology and underlying assumptions made by management, including the related disclosures in the 2017 annual accounts. The disclosures relating to the fair values of the financial instruments meet the requirements under EU-IFRS.

Foreign exchange reserve of subsidiaries and branches

Key audit matter	RBS N.V. holds investments in subsidiaries and branches across the world and is exposed to the risk of currency movement in equity due to translation of such investments back into the functional currency. In order to reduce such volatility on consolidation, RBS N.V. employs a net investment hedging strategy to manage the currency risk and allocated a set of forward contracts against a particular investment. The portion of foreign exchange differences arising on the hedged investments and on the hedging instrument, determined to be an effective hedge, are recognised in the foreign exchange reserve within equity. Any ineffective portion is recognised in profit and loss account. On disposal of (part of) a foreign operation, the amount accumulated in the foreign exchange reserve is reclassified from equity to the profit and loss account. For this reason, we consider the foreign exchange reserve of subsidiaries and branches as a key audit matter. Early 2017 RBS N.V. identified foreign exchange losses from the disposal of foreign operations in prior years. This had no impact on the total of presented equity.
Our audit approach	Finally, we reviewed the completeness and accuracy of the disclosures relating to the foreign exchange reserves adjustments on compliance with EU-IFRS requirements, including those related to reclassifications to income statement. Reference is made to the sections '7 Foreign currencies' and '20 Derivatives and hedging' in the Accounting Policies' to the financial statements and Note 4 to the 'Consolidated statement of changes in equity'.
Our observations	Based on our procedures performed we concur with the foreign exchange reserve as at 31 December 2017 and the reclassifications to income statement in 2017. The reporting methodology and accounting policies including the related disclosures in the 2017 annual account meet the requirements under EU-IFRS.

Other information

Report on other information included in the annual report

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

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

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

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

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

The Managing Board is responsible for the preparation of the other information, including the Managing Board report in accordance with Part 9 of Book 2 of the Dutch Civil Code and other information pursuant to Part 9 of Book 2 of the Dutch Civil Code.

Report on other legal and regulatory requirements

Engagement

We were engaged by the Supervisory Board as auditor of RBS N.V. on 22 April 2016, as of the audit for the year 2016 and have operated as statutory auditor since that date.

No prohibited non-audit services

We have not provided prohibited non-audit services as referred to in Article 5(1) of the EU Regulation on specific requirements regarding statutory audit of public-interest entities.

Other non-prohibited services provided

In addition to the statutory audit of the financial statements we provided the following services:

- Regulatory reporting: We issued auditor's reports and reports of factual findings following the audit of the prudential statements prepared by management on behalf of the Dutch Central Bank, consisting of Financial Reporting (FinRep), Common Reporting (CoRep), Interest rate risk reporting, Deposit Guarantee Schema (DGS) and Asset Segregation.

Description of responsibilities for the financial statements

Responsibilities of the Managing Board and the Supervisory Board for the financial statements

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

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

The Supervisory Board is responsible for overseeing the company's financial reporting process.

Our responsibilities for the audit of the financial statements

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

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

Other information

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. The materiality affects the nature, timing and extent of our audit procedures and the evaluation of the effect of identified misstatements on our opinion.

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

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

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

We communicate with the Supervisory Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant findings in internal control that we identify during our audit. In this respect we also submit an additional report to the audit committee in accordance with Article 11 of the EU Regulation on specific requirements regarding statutory audit of public-interest entities. The information included in this additional report is consistent with our audit opinion in this auditor's report.

We provide the Supervisory Board with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Supervisory Board, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, not communicating the matter is in the public interest.

Amsterdam, 24 April 2018
Ernst & Young Accountants LLP

Signed by A.B. Roeders

Other information

Articles of association

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

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

- The participation in, collaboration with and financing, administration and management of other enterprises and companies and the performance of all acts, activities and services which are related or may be conducive thereto.

- The engagement in banking and stockbroking activities, the management of third party assets, acting as trustee, administrator, executor of wills and executive director, non-executive director or liquidator of companies or other organisations, the provision of insurances and the performance of all other acts and activities which are related or may be conducive thereto, all in the broadest possible sense.

- The fostering of the direct and indirect interests of all those who are involved in any way in the Company and the safeguarding of the continuity of the Company and its affiliated enterprise(s).

Profit appropriation

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

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

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

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

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

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

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

Other information

Shares and voting rights

The company's share capital at 31 December 2017 and 2016 consisted of 11,112 issued and fully paid ordinary shares of €4.50 each. The Company's authorised share capital amounts to €225,000. It comprises 41,500 ordinary shares and 8,500 preference shares, each with a nominal value of €4.50.

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

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

Relations with shareholders

Rights of shareholders

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

Meetings of shareholders and convocation

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

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

Incorporation and registration

RBS Holdings N.V. is the parent company of the RBS Holdings N.V. consolidated group of companies. RBS N.V. is a public limited liability company, incorporated under Dutch law on 30 May 1990, and registered at Gustav Mahlerlaan 350, 1082 ME Amsterdam, the Netherlands and is entered in the Trade Register of the Amsterdam Chamber of Commerce under no. 33002587.

Code of conduct

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

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

The code of conduct is available on the RBS Group's website www.rbs.com and will be provided to any person without charge, upon request, by contacting Company Secretariat on the telephone number listed on page 137.

Additional information

Additional information

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

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

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

Issued share capital
The issued share capital of RBS N.V. consists of 11,112 ordinary shares with a nominal value of €4.50 each.

Dividends
The Group's policy is to pay dividends on ordinary shares taking account the capital position and prospects. For further information on the payment of dividends, refer to Note 6.

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

For further information on off-balance sheet commitments and contingent liabilities see Note 22 to the Financial Statements.

Credit ratings
The senior unsecured long-term and short-term credit ratings of RBSG, RBS plc and RBS N.V. are investment grade by Moody's, Standard and Poors and Fitch.

In April 2018, Moody's downgraded the senior unsecured long-term credit ratings of RBS plc and RBS N.V. from A3 to Baa2 with the short term credit ratings remaining at P-2.

The outlook for RBSG and RBS N.V. is currently stable for S&P, Fitch and Moody's.

The resulting changes in ratings are set out in the table below.

	Moody's (1)				Standard and Poor's				Fitch			
	Current rating		Previous rating		Current rating		Previous rating		Current rating		Previous rating	
	Long term	Short term	Long term	Short term	Long term	Short term	Long term	Short term	Long term	Short term	Long term	Short term
RBSG plc	Baa3	P-3	Baa3	P-3	BBB-	A-3	BBB-	A-3	BBB+	F2	BBB+	F2
RBS plc	Baa2	P-2	A3	P-2	BBB+	A-2	BBB+	A-2	BBB+	F2	BBB+	F2
RBS N.V.	Baa2	P-2	A3	P-2	BBB+	A-2	BBB+	A-2	BBB+	F2	BBB+	F2

Note:
(1) Moody's also assigns long-term and short term deposits ratings to the operating companies. These are Baa2 and P-2 respectively for RBS plc and RBS N.V..

Additional information

Risk factors

Set out below are certain risk factors that could adversely affect the financial position, results of operations, reputation or execution of the wind-down of legacy activities of RBS Holdings N.V. and its subsidiaries (collectively, the 'RBSH Group') and cause them to be materially different from what is expected. RBSH Group is a subsidiary of The Royal Bank of Scotland Group plc ('RBSG' and, together with its subsidiaries, the 'RBS Group') and depends on the RBS Group to conduct its operations. Accordingly, a number of risk factors described below which relate to the RBS Group will also be of relevance to the RBSH Group and the occurrence of any such risks could also directly or indirectly impact the RBSH Group's financial position, results of operations, reputation or execution of the wind-down of its legacy activities. 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 RBSH Group.

The RBSH Group is in the process of implementing transfers of a substantial part of the business activities of RBSG's Dutch banking subsidiary, The Royal Bank of Scotland N.V. ('RBS N.V.') to The Royal Bank of Scotland plc ('RBS plc', to be renamed NatWest Markets Plc) and third parties, with a view to winding down certain legacy activities, in order to decrease financial and regulatory risk. At the same time, in anticipation of Brexit, the RBS Group has announced that it will be re-purposing RBS N.V. for the NatWest Market franchise's European business and further structural changes to RBS Group's Western European operations may also be required. The process of winding-down the legacy activities, and the concurrent re-purposing of RBS N.V. entails significant execution and regulatory risk which may in turn have a material adverse effect on the RBSH Group.

As part of the implementation of the RBS Group's transformation programme, the RBS Group has been implementing the transfers of a substantial part of the business activities of RBS N.V. to RBS plc and third parties, including the proposed sale of Alawwal Bank, in which the RBSH Group holds a 40% interest ('the Transfers'). The Transfers have been carried out since 2011 and a substantial part of the business activities of RBS N.V. have been successfully transferred to RBS plc or sold to third parties.

In 2015, the RBSH Group formulated a strategy to complete the planned Transfers and certain other steps with a view to further winding-down its remaining operations.

RBSH Group holds 40% of Alawwal Bank (in the Kingdom of Saudi Arabia) via a consortium comprised of RBSG, Stichting Administratiekantoor Beheer Financiële Instellingen (the Dutch State, successor to Fortis) and Banco Santander S.A. ('Santander') who jointly acquired RBS Holdings on 17 October 2007 through RFS Holdings B.V. ('RFS Holdings') (together, the 'Consortium'). On 25 April 2017, Alawwal Bank announced that it had started merger discussions with Saudi British Bank. It was recently announced that the proposed merger had been delayed. The proposed merger of Alawwal and Saudi British Bank is subject to execution risk and the exact terms and timing of the merger is subject to uncertainty.

At the same time as the Transfers, in anticipation of Brexit, the RBS Group has announced that it will be re-purposing RBS N.V. to serve the NatWest Market franchise's European business. Further structural changes to the RBS Group's Western European operations may also be required. See 'The RBS Group and the RBSH Group are subject to political risks, including economic, regulatory and political uncertainty arising from the referendum on the UK's membership of the European Union. As a result of this referendum and in anticipation of Brexit, the RBS Group has announced that it will be re-purposing RBS N.V. for the NatWest Market franchise's European business and further structural changes to Group's Western European operations may also be required, which could adversely impact the RBSH Group's business, results of operations, financial condition and prospects.'

The RBSH Group's ability to wind-down its legacy operations and to complete all Transfers and other necessary steps within the time frames contemplated, or at all, depends on a number of factors, including factors not entirely within the RBSH Group's control. The occurrence of any of the risks described above could have a material adverse effect on the RBSH Group's ability to execute the wind-down of its legacy activities and pending the completion thereof, may adversely affect its business, results of operations, financial condition and/or capital position. Due to evolving regulatory circumstances, the RBS Group may also revisit the RBSH Group's current plans regarding the wind-down of the legacy portfolios and the re-purposing of RBS N.V. and therefore such plans may be subject to change.

The RBS Group and the RBSH Group are subject to political risks, including economic, regulatory and political uncertainty arising from the referendum on the UK's membership of the European Union. As a result of this referendum and in anticipation of Brexit, the RBS Group has announced that it will be re-purposing RBS N.V. for the NatWest Market franchise's European business and further structural changes to Group's Western European operations may also be required, which could adversely impact the RBSH Group's business, results of operations, financial condition and prospects.

In a referendum held in the United Kingdom ('UK') on 23 June 2016 (the 'EU Referendum'), a majority voted for the UK to leave the European Union ('EU'). On 29 March 2017 the UK Government triggered the exit process contemplated under Article 50 of the Treaty on European Union. This provided for a maximum two year period of negotiation to determine the terms of the UK's exit from the EU (also known as 'Brexit') and set forth the framework for the UK's new relationship with the EU.

On 19 March 2018, a new version of the European Union (Withdrawal) Bill (the 'Withdrawal Bill') was published, which included the terms for a 21-month transition period. Such transition period, if finally agreed, will end on 31 December 2020.

Risk factors continued

After this period the UK's EU membership and all associated treaties will cease to apply, unless some form of further transitional agreement encompassing those associated treaties is agreed or there is unanimous agreement by the European Council with the UK to extend the negotiation period defined under Article 50 or within the terms of the Withdrawal Bill. There is no certainty that negotiations relating to the terms of the UK's relationship with the EU will be completed within the timeframe designated by Article 50 and the Withdrawal Bill. Furthermore, the Withdrawal Bill aims to repeal the European Communities Act of 1972 and to transpose EU law relevant to the UK into national law upon Brexit, but the precise terms of the Withdrawal Bill, if enacted by the UK Parliament, are uncertain and it remains unclear how the Withdrawal Bill will impact the legal and regulatory landscape in the UK after it becomes effective.

This prevailing uncertainty relates to the timing of Brexit, as well as to 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. The timing of, and process for, such negotiations and the resulting terms of the UK's future economic, trading and legal relationships with both the EU and other counterparties could impact the RBS Group's and the RBSH Group's financial condition, results of operations and prospects. The direct and indirect effects of Brexit are expected to affect many aspects of the RBS Group's and the RBSH Group's business and operating environment, including as described elsewhere in these risk factors, and may be material.

The longer term effects of Brexit on the RBS Group's and the RBSH Group's operating environment are difficult to predict, and are subject to wider global macro-economic trends and events, but may significantly impact the RBS Group and the RBSH Group and their 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. 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, the longer-term effects of this uncertainty are likely to endure and their severity increase in the absence of such agreements.

There is related uncertainty as to the respective legal and regulatory arrangements under which the RBS Group and its subsidiaries (including the RBSH Group) will operate when the UK is no longer a member of the EU. The RBS 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 cost and timing of that authorisation process is uncertain.

The RBS Group has already announced plans to re-purpose its Dutch banking subsidiary, RBS N.V., to conduct the NatWest Market franchise's European business and further changes to the RBS Group's business operations may be required. The ability of RBS plc (to be renamed NatWest Markets Plc) to utilise RBS N.V. as a platform for its European business is subject to uncertainty and there is no guarantee that the use of such platform will be successful.

The RBS Group is also monitoring proposed amendments to the prudential framework for non-EU banks operating within in the EU. These and any other restructuring or commercial actions as well as new or amended rules, could have a significant impact on the RBS Group's operations and/or legal entity structure, including attendant restructuring costs, capital requirements and tax implications and as a result adversely impact the RBS Group's and the RBSH Group's profitability, business model and product offering. See 'The RBS Group and the RBSH Group have been, and will remain, in a period of major business transformation and structural change through to at least 2019 as they implement their own transformation programmes and seek to comply with UK ring-fencing and recovery and resolution requirements. Additional structural changes to the RBS Group and the RBSH Group's operations will also be required as a result of Brexit. These various transformation and restructuring activities are required to occur concurrently, which carry significant execution and operational risks, and the RBSH Group may not be a viable, competitive and profitable bank as a result.'

The RBS Group and the RBSH Group face additional political uncertainty as to how the Scottish parliamentary process may impact the negotiations relating to Brexit. RBSG and RBS plc (to be renamed NatWest Markets Plc) are each headquartered and incorporated in Scotland. Any changes to Scotland's relationship with the UK or the EU (as an indirect result of Brexit or other developments) would impact the environment in which the RBS Group and its subsidiaries (including the RBSH Group) operate, and may require further changes to be made to the RBS Group's or the RBSH Group's structure, independently or in conjunction with other mandatory or strategic structural and organisational changes and as a result could adversely impact the RBS Group and the RBSH Group.

The RBSH Group is currently subject to increased political risks as a result of the UK Government's majority ownership stake in RBSG. The UK Government in its November 2017 Autumn Budget indicated its intention to recommence the process for the privatisation of RBSG, although there can be no certainty as to the commencement of any sell-downs or the timing or extent thereof. Were there to be a change of UK government as a result of a general election, the RBS Group may face new risks as a result of a change in government policy. In its 2017 manifesto, for example, the Labour Party announced its intention to launch a consultation on breaking up the RBS Group to create new local public banks, a move that could impact the RBS Group.

In addition to the political risks described above, the RBS Group remains exposed to risks arising out of geopolitical events, such as the imposition of trade barriers, the implementation of exchange controls and other measures taken by sovereign governments that can hinder economic or financial activity levels.

Risk factors continued

The RBS Group and the RBSH Group have been, and will remain, in a period of major business transformation and structural change through to at least 2019 as they implement their own transformation programmes and seek to comply with UK ring-fencing and recovery and resolution requirements. Additional structural changes to the RBS Group and the RBSH Group's operations will also be required as a result of Brexit. These various transformation and restructuring activities are required to occur concurrently, which carry significant execution and operational risks, and the RBSH Group may not be a viable, competitive and profitable bank as a result.

Since early 2015, the RBS Group has been implementing a major restructuring and transformation programme, articulated around a strategy focused on the growth of 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. Part of the focus of this transformation programme is to downsize and simplify the RBS Group, reduce underlying costs and strengthen its overall capital position. The transformation programme also aims to improve customer experience and employee engagement, update its operational and technological capabilities, strengthen governance and control frameworks and better position the RBSH Group to operate in compliance with the UK ring-fencing regime by 1 January 2019. Together, these initiatives are referred to as the 'transformation programme'.

This transformation programme, including the restructuring of its NatWest Markets franchise, is being completed at the same time as the RBS Group is going through a period of very significant structural reform to implement the requirements of the UK ring-fencing regime and the requirements of the bank recovery and resolution framework. It is complex and entails significant costs and operational, legal and execution risks. See '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 RBS Group and the RBSH Group's business, including with respect to the perimeter of the RBSH Group's activities and the assets, liabilities and businesses that it holds. The steps required to implement the UK ring-fencing regime are complex and entail significant costs and operational, legal and execution risks, which risks may be exacerbated by the RBS Group's other ongoing restructuring efforts. The implementation of ring-fencing will fundamentally reshape the RBS Group and RBSH Group's business and operations.'

Due to changes in the macro-economic and political and regulatory environment in which it operates, in particular as a result of Brexit, the RBS Group and the RBSH Group have been required to reconsider certain aspects of their current restructuring and transformation programme. In anticipation of Brexit the RBS Group has announced that it will be re-purposing RBS N.V. to serve the NatWest Market franchise's European business. Further structural changes to the RBS Group's Western European operations may also be required, including in response to proposed changes to the European prudential regulatory framework for banks and investment banks.

These proposals 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 and may apply to the RBS Group once the UK has formally exited the EU. The ability of the RBS Group to successfully re-purpose and utilise RBS N.V. as the platform for the NatWest Market franchise's European business following Brexit is subject to numerous uncertainties, including those relating to Brexit negotiations. See 'The RBS Group and the RBSH Group are subject to political risks, including economic, regulatory and political uncertainty arising from the referendum on the UK's membership of the European Union. As a result of this referendum and in anticipation of Brexit, the RBS Group has announced that it will be re-purposing RBS N.V. for the NatWest Market franchise's European business and further structural changes to Group's Western European operations may also be required, which could adversely impact the RBSH Group's business, results of operations, financial condition and prospects.'

One proposal made by the European Commission would impose a requirement for any bank established outside the EU, which has an asset base within the EU exceeding a certain size and has two or more institutions within the EU, to establish a single intermediate parent undertaking ('IPU') in the European Union under which all EU entities within that group will operate.

The RBS Group and the RBSH Group are currently taking steps to plan for how these proposals, if adopted as currently proposed, may impact the RBS Group and the RBSH Group and their current plans to implement the UK ring-fencing regime (which will come into force on 1 January 2019 ahead of any IPU being required). The impact of these proposals could be material given the expectation that the RBS Group and the RBSH Group would continue to carry out operations in the EU. This could result in material additional capital requirements and could have adverse tax implications.

The scale and scope of the changes currently being implemented present material operational, people and financial risks to the RBSH Group. The transformation programme and structural reform agenda comprise a large number of concurrent actions and initiatives, any of which could fail to be implemented due to operational or execution issues. Implementation of such actions and initiatives 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 RBS Group and RBSH Group's control. Furthermore it requires the implementation and application of robust governance and controls frameworks and there is no guarantee that the RBS Group and the RBSH Group will be successful in doing so.

Risk factors continued

The planning and execution of the various restructuring and transformation activities is disruptive and will continue to divert management resources from the conduct of the RBS Group and the RBSH Group's operations and development of its business. Any additional restructuring and transformation of the RBS Group and the RBSH Group's activities would increase these risks and could result in further material restructuring and transformation costs, jeopardise the delivery and implementation of a number of other significant change projects, impact the RBS Group and the RBSH Group's product offering or business model or adversely impact the RBS Group and the RBSH Group's ability to deliver their strategy and meet their targets and guidance, each of which could have a material adverse impact on the RBSH Group's results of operations, financial condition and prospects.

There can be no certainty that the RBS Group will be able to successfully complete its transformation programme and programmes for mandatory structural reform, nor that the restructured RBSH Group will be a viable, competitive or profitable banking business.

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 RBS Group and the RBSH Group's business, including with respect to the perimeter of the RBSH Group's activities and the assets, liabilities and businesses that it holds. The steps required to implement the UK ring-fencing regime are complex and entail significant costs and operational, legal and execution risks, which risks may be exacerbated by the RBS Group's other ongoing restructuring efforts. The implementation of ring-fencing will fundamentally reshape the RBS Group and RBSH Group's business and operations.

The requirement for large UK banks taking deposits 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).

By the end of 2018, the RBS Group intends to have placed the majority of its UK and Western European banking business in ring-fenced banking entities organised as a sub-group ('RFB') under an intermediate holding company named NatWest Holdings Limited, which will ultimately be a direct subsidiary of RBSG and will own 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 the RBS plc (which will be renamed NatWest Markets Plc and sit outside the RFB). The RBSH Group and the RBS International businesses will also sit outside the RFB.

As part of this restructuring, the majority of existing personal, private, business and commercial customers of the current RBS plc (to be renamed NatWest Markets Plc) is expected to be transferred to the RFB during the second quarter of 2018, specifically to Adam & Company PLC (to be renamed The Royal Bank of Scotland plc). Certain assets and liabilities (including the covered bond programme, certain hedging positions and parts of the liquid asset portfolio) will also be transferred to National Westminster Bank 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. The transfer, as described above, will be effected principally by utilising a legal scheme entitled a 'Ring-Fencing Transfer Scheme' under Part VII of the Financial Services and Markets Act 2000 ('the Scheme').

On 22 March 2018, the Court of Session in Scotland (the 'Court') approved the Scheme. It is expected that the Scheme will be implemented with effect from 30 April 2018 or any later date which the RBS Group may agree with the Prudential Regulatory Authority ('PRA') and the Financial Conduct Authority ('FCA').

In addition, during the second half of 2018, it is proposed that NatWest Holdings Limited, being the parent of the future RFB will become a direct subsidiary of RBSG. This is expected to occur through a capital reduction of RBS plc (to be renamed NatWest Markets Plc), which will be satisfied by the transfer of the shares in NatWest Holdings Limited currently held by RBS plc (to be renamed NatWest Markets Plc) to RBSG, which will occur via a further and separate court process, which is subject to the relevant court and regulatory approvals. It is possible that the court process described above may result in amendments being required to be made to the RBS Group's current plan and that this may result in delays in the implementation of the UK ring-fencing compliant structure, additional costs and/or changes to the RBS Group's and the RBSH Group's business.

During the course of 2018, it is proposed that the RBS Group will seek to implement a second, smaller ring-fencing transfer scheme under Part VII of the Financial Services and Markets Act 2000 as part of its strategy to implement its future ring-fencing compliant structure, which is proposed to transfer certain assets from National Westminster Bank Plc to RBS plc (to be renamed NatWest Markets Plc). Such a scheme would be subject to board and regulatory approval, the review and report by an Independent Skilled Person appointed by the RBS Group with the prior approval of the PRA (having consulted with the FCA) and the sanction of the Court.

As a result of the implementation of the changes described above, there will be a material impact on the composition of the RBS Group's assets and liabilities and the businesses it operates and will require a significant legal and organisational restructuring of the RBS Group and the transfer of large numbers of assets, liabilities, obligations, customers and employees between legal entities within the RBS Group.

Risk factors continued

The RBS Group's final ring-fenced legal structure and the actions being taken to achieve it, remain subject to, amongst other factors, additional regulatory, board and other approvals.

The implementation of these changes involves a number of risks related to both the revised RBS Group and RBSH Group structures and also the process of transition to such new structures. Those risks include the following:

- As a result of ring-fencing, certain customers will be moved to the RFB and certain customers will be required to deal with both the RFB and other RBS 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. The RBS Group is unable to predict how some customers may react to these and other required changes.
- As part of the establishment of the RFB, the RFB will need to operate independently from the other RBS Group entities outside the RFB and as a result, amendments will need to be made to the RBS Group's existing corporate governance structure to ensure the RFB is independent from the other RBS Group entities outside the RFB. This new structure, which will also require the approval of the PRA, may result in divergences between the various governance bodies within the RBS Group and create operational challenges.
- In order to comply with the requirements of the UK ring-fencing regime, the RBSH 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 legislation and 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 the RFB and other RBS Group entities outside the RFB 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. Any duplication of certain infrastructure or functions between the RFB and other RBS Group entities outside the RFB that are required to comply with the UK ring-fencing legislation and rules and dis-synergies resulting therefrom may in turn result in additional costs and/or changes to the RBS Group's business and operations
- The implementation of the UK ring-fencing regime will significantly impact the management of the RBS 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 RBS Group and its subsidiaries. The ability of bank entities outside the RFB to meet funding and capital prudential requirements may be dependent on obtaining an adequate credit rating. Once the UK ring-fencing regime is implemented, reliance on intragroup exemptions in relation to large exposures and liquidity will not be possible between the RFB and other RBS Group entities outside the RFB and may result in risk-weighted assets inflation.

  From 2026 it will not be possible for the RBS Group entities outside the RFB to participate in the same defined benefit pension scheme as RFB entities or their wholly-owned subsidiaries. As a result, it will be necessary to restructure the RBS Group's defined benefit pension scheme (including The Royal Bank of Scotland Group Pension Fund ('Main scheme')). This restructuring will be such that either the RFB or other RBS Group entities outside 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 RBS Group. Although a number of transfers will be made at book value between fully owned RBS Group entities, certain transfers will be made at fair value which may result in a profit or loss being recognised by RBS 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 RBS Group entities outside the RFB and the ability to transfer tax losses.

The steps required to implement the UK ring-fencing regime within the RBS Group (including with respect to the RBSH Group) to comply with the relevant rules and regulations are 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 RBS Group's other ongoing restructuring efforts (many of which may impact the RBSH Group). 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 Brexit, as well as further political developments or changes to the RBS Group's current strategy, may require the RBS Group to further restructure its operations (including certain RBS Group operations in the UK and Western Europe) and may in turn require further changes to be made to the RBS Group's ring-fencing plans (including the planned structure of the RBS Group post implementation).

The completion of ring-fencing will substantially reconfigure the way RBSG holds its businesses and the legal entities within the RBS Group. There is no certainty that the RBS Group will be able to complete the legal restructuring and migration of customers' assets and liabilities by the 1 January 2019 deadline or in accordance with future rules and the consequences of non-compliance are currently uncertain. Conducting the RBS Group's operations in accordance with the new rules may result in additional costs (transitional and recurring) following implementation and impact the RBS Group's and/or the RBSH Group's profitability. As a result, the implementation of the UK ring-fencing regime could have a material adverse effect on the RBSH Group's reputation, results of operations, financial condition and prospects.

Risk factors continued

The RBS Group and the RBSH Group are 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 RBSH Group's operations, operating results, reputation, financial position and future prospects, including the wind-down of legacy activities and the re-purposing of RBS N.V..
The RBS Group's operations remain diverse and complex and the RBS Group and the RBSH Group operate in legal and regulatory environments that expose them to potentially significant legal and regulatory actions, including litigation claims and proceedings and civil and criminal regulatory and governmental investigations, and other regulatory risk. Any such ongoing or new disputes, litigation, regulatory and governmental investigations could delay or impair RBSH's ability to wind-down its legacy activities or to re-purpose RBS N.V.. The RBS Group and RBSH Group have settled a number of legal and regulatory actions over the past several years but continue 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 RBS Group's view, the most significant legal and regulatory actions to which the RBS Group, including RBSH Group, are currently exposed. However, the RBS Group and the RBSH Group are 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 RBSH 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 government securities), product mis-selling, customer mistreatment, anti-money laundering, sanctions, antitrust and various other compliance issues.

In the US, ongoing matters include certain matters relating to legacy RMBS activities including investigations by the US Department of Justice (DOJ) and several state attorneys general and various civil claims. See pages 83 to 85 for details of matters relating to the RBSH Group. See pages 313 to 325 of the RBS Group's Annual Report & Accounts for details of matters relating to the RBS Group. While the RBSH Group may not be directly involved in certain matters involving the RBS Group, any final adverse outcome of those matters, including the imposition of large monetary penalties or fines, may also have an adverse effect on the RBSH Group.

The RBS Group and the RBSH Group continue to cooperate with governmental and regulatory authorities in relation to ongoing regulatory actions. 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 RBS Group and the RBSH Group will continue to have a material exposure to legal and regulatory actions relating to legacy issues in the medium term and 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.

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 RBS Group and the RBSH 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 RBS Group and the RBSH 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 RBS Group's and/or the RBSH Group's financial condition and results of operations as well as their reputation. The outcome of on-going claims against the RBS Group and the RBSH Group may give rise to additional legal claims being asserted against the RBS Group and the RBSH Group. Adverse outcomes or resolution of current or future legal or regulatory actions could result in restrictions or limitations on the RBS Group's and the RBSH Group's operations, adversely impact the implementation of the RBS Group's current transformation programme or the execution of the RBSH Group's wind-down of legacy activities or the re-purposing of RBS N.V., as well as their capital position and ability to meet regulatory capital adequacy requirements. Any financial consequences relating to legal or regulatory actions will become proportionally more significant for the RBSH Group if it continues to reduce its balance sheet.

Operational risks are inherent in the RBSH Group's businesses and these risks are heightened as the RBS Group implements its transformation programme and the RBSH Group implements the wind-down of legacy activities, 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 RBSH 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 RBS Group or RBSH Group, including cybercrime;
- compromise of the confidentiality, integrity, or availability of the RBS Group or the RBSH Group's data, systems and services;

Risk factors continued

- failure to identify or maintain the RBS Group or the RBSH Group's key data within the limits of their agreed risk appetite;
- failure to provide adequate data, or the inability to correctly interpret poor quality data;
- failure of the RBS Group or the RBSH Group's technology services due to loss of data, systems or data centre failure as a result of the RBSH Group's actions or actions outside the RBSH Group's control, or failure by third parties to restore services;
- failure to appropriately or accurately manage the RBS Group or the RBSH Group's operations, transactions or security;
- incorrect specification of models used by the RBS Group or the RBSH Group or implementing or using such models incorrectly;
- failure to effectively design, execute or deliver the RBS Group's transformation programme, the RBSH Group's wind-down of legacy activities or the re-purposing of RBS N.V.;
- failure to attract, engage or retain staff;
- insufficient resources to deliver change and business-as-usual activity;
- decreasing employee engagement or failure by the RBSH Group to embed new ways of working and values; or
- incomplete, inaccurate or untimely statutory, regulatory or management reporting.

Operational risks are and will continue to be heightened as a result of the number of initiatives being concurrently implemented by the RBSH Group, including the implementation of the RBS Group's transformation programme, including its cost-reduction programme, the implementation of the UK ring-fencing regime, as well as the execution of the RBSH Group's wind-down of legacy activities and the re-purposing of RBS N.V.. Individually, these initiatives carry significant execution and delivery risk and such risks are heightened as their implementation is often 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 RBS Group's and the RBSH Group's ability to maintain effective internal controls and governance frameworks. Although the RBS 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 RBS Group and the RBSH Group. Ineffective management of operational risks could adversely impact the execution of the RBSH Group's wind-down of legacy activities and the re-purposing of RBS N.V., and may have a material adverse effect on the RBS Group's and/or the RBSH Group's business, financial condition and results of operations.

The RBSH Group's operations are highly dependent on its and the RBS Group's IT systems. A failure of its or the RBS 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 RBS Group or the RBSH Group to regulatory sanctions.

The RBS Group's and the RBSH 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 RBS Group's and the RBSH 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 RBS Group's and the RBSH Group's operations.

The vulnerabilities of the RBS Group's and the RBSH Group's IT systems are in part due to their complexity, which is attributable to overlapping multiple dated systems that result from the RBS Group's historical acquisitions and insufficient investment prior to 2013 to keep the IT applications and infrastructure up-to-date. Within a complex IT estate, the risk of disruption due to end-of-life hardware and software may create challenges in recovering from system breakdowns. In 2017, the RBSH Group made progress to remediate or replace out of date systems, reducing the overall risk of disruption. However, some risk remains, and will require continued focus and investment on an on-going basis to limit any IT failures which may adversely affect the RBS Group's or the RBSH Group's relationship with their customers and their reputation, and which may also lead to regulatory investigations and redress.

The RBS Group's and the RBSH Group's regulators continue to actively monitor progress being made by banks to modernise, manage and secure their IT infrastructure and environment, 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 RBS Group's or the RBSH Group's ability to provide service to their customers, which could result in significant compensation costs or fines resulting from regulatory investigations and could breach regulations under which the RBS Group and the RBSH Group operate.

In particular, failures or breaches resulting in the loss or publication of confidential customer data could cause long-term damage to the RBS Group's and/or the RBSH Group's reputation, business and brands, which could undermine its ability to attract and keep customers.

Risk factors continued

The RBS Group and the RBSH Group currently are implementing a number of complex change initiatives, including the transformation programme, the UK ring-fencing regime and the restructuring of the NatWest Markets franchise. A failure to safely and timely implement one or several of these initiatives could lead to disruptions of the RBS Group's or the RBSH Group's IT infrastructure or loss or publication of confidential customer data and in turn could cause long-term damage to the RBS Group's and the RBSH Group's reputation, brands, results of operations and financial position. In addition, recent or future regulatory changes, such as the EU General Data Protection Regulation and the CMA's Open Banking standard, increase the risks relating to the RBS Group's and the RBSH Group's ability to comply with rules that impact its IT infrastructure. Any non-compliance with such regulations could result in regulatory proceedings or the imposition of fines or penalties and consequently could have a material adverse effect on the RBS Group's and the RBSH Group's business, reputation, financial condition and future prospects.

The RBS Group has made, and will continue to make, considerable investments in its (including the RBSH Group's) IT systems and technology to further simplify, upgrade and improve its capabilities to make them more cost-effective and improve controls, procedures, strengthen cyber security defences, enhance the digital services provided to bank customers and improve the RBS Group's and the RBSH Group's competitive position, which is designed to reduce the potential for system failures which adversely affect their relationship with their customers and reputation, which may lead to regulatory investigations and redress. However, the RBS Group's and the RBSH Group's current focus on cost-saving measures, as part of the transformation programme, may impact the resources available to implement further improvements to the RBS Group's and the RBSH Group's IT infrastructure and technology or limit the resources available for investments in technological developments and/or innovation.

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 RBSH Group's operations, its ability to retain or grow its customer business or its competitive position and could negatively impact the RBSH Group's financial position.

The RBS Group and the RBSH Group are exposed to cyberattacks and a failure to prevent or defend against such attacks and provide, as appropriate, notification of them, could have a material adverse effect on the RBSH Group's operations, results of operations or reputation.

The RBS Group and the RBSH Group are subject to regular cybersecurity attacks and related threats, which have targeted financial institutions, corporates, governments and other institutions across all industries. The RBS Group and the RBSH Group are increasingly reliant on technology which is vulnerable to attacks and these attacks continue to increase in frequency, sophistication and severity and could have a material adverse effect on the RBSH Group's operations, customers and reputation.

The RBS Group and the RBSH Group rely on the effectiveness of their internal policies, controls, procedures and capabilities to protect the confidentiality, integrity and availability of information held on their computer systems, networks and devices, and also on the computer systems, networks and devices of third parties with whom the RBS Group and the RBSH Group interact. In connection with the implementation of the UK ring-fencing regime, certain systems, networks or devices may be migrated from the RBSH Group level to the entities within the RFB, which may cause disruption or impact the effectiveness of such systems, networks or devices.

The RBS Group and the RBSH Group take appropriate measures to prevent, detect and minimise attacks that could disrupt the delivery of critical business processes to their customers. Because financial institutions such as the RBSH Group operate with complex legacy infrastructure, they may be even more susceptible to attack due to the increased number of potential entry points and weaknesses. In addition, the increasing sophistication of cyber criminals may increase the risk of a security breach of the RBS Group's and the RBSH Group's systems and as security threats continue to evolve the RBS Group and the RBSH Group may be required to invest additional resources to modify the security of their systems, which could have a material adverse effect on the RBS Group's and the RBSH Group's results of operations.

Failure to protect the RBSH Group's operations from cyberattacks or to continuously review and update current processes and controls in response to new or existing threats could result in the loss of customer data or other sensitive information as well as instances of denial of service for the RBSH Group's customers and staff.

The RBS Group and the RBSH Group's systems, and those of third parties suppliers, are often subject to cyberattacks which have to date been immaterial to the RBS Group's and the RBSH Group's operations. In 2017, the RBS Group experienced 11 distributed denial of service ('DDOS') attacks against customer-facing websites, one of which caused minimal customer impacts for a short period of time.

This represents a decrease from 26 attacks against the RBS Group in 2016, but a recent surge of activity in the fourth quarter of 2017 points towards an increasing trend of such attacks into 2018. The RBS Group's DDOS mitigation controls have recently been strengthened and will continue to be strengthened further in 2018. However, there can be no assurance that those and the RBS Group and the RBSH Group's other strategies to defend against cyberattacks, including future DDOS attacks, will be successful and avoid the potential adverse effects of cyberattacks on the RBS Group or the RBSH Group.

The Bank of England, the FCA and HM Treasury in the UK and regulators in the US and in Europe continue to recognise cybersecurity as a systemic risk to the financial sector and have highlighted the need for financial institutions to improve resilience to cyberattacks and provide timely notification of them, as appropriate. The RBS Group expects greater regulatory engagement, supervision and enforcement on cybersecurity in the future.

Risk factors continued

The RBS Group and the RBSH Group continue to participate in initiatives led by the Bank of England and other regulators designed to share best practice and to test how major firms respond to significant cyberattacks.

The outputs of this collaboration along with other regulatory and industry-led initiatives are continually incorporated into the RBS Group's and the RBSH Group's on-going IT priorities and improvement measures. However, the RBSH Group continues to expect that it and the RBS Group will be targeted regularly in the future but there can be no certainty that the RBSH Group will not be materially impacted by a future attack.

Any failure in the RBS Group's cybersecurity policies, procedures or controls, could lead to the RBSH Group suffering financial losses, reputational damage, a loss of customers, additional costs (including costs of notification of consumers, credit monitoring or card reissuance), regulatory investigations or sanctions being imposed and could have a material adverse effect on the RBSH Group's results of operations, financial condition or future prospects.

The RBSH Group's business performance and financial position could be adversely affected if its or the RBS Group's capital is not managed effectively or if it or the RBS Group is unable to meet their prudential regulatory requirements, including their capital targets. Effective management of the RBS Group's and the RBSH Group's capital is critical to their ability to operate their businesses, comply with regulatory obligations, pursue their transformation programmes and current strategies, resume dividend payments on RBSG ordinary shares, maintain discretionary payments and pursue their strategic opportunities.

Entities within the RBS Group and RBSH Group (including RBS N.V.) are required by regulators in the UK, the EU and other jurisdictions in which they undertake regulated activities to maintain adequate capital resources. Adequate capital also gives the RBS Group and the RBSH Group financial flexibility in the face of continuing turbulence and uncertainty in the global economy and specifically in their core UK and European markets.

The RBS Group currently targets a CET1 ratio at or above 13% throughout the period until completion of its restructuring. On the PRA transitional basis, the RBS Group's and the RBSH Group's CET1 ratio were 15.9% and 24.9%, respectively, at 31 December 2017, compared with 13.4% and 21.2%, respectively, at 31 December 2016.

The target capital ratio for RBS Group and RBSH Group, including subsidiaries, is based on regulatory requirements and internal modelling applied on stress scenarios. However, the ability to achieve such targets depends on a number of factors, including the implementation of the RBS Group's and the RBSH Group's transformation programme and any of the factors described below. A shortage of capital could arise from:

- a depletion of the RBS Group's or the RBSH 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, impairments or accounting charges;
- reduced upstreaming of dividends from the RBS Group's subsidiaries as a result of the Bank of England's approach to setting MREL within groups, requiring sub-groups, such as the RBSH Group, to hold internal MREL resources sufficient to match both their own individual MREL as well as the internal MREL of the subsidiaries constituting the sub-group;
- an increase in the amount of capital that is required to meet the RBSH Group's regulatory requirements, including as a result of changes to the actual level of risk faced by the RBS Group or the RBSH Group, factors influencing the PRA's determination of the firm-specific Pillar 2B buffer applicable to the RBS Group, 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 RBS Group or the RBSH Group, including countercyclical buffers, increases in risk-weighted assets or in the risk weighting of existing asset classes, or an increase in the RBS Group's view of any management buffer it needs, taking account of, for example, the capital levels or capital targets of the RBS Group's peer banks and criteria set by the credit rating agencies;
- the implementation of the RBS Group's transformation programme, including in response to implementation of the UK ring-fencing regime, means certain intragroup funding arrangements will be limited and may no longer be permitted and the RBS Group entities, including the RBSH Group, may need to increasingly manage funding and liquidity at an individual RBS Group or RBSH Group entity level, which could result in the RBS Group and the RBSH Group being required to maintain higher levels of capital in order to meet their regulatory requirements than would otherwise be the case, as may be the case if the Bank of England were to identify impediments to the RBS Group's resolvability resulting from new funding and liquidity management strategies. In addition, once the UK ring-fencing regime is implemented, reliance on intragroup exemptions in relation to large exposures and liquidity will not be possible between the RFB and other RBS Group entities outside the RFB (including the RBSH Group) and may result in risk-weighted assets inflation.

In addition, the RBS Group's capital requirements, determined either as a result of regulatory requirements, including in light of the implementation of the UK ring-fencing regime and the establishment of the RFB or management targets, may impact the level of capital required to be held by the RBSH Group and as part of its capital management strategy, the RBS Group may decide to impose higher capital levels to be held by the RBSH Group.

The RBS Group's and the RBSH 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, natural attrition and other capital management initiatives.

Risk factors continued

Further losses or a failure to meet profitability targets or reduce risk-weighted assets in accordance with or within the timeline contemplated by the RBS Group's capital plan, a depletion of its or the RBSH Group's 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 they need to hold (including as a result of the reasons described above), would adversely impact the RBS Group's or the RBSH Group's ability to meet their capital targets or requirements and achieve their capital strategy during the restructuring period.

If the RBS Group or the RBSH Group are determined to have a shortage of capital, including as a result of any of the circumstances described above, the RBS Group and the RBSH 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 RBS Group or the RBSH Group (or any of its individual subsidiaries) being subject to regulatory interventions and sanctions. The RBS Group's regulators may also request that the RBS Group carry out certain capital management actions, which may impact the RBSH Group, or, in an extreme scenario, this may also trigger the implementation of the RBS Group's recovery plans. Such actions may, in turn, affect, among other things, the RBS Group's and/or the RBSH Group's product offering, ability to operate their businesses, comply with their regulatory obligations, pursue their transformation programme and current strategies, resume dividend payments on RBSG ordinary shares, maintain discretionary payments on capital instruments and pursue strategic opportunities, affecting the underlying profitability of the RBS Group and the RBSH Group and future growth potential.

If, in response to such shortage, certain regulatory capital instruments are converted into equity or the RBS Group raises additional capital through the issuance of share capital or regulatory capital instruments, existing RBSG shareholders may experience a dilution of their holdings. The success of such issuances will also be dependent on favourable market conditions and the RBS Group may not be able to raise the amount of capital required or on satisfactory terms. Separately, the RBS Group may address a shortage of capital by taking action to reduce leverage and/or risk-weighted assets, by modifying the RBS Group's legal entity structure or by asset or business disposals. Such actions may affect the underlying profitability of the RBS Group and the RBSH Group.

The RBSH Group's borrowing costs, its access to the debt capital markets and its sources of liquidity depend significantly on its and the RBS Group's credit ratings and, to a lesser extent, on the UK sovereign ratings.

The credit ratings of RBS N.V., as well as those of RBSG, RBS plc and other RBS Group entities directly affect the cost of funding and capital instruments issued by those entities, as well as secondary market liquidity in those instruments. The implementation of ring-fencing is expected to change the funding strategy of the RBS Group and the RBSH Group.

A number of UK and other European financial institutions, including RBSG, RBS N.V., RBS plc and other RBS Group entities, 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, RBS plc and RBS N.V. are investment grade by Moody's, S&P and Fitch. In April 2018, Moody's downgraded the senior unsecured long-term credit ratings of RBS plc and RBS N.V. from A3 to Baa2 with the short term credit ratings remaining at P-2. The outlook for RBSG, RBS plc and RBS N.V. is currently stable for S&P, Fitch and Moody's.

Rating agencies regularly review the RBS N.V., RBSG, RBS plc and RBS Group entity credit ratings, and their ratings of long-term debt are based on a number of factors, such as the RBS Group's financial strength as well as factors not within the RBSH Group's control, including political developments, conditions affecting the financial services industry generally and other macroeconomic and political developments, including in light of the outcome of the negotiations relating to the form and timing of Brexit. In addition, the rating agencies may further review the RBSG, RBS plc, RBS N.V. and other RBS Group entity ratings, as a result of the implementation of the UK ring-fencing regime and related reorganisation as well as pension and litigation/regulatory investigation risk, including potential fines relating to investigations relating to legacy conduct issues. A challenging macroeconomic environment, a delayed return to satisfactory profitability and greater market uncertainty could negatively impact the RBS Group's, RBS plc, and in particular, RBS N.V.'s credit ratings and potentially lead to ratings downgrades which could adversely impact the RBS Group and the RBSH Group's (and in particular, RBS N.V.'s) ability to fund, and the cost of that funding, if any.

As a result, RBS N.V.'s ability to access capital markets on acceptable terms and hence the ability to raise the amount of funding required, and the RBS Group's ability to meet its regulatory requirements and targets, including those relating to loss-absorbing instruments to be issued by the RBS Group, could be affected. See '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 RBS Group and the RBSH Group's business, including with respect to the perimeter of the RBSH Group's activities and the assets, liabilities and businesses that it holds. The steps required to implement the UK ring-fencing regime are complex and entail significant costs and operational, legal and execution risks, which risks may be exacerbated by the RBS Group's other ongoing restructuring efforts. The implementation of ring-fencing will fundamentally reshape the RBS Group and RBSH Group's business and operations'.

Risk factors continued

Any reductions in the long-term or short-term credit ratings of RBSG, RBS plc and, in particular, RBS N.V., including downgrades below investment grade, could adversely affect the RBSH Group's issuance capacity in the financial markets, increase the funding and borrowing costs of the RBSH Group and, in particular, RBS N.V., require the RBSH Group and, in particular, RBS N.V., to replace funding lost due to the downgrade, which may include the loss of customer deposits and may limit the RBSH Group's and, in particular, RBS N.V.'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 and clients willing to enter into transactions with the RBSH Group and, in particular, RBS N.V., and adversely affect its competitive position, all of which could have a material adverse impact on the RBSH Group's earnings and, in particular, RBS N.V.'s cash flow and financial condition.

Individual credit ratings of RBSG, RBS plc, RBS International, RBS Securities Inc., National Westminster Bank Plc, Ulster Bank Ltd, Ulster Bank Ireland DAC and Adam & Company PLC are also important to the RBS Group when competing in certain markets such as corporate deposits and over-the-counter derivatives. As discussed above, the success of the implementation of the UK ring-fencing regime and the restructuring of the RBSH Group is in part dependent upon RBS N.V. maintaining a sustainable investment grade credit rating and being able to satisfy their funding needs. A failure to maintain such a rating, or any subsequent downgrades, may threaten the ability of RBS N.V. or other entities outside of the RFB to satisfy their funding needs.

The major credit rating agencies downgraded and changed their outlook to negative on the UK's sovereign credit rating in June 2016 and September 2017 following the UK's decision to leave the EU. Any further downgrade in the UK Government's credit ratings could adversely affect the credit ratings of RBS Group entities (including RBS N.V.) 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, RBS plc, RBS N.V. and other RBS Group entities.

The RBSH Group's ability to meet its obligations including its funding commitments depends on the RBSH 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.

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. Any uncertainty relating to the credit risk of financial institutions may lead to reductions in levels of interbank lending or may restrict the RBSH Group's access to traditional sources of funding or increase the costs or collateral requirements for accessing such funding.

In addition, the RBSH Group remains partially reliant on the RBS Group for liquidity and funding support. If the RBSH Group is unable to manage its liquidity resources, its liquidity position could be adversely affected and therefore impact its ability to repay borrowings as they mature, to meet its obligations under committed financing facilities or to comply with regulatory funding requirements. In a time of reduced liquidity, the RBSH 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 RBSH Group's financial condition, results of operations and execution of the wind-down of legacy activities.

The RBS Group and RBSH Group's businesses and performance can be negatively affected by actual or perceived economic conditions in the UK and globally and other global risks, including risks arising out of geopolitical events and political developments.

Actual or perceived difficult global economic conditions can create challenging economic and market conditions and a difficult operating environment for the RBSH Group's businesses and its customers and counterparties. As part of its revised strategy, the RBS 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 Brexit are difficult to predict and are 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, an extended period of low inflation and low interest rates, although monetary policy has begun the process of normalising in some countries.

The normalisation of monetary policy in the USA may affect some emerging market economies which may raise their domestic interest rates in order to avoid capital outflows, with negative effects on growth and trade.

Risk factors continued

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, volatility in the value 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 RBSH Group is exposed 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 RBSH Group directly by resulting in credit losses and indirectly by further impacting global economic growth and financial markets.

In addition, the RBSH Group is exposed to the economy of Saudi Arabia through its equity investment in Alawwal Bank. With weak global oil prices continuing to drag on growth, Saudi Arabia is experiencing a severe economic downturn. Despite mitigating factors, such as OPEC's 30 November 2016 decision to cut the production of crude oil resulting in raising global crude oil prices, the short and medium term outlooks for Saudi Arabia remain uncertain and economic growth continues to be adversely affected. In turn, such developments could impact the share price of Alawwal Bank, and therefore the value of the RBSH Group's investment therein.

The RBSH Group is also exposed to interest rate and foreign exchange risks. Changes in currency rates, particularly in the euro-sterling and euro-US dollar exchange rates, affect the value of assets, liabilities, income and expenses denominated in non-euro currencies and the reported earnings of the RBSH Group's non-Eurozone incorporated subsidiaries and may affect the RBSH 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.

Developments relating to current economic conditions, including those discussed above, could have a material adverse effect on the RBSH Group's business, financial condition and results of operations, and may impede the execution of the wind-down of its legacy activities as adverse market conditions may result in the RBSH Group not being able to complete planned Transfers on a timely basis or at prices which would otherwise be attractive to it.

In addition, the RBSH 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, including secession movements or the exit of other Member States from the EU, armed conflict, pandemics, state and privately sponsored cyber and terrorist acts or threats, and the responses to them by governments, could also adversely affect economic activity and have an adverse effect upon the RBSH Group's business, financial condition and results of operations.

The financial performance of the RBSH 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 RBSH 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 the RBSH Group's businesses.

In particular, the RBSH Group has significant exposure to certain individual customers and other counterparties, including in weaker business sectors and geographic markets and also has concentrated country exposure in emerging economies. As the RBSH Group winds down its legacy activities and withdraws from many geographic markets and continues to materially scale down its international activities, the RBSH Group's relative exposure to certain geographies and counterparties will increase.
Any adverse impact on the credit quality of the RBSH Group's customers and other counterparties, coupled with a decline in collateral values, could lead to a reduction in recoverability and value of the RBSH Group's assets and higher levels of impairment allowances, which could have an adverse effect on the RBSH Group's operations, financial position or execution of the wind-down of its legacy activities.

The credit quality of the RBSH 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. 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 RBSH Group's ability to enforce contractual security rights. With any further deterioration in the outlook, the credit quality of these counterparties may require the RBSH Group to make additional provisions, which in turn would reduce earnings and impact the RBSH Group's profitability.

In addition, the RBSH 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 RBSH Group, which is most likely to occur during periods of illiquidity and depressed asset valuations, such as those experienced in recent years. Any such deterioration in the RBSH Group's recoveries on defaulting loans could have an adverse effect on the RBSH Group's results of operations, financial condition and execution of the wind-down of its legacy activities.

Risk factors continued

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 RBSH Group. This systemic risk may also adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with which the RBSH 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 RBSH Group's financial counterparties could have a material adverse effect on the RBSH Group's access to liquidity or could result in losses which could have a material adverse effect on the RBSH Group's financial condition, results of operations and execution of the wind-down of its legacy activities.

The trends and risks affecting borrower and counterparty credit quality have caused, and in the future may cause, the RBSH Group to experience further and accelerated impairment charges, increased repurchase demands, higher costs, additional write-downs and losses for the RBSH Group and an inability to engage in routine funding transactions.

Failure to retain qualified and sufficient staff may adversely impact the RBSH Group.

As a result of the execution of the run-down of its legacy activities, the number of staff employed by the RBSH Group has reduced significantly in recent years. Execution of the wind-down of legacy activities as well as the re-purposing of RBS N.V. depends on the RBSH Group's 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 addition, the market for skilled personnel is increasingly competitive, thereby raising the cost of hiring, training and retaining skilled personnel.

The RBS Group's evolving strategy and the RBSH Group's run-down strategy have led to the departure of a large number of experienced and capable employees and may continue to cause experienced staff members to leave and prospective staff members not to join. The lack of continuity of senior management and the loss of important personnel coordinating certain or several aspects of the RBSH Group's wind-down of legacy activities could have an adverse impact on its successful execution and its ability to meet its regulatory commitments. In addition, the RBSH Group has outsourced a number of key functions to RBS Group executives and employees, and is therefore dependent on such executives and employees for the wind-down of legacy activities.

The RBSH Group's businesses are subject to substantial regulation and oversight. Significant regulatory developments and increased scrutiny by the RBSH Group's key regulators has increased, and is likely to continue to increase, compliance and conduct risks and could have a material adverse effect on how the RBSH Group conducts its business, its results of operations, financial condition and execution of the run-down of its legacy activities.

The RBSH 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 recovery 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 RBSH Group operates and will operate in the future, including as a result of the adoption of rules relating to the UK ring-fencing regime, severe restrictions 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, anti-tax evasion, payment systems, and antiterrorism laws and regulations, have resulted in the RBSH Group facing greater regulation and scrutiny in the jurisdictions in which it operates.

Recent regulatory changes, proposed or future developments and heightened levels of public and regulatory scrutiny in the jurisdictions in which the RBSH Group operates 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 RBSH 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 Brexit and the unprecedented degree of uncertainty as to the respective legal and regulatory frameworks in which the RBS Group and the RBSH Group 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 RBSH Group once the UK has formally exited the EU). In addition, the RBS 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.

Risk factors continued

Any of these developments (including failures to comply with new rules and regulations) could have a significant impact on how the RBSH Group conducts its business, its authorisations and licences, the products and services it offers, its reputation and the value of its assets, its operations or legal entity structure, including attendant restructuring costs and consequently have a material adverse effect on the RBSH Group's business, funding costs, results of operations, financial condition and prospects.

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 RBSH 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 RBSH Group as well as liquidity and leverage requirements, either on a solo, consolidated or subgroup level (and taking into account the new legal structure of the RBS Group and the RBSH Group 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 UK rules, BRRD, MREL or by the FSB's recommendations on TLAC;
- 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 RBS Group and/or the RBSH Group in isolation or together with other large financial institutions with respect to market conduct wrongdoing;
- additional rules and regulatory initiatives and review relating to customer protection 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 restrictions on the RBSH 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;
- 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;
- new or increased regulations relating to customer data and privacy protection, including the EU General Data Protection Regulation;
- the introduction of, and changes to, taxes, levies or fees applicable to the RBSH Group's operations, such as the imposition of a financial transaction tax, changes in tax rates, restrictions on the tax deductibility of interest payments or further restrictions imposed on the treatment of carry-forward tax losses and may 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 RBSH Group, including through the imposition of increased compliance obligations.

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 RBSH Group to comply with such laws, rules and regulations, may have a material adverse effect on the RBSH 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 RBSH Group's ability to engage in effective business, capital and risk management planning.

The RBS Group and the RBSH Group rely on valuation, capital and stress test models to conduct their business, assess their risk exposure and anticipate capital and funding requirements. Failure of these models to provide accurate results or accurately reflect changes in the micro- and macro-economic environment in which the RBS Group and the RBSH Group operate or findings of deficiencies by the RBSH Group's regulators resulting in increased regulatory capital requirements could have a material adverse effect on the RBSH Group's business, capital position or results of operations.

Given the complexity of the RBS Group and the RBSH Group's business, strategy and capital requirements, the RBSH 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 stress testing.

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.

Risk factors continued

Failure of these models to accurately reflect changes in the environment in which the RBSH Group operates or to be updated in line with the RBS Group's or the RBSH 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 RBSH Group's risk exposure or the risk profile of the RBSH Group's financial instruments or result in the RBSH Group being required to hold additional capital. The RBSH 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 RBSH 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 RBSH Group's regulators.

Some of the analytical models used by the RBSH Group are predictive in nature. In addition, a number of internal models used by the RBSH Group are designed, managed and analysed by the RBS Group and may inappropriately capture the risks and exposures relating to the RBSH Group's portfolios.

Some of the RBSH Group's internal models are subject to periodic review by its regulators and, if found deficient, the RBSH 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 RBSH Group's capital position.

The RBSH 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 RBSH Group's reputation, business, financial condition, results of operations, minimum capital requirements and execution of the wind-down of its legacy activities

The reported results of the RBSH 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 RBSH Group's results and financial position, based upon going concern, materiality and significant judgements and estimates, include provisions for liabilities and impairment provisions, which are discussed in detail in 'Critical accounting policies and key sources of estimation uncertainty' on page 57. 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 RBSH Group are discussed in 'Accounting developments' on page 58. 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 RBSH 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 the execution of the wind-down of legacy activities of the RBSH 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 introduced 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 tend to result in an increase in overall impairment balances when compared with the previous basis of measurement under IAS 39. The RBS Group expects IFRS 9 to increase earnings and capital volatility in 2018 and beyond.

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 RBSH 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 RBSH Group's internal valuation models require the RBSH 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 RBSH Group's earnings, financial condition, capital position and execution of the run-down of its legacy activities.

Risk factors continued

The RBSH Group is exposed to conduct risk which may adversely impact the RBSH Group or its employees and may result in conduct having a detrimental impact on the RBSH Group's customers or counterparties. In recent years, the RBS 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 RBS Group and the RBSH Group are exposed to various forms of conduct risk in the conduct of their operations. These include business and strategic planning that does not adequately reflect the RBS Group's customers' needs, ineffective management and monitoring of products and their distribution, actions take that may not conform to their customer-centric focus, 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 RBS Group's and the RBSH Group's businesses are also exposed to risks from employee misconduct including non-compliance with policies and regulatory rules, negligence or fraud (including financial crimes), any of which could result in regulatory fines or sanctions and serious reputational or financial harm to the RBS Group and/or the RBSH Group. In recent years, a number of multinational financial institutions, including entities within the RBS 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 RBS Group may not succeed in protecting itself from such conduct in the future. It is not always possible to timely detect or deter employee misconduct and the precautions the RBS Group and the RBSH Group take to prevent and detect this activity may not always be effective.

The RBS Group and the RBSH Group have implemented a number of policies and allocated new resources in order to help mitigate against these risks. The RBS Group and the RBSH Group have also prioritised initiatives to reinforce good conduct in their engagement with the markets in which they operate, together with the development of preventative and detective controls in order to positively influence behaviour.

The RBS Group's and the RBSH Group's transformation programme is also intended to improve the control environment. Nonetheless, no assurance can be given that the RBS Group's strategy and control framework (which applies to the RBSH Group) will be effective and that conduct issues will not have an adverse effect on the RBSH Group's results of operations and financial condition.

The RBSH Group may be adversely impacted if its risk management is not effective.

The management of risk is an integral part of all of the RBSH Group's activities. Risk management includes the definition and monitoring of the RBSH Group's risk appetite and reporting of the RBSH Group's exposure to uncertainty and the consequent adverse effect on profitability and 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 RBSH Group's reputation or its relationship with its customers, shareholders or other stakeholders, which in turn could have a significant effect on the RBSH Group's business, financial condition, results of operations and execution of the wind-down of legacy activities.

The legal demerger of ABN AMRO Bank N.V. (as it was then named) has resulted in a cross liability that affects the legal recourse available to investors.

On 6 February 2010, ABN AMRO Bank N.V. (as it was then named) was demerged into two entities, being RBS N.V. (the former ABN AMRO Bank N.V.) and the new ABN AMRO Bank.

In principle, investors now only have recourse to the entity to which the relevant assets and liabilities have been transferred for payments in respect of the appropriate securities. Under the Dutch Civil Code, however, each entity remains liable to creditors for the monetary obligations of the other entity that existed at the date of the legal demerger in the event that the other entity cannot meet its obligations to those creditors. In each case, the liability relates only to obligations existing at the date of the legal demerger.

The liability of RBS N.V. is limited to the equity retained at legal demerger. At the time of the legal demerger, this liability amounted to €4.0 billion and this liability will reduce over time. The liability of the new ABN AMRO Bank N.V. is limited to the amount of equity acquired at legal demerger, which amounted to €1.8 billion, which will also reduce over time.

RBS N.V. has made arrangements to mitigate the risks of liability to the creditors which transferred to the new ABN AMRO Bank upon legal demerger. The new ABN AMRO Bank has also made arrangements to mitigate the risks of liability to the creditors that remain in RBS N.V.. Both of these entities hold the level of regulatory capital agreed upon with the DNB for purposes of covering any residual risks.

Forward-looking statements

Cautionary statement regarding forward-looking statements

Certain sections in this document contain 'forward-looking statements' as that term is defined in the United States Private Securities Litigation Reform Act of 1995, such as statements that include the words 'expect', 'estimate', 'project', 'anticipate', 'commit', 'believe', 'should', 'intend', 'plan', 'could', 'probability', 'risk', 'Value-at-Risk (VaR)', 'target', 'goal', 'objective', 'may', 'endeavour', 'outlook', 'optimistic', 'prospects' and similar expressions or variations on these expressions.

In particular, this document includes forward-looking statements relating, but not limited to: the execution of the winding-down of RBS N.V.'s legacy activities and the transfer and sale of a substantial part of its business activities to other RBS entities and the timing thereof; the re-purposing of RBS N.V. and the timing thereof; future profitability and performance, including financial performance targets such as return on tangible equity; cost savings and targets, including cost:income ratios;; litigation and government and regulatory investigations, including the timing and financial and other impacts thereof; structural reform and the implementation of the UK ring-fencing regime; the implementation of RBSG's transformation programme, including the restructuring of the NatWest Markets franchise; the satisfaction of RBSG's residual EU State Aid obligations; the continuation of RBSG's and RBS N.V.'s balance sheet reduction programme, including the reduction of risk-weighted assets (RWAs) and the timing thereof; capital and strategic plans and targets; capital, liquidity and leverage ratios and requirements, including CET1 Ratio, RWA equivalents (RWAe), Pillar 2 and other regulatory buffer requirements, minimum requirement for own funds and eligible liabilities, and other funding plans; funding and credit risk profile; capitalisation; portfolios; net interest margin; customer loan and income growth; the level and extent of future impairments and write-downs, including with respect to goodwill; restructuring and remediation costs and charges; future pension contributions; and RBSG's and RBS N.V.'s exposure to political risks, operational risk, conduct risk, cyber and IT risk and credit rating risk and to various types of market risks, including interest rate risk, foreign exchange rate risk and commodity and equity price risk; customer experience including the Net Promotor Score (NPS); employee engagement and gender balance in leadership positions.

Limitations inherent to forward-looking statements

These statements are based on current plans, estimates, targets and projections, and are subject to significant inherent risks, uncertainties and other factors, both external and relating to the RBS Group and RBS N.V.'s strategy or operations, which may result RBS N.V. being unable to achieve the current targets, predictions, expectations and other anticipated outcomes expressed or implied by such forward-looking statements. In addition, certain of these disclosures are dependent on choices relying on key model characteristics and assumptions and are subject to various limitations, including assumptions and estimates made by management. By their nature, certain of these disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated.

Accordingly, undue reliance should not be placed on these statements. Forward-looking statements speak only as of the date we make them and we expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the RBSG's or RBS N.V.'s expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Important factors that could affect the actual outcome of the forward-looking statements

We caution you that a large number of important factors could adversely affect the results of the RBS Group and/or RBS N.V. or their ability to implement their strategies, cause the RBS Group or RBS N.V. to fail to meet their targets, predictions, expectations and other anticipated outcomes or affect the accuracy of forward-looking statements we describe in this document including in the risk factors set out in the RBS N.V.'s 2017 Annual Report and other risk factors and uncertainties discussed in this document.

Forward-looking statements

These include the significant risks for RBSG and the RBSH Group presented by: the RBSH Group's ability to access sources of liquidity and funding; the outcomes of the legal, regulatory and governmental actions and investigations that RBSG and the RBSH Group are or may be subject to and any resulting material adverse effect on RBSG and the RBSH Group of unfavourable outcomes and the timing thereof (including where resolved by settlement); economic, regulatory and political risks, including as may result from the uncertainty arising from Brexit and from the outcome of general elections in the UK and changes in government policies; RBSG's ability to satisfy its residual EU State Aid obligations and the timing thereof; RBSG's ability to successfully implement the significant and complex restructuring required to be undertaken in order to implement the UK ring fencing regime and related costs; RBSG's ability to successfully implement the various initiatives that are comprised in its restructuring and transformation programme, particularly the proposed further restructuring of the NatWest Markets franchise, the balance sheet reduction programme and its significant cost-saving initiatives and whether RBSG and the RBSH Group will be a viable, competitive, customer focused and profitable bank especially after its restructuring and the implementation of the UK ring-fencing regime; the dependence of the RBSH Group's operations on its and RBS Group's IT systems; the exposure of RBSG and the RBSH Group to cyber-attacks and their ability to defend against such attacks; the RBSH Group's reliance on the RBS Group for capital, liquidity and funding support; RBSG's and the RBSH Group's ability to achieve their capital, funding, liquidity and leverage requirements or targets which will depend in part on RBSG and the RBSH Group's success in reducing the size of their business and future profitability as well as developments which may impact its CET1 capital including additional litigation or conduct costs, additional pension contributions, further impairments or accounting changes; ineffective management of capital or changes to regulatory requirements relating to capital adequacy and liquidity or failure to pass mandatory stress tests; RBSG's and the RBSH Group's ability to access sufficient sources of capital, liquidity and funding when required; changes in the credit ratings of RBSG, RBS plc, RBS N.V. or the UK government; declining revenues resulting from lower customer retention and revenue generation in light of RBSG's strategic refocus on the UK; as well as increasing competition from new incumbents and disruptive technologies.

In addition, there are other risks and uncertainties that could adversely affect the RBS Group and the RBSH Group's results, ability to implement their strategies, cause them to fail to meet their targets or the accuracy of forward-looking statements in this document. These include operational risks that are inherent to the RBSH Group's business and will increase as a result of RBSG's and the RBSH Group's significant restructuring and transformation initiatives being concurrently implemented; the potential negative impact on RBSG's and the RBSH Group's business of global economic and financial market conditions and other global risks, including risks arising out of geopolitical events and political developments; the impact of a prolonged period of low interest rates or unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices; basis, volatility and correlation risks; the extent of future write-downs and impairment charges caused by depressed asset valuations; deteriorations in borrower and counterparty credit quality; heightened regulatory and governmental scrutiny (including by competition authorities) and the increasingly regulated environment in which RBSG and the RBSH Group operate as well as divergences in regulatory requirements in the jurisdictions in which RBSG and the RBSH Group operate; the risks relating to RBSG's or the RBSH Group's IT systems or a failure to protect themselves and their customers against cyber threats, reputational risks; risks relating to increased pension liabilities and the impact of pension risk on RBSG's and the RBSH Group's capital positions; risks relating to the failure to embed and maintain a robust conduct and risk culture across the organisation or if their risk management framework is ineffective; the RBSH Group's ability to attract and retain qualified personnel; limitations on, or additional requirements imposed on, the RBSH Group's activities as a result of HM Treasury's investment in RBSG; the value and effectiveness of any credit protection purchased by the RBSH Group; risks relating to the reliance on valuation, capital and stress test models and any inaccuracies resulting therefrom or failure to accurately reflect changes in the micro and macroeconomic environment in which the RBSH Group operates, risks relating to changes in applicable accounting policies or rules which may impact the preparation of RBSG's and the RBSH Group's financial statements or adversely impact their capital positions; the impact of the recovery and resolution framework and other prudential rules to which RBSG and the RBSH Group are subject; the application of stabilisation or resolution powers in significant stress situations; contribution to relevant compensation schemes; the execution of the run-down and/or sale of certain portfolios and assets; the recoverability of deferred tax assets by the RBSH Group; RBSH Group's exposure to cross liabilities resulting from the legal demerger of ABN Amro Bank N.V. (as it was then named); and the success of RBSG and the RBSH Group in managing the risks involved in the foregoing.

The forward-looking statements contained in this document speak only as at the date hereof, and RBSG and the RBSH Group do not assume or undertake any obligation or responsibility to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The information, statements and opinions contained in this document do not constitute a public offer under any applicable legislation or an offer to sell or solicit of any offer to buy any securities or financial instruments or any advice or recommendation with respect to such securities or other financial instruments.

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
C&RA	Conduct & Regulatory Affairs
CDO	Collateralised debt obligation
CDS	Credit default swap
CET1	Common equity tier 1
CRD	Capital Requirements Directive
CRR	Capital requirements regulation
CVA	Credit valuation adjustment
DVA	Debit valuation adjustment
EAD	Exposure at default
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
ECL	Expected credit losses
ERF	Executive Risk Forum
EU	European Union
FCA	Financial Conduct Authority
FI	Financial institution
FSB	Financial Stability Board
FVA	Funding Valuation Adjustment
HMT	HM Treasury
IAS	International Accounting Standards
IASB	International Accounting Standards Board
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IPV	Independent price verification
IRC	Incremental risk charge
LIBOR	London Interbank Offered Rate
LGD	Loss given default
MREL	Minimum requirement for own funds and eligible liabilities
NTIRR	Non-traded interest rate risk
OREC	Operational Risk Executive Committee
PD	Probability of default
PRA	Prudential Regulation Authority
REIL	Risk elements in lending
RFB	Ring-fenced banking entities
RMBS	Residential mortgage-backed securities
RoI	Republic of Ireland
RoW	Rest of the World
RWA	Risk-weighted asset
SE	Structured entity
SEC	US Securities and Exchange Commission
SVaR	Stressed value-at-risk
TLAC	Total loss absorbing capacity
UK	United Kingdom
US/USA	United States of America
VaR	Value-at-risk

In the Report and Accounts and unless specified otherwise, the terms 'company' and 'RBS Holdings' mean RBS Holdings N.V.. RBS Holdings N.V. is the parent company of The Royal Bank of Scotland N.V. (RBS N.V.) consolidated group of companies and associated companies (RBSH Group). The Royal Bank of Scotland Group plc (RBSG) is the ultimate holding company of RBSH Group. RBS Group refers to RBSG and its consolidated subsidiaries and associated companies. RBS plc refers to The Royal Bank of Scotland plc. The terms 'Consortium' and 'Consortium Members' refer to RBSG, Stichting Administratiekantoor Beheer Financiële Instellingen (the Dutch State, successor to Fortis) and Banco Santander S.A. (Santander) who jointly acquired RBS Holdings on 17 October 2007 through RFS Holdings B.V. (RFS Holdings).

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

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 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.

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'.

Capital requirements regulation (CRR) - refer to CRD IV.

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 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.

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.

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).

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 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.

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 the Group 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 the Group. 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 the Group 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 the Group 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 the Group to support the risks to which it is exposed.

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.

Encumbrance - an interest in an asset held by another party. Encumbrance usually restricts the asset's transferability until the encumbrance is removed.

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 losses - 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 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.

Expected loss (EL) - expected loss represents the anticipated loss on an exposure over one year. It is determined by multiplying probability of default, loss given default and exposure at default and can be calculated at individual, credit facility, customer or portfolio level.

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.

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.

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.

Gross yield - the interest rate earned on average interest-earning assets i.e. interest income divided by average interest-earning assets.

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.

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.

Internal Capital Adequacy Assessment Process (ICAAP) - the Group'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 the Group'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.

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 Group Executive Committee.

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.

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 the Group is unable to meet its financial liabilities when they fall due.

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.

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 the Group 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.

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.

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.

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.

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 Group'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 the RBS Group.

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.

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 the Group 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.

Reverse repurchase agreement (Reverse repo) - refer to Sale and repurchase agreements.

Risk appetite - an expression of the maximum level of risk that the Group is prepared to accept to deliver its business objectives.

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 the Group in respect of sales and liability settlement balances are amounts owed by the Group in respect of purchases.

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.

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 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.

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 the Group's auditors to enable them to express an opinion on the Group's financial statements.

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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